

COVID-19 Handbook

Yale Program on Financial Stability

As of August 25, 2020

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Introduction

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Founded in 2013, **The Yale Program on Financial Stability’s mission** is to create, disseminate, and preserve knowledge about financial crises. We currently have four major projects: Systemic Risk Institute, New Bagehot, Global Financial Crisis, and the Financial Crises Archives. The diagram below represents how each project correlates with the YPFS:

YPFS PROJECTS	
Systemic Risk Institute	(purple + light red)
New Bagehot	(purple)
Global Financial Crisis	(dark blue + dark purple)
Financial Crises Archives	(blue + purple)



In its early years, researchers at the YPFS authored dozens of case studies on these topics, and hosted an annual set of meetings to bring together policymakers from around the world. These activities covered both “peacetime” policies designed to prevent crises, and “wartime” policies designed to fight crises in progress.

More recently, it became clear that the biggest knowledge gaps existed for wartime policies. During the Global Financial Crisis, nations around the world had attempted hundreds of crisis interventions, only a fraction of which had been studied by researchers. Going back further in time, most research on past crises focused on macroeconomic issues, with much less attention paid to the mechanics of crisis-fighting tools. To fill this gap, the YPFS launched the New Bagehot Project in 2017, made possible by generous support from Jeff Bezos, Bloomberg Philanthropies, Bill Gates, the Peter G. Peterson Foundation, and an anonymous donor.

The New Bagehot Project was named in honor of Walter Bagehot, the author of *Lombard Street* (1873), still considered the seminal text on crisis fighting. Bagehot’s advice for central bankers in a crisis can be summarized as “lend freely at a penalty rate against good collateral”. This advice is still considered near-gospel by many central bankers, but it is insufficient to guide the complex policy actions necessary to stabilize a 21st century financial system. The New Bagehot Project aims to expand the crisis-fighting playbook through detailed case studies of specific interventions, synthesizing these case studies into best practices, and then presenting this synthesis across a variety of media.

Beginning in March 2020, the New Bagehot project shifted its focus to real-time analysis of financial policies created in response to the ongoing COVID-19 pandemic and its economic consequences. Posts are regularly published on YPFS’ [Systemic Risk Blog](#), where individuals can follow to read examinations of policies around the world—including lessons learned as programs develop and are utilized.

COVID-19 Financial Response Tracker

In companion with the ongoing number of mini-cases written about policies worldwide, YPFS launched the [COVID-19 Financial Response Tracker](#) (CFRT), which follows economic

interventions by central banks, fiscal authorities, and international organizations aimed at combating the negative effects of the coronavirus pandemic and restoring financial stability. The tracker will also highlight significant proposals from government representatives and institutions. Each tracker entry will provide summary information and link to relevant press releases or articles about the intervention. The [COVID-19 Financial Response Tracker Visualization](#) (CFRTV) graphically depicts the CFRT's entries according to country and type of intervention. The intent of the Tracker and Visualization platform is to inform citizens, policymakers, and government officials about state actions against COVID-19.

To date, there over 2,500 logged proposals, policy changes, and updates to existing policies in response to COVID-19. While the Tracker and Visualization are not meant to be comprehensive but we aim to track as many interventions as possible across the globe. A link to a 5/10/2020 version of the tracker in excel format is available [here](#).

You can read more about the CFRT project in the Appendix.

Resource Guides

Finally, YPFS is putting together resource guides that gather and synthesize materials on crisis response topics that are of particular interest in the present situation. A resource guide consists of an overview and a spreadsheet that catalogs past and current examples of the intervention type, identifies interesting program features, summarizes existing evaluations of programs, and shares general resources on the topic. New resource guides will be added as they become available.

- [Bankruptcy Law and Macroprudential Policy](#)
- [Critical Industries](#)
- [Funding for Lending](#)
- [Insurance Regulation Measures](#)
- [International Institutions](#)
- [Macroprudential Policy: Capital](#)
- [Macroprudential Policy: Liquidity](#)
- [Macroprudential Policy: Regulatory Relief](#)
- [Macroprudential Policy: SMEs](#)
- [Market Liquidity Programs](#)
- [Residential Mortgage Relief](#)
- [Short-Selling Bans](#)
- [SME Credit Guarantee Programs](#)
- [Support to Individuals](#)
- [Swaps](#)

Key Program Summaries

YPFS will be maintaining documents that provide up-to-date summaries of certain key programs adopted in response to the current pandemic. Depending on the program, these documents may include things like detailed timelines showing when a program was introduced and when and how it was amended. They may also include data on usage to date.

- [View Paycheck Protection Program \(PPP\) Timeline](#)
- [View Main Street Lending Program \(MSLP\) Timeline](#)
- [View Paycheck Protection Program Lending Facility \(PPPLF\) Timeline](#)
- [View Comparing Fed programs GFC and COVID-19](#)

2020 YPFS Preliminary Discussion Drafts

Over the past few years, YPFS has written thousands of pages of summary materials on past interventions, including the key design decisions that policy makers must consider. While not all our case studies are complete, we are making our materials available at this time. The case studies are written from a policymaker's point of view and are meant to inform current decision-makers. Most case studies have links to the relevant primary documents generated by the financial institution that initiated the program as well as other documents relevant to the design and implementation of the program.

- [Explore YPFS Preliminary Discussion Drafts in our Resource Library](#)
- [View a list of our case studies of previous interventions](#)

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Critical Industries

Critical industries play key roles in supply chains and transportation and are often vital to keep the economy running smoothly. However, due to high fixed costs, these industries are also highly vulnerable to targeted economic shocks. Policies targeted to aid these critical industries must take account of the tools available, as well as obligations to protect taxpayers by attempting to guarantee recuperation of funding.

Analysis

Aid to Airlines and other Critical Industries During Crises

By Rosalind Z. Wiggins and Vaasavi Unnava

Original post [here](#).

The [air transportation industry across the globe has been dramatically affected](#) by the outbreak of COVID-19. Government-issued travel bans and warnings to self-quarantine have forced the cancellation of trips. Passengers are [down](#) more than 90%. Airplane manufacturers, such as Boeing in the US, are [facing assembly line shutdowns](#) and possible delays of ordered planes. Related businesses such as suppliers, airports, and duty-free stores are also facing serious impacts.

Since February, several countries have provided support to help their airlines absorb the economic impacts. These actions include: direct cash subsidies ([China](#)), tax rebates and forgiveness (Australia), loan guarantees ([Sweden](#), [Finland](#)), exemption from airport fees ([Taiwan](#)), loss support, and direct aid to cover employee wages ([Denmark](#)). Several countries offer a combination of interventions, such as [South Korea](#) and the [US](#).

We consider the recent actions in the context of past assistance to airlines and other critical industries and discuss what other countries might consider in providing such assistance.

Critical Industries

Airlines are critical industries that play key roles in transportation and supply chains for passengers and cargo. Yet, they are characterized by high fixed costs and variable income streams. The ability to adjust current expenses does not directly align with drops in revenue creating cash flow challenges and making them especially vulnerable to economic shocks. ([Nolan, Ritchie and Rowcroft 2004](#)). The terrorist attacks of 9/11, in which the US closed its airspace, showed that the industry may need state aid to avoid bankruptcy and restore operations to pre-shock levels. ([Nolan, Ritchie and Rowcroft 2004](#)). With credit markets drying up, private liquidity was difficult to come by, [layoffs began](#), leading the government to provide assistance in the form of direct grants and loan guarantees through the [Air Transportation Safety and System Stabilization Act](#) (ATSSA). Similar economic factors justified the government's facilitating mergers to stabilize the industry in the 1980s.

Other modes of transportation have also been deemed critical industries. During the current COVID-19 pandemic, [the UK has temporarily nationalized its railways](#) in a preemptive move to “provide stability and certainty” and ensure that they are available for essential travel. Contractors will continue to operate their routes, but the government will collect all revenues and take on all risk. In the [US](#), the government provided \$1 billion in grants to its government-owned passenger railroad, Amtrak, 50% of the company's 2020 budget.

Beyond transportation, governments have assisted other nonfinancial industries whose failure might pose a systemic risk to the economy. During the global financial crisis (GFC) of 2007-09, the US rescued two of its “Big Three” auto manufacturers, General Motors (GM) and Chrysler. Factors cited in the decision to provide aid in those cases were the size of the firms; the concentration of the industries within a specific region; the potential job losses; the potential knock-on effects to suppliers in the highly integrated industry that might destabilize other manufacturers; and the broader economic impacts in the midst of the financial crisis.

France, Russia, and Sweden also provided assistance to their auto industries during the GFC. France provided a package of loans to manufacturers (Renault and Peugeot/Citroen), auto finance companies, and suppliers. Russia provided a one-year interest-free loan and facilitated the refinancing of investment projects. Sweden guaranteed significant loans.

Tools Available

Once a government decides to assist a critical industry, it needs to consider what tools it has available, and how and when it will use them. Possible tools include loans, equity or warrant purchases, loan guarantees, or some combination of these, to provide the necessary capital for companies to maintain or achieve solvency. Equity can be especially useful to protect taxpayers, although governments are often reluctant to take over the management of private companies, as noted below.

In general, approaches appear to fall into three loose categories: (i) short-term liquidity relief, where the aim is to provide liquidity and support wages; (ii) mid-term aid, which focuses on providing liquidity relief for longer periods and or in larger quantities, through loans or loan guarantees; and (iii) longer term aid, which provides sustained support and protects companies’ solvency through operational recovery and structural reform. Example of this last tool include the multifaceted packages implemented by South Korea, the US, and Italy, which [re-nationalized Alitalia](#) after efforts to find a buyer failed.

The COVID-19 pandemic is unique in that the economic shock has been largely government-induced. Countries quickly deployed targeted relief focused on the airline industry. Their earliest responses included:

- Direct cash subsidies or grants ([China](#) and [US](#))
- Suspension or refund of taxes and or fees (Australia, [South Korea](#), Taiwan)
- Direct absorption of losses
- Grants for payment of wages ([Denmark](#)).

Because the air travel industry is highly taxed, waiving, refunding or reducing some or all of these taxes is a particularly quick way to funnel cash to the industry amidst the sudden drop in ridership. Tax relief can be quickly implemented because it requires minimal administrative

start-up costs. Once airlines recover, taxes and fees can be reinstated gradually to provide a soft cushion for recovery efforts.

Given the unique factors of the pandemic, other first-wave support has taken the form of grants to support the continuation of wages for air industry workers or financial support for furloughed workers. These may be in narrow targeted efforts (as in the case of the [US](#)) or as broad-based plans that also apply beyond the industry (as [Denmark](#) has provided).

Governments also use loans or loan guarantees have to provide longer term and more substantial support. Loans can also be used to “buy time” for private funding sources to recover, to bridge temporary distortions to cash flows. Several countries made loans to industries affected by 9/11. The US and France provided loans to the auto industry during the GFC. The US used [bridge loans to keep Chrysler and GM](#) afloat during a presidential transition in 2008; the government used the transition period to assess if the companies would need further assistance.

In extending loans, governments must decide:

- Amount of loan
- Interest rates
- Collateral
- Maturity
- Other commitments such as reporting, governance restrictions

Loans can be flexible, subject to the government’s capacity, and easily tailored, extended, or increased as circumstances change.

Loan guarantees represent a commitment rather than an actual loan. They allow governments to leverage their resources to extend more funding than they can directly. However, loan guarantees depend on there being private lenders willing to lend. This may not always be the case if banks are also distressed, as during the GFC. When there is no financial crisis, a guarantee may help a distressed industry get the funds it needs.

Loans and loan guarantees may also be bundled with other forms of assistance and are often a step-up from initial actions. In the current crisis, for example, Denmark first provided support for wages, and then later announced (along with Sweden) up to \$302 million in credit guarantees for Scandinavian Airlines.

South Korea has also bundled the availability of loans into [a comprehensive package of airline industry support measures](#). Relief has been in place for Korea-China routes since early February. In mid-February, the government made a major announcement – up to 300 billion won in emergency loans, deferred fees for three months with gradual restart, guarantees to replace aircraft lease deposits, and support in reestablishing business. In March the government announced [additional supports](#) relating to the waiver of airport fees and assistance to terminal

operations for 3-6 months. The combined supports are designed not only to offset the cost of lost passengers but also to promote a quick return to operating and rebuilding capacity. It is formally divided into three phases: (i) emergency damage support, (ii) support for securing a new market, and (iii) management stabilization support.

The [US coronavirus rescue](#) legislation provides \$78 billion to the airlines in the form of direct cash grants, loans, and loan guarantees available through March 2022. The bill also temporarily suspends excise tax and kerosene taxes for air carriers through January 1, 2021. In return for financial assistance, air carriers may not put employees on temporary furlough status, engage in share buybacks, or issue dividends. Also, highly compensated employees are subject to restrictions on their pay.

The current US assistance is similar in form but far surpasses the assistance provided to airlines in the wake of the 9/11 attacks the US, when the government closed all US airspace. ([Lewinsohn 2005](#)). At that time, the government provided aid for airlines through the Air Transport Safety and System Stabilization Act of 2001. That act provided \$5 billion in direct grants for compensation for federal actions and subsequent losses related to the attacks and the subsequent shut down of air travel, and up to \$10 billion in loan guarantees. Eligible airlines used approximately 10% of the available guarantees. Although there were still airline bankruptcies in the years that followed, some commenters believe that the assistance [was successful in that it prevented immediate bankruptcies](#) during an economic downturn. ([Lewinsohn 2005](#)).

Even if a crisis is short-lived, companies will need a period in which to recover to pre-crisis levels. The assistance packages and loans offered by Korea and the US seem to acknowledge this and anticipate challenges even after the epidemic subsides. Another example is [Singapore Airlines](#) which, in response to the COVID-19 crisis, announced that it had secured a loan of S\$4 billion from DBS Bank to cover its near-term liquidity needs. It also planned to raise S\$14 billion from its existing shareholders through a rights offering (to purchase shares and bonds) underwritten by its majority shareholder, the sovereign investment fund, Temasek Holdings. This would provide capital that would not only help it weather the pandemic but would also strengthen its return to operations after.

Should a crisis extend for longer than expected, governments may have to extend or increase aid to forestall the further decline of weakened companies. In such instances, tools that may be utilized include:

- additional or longer-term loans
- capital injections
- restructuring
- bankruptcy
- nationalization.

Some of these solutions, such as extended loans, are quicker to put in place than others, i.e., capital injections and restructuring. However, restructurings, whether through bankruptcy or not may require additional funding directly from the government or from private sources, potentially with further government guarantees. The availability and ease of implementation of these later solutions usually depend on what standing powers the government has. In other contexts, additional legislation may be needed, which would be more time consuming.

It should also be noted that there is always the possibility that the effects of a crisis may reveal preexisting fundamental financial weaknesses that would need to be addressed upfront if companies are going to be saved from collapse. Sometimes these are revealed upfront, as in the case of [Italy--which in response to the COVID-19 pandemic, has re-nationalized Alitalia](#); the airline had been attempting to sell itself for a year and was thought to be unable to weather the pandemic without assistance.

There are several types of nationalization. Governments can take control of a company or industry e. through government fiat, using existing authority or new legislation; capital injections; or as the result of providing funding for a restructuring. Italy nationalized Alitalia by government fiat. The country had previously used a similar strategy in the aid provided to Parmalat, an Italian dairy company, when the Italian government [issued an emergency decree](#) to allow Parmalat to file for bankruptcy to receive financial aid and undergo intensive restructuring. During the GFC, the US took control of GM as a result of funding its bankruptcy and receiving equity in the company.

Taxpayer Protection

Another important issue for governments to consider is how to structure the intervention to ensure repayment and protect taxpayer funds. Several elements can address this:

- Rates and fees that incentivize repayment once private funding is available
- Loan provisions that restrict share buybacks and paying dividends
- Loan provisions that affect desired policies
- Restrictions on executive compensation
- Collateral that secures the loan
- An equity interest for the government

A simple protection for lent funds would be to set the rate and terms of loans to incentivize payoff when private credit avenues are again available. In accordance with Bagehot's dictum to lend at a penalty rate, setting a rate above the usual market rate will incent borrowers to pay off or refinance the loan from private sources when the market recovers. Restrictive loan terms, such as those relating to buyback of shares and payment of dividends, prohibit the firm from misappropriating government funds. Terms may also require heightened government oversight and reporting, which a firm may find burdensome, incentivizing accelerated repayment.

In the US, during the GFC and since, the payment of executive compensation at firms receiving government assistance has been a controversial issue. Aid provided under the [Troubled Asset Relief Program \(TARP\)](#) during the GFC was subject to these types of restrictions. There is some evidence that these restrictions created incentives for companies to repay the government early. Terms of the aid offered in the current COVID-19 programs also restrict certain executive pay.

Loan terms have also been used as a means to interject industrial policy into a situation such as during the GFC, when the restructuring of GM and Chrysler were conditioned on lowering labor costs and producing energy efficient autos.

Loans may also be secured by collateral; however, this is not always available. A firm or industry may be highly leveraged, having already granted security interests on much of its assets. In this case, receiving equity interests may be an alternative that provides some potential upside to taxpayers.

The theory behind equity interests is that the taxpayers can share in the company's recovery, which their assistance funded. This can be achieved through the grant of warrants that provide the opportunity to purchase shares at a nominal price, preferred shares that are convertible into common shares, or an outright purchase or grant of common shares.

US Treasury Secretary Mnuchin said that rather than make outright grants, the [Treasury intends to take equity stakes](#) in airlines in exchange for the cash grants (which must be used for employee wages, salaries, and benefits) contemplated by the COVID-19 assistance. Equity stakes are common in government bailouts. Such "equity stakes" would in theory permit taxpayers to benefit from the financial recovery of the firm. At this time, it remains unclear in what form this equity interest would take.

In the GFC, the government received warrants to purchase stock (GM) and convertible preferred stock (AIG). Another example is the actions of the New Zealand government which utilized equity purchases as a means of cash injection when [refinancing Air New Zealand](#) after the 9/11 attacks. Another successful example, not during a financial crisis, was the utilization of a combination of loan warrants and guarantees in the [aid provided to Chrysler in 1980](#), which resulted in a net profit for the US government.

Developing countries may rely on [sovereign wealth funds](#), which store capital in investment funds during high-income times to fund government policies in low-income times. Other rescues rely on private sector solutions, such as the [formation of a lifeboat fund via private banks](#) for the rescue of Pan Electric Corporation in Singapore. With the global demand shock progressing rapidly through various industries almost simultaneously, a private sector solution may not be the most effective in the current economic environment.

Some commenters have critiqued the [use of warrants](#) as financial injections for poorly managed firms. Another sees the possibility of bankruptcies as necessary to prevent moral hazard if only cash grants or loan programs are offered. ([Casey and Posner 2015](#)). Another critic argues that

one-off and full bailouts from the state are inefficient and should not be utilized; standard bankruptcies, perhaps with government assistance, are preferred. (Couwenberg and Lubben 2018). Consistent with this argument, [the Congressional Oversight Panel](#) found that the use of bankruptcy in the aid provided for GM and Chrysler [prevented moral hazard](#) as the companies faced disincentives to apply for aid. The panel estimated that up to 1.1 million auto-related jobs would have been lost if the companies had failed.

Conclusion

Various tools are available to countries that may need to provide assistance to critical industries that experience distress in a crisis. The COVID-19 crisis has shown that direct grants and industry-specific remedies such as the suspension or refund of taxes may be readily available as a first response to quickly provide liquidity. However, as the crisis persists, additional assistance may be needed to sustain companies. Loans and loan guarantees have often been applied at this juncture. A prolonged crisis or the existence of fundamentally weak organizations pose a risk that solvency issues may appear, requiring more intensive measures such as capital injections and restructurings, with or without government assistance, if firms are to recover from the crisis and avoid collapse.

Case Studies and Policy Changes

US Provides Aid to Airlines in Historic Relief Bill

By Vaasavi Unnava

Original post [here](#).

The [US coronavirus rescue bill](#) that the Senate passed on March 25 provides \$78 billion to the airlines in the form of loans, loan guarantees, and cash grants. The bill also temporarily suspends excise tax and kerosene taxes for air carriers.

Airline aid in the bill is split between passenger air travel, cargo air travel, and industries closely involved in national security:

- Passenger Air Carriers: \$25 billion allocated in loan guarantees, \$25 billion allocated in cash grants.
- Cargo Air Carriers: \$4 billion allocated in loan guarantees, \$4 billion allocated in cash grants.
- Air Industry Firms involved in National Security ([implicitly allocated for Boeing](#)): \$17 billion allocated in loan guarantees,
- Contractors Providing Aviation-related Services: \$3 billion allocated in cash grants.

In exchange for loan guarantees, the law also requires the government to receive warrants or other senior debt or equity of the business receiving aid. During negotiations over the bill, Treasury Secretary Mnuchin said that rather than make outright grants, the [Treasury intends to take equity stakes](#) in airlines in exchange for the cash grants (which must be used for employee wages, salaries and benefits). Such “equity stakes” would in theory permit taxpayers to benefit from the financial recovery of the firm. Equity stakes are common in government bailouts. At this time, it remains unclear how the Treasury would implement any such equity stake. In the most recent global financial crisis, the government received warrants to purchase stock (General Motors) and convertible preferred stock (AIG).

In the Senate bill, also, in return for financial assistance, air carriers may not put employees on temporary furlough status, engage in share buybacks, or issue dividends. Additionally, highly compensated employees with compensation exceeding \$425,000 annually may not receive a raise in 2020. The bill would also prevent these employees from receiving severance pay that exceeds twice the compensation they received in 2019. Employees compensated above \$3 million can receive \$3 million plus 50% of the excess received compensation in the calendar year 2019.

The authority for the airline aid program expires on March 1, 2022. The suspension of excise and kerosene taxes regularly levied on air carriers extends to January 1, 2021.

The United States previously provided aid for airlines through the Air Transport Safety and System Stabilization Act of 2001. That act provided \$5 billion in direct grants for compensation for federal actions and subsequent losses related to the 9/11 terrorist attacks and the subsequent shut down of air travel, and up to \$10 billion credit assistance in the form of loan guarantees. Airlines used approximately 10% of the program's loan capacity. Although airline bankruptcies emerged in the years that followed, some purport that the legislation [succeeded in that it prevented immediate bankruptcies](#) during the economic downturn that followed the terrorist attacks. With the assistance proposed in the Senate bill, the US joins other countries that have taken steps to support airlines during the COVID-19 pandemic. Countries have attempted to mitigate the [economic impacts of the crisis](#) in various ways. Some approaches, such as subsidies for continuing to operate ([China](#)), suspension and/or refunds of taxes ([Australia](#)), and support for laid-off employees ([Denmark](#) and [Finland](#)), appear to target short-term relief. [South Korea](#) has outlined a series of support measures, including emergency support measures, deferred payment of fees, loan screening measures for airlines requesting aid due to liquidity shortages, and guaranteeing lease deposits on leased aircraft.

US Begins Airline and Aviation Interventions

By Alex Nye, Vaasavi Unnava, and Rosalind Wiggins

Original post [here](#).

On April 20, the U.S. [Treasury Department announced](#) that it had finalized agreements with six major airlines – Allegiant Air, American Airlines, Delta Air Lines, Southwest Airlines, Spirit Airlines, and United Airlines – for \$20.5 billion in assistance under the [Payroll Support Program \(PSP\)](#) established by the CARES Act. It said five other airlines plan to participate, which would bring participation to 95% of U.S. air carrier capacity.

Four airlines – Hawaiian Airlines, United Airlines, American Airlines, and Spirit Airlines – have also announced their intent to apply for \$10.4 billion under the Economic Relief Program (ERP). The government has disbursed an additional \$9.1 billion in aid to aviation-related industries through other programs, which like the ERP, are authorized under the CARES Act..

Under the PSP, Treasury will provide grants and loans to support payroll for the carriers' employees as the COVID-19 pandemic continues to depress demand. The PSP makes up to \$25 billion available for passenger carriers in grants and loans. The ERP makes up to \$29 billion available in loans and loan guarantees.

Presently, the CARES Act is one of the only broad-based grant and loan programs for airlines that governments have established during the current COVID-19 crisis. (See the earlier YPFS blog on the CARES Act [here](#) and our blog on aid to airlines around the world [here](#)).

The government has standardized its approach in providing aid to larger carriers. Treasury has decided to allocate [70% of funds through grants and 30% through low-interest, 10-year loans](#). This ratio was hotly negotiated, as airlines had expected that the support would [exclusively come as grants](#). However, Treasury determined that larger airlines should [compensate taxpayers](#) for the large sums allocated.

The table below shows the terms of the PSP awards announced publicly or filed through the SEC, including announced expected agreements with the Treasury by Alaska Airlines, Hawaiian Airlines, and JetBlue Airways. Note that data are not yet available for Frontier Airlines and SkyWest Airlines, the two other airlines that Treasury expects to participate.

Airlines must use PSP funds exclusively to pay employee wages, salaries, and benefits. They must also agree not to conduct involuntary layoffs or furloughs, or reduce pay rates and benefits through September 2020; to not engage in stock buybacks or dividend payments through September 2021; and to limit certain executive compensation through March 2022. The government will not forgive PSP loans, which mature in ten years, but which may be prepaid without penalty at any time.

The CARES Act provides that the government “may receive warrants, options, preferred stock, debt securities, notes, or other financial instruments” from the airlines in exchange for PSP support. The Treasury has decided it will only take equity interests in airlines that receive more than [\\$100 million](#) in PSP aid. So far, the government has taken those equity interests in the form of warrants exercisable for common shares at their April 9, 2020 prices, at any point over a five-year period.

Assistance under the CARES Act Payroll Support Program

Airline	Grants	Loans	Warrants	Price per Share	Preferred/Common	Related Link
	(in millions)	(in millions)				
Amount	Principal	# Shares				
Alaska Airlines***	\$725	\$267	--	\$31.61	Common	Form 8-K
Allegiant Air	\$86	\$21.6	25,898	\$83.33	Common	Form 8-K
American Airlines**	\$5,815	\$1,714	13.7 million	\$12.51	Common	Form 8-K
Delta Airlines	\$3,800	\$1,600	6.4 million	\$24.39	Common	Form 8-K
Hawaiian Airlines**,***	\$233	\$57	~ 1%	\$11.82	Common	Form 8-K
JetBlue Airways***	\$685.1	\$250.7	--	--	--	Press Release *
United Airlines**	\$3,500	\$1,500	4.6 million	\$31.50	Common	Form 8-K
Southwest Airlines***	~\$2,300	~\$1,000	2.6 million	--	--	Press Release *
Spirit Airlines**	\$264.3	\$70.4	143,541	\$14.08	Common	Form 8-K

Note: Amounts shown indicate the maximums agreed to by Treasury and carrier

(--) indicates data is not available.

() 8-K not yet available*

*(**) Airline has announced intent to apply or has applied (Hawaiian) for aid under ERP*

*(***) Airline has announced details but has not signed an agreement with Treasury*

On April 20, the Treasury announced that it had released [initial disbursements under the PSP, totalling \\$2.9 billion](#), to two major airlines and 54 smaller ones. Over 230 airlines have applied for assistance under the PSP, and Treasury is still processing applications. If applications exceed the amount authorized for any category of eligible participants, the Treasury has stated that it may adjust award amounts and related components on a [pro rata](#) basis.

Economic Relief Program

Four airlines have said they intend to participate in the ERP. Treasury has accepted the application of one airline, Hawaiian Airlines; Treasury has yet to reach an agreement with two others, United Airlines, American Airlines, and Spirit Airlines.

Loans under the ERP are secured, would bear interest at the market rate before the COVID-19 outbreak, and would be for a five-year term. ERP participants [must establish](#) that they have exhausted other available credit. They must also agree to not engage in stock buybacks or pay dividends until 12 months after they pay off the loan; maintain workforce levels at 90% of their March 2020 levels until September 30, 2020; adhere to government restrictions on executive compensation; and maintain certain specified services. The ERP also mandates that Treasury receive warrants from participants whose stock trades on a national exchange (an optional stipulation under the PSP). For other participants, receipt of an equity interest in the form of a warrant or a senior debt instrument is at the secretary's discretion.

Hawaiian Airlines applied for and received a secured loan of [\\$364 million](#) with a five-year term. Once finalized, the airline will issue warrants to the U.S. government that are convertible into 6.7% ownership and exercisable at the price of \$11.82 per share. United Airlines announced its plans to apply for a secured loan of up to [\\$4.5 billion](#), and it would issue warrants for up to 14.2 million shares in common stock, exercisable at \$31.50 per share. American Airlines is seeking [\\$4.75 billion](#), and plans to issue warrants for 38.0 million shares of common stock, exercisable at \$12.51 per share. Spirit Airline expects to receive [\\$741 million](#) under the ERP and to issue warrants exercisable into 5.3 million shares at a strike price of \$14.08. Each warrant agreement prices shares at market close as of April 9, 2020.

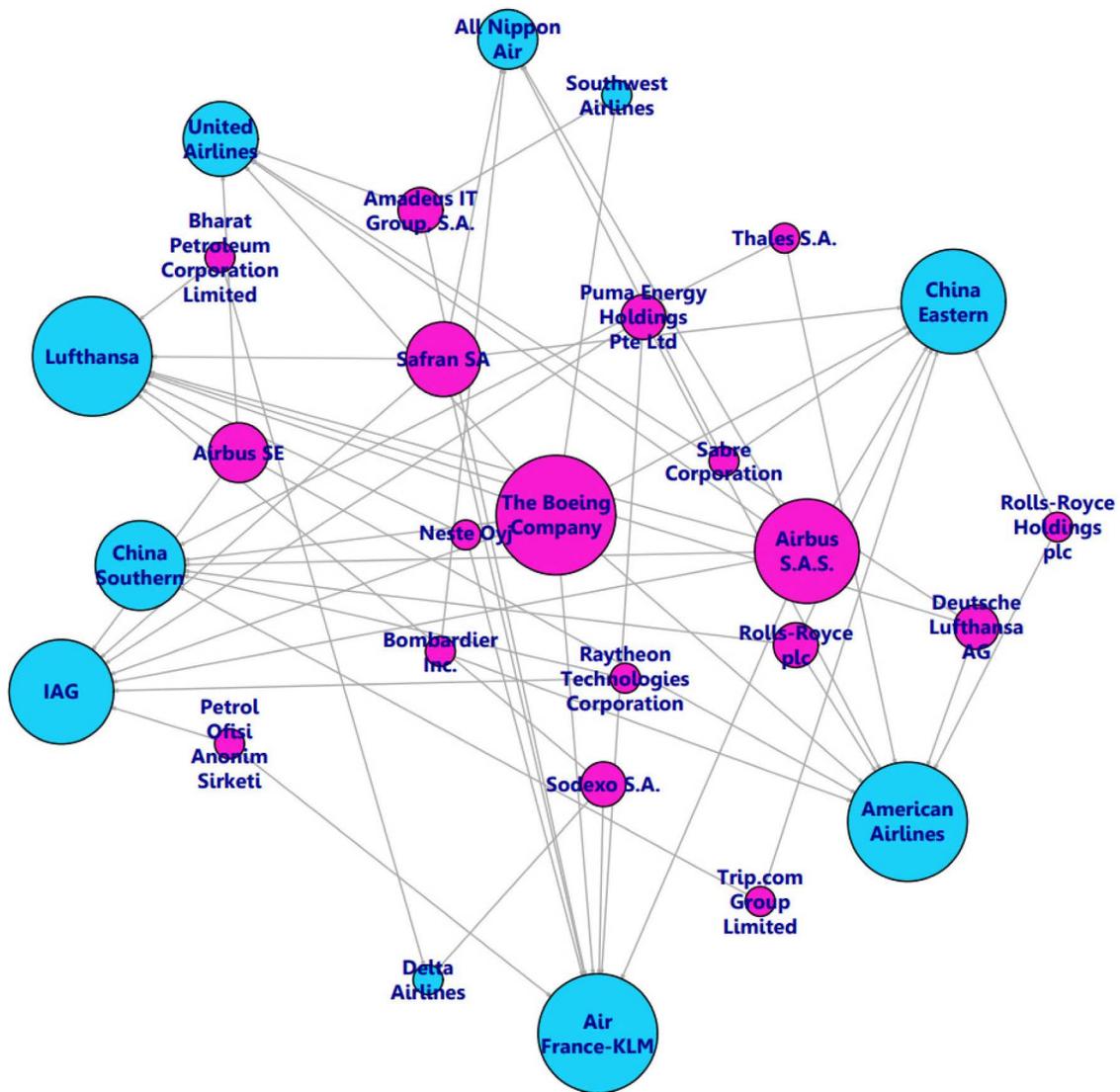
In line with requirements to exhaust all other sources of funding, two airlines, Alaska Airlines and United Airlines, have secured external funding from major banks. Wells Fargo lent Alaska Airlines [\\$425 million](#) via a senior secured loan with an interest rate based on LIBOR plus an increasing margin over the duration of the loan. The loan extends for 364 days. Similarly, Bank of American has lent United Airlines [\\$250 million](#), with an interest rate no lower than 2% that increases over the duration of the loan, to be extended through April 6, 2021. Through Citibank, Spirit Airlines entered into a revolving credit facility for an initial commitment amount of [\\$110 million](#), and borrowed an additional \$25 million on April 20th.

Other Assistance

In addition to aid to airlines, the CARES Act allocates [\\$17 billion for aid](#) to Boeing (although not explicitly named), the largest national defense contractor and aircraft supplier. Manufacturers are feeling the reverberations of depressed demand, with [cancelled orders](#) for major suppliers and [cuts in production](#), leaving many manufacturers requesting aid from governments around the world. The chart below visualizes the global connections between the top suppliers and the largest airlines, and the number of airlines they supply.

Still under negotiation with the Treasury, a potential aid package for Boeing has hit a roadblock as [CEO Dave Calhoun opposed providing](#) the US government an equity stake in exchange for aid. It's unclear whether negotiations will resume or conclude in the near future.

The US's [CARES Act](#) also suspends an array of airline excise taxes through the end of 2020. Although the tax relief is estimated to amount to [\\$8 billion in aid](#), it is dwarfed by the other aid given to the industry under the CARES Act. [Private jet companies](#) are expected to be the greatest beneficiaries of the suspension in excise tax.



Source: SNL. Node size is weighted by the number of connections to other nodes.

Finally, Title XII of the CARES Act provides the Federal Aviation Administration (FAA) \$10 billion in aid to be awarded as grants as economic relief to commercial service airports and general aviation airports. All airports receiving funding through the FAA must maintain, through December 2020, at least 90% of the individuals employed as of March 27. As of April 15, the FAA has awarded [\\$9.1 billion](#) to over 3,000 airports across the United States.

Aviation Interventions Continue Internationally

By Vaasavi Unnava and Alex Nye

Original post [here](#).

Governments around the world have committed many billions of dollars to help the aviation sector survive the COVID-19 crisis. This aid comes in the form of grants, loans, loan guarantees, tax relief, and other subsidies. Some programs are targeted at specific firms and others provide broad-based support. The US is implementing what it expects to be the largest targeted package for the industry. Singapore's program appears to be the second most generous.

COVID-19 has buffeted the international and domestic aviation industries. On April 20, the International Civil Aviation Organization (ICAO) [predicted](#) airlines will lose at least \$160 billion on international air travel over the first nine months of 2020. The suppliers for these airlines are also suffering. Some are [shuttering manufacturing facilities](#) to conserve funds.

The U.S. [CARES Act](#) provides the industry with up to \$78 billion in loans, loan guarantees, and cash grants. Other countries have also begun to financially support their aviation industries (see the earlier YPFS [blog](#)). Few other countries took a comprehensive approach like the US; most offer one or two narrow facilities to their airlines instead of aiding the entire sector.

The United Kingdom has largely encouraged airlines to utilize the broader [Covid Corporate Financing Facility](#) (CCFF), which provides credit by buying commercial paper issued by businesses needing aid due to COVID-19 disruptions. Through the CCFF, the UK has awarded £600 million to the British budget airline group, EasyJet. The CCFF offers [standardized terms](#) on commercial paper purchases for any company requiring aid. In particular, all commercial paper purchases require that the commercial paper matures within a year and have at least an A- rating or the equivalent from a ratings agency as of March 1, 2020.

Nigeria has set up a [Targeted Credit Facility](#), which aims to support companies especially impacted by COVID-19, including airlines.

Not all airlines requesting state aid have received it. Virgin Atlantic requested [£500 million](#) in the form of grants and loans from the UK government, but has yet to receive aid. [Sir Richard Branson](#), the head of Virgin Atlantic, is a tax resident of the British Virgin Islands and pays no UK income tax. This has made the [government hesitant](#) to rescue Virgin Atlantic. UK manufacturers Rolls Royce and Airbus UK have [supported the aid](#) to Virgin Atlantic. They [argued](#) that the Virgin Atlantic plays an integral role in the UK's manufacturing supply chain. Virgin Atlantic is a major customer for Rolls Royce parts and the Airbus A330 (whose wings are designed and manufactured in the UK).

A [request for aid](#) from Air France-KLM has hit a similar roadblock, resulting from a conflict between its two government [shareholders](#); the government of France has a 14.3% stake and the government of the Netherlands has a 14% stake. The company appears to be [nearing an](#)

[agreement](#) with the French government. The rescue is reportedly an EUR 10 billion (\$10.9 billion) deal under which the French government will guarantee 90% of bank loans to Air France-KLM and provide some loans to the airline through a government emergency fund.

Norway used a NOK 6 billion loan [guarantee program](#) to support its airlines. It provides a 90% government guarantee on lending to participants. Troubled carrier [Norwegian Air Shuttle](#) can receive up to [NOK 3 billion](#) under the program. The program also guarantees NOK 1.5 billion in loans for multinational airline SAS and NOK 1.5 billion for Widerøe and other airlines. In Norway, [a private-sector analyst](#) argued that the aid provided to Norwegian Air Shuttle is likely not large enough; he said it would only pay for 1.5 months of Norwegian Air Shuttle grounding its aircraft.

Similarly, Sweden has provided a [credit guarantee](#) framework for its airlines, with a maximum of SEK 5 billion (\$500 million) to any airline. Finland has provided a [€600 million state guarantee](#) for Finnair, a state-owned airline.

Some multinational airlines have coordinated aid from multiple governments. One example is [SAS](#), which is 14.82% owned by the Swedish government and 14.24% owned by the Danish government. SAS received an [EUR 137 million guarantee](#) on a revolving credit facility from the Danish government; a [90% credit guarantee](#) worth [NOK 1.5 billion](#) from the Norwegian government; and [credit guarantees worth SEK 1.5 billion](#) (about \$142 million) from the Swedish government (from its SEK 5 billion program).

Italy has chosen to [re-nationalise Alitalia](#) after the airline requested aid. The government [plans to downsize](#) the airline to a quarter of its current size. The [government had attempted to](#) turn around Alitalia and privatize it after a bankruptcy in 2009. That effort stalled until Etihad Airways took a 49% stake in Alitalia in 2014. The company briefly improved, but lapsed back into [bankruptcy proceedings](#) in 2017. The Italian [government](#) recently injected EUR 500 million into a state-owned company it plans to use to execute the nationalization in [June](#).

Singapore has offered a large amount of aid to its aviation industry. The [government](#) plans to spend S\$15.1 billion (\$10.6 billion) on a program paying 75% of all employee wages in the industry up to S\$4,600 (\$3,200) per month. Singapore's state-owned investment company, [Temasek](#), said that it would underwrite the sale of S\$15 billion worth of Singapore International Airlines shares and convertible bonds. Singapore's biggest bank, DBS, will provide the airline with a bridge loan of S\$4 billion (\$2.8 billion). Temasek currently has a 56% stake in the airline. The [government](#) also said it would provide S\$350 million (~\$246 million) in relief from aviation taxes and fees.

Other governments have chosen to aid their airlines and aviation industries through their tax code. The Republic of Korea offered [tax measures](#) supplementing [300 billion won of liquidity support](#) for budget carriers from the state development bank. Australia initially offered its ailing airlines [A\\$715 million in tax relief](#) (\$457 million). The [Australian government](#) eventually offered A\$160 million (\$102 million) in other aid to its two biggest airlines (Qantas and Virgin

Australia) in exchange for the airlines maintaining a core set of regional flights. This was not enough to save [Virgin Australia](#), which entered voluntary bankruptcy after the Australian government did not respond to its A\$1.4 billion (\$894 million) bailout request.

Around the world, governments and suppliers are still negotiating terms of any potential direct aid to suppliers and airports. Officials from Airbus have [asked for funding](#) from the French government, as the company [cuts production](#) by one third. So far, France has not allocated aid to Airbus. The Hong Kong Airport Authority (HKAA) allocated [HK\\$50 million](#) (\$6.5 million) to fund retraining for up to 25,000 airport staff on unpaid leave. The HKAA also reduced rents by 50-70% for shops within airports in a HK\$630 million program (\$81 million).

More Aid Offered To Airlines as Pandemic Continues to Depress Demand

By Vaasavi Unnava

Original post [here](#).

For four months, social distancing measures have hobbled the airline industry with depressed demand, grounded flights, and net losses. Ridership remains low, held down by travel prohibitions between countries that normally supply heavily trafficked routes. With persistent losses and pessimistic future forecasts, several European airlines have now received aid from their governments to maintain solvency for those companies critical to industry supply chains.

In March 2020, industry-wide revenue for passenger air fare dropped to [nearly half](#) the revenues a year prior. The dramatic shock, in an industry characterized by high fixed costs with little room for volatile revenues, immediately required interventions from governments around the world. For many privately owned air carriers, [these interventions](#), typically in the form of tax reductions and payroll support, provided quick relief.

While some countries have stopped there, the United States and some countries in Europe have used the temporary relief provided by payroll support subsidies to negotiate more complex deals for aid in exchange for equity or warrants. By late April, many European airlines negotiated some form of aid from their home country governments; now two more airlines join the group, with an additional \$10 billion in credit guarantees, state loans, and capital investment.

Figure 1. Allocated aid to airlines in Europe.

Airline	Allocated in Local Currency*	Local Currency to USD	Aid in Dollars
EasyJet	£600	1.28	\$768
Norwegian Air Shuttle	NOK 3000	0.11	\$330
SAS (Norway)	NOK 1500	0.11	\$165

Widerøe and other airlines	NOK 1500	0.11	\$165
Swedish Credit Guarantee	SEK 5000	0.11	\$550
SAS (Sweden)	SEK 1500	0.11	\$165
FinnAir	€600	1.17	\$702
SAS (Denmark)	€137	1.17	\$160.29
Alitalia	€500	1.17	\$585
KLM (The Netherlands)	€3,400	1.17	\$3,978
Deutsche Lufthansa	€6,000	1.17	\$7,020
		Total	\$14,423.29

(*) millions

The Netherlands has approved [€3.4 billion](#) in state loans and guarantees for KLM, part of the Air France-KLM travel group. Germany will provide a capital investment of [€6 billion](#) to Deutsche Lufthansa AG (DLH), the parent company for the Lufthansa Group. These measures complement the [renationalization of Alitalia](#) by the Italian government, which was announced in March.

The Netherlands has utilized a mixture of state loan guarantees and state loans to aid KLM. Of the allocated €3.4 billion, €2.4 billion will be state guaranteed bank loans while the last €1 billion will be a direct loan from the state. The direct loan from the state runs in tranches through 2025, with maturities ranging from nine months to five years.

For KLM, the loans come with a suite of additional terms. KLM must reduce costs by 15 percent. Employees who make more than three times the average salary at the company must reduce their salary by at least 20 percent. Employees who earn less are also asked to take salary reductions, though at a lesser rate. While the loans from this package are outstanding, KLM cannot pay dividends to shareholders or bonuses to its employees. The air carrier must also reduce its annual evening flights by 7,000 to 25,000. As an environmental requirement, KLM must reduce the aviation sector's carbon emissions by 50% of 2005 levels by 2030. Finally, the Dutch government asked parent company Air France-KLM and both of its subsidiaries to substantively reorganize to reduce costs.

Unlike the Netherlands, Germany has injected capital into Lufthansa through Lufthansa's parent company, DLH, in exchange for equity. Of the €6 billion allocated:

- €300 million is in new equity, equivalent to 20% of Lufthansa's share capital,
- €4.7 billion is in non-convertible, non-voting equity, and
- €1 billion is in a non-voting convertible debt instrument.

The government will conduct the recapitalization through the Economic Stabilization Fund, a fund specifically set up to aid companies directly affected by the coronavirus outbreak. As part of its recapitalization plan, Deutsche Lufthansa AG will redeem all outstanding equity and debt by 2026. It must also suspend dividends and share buybacks while the German government has ownership over DLH debt and equity. Also, until the state redeems 75% of its outstanding capital, DLH cannot pay bonuses to management.

The agreement between DLH and the German government extends further than the arrangements that other governments have made. DLH is not permitted to purchase stakes in competitors or subsidize troubled subsidiaries. To help other carriers compete with the airline aided by the state, the government has required DLH to divest from 24 slots a day at two of its hub airports--Frankfurt and Munich--making the slots available to competitors. Accompanying the €6 billion state aid package is a €3 billion state guarantee of any private loans taken by DLH.

Some European airlines are already partially owned by governments in their home countries. Prior to the additional recapitalization, the Dutch government [owned](#) 14.3% of Air France-KLM shares, matching the French stake. FinnAir enjoys status as Finland's flag carrier, with the Prime Minister's office as the [largest shareholder](#) of the company, owning [56% of shares](#). Because of the extant government stakes in these carriers, the leadership of these companies might feel more comfortable with additional conditions imposed by new government assistance, as in the case of the Dutch assistance to KLM.

In comparison, Lufthansa's CEO [expressed concerns](#) about government interventions affecting the airline's ability to remain competitive if there were too many constraints. Leadership may [have found comfort](#) in the deal's "silent participation" clause, which prevents the German government from selling Lufthansa shares on third-party markets.

In a related vein, Virgin Atlantic's reluctance to rely on government funding has led its CEO and Founder, Richard Branson, to [sell stakes](#) in part of its parent organization to keep it profitable. After months of fundraising, the airline recently agreed to a [\\$1.2 billion rescue deal](#) funded exclusively by private markets.

A similar trend may be playing out in the United States, where airlines and suppliers have left billions of dollars in government aid outstanding while searching for other sources of funds. [Executives](#) originally [balked](#) at Treasury Secretary Mnuchin's insistence that companies that took the available loans would be required to provide some form of equity to the government, a practice the government relied on during the Global Financial Crisis with positive outcomes.

Federal Reserve lending facilities remain untapped by major airlines, though the announcement of these facilities [opened up private markets](#) to debt issuances from troubled carriers. On June 25, American Airlines [issued \\$2.5 billion](#) in senior secured notes, due in 2025, at an 11.75% interest rate. United Airlines [issued \\$1 billion of stock](#) in April and [an additional \\$1 billion worth](#) of shares in late June. Southwest Airlines has improved its capital position by relying on a

mixture of equity and debt issuances. The airline [sold](#) \$1 billion in common stock and \$1.6 billion in convertible senior notes in late April.

Other airlines and air companies relied largely on bond issuances. Boeing Company [issued \\$25 billion](#) worth of corporate bonds in May, following Delta's [\\$3.5 billion](#) bond issuance. Delta's bond issuances come at a high cost--in addition to high interest rates, the company pledged landing slots at Kennedy, Heathrow, and LaGuardia airports as collateral.

As of June 25, Treasury had dispensed [over \\$25 billion](#) in support to passenger air, cargo air, and airline supply companies through its Payroll Support Program (PSP), a [section of the CARES Act](#) that provides grants to air carriers and affiliates to continue paying employees during depressed flight demand. Treasury has dispensed funds to over three hundred passenger air carriers of all sizes. Almost all of the support was in the form of grants. However, for the largest 13 carriers, which accounted for \$6 billion in disbursements, a portion was in the form of loans and they were required to provide warrants for shares in exchange. In total, passenger airlines have claimed nearly all allocated aid to them by the PSP, with approximately [\\$800 million still outstanding](#). Cargo air carriers have received \$640 billion, while eligible contractors have received \$1.4 billion.

Funding is still available through the Emergency Relief Program (ERP), through which the government may provide secured loans to eligible aviation industry participants that show they have exhausted market options. As of June 16, Treasury had received [190 applications](#) for loans under the ERP. On July 2, Treasury [announced](#) five airlines were in line to receive loans under the ERP: American Airlines, Frontier Airlines, Hawaiian Airlines, SkyWest Airlines, and Spirit Airlines. Though terms aren't finalized, American Airlines disclosed the same day that it expects to [receive \\$4.75 billion](#) in loans from the Treasury under the CARES Act, increasing its liquidity position to \$15 billion. Other airlines have yet to disclose information on anticipated loan terms or size.

However, despite having raised funds from the market and received Treasury aid, US airlines are still struggling to stay profitable. United Airlines was the recipient of [\\$3.5 billion in grants](#) and a \$1.5 billion loan in exchange for warrants through the PSP, however, it announced on July 8th that it would [involuntarily furlough half of its US workforce](#)--or 36,000 employees--beginning on October 1st, if demand stays depressed. Hawaiian Airlines also expects to [reduce employee headcount](#) largely based on its forecast of prolonged reduced ridership: it has a planning assumption that there will be a 10-15% reduction in its anticipated flight schedule for the summer of 2021 (as compared to historical averages). Even after receiving aid from the Treasury, American Airlines has notified employees of the possibility of furloughing [25,000 staff](#) in the coming months and has [threatened to cancel orders](#) of Boeing's 737 MAX jet.

[Several other major US airlines are](#) in a similar situation, with earnings reports revealing the extent of the economic pain. On July 20, United Airlines reported a [\\$1.6 billion loss](#) in Q2, with analysts [warning against](#) holding airline stocks. Delta Airlines, expected to perform strongest of the group, faced a [90% drop in revenues](#) at its lowest point in Q2. JetBlue Airways also [faced](#)

[losses](#), and the company expects revenue to drop 80% in the third quarter. American Airlines posted a [86% drop](#) in revenues year over year. Analysts [expect](#) a slow recovery, with prolonged losses into late 2020, if not longer.

For some troubled European airlines, analysts predict similar challenges. Andrea Giuricin, a transport economist, expressed concerns that nationalisation [will not provide](#) the foundation that some airlines need to compete in an already depressed and competitive market. An example is Alitalia, which in comparison to competitors flies smaller planes that can hold fewer passengers, leaving the airline vulnerable to losses on routes profitable for larger airlines. The airline also comparatively has more ground personnel protected by strong unions, while falling behind in international flights to Italy. The Italian government hasn't yet announced the final restructuring plan for renationalisation.

As the rate of air travel struggles to return to pre-crisis levels due to the continued persistence of the virus, many airlines fight to remain profitable. The industry continues to face high fixed costs and any ability to adjust current expenses does not directly align with drops in revenue creating cash flow challenges and [making them especially vulnerable to economic shocks](#). The terrorist attacks of 9/11, after which passenger demand dropped dramatically once US airspace reopened, showed that the industry might [require state aid](#) to avoid bankruptcy and restore operations to pre-shock levels; in that circumstance such aid was provided.

Strategies used by several Asian governments demonstrate that there are other options for state aid that can address high fixed costs rather than directly mitigating the effects of lost income. The Singaporean [government](#) plans to spend S\$15.1 billion (\$10.6 billion) on a program paying 75% of all employee wages in the industry up to S\$4,600 (\$3,200) per month. In Korea, the government [guaranteed aircraft lease deposits](#) for airlines. The government also reduced occupancy taxes. The Hong Kong Airport Authority (HKAA) allocated [HK\\$50 million](#) (\$6.5 million) to fund retraining for up to 25,000 airport staff on unpaid leave.

As airlines are critical industries that play key roles in transportation and supply chains for passengers and cargo, governments will likely adopt multiple strategies to keep local air carriers afloat. The persistence of the pandemic, which some commenters predict may last into mid-2021, may require multiple interventions in the air industry during the coming months.

Liquidity and Market Liquidity

Central banks support will normally provide large amounts of liquidity to encourage credit markets to operate in times where they tend to slow or completely freeze. Market and emergency liquidity relief comes in various forms, such as increased central bank repurchase agreement activity, large-scale direct purchases of obligations like government debt, corporate bonds, or commercial paper on primary and secondary markets, and expanding the scope of existing facilities and operations by increasing tenor and widening eligibility, to name a few.

Analysis

Central Banks Introduce Programs to Improve Liquidity in Key Markets

By June Rhee with Research Support from Aidan Lawson and Manuel Leon Hoyos

Original post [here](#).

As the coronavirus crisis continues to disrupt global markets, several countries have adopted new or revised programs to improve liquidity in specific credit markets that are critical to households and businesses. Similar market liquidity programs were introduced during the 2007–2009 Global Financial Crisis (GFC) to backstop wholesale funding markets. Although evaluations of these programs are limited due to the difficulty in isolating the independent effects of these programs, studies report that most of these programs, regardless of size, were helpful in reducing disruptions in these markets by assisting [price discovery](#), [restoring confidence](#) and [catalyzing market volume](#).

When designing a market liquidity program, policymakers need to make key design decisions about:

1. Legal authority - what is the legal authority of the central bank for intervening in these markets?
2. Stigma problem - how do you ensure wide enough participation in the programs?
3. Loans: recourse or non-recourse and term - if the central bank is providing a loan, what are specific features that the central bank should be mindful of?
4. Eligibility - which institutions are allowed to participate in the program?
5. Haircuts, interest rates, and fees - how will the central bank strike a balance between incentivizing the participants to reenter the market and minimizing the risk to the central bank?
6. Relief from regulatory requirements - what existing regulatory restrictions may restrict the usage and efficiency of the program?

Below is a summary of how policymakers have approached these questions in the past.

Legal Authority

The legal authority of a central bank can influence the method by which it intervenes in credit markets. During the GFC, central banks either purchased or made loans in market liquidity programs. The Bank of England, ECB, and Bank of Japan directly purchased securities. Their

legal framework authorized them to make outright asset purchases and they had a history of direct participation.

In contrast, in the U.S., [section 13\(3\)](#) of the Federal Reserve Act allows the Fed to lend to nonbanks through its discount window only in “unusual or exigent” circumstances. Its power to purchase market instruments is limited. For that reason, in designing several programs during the GFC, the Fed lent funds to an intermediary, and the intermediary would then purchase eligible market instruments and post them to the Fed as collateral for the loan.

Because of the legal limitations, the Fed’s [Term Asset-Backed Securities Loan Facility](#) (TALF) provided term credit against newly issued ABS rather than making outright purchases. Similarly, the Fed’s [Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility](#) (AMLF) lent funds to an intermediary such as a depository institution or a broker-dealer so that entity could purchase asset-backed commercial paper (ABCP) from money market mutual funds. The Fed has reintroduced revised versions of the TALF and AMLF recently in response to the coronavirus crisis. Posts on the recent TALF can be found [here](#) and the recent AMLF can be found [here](#).

One [study](#) observed that the legal restrictions were the only reason the Fed used an intermediary to purchase assets in the earlier GFC programs. The loan vs. purchase decision does not seem to have made a noticeable difference on the effectiveness of these programs. Non-recourse loans and purchasing are economically similar for central banks.

On the other hand, some countries’ central banks are able to use their regular or standing operations to lend to nonbanks. These programs naturally took the form of loans, as seen in [Australia](#), [Canada](#) and [Chile](#).

Limitation on legal authority also led the Fed to use special purpose vehicles (SPVs) as a third party intermediary in these programs. A caution for using an SPV is that they can be complex. Utilization of an SPV in the Fed’s GFC-era [Money Market Investor Funding Facility](#) (MMIFF) may have delayed the Fed’s efforts to reach illiquid markets. The program took more than one month to get off the ground. Certainly, [response time is an element of effectiveness](#).

SPVs have advantages. [South Korea](#) has and is now using a fund jointly financed by the Bank of Korea and private institutional investors to conduct market liquidity programs. [Some observers](#) [p.42] argue that the existence of an intermediary vehicle separate from the central bank can make it easier to use private institutions as agents, asset managers, and custodians.

Stigma Problem

These programs can only work if financial institutions participate. During a crisis, financial institutions may be reluctant to draw on emergency lines of credit from the central bank if doing so could signal weakness to others. Moreover, the perception of weakness does not need to be based on reality to keep eligible institutions from participating in emergency lending programs (see [here](#) [p.25]).

One way the Fed addressed stigma during the GFC was through auctions, as in its [Term Auction Facility](#). For that facility, auctions provided safety in numbers. Also, since the price was set by the auction, it did not imply that borrowers were paying a penalty rate. Moreover, because auctions were held only at certain times, unlike a standing facility, using the facility did not imply a borrower had an immediate need for funding (see [here](#)).

Some programs were run as standing facilities and used other features to deal with stigma.

First, [limited or lagging disclosure](#) can prevent stigma: if the market doesn't know a bank has received government liquidity, that bank won't suffer from stigma. In the U.S., however, post-GFC disclosure requirements imposed on the Fed may raise stigma problems. The Fed now must report to the Congress for any use of emergency lending authority under [section 13\(3\) of the Federal Reserve Act](#). Within seven days of establishment of any section 13(3) program, also, the Board must report detailed transaction-level information to the Congress on any lending activity it conducts under those programs.

Second, offering uniform access for all financial institutions, irrespective of their condition and systemic importance, can prevent stigma. For that reason, central banks sometimes [encourage healthy institutions to participate](#).

The stigma problem is mainly relevant for government programs that financial institutions don't use in normal times. The ECB during the GFC was able to lend billions of euros in the early days of the GFC in part because its facility was already available to hundreds of financial institutions and had been used regularly. Banks could avoid stigma because that borrowing was seen as [unremarkable](#).

Loans: Non-recourse and Term

The [advantage of recourse loans](#) is that repayment is backed by the financial resources of the borrower. Earlier programs by the Fed heading into the GFC were recourse but later ones were non-recourse as the Fed was lending to [new counterparties whose financial condition could not be readily assessed](#). In other cases, the Fed found it would be [counterproductive to expose counterparties to the risk of a decline in the collateral's value](#).

Non-recourse loans by the Fed generally accompanied a private loss-sharing arrangement to mitigate the risk it took in collateralized non-recourse loans. In [TALF](#), this created an [incentive for participants to establish sound collateral for the securities](#), since they took the first risk of loss. In view of the long term to maturity of the loans, and wide-variety of newly issued spreads and credit quality across the ABS market, it was [desirable to have private investors' scrutiny](#). This involvement also [avoided undercutting market mechanisms](#) for allocating credit to borrowers by relying on private structuring and pricing of new securitizations. Relying on private investors in newly issued ABS and CMBS also [provided benchmark pricing to the market](#).

The terms of loans generally mirrored the terms of underlying collateral ([AMLF](#) and [Commercial Paper Funding Facility](#) (CPFF)). In [TALF](#), the term was initially one year, which was shorter

than that of underlying assets posted as collateral for the loan. This mismatch meant that the financing would expire before the underlying debt securities were paid back, leaving the investors to assume the full risk for the rest of the term left in the investment. The Fed recognized that flaw and extended the term to three to five years, reflecting the maturity of underlying assets.

Eligibility

Many U.S. programs during the GFC were limited to institutions the government was already familiar with. In the case of the [AMLF](#), to facilitate quick implementation of the program, the Fed relied on institutions with which it had existing relationships (depository institutions and broker-dealers) to act as intermediaries and to be the actual borrowers under the program.

Haircuts, Interest Rates and Fees

Setting haircuts, interest rates and fees are a balancing act. For a program to be effective and ensure widespread use, these should be high enough to minimize moral hazard but not too high as to deter participation.

[The Bank of England's GFC-era Commercial Paper Facility](#) bought CP at spreads that were significantly below market rates at the time, but significantly above those expected to prevail in normal conditions. Initially this was to help drive market spreads down and provide a backstop. This was set up to [be self-liquidating as normal market conditions returned](#).

Haircuts and interest rates also represented the risks the central bank was taking on with illiquid assets. In launching Outright Purchases of CP, [Bank of Japan governor Masaaki Shirakawa stated](#) that the bid rate would be “more favorable than the market interest rates when the market is malfunctioning;” since losses on any purchased CP come at a cost to the taxpayers, a penalty rate would ensure that taxpayers were compensated for taking on the credit risk. The [CPFF](#) used interest rate as a security feature where the accumulation of interest was expected to absorb losses and provide additional protection for central banks (see [here](#)[p.197]).

However, the [AMLF](#) did not impose any haircuts. Under the AMLF, borrowers purchased ABCP at amortized cost, not at depressed values. The Fed feared further market instability if another money market fund were to “break the buck,” that is, to announce that the market value of its assets had fallen below 99.5% of book value. The Fed, instead, to minimize the risk that it undertook, only took high-quality ABCP as collateral and tightened the requirements as the program progressed.

Fees should be sufficient to cover central banks' costs of managing each program. A Bank of England report emphasizes that fees in GFC programs were not designed to manage the risks to the central bank or to the public—those risks should have been adequately covered by collateral and haircuts (see [here](#)).

The Fed sometimes relies on private institutions to ensure the accuracy and efficacy of these programs. In the [TALF](#), agents were hired to handle administrative activities between the Fed

and the borrowers. Bank of New York Mellon, the program custodian, was responsible for holding collateral, collecting and distributing payments and administrative fees, and validating the pricing and ratings submitted for pledged securities. Collateral monitors, selected by the Federal Reserve Bank of New York, provided data and modeling services used in risk assessments and also validated collateral pricing and ratings.

Relief from Regulatory Requirements

To ensure the effectiveness of these programs to reach their intended markets, central banks have at times exempted or limited existing legal restrictions.

In the [AMLF](#), because the Fed protected borrowing banks from credit or market risk in holding ABCP, the Fed assessed no regulatory capital charge on banks for those holdings. The Fed also exempted banks from the maximum limit that Fed rules imposed on a bank's "covered transactions" with any single affiliate of the bank from 10% of the bank's equity to 20%. This allowed the AMLF borrowing banks to purchase ABCP from their affiliated money market funds.

In the [TALF](#), the government made it clear that the executive compensation restrictions that Congress had mandated for companies receiving taxpayer support under the Troubled Asset Relief Program (TARP) would not be applied to TALF sponsors, underwriters, and borrowers. This was to encourage participation in the program. In [another program](#), the Fed didn't make this clear, and some potential borrowers were unsure whether to participate.

Effect on Lending to Households and Businesses

Market participants and government officials have claimed that various market liquidity programs succeeded in channeling credit to frozen markets, although empirical evidence is limited. Post-GFC, some in the U.S. have attempted to compare programs to identify which have been the most effective in channeling credit to households and businesses. [One paper by Fed economists argued](#) that TALF had the most direct impact on consumers. They attribute TALF's success to its three features: (i) a non-recourse loan structure, (ii) longer maturities than discount window and other lending programs, and (iii) availability to a wide set of market participants, beyond the Fed's traditional counterparties.

Treasury Backstop for Fed Lending under CARES Act: Lessons from 2008 TALF

By June Rhee with research support from Aidan Lawson

Original post [here](#).

[Section 4003\(b\) of the CARES Act](#) appropriates \$454 billion for the Treasury to backstop Federal Reserve (Fed) lending programs aimed at supporting credit flows to businesses, states, or municipalities in the midst of the coronavirus pandemic.

The week before the CARES Act was signed into law, the Treasury had already used [\\$50 billion in total](#) from the [Exchange Stabilization Fund \(ESF\)](#) to backstop five Fed emergency lending programs, including the [reintroduced Term Asset-Backed Securities Loan Facility \(TALF\)](#). In 2008 during the Global Financial Crisis (GFC) the Treasury backstopped the [first TALF](#) using funds appropriated by Congress in the [Emergency Economic Stabilization Act of 2008 \(EESA\)](#).

The Fed has yet to determine the nature of any emergency lending programs (see [here](#) for discussion on the Fed's section 13(3) power) it will launch under this authority, but Fed Chairman Jerome Powell [said](#) on March 26 that the Fed's emergency lending powers are dependent on this Treasury backstop: “[Effectively, \\$1 of loss-absorption is worth \\$10 worth of loans.](#)” The Treasury backstop certainly [extended the Fed's lending power](#) during GFC but what were the Treasury and Fed's expectations in actually using this backstop? These expectations certainly influenced the design of 2008 TALF and a recent report to Congress includes the Fed's expectation in the 2020 TALF.

Pre-CARES Act Treasury Backstop in 2020 TALF

On March 23, the Fed and the Treasury reintroduced [TALF](#) to support credit flows to households and businesses in the midst of economic distress caused by the coronavirus pandemic. Similar to the 2008 TALF, a special purpose vehicle (SPV) will make a total of \$100 billion three-year nonrecourse loans to US companies that own eligible ABS. The SPV is funded by a recourse loan from the Federal Reserve Bank of New York (FRBNY) and an initial \$10 billion equity investment by the Treasury. The Fed relies on [Section 13\(3\) of the Federal Reserve Act \(FRA\)](#) and the Treasury uses the Exchange Stabilization Fund to backstop the 2020 TALF.

On March 29, [the Fed's report to Congress pursuant to Section 13\(3\)](#) revealed the Fed's expectation in using the Treasury backstop. The Fed “does not expect at this time that the TALF will result in losses in excess of the Department of the Treasury's equity investment”. Therefore, it seems the Fed is interpreting the Treasury's backstop as available to use. Similar language is included in the report to Congress for the [Primary Market Corporate Credit Facility](#), and the [Secondary Market Corporate Credit Facility](#).

Treasury Backstop in 2008 TALF

The [Emergency Economic Stabilization Act of 2008](#), which Congress passed in the midst of the GFC, established the [Troubled Assets Relief Program \(TARP\)](#) to help stabilize the US financial system and restore credit flows to households and businesses. It enabled the Treasury “[to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system.](#)” Initially, Congress authorized \$700 billion for TARP. It reduced TARP’s size to \$475 billion in 2010 in the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#).

Structure of Treasury Backstop in 2008 TALF

The [2008 TALF](#) was a joint program between the Treasury and the Fed aimed at restarting the asset-backed securities (ABS) markets, which had come to a near complete halt in the fall of 2008 after the bankruptcy of the Lehman Brothers investment bank. The Fed, under [Section 13\(3\) of the FRA](#), and the Treasury, using TARP funds, initially committed \$200 billion. Later on February 10, 2009, this commitment was expanded up to a potential \$1 trillion. The FRBNY made non-recourse loans to investors to purchase eligible ABS and the Treasury provided credit support for these loans.

Initially the staff at the Fed settled on [two possible models](#) for the Treasury backstop. The Board staff preferred market participants forming funds that would invest in ABS to which the Fed would provide leverage, the Treasury would provide mezzanine financing, and private investors would provide equity. A similar model without the leverage from the Fed was adopted by the Treasury as the [Public-Private Investment Program \(PPIP\)](#) during the GFC. The FRBNY staff favored a model under which the Fed would lend to private investors holding ABS, with the Treasury providing the Fed credit protection for those loans. This model became TALF. An important advantage of this model was that it would naturally sunset when credit risk spreads normalized and alternative financing became more attractive than TALF loans. (see [here](#))

The FRBNY created a special purpose vehicle (SPV, TALF LLC) to manage assets posted as collateral for the loans. The SPV was initially funded by a \$100 million drawing on the Treasury’s \$20 billion commitment to purchase subordinated debt issued by the SPV. \$16 million of this initial funding was set aside for administrative funding. If the SPV needed further funding beyond \$20 billion committed by the Treasury, the FRBNY would lend up to \$180 billion. The FRBNY’s loan to the SPV was senior to the Treasury’s subordinated debt, with recourse to the SPV, and secured by all the assets of the SPV.

Loan repayments and proceeds from asset sales were distributed in the following order under the [credit agreement](#) among the SPV, the FRBNY and the Treasury:

1. pay general TALF program administrative expenses,
2. repay the \$16 million Treasury loan made to the SPV to cover administrative expenses,
3. repay outstanding principal on any FRBNY senior loans,

4. fund the cash collateral account,
5. repay outstanding principal on any Treasury loans,
6. repay FRBNY loan interest,
7. repay Treasury loan interest, and
8. repay any other obligations that may arise that have not been specified by the agencies.

Any residual returns were shared by the Treasury (90%) and the FRBNY (10%).

Expectations on Actual Usage of Backstop and Features of 2008 TALF

Unlike the 2020 TALF, testimonies by Treasury and Fed officials seem to suggest that neither the Treasury nor the Fed expected that the Fed would need to resort to the backstop. William R. Nelson, then Deputy Director of the Division of Monetary Affairs in the Board testified that [“\[a\]lthough the Treasury provided credit protection for the Federal Reserve, the risk controls built into the TALF..., were designed to keep the risk for the US government as a whole very low”](#).

For further discussion on the risk controls built into 2008 TALF reflecting the Treasury and Fed’s expectation, see the [YPFS case on the 2008 TALF](#).

Barriers to Access Impede Utilization of Municipal Liquidity Facility

By Vaasavi Unnava

Original post [here](#).

Many states are facing barriers to access the Federal Reserve's \$500 billion [Municipal Liquidity Facility \(MLF\)](#) due to constraints on general debt issuance in their constitutions.

Congress authorized the MLF in the CARES Act. The program authorizes the Fed to purchase up to \$500 billion in debt issued by states and counties and cities of a certain size and is intended to help mitigate the economic impacts of the COVID-19 pandemic. The program represents a new area for the Fed, which has not traditionally lent to government subdivisions. The CARES Act separately also provided for \$150 billion in grants to states to offset direct costs of the COVID-19 pandemic.

As originally implemented, the MLF provided limited opportunities for participation by cities and counties, instead allowing states to procure funding and distribute it amongst political subdivisions in their geographic area. However, as governors vocalized the extensive [barriers to access](#), the Federal Reserve [expanded eligibility](#) from 10 cities and 16 counties to 87 cities and 140 counties. The Fed also extended the program's end from September to December in response to states' concerns.

Despite the changes, legal and practical hurdles still might limit utilization of the Fed's program, which Congress intended to be a key tool to help states and municipalities manage the impacts of the virus. Many of these legal hurdles are written into constitutions to maintain fiscal responsibility in state spending. Moreover, some states can't issue debt without voter approval, posing the challenge of conducting a ballot under extensive social distancing guidelines.

State Debt Issuance Caps

Many states have constitutionally-mandated caps on the amount of debt a government can issue within a fiscal year. These caps can vary dramatically.

[Oregon](#), for example, only allows the issuance of \$50,000 of aggregate debt, a sum small enough to render debt issuances unviable. Other states have much higher caps. For instance, [South Carolina](#) can issue debt up to 5% of its revenues from the previous fiscal year--an estimated \$660 million for the state based on 2019 collections. [Ohio](#) utilizes a similar metric, requiring that debt obligations not exceed 5% of its general revenue fund plus net proceeds from lottery sales, making approximately \$769 million its borrowing cap, based on 2019 revenues. Some states, such as Nevada, set caps based on the total assessed value of property in the state.

Debt servicing caps can operate as an informal form of debt issuance caps, limiting the size of debt issuances implicitly by limiting debt servicing costs. Debt servicing caps limit the size of

principal and interest payments on existing debt to some percentage of a state's budget or revenue. For example, [Florida](#) provides that debt servicing cannot exceed 6% of revenues without legislative approval. [Illinois](#) has a relatively high debt issuance cap of 15% of general revenues, and aggregate debt servicing [cannot exceed](#) 7% of appropriations from the general revenues of the preceding year.

Voter Approval

In the context of COVID-19, the most pressing barrier to debt issuance is state requirements for voter approval. [Twenty-one](#) states in the U.S. require some form of voter approval before debt can be issued. Two types of voter approval are common: approval of the issuance or approval of the size of an issuance beyond a debt cap.

South Carolina, as mentioned earlier, may issue a sizable amount of debt, but the issuance must be preapproved by either two-thirds of the electorate or the legislature. [Rhode Island](#) may exceed its debt cap of \$50,000 only if approved through a referendum. [Texas](#) requires the approval of a majority of voters, in addition to approval from the legislature.

Extensive social distancing guidelines have complicated voting procedures, leading many states to [delay or cancel their primary elections](#) to prevent the spread of the virus. Without opportunities to vote, some states cannot legally issue debt.

Legislative Approval

In addition to debt issuance caps, many states require that the legislature approve proposed debt issuances of any amount; sometimes this approval is coupled with voter approval requirements. Legislative approval requirements often need a supermajority to pass, which creates a high bar.

[Delaware](#), which is permitted to issue up to 5% of the estimated net revenues of that year (approximately \$210 million based on 2019 revenues) requires approval from three-fourths of the legislature. Illinois requires either approval from a majority of voters or from three-fifths of the legislature to allocate funding. [Maine](#)'s issuance cap of \$2 million can be exceeded if passed by two-thirds of both houses of the state legislature and approved by voters in a referendum. Though [Virginia](#) only requires approval by a simple majority of both houses of the legislature, it also has a referendum requirement.

Social distancing guidelines have affected the daily operations of many state legislatures, [temporarily suspending](#) many sessions without means to operate remotely. Combined with the inability to conduct referendums, current health and safety requirements create barriers to states obtaining the necessary approvals for debt issuance.

Coverage

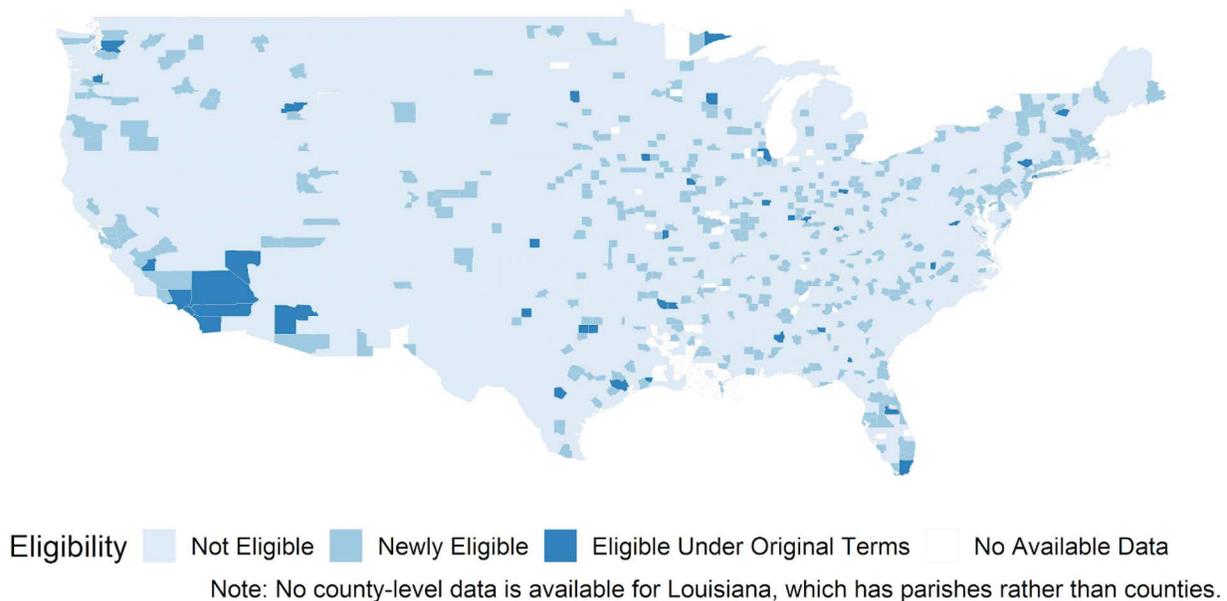
Practical difficulty in meeting requirements for legislative or voter approvals may prevent some states from participating in the MLF. Some counties and cities are eligible to participate in the MLF directly, although the scope of eligibility, even under the expanded criteria, has been

contested. The cities and counties eligible--even with the latest expansion in eligibility--are largely urban centers; many cities and municipalities in rural or suburban settings must therefore rely on state aid to receive funding for their local coronavirus response mechanisms, as seen in the chart below.

Eligible counties and cities may also face similar logistical barriers preventing debt issuances on a local level. City councils or governments must adhere to strict social distancing guidelines and are unable to hold referendums in their jurisdictions while maintaining public safety.

While some Federal Reserve officials [acknowledged](#) the limitations of the facility prior to the expansion, they have made no indication of additional expansions to the facility. As the first facility the Fed has created in this crisis to provide liquidity to municipalities, the MLF may expand or change as the COVID-19 crisis continues.

New Coverage Under the Municipal Liquidity Facility



Smaller cities and counties ineligible for direct access to the MLF must rely on allocations from state governments for MLF aid. However, as noted above, several states face legislative and logistical barriers that impede access to the MLF. Presently, it's unclear how smaller counties and cities within those states' jurisdictions could receive aid if liquidity help cannot reach the states

allocating funds. Congressional proposals for using federal government funds for municipal coronavirus expenses have [received bipartisan support](#).

Summary

With direct state applications hampered through multiple barriers to debt issuances, it is unclear whether states will be able to fully participate in the program to cover the additional scores of counties and cities ineligible for the MLF. To issue debt, many states must pass legislation or receive approval by a supermajority of voters, both logistically challenging while adhering to social distancing guidelines. Other states, though able to issue debt, have low debt issuance caps, preventing them from issuing debt to the extent needed to address municipal funding needs.

It is also unclear whether the original \$500 billion allocated will be enough to fund all the financial needs of states and municipalities as many states report large [estimated deficits](#) due to COVID-induced budgetary shortfalls. Inflexible barriers to access may exacerbate this issue, allocating aid to states that can more easily issue debt.

As social distancing guidelines relax, it is possible that state legislatures may be able to return to sessions and pass debt issuances. With the facility extending into December 2020, there are still opportunities to provide coverage to municipalities that need aid in fighting the COVID-19 pandemic.

Use of Federal Reserve Programs – 07/09/2020

By Pascal Ungersboeck

Original post [here](#).

Below we report on operational Fed programs, based on the Fed's weekly [H.4.1 release](#). Since last week, the Term Asset-Backed Securities Loan Facility has started operations; however, no funds have been extended so far. The ECB, BoE and BoJ further decreased their use of the swap lines established with the Fed in March.

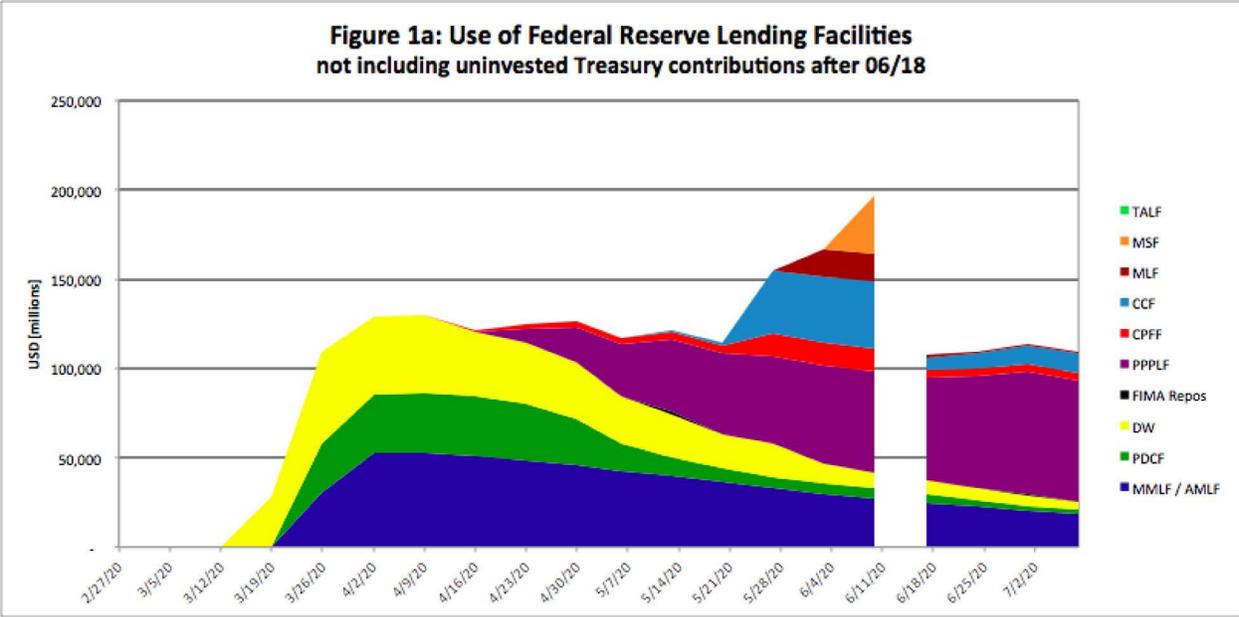
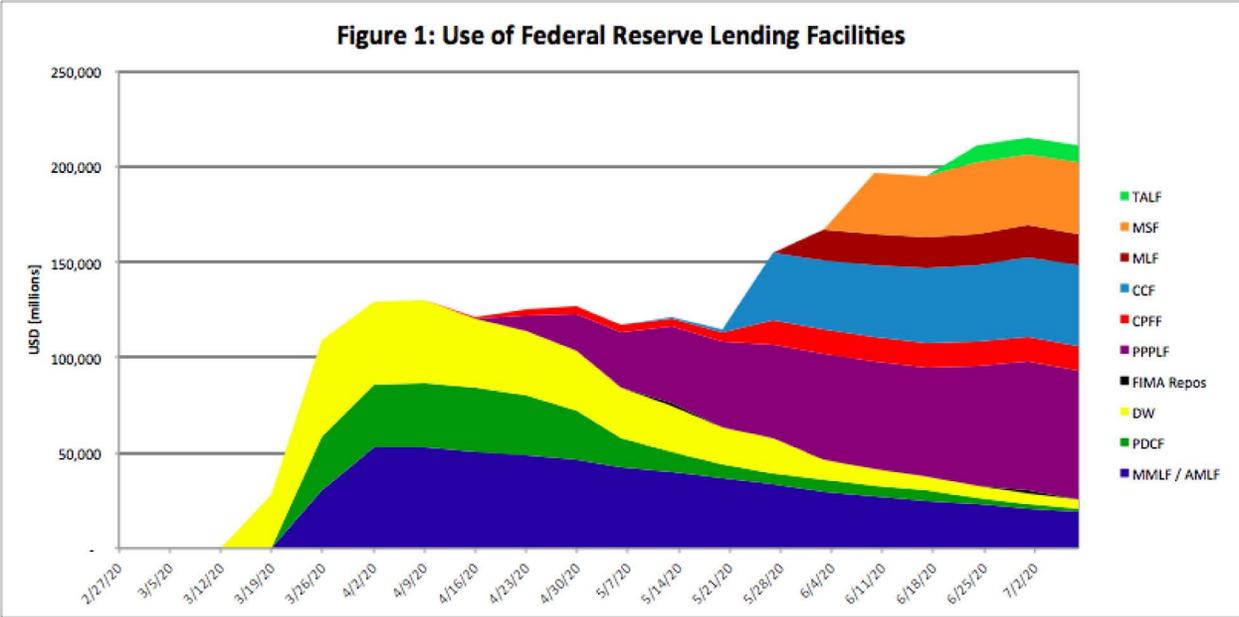
Note on Treasury contributions to Federal Reserve Programs

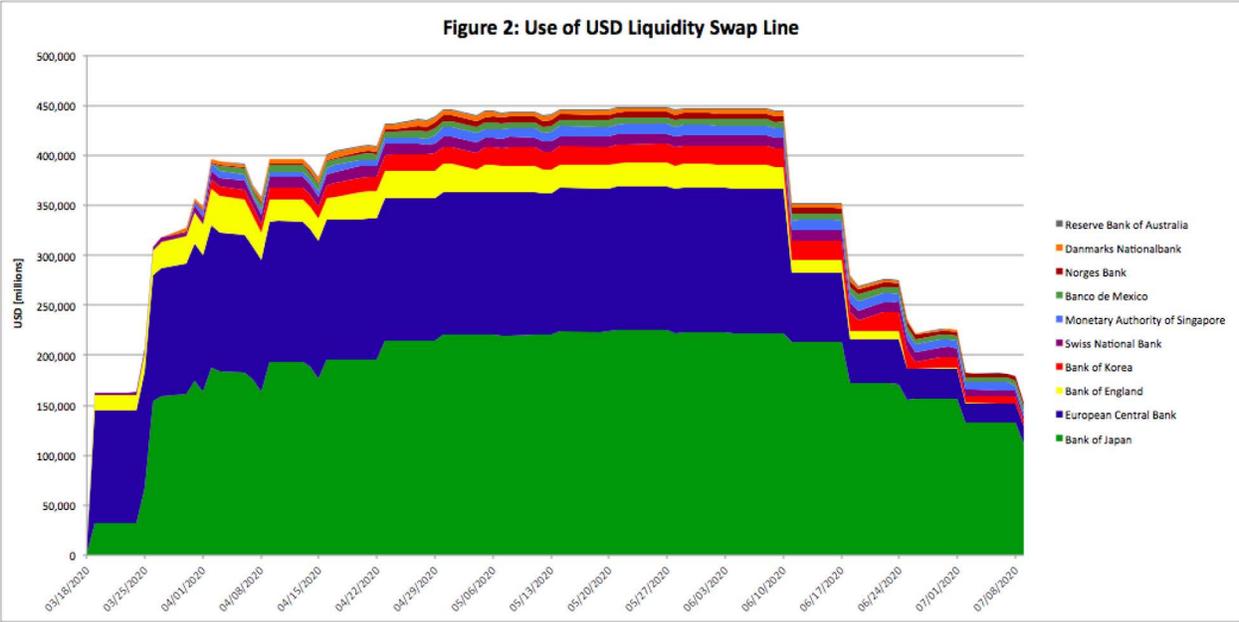
The Treasury announced on April 9 that it intended to use funds available under the CARES Act to purchase equity in special purpose vehicles established under Fed lending programs. On June 16, the Federal Reserve Bank of New York received the most recent contribution of \$10 billion to [TALF](#). In total, the Treasury has invested a total of \$114 billion in six facilities. Per the facility agreements, 85% of the equity contributions to the [CCF](#), [CPFF](#), [MLF](#), [MSF](#) and [TALF](#) have been invested in nonmarketable Treasury securities; \$31.9 billion for the CCF, \$8.5 billion for the CPFF, \$14.9 billion for the MLF, \$31.9 billion for the MSF, and \$8.5 billion for TALF.

As of July 2, there is \$211 billion outstanding across 10 facilities (Figure 1); \$109 billion out of the total has been used to purchase targeted assets. The total amount outstanding is slightly down from last week, when it stood at \$215 billion - \$114 billion excluding Treasury contributions. It is the first time the total has declined since the launch of the first programs in March. Figure 1a below reports the outstanding amount of each facility, not including Treasury contributions that are invested in securities, from June 18 onwards.

Note on Federal Reserve Swap lines

Over the last month, central banks significantly reduced their use of the USD swap lines established with the Fed in March. The reduction is due to the expiration of 84-day swaps entered during the early weeks of the crisis. Auctions for these swaps were conducted weekly. As these contracts are reaching maturity, the total outstanding amount declined by almost \$300 billion since its peak on May 27. As of July 9, the total amount still outstanding is \$153 billion, down from \$183 billion last week. The BoJ and ECB are now the only counterparties with an outstanding amount above \$10 billion. At \$112 billion outstanding, the BoJ's share represents 73 percent of the total. The ECB stands at \$17 billion; together the two largest counterparties hold 84 percent.





CB Swaps				AMLF / MMLF				PDCF			
GFC		COVID		GFC		COVID		GFC		COVID	
9/17/08	62,000	3/11/20	58	10/8/08	139,481	3/11/20	-	3/5/08	-	3/11/20	-
9/24/08	141,900	3/18/20	44	10/15/08	122,763	3/18/20	-	3/12/08	-	3/18/20	-
10/1/08	286,432	3/25/20	206,051	10/22/08	107,895	3/25/20	30,634	3/19/08	28,800	3/25/20	27,718
10/8/08	335,184	4/1/20	348,544	10/29/08	96,010	4/1/20	52,667	3/26/08	37,023	4/1/20	33,050
10/15/08	406,882	4/8/20	358,077	11/5/08	85,097	4/8/20	53,171	4/2/08	34,443	4/8/20	33,018
10/22/08	477,159	4/15/20	378,291	11/12/08	76,546	4/15/20	50,656	4/9/08	26,479	4/15/20	33,409
10/29/08	498,860	4/22/20	409,712	11/19/08	61,923	4/22/20	48,810	4/16/08	25,655	4/22/20	31,526
11/5/08	528,355	4/29/20	438,953	11/26/08	53,309	4/29/20	46,277	4/23/08	18,555	4/29/20	25,504
11/12/08	563,716	5/6/20	444,885	12/3/08	49,234	5/6/20	42,763	4/30/08	17,775	5/6/20	14,903
11/19/08	562,090	5/13/20	440,934	12/10/08	34,425	5/13/20	39,820	5/7/08	16,260	5/13/20	10,288
11/26/08	475,435	5/20/20	446,103	12/17/08	27,421	5/20/20	36,449	5/14/08	14,485	5/20/20	7,501
12/3/08	506,819	5/27/20	448,946	12/28/08	23,993	5/27/20	33,244	5/21/08	13,555	5/27/20	6,241
12/10/08	582,575	6/3/20	446,945	1/7/09	23,765	6/3/20	29,859	5/28/08	10,125	6/3/20	5,847
12/17/08	583,135	6/11/20	352,597	1/14/09	16,093	6/10/20	26,977	6/4/08	7,750	6/10/20	5,829
12/24/08	552,728	6/18/20	279,497	1/21/09	14,775	6/17/20	24,680	6/11/08	8,520	6/17/20	5,306
12/31/08	553,728	6/25/20	228,669	1/28/09	15,967	6/24/20	22,889	6/18/08	8,145	6/24/20	3,624
1/7/09	538,162	7/2/20	182,858	2/4/09	16,933	7/1/20	20,637	6/25/08	1,690	7/1/20	2,486
1/14/09	510,514	7/9/20	153,041	2/11/09	14,185	7/8/20	18,927	7/2/08	-	7/8/20	1,874

DW				PPPLF				CPFF			
GFC		COVID		GFC		COVID		GFC		COVID	
9/10/08	23,455	3/11/20	11			3/11/20	-	10/15/08	-	3/11/20	-
9/17/08	33,401	3/18/20	28,224			3/18/20	-	10/22/08	-	3/18/20	-
9/24/08	39,327	3/25/20	50,768			3/25/20	-	10/29/08	144,808	3/25/20	-
10/1/08	49,524	4/1/20	43,744			4/1/20	-	11/5/08	243,305	4/1/20	-
10/8/08	98,107	4/8/20	43,449			4/8/20	-	11/12/08	257,287	4/8/20	-
10/15/08	101,853	4/15/20	36,284			4/15/20	-	11/19/08	270,879	4/15/20	974
10/22/08	107,547	4/22/20	33,742			4/22/20	8,009	11/26/08	294,094	4/22/20	2,732
10/29/08	110,737	4/29/20	31,759			4/29/20	19,488	12/3/08	303,880	4/29/20	3,372
11/5/08	108,567	5/6/20	26,494			5/6/20	29,181	12/10/08	312,414	5/6/20	3,988
11/12/08	99,180	5/13/20	24,239			5/13/20	40,580	12/17/08	318,843	5/13/20	4,292
11/19/08	92,645	5/20/20	19,535			5/20/20	45,090	12/28/08	331,686	5/20/20	4,293
11/27/08	91,725	5/27/20	18,198			5/27/20	49,211	1/1/09	334,102	5/27/20	12,794
12/3/08	87,813	6/3/20	11,011			6/3/20	55,230	1/7/09	334,409	6/3/20	12,795
12/10/08	89,952	6/10/20	8,427			6/10/20	56,983	1/14/09	334,705	6/10/20	12,796
12/17/08	90,237	6/17/20	7,479			6/17/20	57,552	1/21/09	350,524	6/17/20	12,797
12/28/08	84,898	6/24/20	6,237			6/24/20	62,597	1/28/09	248,091	6/24/20	12,798
1/1/09	93,769	7/1/20	5,860			7/1/20	68,133	2/4/09	258,664	7/1/20	12,799
12/17/08	90,237	7/8/20	4,846			7/8/20	67,685	2/11/09	251,206	7/8/20	12,802

CCF				FIMA Repos				MLF			
GFC		COVID		GFC		COVID		GFC		COVID	
		3/11/20	-			3/11/20	-			3/11/20	-
		3/18/20	-			3/18/20	-			3/18/20	-
		3/25/20	-			3/25/20	-			3/25/20	-
		4/1/20	-			4/1/20	-			4/1/20	-
		4/8/20	-			4/8/20	1			4/8/20	-
		4/15/20	-			4/15/20	-			4/15/20	-
		4/22/20	-			4/22/20	-			4/22/20	-
		4/29/20	-			4/29/20	2			4/29/20	-
		5/6/20	-			5/6/20	-			5/6/20	-
		5/13/20	305			5/13/20	1,404			5/13/20	-
		5/20/20	1,801			5/20/20	1			5/20/20	-
		5/27/20	34,853			5/27/20	1			5/27/20	-
		6/3/20	36,154			6/3/20	-			6/3/20	16,075
		6/10/20	37,374			6/10/20	-			6/10/20	16,077
		6/17/20	38,916			6/17/20	-			6/17/20	16,079
		6/24/20	40,617			6/24/20	1			6/24/20	16,080
		7/1/20	41,940			7/1/20	1,001			7/1/20	16,081
		7/8/20	42,644			7/8/20	-			7/8/20	16,082

MSF				TALF			
GFC		COVID		GFC		COVID	
		3/11/20	-	12/17/08	-	3/11/20	-
		3/18/20	-	12/24/08	-	3/18/20	-
		3/25/20	-	12/31/08	-	3/25/20	-
		4/1/20	-	1/7/09	-	4/1/20	-
		4/8/20	-	1/14/09	-	4/8/20	-
		4/15/20	-	1/21/09	-	4/15/20	-
		4/22/20	-	1/28/09	-	4/22/20	-
		4/29/20	-	2/4/09	-	4/29/20	-
		5/6/20	-	2/11/09	-	5/6/20	-
		5/13/20	-	2/18/09	-	5/13/20	-
		5/20/20	-	2/25/09	-	5/20/20	-
		5/27/20	-	3/4/09	-	5/27/20	-
		6/3/20	-	3/11/09	-	6/3/20	-
		6/10/20	31,875	3/18/09	-	6/10/20	-
		6/17/20	31,876	3/25/09	4,711	6/17/20	-
		6/24/20	37,502	4/1/09	4,692	6/24/20	8,500
		7/1/20	37,502	4/8/09	4,692	7/1/20	8,753
		7/8/20	37,503	4/15/09	6,379	7/8/20	8,753

Liquidity Swap Lines

The USD [swap lines](#) are bilateral agreements between the Fed and foreign central banks. They allow foreign central banks to exchange domestic currency for US dollars. The Fed currently maintains swap line agreements with 14 central banks.

Money Market Mutual Fund Liquidity Facility

The [MMLF](#) allows the Fed to fund the purchase of money market mutual fund assets. The program is established under section 13(3) of the Federal Reserve Act.

Discount Window

The [DW](#) is a standing facility that allows the Fed to provide collateralized loans to depository institutions.

Primary Dealer Credit Facility

The [PDCF](#) allows the Fed to extend collateralized loans to primary dealers. The facility was established under section 13(3).

Paycheck Protection Program Liquidity Facility

The [PPPLF](#) allows the Fed to provide financial institutions with liquidity backed by loans to small and medium businesses extended under the federal government's Paycheck Protection Program and guaranteed by the Small Business Administration. The Program is established under section 13(3).

Commercial Paper Funding Facility

The [CPFF](#) provides a liquidity backstop to issuers of commercial paper and was also established under section 13(3). It is operated by the FRBNY through a special purpose vehicle, the Commercial Paper Funding Facility II LLC.

Primary and Secondary Market Corporate Credit Facility

The [PMCCF](#) and [SMCCF](#) were set up under section 13(3) to support credit to employers through purchases of newly issued bonds and support market liquidity for outstanding corporate bonds. These facilities operate through a special purpose vehicle, the Corporate Credit Facility LLC (CCF LLC).

Federal Reserve Programs Involve More Risk than in GFC

By Rosalind Z. Wiggins and Greg Feldberg with Research Support from Pascal Ungersboeck

Original post [here](#).

In this post we consider the risk profiles of the programs that the Fed has implemented during the COVID-19 crisis as compared to those it adopted during the global financial crisis of 2007-09 (GFC) and the role of the Treasury's backstop in each instance.

In earlier posts, we considered how the Treasury's use of \$454 billion authorized by the [United States CARES Act](#) to [backstop Federal Reserve \(Fed\) programs](#) might leverage the funds into trillions of liquidity for the economy. Thus far, this strategy has seen the Fed launch nine programs potentially offering up to \$1.950 trillion of loans backed by \$215 billion of Treasury funds, or roughly 47% of the available amount. Consistent with the CARES ACT, these facilities were launched pursuant to [Section 13\(3\) of the Federal Reserve Act](#), which requires, among other things, that the Fed be secured and that it seek to protect taxpayers. As of June 11, the Treasury has made investments into all SPVs for all programs except the TALF, and loans have been extended under the Municipal Liquidity Facility, the Corporate Credit Facility, and the Commercial Paper Funding Facility.

The Fed also launched two other Section 13(3) facilities without Treasury backing, the Primary Dealer Credit Facility, which provides recourse loans to primary dealers, and the Paycheck Protection Program Lending Facility, which finances Paycheck Protection Program loans guaranteed by the Small Business Administration. Loans have been extended under both these programs.

Fed Taking on more Credit Risk

Four of the Section 13(3) programs implemented by the Fed are variations of programs that it implemented during the GFC. However, as [Chairman Powell](#) has acknowledged, this time the Fed is [taking on more risk](#). An April letter [from the Congressional Budget Office](#) (CBO) also concluded that, this time, the Fed is taking on “substantial additional credit risk for the government.”

Because of the wide impact of the government's shutdown orders in response to the COVID pandemic, the programs that the Fed has implemented with Treasury support aim to distribute liquidity across wide swaths of the economy and reach borrowers to whom the Fed has not traditionally lent. These include corporations (Primary and Secondary Market Corporate Credit Facilities), political subdivisions (Municipal Liquidity Facility), and small and medium-sized businesses (Main Street Facilities).

Federal Reserve loan programs established under FRA Section 13(3) with the approval of the Treasury Secretary					
Fed Program	Date Authorized	Maximum Authorized	Total amount outstanding as of June 11 [USD mn]	Share of total amount outstanding invested in Treasury securities	Total Treasury Support [Equity investment unless stated otherwise]
Primary Dealer Credit Facility (PDCF)*	17-Mar	Not stated	\$5,829	N/A	N/A
Commercial Paper Funding Facility (CPFF)*	17-Mar	Not stated	\$12,796	\$8,500	\$10 billion in SPV
Money Market Mutual Fund Liquidity Facility (MMLF)*	18-Mar	Not stated	\$26,977	N/A	\$10 billion in credit protection
Term Asset-Backed Securities Loan Facility (TALF)*	23-Mar	\$100 billion	N/A	N/A	\$10 billion in SPV
Primary Market Corporate Credit Facility (PMCCF)	23-Mar	\$750 billion shared evenly	\$37,374	\$31,875	\$75 billion in SPV
Secondary Market Corporate Credit Facility (SMCCF)					
Municipal Liquidity Facility (MLF)	9-Apr	\$500 billion	\$16,077	\$14,875	\$35 billion in SPV
Paycheck Protection Program Lending Facility (PPPLF)	9-Apr	Not stated	\$56,983	N/A	N/A. Extensions of credit under the PPPLF are fully collateralized by downstream loans that are fully guaranteed by the SBA.
Main Street Expanded Loan Facility (MSELF)**	8-Apr	\$600 billion shared evenly	\$31,875	\$31,875	\$75 billion in SPV
Main Street New Loan Facility (MSNLF)**					
Main Street Priority Loan Facility (MSPLF)**					
Total		[\$1.950 trillion]	\$187,911	87,125	\$215 billion

* A similar program was implemented during the GFC.

**We refer to these programs on a combined basis as the "Main Street Lending Program", a convention used by the Fed and Treasury.

Some of the programs are accepting riskier collateral than the Fed accepted under its GFC programs. The Fed's GFC programs provided collateralized loans and required that such loans be "secured to the satisfaction of the lending reserve bank," i.e., that there be a high degree of likelihood that the Fed would be repaid and not experience losses, as required by the Fed's then interpretation of Section 13(3). See this [YPFS blogpost](#) for a discussion of Section 13(3).

Acceptable collateral under most GFC programs was limited to Treasuries, agency securities, and other investment-grade securities. Only after Lehman's bankruptcy did the Fed expand the categories of eligible collateral under some programs to include riskier securities. For example, the collateral eligible to be pledged at the Primary Dealer Credit Facility (PDCF), which provided recourse loans, was originally limited to limited to investment-grade debt securities. It was then

expanded to closely match all types of collateral that could be pledged in the tri-party repo systems of the two major clearing banks. The collateral for the Term Securities Lending Facility (TSLF) was also expanded to include all investment-grade debt securities, whereas, previously it accepted only Treasury securities, agency securities, and AAA-rated mortgage-backed and asset-backed securities.

The most significant question of risk that arose under Section 13(3) during the GFC was with respect to the [Commercial Paper Funding Facility \(CPFF\)](#), under which the Federal Reserve Bank of New York provided loans to a special purpose vehicle to purchase newly issued commercial paper from issuers. The loans were non-recourse to the participating issuers and secured by the commercial paper. To resolve any issues of adequacy of security, the Fed required issuers to pay an insurance fee as extra security for the loan. [Scott Alvarez, former Board General Counsel](#) and his legal team penned a memo concluding that such a mechanism was sufficient to meet the requirements of Section 13(3).

The Fed was repaid all amounts of loans under its GFC programs, earned interest and fees on its loans, and experienced a net profit with respect to its programs. (CBO Ltr p. 20).

By comparison, the COVID-19 Section 13(3) programs have more risk built into them, as they are accepting a wide range of assets as collateral, including accepting lower quality collateral than the Fed has accepted in the past.

Several Fed programs will accept as collateral, “fallen angels,” bonds that were initially given an investment-grade rating, but which have since lost their investment grade rating due, in part, to the economic slowdown brought on by COVID-19. The following programs show the range of collateral that is being accepted:

- TALF can buy new AAA CLO tranches
- PMCCF can buy syndicated loans, and “fallen angels”
- SMCCF can buy HY ETFs and high-yield bonds, including “fallen angels”
- The Main Street facilities could help smaller leveraged loan issuers (<\$150mn), the middle-market, that have depended on private equity lenders.

With the exception of the PDCF, the COVID-19 program loans are non-recourse to participants; in the event of default, the Fed would be able to take possession of the collateral to make itself whole. The Fed programs also seek to manage risk by varying the interest rates charged and the haircuts that are applied to different collateral. For example, under the 2020 TALF, there are three levels of interest rates. There are also three levels of haircuts ranging from 5% for ABS backed by prime credit card debt of less than a year duration, to 22% for 6-year leveraged loans.

By comparison, the 2008 TALF initially accepted only newly issued, highly rated ABS backed by new or recently extended auto loans, credit card loans, student loans, and small business loans. The program was later expanded twice to accept a wider range of collateral, but securities were

required to have triple-A ratings from two or more rating agencies and were subject to an additional risk assessment by the Federal Reserve. The collateral was also subject to a haircut that depended on its [riskiness](#). The Fed considered accepting other types of securities, such as residential mortgage-backed securities and collateralized loan obligations, but ultimately decided they would present an unacceptable risk. At its highest, the 2008 TALF was authorized to purchase up to \$1 trillion of ABS and was backstopped by \$100 billion of Treasury funds from the TARP. See this [YPFS blogpost](#) for a discussion of the two TALF programs.

A Treasury Backstop for COVID Facilities

When one reviews the testimonies by Treasury and Fed officials regarding the 2008 TALF, they seem to suggest that neither the Treasury nor the Fed expected that the Fed would need to resort to the backstop. The recent CBO report noted that the Fed did not sustain losses on its GFC Section 13(3) program lending and that the interest and fees under such programs resulted in a profit to the Fed.

With respect to the COVID-19 lending, the CBO concluded that a broader range of lending was expected and that the Fed would likely take on greater risk under the new programs than it had during the GFC. Despite these factors, it concluded that in aggregate, the result would be similar to that of the GFC programs in that “income and costs will roughly offset each other [on average].”

However, the CBO also added important nuance to its analysis:

That additional lending will result in substantial additional credit risk for the government, however, which could have a wide range of budgetary effects. In CBO’s assessment, there is a high probability that the lending will result in a small net profit for the government, thus reducing the deficit, but there also is a small probability that the provisions could result in a very large loss – an outcome that would significantly increase the deficit. Finally, CBO expects that the performance of loans and assets will vary across facilities, with some realizing net losses and others net gains. (emphasis added.) ([CBO Ltr 03/2020](#), p.20-21).

With the possibility of losses being discussed, the CBO also concluded that if losses were to occur, the Treasury’s equity investments would be “available to cover loan defaults or other losses” ([CBO Ltr 03/2020](#), p.20).

[Former Secretary Timothy Geithner](#) has earlier posited that it would be acceptable for a central bank to accept losses when fighting a crisis: “Of course the central bank should be prepared to take losses. In fact, it is highly likely given all the risk and uncertainty in panics that the appropriate use of the lender of last resort authority might well result in some losses.”

During the current crisis, statements by Chairman Powell and the Fed have expressed the position that the Treasury’s investments in the Section 13(3) programs were available to act as loss backstops. Messages from Secretary Mnuchin were not so clear until May 18, when during

testimony to the Senate Banking Committee, he clarified that the Treasury was willing to absorb losses from the Section 13(3) programs. (See a [YPFS blog](#) discussing this point.)

Prior to Secretary Mnuchin's testimony, some legal and media commentators^[1] had coalesced around a similar interpretation. Professor Kathryn Judge of Columbia Law School wrote in a blogpost that, "Although not statutorily required, [the Treasury backstops] signal the Treasury's willingness to share in the losses given the credit risk that these programs may entail." ([Blue Sky Blog Post](#)). While not definitive, broad-based discussion regarding the possibility of losses may provide the Fed and Treasury some coverage against later scrutiny, at least with respect to those programs authorized by the CARES Act. In March, before the CARES Act passed, Professor Judge urged Congress to endorse the Fed's early actions: "An additional benefit of having Congress bless the Fed's action and focus on ex post accountability is that it could stop any opportunistic denials of legal authority later in this crisis." The CARES Act provisions do seem to provide some coverage by laying out guidelines.

The Treasury's willingness to absorb losses will ultimately be judged by what occurs. As the key shareholder of the special purpose vehicles supporting many of the Fed's programs, it has the ability to influence the Fed's administration of programs to minimize credit risk. Any moves to tighten terms, however, may impact participants negatively and may create friction with the overall intent of the programs to shore up the economy. There have already been questions about whether some of the Fed's [requirements are too strict](#) to achieve its broad goal. It has responded to such criticism with respect to the Municipal Liquidity Facility, for example, by expanding it twice, significantly expanding the number of eligible municipalities including some with [less than 500,000 residents](#).

The COVID-19 programs are still very new and some of them have not yet become operational. There may be additional changes to the terms and risk profiles of these programs as they are brought on board and possibly expanded if the economic effects of the shutdown persist even as the country starts to reopen. Ultimately, these questions will be answered by future developments, including usage and how the economy responds.

[1] See for example the law firm [Skadden Arps](#) "A key purpose of Treasury's investment in certain of these programs is to mitigate credit risk to the Federal Reserve in order to satisfy these legal conditions. Treasury's equity investments in those programs protect the credit extended by the Federal Reserve by absorbing first losses. ", [WNBC](#) ("The program is structured so the Treasury takes the first hit if there are any losses. Taking on those risks places it on top of the credit stack so that the Treasury, in essence, becomes the top shareholder of deals totaling \$4 trillion."), and [NY Times](#) ("Treasury Secretary Steven Mnuchin has a favorite talking point. . . Because the Fed expects most borrowers to pay back, it does not need one-for-one support. As a result, a mere \$10 billion from the Treasury can prop up \$100 billion in Fed lending. And voilà – the \$454 billion Congress dedicated to Fed programs in the aid bill can be multiplied many times.").

Early Use of Federal Reserve Programs

By Pascal Ungersboeck and Greg Feldberg

Original post [here](#).

After the COVID-19 crisis began, the Federal Reserve quickly announced a number of emergency lending facilities, largely based on programs it first introduced during the Global Financial Crisis of 2007-09 (GFC). These programs have varied in size and speed of implementation. Bank reserve balances at the Fed have reached a historic high in recent weeks, exceeding \$3 trillion for the first time, suggesting banks could lend much more.

This post discusses the early use of the following Fed [lending programs](#): (1) primary credit through the discount window, (2) central bank swap lines and FIMA repos, (3) the Money Market Mutual Fund Liquidity Facility (MMLF), (4) the Primary Dealer Credit Facility (PDCF), and (5) the Commercial Paper Funding Facility (CPFF).

In addition to these programs, the Fed [announced](#) two facilities to purchase corporate bonds on March 23. The Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF) are not yet operational, as of April 21. Similar programs announced by the [European Central Bank](#) (ECB) and [Bank of England](#) (BoE) are now operating.

The Discount Window

The [discount window](#) is a standing facility the Fed uses to provide collateralized loans to depository institutions. On [March 15](#), the Fed lowered the primary credit rate, the interest rate it charges most banks, from 1.75% to 0.25%, lower than the lowest rate it charged during the GFC. It also said it would provide discount window credit for up to 90 days, rather than 30 days. Discount window lending surged during the following weeks from a negligible amount on March 11 to \$28.2 billion on March 18 and \$50.8 billion on March 25.

That's faster than the take-up of discount window lending during the GFC. The Fed lowered the primary rate and extended the terms from overnight to 30 days in August 2007 without seeing significant usage (see the Fed's data [here](#)). Usage still picked up slowly after the failure of Bear Stearns and the Fed's extension of the terms to 90 days in March 2008. Volumes rose more rapidly amidst the volatile market conditions that followed the failure of Lehman Brothers in September, from under \$20 billion to as high as \$110 billion in October. It should be noted that during the GFC banks were reluctant to borrow from the discount window out of concern that their borrowing would signal financial weakness. To resolve the issue, the Fed established the Term Auction Facility (TAF) in December 2007. The facility provided term credit to depository institutions without the stigma associated with the discount window. The TAF was heavily used, with [\\$493 billion](#) outstanding at its peak in March 2009.

Central Bank Liquidity Swap Lines and FIMA repos

The [swap lines](#) are bilateral agreements between the Fed and foreign central banks. They allow foreign central banks to exchange domestic currency for US dollars in order to satisfy the dollar liquidity demand of local banks and businesses. The Fed operates the swap lines under Section 14 of the Federal Reserve Act. As of March 19, the Fed had established swap lines with [14 central banks](#). (See the YPFS [blog](#)). The Fed swap lines were operational immediately after their announcement and constitute the most used program in recent weeks, with \$378.3 billion outstanding as of [April 15](#).

On [March 31](#), the Fed announced a new program to provide dollars to countries with whom it doesn't have swap agreements. The FIMA Repo Facility allows foreign central banks and international monetary authorities to exchange US Treasuries for US dollars. The Fed did not enter into repos with other central banks during the GFC. (See the YPFS [blog](#)). There are no outstanding FIMA repos as of April 15.

As for the discount window, swap-line usage has grown much more rapidly this time, compared to the GFC. Then, usage rose to \$24 billion in the months after the Fed set up the lines in December, 2007, and to \$62 billion during the summer of 2008. But usage expanded rapidly during the month after the failure of Lehman Brothers and reached [\\$583 billion](#) in December.

Currently, the Bank of Japan (BoJ) is the biggest counterparty with 47 percent of the total outstanding amount, followed by the ECB (37%) and the BoE (6%). These same three banks were the biggest counterparties at peak usage during the GFC. The ECB (51%) drew a majority of the funds at the time, followed by the BoJ (22%) and the BoE (8%).

Money Market Mutual Fund Liquidity Facility (MMLF)

The Fed established the [MMLF](#) under section 13(3) of the Federal Reserve Act. It allows the Fed to purchase assets from money market mutual funds. The Fed announced the program on March 18 and it became operational on March 23. The current program is similar to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ([AMLF](#)) announced on September 19, 2008, and operational three days later. Under the MMLF, the Federal Reserve Bank of Boston makes direct loans to borrowers, allowing for rapid implementation. (See the YPFS [blog](#)).

The MMLF is the most used program that the Fed has established under section 13(3) during the current crisis so far, with \$50.7 billion outstanding as of [April 15](#). It has been less used in the first month than its GFC counterpart, the AMLF. That program peaked within two weeks of its announcement at \$152 billion outstanding on [October 2, 2008](#), indicating the dire conditions in money markets following Lehman's failure.

Primary Dealer Credit Facility (PDCF)

The [Primary Dealer Credit Facility](#) allows the Fed to extend collateralized loans to primary dealers under section 13(3). The program was announced on March 17, and became operational

three days later. During the GFC, the PDCF was among the first programs the Fed announced. It was announced on March 16, 2008, and became operational the next day. (See the YPFS [blog](#)).

Currently, [\\$33 billion](#) is outstanding through the facility. Current use is very similar to the use of the program during its first four weeks of 2008. Under the PDCF, the Federal Reserve Bank of New York provides loans through a clearing bank. Collateral is assigned to a FRBNY account within the clearing bank. The use of the established financial infrastructure with primary dealers allowed for fast implementation.

Commercial Paper Funding Facility (CPFF)

The [CPFF](#) provides a liquidity backstop to issuers of commercial paper and was also established under section 13(3). The Fed announced the program on March 17 and the facility became operational on April 14. The CPFF took longer to implement because its operations require the Fed to engage in transactions that fall outside its traditional operating framework. To extend its reach, the Federal Reserve Bank of New York set up a special purpose vehicle, the Commercial Paper Funding Facility II LLC (CPFF II LLC), held in custody at State Street. Operations are conducted through the SPV while primary dealers serve as intermediaries for issuance requests. All issuers are required to register at least two days prior to their first issuance, registration began on April 7. The additional time required to build the [facility's infrastructure](#) explains the operational delay. (See the YPFS [blog](#)). As of [April 15](#), the facility had just \$974 million outstanding. During the GFC, the Fed announced a similar CPFF program on October 7, 2008, and it became operational on October 27. The earlier CPFF was heavily used immediately, with [\\$270 billion outstanding](#) within 4 weeks of its launch.

Recently, Japan and the UK have implemented similar programs. The BoE's commercial paper facility, [Covid Corporate Financing Facility](#) (CCFF), was announced on March 17 and opened for drawings within five days. (See the YPFS [blog](#)). The Bank of Japan announced more frequent auctions and increased amounts for outright commercial paper auctions on March 16, with a first auction two days later. (See the YPFS [blog](#)).

Summary table

CB Swaps				AMLF / MMLF				PDCF			
GFC		COVID		GFC		COVID		GFC		COVID	
12/25/07	24,000	2/26/20	44	9/24/08	72,667	2/26/20	-	2/20/08	-	2/26/20	-
1/1/08	24,000	3/4/20	48	10/1/08	152,108	3/4/20	-	2/27/08	-	3/4/20	-
9/17/08	62,000	3/11/20	58	10/8/08	139,481	3/11/20	-	3/5/08	-	3/11/20	-
9/24/08	141,900	3/18/20	44	10/15/08	122,763	3/18/20	-	3/12/08	-	3/18/20	-
10/1/08	286,432	3/25/20	206,051	10/22/08	107,895	3/25/20	30,634	3/19/08	28,800	3/25/20	27,718
10/8/08	335,184	4/1/20	348,544	10/29/08	96,010	4/1/20	52,667	3/26/08	37,023	4/1/20	33,050
10/15/08	406,882	4/8/20	358,077	11/5/08	85,097	4/8/20	53,171	4/2/08	34,443	4/8/20	33,018
10/22/08	477,159	4/15/20	378,291	11/12/08	76,546	4/15/20	50,656	4/9/08	26,479	4/15/20	33,409

DW			FIMA Repos				CPFF			
GFC		COVID	GFC		COVID		GFC		COVID	
8/27/08	18,901	2/26/20	13	NA	2/26/20	-	10/1/08	-	2/26/20	-
9/3/08	19,000	3/4/20	1		3/4/20	-	10/8/08	-	3/4/20	-
9/10/08	23,455	3/11/20	11		3/11/20	-	10/15/08	-	3/11/20	-
9/17/08	33,401	3/18/20	28,224		3/18/20	-	10/22/08	-	3/18/20	-
9/24/08	39,327	3/25/20	50,768		3/25/20	-	10/29/08	144,808	3/25/20	-
10/1/08	49,524	4/1/20	43,744		4/1/20	-	11/5/08	243,305	4/1/20	-
10/8/08	98,107	4/8/20	43,449		4/8/20	1	11/12/08	257,287	4/8/20	-
10/15/08	101,853	4/15/20	36,284		4/15/20	-	11/19/08	270,879	4/15/20	974

Data compiled by authors from <https://www.federalreserve.gov/releases/h41/>

Federal Reserve to Report Monthly on CARES Act Program

By Priya Sankar

Original post [here](#).

On [April 23](#), the Federal Reserve said it will include additional detailed information in its monthly reports that are released to the public on four lending and liquidity programs it is establishing with Treasury equity under the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

A week earlier, Bharat Ramamurti, member of the COVID-19 Congressional Oversight Commission, [had requested](#) from Chairman Powell enhanced public disclosure for these and other Fed programs utilizing Treasury funds.

The [policy will cover](#) the \$600 billion Main Street Lending Program, [two corporate debt purchasing programs](#) totalling \$750 billion, and its \$500 billion program to purchase state and municipal debt, according to press reports. The Treasury has made available a combined \$185 billion for such programs.

Section 13(3) of the Federal Reserve Act, which governs the Fed's emergency authority and the above programs, requires that it make an initial and then monthly [reports](#) to Congress upon the establishment of a new program. Although the identities of participants and details of loans are required to be included in such reports, the Chairman may request that they be kept confidential. For each of the four facilities receiving Treasury equity support, the Fed's recent announcement states that it will publish the reports without redacting the names and details of participants; amounts borrowed and interest rate charged; and overall costs, revenues, and fees.

Many observers criticized the Fed for not revealing the identities of banks and other companies that it supported during the global financial crisis (GFC). In 2010, through [the Dodd-Frank Act](#), Congress required the Fed to publish transaction data one year after closing an emergency facility.

There are concerns that the disclosure requirement may cause a stigma, leading borrowers to not use the facilities for fear of being perceived as troubled and potentially undermining the goal of the facilities to restore financial stability. [Former Fed general counsel](#) Scott Alvarez is concerned that stigma may be worse in the current crisis. He said, "It could be more discouraging to businesses if that information is disclosed" contemporaneously with the program, revealing financial details that could advantage competitors.

These enhanced public disclosures [will not include information](#) on recipients of Paycheck Protection Plan (PPP) loans, as they are administered by the Small Business Administration, although the Fed has also created a liquidity facility for banks making PPP loans (the Paycheck Protection Plan Liquidity Facility). The enhanced disclosure also does not cover other Fed lending programs directed towards financial markets. However, the Fed will release higher-level

aggregate data on all Section 13(3) programs monthly, and is legally obligated to disclose borrowers one year after the programs end.

“The Federal Reserve is committed to transparency and accountability by providing the public and Congress detailed information about our actions to support the economy during this difficult time,” Chair Jerome H. Powell said in the Fed’s press release.

Use of Federal Reserve Programs

By **Pascal Ungersboeck**

Original post here.

The Federal Reserve recently announced a number of lending facilities, based on programs first implemented during the Global Financial Crisis of 2007-09. This post provides an update on the use of Fed lending programs since April 16. It also introduces the Fed's newest lending facility, the [Paycheck Protection Program Liquidity Facility](#) (PPPLF); discusses international use of the Fed's liquidity swap lines; and provides an overview of similar lending programs in Europe and the United Kingdom. Our previous post on the early use of Fed programs is available [here](#).

Recent use of Fed programs

The total outstanding amount for the Fed's main lending programs has changed little over the past two weeks, increasing from USD 120bn to 123bn, down slightly from a peak of USD 129bn on April 9. Usage of the discount window declined by USD 5bn since April 16.

The outstanding balances of the [Money Market Mutual Fund Liquidity Facility](#) (MMLF) and [Primary Dealer Credit Facility](#) (PDCF) decreased by USD 4bn and USD 8bn, respectively. The outstanding amount with the [Commercial Paper Funding Facility](#) (CPFF) increased from less than USD 1bn to USD 3.3bn and remains small relative to overall lending.

The declines in usage of the MMLF and PDCF were offset by the extension of loans through a new facility, the Paycheck Protection Program Liquidity Facility (PPPLF).

Usage of the Fed's USD liquidity swap lines continued to increase over the last two weeks. Swap lines remain the largest program, with USD 438bn outstanding as of April 30. The use of the [Foreign and International Monetary Authorities](#) (FIMA) Repo facility, available to provide US dollar liquidity to central banks that don't have access to an established swap line with the Fed, remains negligible at USD 2mn outstanding.

The Fed has yet to launch two corporate bond purchase programs that it announced on March 23.

The Paycheck Protection Program Liquidity Facility (PPPLF)

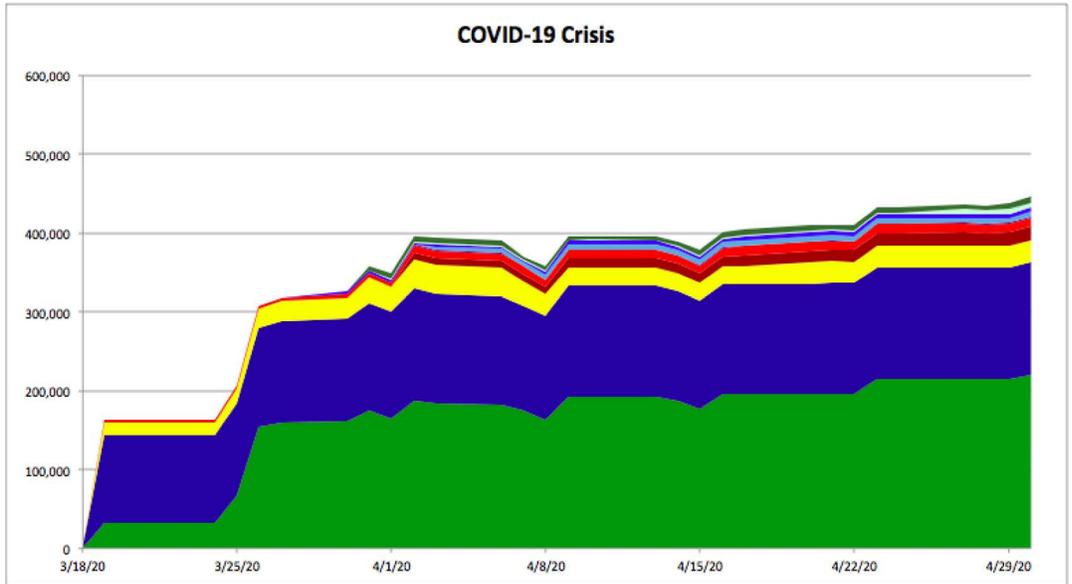
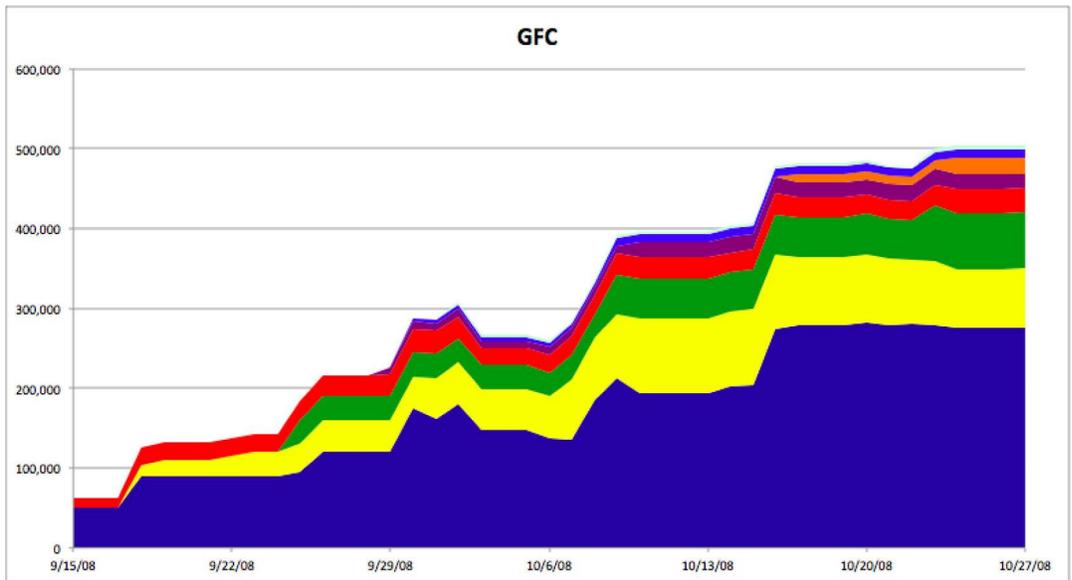
The Paycheck Protection Program Liquidity Facility (PPPLF) allows the Fed to provide financial institutions with liquidity backed by loans to small and medium businesses extended under the federal government's Paycheck Protection Program. The PPPLF was announced on April 9 and became operational one week later. Immediate use was moderate with USD 8bn outstanding on April 23. It stands at USD 19bn as of April 30, showing a large increase as other asset-purchase programs saw their outstanding balance decline.

On April 30 the Fed announced an extension of the program, allowing it to include additional lenders and expand eligible collateral. Under the new framework, eligible lenders include all lenders approved by the Small Business Administration (SBA). Also, lenders can now pledge purchased PPP loans as collateral.

Swap Line Use

The network of 14 dollar liquidity swap lines remains the most used emergency program with USD 438bn outstanding as of April 30. On average, the outstanding amount has increased by USD 14bn every day since March 19. The European Central Bank (ECB), Bank of Japan (BoJ), Bank of England (BoE), and Swiss National Bank (SNB) drew funds on the first day of the program and were gradually joined by six other central banks. By April 3, 10 central banks had a positive outstanding balance.

- Monetary Authority of Singapore
- Norges Bank
- Danmarks Nationalbank
- Banco de Mexico
- Reserve Bank of Australia
- Swiss National Bank
- Bank of Korea
- Bank of England
- European Central Bank
- Bank of Japan



As during the Global Financial Crisis of 2007-09 (GFC), the BoE, BoJ, and ECB constitute the three largest counterparties. They have drawn 88% of funds currently outstanding. The ECB was the largest single counterparty during the GFC with USD 313bn outstanding at its peak. The ECB also made heavy use of the line during the first days following the announcement of the facilities. It drew USD 112bn on March 19, the first day the facility was reactivated. The ECB has since slowly increased its use of the line to USD 143bn outstanding on April 30, on average by USD 1bn per trading day. The BoJ has increased its usage more gradually and has exceeded the ECB's use since March 26. Since then, the BoJ has increased its drawings by USD 6bn every day on average, as of April 30 it has USD 220bn outstanding.

Ten out of 14 participating central banks have used their swap line. Nine banks used the swap lines during the GFC. Other than the three largest central banks, the central banks of Norway, Denmark, Australia, Switzerland, and Korea used the lines during both crises. The central bank of Sweden drew funds only during the GFC, while the central banks of Singapore and Mexico are currently drawing funds but did not use their line during the GFC.

International Comparison

The ECB announced its main asset-purchase program, the [Pandemic Emergency Purchase Program](#) (PEPP), on March 18. It expects to purchase up to EUR 750bn in private and public sector securities until “the COVID-19 crisis phase is over.” As of May 1, the facility had EUR 118bn outstanding, 0.7% of the Eurozone's GDP. The marginal lending facility, the ECB's equivalent of the discount window, has no balance outstanding as of May 1.

In the UK, the BoE implemented the [Covid Corporate Financing Facility](#) to purchase commercial paper from British issuers. As of April 29, the facility has an outstanding balance of GBP 15.91bn, or 0.7% of GDP. The USD 123bn in loans outstanding at the Fed as of April 30 constitute 0.6% of GDP.

Summary Table

CB Swaps				AMLF / MMLF				PDCF			
GFC		COVID		GFC		COVID		GFC		COVID	
12/25/07	24,000	2/26/20	44	9/24/08	72,667	2/26/20	-	2/20/08	-	2/26/20	-
1/1/08	24,000	3/4/20	48	10/1/08	152,108	3/4/20	-	2/27/08	-	3/4/20	-
9/17/08	62,000	3/11/20	58	10/8/08	139,481	3/11/20	-	3/5/08	-	3/11/20	-
9/24/08	141,900	3/18/20	44	10/15/08	122,763	3/18/20	-	3/12/08	-	3/18/20	-
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10/29/08	498,860	4/22/20	409,712	11/19/08	61,923	4/22/20	48,810	4/16/08	25,655	4/22/20	31,526
11/5/08	528,355	4/29/20	438,953	11/26/08	53,309	4/29/20	46,277	4/23/08	18,555	4/29/20	25,504

DW				PPPLF				CPFF			
GFC		COVID		GFC		COVID		GFC		COVID	
8/27/08	18,901	2/26/20	13	NA		2/26/20	-	10/1/08	-	2/26/20	-
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9/17/08	33,401	3/18/20	28,224			3/18/20	-	10/22/08	-	3/18/20	-
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10/15/08	101,853	4/15/20	36,284			4/15/20	-	11/19/08	270,879	4/15/20	974
10/22/08	107,547	4/22/20	33,742			4/22/20	8,009	11/26/08	294,094	4/22/20	2,732
10/29/08	110,737	4/29/20	31,759			4/29/20	19,488	12/3/08	303,880	4/29/20	3,372

CB Swaps				AMLF / MMLF				PDCF			
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DW				PPPLF				CPFF			
GFC		COVID		GFC		COVID		GFC		COVID	
8/27/08	18,901	2/26/20	13	NA		2/26/20	-	10/1/08	-	2/26/20	-
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9/10/08	23,455	3/11/20	11			3/11/20	-	10/15/08	-	3/11/20	-
9/17/08	33,401	3/18/20	28,224			3/18/20	-	10/22/08	-	3/18/20	-
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10/29/08	110,737	4/29/20	31,759			4/29/20	19,488	12/3/08	303,880	4/29/20	3,372

FIMA Repos		
GFC	COVID	
NA	2/26/20	-
	3/4/20	-
	3/11/20	-
	3/18/20	-
	3/25/20	-
	4/1/20	-
	4/8/20	1
	4/15/20	-
	4/22/20	-
4/29/20	2	

Case Studies and Policy Changes

Fed Introduces Modified Primary Dealer Credit Facility

By June Rhee

Original post [here](#).

On March 17, the Federal Reserve authorized the [Primary Dealer Credit Facility \(PDCF\)](#) “to support the credit needs of American households and businesses” by enabling primary dealers to support normal market functioning.

The Fed used its authority under section 13(3) of the Federal Reserve Act to implement the new program (see [here](#)). Section 13(3) allows the Fed to lend to nonfinancial organizations when the Federal Reserve Board determines there are “unusual and exigent circumstances.”

The Fed last employed a PDCF in March 2008 during the Global Financial Crisis to improve the ability of primary dealers to provide financing to participants in securitization markets and promote the orderly functioning of financial markets.

The terms of the current PDCF (see [here](#)) closely follow the terms of the 2008 PDCF (see [here](#)). As in 2008, the Federal Reserve Bank of New York will offer loans to primary dealers. The loans will be made available for terms of up to 90 days at a primary credit rate or discount rate. Loans can be secured by collateral eligible for pledge in the Fed’s open-market operations. Also eligible are investment-grade corporate debt securities, international agency securities, investment grade commercial paper, municipal securities, mortgage-backed securities, asset-backed securities, and equity securities. The Fed will accept commercial mortgage-backed securities (CMBS), collateralized loan obligations (CLOs), and collateralized debt obligations (CDOs) that are AAA-rated.

The Fed plans to make the PDCF available for at least six months and may extend the facility if conditions warrant. The primary dealers will be able to access the facility starting on March 20, 2020.

Click [here](#) to read a YPFS case study that discusses the 2008 PDCF in detail and provides access to the key documents utilized with that facility.

Fed Reintroduces Commercial Paper Funding Facility

By Rosalind Z. Wiggins

Original post [here](#).

On March 17, the Federal Reserve announced that it would implement a [Commercial Paper Funding Facility \(CPFF\)](#) to support the flow of credit to businesses and households during the coronavirus pandemic.

The Fed used its authority under section 13(3) of the Federal Reserve Act to implement the new program (see [here](#)). Section 13(3) allows the Fed to lend to nonfinancial organizations when the Federal Reserve Board determines there are “unusual and exigent circumstances.” This is the Fed’s first use of that authority since the Global Financial Crisis of 2007-09.

The Fed last employed a [CPFF in October 2008](#), when in the midst of the Global Financial Crisis outstanding CP had dropped by roughly \$300 billion. At that time, the market experienced severe shortening of maturities and increased rates making it difficult for issuers to place new paper.

The language in the terms of the new CPFF closely follows the language in the earlier CPFF. As in 2008, the Federal Reserve Bank of New York (FRBNY) will make loans to a special purpose vehicle that will purchase highly-rated US dollar-denominated, three-month unsecured and asset-backed commercial paper from eligible US issuers. As before, eligible issuers are U.S. issuers of commercial paper, including U.S. issuers with a foreign parent company. The program will purchase commercial paper until March 17, 2021. The Fed could extend the facility past that date. The 2020 CPFF Terms and Conditions can be found [here](#) and the 2008 CPFF Terms and Conditions and FAQs can be found [here](#) and [here](#), respectively.

The new program is supported by \$10 billion in credit protection provided by the U.S. Treasury Department, using the Exchange Stabilization Fund (ESF). The earlier CPFF was also supported by \$50 billion from the Treasury.

The 2008 CPFF’s role in helping to revive the term-lending market has been debated. However, in its first weeks it was highly utilized and purchased the overwhelming majority of new term CP. At its highest level in January 2009, the CPFF held \$350 billion of CP, 20% of all outstanding CP. Evidence suggests that the 2008 CPFF provided market participants a rollover option for maturing paper and helped restore lending by CPFF participants to their non-financial corporate borrowers.

Click [here](#) to read a YPFS case study that discusses the 2008 CPFF in detail and provides access to the key documents utilized with that facility.

Fed Provides Liquidity Options to Cities and States

By Rosalind Z. Wiggins

Original post [here](#).

Over the past couple of weeks in response to the stresses of the COVID-19 pandemic the bond markets that states and cities traditionally access to raise funds have recently stalled; the “primary market that has all but shut down” as rates have followed Treasuries downward and many investors sell to await a rebound. ([Funk 03/23/2020](#)) ([Oh 2020](#)). In addition, many of the financial institutions that usually buy these bonds and make markets in them have been reluctant to do so because they are holding large quantities. ([Oh 2020](#)). Further, the commercial paper market has been experiencing runs. ([Tumulty 03/23/2020](#))

Hoping to provide a safety net for states and cities which are facing increased costs from fighting the health crisis while having to continue to fund payroll, pensions and debt service, the Federal Reserve (the “Fed”) has in the past three days provided three facilities aimed at assisting these entities with accessing liquidity.

- On March 20th, the Fed expanded the recently announced [Money Market Mutual Fund Liquidity Facility \(MMLF\)](#) to permit financial institutions to also borrow from the Federal Reserve Bank of Boston (FRBB) to purchase highly rated US municipal short-term debt with maturities of 12 months or less (“municipal debt”) from eligible single-state or other tax exempt money market funds (“state and city funds”). The FRBB will make nonrecourse loans to eligible financial institutions (including depository institutions, bank holding companies and US branches of foreign banks) anywhere in the country to facilitate the purchases. The MMLF would continue to provide loans to financial institutions to purchase designated high-quality assets from money market mutual funds (“money funds”).
- In another move, [the Fed announced today](#) that it would expand the MMLF further to permit the purchase of (i) negotiable certificates of deposits issued by states, municipalities, or banks, and (ii) highly rated municipal variable rate demand notes (VRDNs) with maturities of 12 months or less. The MMLF will begin accepting certificates of deposits and VRDNs as of March 25. However, such items purchased on March 23 and 24 may be accepted if pledged on March 25th.
- MMLF loans secured by municipal debt or VRDNs would be made at a rate equal to the primary rate plus 25 bps. Loans secured by Treasuries or agency securities would be at a rate equal to the primary rate, and loans secured by other collateral would be at a rate equal to the primary rate plus 100 bps.
- Also, as of [today](#) the Fed has expanded the ([Commercial Paper Funding Facility \(CPFF\)](#)) (reintroduced on March 17th) to include as eligible securities high-quality, tax-

exempt commercial paper providing purchasers for municipal issuers. Under the CPFF, the Federal Reserve Bank of New York provides loans to a special purpose vehicle that purchases high-quality commercial paper from eligible issuers.

- For additional details see the [updated MMLF Term Sheet](#).
- For additional details see the [updated CPFF Term Sheet](#).

The Fed is employing all its tools to maintain the flow of funds to states and municipalities that may be experiencing liquidity constraints and or having difficulty placing new debt. During the Global Financial Crisis (GFC), many cities experienced severe economic stress as they suffered reduced tax revenues, losses on portfolios and higher unemployment. Several major cities, with Detroit, MI and Stockton, CA being the largest, filed for bankruptcy protection.

The Fed's efforts provide some avenues for states and cities needing liquidity but the Fed's arsenal in this area is not the broadest. Pursuant to [Section 14 of the Federal Reserve Act](#), the Fed can purchase municipal debt with maturities up to six months through its Open Markets Operations. This has led some commentators to state that what is also needed is action from the Congress to provide such broader authority to the Fed. Senator Bob Menendez, (D-NJ) has proposed "[The Municipal Bonds Emergency Relief Act](#)" that would amend the Federal Reserve Act to allow the Fed to buy municipal bonds of any maturity under "unusual and exigent circumstances." The bill would also include coverage for hospitals and colleges that issue tax-exempt bonds. The bill has received support from the Securities Industry and Financial Markets Association and the National League of Cities, but was not included in the bill proposed by the Senate and was cited as one of its weaknesses by the Democrats. ([Tumulty 03/23/2020](#))

The MMLF and the CPFF were both established under Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary (see [here](#)). Section 13(3) allows the Fed to lend to any "individual, partnership or corporation" when the Federal Reserve Board determines there are "unusual and exigent circumstances". Using the Exchange Stabilization Fund, the Treasury has provided credit protection to the Fed for both programs.

Both the MMLF and CPFF are similar to programs that the Fed utilized during the GFC, however, then, municipal debt, certificates of deposits, VRDNs, and tax-exempt commercial paper were not included in the programs. These recent amendments demonstrate that the plans have some flexibility and can be easily expanded if the Fed determines circumstances warrant.

Fed Reintroduces Term Asset-backed Securities Loan Facility

By Aidan Lawson

On March 23, the Federal Reserve reintroduced [the Term Asset-Backed Securities Loan Facility \(TALF\)](#), one of its many programs used in the Global Financial Crisis (GFC), to further support households, businesses, and the U.S. economy overall.

The Fed used its authority under Section 13(3) of the Federal Reserve Act to implement the new program (see [here](#)). Section 13(3) allows the Fed to lend to any “individual, partnership or corporation” when the Federal Reserve Board determines there are “unusual and exigent circumstances” with the Treasury Secretary’s approval. The Treasury used the Exchange Stabilization Fund (ESF) to make a \$10 billion equity investment to the new TALF.

Under the new TALF, the Fed, “to help meet the credit needs of consumers and small businesses” will use a special purpose vehicle (SPV) to make a total of \$100 billion in three-year nonrecourse loans to U.S. companies that own eligible asset-backed securities (ABS). The SPV will be funded by a recourse loan from the Reserve Bank of New York and the Treasury’s equity investment. The new TALF is to be open through September 30, 2020, unless the Fed extends it.

The [terms and conditions of the new TALF](#) mostly follow the language of the \$200 billion [TALF that was announced in November 2008](#) and [in operation in March 2009](#) during the GFC. However, while the 2008 TALF [progressed to include newly issued](#) and [legacy commercial mortgage-backed securities](#), the 2020 TALF only includes non-mortgage asset-backed securities, such as those backed by student loans, small business loans guaranteed by the Small Business Administration (SBA), and automobile loans, among others.

The Fed also continues to purchase Treasury securities and agency mortgage-backed securities as part of its open market operations. On March 23, the Fed expanded these operations to include the purchase of agency commercial mortgage-backed securities and increased their purchases from a total of \$700 billion to an amount “needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy” (see [here](#)). Loans will be priced based on the collateral pledged with the appropriate LIBOR swap rate, and haircuts will be applied based on sector, weighted average life, and historical volatility of the ABS (see [here](#)).

Bank of England activates the Contingent Term Repo Facility

By Manuel Leon Hoyos

Original post [here](#).

On March 24, 2020, the Bank of England activated a liquidity “insurance” facility that it created after the 2007-09 Global Financial Crisis to be available in a crisis such as the current one.

The [Contingent Term Repo Facility \(CTRF\)](#) aims to “help alleviate frictions observed in money markets in recent weeks, both globally and domestically, as a result of the economic shock caused by the outbreak of Covid-19.” Financial institutions will be able borrow cash from the central bank reserves for a 3-month term in exchange for less liquid assets. CTRF operations will run for the next two weeks and the Bank of England will announce further operations as needed.

The CTRF was [established in 2014](#) and replaced the then existing facility that aimed to mitigate risks to financial stability arising from a market-wide shortage of short-term sterling liquidity. The CTRF forms part of the [Sterling Monetary Framework](#) and serves as a temporary enhancement for firms that need “cheap, plentiful cash at term.” The Sterling Monetary Framework provided a “liquidity upgrade” in that it allows firms to swap less liquid collateral for the most liquid assets in the economy.

The contingent nature of the CTRF allows the Bank of England to provide liquidity against the full range of eligible collateral at any time, term and price it chooses, in response to actual or prospective exceptional market-wide stress. Institutions eligible for the Bank’s Discount Window Facility (DWF) are eligible to participate in the CTRF.

Under the [terms and conditions](#), the program size is unlimited. The minimum bid is £5 million and allocations have a fixed price (Bank Rate plus 15bps) with full allotment. Eligible collateral consists of the full range of [SMF collateral – Levels A, B and C](#). Level A collateral comprises assets expected to remain liquid, such as high-quality sovereign debt. Level B consists of assets that would normally be liquid, such as sovereign debt, supranational and private sector debt and the highest-quality asset-backed securities. Level C consists of typically less liquid assets, such as securitizations, securities delivered by the same entity that originated the underlying assets, and portfolios of loans, including mortgages.

The Bank of England can lend in major currencies through its standing bilateral swap lines with the Federal Reserve, Bank of Canada, European Central Bank, Bank of Japan, and Swiss National Bank.

Federal Reserve Supports Corporate Bond Markets

By Manuel Leon Hoyos

Original post [here](#).

On March 23, the Federal Reserve [introduced two new facilities](#) to support credit to large US companies. One will purchase newly issued bonds and loans on the primary market and the other will purchase outstanding corporate bonds and exchange-traded funds (ETFs) on the secondary market. The Fed used its emergency authority under section 13(3) of the Federal Reserve Act to create these programs.

Under both facilities, the Federal Reserve Bank of New York will lend to a special purpose vehicle (SPV) on a recourse basis. These loans will be secured by all assets of the SPV. The US Treasury, using the Exchange Stabilization Fund (ESF), will provide \$20 billion in equity—\$10 billion for each SPV.

Under the Primary Market Corporate Credit Facility, the SPV will transact directly with US-based companies with material operations in the US. The SPV will purchase investment-grade (BBB-/Baa3 or higher) corporate bonds with maximum maturities of four years. It will also grant loans at interest rates informed by market conditions. The Fed designed the facility to help companies “maintain business operations and capacity” during the coronavirus disruption.

The Fed set limits on each issuer’s total borrowing while it participates in the program, including its borrowing from the SPV. The limits are based on the issuer’s credit rating. An AAA/Aaa1-rated issuer’s total outstanding bonds and loans may not exceed 140% of its maximum outstanding bonds and loans on any day during the 12-month period ending March 22, 2020. For BBB-/Baa3-rated companies, the limit is 110%.

Borrowing companies may defer interest and principal payments for the first six months of their loans, which may be extendable at the Fed’s discretion. The commitment fee will be set at 100 bps. Bonds and loans will be callable at any time at par. (See the [term sheet](#)).

Under the Secondary Market Corporate Credit Facility, a separate SPV will purchase investment grade (BBB- or higher) corporate bonds with maximum maturities of five years. As with the primary market facility, issuers must be US-based and have material operations in the US. Companies that receive direct financial assistance under the new federal CARES Act will not be eligible.

The SPV can also purchase US-listed exchange-traded funds (ETFs) whose investment objective is to provide broad exposure to the market for US investment-grade corporate bonds. The SPV will purchase corporate bonds at “fair market value” and up to a maximum of 10% of the issuer’s maximum bonds outstanding. It will purchase ETFs up to a maximum of 20% of an ETF’s assets. Amidst price dislocation in the ETF market, rather than purchase at fair market value, the Fed says in its term sheet: “The Facility will avoid purchasing shares of eligible ETFs when they

trade at prices that materially exceed the estimated net asset value of the underlying portfolio.”
(See the [term sheet](#)).

ECB Unveils Pandemic Emergency Purchase Programme

By Aidan Lawson

Original post [here](#).

On March 18, the ECB unveiled a temporary program to purchase up to €750 billion in public and private-sector securities until the “crisis phase” of the COVID-19 crisis is over, but at least until the end of 2020.

The [Pandemic Emergency Purchase Programme \(PEPP\)](#) is an expansion of the ECB’s [Asset Purchase Programme \(APP\)](#), a package of asset-purchase measures that the ECB initiated in 2014 to support monetary policy. The PEPP, like the earlier APP, includes programs to buy [sovereign debt](#), [covered bonds](#), [asset-backed securities](#), [corporate bonds](#), and [commercial paper](#). As with the APP, the ECB will make available for lending any securities that it purchases under the PEPP.

Purchasing conventions are based on the type of asset purchased. They generally follow the guidelines for the relevant ECB APP. For instance, purchases of sovereign debt under the PEPP would generally follow the same rules as purchases made under the APP’s sovereign debt program, unless otherwise specified in the [PEPP framework](#).

The table below shows eligible securities for the PEPP, as announced on March 18. However, the ECB may waive some requirements to allow for wider participation. For example, the ECB waived the eligibility requirements for Greek debt because Greek financial markets have been severely destabilized, and previous commitments by the Greek government to achieve structural reform would be more difficult if it could not access the PEPP.

Security	Minimum Credit Rating	Maturity	Purchase Limits
Sovereign debt	Credit Quality Step 3	70 days – 30 yr + 364 days	33% of total debt if issued by sovereign 50% of total debt if issued by international institution
Corporate bonds	Credit Quality Step 3	6 mo. – 30 yr + 364 days	70% per ISIN ^[1]
Covered bonds	Credit Quality Step 3	Unspecified	70% per ISIN 30% per ISIN for Greece + Cyprus

[Asset-backed securities](#)

Credit Quality Step 3 Unspecified

70% per ISIN

30% per ISIN for Greece + Cyprus

The ECB published details of the new program in the Journal of the European Union on March 26. It had changed some details. Most significantly, it [removed](#) the limit to buy no more than 33% of any country’s bonds, which was in the initial announcement (see here, [point number \(6\)](#), and [here, Article 5](#)). This has given the ECB the authority to essentially purchase unlimited amounts of sovereign debt, up to the €750 billion limit.

In the updated publication, the ECB said that it would “not tolerate any risks to the smooth transmission of its monetary policy in all jurisdictions of the Euro area.” While a wide range of securities are eligible for purchase under PEPP, the vast majority of securities purchased under the APP have been government debt (see [here](#)).

Generally, the allocation of purchases will be proportionate to the amount of ECB capital subscribed to by euro-area national central banks. Therefore, it is likely that Germany, France, and Italy will obtain a sizable share of the ECB funding (see [here](#)).

Still, the language allows the ECB some discretion. The ECB can make purchases “in a flexible manner allowing for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions.”

The decision to remove the purchase limit on government debt suggested that the ECB prefers to use the PEPP instead of the Outright Monetary Transactions (OMT). The ECB [has confirmed](#) this. OMT, which would allow the ECB to buy essentially unlimited quantities of an individual nation’s sovereign debt, has not been used since the ECB introduced it in 2012. Countries are required to apply for aid, leading to [concerns about stigmatization](#) of OMT aid, and assistance comes with “strict conditionality,” sometimes taking the form of a macroeconomic adjustment program or even the involvement of the IMF (see [here](#)).

The ECB earlier created two covered-bond purchase programs—in 2009 during the Global Financial Crisis and in 2011 during the sovereign debt crisis. The ECB purchased €60 billion and €16.4 billion in bonds in the two programs, respectively. The purpose of the two programs was to restore liquidity to the market, tighten credit spreads, ease bank funding costs, and promote lending. Observers view the first program as a modest success, while the impact of the second is less clear. *See the YPFS [case for more](#).*

[1] An International Securities Identification Number (ISIN) is a 12-digit code used to unify different ticker symbols and identifications that can vary across exchanges, currencies, and countries. As such, a 70 percent purchase limit on an ISIN indicates that the ECB can purchase up to 70% of the outstanding issue of that particular security or debt instrument (see [here](#)).

Federal Reserve Expands Support to Corporate Bond Markets

By Manuel Leon Hoyos

Original post [here](#).

On April 9, the Federal Reserve (Fed) [updated and expanded](#) the [corporate bond-buying programs originally announced on March 23](#) to support credit to riskier corporations.

The Fed used its authority under Section 13(3) of the Federal Reserve Act to implement the [Primary Market Corporate Credit Facility \(PMCCF\)](#) and the [Secondary Market Corporate Credit Facility \(SMCCF\)](#) (see [here](#)). For both facilities, the Federal Reserve Bank of New York lends to a special purpose vehicle (SPV) on a recourse basis. These loans are secured by all assets of the SPV. The Treasury, using the Exchange Stabilization Fund (ESF), increased the amount of equity it will provide from \$20 billion to \$75 billion – \$50 billion for the PMCCF’s SPV and \$25 billion for the SMCCF’s SPV. The combined size of both facilities can now be up to \$750 billion; the Fed has not provided any allocation between the two programs. Further discussion on the Treasury backstop can be found [here](#).

Under both facilities, companies that receive direct financial assistance under the new [CARES Act](#) or other subsequent federal legislation are not eligible. Eligible institutions must satisfy the conflict-of-interest requirements of section 4019 of the CARES Act. Both facilities are to be open through September 30 unless the Fed and Treasury extend it.

Under the PMCCF, the SPV transacts directly with US-based companies with material operations in the US. The SPV purchases investment-grade corporate bonds with maximum maturities of four years. [The latest revision](#) includes purchases of portions of syndicated loans or bonds at issuance.

The Fed set limits on each issuer’s total borrowing under the PMCCF. The limits are based on the issuer’s credit rating. [Initially](#), for an AAA/Aaa1-rated issuer, the total outstanding bonds and loans were not to exceed 140% of its maximum outstanding bonds and loans on any day during the 12-month period ending March 22, 2020. [The latest revision](#), however, reduces this limit to 130%. Additionally, the maximum amount of instruments that both the PMCCF and the SMCCF combined can purchase from an eligible issuer is limited to 1.5% of the combined potential size of both facilities.

Under the SMCCF, [the SPV has purchased investment grade corporate bonds](#) with maximum maturities of five years at a fair market value up to 10% of the issuer’s bonds outstanding. As with the PMCCF, issuers must be US-based and have material operations in the US. The SPV also has [purchased US-listed exchange-traded funds \(ETFs\)](#) whose investment objective is to provide broad exposure to the market for US investment-grade corporate bonds. [The latest revision](#) adds ETFs whose primary investment objective is exposure to US high-yield corporate bonds. Purchases of ETFs are limited to 20% of an ETF’s assets. Amidst price dislocation in the

ETF market, rather than purchase at fair market value, the Fed says in its term sheet: “The Facility will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio.”

Federal Reserve Broadens Range of Eligible Collateral for TALF

By June Rhee

Original post [here](#).

On April 9, [the Federal Reserve \(Fed\) broadened the range of eligible collateral](#) for [the Term Asset-Backed Securities Loan Facility \(TALF\)](#) to include riskier assets such as legacy commercial mortgage backed securities (CMBS) and collateralized loan obligations (CLOs).

The Fed [reintroduced TALF on March 23](#). It was one of the many programs the Fed used in the 2007-09 Global Financial Crisis to support households, businesses, and the economy. Under the original TALF, the Federal Reserve lent on a non-recourse basis to holders of highly rated asset-backed securities (ABS) backed by newly and recently originated consumer and small business loans.

The 2020 TALF initially only included newly issued non-mortgage asset-backed securities, such as those backed by student loans, small business loans guaranteed by the Small Business Administration, and automobile loans as eligible collateral. However, the expanded 2020 TALF now accepts the triple-A rated tranches of both legacy CMBS and newly issued static CLO as eligible collateral. Single-asset single-borrower CMBS and commercial real estate CLOs are excluded. The other [terms and conditions of the new TALF](#) mostly follow the language of the \$200 billion [TALF that the Fed announced in November 2008](#) and implemented [in March 2009](#) during the GFC.

Under the 2020 TALF, the Fed, "to help meet the credit needs of consumers and small businesses," will use a special purpose vehicle to make a total of \$100 billion in three-year nonrecourse loans to US companies that own eligible collateral. The SPV will be funded by a recourse loan from the Reserve Bank of New York and the Treasury's equity investment. The new TALF is to be open through September 30, unless the Fed and Treasury extend it, and participating borrowers and issuers will be subject to conflict-of-interest requirements under [section 4019 of the CARES Act](#).

The Fed used its authority under Section 13(3) of the Federal Reserve Act to implement the 2020 TALF (see [here](#)). Section 13(3) allows the Fed to lend to any "individual, partnership or corporation" when the Federal Reserve Board determines there are "unusual and exigent circumstances," with the Treasury Secretary's approval. The Treasury used the Exchange Stabilization Fund to make a \$10 billion equity investment in the 2020 TALF. Further discussion on the Treasury backstop and the 2008 TALF can be found [here](#).

The Fed will haircut collateral based on the riskiness of underlying assets, as in the 2008 TALF. The haircuts range from 5% for short-term Small Business Administration loans to 22% for longer-term leveraged loans.

The Fed also continues to purchase Treasury securities and agency mortgage-backed securities as part of its open market operations. On March 23, the Fed expanded these operations to include the purchase of agency commercial mortgage-backed securities and increased their purchases from a total of \$700 billion to an amount “needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy” (see [here](#)). Loans will be priced based on the collateral pledged with the appropriate LIBOR swap rate, and haircuts will be applied based on sector, weighted average life, and historical volatility of the ABS (see [here](#)).

Click [here](#) to read a survey post on market liquidity programs including the TALF and [here](#) to read a YPFS case study that discusses the 2008 TALF in detail and provides access to the key documents utilized with that facility.

Federal Reserve Announces New Municipal Liquidity Facility

By Vaasavi Unnava and Rosalind Z. Wiggins

On April 9, the [Federal Reserve announced](#) the [Municipal Liquidity Facility \(MLF\)](#) as part of a new series of facilities providing up to \$2.3 trillion in loans to support the economy. The facility aims to ease cash flow pressures on state and local governments as they adjust to a [decline in municipal and state revenues and face greater than expected](#) public health costs due to the COVID-19 pandemic .

The Federal Reserve established the MLF pursuant to its Section 13(3) authority under the Federal Reserve Act (FRA); it was approved by the Treasury Secretary.

The Federal Reserve will operate the facility by recourse lending to a newly-established special purpose vehicle (SPV). The SPV will then purchase eligible notes directly from eligible issuers. The SPV may purchase up to \$500 billion of eligible notes. The Treasury Department will fund the facility with an initial equity investment of \$35 billion from funds appropriated to its Exchange Stabilization Fund under the CARES Act. This structure is similar to that of the [Commercial Paper Funding Facility](#), which the Fed first used during the Global Financial Crisis in 2008-09 (GFC) and which it has recently reintroduced.

Eligible issuers under the MLF include all the states and the District of Columbia, cities with greater than one million residents, and counties with greater than two million residents. Only [10 cities](#) and [16 counties](#) meet the above criteria, according to the latest Census data. To provide aid to municipalities ineligible to participate in the MLF, participating states may utilize the proceeds generated through the issuance of eligible bonds to purchase similar notes from municipalities within their jurisdictions. An eligible state, city, or county may participate through a related entity that normally issues notes on its behalf, but only one issuer per state, city, or county is eligible.

In addition to utilizing proceeds to purchase similar notes from political subdivisions, localities may use proceeds from the sales of eligible notes to the MLF for mitigation of reduced cash flows from income tax deferrals due to extensions to the tax filing deadlines. They may also be used to address reductions in revenues due to COVID-19 or for payments of principal and interest on other obligations.

Notes that are eligible for purchase under the MLF include tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), or other short-term debt that matures no later than 24 months after issuance. The price of notes purchased will be based on the issuer's rating at the time of issuance. Issuers are required to pay an origination fee equal to 10 basis points (0.1%) of the principal amount of the notes being purchased by the SPV. The fee will be deducted from the proceeds of the issuance.

The SPV may purchase multiple note issuances from an eligible issuer but the total amount purchased from any one issuer cannot exceed 20% of the issuer's 2017 revenues from their government's own sources and utilities revenues. However, a state may request that the SPV purchase more than the 20% limit to assist municipalities ineligible to participate in the MLF. The purchased notes are callable by the issuer at any time before maturity at par value.

The Federal Reserve plans to stop purchases under the MLF on September 30, although the facility may be extended if needed. The Fed plans to continue funding the SPV until all underlying assets mature or are sold.

Establishment of the MLF follows [previous Federal Reserve efforts](#) to provide liquidity to municipalities. On March 23, the Federal Reserve began accepting highly-rated municipal bonds, commercial paper, and other securities as collateral under the Commercial Paper Funding Facility (CPFF) and the Money Market Liquidity Facility (MMLF). The CPFF and MMLF are similar to programs that the Fed utilized during the GFC, however then municipal debt, tax-exempt municipal commercial paper and municipal securities were not included in the programs. Notably the Fed chose to implement the MLF under its FRA Section 13(3) emergency authority rather than utilize its authority under [FRA Section 14](#), which provides that the Fed can purchase municipal debt with maturities up to six months through its Open Markets Operations. Commenters had called for broader authority than that, a gap that the CARES Act seems to have filled.

During the current pandemic, other countries have also made adjustments to aid municipalities with cash flow needs. Canada has provided a [similar expansion](#) allowing the purchase of municipalities' commercial paper by its Commercial Paper Purchase Program. Other countries have pursued fiscal responses to liquidity squeezes in municipalities, such as Finland's [€100 million allocation](#) to municipalities to support business owners affected by COVID-19.

Bank of Canada Establishes Series of Programs to Promote Market Liquidity

By Aidan Lawson

Original post [here](#).

Since the beginning of April, the Bank of Canada (BoC) has launched three market-liquidity programs. Two are new asset purchase programs, under which it will buy commercial paper and government bonds. The third is an activation of a standing repurchase agreement (repo) facility to get cash to market participants.

COMMERCIAL PAPER PURCHASE PROGRAM (CPPP)

The BoC [announced](#) its intent to directly purchase commercial paper under a new Commercial Paper Purchase Program (CPPP) on March 27, with purchases commencing on April 2. The BoC buys commercial paper (including asset-backed commercial paper) with up to a 3-month maturity on both the primary and secondary markets.

To be eligible, the commercial paper must be issued by Canadian businesses, municipalities, and provincial agencies through already-existing commercial paper programs. Issuers must have a minimum short-term credit rating of R-1 High/Mid/Low from DBRS Morningstar as of April 2, though the BoC can approve issuers that are downgraded after that date or are not rated by DBRS, so long as they have ratings from Fitch, Moody's, or S&P. The BoC limits individual purchases to 1.25 times the largest amount of Canadian dollar-denominated commercial paper that an issuer had outstanding on any day in the last year. The CPPP is expected to last for 12 months.

Purchases are made daily and priced at a fixed rate based on the 3-month Canadian overnight index swap (OIS) rate, which is the Canadian Overnight Repo Rate Average (see [here](#), pp. 17). Pricing varies based on the credit risk of the issuer (see [here](#)). Aggregate results are published weekly by the BoC, but individual transaction data are not. As of April 8, the facility has purchased CAD\$1.9 billion of commercial paper (see [here](#)).

The BoC has enlisted the help of Blackrock Financial Markets Advisory, TD Asset Management, and CIBC Mellon to act as advisor, asset manager and custodian, respectively.

SECONDARY MARKET BOND PURCHASE FACILITY

On April 1, the BoC launched a program to purchase at least CAD\$5 billion in government bonds on the secondary market. These purchases are via reverse auction and conducted across the yield curve.

The BoC [announced](#) the program on March 27. So far, the BoC has conducted six auctions for a total of CAD\$7.15 billion. It is planning on purchasing another CAD\$500 million in 30-year

government debt today (see [here](#)). The BoC releases details about the date and maturity of bonds it will purchase every two weeks. It announces more specific operational details closer to the date of each auction (see [here](#)).

CONTINGENT TERM REPO FACILITY (CTRF)

On April 3, the BoC [activated](#) the Contingent Term Repo Facility (CTRF). The [CTRF](#) is an unlimited emergency repo facility designed to counter severe liquidity stresses. It engages in one-month repurchase (repo) agreements with market participants that “demonstrate significant activity” in Canadian dollar money markets or fixed income markets. The BoC has considerably increased its presence in repo markets since the beginning of April, nearly doubling its repo activity from CAD\$64.8 billion to CAD\$110.7 billion as of April 8 (see [here](#)). This is the most the BoC has participated in the repo market, including at the height of the Global Financial Crisis.

All government and government-guaranteed bonds are eligible, as well as Canada Mortgage Bonds and National Housing Act (NHA) MBS, which are two types of mortgage bonds insured and guaranteed by the Canada Mortgage and Housing Corporation (see [here](#), pp. 57). The CTRF began operation on April 6 and is open for a year. The CTRF is similar to the Bank of England’s facility [of the same name](#).

Federal Reserve Expands Eligibility for Municipal Liquidity Facility

By Vaasavi Unnava

Original post [here](#).

On April 27, the Federal Reserve announced an [expansion](#) in scope and duration of the [Municipal Liquidity Facility](#) (MLF), a new facility established on April 9 to alleviate the funding needs of cities, counties, and states as municipalities fight the ongoing threat of COVID-19 across the United States and bond markets stall.

The new terms of the MLF allow the 50 states, counties of 500,000 residents or more, and cities of 250,000 residents or more to sell their debt issuances directly to a special purpose vehicle created and funded by the Federal Reserve. The new rule is significantly more inclusive than the previous standard, as seen in the table below.

	Number of Cities	Population Covered (City)	Number of Counties	Population Covered (County)
Original MLF Terms	10	~26,000,000	16	~54,000,000
Revised MLF Terms	87	~62,000,000	140	~162,000,000

Source: Census [City](#) and [County](#) Population Estimates

In addition to the changes in participation, the Federal Reserve revised standards for eligible notes. Eligible notes may now have maturities of up to 36 months after issuance, twelve months longer than the original 24 month maturity.

New guidelines regarding ratings also affect eligibility of issuances. Eligible issuers must have “investment grade” ratings--ratings of at least a BBB-/Baa3--as of April 8, by two or more nationally recognized statistical ratings organizations (NRSRO), such as Standard and Poor’s or Fitch. If an NRSRO subsequently downgrades an issuer after April 8, the issuer must raise their ratings to at least BB-/Ba3 by the time the MLF makes a purchase.

The Federal Reserve has also expanded participation in the facility to multi-state entities, such as the Port Authority of New York and New Jersey. The MLF will hold multi-state entities to higher standards. Multi-state entities must have ratings of A-/A3 as of April 8 by two or more

NRSROs. Should NRSROs downgrade the entity, it must raise its ratings to BBB-/Baa3 by the time of purchase.

Multi-state entities may issue, in one or more issuances, up to 20% of the entity's gross revenue in 2019; however, unlike states, multi-state entities may not issue in excess of the applicable limit and transfer the funding to political subdivisions within their jurisdictions.

Finally, the Federal Reserve has changed the facility's termination date from September to December 2020.

Elected officials [widely criticized](#) the original terms of the MLF as too restrictive, making the funds unavailable to many cities and counties that needed aid. The previous iteration of the facility only allowed 10 cities and 16 counties to participate directly in the funding mechanism. Some [senators](#) complained that their states would qualify for aid, but their states' towns or counties were exempt. The previous iteration of the facility appeared to attend to this issue by allowing states to issue bonds and distribute the funding directly to municipalities within their jurisdictions. However, it appears this mechanism may not be direct enough, as some [states struggle to issue debt](#) based on state constitution barriers.

The Federal Reserve also said that it is [considering](#) allowing some governmental entities that issue revenue bonds to directly participate in the MLF as eligible issuers. However, it's unclear whether the Federal Reserve will approve this.

India Extends Special Liquidity Facility to Mutual Funds

By Priya Sankar

Original post [here](#).

On [April 27](#), the Reserve Bank of India (RBI) announced a ₹ 500 billion (\$6.6 billion) special liquidity facility for mutual funds (SLF-MF), in response to increased volatility in capital markets due to the COVID-19 pandemic. The SLF-MF operated for two weeks and closed on May 11.

The RBI reports that the program had [₹24.3 billion outstanding](#) as of May 11, of which ₹20 billion was allotted on April 27 and ₹4.3 billion was allotted on April 30. The Indian mutual fund industry has about \$300 billion in total assets under management, according to an industry association [website](#). [More than half](#) of those assets are in debt funds.

In the midst of increased client redemptions and drained liquidity in the debt market due to the COVID-19 crisis, [concerns around the potential contagion effects](#) were accelerated after Franklin Templeton's Indian arm halted withdrawals and shut six high-risk debt funds, trapping over \$3 billion of investor money.

To address this concern, the RBI established the SLF-MF. In a statement, the RBI [said](#) that market stress was “confined to the high-risk debt [mutual fund] segment at this stage; the larger industry remains liquid.” The SLF-MF is a 90-day repo operation at the fixed [repo rate of 4.4%](#). The SLF-MF was open from April 27 to May 11 to [liquidity adjustment facility](#) eligible banks. Borrowing banks must use these funds to meet liquidity needs of mutual funds by (i) extending loans, or (ii) undertaking outright purchase of and/or repos against the collateral of investment grade corporate bonds, commercial papers (CPs), debentures and certificates of deposit (CDs) held by mutual funds..

Liquidity support provided by the funds obtained through the SLF-MF is eligible to be classified as held to maturity (HTM) in excess of 25% of the total investment permitted to be included in the HTM portfolio. It is also exempt from banks' capital market exposure limits.

Responding to the requests from banks, these regulatory benefits also became available to all banks providing liquidity support to mutual funds regardless of whether they used funds from the SLF-MF or from their own resources as of [April 30](#). A bank claiming the regulatory benefits was required to submit a weekly statement containing consolidated information on its support as long as the SLF-MF was open.

[Some commentators](#) view the SLF-MF as a step in the right direction, easing liquidity concerns and providing a psychological signal to mitigate investor panic. However, the measure is small relative to the asset management sector as a whole. According to the RBI's most recent [Financial Stability Report](#) (p.51), mutual funds are “the largest net providers of funds to the financial system.”

India faces a substantial [crisis of confidence](#), as its economy has been at a standstill since the nationwide lockdown implemented in early March. Even before COVID-19 concerns, rising corporate defaults, the collapse of lenders, and questionable lending practices in the mutual fund industry raised questions about the resilience of the financial system in India. On May 12, India's Prime Minister Narendra Modi [announced](#) a \$260 billion economic rescue package, an amount equal to 10% of India's GDP, but currently [short on details](#).

Bank of Japan Increases Liquidity Measures

By Manuel Leon Hoyos

Original post [here](#).

On May 22, the Bank of Japan (BOJ) extended and expanded its “[Special Program to Support Financing in Response to the Novel Coronavirus \(COVID-19\)](#)” to 75 trillion yen (about \$700 billion). This includes three programs: (1) \$186 billion in Outright Purchases of Commercial Paper and Corporate Bonds, (2) \$233 billion for the Special Funds-Supplying Operations, and (3) [\\$279 billion](#) for the recently launched New Fund-Provisioning Measure to support small and medium-sized enterprises. The duration of the measures was extended by six months from September 30, 2020 to March 31, 2021. On [March 16](#), the BoJ had announced emergency measures to facilitate corporate financing that included the first two measures (For details on the third measure, see this [YPFS blog post](#)).

On [April 27](#), the BoJ increased its upper-limit on Outright Purchases of Commercial Paper and Corporate Bonds to [\\$186 billion](#). This is a standing facility the BoJ has used for many years to conduct its monetary policy. Eligible counterparties must have a current account at the BoJ and be deemed sufficiently creditworthy. The mechanism requires counterparties to bid in competitive auctions the yield at which they desire to sell commercial paper or corporate bonds. The updated terms and conditions can be found [here](#).

On April 27, the Special Funds-Supplying Operations was expanded from \$72 billion to [\\$233 billion](#). It also increased the number of eligible counterparties to include member financial institutions of central organizations of financial cooperatives ([rules published on May 1](#)) and expanded the range of eligible collateral to private debt in general, including household debt. The BoJ now applies a positive interest rate of 0.1% to the outstanding balances of current accounts held at the BoJ. The program lends against corporate debt at a 0% interest rate, with maturities up to one year. The original terms and conditions can be found [here](#).

Additionally, the BoJ has further incorporated [active purchases of Japanese government bonds \(JGBs\) and Treasury discount bills \(T-Bills\)](#) to maintain stability in the bond market and stabilizing the yield curve at a low level.

During the 2007-09 global financial crises, the BoJ introduced both the Special Funds-Supplying Operations and Outright Purchases of Commercial Paper. Both of these programs had intended to facilitate corporate financing and were thought to have contributed to lowering interest rates in the commercial paper market.

Click [here](#) to read a YPFS case study on the BoJ Outright Purchase of Commercial Paper and [here](#) for the Special Funds-Supplying Operations during the GFC. These cases provide details of the program and access to key documents.

The Bank of Mexico Plans to Inject \$30 billion to Provide Liquidity

By Manuel Leon Hoyos

Original post [here](#).

On April 21, the Bank of Mexico ([Banxico](#)) unveiled a [series of liquidity measures totaling \\$30 billion](#) to “foster an orderly functioning of financial markets, strengthen the credit channels and provide liquidity for the sound development of the financial system.”

The market liquidity measures total [3.3% of last year’s GDP](#). So far, only the [government securities swaps](#) have been in operation; rules for additional facilities were published last week. In addition to these measures, Banxico [cut interest rates by 50 basis points](#), and again on May 14 [to 5.5%](#) – its lowest level [since December 2016](#). So far, Banxico has cut 175 basis points this year.

Mexico, the second largest Latin American economy, has been hit hard by the COVID-19 crisis. Since February, the Mexican peso has [depreciated by over 20%](#). The country has experienced shortages in foreign exchange liquidity and a sharp fall in commodity prices – particularly [crude oil prices](#). According to Banxico, the crisis has brought “the greatest contraction ever recorded of holdings of emerging economies’ assets, especially of fixed-income instruments.” Additionally, Mexico’s sovereign credit rating and Mexico’s national oil company Pemex have been downgraded. Mexico’s central bank expects the Mexican economy to contract [by 5% in the first half of 2020](#) – a forecast that might be revised in the next quarterly report at the end of May. The [IMF currently expects a 6.6% contraction in 2020](#).

The \$30 billion in liquidity includes programs financing SMEs and individuals, the corporate debt market, the government debt market, and other domestic debt markets. In addition, existing facilities have been expanded to provide greater liquidity and foreign exchange hedges. Banxico published rules for financial institutions on these measures in Mexico’s Official Journal [Circular 15/2020](#) on May 13 and Circulars [16/2020](#), [17/2020](#), and [18/2020](#) on May 19.

For SMEs funding:

- A [\\$10 billion financing facility directed to support micro, small-, and medium-sized enterprises, and individuals](#) will operate through commercial and development banks. Resources will come from Banxico’s Monetary Regulation Deposits (DRM) or, if necessary, the Banxico will provide financing at terms of 18-24 months, at the overnight interbank interest target rate. The DRMs are mandatory long-term deposits from national credit institutions in the Banxico and have an indefinite maturity date and generate yields equivalent to the interbank funding rate. They differ from the reserve requirement used by other central banks in that the DRM is not continually adjusted according to fluctuations in the benchmark liabilities of the banks. The DRM may be

used as collateral in Banxico's transactions with banking institutions such as in liquidity-providing auction. (see [here](#) on DRM). Securities eligible for the Ordinary Additional Liquidity Facility (FLAO) will be eligible for this facility. The FLAO has been available since 2008 and offers liquidity to commercial banks through collateralized credits or repos, at a reduced cost of 1.1 times the Bank of Mexico's target overnight interbank interest rate.

- A [\\$4 billion temporary collateralized financing facility](#) is directed for commercial banks holding corporate loans of micro, small- and medium-size enterprises. The facility will provide financing at a term of 18-24 months, at the target overnight interbank interest rate. The financing will be guaranteed by the SME corporate loans held by the commercial banks, with credit ratings of at least "A" at local scale, by at least two rating agencies.

For the corporate debt market:

- A [\\$4 billion Corporate Securities Repurchase Facility \(FRTC\)](#) aims to support the corporate debt market by providing liquidity for short-term corporate securities and long-term corporate debt. Eligible securities include those issued by nonfinancial private companies that reside in Mexico and comply with FLAO criteria. The cost of the repos will be 1.1 times the average of the overnight interbank interest rate.

For the government debt market:

- A [\\$4 billion facility to repurchase government securities](#) at longer terms than in regular open market operations aims to facilitate intermediation of government securities. Financial institutions holding government debt will obtain liquidity without the need to dispose of their securities in stressed financial markets. The cost of repurchase agreements will be set at 1.02 times the average of the overnight interbank interest rate.
- A [\\$4 billion facility for auctions of government securities swaps](#) will trade long-term securities of at least 10 years in exchange for shorter maturities of up to 3 years to promote proper functioning of the government debt market. The terms for each swap will be determined in each auction. The first auctions occurred on [April 29](#).

For the general domestic debt market:

- A \$4 billion temporary debt securities swap facility is to promote an orderly behavior of Mexico's debt market. The facility aims to provide liquidity for securities that have become illiquid in the secondary market. Eligible institutions can exchange debt securities exchange for government securities. FLAO criteria apply for Peso-denominated securities eligible for the facility.

Other extensions of existing facilities:

- The Bank of Mexico [widened the eligibility of debt securities](#) in FLAO repos and of collateral for foreign exchange hedges settled by differences in [US dollar credit auctions](#). Securities eligible in Mexican pesos must have credit ratings of at least “A” in the local scale or “BB+” in the global scale (for securities denominated in foreign currency), from at least two agencies.
- In order to foster a sound functioning of the money market, Banxico has preserved excess liquidity during trading hours. To foster the orderly operating conditions in the MXN/USD exchange market, particularly when markets in Asia and Europe operate, by instruction of the Mexican Foreign Exchange Commission, the Bank of Mexico will conduct [hedge transactions settled by differences in US dollars at hours when Mexican markets are closed](#).
- Banxico reduced the DRM [by \\$2 billion](#). The resources will improve the liquidity of these institutions and their capacity to grant credit.

Federal Reserve Expands Support to Corporate Bond Markets Again

By Manuel Leon Hoyos

Original post [here](#).

On June 15, the Federal Reserve (Fed) [updated and expanded](#) the Secondary Market Corporate Credit Facility (SMCCF), one of the [Fed's corporate bond-buying programs](#), to support market liquidity and the availability of credit for large employers. The recent change allows the facility to buy [U.S. corporate bond portfolios that track a broad market index](#).

Bonds eligible for the [Broad Market Index](#) must:

- have remaining maturity of up to 5 years
- be issued in the U.S. or under the laws of the U.S
- meet the same rating requirements for eligible individual corporate bonds under the SMCCF
- not be issued by an insured depository institution, depository institution holding company, or subsidiary of a depository institution holding company, as defined in the Dodd-Frank Act.

Ratings are subject to review by the Fed. This expansion will [complement](#) the Fed's purchases of exchange-traded funds. As of May 19, the Fed's total [outstanding amount of loans under the SMCCF was \\$1.29 billion](#). For more information about the SMCCF and the Primary Market Corporate Credit Facility, see the previous [YPFS blog post](#).

Japan Begins Capital Injections for Financial Institutions in Response to COVID-19

By June Rhee with research assistance from Vaasavi Unnava

Original post [here](#).

*****The author would like to thank Junko Oguri for exceptional research support and comments.**

On June 13, the Japanese Diet passed an [amendment to the Act on Special Measures for Strengthening Financial Functions](#) (ASFF) extending the period of government capital injection to financial institutions from March 31, 2022 to March 31, 2026 and expanding the available public funds for the injection from ¥12 trillion to ¥15 trillion.

The ASFF, first introduced in 2004, has injected ¥674.84 billion into 30 institutions over the past 16 years. A YPFS case on the previous ASFF can be accessed [here](#). ¥474.34 billion remains outstanding as of September 2019. (see [here](#)) The first amendment was during the 2007-09 global financial crisis (GFC) introducing a focus for SME-support. Under this amendment, [the government had injected ¥309 billion](#) to various financial institutions.

In proposing the new amendment this month, the Japan Financial Services Agency (JFSA) [emphasized](#) that the domestic financial system is currently sound and this is a preemptive measure ensuring the long-run soundness of the financial system so that it can continue to support small and medium-sized enterprises (SMEs) impacted by the COVID-19 crisis and revitalize the economy.

All financial institutions are eligible for capital injections, however, as the amended ASFF specifically focuses on SME lending, the main recipients of the capital injection are expected to be regional banks. Institutions must first submit an application to the JFSA. The application will include: (i) numerical targets for an institution's profitability and efficiency, and means to achieve those targets, (ii) related commitments by the management, and (iii) measures the institution will take to facilitate credit to SMEs and revitalize the local economy. (see [here](#))

The Financial Functions Enhancement Examination Committee, currently composed of five members from the private sector, then will review each application. It will evaluate: (i) the feasibility of the targets, (ii) whether the institution will be able to repay within 15 years, and (iii) current asset value. (see [here](#)) The review meeting minutes and participants' list will be posted [here](#).

However, the amended ASFF allows financial institutions "affected by coronavirus" to apply for an injection without meeting the first two hurdles. Such institutions must meet only the third hurdle, to describe measures they will take to facilitate credit to SMEs. "Affected" institutions are those whose "financial statements have gotten considerably worse due to the coronavirus or

measures to prevent coronavirus, or if the financial institution needs to lend to companies that are affected by coronavirus or measures to prevent coronavirus.”

Moreover, the review process for these “affected” institutions will neither consider the feasibility nor the 15-year deadline but only consider the best possible asset value of the institution based on available information. (see [here](#)) However, a news report [notes](#) that the JFSA had expressed intentions to set repayment dates for each bank receiving capital injection.

Once the application is approved, the Deposit Insurance Corporation of Japan (DICJ) will purchase preferred shares, as consistent with injections under the previous ASFF. However, the amended ASFF further allows the DICJ to purchase common stocks and subordinated debt from the “affected” institutions. It is not clear whether the common stocks will be voting or non-voting.

The JFSA notes that a wider variety of capital will meet the needs of different financial institutions. The JFSA also announced lower dividend rates than normal for shares purchased from affected financial institutions. (see [here](#)) The DIJC has existing guidelines on [exercising voting rights](#) and [disposing of preferred shares](#) but these have yet to be updated. The capital injection for affected financial institutions does not require recipient companies to limit dividend payments to existing shareholders.

A commentator [questions](#) the amended ASFF as it no longer sets a repayment deadline. Regional banks have already been struggling with the decline in population and in the number of borrowers. Some market observers are skeptical about whether banks receiving ASFF capital will be able to repay.

The same commentator [notes](#) that Mr. Toshihide Endo, the Commissioner of the JFSA, had denied that the amended ASFF would lead to nationalization. Although the JFSA has promised a rigorous review process for the application and its best efforts to improve profitability and management of the assisted institutions, the commentator remains pessimistic about the future of regional banks.

Takahide Kiuchi, a former Bank of Japan Policy Board Member, [acknowledges](#) that this amended ASFF may carry a risk of moral hazard in the long run but emphasizes that it is justified under the current unusual economic environment. Kiuchi also commends the government for implementing this difficult policy early on.

[Ogawa and Tanaka](#) examine the nature of the shocks that hit the SMEs during the GFC and how they responded to these shocks. They find that the capital injection under the ASFF may have acted to strengthen the role of financial institutions as a buffer for SMEs against these shocks.

ECB Announces New Eurosystem Repo Facility to Provide Euro Liquidity

By Aidan Lawson

Original post [here](#).

On June 25 the European Central Bank (ECB) [announced](#) a new facility to provide euro liquidity to non-eurozone central banks. The announcement does not specify the total size of this new facility.

The Eurosystem repo facility for central banks (EUREP) is designed as a “precautionary backstop to address pandemic-related euro liquidity needs outside [the] euro area” (see [here](#)). It is intended to reduce both the impacts and risks of sudden sell-offs of euro-denominated assets and any potential confidence-related spill-over effects into the euro area. The EUREP complements the ECB’s standing swap lines with 11 countries (see [here](#)) and one bilateral repo agreement (see [here](#)), addressing the limited access to euros that central banks have.

Any non-Eurosystem central bank can request a EUREP line, even those that already have existing bilateral swap lines or repo arrangements. The ECB’s Governing Council, which consists of 25 total members - 6 from the Executive Board and the governors of the 19 national central banks - makes the final decision. Central banks that are accepted will be able to borrow euros in exchange for euro-denominated debt issued either by euro-area governments or supranational institutions.

While a term sheet has not yet been released, the ECB has specified that the facility will be “slightly” more expensive than its existing bilateral swap and repo lines. The range of collateral will be narrower (see [here](#)). These terms, and the involvement of the Governing Council, reflect the ECB’s desire for the facility to be used exclusively as a backstop, rather than a facility that non-euro central banks turn to immediately.

EUREP may also be seen as a complement to its U.S.-based counterpart: the Federal Reserve’s temporary repurchase agreement facility for foreign and international monetary authorities, or “FIMA repo facility.” The FIMA repo facility, created on March 31, mirrors the EUREP’s function as a liquidity backstop. However, unlike EUREP, it is only available to central banks and other foreign monetary authorities with existing accounts with the central bank. For more information on the FIMA repo facility, see the following [YPFS blog](#). The usage of FIMA repo facility has been low, with \$1.4 billion in dollar repos outstanding as of the week of May 13, and limited activity since then.

However, the Fed’s existing swap lines with 14 central banks have been used extensively, peaking at over \$440 billion at the beginning of May (see [here](#)). The ECB has not published usage data for their swap lines or bilateral repo agreements. Swap lines were an effective tool in meeting demand for widely used currencies, especially during the Global Financial Crisis (GFC).

The Fed's swap lines were used extensively by the ECB, the Bank of Japan, and other major central banks during the GFC (see [here](#)). For more information on usage of swap lines currently and during the GFC, see the following [YPFS blog](#).

EUREP will be active through June 2021, and the exact pricing, collateral eligibility and tenor of the repos are still unknown. We will publish updates as details become available.

Brazil's central bank injects liquidity in financial markets

By Aidan Lawson

Original post [here](#).

In March, [Brazil's central bank \(BCB\)](#) unveiled a [series of liquidity measures totaling \\$243 billion](#) (1.2 trillion Brazilian reais) to ensure that “financial institutions have funding to meet the market’s liquidity needs.” The measures represent about 16.7% of last year’s GDP. In addition, the BCB can now temporarily purchase government bonds directly in the primary market and purchase corporate bonds in the secondary market due to recent constitutional amendments.

Brazil, the largest Latin American economy, has been hit hard by COVID-19. It recently became the [second country after the U.S. to surpass 50,000 deaths](#). Since March, Brazil has experienced shortages in foreign exchange liquidity; the [Brazilian real has depreciated](#) by over 25%; and Brazil’s national debt hit a record 79.7% of GDP in April. The [IMF currently expects a 9.1% contraction in 2020](#). (For the Bank of Mexico’s liquidity measures, see this [YPFS blog post](#).)

The BCB stated that it “[will not hesitate to use its entire arsenal](#) to ensure [financial stability](#) and smooth operation of the money and [foreign exchange markets](#) – supporting, therefore, the normal functioning of the Brazilian economy.”

On May 7, [Brazil amended its constitution](#) to temporarily allow the BCB to directly purchase government debt during the COVID-19 crisis. Previously, the BCB could only buy government debt on secondary markets. [BCB's President Roberto Campos Neto said](#) that the newly granted powers are intended for “market stabilisation and not an alternative form of monetary policy.”

Additionally, the BCB [can now purchase corporate bonds in the secondary market](#). In regards to these non-financial sector assets, the constitutional amendment sets limitations. Securities must have a BB- rating or higher provided by an international credit rating agency, and the reference price published by a financial market entity needs to be approved by the BCB ([BCB Circular 4028](#)).

The [\\$243 billion in liquidity measures](#) include fostering credit for SMEs, increase in the amount reserve requirements are taken into account in the Liquidity Coverage Ratio, reduction of the Capital Conservation Buffer, restrictions on dividends distribution and top managerial compensation, and other temporary relaxation of rules. Among those measures, this post focuses on measures aiming to support certain financial markets.

For the credit market by providing liquidity to financial institutions:

- Through the Special Temporary Liquidity Facility (LTEL-LFG), the BCB lends up to \$134 billion to financial institutions backed by Guaranteed Financial Letters (LFG) collateralized by loan pools or securities. Financial letters’ primary issuance must be

registered with a central depository, and the financial assets or securities pledged as collaterals must be fiduciarily assigned to the BCB ([CMN Resolution 4795](#)).

- Through the Special Temporary Liquidity Line (LTEL), the BCB lends up to \$18.2 billion in domestic-currency to financial institutions backed by debentures. These operations are guaranteed by reserves that financial institutions hold at BCB ([CMN Resolution 4786](#)).
- The New Term Deposit with Special Guarantees (NDPGE) offers an alternative fundraising instrument to financial institutions members of the [Credit Guarantee Fund \(FGC\)](#). The FGC is one of the two private nonprofit entities in Brazil that provides deposit insurance and protects clients of financial institutions in the event of resolution. It is regulated by the National Monetary Council and the BCB. The NDPGE increases the guarantee amount for its member institutions in an amount corresponding exactly to their net worth, limited to \$400 million ([CMN Resolution 4785](#)). The NDPGE [was used in 2009 during the 2007-09 global financial crisis](#) and is now expected to [expand credit provision by \\$40 billion](#). FGC's guarantees do not involve public funds since they are funded by premiums paid by member institutions.

For the government bond market:

- The BCB will conduct up to \$10 billion in repurchase operations (repos), with up to one-year terms, collateralized by Brazilian sovereign bonds denominated in US dollars. The repos are expected to reduce volatility in the market. A 10% haircut will apply and there is a transfer of margin during the repurchase maturity period, whenever the exposure of any counterparty is equal to or greater than \$500,000 ([BCB Circular 3990](#)).

For the foreign exchange (FX) market:

The BCB has been intervening in foreign exchange markets, supported by a cushion of foreign exchange reserves. That support was as high as 20% of Brazil's GDP in March. BCB interventions may be conducted through currency swaps, operations in the spot market, and repo lines of credit.

- In March, the BCB and the [U.S. Federal Reserve established a \\$60 billion liquidity swap line](#) for at least six months. The swap line potentially expands U.S. dollar availability in the domestic market, and does not entail economic policy conditionalities. [BCB's President Campos Neto said](#) that “for Brazil, the swap line reassures external investors and commercial partners. But it works much more as a signal than as an effective source of U.S. dollars for the Brazilian economy, since we do not foresee the need to use the facility.”
- Tax effects arising from the FX hedge operations of banks will not be deducted from their equity ([CMN Resolution 4784](#)). Banks hedge their investments on equity held abroad, in order to obtain protection against exchange-rate fluctuations. The estimated capital

relief is \$9.2 billion, which could allow for an additional \$104 billion in credit operations.

- A legislative change eliminated the tax asymmetry between the financial impacts of exchange-rate fluctuations on banks' investments overseas and the impact of the associated foreign-exchange rate hedge of this investment ([Provisional Measure 930](#)). This asymmetry is an incentive for banks to contract excess protection – the so-called overhedge. In times of higher FX volatility, the effect of the FX variations on the overhedge increases demand for dollar liquidity by banks, reinforcing FX volatility and entailing negative effects on FX market functionality.

Table 1: Brazil's Central Bank Liquidity Measures Usage (as of June 29, 2020)

Liquidity Measures	Potential	Implemented
Special Temporary Liquidity Line (LTEL-LFG): loans backed by Guaranteed Financial Letters (LFG)	\$134 billion	\$5.2 billion
Special Temporary Liquidity Line (LTEL): loans backed by debentures	\$18.2 billion	\$0.6 billion
New Term Deposits with Special Guarantees (NDPGE)	\$40 billion	\$1.2 billion
One-year term repos backed by federal government bonds	\$10 billion	\$4.6 billion
Swap Lines with the Federal Reserve	\$60 billion	Not used
Overhedge: capital relief	\$104 billion	\$104 billion

Source: Brazil's Central Bank, Presentations by Governor Roberto Campos Neto. [June 29](#) and [June 26](#).

RBI to provide liquidity to non-bank financial firms

By Junko Oguri

Original post [here](#).

On July 1, the Reserve Bank of India (RBI) [announced](#) guidelines for a \$4 billion (₹300 billion) special liquidity scheme (SLS) to purchase short-term debt from eligible non-banking financial firms (NBFCs) and housing finance companies (HFCs). The RBI said its purpose is to “avoid any potential systemic risk to the financial sector.”

This liquidity scheme is consistent with what the Finance Minister announced as part of a COVID-19 relief package on [May 13](#). The Indian government’s broader [“Self-Reliant India Movement”](#) (Aatmanirbhar Bharat Abhiyaan), a special economic and comprehensive package, is equivalent to [10% of India’s GDP](#).

SBI Capital Markets (SBICAP), a subsidiary of a state-owned commercial lender, set up [the SLS Trust](#), a special purpose vehicle (SPV). RBI will provide funds by subscribing to special securities issued by the Trust. These securities will be granted unconditional and irrevocable guarantees by the Indian government. RBI will provide liquidity to the SLS Trust based on its realized purchases of short-term paper from eligible companies. The total outstanding short-term paper purchased by the Trust may not exceed \$4 billion (₹300 billion).

In order to participate in the SLS, NBFCs and HFCs must fulfill the following eligibility criteria:

- NBFCs, including Microfinance Institutions, that are registered with the RBI under the RBI Act, 1934, excluding those registered as Core Investment Companies;
- HFCs that are registered under the National Housing Bank Act of 1987;
- The eligible institution’s capital adequacy ratio should not be below the regulatory minimum (i.e., 15% for NBFCs and 12% for HFCs);
- The institution’s net non-performing assets should not be more than 6% (as of March 31, 2019);
- The institution should have made a net profit in at least one of the last two preceding financial years;
- The institution’s borrowing should not have been reported as “special mention account” (whose repayments are overdue for between 31 to 90 days) by any bank during the one year prior to August 1, 2018; and
- The institution should be rated investment grade by an Securities and Exchange Board of India (SEBI) [\[FG1\]](#) registered rating agency.

The SLS Trust will purchase commercial paper (CP) and negotiable certificate of deposits (NCDs) of eligible NBFCs and HFCs on an application basis. The Trust can invest in securities either on the primary or secondary market.

The CP and NCDs of eligible institutions must meet [the following requirements](#):

- The CP and NCDs must be rated investment-grade by credit rating agencies registered with SEBI.
- The CP and NCDs must be issued before September 30, when the SPV will cease purchases.
- The CP and NCDs must have residual maturity of up to 90 days.
- The CP and NCDs should be in the NBFCs and HFCs' standard books as on date of sale and should not have defaulted on that date.

The SLS Trust has launched an investment committee, consisting of representatives from the SBICAP and its parent company, the State Bank of India. The unanimous decision by the committee will ultimately determine further details of the purchase, including the followings:

- Any additional evaluation criteria
- Optional collateral requirement
- The maximum amount of liquidity that the Trust will provide to a single NBFC/HFC
- Interest rate (yield)
- Purchasing market (primary/secondary)

The NBFCs and HFCs must use the acquired liquidity solely to repay pre-existing liabilities and shall not be used to expand assets.

The SLS is similar to a liquidity scheme that RBI set up during the Global Financial Crisis. [In February 2009](#), RBI announced a liquidity scheme of ₹200 billion (\$2.6 billion) for NBCFs in order to “meet the temporary liquidity mismatches.” An SPV was set up to purchase short-term paper, and RBI extended the scheme [twice](#). [Anand Sinha](#), former Deputy Governor of the RBI, recalls that “the actual condition of NBFCs was not so alarming” and only one NBCF used the scheme.

Some commenters argue that the SLS will successfully support small and medium-sized non-banks that are unable to raise funds from CP and bond markets. [One commentary suggests](#) that NBFCs could be facing CP repayments of close to \$8.7 billion (₹650 billion) in the coming three months.

At the same time, some are doubtful that the SLS will be sufficient to buttress financial stability. For instance, Abizer Diwanji, leader for financial services at EY, [notes](#) that the SLS could be too small given that NBFCs account for \$3.6 trillion (₹27 trillion) in term of lending, of which \$2.5 trillion (₹19 trillion) is financed via the capital markets.

Non-banks in India had been [facing difficulties before the COVID-19 crisis](#), particularly since the default of [Infrastructure Leasing & Financial Services \(IL&FS\) in September 2018](#). On July 1, Fitch Ratings [reported](#) that India's non-bank financial institutions will "continue to face elevated near-term risks, even as economic activity picks up with the easing of the country's nationwide lockdown." The same commentary also noted that the moratorium will "erode payment discipline and its extension will result in lagged asset-quality problems" for non-banks, "particularly when combined with the economic damage from the pandemic and lockdown."

As of July 7, India has reported more than [719,600 total cases](#). The country has [overtaken](#) Russia as the third country in terms of positive cases, behind the US and Brazil.

Implications of the German Constitutional Court's Objection to the ECB's Public Sector Purchase Program

By Aidan Lawson

Original post [here](#).

The Bundesbank, the German central bank, will continue to participate in the European Central Bank's [Public Sector Purchase Program \(PSPP\)](#) after the German finance minister and parliament declared that the Bundesbank's participation was allowable under EU guidelines.

This is the latest episode in a legal battle that has seen Germany's Federal Constitutional Court (the "Court") pitted against the European Central Bank (ECB). The Court fulfills a judicial review function similar to the U.S. Supreme Court.

The Court initially issued several preliminary inquiries for review to the Court of Justice of the European Union (CJEU) in 2017. The German Court argued that the PSPP purchases constituted monetary financing of ECB member state budgets, overstepped the monetary policy mandate of the ECB, and created "a potential encroachment upon the Member States' competences and sovereignty in budget matters." The CJEU [ruled](#) in December 2018 that the program did not overstep the ECB's monetary policy mandate.

But the German Court returned to the issue in May 2020. It delivered a landmark [ruling](#) that disregarded the CJEU's previous judgment, arguing that the ECB's actions qualified as ultra vires, or done beyond one's legal power or authority. The Court also argued the CJEU's decision violated the principle of proportionality, which states that any action by EU institutions (including the ECB) "shall not exceed what is necessary to achieve the objectives of the Treaties" among sovereign European nations (see [here](#), pp. 18).

It should be noted that the Court explicitly stated that its ruling in May 2020 did not concern any COVID-19-related financial assistance measures.

In the May ruling, the Court cited a number of economic effects of the PSPP that it said the European Central Bank and court had failed to consider. These were:

1. The bond-buying allowed member states to obtain cheaper financing than they otherwise would be able to.
2. The size and duration of the program created proportionality concerns, even if the initial terms may have been proportionate.
3. The purchase of "high-risk" government bonds by the ECB improved the financial condition of the banks selling these and improved their credit rating.
4. As the PSPP lowered interest rates, it could have allowed companies that were not viable to continue operating, raising moral hazard concerns.

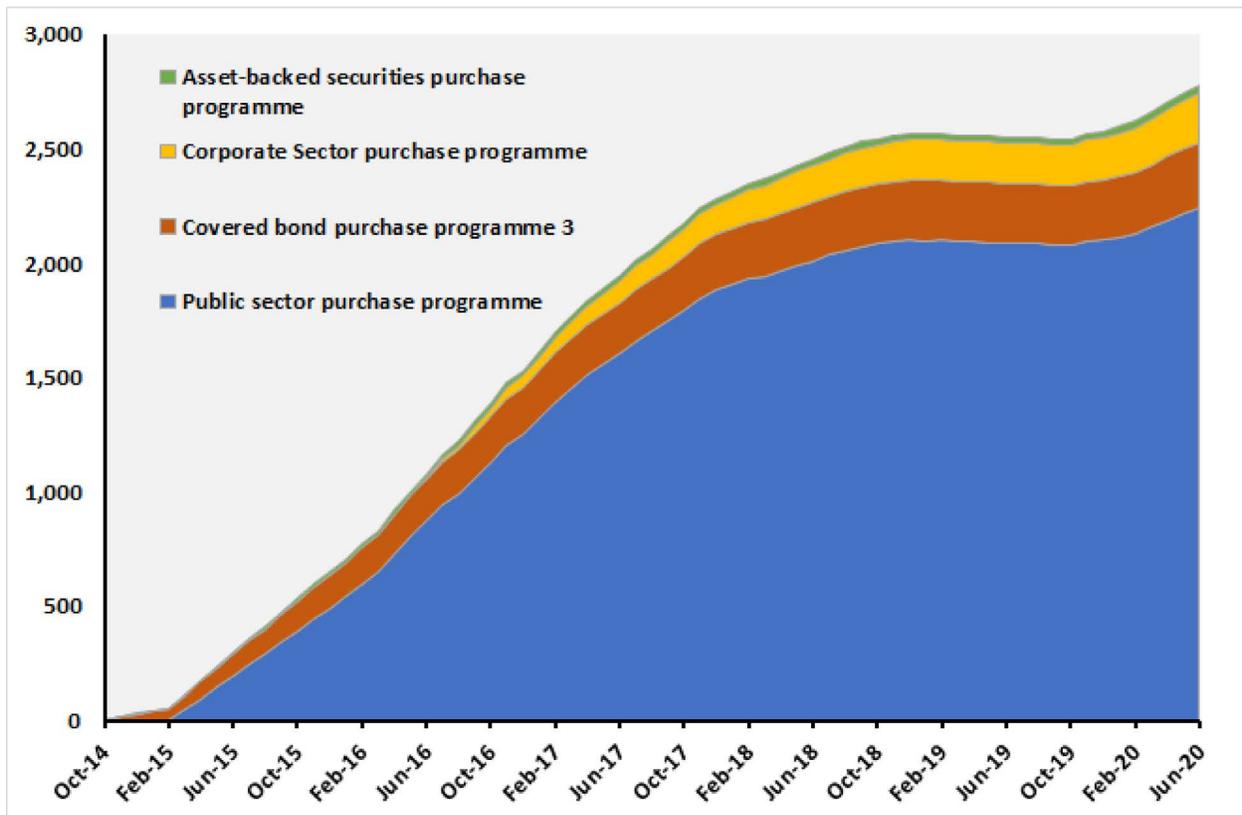
The Court did not express a view on whether the PSPP constituted monetary financing, which is prohibited by Article 123 of the TFEU (see [here](#), pp. 99).

While the Court, as a German judicial body, has no authority over the ECB or other member states, the May ruling meant that the Bundesbank would not be allowed to participate in the PSPP. The PSPP is by far the largest of the ECB’s asset purchase programs and the Bundesbank is the largest participant, per the [capital subscription guidelines](#) for the ECB. Purchases consist of bonds issued by governments, euro-area international organizations, and multilateral development banks.

To address these concerns, the Court requested that the ECB conduct a “proportionality assessment.” The ECB had three months to conduct this assessment, and the Court threatened to block the Bundesbank from participating in the program if it was not done within three months.

In response, the ECB released several unpublished documents and meeting minutes to the German government that highlighted the debate amongst ECB members of the economic effects of the asset purchases (see [here](#)). In late June, the German finance minister and parliament [declared](#) that the assessment delivered by the ECB met the requirements outlined in the Court’s ruling, which allows the Bundesbank to continue purchasing bonds.

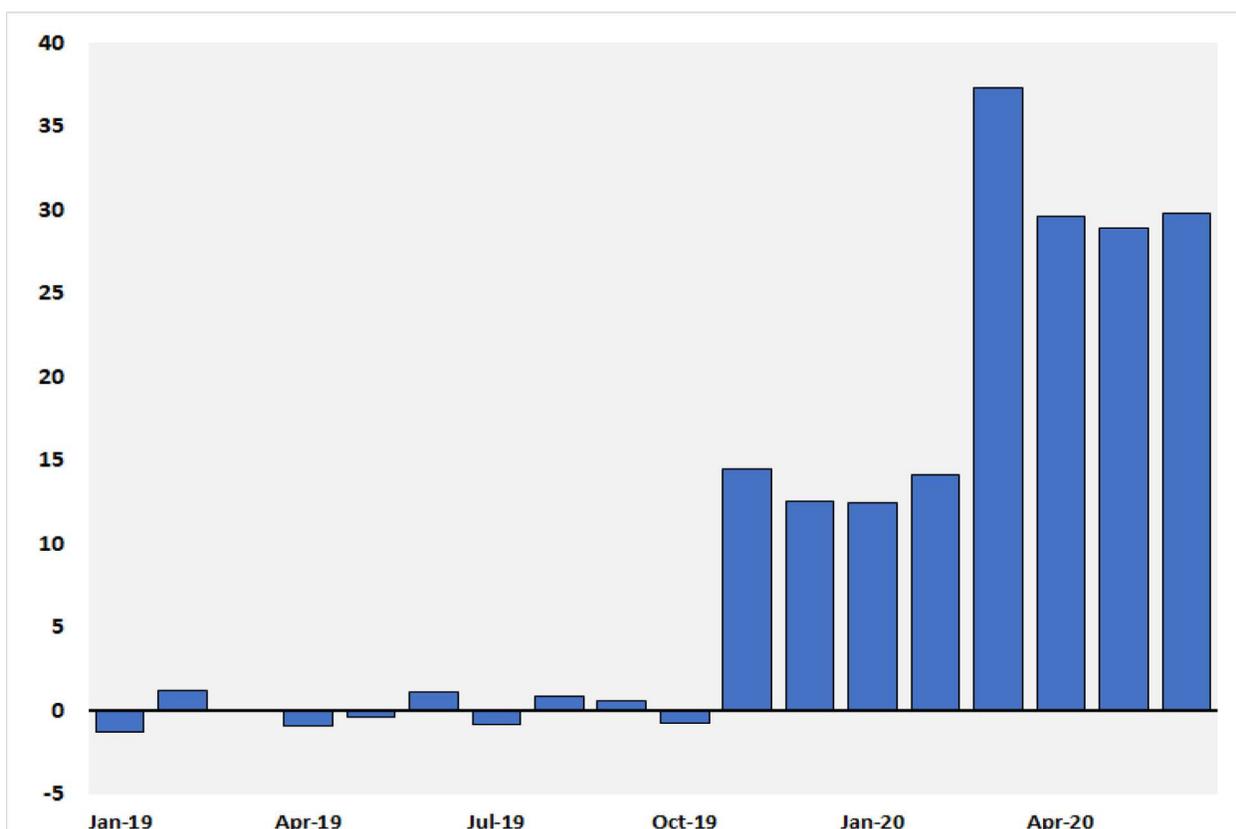
Figure 1. Total ECB Expanded Asset Purchase Programme (EAPP) holdings (EUR Billions)



Bundesbank President Jans Weidmann tacitly [sided](#) with the German Court. Over the past nine years, he has consistently spoken against the ECB’s unconventional policies (see [here](#)). It is currently unclear if the Bundesbank will issue a formal statement on this decision or just let the deadline on August 5 pass, since the Bundesbank has not generally supported the ECB’s unconventional programs in the past. Regardless, individuals close to the matter have stated that the central bank would “take its lead” from the German government and finance minister (see [here](#)).

In response to the COVID-19 crisis, the ECB has dramatically increased the scale of its asset purchases, primarily through the PSPP, as well as through the [new temporary pandemic emergency purchase programme \(PEPP\)](#). For more information on PEPP, see this [YPFS blog post](#). From February 2020 to March 2020 the amount of securities purchased under the PSPP increased from €14.1 billion to €37.3 billion. See Figures 1 and 2 below for a breakdown of the ECB’s standing asset purchase facilities.

Figure 2. Monthly net PSPP asset purchases (EUR billions)



The May ruling received some [backlash](#), with a former ECB vice president calling it “[nonsensical](#).” The far-right Alternative for Germany (AfD) party has already [unveiled](#) pending

legal action against the PEPP. Some members of the European parliament have expressed [concern](#) that the challenge could be the first of many by national governments that seek to question the independence and credibility of the CJEU and ECB.

The Federal Reserve expands eligible counterparties and agents in three emergency facilities

By **Manuel Leon Hoyos**

Original post [here](#).

On July 23, the Federal Reserve [expanded eligible counterparties and agents in three emergency lending facilities](#): the Term Asset-Backed Securities Loan Facility ([TALF](#)), the Commercial Paper Funding Facility ([CPFF](#)), and the Secondary Market Corporate Credit Facility ([SMCCF](#)). This move is aimed at increasing the Fed’s operational capacity and reach into the targeted markets.

The Federal Reserve Bank of New York (FRB-NY) has relied on existing [primary dealers](#) as counterparties and agents. However, it now seeks to expand counterparties to include non-primary dealers. The FRB-NY has [requested expressions of interest](#) in order to identify additional commercial paper dealers for the CPFF, agents for the TALF, and broker-dealers for the SMCCF.

Any new counterparty or agent should be a broker-dealer registered with the Securities and Exchange Commission (SEC) and regulated as a member of the Financial Industry Regulatory Authority (FINRA) with an established track record operating in the targeted market, a net regulatory capital of at least \$1 million, and shareholders’ equity of at least \$1 million.

Potential counterparties and agents will be prioritized based on their ability to add operational capacity or expand the access and reach of the facility (see the latest terms and conditions for the [TALF](#), [CPFF](#) and [SMCCF](#)).

The three emergency lending facilities were created under section 13(3) of the Federal Reserve Act, under “unusual and exigent circumstances,” with the U.S. Treasury Secretary’s approval and an equity investment. The facilities are part of a [\\$2.3 trillion Fed lending package](#) aimed at supporting the flow of credit to households, businesses, and the broader economy.

Federal Reserve Extends Lending Programs to December 31

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [July 28](#), the Federal Reserve announced that seven of its COVID-19 emergency lending facilities that were set to expire on or around September 30 have been extended to December 31.

These deadline extensions come after multiple [comments](#) from Fed officials regarding the importance of the public health response and the uncertainty regarding how long the crisis will last. Federal Reserve officials are meeting on July 28 and 29 but are not expected to announce new stimulus measures.

The table below lists expiration dates for all nine active emergency Fed lending facilities.

Lending Facility	Original Expiration	New Expiration
Primary Dealer Credit Facility (PDCF)	September 20, 2020	December 31, 2020
Money Market Mutual Fund Liquidity Facility (MMLF)	September 30, 2020	December 31, 2020
Primary Market Corporate Credit Facility (PMCCF)	September 30, 2020	December 31, 2020
Secondary Market Corporate Credit Facility (SMCCF)	September 30, 2020	December 31, 2020
Term Asset-Backed Securities Loan Facility (TALF)	September 30, 2020	December 31, 2020
Paycheck Protection Program Liquidity Facility (PPPLF)	September 30, 2020	December 31, 2020
Main Street Lending Program (MSLP)	September 30, 2020	December 31, 2020
Municipal Liquidity Facility (MLF)	September 30, 2020	December 31, 2020 *extended on April 27
Commercial Paper Funding Facility (CPFF)	March 17, 2021	n/a

For usage information about the Fed facilities, see YPFS's [July 24 update](#). YPFS has also created detailed timelines for the [Paycheck Protection Program Liquidity Facility](#) and the [Main Street Lending Program](#).

Bank of England Rapidly Expands Asset Purchase Facility

By Adam Kulam

Original post [here](#).

In response to the COVID-19 crisis, the Bank of England (BoE) has expanded its existing Asset Purchase Facility (APF) from GBP 445 billion to GBP [745 billion](#) (USD 950 billion).

BoE created the APF in January 2009 to [ease corporate credit](#) conditions during the 2007-2009 Global Financial Crisis. One month later, BoE expanded the APF remit to achieve monetary policy objectives through [quantitative easing](#) (QE), and purchased GBP 200 billion of UK government bonds. Last March, BoE relied on QE to restore order to gilt markets and guide price levels towards its 2% inflation target. As [global financial conditions tightened](#) due to COVID-19, the BoE's Monetary Policy Committee (MPC) noted that "conditions in the UK gilt market had deteriorated substantially as investors sought shorter-dated instruments that were closer substitutes for highly liquid central bank reserves."

Worldwide, financial market participants moved money [away from risky assets](#) and government bonds, and shifted to cash, especially US dollars. Within the UK, fixed-income strategists [expected](#) the British government to launch ambitious fiscal stimulus measures to counter the effects COVID-19 on businesses and consumers. Her Majesty's Treasury's (HMT) [Budget 2020](#), announced on March 11, described just GBP 30 billion of coronavirus relief, and the government's five-year macroeconomic forecasts limited the incorporation of additional COVID-19 spending into its projections of fiscal expenditure. On March 17, Chancellor Rishi Sunak [announced](#) additional emergency support for both new and existing programs, and the additions were not captured by the Budget 2020's GBP 30 billion figure.

The UK government's successive announcements of COVID-19 interventions stirred concerns about whether investors would have sufficient [demand](#) for the gilts that the government would have to issue to pay for the stimulus. By March 19, UK financial markets exhibited [heightened volatility](#): the GBP/USD exchange rate hit a 35-year low, risky asset prices fell, both investment-grade and high-yield bond spreads soared, and gilt yields spiked. After the Debt Management Office (DMO), which is a part of the HMT responsible for government wholesale sterling debt issuance, successfully completed the morning's auction, gilt markets [entered into a standstill](#).

On [the same day](#), the MPC obtained permission from HMT to purchase GBP 190 billion of gilts and GBP 10 billion of non-financial, investment-grade corporate debt from the secondary market to address the deteriorating conditions of gilt markets. "Had the Bank not stepped in, things would have gotten very difficult," [said](#) Sir Robert Stheeman, chief executive of the DMO. Gilt purchases commenced on [March 25](#), and corporate bond purchases on [April 7](#).

By June 17, the APF had grown to GBP 613 billion while the MPC [maintained the Bank Rate steady](#) at 0.10%. After completing nearly 80% of its emergency asset purchases, the MPC

decided to raise the APF target by an additional GBP 100 billion of government debt, bringing the total stock to GBP 745 billion. Though the MPC [acknowledged](#) that recent setbacks to output and demand growth were not as bad as previously expected, 12-month CPI inflation remained low at 1.5% in March, 0.8% in April, and 0.5% in May. Some MPC members expressed a concern that inflation would fall even further due to prolonged unemployment. While the MPC's March vote on QE was unanimous at 9-0, the June vote was 8-1: Andy Haldane [later explained](#) his belief that the upside news about demand outweighed the negative outlook on British labor markets, so further monetary easing was unnecessary.

The MPC omitted corporate debt purchases in its second round of expansion. The [June 17 minutes](#) offer details on high corporate credit demand, stabilization of credit conditions for firms, the UK government's other corporate financing facilities, and already-indebted firms' desires to seek other methods for raising capital. At the same meeting, the MPC decided to slow the [weekly volume of asset purchases by about two-thirds](#) because liquidity conditions improved, and asserted that it would be willing and able to raise the volume of weekly purchases if conditions worsened again.

The BoE purchases assets through the Asset Purchase Facility Fund Limited (APF), which is [a wholly-owned subsidiary](#) of the BoE, [to raise prices and lower the yields](#) on assets held by non-banks. As shown in Figure 1, BoE [provides loans](#) to the APF so that it can purchase assets. Depending on the MPC's policy stance, the APF may repay loan principal or reinvest proceeds from gilt redemptions

HMT sets the APF's risk and control frameworks. HMT also fully indemnifies the APF's net financial gains and losses. In a [2013 Quarterly Bulletin](#), the BoE acknowledged that APF involves large and variable cash transfers between the BoE and HMT, but stressed that the APF's annual losses and gains are not appropriate metrics of success. Rather, the BoE argued, the success of the APF should be determined by its effects on credit conditions, nominal spending, and their effects on the medium-term inflation target.

Within the HMT, [DMO](#) has the remit to minimize the government's long-term financing costs. DMO issues gilts to [primary market buyers](#), who trade gilts on [secondary markets](#). After the APF buys gilts from the secondary market, APF may lend a proportion of its gilts to DMO through the [Debt Management Account](#) for DMO's [short-term repo activities](#). In exchange for APF gilts, the DMO posts government securities of equal value and longer maturity as collateral, so there is no net change in the value of the APF's gilt portfolio. The purpose of on-lending is to resolve market frictions stemming from the APF's asset purchases.

Since 2016, the APF's asset purchases have mostly maintained the same [operating procedures](#). However, for the expanded APF in response to the COVID-19 crisis, it now includes the following changes:

- The MPC changed [the definition](#) of residual maturities from 7-15 years to 7-20 years (“medium”) and from 15+ years to 20+ years (“long”) to “free up additional headroom to purchase gilts” equally across the maturity sectors.
- On [April 22](#), BoE doubled the gilt lending limit to insulate DMO repo facilities, which use gilts as collateral, from the Bank's extensive gilt purchases, and minimize frictions between the APF and DMO.
- On [June 4](#), BoE expanded the list of eligible corporate debt to include bonds with 3 months-to-maturity par call features.

BoE pledged to [coordinate any reduction](#) in the APF with the DMO. BoE Governor Andrew Bailey suggested that an exit strategy could involve gradual asset maturation or sales.

BoE emphasized that the combination of the APF and [HMT's programs](#) on workers' support, business assistance, tax deferrals, and other fiscal relief [improved confidence in sterling markets](#): the sterling appreciated slightly, gilt yields fell, and the yield curve flattened. BoE also [acknowledged](#) that while the gilt market calmed, repo and money markets remained unstable and LIBOR-OIS spreads were still high. In a June 2020 [interview](#) with Sky News, Governor Andrew Bailey said that the BoE's recent APF interventions worked because they restored order to markets. He said that the BoE decided to inject liquidity into the gilt market in order to reach the more illiquid nonbanking markets. At a Financial Times [digital event](#), Governor Bailey acknowledged that the rapid expansion of quantitative easing both calmed the financial markets and smoothed the “profile of government borrowing.”

[Some commentators](#) have voiced concerns about threats to BoE's independence due to the expansion of the APF. On June 25, 2020 BoE's former deputy governor Paul Tucker [claimed](#) that the APF purchased more than what was necessary for market liquidity, and that this was not a “classic market maker of last resort operation” in a virtual Royal Economic Society event. On the other hand, Governor Bailey [emphasized](#) that it was a mere by-product of the current economic situation that the government was the largest borrower and the largest beneficiary of BoE's asset purchases.

Though at least one other major central bank has attempted to [partially unwind](#) large-scale asset purchases within the last decade, the BoE has not officially planned to decrease the APF's outstanding holdings since beginning [quantitative easing](#) (QE1) in January 2009. Over the next decade, BoE conducted successive asset purchases of GBP 175 billion (QE2), GBP 60 billion (QE3), and GBP 10 billion (Corporate Bond Purchase Scheme). The Yale Program on Financial Stability has published [cases](#) that cover these programs in greater detail.

[Studies suggested](#) that the BoE's asset purchases from 2009 through 2016 had positive effects on price levels, output, and stock prices, and a negative effect on 10-year gilt yields. [Some researchers](#) argued that QE also decreased liquidity risk and lowered interbank credit spreads. There is also [evidence](#) that BoE's asset-purchase shocks worked better during times of high financial market stress (2008-2010) rather than low market stress (after 2010). Though

scholars generally agree that the UK's QE worked, they [cannot pinpoint the policy channel](#) through which the purchases were transmitted from the financial system to the real economy.

In addition to the expansion of APF, BoE cut rates by 15 basis points in response to the COVID-19 crisis to a level of 0.10%, the lowest Bank Rate in the Bank's [325 years](#) of operation. It also put forth the [Term Funding Scheme with additional incentives for SMEs \(TFSME\)](#), the [COVID Corporate Financing Facility \(CCFF\)](#), and supervisory and [prudential easing](#).

UK Introduces Covid Corporate Financing Facility

By Aidan Lawson

Original post [here](#).

On March 17, the UK government announced the creation of the [Covid Corporate Financing Facility \(CCFF\)](#) to purchase commercial paper from issuers that “make a material contribution to the UK economy.” Eligible issuers will broadly include all UK-incorporated companies, including those with foreign parents. The program will not purchase commercial paper issued by banks or their affiliates, or by leveraged investment vehicles.

The facility will purchase commercial paper between 10:00 and 11:00 each morning in both primary and secondary markets. In primary market purchases, the facility will purchase commercial paper through just one dealer each day. Issuers wishing to sell their commercial paper will have to coordinate to ensure that only one dealer sells to the facility each day. The Bank of England will publish aggregate data weekly but will not identify issuers or securities.

The facility will purchase investment-grade commercial paper with maturities ranging from one week to 12 months. Securities must have a face value of at least £1 million and cannot include features such as subordination or extendibility.

While the facility will be open for a minimum of 12 months, the Bank of England and HM Treasury said that it would be operational “for as long as needed to relieve cash flow.” The Bank of England pledged to provide six months’ notice before closing the facility. Current details can be found [here](#). The Bank of England will release more details, including terms and conditions and a pricing schedule, on March 23.

The Bank of England operated two similar facilities during the Global Financial Crisis. The Commercial Paper Facility (CPF) began operating in February 2009. Similar to the CCFF, it purchased investment-grade commercial paper from stressed nonfinancial companies. The Bank of England closed the facility in November 2011 after purchasing £2.4 billion in commercial paper. Most of its purchases occurred in early 2009.

The Secured Commercial Paper Facility (SCPF) began operating later in 2009. It was similar to the CPF. However, it purchased asset-backed commercial paper, and its eligibility criteria were much narrower. The SCPF only purchased CP from one institution while it was active. Monthly issuance peaked at about £30 million, and the facility was terminated in August 2016.

Despite the modest usage of both programs, market observers argued that the presence of these facilities showed that there would be a backstop should the market require one, restoring confidence.

Fed introduces Money Market Mutual Fund Liquidity Facility

By Rosalind Z. Wiggins

Original post [here](#).

Money market mutual funds (“money funds”) are common investments for families, businesses, pension funds, municipalities and others. On March 18th, the Federal Reserve announced that it would implement a [Money Market Mutual Fund Liquidity Facility \(MMLF\)](#) to enable money funds to meet redemption requests and support the overall flow of credit to businesses and households. Money funds are significant investors in commercial paper, which many businesses rely on as a source of funding.

Under the MMLF, the Federal Reserve Bank of Boston will make nonrecourse loans to eligible financial institutions (including depository institutions, bank holding companies and US branches of foreign banks) anywhere in the country to facilitate the purchase of high-quality assets from eligible prime money funds. Loans will be for no more than 12 months or the term of the assets purchased, if less, and secured by the purchased assets. Assets eligible for purchase include: US Treasuries, agency securities, and highly rated unsecured and asset-backed commercial paper (ABCP) issued by US issuers. For additional details see the [MMLF Term Sheet](#).

Participating financial institutions will not bear any credit or market risk from the purchased assets. For this reason, under a [proposed rule modification](#), federal bank regulators will not require them to hold regulatory capital against these assets.

The Fed established the MMLF under Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary (see [here](#)). Section 13(3) allows the Fed to lend to any “individual, partnership or corporation” when the Federal Reserve Board determines there are “unusual and exigent circumstances”. Although the MMLF loans will be made to depository institutions, they are for the benefit of money funds. Using the Exchange Fund, the Treasury has provided \$10 billion as credit protection to the Fed.

The MMLF is similar to the Asset-backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) operated by the Fed from late 2008 through 2009. That facility funded \$217 billion in purchases of commercial paper from mutual funds at a time when funds were experiencing significant withdrawals and when the commercial paper market was also under distress. It enabled money funds to access liquidity without having to sell assets into illiquid markets and helped fostered liquidity in the ABCP market and money markets more generally.

The MMLF will fund a broader set of asset purchases than the AMLF did but is similarly structured. Although it operated alongside other programs aimed at the same stresses (such as the Commercial Paper Funding Facility, a version of which the Fed [reintroduced on March](#)

[17th](#)), market observers believe the AMLF helped stabilize outflows from money funds and provided reassurance to investors and issuers that they would be able to rollover their commercial paper at maturity. See the Fed's description of the AMLF [here](#).

Federal Reserve Announces \$2.3 trillion Lending Package

By Aidan Lawson and Greg Feldberg

Original post [here](#).

The Federal Reserve [announced](#) on April 9 a series of programs totaling \$2.3 trillion with significant equity participation from the Treasury, including unprecedented direct financing to businesses. The programs include new facilities and expansions of existing programs. By including both riskier securities and issuers, they signal the Fed's willingness to take risks it did not take during the Global Financial Crisis.

The Fed's announcement lays out its plans for using some of the [\\$454 billion Emergency Fund](#) that Congress allocated to the Treasury in the CARES Act. For all of these programs, the Fed will use its authority under Section 13(3) of the Federal Reserve Act to lend to nonbank institutions, with equity support from the Treasury. Section 4003(C)(3)(B) of the CARES Act specifies that, in order for the Fed to use the Treasury's equity support, it must meet all Section 13(3) requirements "relating to loan collateralization, taxpayer protection, and borrower solvency."

The programs include:

- Up to \$600 billion from the Fed, matched by \$75 billion from the Treasury, for the [Main Street Lending Program](#).
- Up to \$500 billion from the Fed, matched by \$35 billion from the Treasury, for the [Municipal Liquidity Facility](#).
- Creation of the [Paycheck Protection Program Lending Facility](#) to support banks issuing Small Business Administration-guaranteed loans under another CARES Act program.

The Fed also announced expansions to existing programs.

- The [Term Asset-Backed Securities Loan Facility \(TALF\)](#) will now accept commercial mortgage-backed securities (CMBS) and collateralized loan obligations (CLOs) as collateral.
- The size of the Treasury equity investment in the [Primary Market Corporate Credit Facility \(PMCCF\)](#) has been increased from \$10 billion to \$50 billion, and portions of newly issued syndicated loans and bonds are now eligible for purchase.
- The size of the Treasury equity investment in the [Secondary Market Corporate Credit Facility \(SMCCF\)](#) has been increased from \$10 billion to \$25 billion and exchange-traded funds (ETFs) exposed to high-yield bonds are now eligible for purchase.

The Main Street Lending Program was originally [announced](#) on March 23 as part of a separate relief package. Until now, the Fed has created programs that provide liquidity to key funding markets, such as those for treasuries, commercial paper, and corporate bonds. In contrast, the

Main Street Lending Program provides funding to small and medium-sized businesses that have up to 10,000 employees or yearly revenue of up to \$2.5 billion.

The program will use a special purpose vehicle (SPV) financed through recourse Fed loans and the Treasury's equity investment to purchase 95% interests in loans made by eligible lenders, which include banks, bank holding companies, and savings and loans companies. Those lenders will retain 5%. These loans can be [newly issued](#) or [already existing](#).

Loans purchased by the SPV will be priced at a floating rate above the Secured Overnight Financing Rate. They must have a four-year term, with a one-year deferral of principal and interest payments. For more information on the Main Street Lending Program see the following [YPFS blog](#).

The Fed also unveiled a [Municipal Liquidity Facility](#) (MLF), which will directly purchase up to \$500 billion in short-term (less than 2 year) municipal debt. As in the Main Street Lending Program, the Fed will lend on a recourse basis to an SPV, with Treasury providing a \$35 billion equity investment. The SPV is limited to purchasing notes totaling 20% of the aggregate amount of general revenue (as of 2017) of the state, city, or county issuing them. Pricing will vary based on the credit rating of the issuer, and all debt issued to the SPV is callable, which means that it can be repurchased at any time by the issuer.

The Fed has provided relief to municipalities in a number of other ways, such as making them eligible for the [Commercial Paper Funding Facility](#) (CPFF) and using municipal debt as collateral for loans under the [Money Market Mutual Fund Liquidity Facility](#) (MMLF). Both of these programs were present in the Fed's crisis fighting efforts during the GFC, but did not include municipal debt. For more information on the MLF see the following [YPFS blog](#).

To support the Small Business Administration's (SBA) [Paycheck Protection Program](#) under the CARES Act, which provides SBA-guaranteed loans to businesses through partnered financial institutions, the Fed established the [Paycheck Protection Program Lending Facility](#) (PPPLF). Financial institutions originating PPP loans are eligible to obtain non-recourse loans from the Facility, which uses the PPP loans as collateral and charges a modest rate of 35 basis points. For more information on the PPPLF see the following [YPFS blog](#).

In addition to these new programs, the Fed dramatically expanded the scope of several existing facilities. The TALF, which was [reactivated](#) on March 23 to facilitate the issuance of asset-backed securities (ABS), uses an SPV to provide three-year secured loans to issuers of ABS. Under the April 9 guidance, the TALF now allows highly rated tranches of outstanding commercial mortgage-backed securities (CMBS), as well as newly issued collateralized loan obligations (CLOs), to be used as collateral. The size of the program remains at \$100 billion. For more information on the TALF see the following [YPFS blog](#).

The Fed substantially expanded the size and scope of the PMCCF and SMCCF, which were first [announced](#) on March 23. The facilities each use Treasury and Fed-funded SPVs to purchase both newly issued (for the PMCCF) and outstanding (for the SMCCF) corporate-debt securities.

The PMCCF received an increase in its Treasury equity investment from \$10 billion to \$50 billion, had its issuance limits changed from risk-based to flat, and is now able to purchase portions of newly issued syndicated loans and bonds.

The SMCCF received an increase in its Treasury equity investment from \$10 billion to \$25 billion and is now able to purchase ETFs that are primarily exposed to high-yield U.S. corporate bonds, though the majority of ETF holdings still must be of those that are exposed to investment grade corporations.

Both facilities now allow issuers that were recently downgraded from the minimally allowed BBB-/Baa3 rating to BB-/Ba3 to participate if the downgrade occurred after March 22.

Any businesses that participate in the Main Street Lending Program are not eligible for either of these facilities. For more information on the PMCCF and SMCCF see the following [YPFS blog](#).

These new programs and changes are just the latest in the Fed's efforts to provide support to a struggling economy. In addition to those mentioned above, the Fed has already announced [unlimited purchases](#) of both Treasuries and agency mortgage-backed securities, rolled out programs aimed at supporting [commercial paper markets](#), [primary dealers](#), and [money market mutual funds](#), and provided dollar liquidity globally via the increased use of [swap lines](#) and a [central bank-only repo facility](#). Chairman Powell has [reiterated](#) that the Fed will continue to use its lending powers "forcefully, proactively, and aggressively until we are confident that we are on the road to recovery."

Federal Reserve further expands access to Municipal Liquidity Facility

By **Corey Runkel**

Original post [here](#).

On June 3, the Federal Reserve Board of Governors [unanimously approved](#) a [second expansion](#) of eligibility under its Municipal Liquidity Facility ([MLF](#)).

Authorized by the CARES Act, the MLF can purchase up to \$500 billion of newly-issued bonds from qualifying municipalities, using funds from the Fed and Treasury. Until this latest action, the MLF had restricted the eligibility of cities and counties based only on their population. The newest terms guarantee the eligibility of at least two political subdivisions and two revenue-bond issuers from each state.

The expansion comes after the Fed [once again weathered criticism](#) from state governors and representatives that the MLF's eligibility criteria were too narrow. The original MLF criteria designated states, the District of Columbia, cities larger than one million residents, counties larger than two million residents, and one revenue-bond issuer (such as a utility or transit authority) per state as the only eligible recipients.

In effect, the original term sheet ceded borrowing privileges to just [10 cities and 16 counties](#). The Federal Reserve at the time said states could funnel the proceeds from bond sales to smaller cities and counties whose budgets had been strained by the effects of the novel coronavirus.

But this approach, while preserving the Fed's historical distance from small borrowers, ran into several issues. For instance, [some states lack the organizational infrastructure to lend](#) to cities and counties. More importantly, several states face legal impediments to borrowing. Twenty-one [states require referenda](#) to issue debt at levels demanded by COVID-19 disruptions, while a [previous YPFS blogpost](#) noted that several more states require legislative supermajorities to push through bond issuances. The current situation presents unique challenges to meeting such requirements, given that social distancing demands have closed many governing bodies and forestalled the possibilities of voting. In many cases, safe alternatives have not yet been designed.

Members of Congress [criticized](#) the Fed's narrow interpretation of the CARES Act, [which did not specify eligibility criteria](#) for the MLF. The Fed's [first expansion](#) on April 27 extended the program from September 30 to December 31, and lowered the eligibility thresholds from 1 million residents per city and 2 million residents per county to 500,000 and 1 million, respectively. As a result, the total number of eligible cities and counties increased from 26 to 227. However, even under the amended criteria, several states still lacked a single municipality that met the population threshold.

The June 3 terms lowered the thresholds again to 250,000 residents per city and 500,000 residents per county. Should a state lack one or two municipalities that meet these thresholds, governors may designate one or two of the largest ineligible cities or counties. Governors may also designate two non-governing entities that currently issue bonds secured by government revenue. Additionally, multi-state revenue-bond issuers, such as the Port Authority of New York and New Jersey and the Washington Metropolitan Area Transit Authority, are now also eligible issuers, provided that minimum credit rating thresholds are met.

The Fed has not changed the original terms regarding the MLF's size, and eligible uses of funds. The facility is authorized to purchase up to \$500 billion in eligible bonds (allocated among the states as [proportions of FY2017 general revenue](#)), and is backstopped by an equity investment of \$35 billion from the Treasury's Exchange Stabilization Fund, as authorized by the CARES Act. The facility takes the form of a special purpose vehicle (SPV) established by the Fed under Section 13(3) of the Federal Reserve Act. The facility may purchase "[tax anticipation notes \(TANs\)](#), [tax and revenue anticipation notes \(TRANs\)](#), [bond anticipation notes \(BANs\)](#), [revenue anticipation notes \(RANs\)](#)," and similar bonds with maturities no longer than 36 months, funding up to 20% of a state, county, city, or revenue-bond issuer's revenue.

Small cities are particularly sensitive to economic shocks due to their dependence on sales tax. Brookings [reported](#) that cities in the Midwest, generally smaller than those in the dense East and heavily urbanized West, rely more on sales taxes. Whereas property values are assessed not more than once a year, and income taxes are filed annually, sales tax receipts enter municipal finances at frequencies varying between once a month and once a year. These higher-frequency collections mean that shocks affect sales tax revenues much more quickly than other types of taxes.

Compounding pressure on the MLF to purchase small-city debt are high-population thresholds and use restrictions on CARES Act grants. Under the Coronavirus Relief Fund, only municipalities with 500,000 residents or more [are eligible](#) and funds may only be used for [necessary and unexpected expenditures](#) demanded by COVID-19. Thus, monies cannot be used to compensate for reduced sales tax receipts, a use that is permissible for proceeds from MLF bond purchases.

The MLF marks [the first time](#) the Federal Reserve has waded into direct purchases of municipal bonds. In 2011, in the wake of the Global Financial Crisis, Republicans in both chambers [balked](#) at suggestions from Democrats that the federal government bail out municipalities. The then-Chair of the Federal Reserve, Ben Bernanke, [said](#) that the Fed had "no expectation or intention to get involved in state and local finance." The Fed's legal authority to buy municipal bonds extended to only 2% of the market, and Bernanke noted that there might be other legal restrictions under the Dodd-Frank Act.

But, in spite of the Fed's historic distance from municipal debt, the efficacy of the MLF may lead to deeper involvement in municipal finances. The initial announcement of the MLF in April immediately stabilized a \$4 trillion market that saw AAA yields [jump from just under 1% to just under 3% in a matter of days](#).

Politico [pointed](#) to House Ways & Means Chair Richard Neal as a catalyst for more intervention in munis. Even before the novel coronavirus, the former mayor of Springfield, Massachusetts, had [established](#) himself as a supporter of municipal bonds. However, aid may instead come from traditional fiscal policy routes should the Fed hold firm on its new eligibility thresholds. Neal represents Springfield and its enclosing county Hampden, each of which just miss these newest MLF population thresholds.

Thus far, Illinois is the only state to [announce](#) its participation in the MLF, issuing \$1.2 billion in 12-month maturities at 3.82%. The MLF became operational on May 26.

Federal Reserve Lowers Pricing for Municipal Liquidity Facility

By **Natalie Leonard**

Original post [here](#).

The Federal Reserve Board [announced](#) August 10 that it would revise pricing for the Municipal Liquidity Facility (MLF). Specifically, the updated [term sheet](#) includes a reduction in the interest rate on MLF loans of 50 basis points across all credit rating categories. The Fed also revised the relationship between interest rates for tax-exempt notes and for taxable notes.

The Fed created the Municipal Liquidity Facility under the authority of Section 13(3) of the Federal Reserve Act. The Treasury, under the authority of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, has made a \$35 billion equity investment in the facility. Read more about the MLF [here](#).

The Fed announced in April that the MLF could lend up to \$500 billion to eligible states, counties, and cities. As of yet, though, it has only extended a single [one-year loan](#) of \$1.25 billion, priced at 3.82%, to the state of Illinois. New Jersey reportedly is also considering requesting a [loan](#) through the facility.

Soon after the Fed launched the facility, a progressive advocacy group [criticized](#) the MLF for unfavorable pricing. According to the group's analysis, before the reduction in pricing, 97% of eligible cities, counties, and states could find better funding on the market. A [letter](#) signed by 53 progressive members of congress similarly criticized the facility for being "functionally unusable." In the Third Report of the Congressional Oversight Committee, the Chair of the Fed Jay Powell and Treasury Secretary Steven Mnuchin responded to such criticism by emphasizing that they had intended the MLF to be only a backstop for municipalities that had trouble getting funded on the municipal market. They also cited a Federal Reserve [study](#) showing that the market for municipal securities has recovered since March.

The new pricing for tax-exempt notes is summarized in the table below. Interest rates are calculated by adding the comparable maturity overnight indexed swap (OIS) rate to the spread in the table below, based on the debt issuer's credit rating. For most high-rated eligible issuers, the new pricing remains uncompetitive with market rates, so utilization of the facility will likely [remain low](#). New York's Metropolitan Transportation Authority said it [may tap the Fed](#) for half a billion in three-year notes, if pricing beats Wall Street.

Table 1. MLF Spread Table

Credit rating	Spread (bps):
AAA/Aaa	100
AA+/Aa1	120

AA/Aa2	125
AA-/Aa3	140
A+/A1	190
A/A2	200
A-/A3	215
BBB+/Baa1	275
BBB/Baa2	290
BBB-/Baa3	330
Below Investment Grade	540

[Source.](#)

The other change the Fed announced is a minor revision to the rates for taxable eligible notes. Previously, if notes were subject to federal income tax, pricing would be calculated by adding the comparable maturity OIS rate to the spread and dividing by 0.65; now the sum will be divided by 0.7. This improves the interest rate for taxable eligible notes.

This announcement comes as direct aid to state and local governments is unlikely to pass Congress until September. Negotiations over the next round of fiscal spending have [frozen](#) in the Senate, while the White House has stepped in with [four executive orders](#) aimed at continuing expanded unemployment benefits and decreasing payroll taxes. The executive orders did not include funding for state and local governments, who a think tank estimates will face [budget shortfalls](#) of \$555 billion over the next two years.

The Fed says that the pricing will “provide an effective backstop to assist U.S. states and local governments as they weather the pandemic.”

Macroprudential Policy

Central banks do not just support the economy using their ability to set interest rates and provide lender-of-last-resort financing. They, and their financial supervisory colleagues, also have a set of tools to keep financial markets and institutions from running too hot or too cold. These are known as macroprudential policies. With these policies, governments might allow financial institutions to do things like use their capital buffers, allow payment standstills on loans, or use their liquidity buffers. Authorities typically use macroprudential policies to complement fiscal policy and monetary policy.

Analysis

Countries Implement Broad Forbearance Programs for Small Businesses, Sometimes with Taxpayer Support

By Greg Feldberg and Alexander Nye with research support from Kaleb Nygaard

Original post [here](#).

The government-mandated lockdowns in many countries responding to the coronavirus pandemic have threatened the financial health of small businesses, who typically have sufficient cash on hand to cover just [one month](#) of fixed cash-flow needs. Banks, utilities, landlords, and other creditors responded early with temporary payment holidays and other forbearance efforts, often at the urging of regulators. Creditors can grant limited forbearance to assist debtors in normal times. As the lockdown continues, however, private-sector creditors won't be able to afford forbearance alone. To avoid widespread nonpayment from sparking a systemic financial crisis, governments are turning to taxpayers to help small businesses meet their fixed-cost obligations.

When designing a loan forbearance program for small and medium-sized enterprises (SMEs), policymakers consider:

1. Eligible institutions/obligations – Which creditors should offer forbearance, for which types of obligations?
2. Borrower eligibility – What borrowers will be eligible to participate?
3. Implementation – How will the program be implemented?
4. Duration – How long will the program last?
5. Support – Will the taxpayers foot the bill, and if so, how?

Eligible institutions/obligations

In a few cases, government programs have covered all types of fixed-cost obligations that distressed companies face. [Denmark](#) plans to directly pay 25% to 100% of the reported fixed costs for SMEs whose revenues fall by more than 25% during the coronavirus pandemic. More commonly, programs have targeted specific types of obligations to specific types of creditors. SMEs can have fixed-payment obligations to entities in the public sector, financial private sector, and nonfinancial sector.

Public-sector payment obligations can include government-owned utilities and other services, government-sponsored entities, and, of course, taxes. It may be relatively easy for a government to waive such payments for a short period. On March 18, for example, [Dubai and Abu](#)

[Dhabi](#) reduced 15 different customs fees, taxes, and other costs for businesses, including an across-the-board 10% reduction in water and electricity bills owed to the government-run utility.

Banks typically have procedures for working with borrowers who are experiencing temporary financial stress. In this crisis, some of the largest banks voluntarily created [forbearance programs](#). A broad, government-initiated moratorium on loan payments to banks and other financial institutions could effectively protect small businesses during a crisis. Several governments [encouraged bank forbearance on loan principal or interest payments](#). But U.S. banks, though well-capitalized compared to the beginning of the last global financial crisis, may not be able to bear the cost of an unprecedented number of nonperforming loans for very long. And nonbank financial institutions are typically less prepared than banks for a surge in nonpayment by SME debtors.

SMEs also may have obligations to creditors in the nonfinancial private sector, such as landlords, employees, and suppliers. Government programs to help SMEs with these costs are rare, to date. Denmark's direct financial support program pays a proportion of eligible SMEs' bills regardless of the type of creditor. [France's](#) current program allows SMEs to apply to defer rent and utility payments. Programs that target employees, by using government funds to prop up SME payrolls, can become difficult to distinguish from unemployment insurance. In the context of COVID-19, they have become more common. Three examples are the UK's [Coronavirus Job Retention Scheme](#), the Republic of Ireland's [COVID-19 Wage Subsidy Scheme](#), and Germany's [Emergency Aid Grants](#).

Borrower eligibility

While past forbearance programs typically responded to natural disasters just in [affected regions](#), most programs this year have been national, reflecting the nature of the current crisis. Eligibility can be extended very broadly or limited to borrowers meeting specific criteria.

On March 19, Korea's Financial Services Commission (FSC) announced a fixed-cost forbearance program that appears to offer blanket eligibility. Under the [program](#), SMEs can access a six-month minimum extension on existing loans and guarantees from both banks and nonbanks. Blanket eligibility may be most efficient in a pervasive crisis such as the current one, in which the sheer number of affected SMEs is so large as to challenge systematic efforts to distinguish the truly needy. However, blanket eligibility, as seen in [some of India's farm loan waiver programs](#), can also be susceptible to abuse due to the [moral hazard](#).

Recent small-business programs in Europe have tended to limit eligibility to borrowers that meet certain criteria. Greece's [loan principal-repayment holiday](#) restricts participation to businesses in sectors directly impacted by the pandemic that were [current on their obligations when the program was announced](#). [France](#) and [Denmark](#) link eligibility to lost revenues. Denmark's program determines how much support to offer a given business by looking at that business's expected decline in revenues. France conditions eligibility for its [rent forbearance program](#) on a

company having less than €1 million in turnover and having either been ordered closed by the government or losing over 70% of turnover in March 2020 compared to March 2019.

[Parts of Denmark's program are only available](#) to companies with 10 or fewer employees. But strictly using a business's number of employees to determine eligibility may encourage some SMEs to lay off employees before joining the program. Perhaps for this reason, Denmark's program disqualifies businesses that fire workers before joining the scheme.

Implementing restrictive eligibility requirements can impose a significant administrative burden on government resources, which can limit the speed and effectiveness of a program. European governments can track sales that are subject to the value-added tax, which can help businesses illustrate their need, as in the case of [Denmark's program](#). A sufficiently detailed quarterly income tax system could provide similar information.

How does a government implement such a program?

Creditors sometimes [voluntarily decide to grant forbearance](#), even in normal times. This happens when the creditor believes a borrower is viable as a going concern, but can't meet payments due to temporary difficulties. In response to the COVID-19 pandemic, many individual creditors and [creditor associations](#) like the Thai Bankers' Association have announced forbearance programs for SMEs unilaterally.

Government [supervisory authorities \(like the ECB\)](#) can incentivize forbearance. As noted, several authorities have advised banks not to be too quick to mark a loan as nonperforming when the borrower has been affected by the COVID-19 crisis. This can free bank capital for lending in the short run. In the long run, though, it can drain bank capital. Supervisors are faced with a [dilemma](#): "On one hand, protecting the financial system by forcing banks to correct weaknesses in how they assess and manage their loans[;] ...on the other hand, causing a credit crunch for the real economy by being too strict with banks." Credit crunches can be especially dangerous for forbearance programs that do not protect the credit ratings of participating borrowers. Participants in those programs will already have a more difficult time accessing credit with a poor credit rating, and a credit crunch would make this problem worse.

Authorities can outright require forbearance. In some cases, governments pass [laws](#) that require creditors to restructure SMEs loans. The Japanese government passed [such a law](#) during the GFC. The law stipulated: "When debtors asked financial institutions to ease repayment conditions (e.g., extend repayment periods or bring down interest rates), the institution would have an obligation to meet such needs as best as possible." Finance ministries are often responsible for implementing these programs. This was the case with [Italy's year-long debt moratorium](#) during the GFC and [Germany's current program](#). Moratoria are sometimes accompanied by subsidies to the financial institutions for the cost of deferring payments ([Saudi Arabia](#)) or providing some of the funds directly to SMEs ([Denmark](#)).

A government can order related organizations, like state-owned development banks or agencies, to offer forbearance on their loans to businesses. After the natural disasters in 2006 and 2011

the [SME Development Bank of Thailand](#) provided six-month debt moratoria to SMEs in the affected regions.

Governments can also negotiate forbearance programs with creditor associations for institutions like [banks](#) and non-banks, then bind them to the program. The Central Bank of Ireland [announced](#) one such agreement in response to the COVID-19 pandemic. [France](#) and Belgium have government credit mediation programs that individual creditors can use, [put in place](#) in 2008 during the Global Financial Crisis. The credit mediator helps distressed businesses negotiate with banks, credit insurers, supplier credit companies, and other financial institutions.

Duration

Typically, payment forbearance programs operate for a short and specified time period tied to the nature of the crisis. In cases of natural disasters, like destructive floods in [Thailand](#), these programs can last for just a few months, as affected regions return to normalcy. These programs rarely extend beyond six months.

Financial crises are different. Governments that introduce programs as only temporary can end up extending them under political pressure or simply because the economic stress has continued longer than expected. During the GFC, the Italian government, in collaboration with a creditor association, imposed a [loan forbearance program for SMEs](#) in August 2009.

The [program](#) accepted 200,000 applications and rolled over €13 billion in SME debt by December 2010. But as the economic situation did not improve, [Italy continued to extend and modify the program through at least 2014](#). Japan extended its 2009 SME Financing Facilitation Act for several years. Some critics say the government's ongoing forbearance helped perpetuate [Japan's problem of "zombie" SMEs](#).

Taxpayer Support

Some programs directly subsidize the costs of SMEs. A government can seek to limit these costs by only covering losses the SME may suffer due to COVID-19. [Denmark's](#) programs do this. But predicting these impacts is extremely difficult. Governments might make a program less generous if they find an SME's actual performance is better than expected.

[Northern Ireland](#) offered some amount of taxpayer support as well, although it narrowed eligibility to three sectors especially affected by COVID-19: hospitality, tourism and retail. [Germany](#) and the US have tried a more blanket approach to providing taxpayers support. In Germany's program, employers with up to five employees receive a grant of €9,000 and employers with up to fifteen employees receive a grant of €15,000. The [CARES Act](#), as passed by the US Senate on March 25, provides \$10 billion for Small Business Administration (SBA) emergency grants of up to \$10,000 to provide immediate relief for small business operating costs and appropriates \$17 billion to cover six months of payments for current SBA borrowers.

Other programs, like [Saudi Arabia's](#) recent program and India's [farm loan waiver system](#), provide support to SMEs indirectly. They subsidize banks and other creditors for the losses they

bear in supporting SMEs. Programs that put losses on banks and other creditors can be costly to financial stability in the long run. Taxpayers may end up footing the bill if the financial and economic distress caused by the coronavirus response is protracted and affects confidence in bank solvency.

Authorities Restrict Short Sales during COVID-19 Crisis

By Greg Feldberg and Adam Kulam

The COVID-19 pandemic has created extraordinary uncertainty; it is too early to predict how bad it will get or how it will impact the world economy. This uncertainty has substantially elevated the volatility in bond and equity markets. In response, several countries have placed restrictions on short sales. In short sales, an investor sells a security she doesn't own, hoping to profit when its price falls. Economists generally find that the benefits of short selling to market efficiency and liquidity outweigh the potential costs, most of the time. But authorities argue that short sales amidst extreme uncertainty can excessively deflate market prices and lead to further market contagion in a crisis. We discuss: (i) short-sale restrictions during the COVID-19 crisis, (ii) similar actions in earlier crises, and (iii) key design decisions that authorities face in restricting short sales.

Note that, while we focus here on short-sales bans, they are not the only tools authorities have used to address market volatility in the current crisis. Authorities have expanded the mandatory disclosure of net-short positions ([Europe](#)), introduced new circuit breakers to halt trading as prices fell ([Thailand](#)), and even briefly banned all trading for a few days ([Philippines](#)).

2020 Actions

In the COVID-19 crisis, several European countries, such as [Spain](#) and [Italy](#); [South Korea](#); and three Gulf States have [banned short-selling](#). The [Stock Exchange of Thailand \(SET\)](#) and [Securities and Exchange Commission of Pakistan \(SECP\)](#) imposed uptick rules, which only allow short sales to occur just after a stock price has risen. [Turkey's Capital Markets Board](#) and [Indonesian authorities](#) adjusted domestic circuit-breaker rules, which temporarily halt trading on an exchange if a specified index significantly declines in price. The [Johannesburg Stock Exchange \(JSE\) Settlement Authority](#) raised settlement obligations, and pledged to force short-sellers to borrow securities in the open market if it appeared that their short-sales would fail.

Actions in Earlier Crises

For as long as stocks have traded, authorities have blamed short-sellers for market stress and periodically banned their activities ([McGavin \(2010\)](#), p. 207). Bans can be instituted either by a [financial regulator](#) or a self-regulating organization (SRO) such as a stock exchange.

During the Global Financial Crisis, the United States' Securities and Exchange Commission (SEC), in concert with the United Kingdom's Financial Services Authority (FSA), banned short-selling of nearly 1,000 financial stocks in 2008. At the same time, the SEC introduced a temporary requirement that all money managers publicly report any short sales. Amidst the Eurozone debt crisis, several countries banned short selling [for three weeks](#) in August 2011. When China's stock market suffered from turbulence in 2015, the Securities Regulatory

Commission imposed a [new rule](#) requiring short sellers to wait one day before covering their short positions and paying back loans used to buy shares.

Studies of historical uses of short-sales bans haven't found them to be very successful ([Battalio et al. \(2012\)](#), p. 4). Scholars argue that short-sales elling bans decrease market efficiency, impede price discovery, and bring unintended negative effects, such as price inflation ([Hendershott et al. \(2013\)](#), p. 6). One study found that the US ban in 2008 did succeed at significantly reducing shorting activity. But the ban worsened market quality, as measured by quoted and effective spreads, price impacts, and realized spreads ([Boehmer et al. \(2013\)](#), p. 1398, 1399).

Key Design Decisions

Regulators face the following key design decisions in restricting short sales:

- Communicated Purpose – How will the authorities explain the ban?
- Nature of the Ban – Will the ban cover all shorts, or just uncovered or “naked” shorts? Will the authority use other tools, like an “uptick” rule?
- Scope – Will the ban cover shorts on all stocks, or selected companies or sectors?
- Exemptions – Will some market participants, particularly market-makers, be exempt from the ban?
- Timeframe – Will the ban be for a short term, longer term, or indefinite?
- Coordination of Measures – Will the ban apply to other types of bearish activity, and will other countries cooperate?

Communicated Purpose

Authorities' documents and press releases suggest an attempt to curb price decline, control volatility, or bolster market confidence. Authorities typically express the concern that excessive short-selling might misrepresent a company's true value and eventually damage the fundamentals of the underlying company – especially for companies whose counterparties treat the stock price as a proxy for long-term financial health. So they use short-sales bans to avoid a [“crisis of confidence,”](#) as the SEC said in 2008.

Short-sales bans in 2008 focused on shares of financial institutions “whose health may have an impact on financial stability” ([IOSCO, 2008](#)). Regulators in that crisis were concerned about financial contagion, as counterparties took falling share prices to indicate weakness in these companies. “In the context of a credit crisis, where some entities face liquidity challenges but are otherwise solvent, a decrease in their share price induced by short-selling may lead to further credit tightening for these entities, possibly resulting in bankruptcy” ([IOSCO, 2008](#)).

The SEC's September 18, 2008 prohibition of short sales was the first of several around the world. South Korea's Financial Supervisory Service (FSS) banned short sales of all South Korean stocks on September 30, 2008, citing “malignant rumors” in its financial markets ([Bohl et al.](#)

(2014), p. 265). Germany, France, Australia, and the United Kingdom followed similar policy agendas soon after.

Nature of the Ban

In some cases, authorities have banned all short sales. In other cases, they have banned only “naked” or uncovered short sales. In a [“naked” short sale](#), the short seller neither borrows nor arranges to borrow the underlying security by the settlement date. This introduces a settlement risk that the seller will fail to deliver the security when it is due. If a trade fails, the short seller will not receive any cash, and the buyer will not receive any security. These “failures to deliver” (FTDs) are a key measure of naked short-selling, and scholars suggest that naked short sales result in higher levels of volatility than covered short sales ([McGavin \(2010\)](#), pp. 204-6).

Authorities also have to make judgments about how a short sale can be covered ([Howell \(2016\)](#), pp. 15-6). During the “close-out” portion of the short sale, the short seller “covers” their position by re-obtaining the security and returning it to the original lender by the date of settlement. Regulators can set the degree of ownership that satisfies minimum “coverage” thresholds. Authorities may require a short seller to wholly possess the security, to obtain a legal contract entitling the short seller absolute ownership of the security, or use a “locate” requirement, which is more or less a promise from the short seller that they reasonably expect to obtain the security from a third party before the settlement date. There is [some evidence](#) that stringent covering requirements can increase the ratio of informed to uninformed short-sellers.

Another way to regulate short-selling is through [uptick rules](#), which permit traders to short-sell securities only at prices above the current market price. Simply put, short-sales can’t go through until the security’s price rises. Authorities aim to limit the contribution of short-selling to [market abuse or bear raids](#), which may result in steep and sudden price declines ([McGavin \(2010\)](#), p. 214). Authorities also rely on uptick rules to communicate that there are active buyers in the market ([Howell \(2016\)](#), p. 34).

Uptick regimes have re-entered both the [public discussion](#) and the active macroprudential toolkit in the current crisis. The [Stock Exchange of Thailand \(SET\)](#) employed a temporary, three-month uptick rule “to cope with high uncertainties” and volatility related to the COVID-19 outbreak. The [Securities and Exchange Commission of Pakistan \(SECP\)](#) imposed an uptick rule on 36 shares listed on its futures market “in the wake of COVID-19 and its unprecedented effect on global stock markets.”

Also, rather than restrict short sales, authorities have on some occasions sought to limit the possible negative impacts by requiring more disclosure. The UK FSA argued that disclosure-induced transparency would prevent market manipulation and ward off speculation and market overreaction ([McGavin \(2010\)](#), p. 237).

Scope

A short-selling ban can span groups of securities, indexes, or country-wide stock markets and exchanges. In 2008, the SEC first banned short sales on the stocks of the two mortgage government-sponsored enterprises in July. It later extended the ban to 799 financial companies' stocks. In announcing the expanded list, the US SEC noted that it had focused on financial institutions because of "the essential link between their stock price and confidence in the institution."

Of course, short sales are not the only way for investors to take bearish positions on equities. Some authorities have more broadly prohibited all net-short positions, thereby extending the ban to derivative securities and other "[bearish operations](#)" that profit from the problematic securities' price-decline. Several European countries such as [Spain](#) and [Italy](#) recently banned net-short positions, but exempted credit default swaps, corporate debt instruments, and balanced hedging activity.

One study of the 2008 short-sales bans in the US noted that options markets continued to function. The authors were able to [show](#) that banning short-selling slowed the flow of negative information into stock prices, relative to the options markets that weren't covered.

Participant Exemptions

Rather than ban all short-selling, authorities may prohibit or exempt specific market participants. One academic paper classified short-sellers as algorithmic traders, market-makers, or long-term profiteers ([Battalio et al. \(2012\)](#), p. 2). [Market makers](#) are participants that facilitate the purchase and sale of stocks "on a regular and continuous basis at a publicly quoted price." Expansive prohibitions have made it difficult for specialists such as market makers to provide liquidity by short-selling ([Jones \(2012\)](#), p. 27). When the NYSE banned all market participants from short-selling in 1931, it included market makers and "provoked something akin to a short squeeze" and accidentally permitted short-term buyers to ratchet up prices ([Boehmer et al. \(2013\)](#), p. 1367). In 2008, the SEC included algorithmic traders in its ban; some saw this as a mistake, because those traders could not act as informal market makers while the ban was in force. With less competition, the exempted formal market makers collected greater rents from those demanding liquidity. In most recent cases, authorities have [exempted market makers](#).

Timeframe

Temporary short-selling and net-short bans might function as extreme macroprudential tools if they could limit panic selling. During the Global Financial Crisis, "Temporary short selling restrictions were imposed as a means to try and restore financial stability: the constraints could be swiftly introduced; they were easy to sell to the public; and they demonstrated the regulators were taking action to try and control the situation" ([Howell \(2016\)](#), p. 10). Still, temporary bans can cause uncertainty because market participants do not know what is included in the ban ([Howell \(2016\)](#), p. 28-9). Recently, international regulators have clarified the length and scope

of their short-selling restrictions by publishing answers to frequently asked questions (FAQs) on their websites.

Coordination of Measures

In some instances, authorities have coordinated short-sales restrictions across jurisdictions. On September 18, 2008, the Securities and Exchange Commission (SEC) and the Financial Services Authority (FSA) consulted one another before prohibiting the short-sale of domestic financial stocks ([Boehmer et al. \(2013\)](#), p. 1366-7). After the GFC, the European Securities and Markets Authority (ESMA) was established to promote supervisory convergence across the European Union. Recently, the ESMA ensured that the short-sales bans of foreign securities were consistent across markets in multiple nations ([France](#), [Belgium](#), [Greece](#), and [Italy](#)). Regulators coordinate to make their policies transparent and harmonize them with the policies of other regulators. In another recent example, ESMA strengthened the EU's short-sale disclosure requirements, and the UK's Financial Conduct Authority (FCA) imposed [a reciprocal rule](#) to avoid the migration of share-specific short-selling from one market to another. Coordination can be essential to prevent regulatory arbitrage or exploitation by short-sellers ([McGavin \(2010\)](#), p. 238).

Easing Liquidity Regulations to Counter COVID-19

By Priya Sankar, Alexander Nye, and Greg Feldberg

Original post [here](#).

Many countries are easing liquidity regulations to help banks get cash to their customers and to prevent liquidity shortages from spreading across financial markets. Countries are addressing liquidity shortages using two main tools: the liquidity coverage ratio (LCR), which most developed countries implemented in recent years as part of the [Basel III](#) agreements, and the more traditional reserve requirement ratio.

LCR rules require banks to hold high-quality liquid assets (HQLA) sufficient to meet their needs through a 30-day liquidity stress scenario. Most countries that have an LCR rule have now eased its enforcement, encouraged by the [Basel Committee](#) itself in March. Other countries have lowered their reserve requirements, the amount of cash relative to liabilities that banks must hold on reserve with their central bank. A few countries have taken other measures, such as easing rules on foreign exchange liquidity. All of these tools are countercyclical and macroprudential, in that regulators are now using them to spur broad-based lending during a difficult crisis.

This blog discusses options for easing liquidity regulations:

1. Which tool to use?
2. How long will the change last?
3. Will the government provide a backstop?
4. Are there targets or conditions for use?

Which tool to use?

Reserve requirements

Central banks have used reserve requirements to pursue monetary, macroprudential, and other policy goals for a very long time. Since central banks generally pay less than other cash-like instruments, reserves are costly for banks to hold. By raising the reserve ratio, a central bank can impose a tax on banks, tightening credit; by lowering it, the central bank can reduce that tax, incentivizing banks to lend. From the 1930s until the 1990s, the U.S. [Federal Reserve](#) used the reserve ratio frequently as a countercyclical tool, typically in conjunction with its monetary policy.

But reserve requirements lost favor in the U.S. and other developed countries amidst the deregulatory trend in the 1990s and 2000s. In recent years, it is [primarily emerging economies](#) that have used reserve requirements as a countercyclical policy tool. Since 2004, no advanced economy has actively managed its reserve ratio [countercyclically](#); 90% of developing

countries with reserve requirements have done so, including during the 2007-09 global financial crisis.

This trend has held in the current crisis. According to the YPFS Financial-Intervention [Tracker](#), 22 countries, mostly developing countries, have lowered their reserve ratios or otherwise eased their reserve policies this year. The [Democratic Republic of the Congo](#) and [Iceland](#) have cut their ratios to zero, from 2% and 1%, respectively. Others have made larger cuts. The [United Arab Emirates](#) (UAE) cut its reserve ratio from 14% to 7%; [Croatia](#) cut its reserve ratio from 12% to 9%.

Some countries made multiple cuts. [Brazil](#) cut its reserve ratio from 31% to 25% and later to 17%. The [Philippines](#) reduced reserve requirements from 14% to 12% and [signaled](#) up to another 2% of cuts. China cut its reserve ratios three times since the beginning of 2020.

Liquidity Coverage Ratio (LCR)

Global regulators developed the LCR after witnessing extraordinary, systemic wholesale funding runs in the global financial crisis. Its purpose is both microprudential and macroprudential, although some viewed it more as a microprudential tool before the current crisis. By requiring every bank to hold sufficient liquidity to make it through 30 days of stress, the LCR reduces the potential for asset fire sales and wholesale funding runs to spread across banks.

While the decision to ease the LCR is up to the [discretion](#) of supervisors [or financial stability committees](#), the [wording](#) in the 2013 Basel agreement on the LCR strongly suggests supervisors should do so in a systemic crisis. The concern is that the actions banks may take to maintain their LCRs above 100% could lead to the very financial contagion supervisors seek to avoid. “[I]n a situation of sufficiently severe system-wide stress, effects on the entire financial system should be considered.”

The members of the European Union and more than a dozen other countries have eased their LCR policies in response to the COVID-19 crisis. In explaining its policy easing on April 3, the [European Central Bank](#) (ECB) noted: “It is key that banks make use of the buffer under stress, even if that means falling substantially below the minimum 100% level, in order to ensure liquidity in the system and avoid contagion effects and chain reactions that might trigger liquidity problems in other institutions.”

The [UAE](#), [South Africa](#), and [Korea](#) have set new targets of 70%, 80%, and 85%, respectively. The U.S., ECB, and most others that eased their LCRs did not specify a new target below 100%. Some experts have [argued](#) that this lack of specificity will limit the usefulness of easing the LCR in these countries.

A few countries with LCRs, including Australia and China, have not eased them during the COVID-19 crisis. China has aggressively eased its reserve requirements. Australia is unusual in that it allows banks to use a [committed liquidity facility](#) from the central bank to stand in for a substantial portion of high quality liquid assets in calculating their LCRs.

Net Stable Funding Ratio (NSFR)

Global regulators also included the net stable funding ratio (NSFR) in [Basel III](#). The NSFR requires banks to maintain sufficient stable funding to meet maturing liabilities and other needs for one year. This helps to prevent banks relying on wholesale funding during booms and encourages them to better assess liquidity risk on and off their balance sheets.

A handful of countries have adjusted their NSFRs or related policies during the COVID-19 crisis. [Singapore](#) has lowered its NSFR for loans to households and businesses maturing in the next six months from 50% to 25% until September 2021. [India](#) has delayed implementation from April to October. Malaysia is sticking to its July implementation date, but will require an NSFR of 80% rather than 100%. [Australia](#) has allowed banks to include their initial allowance under the central bank's [Term Funding Facility](#) in their calculation of the NSFR.

Foreign Exchange Measures

There is no lender of last resort to help borrowers whose debts are denominated in foreign currencies. During a crisis like the current one, liquidity shortages can propagate across borders, as happened in the Asian financial crisis of 1997-98. Since then, several emerging-market countries have foreign currency reserve requirements or liquidity coverage ratios to address currency mismatches. A few countries raised those requirements prior to the global financial crisis and later eased them. This year, some countries have eased these rules. [South Korea](#) lowered its foreign exchange LCR from 80% to 70% for banks until May. [Indonesia](#) expanded the range of transactions foreign investors could use to hedge their holdings of rupiah.

Measures changing the assets that can be counted for reserve ratios, LCRs, or NSFRs

A few countries changed their definitions of HQLA for the LCR calculation or of assets acceptable as reserves for determining reserve requirements. For example, [Brazil's](#) central bank increased the amount of central bank reserves that financial institutions can count in calculating their LCRs. This had a similar effect as lowering the LCR. Similarly, [Iceland's](#) 1% reserve ratio reduction effectively boosted the HQLAs, and thus the LCRs, for [some banks](#).

The [Dominican Republic](#) revised the rules around its reserve ratio so that financial institutions could count central bank and finance ministry securities for up to 2% of their reserve ratios. This had a similar effect as a reduction in banks' reserve requirements.

In cases where an asset class has become or might become less liquid, [governments](#) might allow those previously liquid assets to count as HQLA for a longer period of time. Canada activated its [hardship exemption](#) for the LCR. [This allows](#) institutions to permit early outflows from retail and small business term deposits without imposing a penalty since they are not required to write down these withdrawals as [LCR outflow](#).

How long will the change last?

Policymakers have to think about how long a liquidity easing tool will be in place, but how they choose to communicate the length of a program can be just as important. In 2012, the Bank for International Settlements (BIS) suggested that easing is more likely to be effective if authorities make a credible commitment to maintain loose policies for a “pre-specified period of time, or conditionally until the threat [...] has passed.”

Some countries have been very specific about the duration of their reserve requirement changes. [Chile](#) said its change allowing banks to fulfill the foreign exchange reserve requirement using Chilean pesos, euros, and Japanese yen would end September 8. [India](#) lowered its cash reserve requirement for one year. The [Philippines](#) framed its easing as conditional on “the impact of COVID-19 on domestic liquidity.” Others, like [Turkey](#), [Sri Lanka](#), and the [UAE](#), did not say anything about how long they would maintain relaxed reserve requirements.

Most countries easing their LCRs were though not specific about the duration of the measure. The [ECB](#) only specified that it would “allow banks to operate temporarily below” the LCR. [South Africa](#) said its LCR cut would last “for the duration of the crisis.” An exception was [South Korea](#), which lowered its foreign exchange LCR only through May.

The 2013 Basel [agreement](#) said that supervisors should have a range of tools for dealing with a bank whose LCR drops below the target, depending on factors such as the severity and duration of the decline and whether the problem is idiosyncratic or systemic. At a minimum, a bank should report to the supervisors with an assessment of its liquidity position. “Potential measures to restore liquidity levels should be discussed, and should be executed over a period of time considered appropriate to prevent additional stress on the bank and on the financial system as a whole.”

The U.S. took such a flexible approach. The central bank [said](#) that a bank that falls below the LCR “must submit a plan to its supervisor. But there is no requirement to rebuild high-quality liquid assets within a specific time period.” The [Bank of England](#) made a similar statement.

Will the government provide a backstop?

The BIS said authorities should coordinate the easing of liquidity buffers with central bank liquidity support. The availability of central bank support can help reassure markets and make financial institutions more likely to actually use the liquidity buffers they have built above the required amounts. In describing first-quarter results to analysts, the CEO of [JPMorganChase](#) said the company’s “liquidity position remains strong” even as it prepares to use internal buffers, reflecting that JPMC has “significant liquidity resources beyond HQLA including the discount window if need be.”

Governments frequently coordinate reserve requirements changes with other liquidity-easing tools. [Kenya](#) cut its cash reserve ratio (CRR) from 5.25% to 4.25% in the same announcement in which it lowered its central bank rate from 8.25% to 7.25%. India coordinated a cut in its CRR with a targeted long term repo operations, an expanded marginal standing facility, and several regulatory changes. Governments might structure programs so that they support one-

another. [Australia](#) allowed financial institutions to count some of their assistance from the central bank's Term Funding Facility toward their LCR.

Policymakers modifying their LCR or NSFR in response to COVID-19 have nearly always chosen to announce the measures at the same time as other policy initiatives. [Singapore](#) announced its NSFR changes and its policy relaxing capital buffers at the same time. The [UK](#) said banks could use their countercyclical capital buffers and liquidity buffers in the same announcement, which also included monetary policy easing and a funding scheme for small businesses.

Are there targets or conditions for use?

Several countries have sought to tie liquidity easing with lending goals during the COVID-19 crisis. The [U.S.](#) said it encouraged banks “to use their capital and liquidity buffers to lend and undertake other supportive actions in a safe and sound manner.” Other countries made similar statements.

Reserve requirements are easier to use for such targeted policies. Authorities can set higher or lower requirements on various types of liability for policy reasons. They can also guide banks to a particular type of lending by lowering the reserve “tax” if banks meet lending targets.

China is a good example. On [March 13](#) (following up with more information on [March 17](#)), China said it would cut its required reserve ratios by 50-100 basis points for large and medium-sized banks that met government criteria for financing small companies. It cut the separate reserve ratio for larger joint-stock banks by 100 basis points, noting: “The funds released are required to be used to issue inclusive finance loans, and the interest rates of these loans would drop significantly, thereby increasing credit support for the inclusive financial areas, such as MSEs and private enterprises.” On [April 3](#), the central bank cut the reserve ratio for the country's 4,000 small and medium-sized banks from 7% to 6%. It also reduced the interest it paid on excess reserves from 72 to 35 bps to further incentivize lending.

[Indonesia](#) aimed to help its export-import sector by cutting rupiah reserve requirements (local currency reserve requirements) by 0.50% “for banks financing export-import activity in coordination with the Government.”

COVID-19 Liquidity Measures

Reserve Requirements (RR)

Lowered: [Algeria](#) (10% to 8%), [Aruba](#) (12% to 11%), [Brazil](#) (31% to 25% to 17%), China ([1.0% cut](#) and then a 0.5% cut) [Croatia](#) (12% to 9%), [Democratic Republic of the Congo](#) (2% to 0%), [Iceland](#) (average RR lowered from 1% to 0%) [India](#) (4% to 3%), [Kenya](#) (5.25% to 4.25%), [Malaysia](#) (3% to 2%), [Moldova](#) (41% to 38.5% for Moldovan lei and other nonconvertible currencies), [Philippines](#) (14% to 12% and authorized to lower to 10%), [Peru](#) (5% to 4%), [Poland](#) (3.5% to 0.5%) [Sri Lanka](#) (5% to 4%), [United Arab Emirates](#) (14% to 7%), [United States](#) (eliminated reserve requirements)

Lowered but with no new target specified: [Belize](#)

Change to Policy: [Argentina](#) (lowered for bank-loans to households and SMEs), [Chile](#) (FX reserve requirements can now be fulfilled by euros, Japanese yen, and Chilean pesos, in addition to US dollars) [Indonesia](#) (lowered RR 50bp for firms financing import-export) [Hungary](#) (exempted credit institutions subject to reserve requirements from their domestic counterparties), [Moldova](#) (increased 20% to 21% for freely convertible currencies), [Dominican Republic](#) (Central Bank and Finance Ministry securities can count for up to 2% of the reserve ratio; a portion of this figure must be used to finance MSMEs and households in strategic sectors)

Foreign Exchange: [Indonesia](#) (8% to 4%), [Peru](#) (50% to 9% for instruments with terms of two years or less; additional FX reserve requirements suspended), [Turkey](#) (lowered by 500bp)

Liquidity Coverage Ratio (LCR)

Lowered: [Korea](#) (100% to 85%), [South Africa](#) (100% to 80%), [United Arab Emirates](#) (100% to 70%)

Allowed banks to fall below LCR, but with no new target specified: [Basel Committee](#), [Canada](#), [Croatia](#), [Denmark](#), [European Union](#), [Finland](#), [Germany](#), [Italy](#), [Japan](#), [Lithuania](#), [Malaysia](#), [Malta](#), [Netherlands](#), [Norway](#), [Poland](#), [Portugal](#), [Romania](#), [Russia](#), [Spain](#), [Sweden](#), [United Kingdom](#), [United States](#)

Changes to Policy: [Australia](#) (portion of aid from the Term Funding Facility in the calculation of the LCR), [Brazil](#) (a larger portion of reserves now count as HQLA when calculating the LCR), [Canada](#) (withdrawals by depositors related to a new hardship exemption will not change the treatment of deposits when calculating the LCR), [Chile](#) (decided not to modify the regulatory limit applicable to the LCR), [Denmark](#) (institutions can count the ability to roll-over short term borrowing from the Danish Central Bank in the LCR), [Mexico](#) (any asset that counted as liquid asset for the LCR as of February 28, can be counted toward the LCR for a period of six months and may be extended for a maximum period up to six additional months), [Russia](#) (eased requirements for one method used to calculate an [alternative](#) to the LCR, the irrevocable credit line)

Foreign Exchange: [Republic of Korea](#) (80% to 70%)

Other Liquidity Ratios

Lowered: [Aruba](#) (18% to 15%)

Net Stable Funding Ratio (NSFR)

Lowered: [Singapore](#) (for loans to individuals and businesses 50% to 25%)

Policy Change: [Australia](#) (included the benefit of the Initial Allowance from the Term Funding Facility in the calculation of the Net Stable Funding Ratio)

Countries Ease Bank Capital Buffers

By Priya Sankar and Greg Feldberg

Original post [here](#).

Countries around the world are easing bank capital requirements to help banks absorb losses and to allow them to maintain the flow of credit during the COVID-19 crisis.

Most of these measures involve the [Basel III capital](#) standards that global regulators agreed to implement after the 2007-09 financial crisis. Thanks to Basel III and like measures, banks across the world have substantially more capital than they had heading into that crisis. However, the current crisis threatens to quickly eat into those capital cushions. Banks are already reporting substantial credit losses and growing balance sheets, as they meet existing commitments and extend new loans. Easing capital standards today is a form of macroprudential policy, because regulators' focus is on maintaining the health of the financial system as a whole.

This blog discusses options for easing capital standards:

1. Which buffer to adjust?
2. Constraints on capital distribution – Do countries enforce them when reducing their capital buffers?
3. How long will the change last?
4. Conditions for use of capital – Does the capital need to be used for a particular purpose?
5. Quality of Capital - Any change in the capital usually required to meet a buffer?
6. Changing risk weights - What kind of assets get their risk weights changed?

Which buffer to adjust?

Under Basel III, all banks must hold high-quality capital equal to 4.5% of their risk-weighted assets, plus a 2.5% capital conservation buffer (CCB). The purpose of the CCB is to encourage banks to conserve capital. When the buffer is breached, banks must limit bonuses to managers and distributions to shareholders. Before the current crisis, about a dozen countries had also imposed a countercyclical capital buffer on their banks (CCyB). The CCyB is a buffer under Basel III that countries can build during boom times and draw down during busts to absorb losses and mitigate the increase in risk-weighted assets; they may set it as high as 2.5%. In addition to the CCB and CCyB, many countries also impose additional buffers on systemically important banks.

During the current crisis, most countries that had earlier activated their CCyB have now cut it. But countries without a CCyB have found other ways to ease capital requirements. Several have told banks they can use their CCBs, resulting in automatic consequences for bonuses and

dividends. Others have reduced the surcharge they had imposed on domestic systemically important banks (D-SIBs), their broader systemic risk buffers (SRBs), or other company-specific buffers.

Countercyclical capital buffer (CCyB)

To combat the COVID-19 crisis, close to 20 governments have released, reduced, or delayed planned increases in their countercyclical capital buffers. As regulators had designed it as a countercyclical tool, it is the easiest to deploy in a crisis.

Ten countries have released their entire CCyB, according to [Yale's Financial-Intervention Tracker](#). The size of the decrease determines its impact. [Sweden](#) reduced its buffer the most, from 2.5% to 0%, freeing SEK45 billion (US\$4.5 billion) in capital; that much capital could make roughly \$60 billion available for lending, or more than 10% of Sweden's GDP. Denmark and France had planned to raise their buffers, but instead cut them to zero.

Bulgaria and the Czech Republic left their buffers at zero, canceling planned increases. In the United States, the [Federal Reserve Board](#) is responsible for setting the CCyB, and has maintained it at zero since 2016. Most countries, including [18](#) in Europe, have also kept their CCyBs at zero since 2016.

Capital Conservation Buffer (CCB)

For countries that had not raised their countercyclical capital buffers before the crisis, the capital conservation buffer (CCB) is a common alternative.

Nine authorities, including the [European Central Bank](#), have allowed banks to use their CCB in the current crisis, according to our tracker. Of these, four replaced it with a new, lower target, and five have encouraged banks to use their buffers without specifying a new target. The United Arab Emirates lowered it the most—from 2.5% to 1%. Brazil and Oman cut their buffers in half, from 2.5% to 1.25%. Sri Lanka lowered it more for large banks (to 1.5%) than for others (to 2%).

By international agreement, the CCB is 2.5% of risk-weighted assets, but countries typically allow their banks a few years to build capital to that level. India and Ukraine had been on the way to building their banks' buffers to 2.5%. With COVID-19, they have delayed further implementation. India has said it will hold its CCB at 1.88%, and Ukraine will hold its CCB at 0.63%.

Domestic Systemically Important Bank (D-SIB) Surcharges and Systemic Risk Buffers (SRBs)

Basel III also introduced capital surcharges for systemically important banks. The purpose of these surcharges is to force banks to internalize the costs of their potential failure on the broader financial system. The Financial Stability Board, which is made up of leading national central banks and finance ministries, determines the “global systemically important banks” (G-SIBs). G-

SIBs are subject to a G-SIB capital surcharge, based on international agreement. Regulators have not revised G-SIB surcharges so far in the crisis.

However, prior to this crisis, many countries had introduced capital surcharges for domestic systemically important banks – banks in their jurisdiction that didn’t make the global list, but which they considered important to their own economies. During the COVID crisis, at least a half-dozen countries have lowered those surcharges. For example, [Canada](#) lowered its surcharge on D-SIBs from 2.25% to 1%.

Some countries reduced D-SIB buffers that applied to individual banks. This is the case in the [Netherlands](#), which reduced the systemic buffer of 3% for three of its five systemically important banks to 2.5% for ING, 2% for Rabobank, and 1.5% for ABN Amro. This will free up EUR 8 billion in capital to back more lending. [Hungary](#)’s D-SIB buffers ranged from 0.5% to 2.0% for its largest banks before the crisis; it has cut all of those to zero.

Under Pillar 2 of the Basel capital accords, supervisors also may set company-specific capital requirements on top of those that apply to all banks. The [ECB](#), among others, has advised banks it directly supervises that they may operate temporarily below the level of capital defined by their Pillar 2 guidance.

Some countries also have a systemic risk buffer (SRB) to cover systemic risks that other aspects of the capital requirements don’t cover. Poland – whose systemic risk buffer [applies](#) to all domestic banks – appears to have [eased](#) its SRB the most, from 3% to 0%. [Finland](#) reduced its systemic risk buffer to zero; it had previously set the systemic risk buffer at 1%-3%, depending on the bank. Finland also lowered its D-SIB buffer for one out of three D-SIBs.

Similarly, Australia’s regulator, in 2017, had set benchmark capital targets above minimum regulatory requirements to enable banks to be regarded internationally as “unquestionably strong.” During this crisis, it [said](#) it “would not be concerned if they were not meeting the additional benchmarks announced in 2017 during the period of disruption caused by COVID-19.”

In mid-March, the [US Federal Reserve](#) and Japan’s [Financial Service Agency](#) said they were encouraging banks to use their buffers, without specifying which buffers or to what extent.

Constraints on Capital Distribution

[Basel](#) standards dictate that banks that do not maintain their CCB standard will face automatic constraints on capital distributions, that is, dividends and share buybacks. These policies are enforced when a bank’s capital dips below its “expanded” CCB, which includes the CCyB and systemic risk buffers.

Many countries that eased capital buffers – including Australia, Canada, [Denmark](#), Estonia, Finland, Iceland, Norway, Sweden, and the U.K. – set an expectation that banks should halt or not increase their dividends. The [ECB](#) has suggested that banks use their additional capital to support the economy and not for capital distributions.

Russia demanded that credit institutions “comply with the set limits for the share of profits to be distributed in accordance with the buffers’ size, including dividend payouts and compensations (incentives) to be paid to management.” The [Czech Republic](#) has explicitly required that banks refrain from making dividend payments or anything else that may compromise their resilience.

US regulators have not imposed a freeze on dividends or other shareholder distributions. The eight US-based G-SIBs [voluntarily suspended stock buybacks](#) in the second quarter of 2020. Fed Chair Jerome Powell [said](#) on April 9 that the Fed is watching “to see how things evolve” but does not yet think a dividend freeze is appropriate. Similarly, Japan’s regulators have encouraged banks to use buffers but have also not commented on dividends.

How Long Will the Easing Last?

Most countries have eased their buffers indefinitely, and many that have maintained or reduced their buffers have acknowledged the possibility of further decreases in capital buffer requirements. However, some have established plans for recovery and reestablishment of their capital buffers. Norway does not anticipate increasing their CCyB until at least [2022](#). [Ukraine](#) eased its CCB by no longer requiring banks to adhere to capital buffer guidelines, and plans on rebuilding it to the full 2.5% by 2023. [Malaysia](#) said it “fully expects” banks to restore their buffers “within a reasonable period” after the end of 2020. [Hungary](#), as noted, has reduced its D-SIB buffers to zero, but has outlined plans for increasing them, starting in 2022.

Conditions for Use of Capital

More than 25 countries cited increased support for lending to businesses and households and maintaining financial stability as primary reasons for freeing up capital by reducing capital buffers. In the [words](#) of the Hong Kong Monetary Authority’s chief executive: “Lowering the countercyclical capital buffer at this juncture will allow banks to be more supportive to the domestic economy, in particular those sectors and individuals that are expected to experience additional short-term stress due to the impact arising from the outbreak.”

Some countries, like Belgium and [Estonia](#), said they were releasing their buffers to absorb the impact of greater loan losses that may occur during the expected COVID-19 recession. [France](#), Sweden, [Poland](#), and others cited expanding credit to small businesses as the goal of reducing their CCyBs. Sweden’s central bank head [said](#): “[W]hat we are doing is freeing up significant lending capacity for the banks.”

Quality of Capital

The [European Central Bank](#) said it will allow banks to use lower-quality Additional Tier 1 or Tier 2 capital to meet their core-capital requirements. [Slovenia](#) took that advice. However, we are not aware of other countries, either in Europe or elsewhere, that have pursued this option.

Changing Risk Weights

Risky assets have higher risk weights than safe assets like Treasuries and consequently require a bank to hold higher capital buffers to mitigate potential losses. By reducing the risk weight calculations of certain categories of assets, governments can ease a bank's regulatory capital requirements and support the supply of credit to those assets.

The [Netherlands](#) has postponed the implementation of a floor on the risk-weighting of mortgages; this means there is no minimum risk weight for mortgages, as planned, which would have required holding a higher capital buffer. The [Russian](#) central bank recommended that banks and other credit institutions, when calculating their capital adequacy ratios, disregard adjusting the risk weights of loans to individuals that have been infected with coronavirus. Like the Netherlands, Russia has reduced the add-ons to risk weights for mortgage loans. Russia is also [eliminating](#) risk weights for foreign currency loans until the end of September for companies making pharmaceutical or medical products.

[Kazakhstan](#) has reduced risk weights for loans to small and medium-sized enterprises from 75% to 50%, and for foreign-exchange loans from 200% to 100%, to support lending.

The Federal Reserve changed its supplementary leverage ratio rule to exclude Treasury securities and deposits held at the Federal Reserve banks from the calculation of the leverage ratio for bank holding companies. This temporarily reduces the Tier 1 capital requirements for financial institutions with over \$250 billion of assets by about 2% relative to their 3% minimum. The United States has also recently passed legislation to implement the Paycheck Protection Program, which will support provisioning of partially forgivable loans to SMEs. New loans made under this program will have a zero risk weight.

Similarly, the Japanese central bank and regulator said they would [temporarily revise](#) the leverage ratio to exclude banks' accounts at the Bank of Japan.

Countercyclical Capital Buffer (CCyB)

Released: [Belgium](#) (from 0.5%), [Denmark](#) (1.0%), France (0.25%), [Germany](#) (0.25%), [Iceland](#) (2%), [Ireland](#) (1%), [Lithuania](#) (1%), [Sweden](#) (2.5%), [Switzerland](#) (remains 2% on mortgage exposures), [UK](#) (1%)

Lowered: [Hong Kong](#) (from 2% to 1%), [Norway](#) (2.5% to 1%)

Cancelled planned increase: [Bulgaria](#) (held at 1%), [Czechia](#) (1.75%), France (0.25%)

Set at zero indefinitely: [India](#), [Italy](#), [Russia](#), [Spain](#)

Capital Conservation Buffer (CCB)

Specifically lowered: [Brazil](#) (to 1.25%), [Oman](#) (1.25%), [Sri Lanka](#) (1.5% for large banks, 2% for others), [UAE](#) (1%)

Lowered but with no new target specified: European Central Bank, [Malaysia](#), [Russia](#), [Slovakia](#), [South Africa](#)

Delayed implementation of full buffer: [India](#) (now at 1.88%), [Ukraine](#) (0.63%)

Systemic Risk Buffer (SRB) and Domestic Systemically Important Bank (D-SIB) Surcharge

Lowered: [Australia](#) (various to 0%), [Canada](#) (from 2.25% to 1%), [Estonia](#) (1% to 0%), Denmark (3% to 2% for [Faroe Island exposures](#)), [Finland](#) (range of 1%-3% to 0%), [Hungary](#) (0.5%-2.0% range to 0%), [Netherlands](#) (3% to range of 1.5%-2.5%), [Poland](#) (3% to 0%), [UAE](#) (various to 0%)

Maintained: [United Kingdom](#)

Other capital easing

[Aruba](#) (lowered capital adequacy ratio from 16% to 14%), [US](#) (allowed bank holding companies to exclude Treasuries in calculating the supplementary leverage ratio; lowered leverage ratio for community banks from 9% to 8%), Japan (allowed banks to exclude central bank accounts in calculating the leverage ratio)

Generic statements on use of buffers

[US](#), [Japan](#)

Governments Provide Financial Regulatory Relief

By Aidan Lawson and Greg Feldberg

Original post [here](#).

The COVID-19 crisis has led governments across the world to temporarily ease the operational burden of supervisory and regulatory activities on the financial institutions they regulate. These regulatory relief efforts can be broken down into three major categories:

1. Reducing supervisory activities such as stress tests and bank examinations.
2. Delaying the implementation of new rules or laws.
3. Reducing reporting requirements.

The YPFS Financial-Intervention Tracker shows 85 such regulatory relief measures to date, as summarized in our [Resource Guide](#). As the COVID-19 crisis unfolds, [regulators](#) have pledged to continue to find new ways to help financial companies focus on their COVID-19 response in a safe and sound manner.

Reducing supervisory activities

In many cases, supervisors have reduced the scope of their annual stress tests and other supervisory activities.

The U.S. Federal Reserve [announced](#) on March 24 its intent to significantly scale back its annual examination activities. The Fed will not conduct examinations on-site at the banks it supervises “until normal operations are resumed at the bank and Reserve Banks.” Instead, it will focus on off-site monitoring. “Monitoring efforts will concentrate on understanding the challenges and risks that the current environment presents for customers, staff, for firm operations and financial condition, and for the largest firms, the risks to financial stability.”

The Fed has deferred “a significant portion” of examinations for institutions with greater than \$100 billion in total consolidated assets. However, the Fed did not suspend its annual stress test exercise, conducted only by the largest bank holding companies (see [here](#), pp. 2). It has ceased all regular exam activity for smaller institutions, “except where the examination work is critical to safety and soundness or consumer protection, or is required to address an urgent or immediate need” (see [here](#)). Banks that are not highly rated, or have existing liquidity, asset quality, consumer protection, or miscellaneous issues will continue to receive regular examinations. The Fed also said that banks will have an additional 90 days to remediate existing supervisory findings, unless otherwise specified.

Many countries similarly curtailed regular supervisory activities. For example, the [Central Bank of Hungary](#) (MNB) postponed on-site inspections unless absolutely necessary and said it would not use its supervisory powers if banks breached their Pillar II capital buffers. [South](#)

[Korea](#), [Egypt](#), and others have suspended ongoing investigations during the crisis. [Romania](#) postponed the deadline for collecting contributions to its [Bank Resolution Fund](#) for three months, with a possible extension of up to six.

The [Bank of England](#) cancelled its 2020 stress tests, cut back on in-person supervisory visits, and postponed the publication of its 2019 biennial exploratory scenario on liquidity buffers and facilities to “alleviate burdens on core treasury staff at banks.”

The [European Banking Authority](#) postponed its Europe-wide stress test exercise to 2021 to “allow banks to focus on and ensure continuity of their core operations, including support for their customers.” In place of the stress test, the EBA will carry out an additional transparency exercise to update information about banks to market participants. The ECB also published [guidance](#) indicating that affiliate supervisors would be postponing on-site inspections, certain compliance measures, and reviews of internal models for six months.

While the [Bank of Russia](#) did not cancel its stress tests, it advised non-governmental pension funds to use a scenario as of September 30, 2019, rather than a more recent one. The [National Bank of Ukraine](#) reduced the number of scenarios it required banks to submit as part of their annual stress testing, but added COVID-19 risk assessments to those scenarios.

[The Financial Action Task Force \(FATF\)](#), which acts as an international standard-setter for illicit financing, money laundering and financing of terrorist groups, simplified due diligence and emphasized flexibility in using their risk-based approach in combating these illegal activities (see [here](#)).

Delays in Implementing New Laws and Rules

Many countries have also deferred the effective dates of recently passed regulation or even suspended ongoing discussions about potential regulatory improvements.

The [European Central Bank](#) said it would consider “extending deadlines for certain non-critical supervisory measures and data requests.” The Bank for International Settlements (BIS) pushed back for one year the [implementation](#) of the final phases of its [framework](#) for margin requirements for non-centrally cleared derivatives. These requirements were put in place to reduce systemic risk and promote central clearing by imposing higher costs on market participants holding non-standard derivatives, which make up a sizable portion of the market (see [here](#), pp. 2 – 4). The effective implementation date is now September 1, 2021, for entities with non-centrally cleared derivatives totaling more than €50 billion outstanding, and a year later for smaller market participants (see [here](#)).

The Fed postponed for six months the implementation of policies regarding the [provision of intraday credit](#), as well as its [revised control framework](#). The changes to the intraday credit provision would modify how the Fed evaluated net debit caps, which are the maximum amounts of overdrafts institutions could incur in their Federal Reserve accounts (see [here](#), sec. 2). The revised control framework “simplifies and increases the transparency of [the Board’s] rules for

determining when one company controls another company,” so that if a company has control over any banking organization, it would generally be subject to Fed regulations (see [here](#)).

[New Zealand](#) has deferred several new initiatives and programs. These include reviews of existing supervisory and stress testing policies and increases in capital requirements (see [here](#)). [Russia](#) is delaying certain compliance requirements for non-governmental funds that will be participating in stress tests until January 2021, and [Canada](#) has suspended “all consultations on regulatory matters,” including the publication of its new benchmark rate for qualifying uninsured mortgages. [Australia](#) has “suspended the majority of its planned policy and supervision initiatives” and [deferred](#) the implementation of new reporting standards for fee structures and derivatives until April 2021. [Peru](#) has deferred new reporting standards for parallel credit lines, or secondary lines of credit, until January 2021.

Regulators have also taken steps to reduce the operational burden on regulatory staff. Australian regulators, for example, [suspended](#) issuing new banking, insurance, and superannuation fund licenses for at least six months.

Reduced Reporting Requirements

Many of the more substantial measures outlined above have also been accompanied by reductions or complete moratoriums on the required publication of financial data, such as annual and quarterly reports. According to our tracker, at least 15 countries, as well as EU regulators and the BIS, have reduced reporting requirements.

The European Securities and Markets Authority (ESMA) has provided substantial guidance to member states on how to approach reporting during the crisis. On March 27, it [recommended](#) that all National Competent Authorities (NCAs), which are government institutions designated by their individual nations to be points of contact with the ESMA about specific policy areas, defer publication of all financial reports. The ESMA also [delayed](#) reporting obligations for [Securities Financing Transactions](#), which involve the use of securities to borrow cash or other investment-grade securities, for all transactions settled until July 13. However, ESMA said it expects reporting for these activities to resume by July 13.

In the U.S., the Securities and Exchange Commission (SEC), Commodities Futures Trading Commission (CFTC), and Fed have all either reduced requirements or extended deadlines for reporting financial information. The SEC [provided](#) a 45-day extension for publicly traded companies to file disclosure reports that would have been due between March 1 and July 1, so long as they file a form explaining “why the relief is needed in their particular circumstances for each periodic report that is delayed.” The CFTC has [granted](#) 30-day forbearance for furnishing compliance reports, exempted dealers and brokers from recording oral communication and timestamping, and provided longer-term [forbearance](#) from periodic reporting for [commodity pool operators](#). The U.S. federal banking agencies [indicated](#) they would not take supervisory action against financial institutions that needed additional time to file their quarterly Call Reports, so long as these reports are submitted within 30 days of the official filing deadline.

The BIS has [reduced](#) reporting requirements for its 2020 global systemically important bank (G-SIB) assessment exercise. The exercise instead will be based on 2019 data, and the BIS will not collect memorandum data, which are used to “assess if changes should be made to the overall G-SIB framework” (see [here](#), pp. 23). Memorandum data include items that measure interconnectedness, complexity, foreign exposures, and short-term funding (see [here](#), pp. 23 – 28). There are 30 G-SIBs.

Several other countries have implemented similar measures. [Italy](#) (60 - 150 days), [Malaysia](#) (30 days), [Sri Lanka](#) (14 – 30 days), [Denmark](#) (90 days), [South Africa](#) (60 – 120 days), [New Zealand](#) (60 days) and [Russia](#) all have provided some form of deferral or lessening of reporting requirements. On March 21, the U.K. [requested](#) an immediate moratorium on the publication of any preliminary financial statements for at least two weeks. The [Bank of Russia](#) indicated that it would not apply its supervisory measures to companies violating reporting requirements and also reduced supervisory reporting requirements for the second quarter of 2020 (see [here](#)). [Brazil](#) has temporarily prohibited both reporting and increases in remuneration for managers and executives of financial institutions until September 30.

Regulatory Relief Category	Jurisdictions
Reducing supervision	Bank for International Settlements , Denmark , European Union (1) (2) (3) , Egypt , Hungary , Korea (1) (2) , Romania , Russia , Sri Lanka , Ukraine , United Kingdom , United States (1) (2) (3)
Delaying Implementation of new regulation	Australia , Bank for International Settlements , Brazil (1) (2) , Canada , New Zealand , Peru , Russia , United States
Reducing reporting requirements	Australia , Bank for International Settlements , Brazil (1) (2) , Denmark , European Union (1) (2) , Indonesia (1) (2) , Italy , Malaysia (1) (2) , Romania , Russia , South Africa , Sri Lanka (1) (2) , Sweden , Ukraine , United Kingdom (1) (2) (3) (4) (5) , United States (1) (2) (3) (4) , Vietnam

Conventional Monetary Policy and the Zero-Lower-Bound

By **Pascal Ungersboeck**

Original post [here](#).

Central banks across the world have eased monetary policy to facilitate smooth market functioning during the Covid-19 crisis. Interest rate cuts are their primary policy tool. Global interest rates are now at historic lows, with 14 of the [38 central banks](#) in a Bank for International Settlements (BIS) database setting their nominal key policy rates at or below 0.25 percent; three are below 0.

This post provides an overview of recent policy rate trajectories and discusses the constraints that policymakers face, as well as possible avenues for further accommodation through the interest-rate channel, with nominal rates at or approaching zero in many countries.

Global interest rates

All countries in the BIS database with positive policy rates before the crisis have announced cuts since the beginning of the year, with the exception of Hungary and Croatia. The United States and [Canada](#) have cut their rates the most among major economies, both by 150 bps. Canada lowered its overnight target rate from 1.75 percent to 0.25 percent in three announcements between March 4 and March 27. The current target rate is lower than the rate of 0.5 percent that the bank targeted at the height of the Global Financial Crisis (GFC) between April 2009 and May 2010. Similarly, the Fed lowered its target for the federal funds rate by 150 bps following two unscheduled FOMC meetings on [March 3](#) and [March 15](#). With a target range between 0 and 0.25 percent, the funds rate returned to the level it stood at in the wake of the GFC, before the Fed engaged in a series of interest rate hikes starting in December 2015.

Most countries have cut their target rates in one or two announcements, with only a small number of central banks making three or more successive cuts. Among countries that have only made a single announcement, [India](#) and [New Zealand](#) made the largest adjustments to their policy rate; both countries cut their target rate by 75 bps. The Reserve Bank of New Zealand cut its [official cash rate](#) from 1 to 0.25 percent on March 15, the lowest target in the bank's history.

Argentina and Turkey cut their rates the most. The [central bank of Argentina](#) has cut its rate by 1700 bps since the beginning of the year. However, those adjustments don't constitute an immediate reaction to Covid-19, but reflect the slowdown of inflation in the country; they are part of an ongoing effort to normalize monetary policy. Turkey announced four successive cuts between [January 17](#) and [April 23](#), lowering its target rate by 325 bps from 12 percent to 8.75 percent. While the first two announcements were made in the context of an ongoing disinflation process, the central bank mentioned a need to address weakening economic activity due to the Covid-19 crisis in its two most recent announcements.

Some central banks have not cut rates at all. This is the case for the Swiss National Bank (SNB), the Bank of Japan (BOJ), and the European Central Bank (ECB). All three had a target rate at or below zero at the onset of the crisis and did not provide further accommodation through this policy channel. The central bank of Hungary also maintained its target rate despite having a positive policy rate at 0.9 percent. The central bank of [Croatia](#) uses the exchange rate of the euro against its domestic currency to guide monetary policy, it did not include an interest rate target in its response to the current crisis.

[Denmark](#) was the only central bank to raise its target rate. Danish policymakers raised the target rate from negative 0.75 to negative 0.60 percent on March 19 to ease downward pressure against the Danish crown and maintain its fixed exchange rate with the euro.

The Zero Lower Bound constraint

Negative interest rates are one possible avenue for further accommodation through the policy rate channel at the Zero Lower Bound (ZLB). Another avenue is forward guidance, that is, expressing the central bank's commitment to maintain rates at a low level for a prolonged period of time.

As the nominal interest rate approaches zero, central banks' ability to cut interest rates through open market operations is limited as investors can choose to hold currency instead of securities. Currency holdings carry zero interest and thus provide a natural floor to interest rates. In practice, however, large cash holdings have associated risks and costs, allowing some central banks to set negative interest rates.

Currently, Switzerland, Japan, and Denmark have the only central banks with a negative interest rate target, which all three implemented before the current crisis. The central bank of [Sweden](#) had a negative policy rate since February 2015 but returned to a target at a nominal rate of zero on January 8, 2020.

The [Swiss National Bank](#) (SNB) has the lowest target rate globally. Its policy rate has stood at negative 0.75 percent since January 15, 2015, to counter the upward pressure on the Swiss franc and to maintain its exchange rate with the euro within an appropriate range. The BOJ has maintained a low rate since the Asian financial crisis. Its policy rate has not exceeded 0.5 percent since September 8, 1995; it has been negative since September 21, 2017. The [ECB](#) has maintained its key policy rate, the rate on main refinancing operations (MRO), at zero since March 2016.

Finally, a number of central banks recently set policy rates at or below 0.25 percent, leaving them with limited room for further accommodation through conventional rate cuts. This is the case for the central banks of [Australia](#), Canada, [Israel](#), New Zealand, [Norway](#), [Peru](#), the United Kingdom, and the US.

Banks that do not set negative policy rates can provide further relief to market participants by communicating a commitment to maintain accommodative policy rates for some time. This can

be explicitly stated as a period of time during which the bank commits to maintain its rate or implicitly by communicating that rates will be maintained until a policy objective is achieved. The Reserve Bank of New Zealand issued explicit forward guidance with its most recent rate cut, promising to maintain the target rate at 0.25 percent for 12 months. Meanwhile, the [ECB](#) tied expectations to a quantified policy objective, committing to announce no further changes in interest rates until “the inflation outlook robustly converges to a level sufficiently close to, but below, 2%.” In the US, the Fed promised to maintain its range until “it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.”

Authorities Urge Prudence in Loan Loss Accounting

By Aidan Lawson, Arwin Ziessler, and Greg Feldberg

Original post [here](#).

Banks and government authorities have tried to help struggling borrowers during the COVID-19 crisis, through widespread payment moratoria and modifications in the terms of loans.

But such efforts are costly to banks. Accounting standards require lenders to set aside reserves against borrowers who are unable to meet payments. Setting aside reserves diminishes banks' income and equity. Nonpayment of interest also hits their income and cash flow.

Meanwhile, recently implemented accounting standards based on lifetime expected credit losses could require banks to sharply increase their loan-loss reserves, further impacting capital.

Of course, credit losses will likely be substantial during this severe economic crisis. Authorities would like to encourage banks to keep working with borrowers, while easing pressure on their earnings and capital to the extent possible.

This blog discusses measures that bank supervisors have taken in two categories:

- Flexibility in classifying individual loans as troubled or nonperforming.
- Easing the capital impact of the transition to lifetime expected loss accounting.

The blog then describes key concerns about the flexibility that supervisors have granted.

The discussion illustrates the tradeoff supervisors face. On the one hand, they want to prevent the procyclicality inherent in regulatory and accounting standards from worsening an already severe credit crunch. On the other hand, they have a responsibility to maintain the integrity and transparency of financial-institution accounting for the long run.

Global regulators, through the Bank for International Settlements, [recommend](#) that any regulatory relief to banks should: (1) be effective in supporting economic activity in the long-run; (2) ensure that banks remain well-capitalized, liquid, and profitable; (3) avoid undermining the long-run credibility of financial policies.

Policy options for flexibility in troubled-asset classification

Borrowers who are experiencing financial hardship may need the terms of their loans eased through restructurings or modifications. Authorities across the world have sought to help such borrowers through payment moratoria and regulatory relief. Loan forbearance, a common form of relief, typically lasts three to six months, in the hope that borrowers' cash-flow issues will be temporary. (See YPFS' discussion on forbearance for [businesses](#) and [individuals](#)).

But accounting standards typically require banks to reclassify modified loans into higher-risk categories, which means that they must set aside additional capital to compensate for the

increased risk. Although a modification may increase the long-run likelihood that a borrower is able to repay, the increased provisioning and lower capital levels that result can disincentivize lenders to work with borrowers.

To reduce that disincentive, governments and regulators have introduced a number of policies, including:

- Guidance stating payment moratoria can be excluded from the number of “past-due” days for a loan.
- Guidance stating that loans for borrowers benefiting from government assistance programs should not automatically be reclassified as nonperforming or in forbearance.

The Basel Committee on Banking Supervision (BCBS) has [endorsed](#) these strategies, so long as supervisors make sure banks use the flexibility prudently (see [here](#), pp. 5).

In the U.S., financial regulators issued an [interagency statement](#) on March 22, emphasizing that lenders should work with borrowers affected by the virus and providing guidance on accounting for loan modifications and reporting of past-due loan balances.

On March 27, the U.S. Congress passed the [CARES Act](#). Section 4013 of the Act gives financial institutions the option not to classify modified loans as [troubled debt restructurings](#) (TDRs), provided that the borrowers were adversely affected by COVID-19 and that they were current on their payments at the end of 2019. Section 4013 applies to modifications made between March 1 and the end of 2020, or later if the national emergency is still in effect. Under the CARES Act, lenders are also not required to report loans affected by Section 4013 as TDRs in reports to regulators or calculate impairment losses that would normally be associated with such modifications.

After the CARES Act passed, regulators [revised](#) the March 22 guidance to incorporate the language in Section 4013. The revised guidance was more flexible than the law. Even modifications that do not qualify under Section 4013 are still not automatically classified as TDRs. The regulators -- with the support of the independent accounting standard-setter, the [Financial Accounting Standards Board \(FASB\)](#) -- stated that “short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not TDRs” (see [here](#), pp. 3).

Many countries -- for example, [Sri Lanka](#), [Romania](#), [Estonia](#), [Kenya](#), [Brazil](#), [South Africa](#), [Australia](#), [Hungary](#), [Nigeria](#), and [Indonesia](#) -- have explicitly stated that loans modified to help borrowers affected by COVID-19 should not be automatically classified as restructured. Romania’s rule applies to non-bank financial institutions (NBFIs) as well as banks. [South Korea](#) allows banks to not label loans to closed businesses as “sub-standard,” provided the owners have demonstrated sufficient repayment capabilities.

Banks in [the Philippines](#) can receive similar relief, but only if they have used or are planning to use the central bank’s (BSP) rediscounting facility. Both [Russia](#) and [Vietnam](#) recommend that

lenders assess loans affected by COVID-19 by using a date that precedes the pandemic. Russia also recommends that restructurings or reassessments should not show up on credit histories (see [here](#)).

Indian financial institutions are still required to provision for restructured loans. However, they are only required to set aside a provision of 10 percent of the amount outstanding of term loans and interest payments to working capital facilities that were [deferred](#) until May 31 (see [here](#)). These provisions will be phased in over the first two quarters of 2020.

Policy options for easing the impact of lifetime expected loss accounting

The implementation of new accounting standards is another source of increased loss provisioning. These standards require lenders to conduct forward-looking assessments of expected credit losses (ECLs) over the lifespan of each asset. The earlier “incurred loss” (IL) models allowed banks to set aside provisions only when it was probable that an asset would fail; they were “too little, too late” during the Global Financial Crisis (GFC). In contrast, the new lifetime expected-loss standards require banks to provision more and earlier. This could theoretically mitigate procyclicality by having banks build loss provisions for use during a downturn.

Lifetime expected-loss models depend on each bank’s ability to accurately forecast and model expected losses. However, by definition, expected-loss models cannot prepare banks for unexpected events such as the COVID-19 crisis. For that reason, the potential capital effects of COVID-19 may be more pronounced than they would have been under an incurred-loss model (see [here](#), pp. 5, 36-37). According to quarterly filings, provisions for credit losses for the six largest U.S. banks increased \$20 billion in the first quarter of 2020 due to the combined impact of COVID-19 and their switch to expected-loss accounting.

Table 1: Expected credit loss provisions of major U.S. financial institutions

Institution	Provision (Q4 2019)	Provision (Q1 2020)	Difference (Q4 2019 and Q1 2020)
JPMorgan Chase	\$1.4 billion	\$8.3 billion	\$6.9 billion
Citigroup	\$2.2 billion	\$7.0 billion	\$4.8 billion
Bank of America	\$941 million	\$4.8 billion	\$3.9 billion
Wells Fargo	\$845 million	\$4.0 billion	\$3.2 billion
Goldman Sachs	\$336 million	\$937 million	\$600 million
Morgan Stanley	\$53 million	\$388 million	\$335 million
Total	\$5.8 billion	\$25.4 billion	\$19.7 billion

To mitigate the impact of expected-loss provisions on capital during this crisis, regulators have pursued the following options:

- Flexibility in interpreting loss provisions.
- Temporary sterilization of the effect of new rules on regulatory capital.
- Allowing banks to temporarily suspend application of the new standard.

Background: CECL and IFRS 9

In the U.S., the Current Expected Credit Losses ([CECL](#)) standard was scheduled to come into effect for large, publicly traded banks in 2020. CECL does not specify a given method for measuring expected credit losses. It allows methods such as historical loan loss, roll-rate, and discounted cash flow analysis. Banks are only required to forecast conditions under a timeframe that is “reasonable and supportable.” Beyond that, they are allowed to use historical averages to model long-run behavior (see [here](#), pp. 10 and [here](#), pp. 30 - 31).

The new IFRS-9 standard, now common outside the U.S., is also based on expected losses, but works differently. It requires businesses to dynamically provision for expected losses based on the credit risk of the assets. The standard classifies assets in three stages. Lower-risk (stage 1) assets only require banks to provision for the next 12 months of expected losses (see [here](#)). Restructuring, renegotiating, lack of payment, and other behaviors can cause assets to be labeled as having a “significant increase in credit risk” (SICR), resulting in reclassification into high-risk groups (stages 2 and 3).

The primary difference between the two standards is that CECL requires lifetime expected provisions for all loans and IFRS-9 requires them only for loans that have had a SICR and moved into Stage 2 or 3. IFRS-9 was implemented [in 2018](#), which limits the tools that regulators can use.

Table 2: Overview of IFRS-9 Expected Credit Loss (ECL) provisioning

ECL Classification	Threshold	Loss Provision	Interest Calculation
Stage 1 (Performing)	Immediately after origination.	12-month expected credit losses	Calculated on the gross carrying amount
Stage 2 (Underperforming)	If credit risk increases significantly and is not considered low.	Lifetime expected credit losses	Calculated on the gross carrying amount
Stage 3 (Nonperforming)	If credit risk increases to the point that it is credit-impaired	Lifetime expected credit losses	Calculated based on the amortized cost

Source: [IFRS-9 information](#)

Basel Committee recommendations during COVID-19

The sudden onset and uncertainty during the COVID-19 crisis amplifies the procyclicality of capital and accounting standards. To mitigate this, the Basel Committee has issued several recommendations on expected credit-loss accounting.

In its [guidance](#), the Basel Committee first emphasized flexibility in determining whether a SICR under IFRS-9 standards has actually occurred. If loans are affected by relief efforts, they should not automatically be reclassified as Stage 2 or 3 on that basis alone.

Second, the Basel Committee expanded the use of transitional arrangements, which allow lenders to phase in the effect that ECL accounting would have on their Tier 1 capital. The Basel III capital agreement already [includes](#) transition arrangements that allow banks to phase in the capital effects of expected-loss accounting over five years. Because of COVID-19, the Basel Committee says that lenders now can either continue to use transition arrangements under the existing framework or defer the capital impact of expected-loss accounting until 2022; after that, banks can phase in the impact on a “straight line basis” over the following three years (see [here](#), pp. 2-3).

However, these transition arrangements have a limited effect (see [here](#), pp. 6). The Financial Stability Institute argues that combining these arrangements with increased flexibility could provide more relief to lenders. However, they warn that doing so could widen the gap between accounting and prudential measures of capital.

Many regulatory bodies -- such as the [European Securities Markets Authority \(ESMA\)](#) and [European Banking Authority \(EBA\)](#) -- have followed the Basel recommendation and stated that loans affected by economic recovery programs should not be considered as having a SICR and moved into high-risk groups. They emphasized that the high degree of uncertainty caused by COVID-19 could adversely affect estimated credit losses and damage the reliability of short-term forecasts (see [here](#), p. 4). To resolve this issue, the European Central Bank (ECB) recommended that “banks give a greater weight to long-term macroeconomic forecasts evidenced by historical information when estimating long-term expected credit losses for the purposes of IFRS 9 provisioning policies” (see [here](#)).

In the U.S., the CARES Act states that U.S. banks would not have to adopt CECL until the end of 2020 or the end of the national emergency, whichever is earlier.

Also, U.S. financial regulators offered institutions that had already adopted CECL the option of delaying its effect on their regulatory capital ratios for two years. After two years, banks have a three-year transition period to phase in the capital impact (see [here](#), pp. 4223). Banks that already adopted CECL can continue to follow the three-year transition period or adopt the new

five-year plan instead. Regulators issued a [policy statement](#) on May 8 that provides flexibility for management in forecasting and estimating credit losses under CECL.

The Bank of England (BOE) and Prudential Regulation Authority (PRA) first discussed IFRS-9 and echoed some of the same points as their Euro-area counterparts (see [here](#)). The PRA discussed many of these points in greater detail in a [letter](#) on March 26, specifically emphasizing the importance of using long-term trends when forecasting and not immediately classifying borrowers into stages 2 and 3. The PRA reiterated that the economic shock from COVID-19 “should be temporary, although its duration is uncertain;” it said that the likelihood of an increase in lifetime credit risk for most borrowers remained unchanged (see [here](#), p. 6).

The [Australian Prudential Regulation Authority](#) recommended similar post-ECL forecasting adjustments: “If the effects of covid-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered.”

Countries recommending flexibility in calculating expected credit losses include [Germany](#), [South Korea](#), [Brazil](#), [New Zealand](#), Singapore, and [Chile](#). Russia stated that loans affected by COVID-19 restructuring should not be classified as worse than stage II (underperforming).

Similarly, [Malaysia](#) stated that temporary COVID-19-related shocks can be interpreted as only affecting 12-month expected credit losses, and not lifetime losses.

Some central banks have supplemented the Basel Committee’s guidance on transitional arrangements by incorporating additional ways to stagger the capital impact that increased provisioning will have. The Central Bank of the UAE required banks to apply a “prudential filter” to IFRS-9 expected loss provisions. This filter allows banks to stagger any IFRS-9 provisions over five years to mitigate the impact on bank capital levels. The [Bangko Sentral ng Pilipinas](#) implemented a similar five-year filter.

Concerns

The fundamental tradeoff that regulators must consider when implementing these policies is how to mitigate procyclicality while retaining credibility. Credibility is hard to gain and easy to lose, especially in periods of economic stress. The more extensive the relief, the larger the tradeoff.

Flexibility could erode comparability

One concern is that flexibility will erode the comparability of financial statements, the main value of accounting standards. Temporary suspensions of already-implemented standards, such as the CECL measures in the CARES Act, may also reduce the comparability of financial statements across and within countries. Of the 17 countries and six international regulators that YPFS identified as having implemented some form of accounting relief, the U.S. and [Romania](#) are the only ones that suspended the adoption of new standards. See Table 3 for a full breakdown of country-based relief. CECL forbearance could cause global financial statement comparability

issues if enough U.S. banks choose to maintain incurred-loss standards while the rest of the world continues to use lifetime-loss models, as they have [since 2018](#).

As it turned out, most major American financial institutions have not opted to use the CECL relief provided by the CARES Act. But most large banks and many small banks did take advantage of the regulatory guidance and delayed the regulatory capital effects of the transition to CECL. The largest U.S. financial institutions have all adopted CECL, and all but three of them -- Wells Fargo, State Street, and Bank of New York Mellon -- have elected to phase in the capital impact over the longer, five-year plan that the regulators made available in the guidance.

The very nature of expected-loss provisioning, which requires managers to make subjective judgments about the future course of the economy, can also erode comparability (see [here](#)). [Varying national guidance](#) on the application of IFRS-9, as well as increased flexibility in transitional arrangements, may alleviate market-based distress but could compromise comparability. Reduced financial statement comparability and increased heterogeneity across bank forecasts and estimations, on the other hand, can dampen procyclicality as financial institutions increase their provisions at different rates.

Regulators may allow forbearance to last for too long

Prolonged forbearance had an adverse effect in both the Japanese banking crisis in the 1990s and the U.S. savings and loan (S&L) crisis in the 1980s.

Japanese financial regulators liberalized their rules throughout the 1970s and '80s. Strong regulation had previously substituted for bank risk management. As controls were relaxed, it became apparent that financial institutions had not begun using modern risk management techniques (see [here](#), pp. 257-259).

The Japanese government responded with broad regulatory forbearance and flexibility, allowing banks to understate the extent of their problems (see [here](#), pp. 49). Ultimately, lax loan classification and provisioning rules, continued dividend payments, competing regulatory authorities, and other factors unique to the Japanese banking system harmed the health of banks (see [here](#), pp. 26-28). In the end, the banking system required aggressive government intervention, consisting of tens of trillions of yen in bank rescues and additional assistance. (For more, see the YPFS cases: [Unnava 2020a](#), [Unnava 2020b](#), and [Unnava 2020c](#)).

Prolonged forbearance also played an exacerbating role in the U.S. S&L crisis. S&Ls, or thrifts, lent money mainly for long-term, fixed-rate mortgages and funded themselves primarily with short-term deposits at interest rates that were capped by the government. As interest rates rose in the late 1970s and early 80's, thrifts experienced deposit outflows and faced catastrophic losses because they could not raise their rates alongside commercial banks (see [here](#)).

In response, the U.S. government relaxed accounting and ownership standards and passed legislation that relaxed regulations. Thrifts shifted from mortgages into riskier assets (see [here](#), pp. 180). Large numbers of new thrifts were chartered, and many "goodwill mergers" took

place, resulting in the overstatement of capital levels. Ultimately, the federal deposit insurer for the industry went bankrupt amidst a deluge of failures (see [here](#), table 8). Many considered the regulatory forbearance to have been a core cause (see [here](#), pp. 32). (For more, see the [YPFS case](#)).

The origins of these crises are very different from COVID-19. In these cases, the extensive, and in some cases exclusive, use of forbearance reflected “the hope that in time a changed economic environment would take care of the problem” (see [here](#), pp. 49). While this rationale still may be a justification for forbearance in the COVID-19 crisis, these policies have complemented large-scale monetary and fiscal policy initiatives supporting both financial and nonfinancial organizations.

Table 3: Summary of International and National Reclassification and Accounting Relief Policies

	Measure	Nation / Institution
Loan Reclassification exclusions	- Past-due day	Philippines , Egypt , India , Sri Lanka
	- Encouraging reclassification flexibility	Australia , Russia (1) (2) (3) (4) , Philippines , Nigeria , Ireland , ECB , United States (1) (2) , Kenya , Romania , ESMA , India (1) (2) , Sri Lanka (1) (2) , South Africa , Ukraine , Korea , Estonia , EBA , European Commission , Malaysia
Accounting Changes	- Flexibility in interpreting loss provisions	Russia , ECB (1) (2) , Kenya , Brazil , IASB , European Commission , South Africa , New Zealand , BCBS , ESMA , EBA , United Kingdom (1) (2) , Korea , Singapore , Australia , Hong Kong , Chile , Germany , Malaysia
	- Sterilization of capital effects	BCBS , Philippines , UAE , United States
	- Temporary suspension of new standards	IFRS (1) (2) , Romania , United States

COVID-19 and Insurance (1 of 3): Helping Individuals and Businesses

By **Greg Feldberg and Alexander Nye**

Original post [here](#).

Insurance companies face unusual challenges during the COVID-19 crisis. This blog describes efforts by companies and their supervisors to:

- Reduce financial burdens on insurance customers, for example, by allowing them to defer premium payments.
- Resolve the controversy over whether existing insurance coverage extends to businesses that have lost revenue during the crisis.

To date, crisis impacts on insurers have come mainly through financial markets rather than through extraordinary claims. Two later blogs will describe measures providing operational regulatory relief to insurers and measures encouraging insurers to conserve capital and avoid procyclical behavior.

1. Reducing financial burdens on customers

The most visible COVID-19-related interventions in the insurance sector offer protection and assistance to customers, whether individuals or organizations.

Some of these measures allow customers to defer paying their insurance premiums and give them grace periods for renewing their policies. Some expand, modify, or clarify existing policies to better protect policyholders from the brunt of COVID-19. Others seek to resolve the problems of insurers who are overwhelmed by claims while customers demand a quick response. A few countries have also encouraged insurance companies to allow deferred payments on loans they hold as assets.

Perhaps the most important measures have been those directly providing customers with financial relief.

Belgium has taken several measures. For unemployed workers, the [National Bank of Belgium](#) postponed premium payments for death, disability, and hospitalization policies related to employer-contracted insurance until September 30. [Consumers in Belgium who demonstrate](#) that they have faced financial difficulties due to COVID-19 can also suspend paying outstanding insurance premiums linked to mortgage loans until September 30. [Businesses interrupted](#) by COVID-19-related lockdowns can obtain premium suspensions for certain types of insurance.

Hong Kong's government [is directly paying](#) the insurance premiums of bus companies and ferry operators for six months.

India's government allows consumers to forbear on their premium payments for the duration of its lockdown; it offers a more generous forbearance policy for life insurance premiums ([IRDAI Circular 1](#), [IRDAI Circular 2](#)) than for [health insurance or motor vehicle insurance](#). The government has repeatedly extended this policy as it extended the lockdown. [India](#) and the [UK](#) are also [allowing](#) consumers to pay life insurance premiums in installments. [India](#) froze auto insurance premium rates at their 2019-20 levels, although, with the decrease in automotive traffic, one would have expected motor vehicle insurance premiums to decrease.

Countries have also extended to insurance companies loan-forbearance programs that they had originally created for banks. In Belgium, mortgage borrowers [can now suspend](#) principal and interest payments to insurance companies through September 30. They can also [postpone](#) non-mortgage loan repayments to insurance companies through September 30. [India](#) has a similar mortgage forbearance policy.

Many insurance companies are expanding or offering more generous interpretations of their policies for customers impacted by COVID-19. This is frequently at the urging of supervisors. Insurance supervisors have given insurers breathing room to help consumers with more flexible supervision policies and forbearance measures that incentivize insurers to provide relief to customers.

Some countries have asked insurance companies to expand or modify the coverage consumers have in their existing policies to fit the extenuating circumstances of COVID-19. They attempted to do this while imposing little risk on the insurers, balancing the generosity of relief with the cost to insurers or the government. For example, [Ireland's government](#) negotiated a voluntary agreement with insurance companies to maintain coverage for businesses' buildings that have been left unoccupied. The agreement also allows businesses to change which property is being covered by a policy.

[Thailand's insurance regulator](#) compelled insurers to cover risks relating to COVID-19, so long as the relevant policies were sold before March 17 and the policyholder did not have the disease.

Some regulators have tried to make it easier for customers to acquire insurance. Thailand and India called on insurers to create affordable microinsurance policies related to COVID-19. In India, these plans act as a [substitute for conventional insurance](#), as most of the country does not have health insurance. Thailand is allowing non-life insurers to offer auto insurance policies with less than one-year terms. Thailand's measures have one side effect that may help insurers. They might [bolster insurer income from premiums](#) in the small short-term auto-insurance market.

In Canada, insurance regulators [expanded the eligibility](#) criteria for lenders to access portfolio insurance for their mortgages. This provision also benefited lenders overall, because it made it easier for them to access the government's [Insured Mortgage Purchase Program \(IMPP\)](#).

Many countries have also loosened regulations surrounding policy underwriting and distribution to allow consumers to purchase policies while remaining socially distant. This involves [cutting](#)

[requirements for complete paper documentation](#) or ensuring that consumers will not have to [pay their premiums in person](#).

As COVID-19 inundated insurers with questions and claims, regulators have tried to ensure that consumers can access their insurance benefits easily and promptly. India issued regulations telling insurers to establish systems that approve or reject claims [within 24 hours](#) and to have all insurance claims related to COVID-19 reviewed by a [claims review committee](#) before they can be rejected. Saudi Arabia [moved](#) the examination of insurance claims online, while [Malaysia's central bank](#) told insurers to facilitate and expedite claims related to COVID-19.

Some regulators have also sought to give insurers some breathing room to respond to the wave of claims. Italy's regulators gave insurers [additional time](#) to respond to complaints and customer inquiries. While [Peru extended](#) the period of time that policyholders could submit claims to insurers, it also told insurers to prioritize responding to managing and paying claims related to health insurance or life insurance.

2. Resolving the controversy over business-interruption insurance

Business-interruption insurance is a common form of property and casualty insurance in the U.S. and other developed countries. It covers a business's loss of revenue due to a covered incident, such as a natural disaster. However, business-interruption policies usually require a policyholder to prove physical damage to the business premises, a condition that most businesses affected by COVID-19 lockdowns have not experienced.

Although some policies don't require physical damage to pay out, they may also exclude pandemics or viruses from their coverage. Many are unclear about their coverage of pandemics or of business closings that government authorities have broadly mandated. That lack of clarity has led to conflicts between insurers and policyholders. (To some extent, this is because a large number of insurance contracts rely on standardized forms that embody "[boilerplate](#)" wording. These forms are then customized to the policyholders' situation, but the amount of customization and negotiation varies greatly and is often limited to larger customers. Because many policies have common wording, they allow for common interpretations to develop. [However](#), because they are reused so often, one problem can quickly taint an entire group of policies.)

Authorities have taken various approaches to resolve these conflicts. For example, the South African regulator provided [guidelines](#) to insurers and consumers on May 12. Those guidelines noted that the regulator had spoken to regulated insurers and found that most business-interruption policies required physical damage; and even policies that covered contagious diseases didn't cover government lockdowns.

The Financial Conduct Authority in the UK [announced](#) on May 1 that it was seeking a court declaration to help determine the basis on which insurance firms should decide whether to accept business-interruption claims. On June 1, the authority [said](#) that it had reviewed more than 500 relevant policies and selected a [representative sample of 17 policy wordings](#) to discuss in court.

In the U.S., where states regulate insurance, 28 [state insurance departments](#) have issued guidance to insurers and consumers on business-interruption coverage during the COVID-19 crisis. The NAIC had earlier [asked](#) insurers to provide data about their business-interruption policies, saying that it hoped the data call would help state insurance regulators evaluate the nature of business-interruption coverage, the size of the market, the extent of exclusions related to COVID-19, and claims and losses related to COVID-19. It has not yet published an analysis of the data it received.

Some governments have considered requiring insurers to retroactively cover COVID-19-related losses that policies didn't cover before the crisis. The state legislatures of Louisiana, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, and South Carolina have [introduced legislation](#) along these lines, although [none of these bills have passed](#).

The industry and its supervisors have warned against such initiatives, including the [NAIC](#) on March 25, and the [International Association of Insurance Supervisors \(IAIS\)](#) on May 7. The IAIS said such actions could “threaten policyholder protection and financial stability.” On April 1, the [European insurance supervisor](#), in guidance to insurers, said: “As a general principle, imposing retroactive coverage of claims not envisaged within contracts could create material solvency risks and ultimately threaten policyholder protection and market stability, aggravating the financial and economic impacts of the current health crisis.”

As an alternative, some countries are considering using government resources to backstop business-interruption insurance provided by the private sector. (See the [YPFS blog](#)). Proposals vary, but they typically limit the losses a private insurer must cover before the government backstop kicks in.

COVID-19 and Insurance (2 of 3): Operational Regulatory Relief

By Greg Feldberg and Alexander Nye

Original post [here](#).

Many insurance supervisors have provided temporary relief to help companies manage during the COVID-19 crisis.

Most of this relief comes in the form of extended deadlines for submitting various reports or provisions that make remote compliance easier. Regulators have also suspended supervisory activities and loosened accounting rules.

This blog discusses such measures. An earlier YPFS [blog](#) described similar regulatory relief measures that bank supervisors have taken during this crisis.

1. Extending deadlines

At least 27 national and transnational insurance regulators extended insurers' deadlines for submitting their [regular supervisory reports](#), according to [an April brief](#) from the Bank for International Settlements (BIS). For example, India's insurance regulator [provided extensions](#) for submitting periodic compliance documents, providing a [30-day respite](#) for filing half-yearly and yearly returns, a cyber security audit, and a "[Board approved Final Re-insurance Programme](#)."

The [EU insurance regulator](#) advised its member countries to provide companies with extended deadlines for 2019 annual reports, 2019 annual solvency and financial condition reports, and 2020 quarterly reports for Q1. It also called on insurers to publicize information on the effects of COVID-19 on their businesses.

U.S. state insurance regulators have taken similar actions. For example, California's regulator [issued a 90-day deadline extension](#) for insurers to file their 2019 annual statements, 2019 supplemental filings, and 2020 first-quarter filings. Regulators in at least six states issued similar policies. Several states also extended their deadlines for compliance with various licensing requirements; for example, with respect to continuing education.

2. Limiting supervisory activities

COVID-19 has also made some relatively simple supervisory activities risky. [Some regulators](#) (including in Botswana, Germany, Italy, Liechtenstein, North Macedonia, Poland, Portugal, Russia, and Singapore) have postponed on-site inspections while others, like [Malta's Financial Supervisory Authority](#), shifted to remote supervision. A [number of U.S. states](#) have used other tools to reduce insurers' administrative burden – including, for example, loosening regulations around the provision of telemedicine.

Some regulators have suspended initiatives or exercises altogether. The [UK's insurance regulator](#) decided not to publish the results of its 2019 insurance stress test and postponed the next insurance stress test to 2022. [Australia's insurance regulator](#) postponed a number of reforms to health insurance data collection. [At least eight](#) national and transnational regulators have also delayed public consultations on new or revised regulatory rules.

Regulators have also provided regulatory relief to insurers who provide forbearance to customers on premiums and to borrowers on mortgage payments. For example, as they have done with bank loans, regulators have allowed insurers to treat loans as performing if borrowers miss payments because of COVID-19.

For example, Canada's insurance regulator has [incentivized insurers](#) to provide premium forbearance to consumers impacted by COVID-19. It did this by changing the capital treatment of the insurance for the duration of the forbearance, up to six months. [South Africa](#) also has tried to provide these incentives by telling insurers that its Prudential Authority would exclude the impact of the foregone premiums from its default risk calculation in situations in which insurers make concessions that increase their outstanding premiums.

In the U.S., the National Association of Insurance Commissioners (NAIC), the organization of state insurance regulators, [issued an interpretation of its accounting principles](#) in mid-April that modified the rule categorizing “premiums and similar receivables as non-admitted assets if they are uncollected for more than 90 days.” The interpretation allows insurers not to recognize those assets as non-performing or non-admitted for their first and second quarter 2020 financial statements.

COVID-19 and Insurance (3 of 3): Capital Conservation and Countercyclical Regulation

By **Greg Feldberg and Alexander Nye**

Original post [here](#).

Insurance supervisors around the world outside the U.S. have urged companies they supervise to conserve capital during the COVID-19 crisis by limiting payouts to shareholders and bonuses to executives.

At the same time, many supervisors have sought to help insurers avoid procyclical behavior by mitigating the impact of volatile market swings on the value of insurance company assets and, in turn, on measures of their capital adequacy.

This blog describes such measures. Our online [spreadsheet](#) provides further details and links to country-specific actions. An earlier YPFS [blog](#) described measures bank regulators have taken to ease capital regulations during this crisis. YPFS blogs this week [discussed measures to help insurance customers](#) and [provide insurance companies with operational regulatory relief](#).

1. Measures to conserve capital

Insurers were generally well-capitalized going into the COVID-19 crisis. However, the lockdown recession could generate an unprecedented shock to their balance sheets in the long run. For that reason, supervisors in more than 19 countries have encouraged, but mostly not required, insurers to conserve their capital by curtailing dividends, other capital distributions to shareholders, and executive compensation, according to a [BIS brief](#). (Many bank supervisors have also done this, as we noted in an earlier [blog](#)).

For example, the UK's Prudential Regulation Authority (PRA) [sent a letter](#) calling on insurers thinking about distributing their profits to shareholders or executives to “pay close attention to the need to protect policyholders and maintain safety and soundness.” Of course, some existing contracts may make it difficult to withhold executive pay even if companies want to. Although the only tool the PRA really deployed here was moral suasion, it apparently was enough to convince some insurers to [pause dividends](#).

The [EU's supervisor](#) has urged insurers to “temporarily suspend all discretionary dividend distributions and share buybacks.” In a statement, it asked any insurers that believe they are legally required to pay dividends or provide significant variable pay for executives to explain their reasoning for doing so to their national insurance regulator. However, [insurers were not convinced](#) to modify or suspend their variable pay plans. The EU was not the only body looking to adjust variable pay plans; a [BIS brief](#) states that at least eight national and transnational insurance regulators asked insurers to modify their variable pay.

Italy's [insurance regulator](#) sent a letter to the industry requesting that its companies “adopt, at individual and group level, extreme prudence in the distribution of dividends and in the payment” of variable pay. [Austria offered](#) the “urgent recommendation to insurance undertakings to refrain from distributing dividends for the previous and current financial year as well as from share buybacks.”

India was also assertive in [its call](#) for insurers to “refrain from dividend pay-outs from profits pertaining to the financial year ending 31st March 2020.” Croatia's insurance regulator took a more aggressive approach; it [banned](#) insurance companies from distributing dividends until April 30, 2021. However, it did not ask insurers to suspend share buybacks or modify variable compensation for executives, unlike some other countries in Europe.

The U.S. has been an exception. The NAIC has been silent on this issue, and no state has asked the companies it regulates to refrain from paying dividends, share buybacks, or paying executive compensation.

2. Measures to avoid procyclical behavior

Supervisors have also used a handful of tools, both automatic and discretionary, to discourage insurance companies from aggravating market stress during the COVID-19 crisis.

To be sure, insurance companies, as long-term investors, are less likely than banks or investment funds to sell assets in market downturns ([Timmer](#), 2016). They do not have to mark the value of their portfolios to market prices as frequently and they are less likely to face funding pressures that require them to raise liquidity in a pinch. As such, it is too early in the COVID-19 crisis to see significant market losses at insurance companies, and markets, for now, have recovered from their recent lows. Early on, [Thailand's regulator](#) concluded in a stress test that its insurers were well-capitalized to handle potential COVID-19-related stresses.

Nonetheless, the international association of insurance supervisors has acknowledged that insurers could be prone to procyclical behavior, for example, in response to actions by rating agencies or supervisors ([Insurance Core Principles](#), 2019, p. 245). In particular, an insurer whose capital falls below a regulatory trigger may face restrictions that lead it to sell assets.

To address this procyclical bias in the rules, the Core Principles encourage supervisors to be flexible in applying triggers during market stress.

Supervisors have exercised such flexibility during the COVID-19 crisis. For example, supervisors in [Canada](#), [Europe](#), the [Netherlands](#), and [South Africa](#) have said they will allow more time for companies to restore capital levels that have fallen below supervisory triggers due to the crisis. Thailand's Office of the Insurance Commission (OIC) [relaxed its capital adequacy ratio](#) for insurance companies in mid-March. Canada's supervisor said it “considers the specific circumstances of the insurer and recognizes that the restoration of Capital Resources levels may take longer for some insurers when operating in a difficult environment.” The Dutch supervisor

said it “takes into account the expected temporary duration of this exceptional situation” when evaluating health insurers’ capital.

Several countries have taken other ad hoc measures to discourage procyclical behavior during the COVID-19 crisis. [Canadian](#) and [Malaysian](#) supervisors have eased capital requirements for interest-rate risk. The [Swiss](#) supervisor said it would allow insurers to temporarily smooth yield curves to dampen the impact of market volatility on regulatory capital. When Korean insurers decided to help prop up domestic financial markets, [Korea’s supervisor](#) modified the risk assessment application system it uses to determine insurers’ liquidity ratios.

The [European Union \(EU\) supervisor](#) also has automatic stabilizers, introduced after the global financial crisis of 2007-09, that are intended to dampen the impact of volatile market prices on insurers’ capital ratios. These include the matching adjustment, the volatility adjustment, and the symmetric adjustment for equity holdings. They are part of the EU’s Solvency II framework for insurance supervision.

The matching adjustment and volatility adjustment allow companies to reduce the net present value of their liabilities in response to declines in the market values of their assets. When market-wide spreads rise above predetermined thresholds, the mechanisms allow companies to increase the discount rate they use to value their liabilities.

The two adjustments work differently. The matching adjustment is for insurers that offer long-term guarantee products, such as annuities, and hold assets to match the maturity of those liabilities. The volatility adjustment can be applied to an insurer’s business more broadly and is intended to reduce the impact of large and sudden changes in market prices.

Solvency II also includes a symmetric adjustment for equity holdings. It requires companies to hold slightly more capital against their equity holdings after markets have risen, and to hold slightly less after markets have fallen.

These adjustments use market data provided by the European insurance supervisor. During the COVID-19 crisis, the supervisor increased the frequency of its reporting of these data inputs from monthly to weekly on [April 30](#), but reduced the frequency to biweekly on [May 19](#).

What issues still need more action?

On May 6, the European Systemic Risk Board (ESRB) met and discussed the macroprudential aspects of their response to COVID-19. One of the key topics [it addressed](#) was the [impact of market illiquidity on insurers and the implications for financial stability](#). They argued that the tools for avoiding the procyclical behavior discussed above may not be enough to head off a run by holders of unit-linked insurance products, which are something like an insurance-investment product hybrid, “if the macroeconomic outlook worsens by more than is currently anticipated.”

The ESRB noted that outflows from high-yield bond funds could put more pressure on the value of less liquid assets, or assets that have become temporarily illiquid, which insurers tend to hold. In such a situation, the ESRB said that the private sector and regulators will have to rely on

central banks to maintain financial stability. A recent article by KPMG’s Global Head of Insurance [stated that](#) the “EU’s Solvency II regime is very sensitive to financial market volatility and movements in bond yields and credit spreads.”

Banks' Second-Quarter Results Boosted by Non-Interest Income and Official Support

By Junko Oguri

Original post [here](#).

In the midst of the COVID-19 lockdown, earnings beat expectations for most large US banks in the second quarter, as a surge in non-interest income offset rising loan-loss provisions, and banks benefitted from Federal Reserve liquidity programs and regulatory forbearance.

Large US banks started reporting their second-quarter earnings last week. Their European peers are expected to follow at the end of this month.

In this blogpost, we analyze 14 large US banks that have published their earnings as of July 20. They are among the 33 firms that participated in this year's Dodd-Frank Act Stress Test (DFAST 2020, see related post [here](#)). They include eight global systemically important banks ([G-SIBs, as of 2019](#)) and six non G-SIBs.

Given the deep recession and prolonged COVID-19 crisis, earning reports can serve as a thermometer of the economy and the financial system.

For the second quarter, investors focused on revenues, credit quality, and loan-loss provisioning. While financial markets have calmed, the real economy has slowed markedly. Unemployment has surged and consumer activity has plummeted due to lockdowns, although the numbers of positive cases and business closings are uneven across the United States. [Small and medium-sized enterprises \(SMEs\)](#) are facing particular difficulties in financing themselves. Various government measures, including the establishment of lending facilities and introduction of relief programs, have been implemented to support households and businesses.

In this blogpost, we analyze earnings reports in terms of six areas: 1) CET1 capital ratio, 2) Net income and revenues, 3) Non-performing loans, 4) Loan loss provisioning, 5) Other regulatory relief and forbearance, and 6) Market reaction and equity price.

G-SIBs: 8 financial institutions

Reporting Date	Firm name
7/14	Citigroup Inc.
	JPMorgan Chase & Co.
	Wells Fargo & Company
7/15	The Bank of New York Mellon Corporation

	The Goldman Sachs Group, Inc.
7/16	Bank of America Corporation
	Morgan Stanley
7/17	State Street Corporation

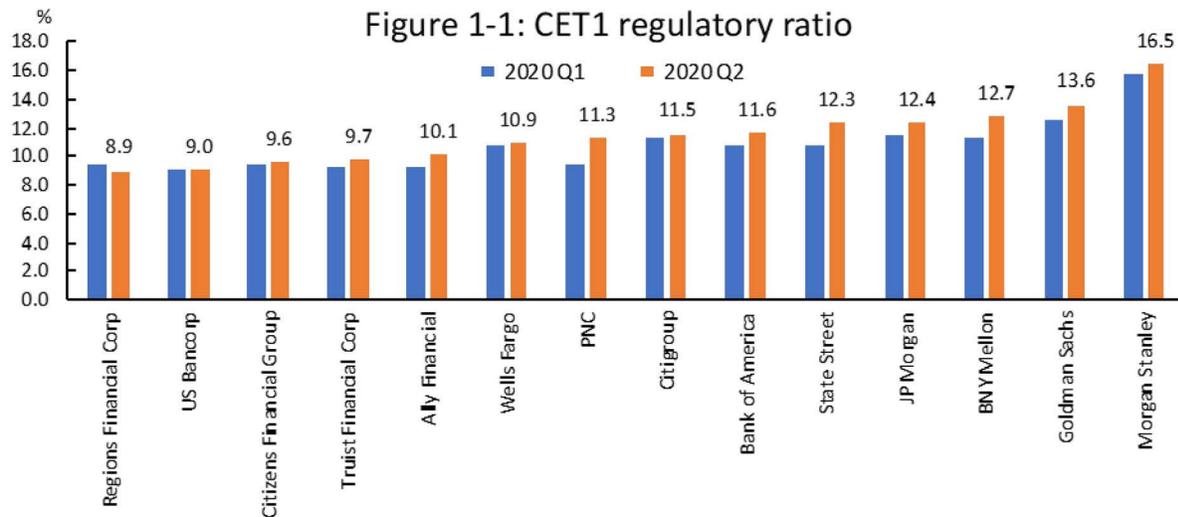
Non G-SIBs: 6 financial institutions

Reporting Date	Firm name
7/15	The PNC Financial Services Group, Inc
7/16	Truist Financial Corporation
	U.S. Bancorp
7/17	Ally Financial Inc.
	Citizens Financial Group, Inc.
	Regions Financial Corporation

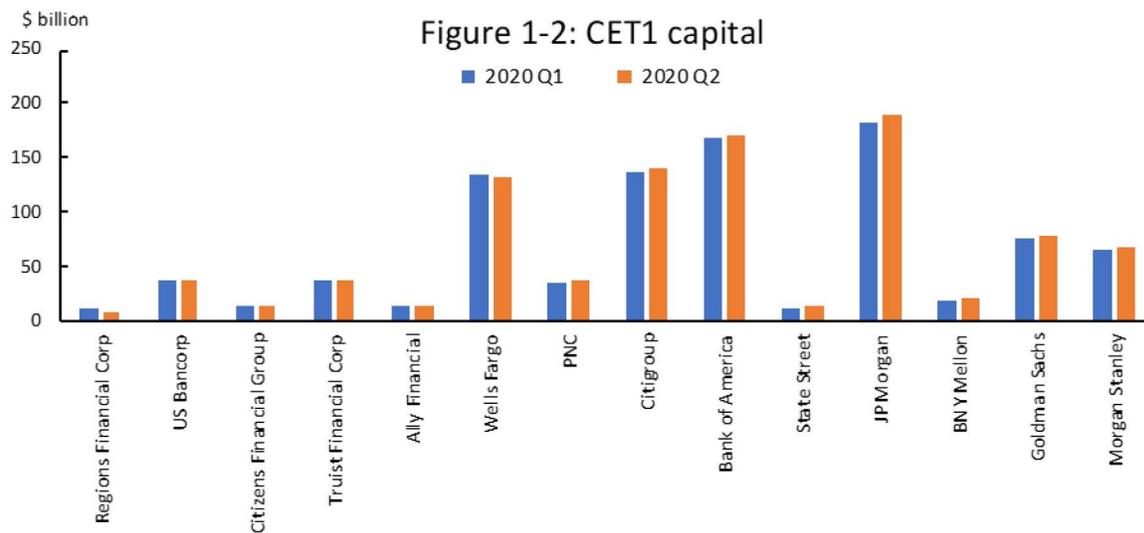
1. CET1 Capital Ratio

The common equity Tier 1 (CET1) capital ratio, an important regulatory indicator of bank solvency, increased quarter-on-quarter (QoQ) for 13 of the 14 financial institutions; the outlier was Regions Financial Corp (Figure 1-1). CET1 capital (the numerator) increased for 12 firms while risk-weighted assets (RWA, the denominator) decreased for 12 firms (Figure 1-2 and 1-3). The increase in CET1 capital for many financial institutions reflected the increase in net earnings in the second quarter.

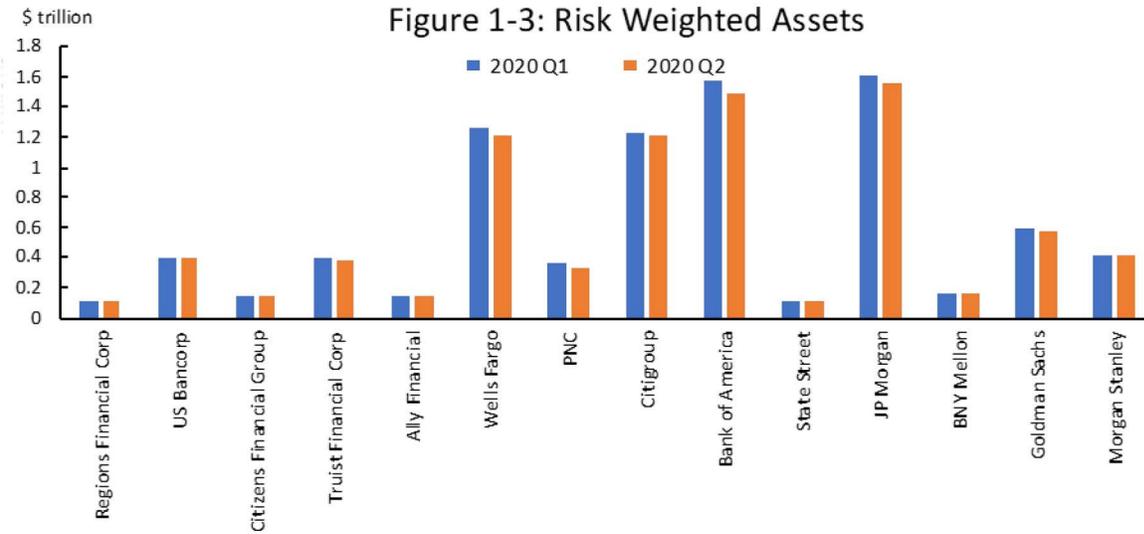
Some financial institutions attributed the decrease in RWA to reduced exposures; for example, Bank of America said that clients in the second quarter paid down \$62 billion of the \$67 billion of loan growth the bank saw in the first quarter (see slide 7 [here](#)).



(Sources) Bloomberg, Bank quarterly reports



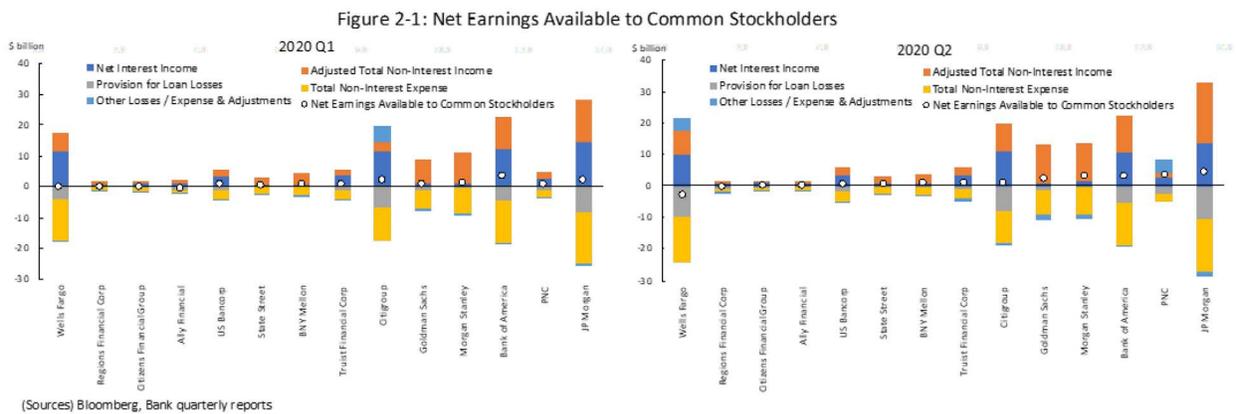
(Sources) Bloomberg, Bank quarterly reports



(Sources) Bloomberg, Bank quarterly reports

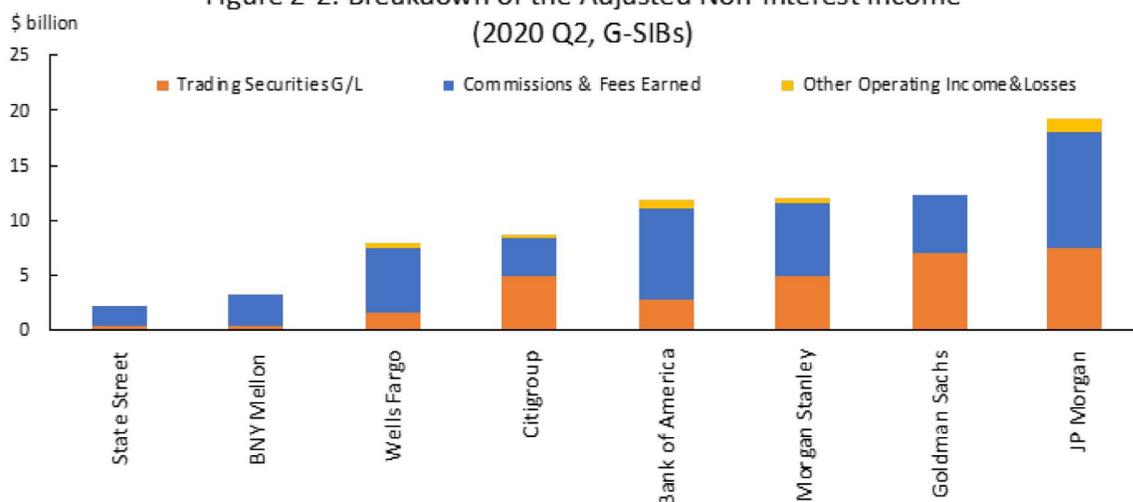
2. Net Income and Revenues

The earnings rose for three of the 14 firms, stayed roughly the same for one firm, and fell for the other 10, compared to the first quarter. However, the results were better than market expectations (Figure 6-1). That result was mostly due to solid non-interest income, which increased for 10 of the 14 firms (Figure 2-1).



Non-interest income was backed by strong non-interest income (Figure 2-2). Trading profit surged, particularly for the G-SIBs, due to the higher client trading activities induced by wider trading spreads in volatile financial markets.

Figure 2-2: Breakdown of the Adjusted Non-Interest Income (2020 Q2, G-SIBs)



(Sources) Bloomberg, Bank quarterly reports

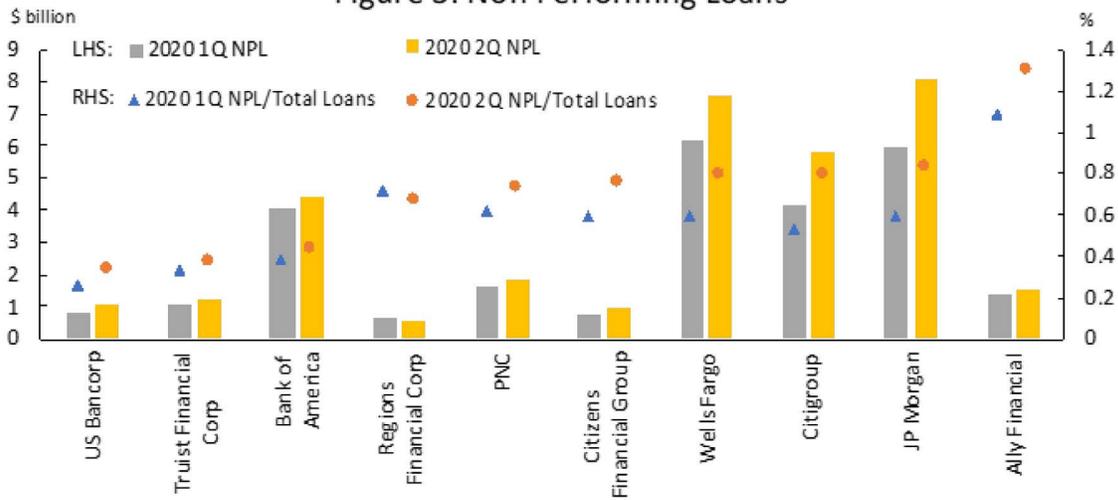
Some financial institutions noted that their equity and fixed-income underwriting business in investment banking sector also contributed to the rise in non-interest income; given the attractive low interest rate, clients' demand on bond issuance has been growing.

Bank executives [said](#) that the strong non-interest income is likely to be transient and that the impact of the trading bonanza is likely to diminish in the second half of 2020. [The Economist](#) notes that more banks may post a net loss in the third quarter if the profits in investment-banking taper while loan-loss provisions keep rising.

3. Non-Performing Loans

While banks' earnings were stronger than expected, non-performing loans (NPLs) increased 24.1% for the 10 banks compared to the second quarter (Figure 3). The ratio of NPLs to total loans increased for 9 of the 10 financial institutions. Many banks noted that in addition to small and medium-sized corporate borrowers, commercial real estate and energy-sector borrowers face severe challenges.

Figure 3: Non Performing Loans



(Sources) Bloomberg, Bank quarterly reports

However, reported nonperforming loans would have been worse if banks had not provided relief to many borrowers, under the cover of accounting and other forbearance provided by the Federal Reserve Board and Congress in response to the COVID-19 pandemic. Many loans went under deferral programs or had their terms modified. (See [here](#) for more details on Loan Modifications, Non-Performing Loans, and Accounting relief).

Banks varied widely in the details they reported on the impact of payment deferrals and other COVID-19 relief. For instance, [Ally Financial](#) exhibited its weekly auto deferral program, while [Regions Financial Corp](#) listed the number of customers’ loan modifications. US Bancorp noted that 130,000 accounts and over \$17 billion in loans have been modified through forbearance programs. JPMorgan said it has provided assistance to nearly 1.7 million accounts, representing \$79 billion in loans, since March 13; the company said its payment deferral activity had trailed off by the end of the quarter (see [here](#), slide 3).

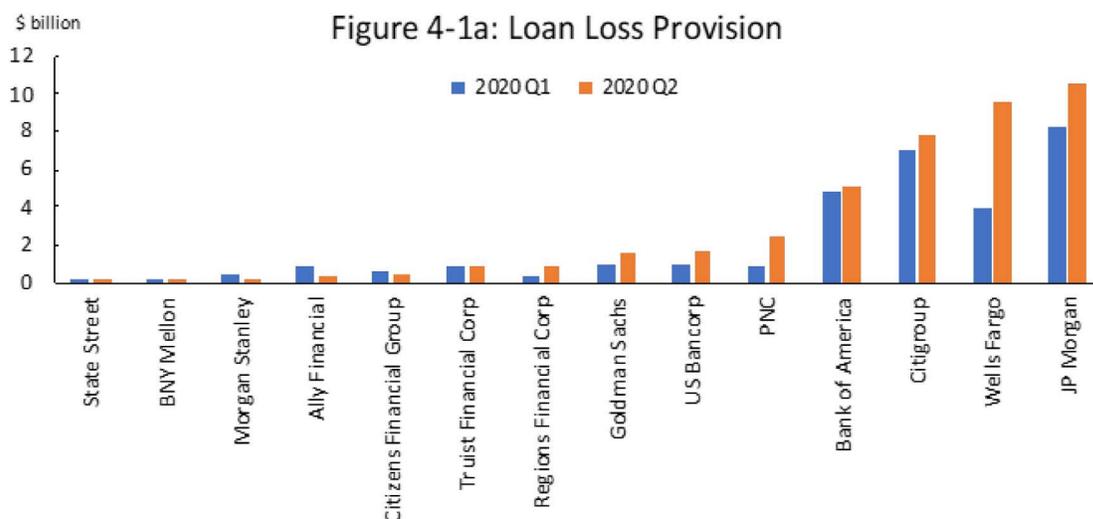
4. Loan Loss Provisioning

For the 14 financial institutions combined, the loan loss provision increased from \$30.3 billion in the first quarter to \$41.6 billion in the second quarter (Figure 4-1a).

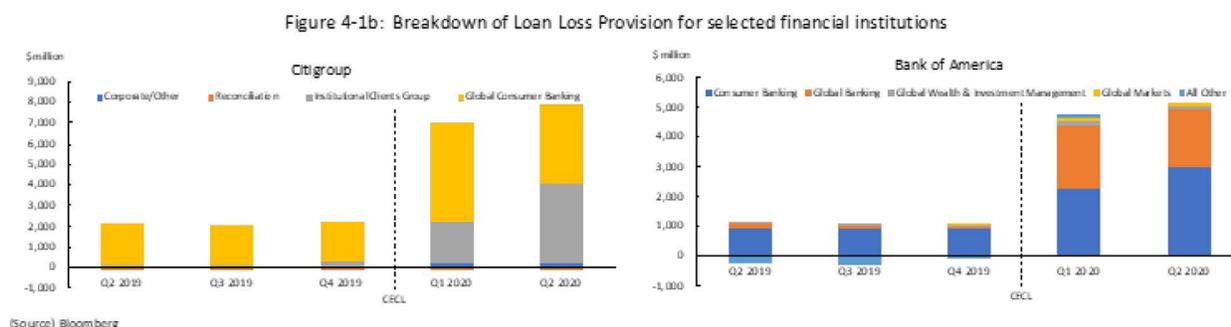
“Current expected credit losses” (CECL), a new accounting methodology for provisioning adopted by large US banks, requires banks to take into account reasonable and supportable forecasts in addition to past and current information. The loan loss provision increased significantly after the introduction of the CECL. The majority of provisioning were in consumer banking (Figure 4-1b).

Large US financial institutions adopted CECL in the first quarter, so this reporting was the second time banks report their loan loss provisioning under the new accounting methodology.

Under the CECL methodology, which requires a more forward-looking, quantitative, model-based approach, banks' provisioning is likely to diverge across banks. In second-quarter



(Sources) Bloomberg, Bank quarterly reports

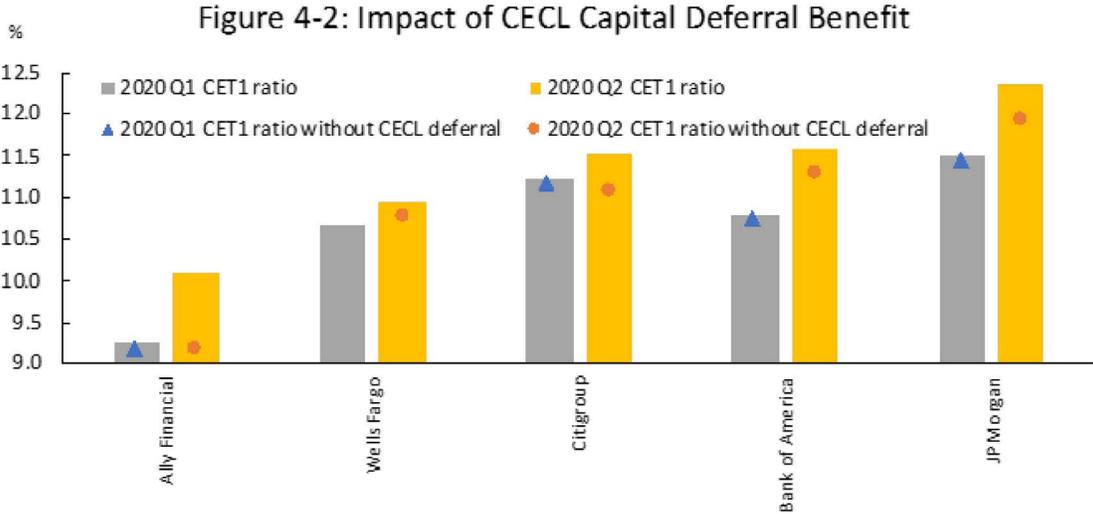


earnings presentations, there was a lot of variety in how banks reported on their CECL modeling.

Because of regulatory forbearance, the surge in loan-loss provisioning did not all show up in banks' regulatory capital calculations. In March 2020, the Fed and other U.S. banking agencies provided banks an option to temporarily delay the impacts of CECL on regulatory capital (see [here](#) for more details). Under these rules, firms that adopt CECL can calculate the estimated impact of CECL on regulatory capital as the day-one impact of adoption plus 25% of the subsequent change in allowance during a two-year deferral period. Most banks that have already adopted CECL reported their CET1 capital based on this rule.

Figure 4-2 indicates the impact of the CECL capital-deferral benefit on CET1 ratios for the first and second quarters. The differences between reported and actual capital ratios are relatively

subtle, at most 0.88%. However, the gap between the CET1 ratio without deferral and CET1 ratio with deferral seems to be widening. Moreover, it should be noted that the US banks will enjoy the transition period a year longer than their international peers, due to the discrepancy of deferral end-dates between the [agreements](#) published by the Basel Committee on Banking Supervision (BCBS) and the CARES Act.



(Sources) Bloomberg, Bank quarterly reports

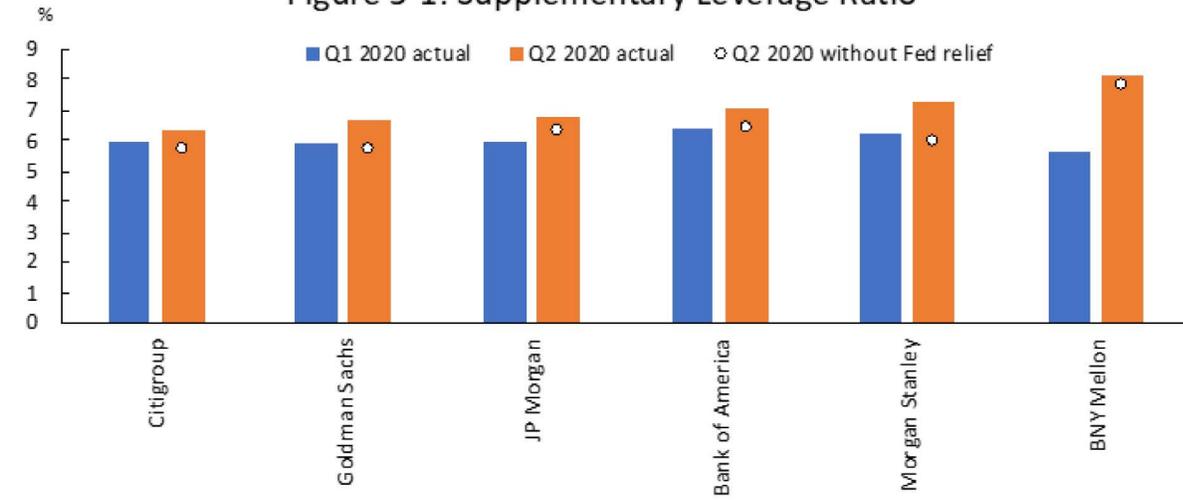
5. Other Regulatory Relief and Forbearance

Since the outbreak of the crisis, the US regulatory agencies, along with their international peers, have [implemented](#) various regulatory relief and macroprudential policies.

(a) Supplementary Leverage Ratio (SLR)

One of the reported numbers that has been impacted by this relief is the Supplementary Leverage Ratio (SLR), the US implementation of the Basel III Tier 1 leverage ratio. Systemic US banks are required to maintain an SLR of at least 5%.

Figure 5-1: Supplementary Leverage Ratio



(Sources) Bloomberg, Bank quarterly reports, Risk.net

Name of the institution	PPP loan / Total loans (%)	Mention on PPP (quote from presentations and earning reports)
Citigroup	0.05	Small Business: issued ~30K loans totaling \$3.4B through SBA's Paycheck Protection Program \$25MM in initial proceeds from Citi's participation in SBA's Paycheck Protection Program to support Community Development Financial Institutions
Regions Financial Corp	0.49	Began receiving PPP applications April 3rd - Through July 8th, funded ~45,000 loans totaling ~ \$5B - Average loan size ~\$106K - 98% of funds to companies with <100 employees - Supported over 600,000 jobs
Citizens Financial Group	0.36	\$4.7 billion PPP loan balance at June 30, 2020 Customer profile skews to small businesses - ~\$98,000 average loan size - ~84% of loans under \$100,000 - ~93% of loans for companies with under 25 employees Over 540,000 jobs supported Expect high percentage to be forgiven over third and fourth quarter
US Bancorp	0.23	U.S. Bank has also loaned \$7.3 billion to over 101,000 customers participating in the Paycheck Protection Program stemming from the CARES Act passed by Congress as a stimulus response to the potential economic impacts of COVID-19. Approximately 87 percent of these loans were for less than \$100,000.

Wells Fargo	0.10	Funded 179,000 commercial loans totaling \$10.1 billion with an average loan size of \$56,000 <ul style="list-style-type: none"> - 60% were for loan amounts less than \$25,000 - 41% were to companies in low-and moderate-income areas or at least 50% minority census tracks - 84% were for companies that had fewer than 10 employees - 90% of companies had less than \$2 million in annual revenue
The PNC	0.53	PNC funded \$13.7 billion of PPP loans during the second quarter.
JP Morgan	0.20	At June 30, 2020 [...] \$19.9 billion of loans under the Paycheck Protection Program (“PPP”)
Bank of America	0.25	Completed ~334,000 PPP loans YTD to deliver \$25B of funding to small business owners (average of \$78k, 99% of loans to businesses with <100 employees)
Truist Financial Corp	1.10	CARES Act Impacts <ul style="list-style-type: none"> - Third largest PPP lender based on gross fundings - Provided accommodations to clients on \$21.2 billion of commercial loans, \$13.8 billion of consumer loans, and \$211 million of credit card loans as of June 30, 2020, representing 11.2 percent of loans and leases held for investment

On April 1, the Federal Reserve allowed the largest bank holding companies to temporarily exclude reserves and Treasury securities from their calculation of total assets for determining the supplementary leverage ratio. A media comment [notes](#) that the Fed relief had a “huge effect” on banks’ balance sheets. The most recent banks’ reports illustrate that impact.

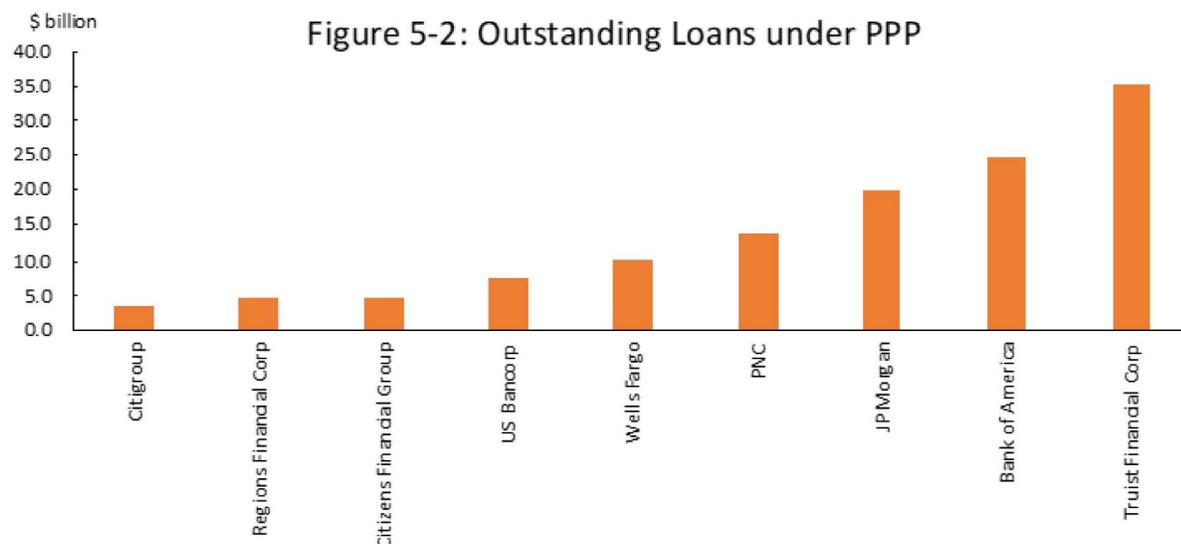
Figure 5-1 compares the SLR for the first quarter without Fed relief, the second quarter without Fed relief, and the second quarter with Fed relief (the reported SLR). For instance, Morgan Stanley benefitted from the relief the most. Its SLR would have been 0.9% less without the relief. The impact of the regulatory forbearance on the SLR is expected to end on March 31, 2021.

(b) Risk weights on loans related to the Fed’s lending facilities

Banks’ balance sheets also reflect their participation in Fed [lending facilities](#) in response to COVID-19. Many banks reported their participation or plans to participate in programs including the Paycheck Protection Program (PPP), Money Market Mutual Fund Liquidity Program (MMLF), and Main Street Lending Program (MSLP).

In particular, nine banks have reported their participation in PPP, many underscoring their lending to the SMEs in their presentations for investors.

Figure 5-2 indicates the outstanding PPP loans for each bank. The amount is expected to increase for the next quarter, supported by strong demand. Banks are also expected to report the impact of the MSLP in third-quarter earning reports.



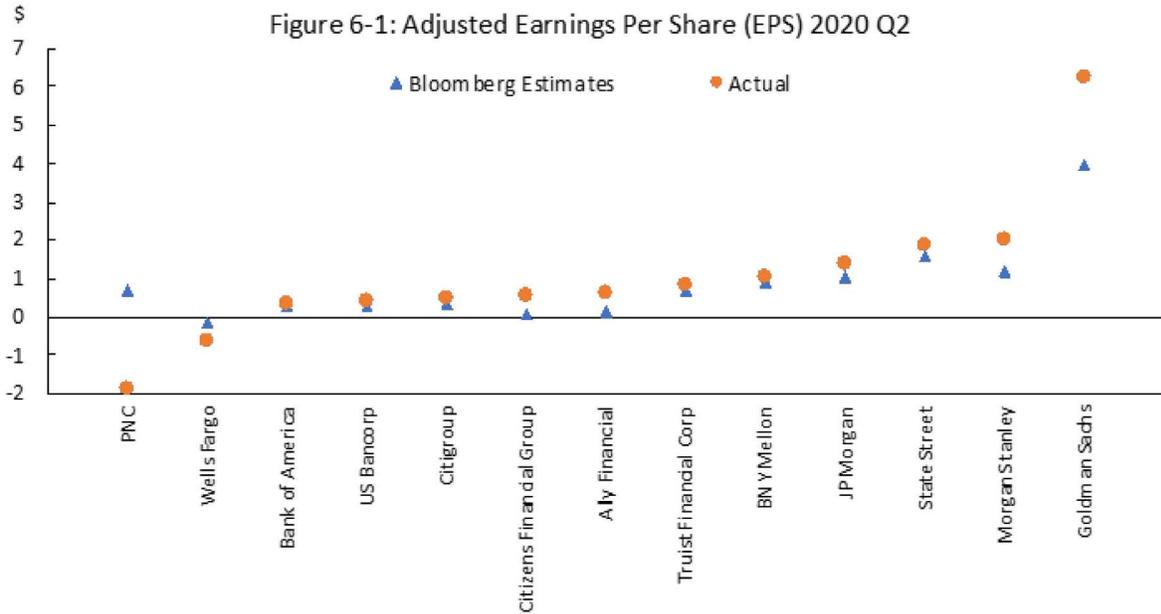
(Sources) Bank quarterly reports

In April, the Federal Reserve and other US regulatory agencies issued [a final interim rule](#) on the regulatory treatment of the PPP loans. In order to facilitate use of the PPP, the regulatory capital effects of participating in the PPP will be neutralized; the PPP loans will be excluded from leverage exposure, consolidated assets, and risk-weighted assets. In terms of CET1 ratio calculation, the PPP loans will be granted 0% risk weights.

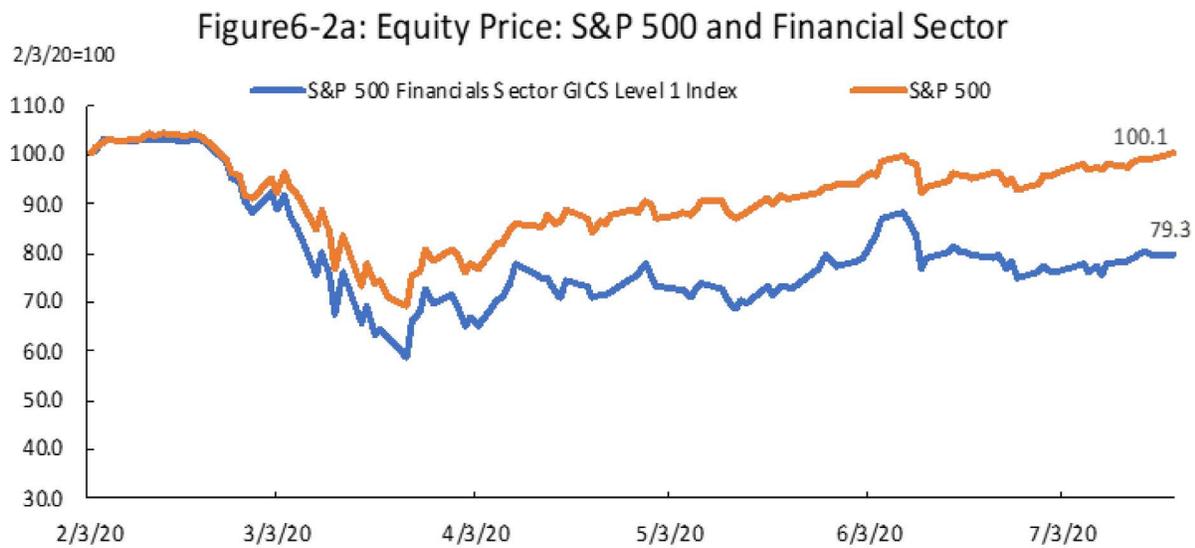
Additionally, non-recourse loans provided under the Money Market Mutual Fund Liquidity Facility also receive [regulatory neutralization](#).

6. Market reaction and equity prices

The earning reports, overall, were better than market participants had expected. Figure 6-1 exhibits the differences between Bloomberg’s consensus estimates and the actual adjusted earnings per share (EPS); for the 12 financial institutions that did not have negative adjusted EPS, the actual results outperformed the market estimates, sometimes with wide margins.



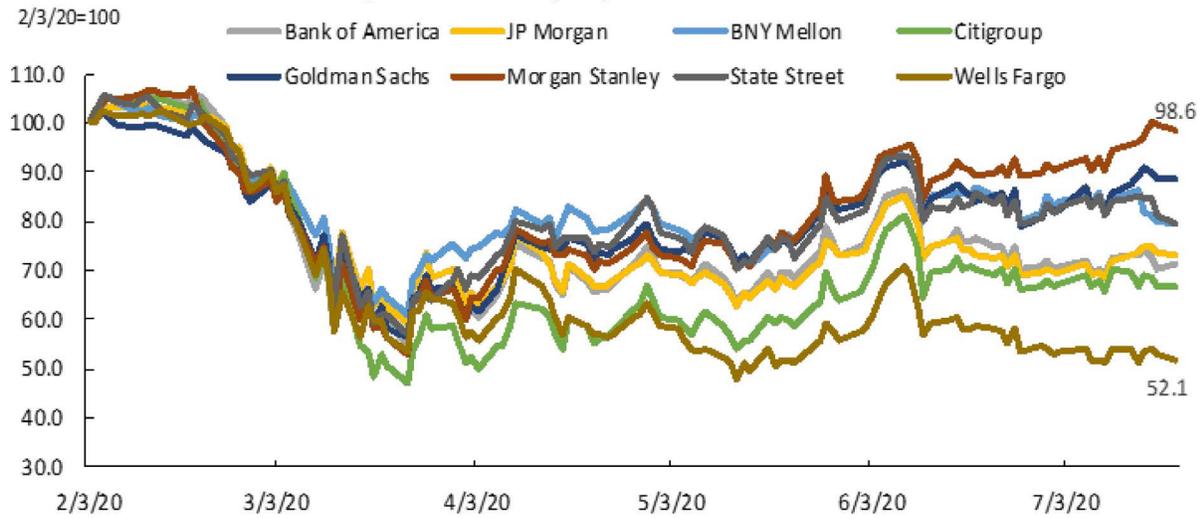
(Sources) Bloomberg



(Sources) Bloomberg

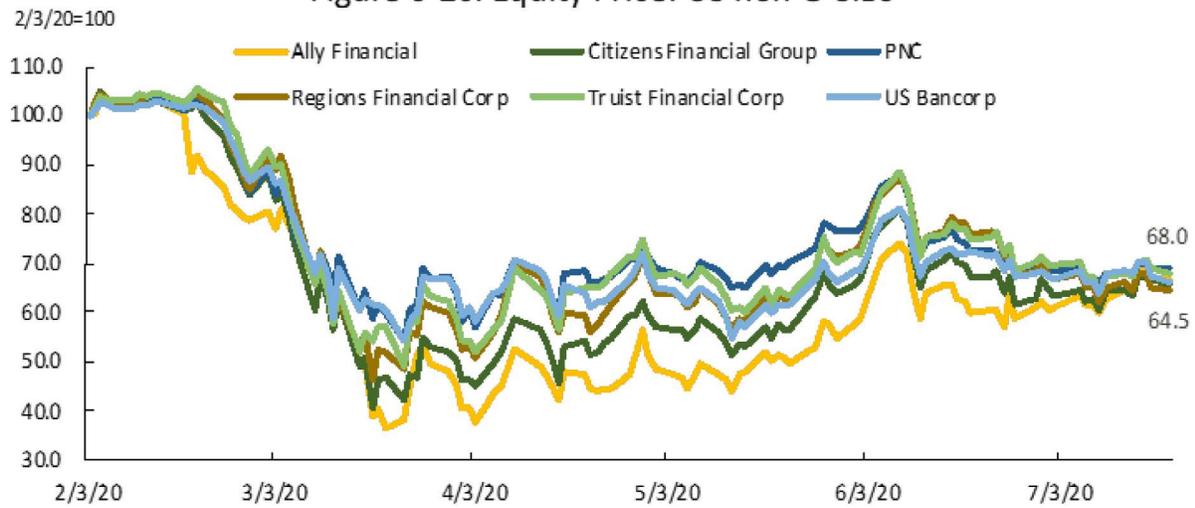
However, market prices suggest that the financial sector still faces many significant challenges. Figure 6-2 show financial firms' slow recovery in equity prices, while the S&P 500 benchmark index has returned to levels reached prior to the outbreak of the COVID-19 crisis. As the crisis and the recession are expected to prolong, the investors expect the next quarter to be as challenging, particularly for non G-SIBs that cannot benefit from the trading profit bonanza or lending in foreign countries, where COVID-19 cases have dwindled.

Figure 6-2b: Equity Price: US G-SIBs



(Sources) Bloomberg

Figure 6-2c: Equity Price: US non G-SIBs



(Sources) Bloomberg

Risks May Suggest a Role for an Extension of Bank Debt Issuance Guarantees

By **Steven Kelly**

Original post [here](#).

Included in the U.S. Coronavirus Aid, Relief, and Economic Security (CARES) Act passed by Congress in March [was temporary reauthorization](#) of federal bank debt guarantees first (and last) used in the Global Financial Crisis (GFC).

During the GFC, the Treasury used the Exchange Stabilization Fund (ESF) to guarantee money market funds (MMFs) and charged fees to do so. The Federal Deposit Insurance Corporation (FDIC) used a novel legal interpretation to create the Debt Guarantee Program (DGP) and Transaction Account Guarantee Program (TAGP), [both of which saw the FDIC guarantee various forms of bank debt](#) for a fee.

The TAGP provided unlimited insurance to certain otherwise-uninsured transaction accounts while the DGP guaranteed new unsecured debt issuance by banks, bank holding companies, and eligible holding company affiliates (henceforth, “banks”). The DGP – created in October 2008 – gave banks approximately a year to issue guaranteed debt and the guarantee lasted to the sooner of either the debt’s maturity or December 31, 2012. This program insured the debt [of 121 entities, peaked at \\$350 billion outstanding, and collected fees of \\$10.4 billion, while paying out only \\$153 million in claims on defaulted debt](#).

After the crisis, Congress barred the FDIC from creating another TAGP and the Treasury from guaranteeing MMFs with ESF funds. However, in the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, Congress made it possible for the FDIC to [set up a new DGP if “a liquidity event exists that warrants use of the guarantee program”](#) as certified by the Boards of the FDIC and the Federal Reserve (the Fed) and the Secretary of the Treasury in consultation with the President – but now only if Congress also [approves it directly](#).

The CARES Act preemptively granted this approval, subjected to the condition that the guarantees end no later than December 31, 2020. CARES also temporarily removed the outright ban on creating a new TAGP or an ESF-funded guarantee of MMFs, again provided that both end by year-end.

Congress is now working to pass another major economic relief act. It should consider extending the DGP approval, even if it decides not to extend the authority for money market and transaction account guarantees.

U.S. policymakers have not spoken publicly about debt guarantees in recent weeks. Still, it’s clear that an extension of the guarantee authorities would give them valuable flexibility in a future crisis response.

Extending the duration of the guarantees would be particularly valuable. While the issuance period Congress granted in the CARES Act was reasonably consistent with the issuance period of the GFC's DGP (roughly eight and 12 months, respectively), the guarantee period as provided by CARES does not persist thereafter. This may make any new DGP ineffective at supporting term funding or addressing the [persistent effects of the current economic crisis](#). Having an authorized, robust DGP, even if not activated, could provide a financial stability backstop through the end of the coronavirus crisis that reduces the odds of this economic crisis becoming a financial crisis.

Future Financial Sector Strength Is Not Certain

Unlike the GFC, the current crisis did not begin in the financial sector; it does, however, carry the potential for negative implications for the financial sector via numerous channels: particularly loan losses, risk aversion, and liquidity demands. The pandemic's economic effects have thus far been attenuated by the fact that banks had a [historically strong capital and liquidity position \(pp. 41-42, 50-51\)](#) at the outset. If the ongoing pandemic places enough cumulative stress on the financial sector, however, the financing of banks themselves may only come on tighter terms, with shorter maturities, or not at all. This is the [general mechanism](#) by which a recession becomes a [financial crisis](#) – amplifying and perpetuating the economic damage.

We know that, for instance, during the GFC, financial firms either failed or were rescued (publicly or privately) over the course of days, not weeks or months. This is because increasingly short-term funding could not be rolled over, and firms became conditionally insolvent. Lehman Brothers, for its part, was [funding 1/3 of its portfolio in overnight repurchase agreements](#) – “repo” – at the time of its failure. Again, no major banks are near this situation at present, but it's illustrative of how pressures can build absent a sufficient policy response. Market liquidity was strained early in the pandemic before the Fed intervened.

A DGP could help to avoid [this bad equilibrium](#) of increasingly unstable funding of banks, sensitive to drying up at any moment. By allowing banks to retain access to term funding at reasonable rates, guarantees on debt issuance could [ensure](#) that they continue term lending, credit risk assumption and other banking activities that support the economy with more certainty. Banks can avoid having their capital position eroded by increasing interest costs and haircuts on their collateral, or worse: in the case of lenders simply deciding to avoid the risk of funding a bank or banks altogether, even a well-capitalized bank could fail quickly.

A DGP's [fee structure](#) (essentially insurance premiums) can help limit moral-hazard concerns and partially protect the FDIC's Deposit Insurance Fund. The knowledge that guarantees are available as a backstop could itself be enough to prevent private lenders stepping away from term risk. Some of the Fed's lending programs this year have provided such reassurance [without being used extensively](#).

Re-Run on the Financial System at the Outset of COVID-19 Disruption

We saw the aforementioned “[flight from maturity](#)” and outright withdrawals of unguaranteed funding start to occur in [repo](#), [commercial paper](#) and [other](#) financial debt during the onset of the pandemic. There’s a risk we could see it again as the health crisis continues, particularly in a so-called “double-dip” recession scenario – what the Fed is calling a “W-shaped” recovery in its bank stress tests (more on this below).

This is particularly the case for foreign banks who lack a stable base of dollar retail deposits. They are especially [dependent](#) upon the unguaranteed dollar funding markets to execute dollar-denominated credit extension. As such, the [run on prime MMFs](#) – primarily institutional, cash stockpiles that purchase risky, short-term private sector assets – in favor of government-only funds (which invest in Treasuries and Agency debt) was [particularly disruptive](#) for these banks.

Approximately \$200 billion flowed out of prime funds in February and March, and over \$1 trillion flowed into government funds by April. This repeated a pattern seen in the GFC and showed that various regulatory reforms have been [inadequate](#) to prevent recurrent disruption; this MMF disruption necessitated the Fed standing up various facilities, [including a backstop to lend non-recourse against banks’ purchases of these assets from MMFs](#).

In the wake of this damage, several notable prime funds have even been closed due to the volatility. As quoted [in Bloomberg](#), Nancy Prior, the President of Fixed Income at Fidelity Investments – the largest holder of MMF assets – said upon the closing of its prime institutional funds, “Time and again we’ve seen a rapid shift from institutional prime funds to government funds.” The Bloomberg article also notes, “Prior said Friday that Fidelity believes its institutional clients’ liquidity needs are better addressed by government-only funds.”

Furthermore, due to profitability concerns as the Fed has cut rates to zero, we’ve also witnessed some government MMFs rejecting new money and [forfeiting management fees](#) to boost returns. Thus, there is both a borrower and investor desire for more stability in this space.

Even without a new guarantee of prime MMFs – which may be less feasible given the fund shutterings, previous Congressional desire to restrict them outright and the growing policymaker chorus calling for more MMF reform (see below) – a DGP could help stabilize this funding (and institutional cash management) market.

By wrapping privately-issued bank paper in an FDIC guarantee that pays immediately upon a missed payment, the debt becomes legally eligible for purchase by government-only funds ([15 U.S.C. 80a-2\(a\)\(16\)](#)). This wrapping thus expands the universe of eligible repo collateral for government MMFs, partially alleviating the downward pressure on rates causing government funds to turn away investors looking for safe, liquid stores of value. A DGP might thus allow policymakers to strike the proper balance between longer-term financial stability concerns (several have called for [new restrictions](#) on prime funds to avoid future public backstopping, if

not their outright closure) and the availability of short-term credit via money market investors throughout the pandemic.

Maintaining banks' market-based funding will be particularly important if we see another financially volatile period like we saw in March and April. In this period, commercial and industrial (C&I) firms drew on their credit lines with banks for [at least several hundred billion dollars](#) (see also: [page 47 of the Fed's latest Financial Stability Report](#)). Foreign banks alone – those most dependent upon wholesale dollar liquidity – increased their C&I loan book by [about \\$150 billion](#) within a few weeks starting in March. The Fed, meanwhile, did not make any direct nonfinancial credit extensions until [the middle of April](#), and [to date](#), has had less than \$10 billion of such extensions outstanding.

Bank credit lines were able to provide “[instant liquidity](#)” to their customers – many of whom eventually paid them down with longer-term bond financing. While the Fed has begun intervening in the bond and commercial paper markets – which also may taper off before a volatility resurgence occurs, these are still a slower and less inclusive form of financing (and more [public](#)) than drawing on revolving credit. Banks [retaining access to liquidity](#) will be essential in the event of another set of rapid economic shutdowns and cancellations. Indeed, banks' relative nimbleness in extending credit – at least to existing customers – has been seen as an asset when designing other economic relief programs such as the [Paycheck Protection Program](#) and the [Main Street Lending Program](#) (see [Appendix C, p. 10](#)).

It remains a risk that absent a DGP, funding pressures on banks, which become funding pressures on firms, would be worse during a second round of volatility – potentially leading directly to financial firm failures or indirectly via commercial firm failures.

It is also worth noting the potential for a DGP to support the goals of other emergency measures already put in motion.

Capital Supporting Public and Private Bond Markets

Given that the DGP offers the U.S. Treasury's full faith and credit to the bond issuances of financial institutions, banks can replace their outstanding funding with new AAA-rated term funding. This would have a number of important synergies with outstanding policies.

In addition to the aforementioned funding stability directly helping limit illiquidity-induced bank capital losses from a new round of flight from unguaranteed term funding of banks, this credit quality upgrade could [reasonably be expected](#) to increase the prices of legacy securities. This would reduce the incentive for investors to reallocate to underpriced legacy securities thereby starving new investments of capital – the avoidance of which is a [goal](#) of the Fed's legacy-bond-buying Secondary Market Corporate Credit Facility (SMCCF), among other facilities. As per the ICE/BofA index, banking firms make up over 20% of the U.S. investment-grade bond market. The collateral upgrade (or, again, even just the announcement of the backstop thereof) and pursuant price appreciation, would also add capital to bond buyers and dealers and reduce

their risk metrics – the levels of which both provide [limits](#) on their ability to support bond markets.

Indeed, the Fed has [justified](#) its vast scale of Treasury and mortgage-backed securities purchases and [its temporary exemptions](#) to the constraints of the Supplementary Leverage Ratio as necessary to reduce banks’ and dealers’ balance sheet constraints, so they can continue to intermediate financial markets. (Regulators have also [neutralized](#) the impact of certain [federal lending](#) programs on all regulatory capital ratios.)

As bank balance sheets expand, however, it will be important that bank solvency remains unimpeachable. A second round of stress tests may soon provide an update on banks’ status in that regard.

Stress Test Legitimacy

While the Fed recently completed [its annual Dodd-Frank Act stress test \(DFAST\) of bank capital levels](#), the stress scenarios were designed before the coronavirus pandemic and the tests executed were based on balance sheets from 12/31/19. Given the relative staleness of such data (bank balance sheets have grown [by approximately 12%](#) during the pandemic) and the fact that many economic indicators have already moved more adversely than the stress test’s severely adverse scenario, two extra tests were born.

First, the Fed released with the standard results [the results of a “sensitivity analysis”](#) in which the 33 banks subject to DFAST were also subjected to various coronavirus-related forward-looking scenarios: a “V-shaped” recovery, a more prolonged “U-shaped” recovery, and a “W-shaped” economic recovery in which the U.S. experiences a second wave of economic lockdowns associated with a virus resurgence.

Unlike the standard stress tests, however, the results of this analysis were not released on a by-bank basis, subjecting them to [criticism and skepticism on grounds of transparency and legitimacy](#) – not least because, in the W-shaped scenario, 25% of banks were shown to be nearly at or below their required regulatory minimum common equity tier 1 (CET1) capital ratio. How the banks’ [other capital requirements \(p. 22\)](#) would be expected to evolve under the sensitivity analysis scenarios was also not disclosed.

The W-shaped scenario showed the bottom quartile of banks falling below 4.8% CET1 to risk-weighted assets; the minimum requirement is 4.5%. The 4.8% figure also does not include the effect of Q1 and Q2 capital distributions, which reduced aggregate capital by another 50 basis points; see [page 20](#) of the analysis.

Second, the Fed is designing a more robust pandemic scenario and, once released, will require banks to resubmit their capital plans within 45 days. The Fed’s Vice Chair of Supervision Randal Quarles has [said](#) the Fed will only release bank-specific information following the incipient additional analysis if it can do so confidently--in other words, if it feels, unlike with June’s sensitivity analysis, that the bank-specific data is granular and precise enough.

This may be especially important in the case of firm-specific capital actions; for instance, Wells Fargo booked its first loss since 2008 in Q2, while Morgan Stanley booked a record profit (and even [spoke of increasing capital distributions](#)). Fed officials may decide to issue firm-specific capital actions which, given the scale of the current crisis, may indeed encourage a reallocation by investors from relatively affected institutions in favor of the unaffected – a phenomenon that can be tempered by the presence of public guarantees. Or, in the case of a blanket dividend ban in which regulators also encourage raising fresh capital, the Fed may want to offset any [pursuant increase](#) in banks’ cost of capital.

As alluded to, it is generally considered [best practice](#) in a crisis to avoid sparking a run on a relatively weak, but conditionally sound financial institution by releasing bank-specific data. During the GFC, however, the then-unprecedented transparency of the seminal stress tests [helped afford them legitimacy and public trust](#). This was made possible by the fact that the stress tests were backstopped by Troubled Asset Relief Program funds: if a firm was found to need to raise capital, but could not raise capital on the market, [over \\$100 billion \(see p. 270\)](#) of allocated and released TARP funds was left to recapitalize these firms – on [publicly-known terms \(see p. 272\)](#). No such funds exist today.

Thus, the Fed is in a [difficult situation if it wants to use the updated stress analysis to drive firm-specific capital actions](#). As noted, in a more severe scenario, a quarter of tested firms were already near or below CET1 regulatory minimums in the less-developed sensitivity analysis. Again, this is but one of the capital ratios banks must meet. Given that, unlike in 2009, there is no public capital backstop proactively in place, firm-specific results of any new stress analysis may cause specific banks to experience renewed stress on market-based funding. In the event that public funds are needed to recapitalize these firms, but are not yet appropriated, a “liquidity event” may indeed occur in the interim. By extending its DGP approval before such an event, Congress could buy itself time to negotiate a recapitalization package if that becomes necessary.

As policymakers consider how to appropriately respond in a lasting way to the scale of the current crisis, provisioning for a robust DGP could provide them with the option of a valuable tool going forward.

Countering COVID-19 with Countercyclical Bankruptcy Policy

By Alexander Nye and Greg Feldberg

Original post [here](#).

Governments are temporarily tilting their bankruptcy laws in favor of debtors to help businesses survive the crisis. Some have taken advantage of the crisis to propose permanent pro-debtor bankruptcy reforms.

Many countries have found that their current bankruptcy laws do not offer enough relief to debtors in these difficult times. This even applies to countries with pro-debtor systems, like [Chapter 11](#) in the United States, that aim to avoid liquidations and restructure all companies that are viable as going concerns. Due to COVID-19, many otherwise viable businesses see themselves without a strategy for recovery until social-distancing measures end. Policymakers fear that this will force countless businesses to liquidate, leaving even more workers unemployed. So many bankruptcies could overwhelm bankruptcy courts, drawing out an already painful process.

In response, countries with creditor-friendly bankruptcy systems--those that focus on the orderly liquidation of insolvent firms for the benefit of creditors--are taking on more of the characteristics of debtor-friendly [systems](#)--which favor restructuring for the benefit of debtors. Creditor-friendly UK and Germany focus on equitably compensating all creditors through liquidation and typically discourage or forbid debtor-friendly practices. The more debtor-friendly US system makes it difficult for creditors [to execute](#) an involuntary bankruptcy and allows companies to continue to conduct transactions after a company has become insolvent, a practice known as “insolvent trading.” [Italy](#) and [France](#) have restructuring procedures that are arguably more debtor-friendly than Chapter 11.

This blog focuses on the temporary measures that governments are taking to save businesses from liquidation and help bankrupt businesses restructure more easily. We survey the following nine tools:

- Moratoria
- Changing the definition of insolvency
- Extended notice periods for debtors
- Changes to preferential transfer rules
- Relaxed rules mandating that managers file for bankruptcy
- Relaxed rules against “wrongful trading”
- Expanded access to simplified bankruptcy procedures

- Modification of existing bankruptcy payment plans
- Preferred status (payment seniority) for lenders to troubled businesses

Moratoria

Governments can impose moratoria on bankruptcy applications to close bankruptcy courts to new cases. They can also put a stop to bankruptcy proceedings for existing cases. Another alternative would be to delay deadlines for creditors and debtors to take certain actions in bankruptcy courts, similar to the [automatic stay](#) in US bankruptcy law.

Some moratoria appear to be tied to other lockdowns of non-essential government services and are thus more about public health policy than macroprudential policy. (We define “macroprudential” as policies that seek to promote financial stability). For example, on March 18, [Switzerland ordered](#) a moratorium on debt collection and bankruptcy proceedings through April 4. Similarly, the [Government](#) of India declared a 21-day lockdown on March 25. The Insolvency and Bankruptcy Board of India (IBBI) [responded](#) on March 29 with a statement that the remaining days of the lockdown would not count toward the various timelines imposed by India’s bankruptcy code.

[Turkey](#) has implemented what is close to a blanket moratorium on bankruptcy. Beginning March 22, Turkey suspended nearly all access to creditor-debtor law through April 30. The “Decree to Suspend Enforcement and Bankruptcy Proceedings” halted all new and current bankruptcy proceedings. The [only proceedings exempted](#) from Turkey’s moratorium are those related to the enforcement of child support.

An alternative to a moratorium is to make it more difficult for creditors to impose bankruptcy on debtors. This approach leaves open the possibility of debtors voluntarily filing for bankruptcy because they need relief during a crisis.

Russia recently [passed](#) a six-month [moratorium](#) during which creditors can take no bankruptcy actions against companies impacted by COVID-19. The law grants the government [discretion](#) over who will benefit from the moratorium. After [May 1](#), government creditors will be exempt from the rule and will be allowed to file against debtors. The [moratorium](#) also halts the enforcement of debts and any financial sanctions that might be imposed as part of bankruptcy proceedings. The moratorium law imposes behavioral expectations on debtors who benefit; it forbids debtors from distributing dividends or buying back their shares during the moratorium. On the other hand, it [also allows](#) creditors to maintain existing attachments on a debtor’s assets and imposes other restrictions on the disposal of assets.

Similarly, [creditors in Czechia](#) will not be able to file bankruptcy petitions against debtors until the state of emergency ends or August 31, whichever comes first. Czechia also proposed what it called [extraordinary moratoria](#) for companies that are still solvent. These are temporary moratoria on payments that can be obtained with fewer administrative barriers, can last up to six months, and do not require the consent of creditors to be approved. Businesses can apply for

these moratoria until August 31. Czechia also will change its bankruptcy code to offer moratoria to debtors who are not yet insolvent, but will probably become insolvent if not helped soon.

Germany has implemented a [version of this policy](#). Debtors can file for bankruptcy, but creditors are not allowed to file against a debtor between March 1 and June 30 unless the debtor's insolvency or over-indebtedness had occurred before March 1. Similarly, [France](#) has stopped creditors from filing insolvency proceedings against a debtor who is unable to meet its outstanding liabilities with its available assets until three months after the end of the country's health emergency period. This protection is only available for debtors who became cash-flow insolvent after March 12.

Changing the definition of insolvency

Some countries are trying to stem the flow of bankruptcies by temporarily increasing the amount of defaulted debt at which a company is deemed insolvent. [Australia](#) increased the threshold for insolvency from AU\$5,000 to AU\$20,000 (from \$2,998 to \$11,992), [India](#) increased from Rs 100,000 to Rs 10,000,000 (from \$1,308.56 to \$130,855.80), and [Singapore](#) plans to increase from [S\\$10,000 to S\\$100,000](#) (\$5,996 to \$59,960).

Extended notice periods for debtors

Government can also give debtors more time to stave off a liquidation by simply increasing the amount of time debtors have to respond to a bankruptcy notice. This can slow down the bankruptcy process at its earliest stages and relieve some of the administrative burden on the courts. For example, Australia [gave](#) debtors six months, rather than 21 days, to respond to a creditor's bankruptcy notice.

Changes to preferential transfer rules

Governments can also use temporary changes to their bankruptcy laws to incentivize creditors to do business with or lend to companies rendered temporarily insolvent by COVID-19. During normal times, many bankruptcy codes (including the [US Bankruptcy Code](#)) allow the estate of the debtor to void or "claw-back" certain transactions executed in the period leading up to the bankruptcy. These transactions are known as preferential transfers. These rules ensure that similar kinds of creditors are treated equitably. However, they also can [discourage](#) banks from lending to or helping rescue a troubled company. A number of countries have made these rules less stringent or provided even larger incentives for creditors to aid a company that may be insolvent.

Germany implemented two policies attempting to reduce disincentives for new lending to and payments by these businesses. First, all loans [granted](#) to companies between March and September cannot count as "an illegal delay of insolvency" and be voided until September 30, 2023. [Second](#), agreements between an insolvent business and its creditors are insolvency-proof until September 30.

Relaxed rules mandating that managers file for bankruptcy

A number of European countries have temporarily modified laws that oblige a company's management to file for bankruptcy within a certain period after the company has become cash-flow insolvent, that is, when it cannot pay its debts as they come due. These efforts also aim to prevent the court system from being flooded with bankruptcy petitions from managers of only temporarily insolvent firms that would ordinarily be forced to file.

[Luxembourg](#) usually mandates that management file for bankruptcy within one month of having missed a payment to a creditor. On March 25, Luxembourg suspended this requirement until June 25.

Other countries have taken an approach that is more generous to debtors. For example, [Germany](#) has suspended management's obligation to file within three weeks after the company has become over-indebted or cash-flow insolvent, through September 30. However, the policy does not protect businesses that became cash-flow insolvent for reasons not related to COVID-19 and businesses where there is "no prospect of eliminating the insolvency." The government also built a statutory assumption that expands the number of debtors who can benefit from the policy. The law assumes that any company that became insolvent in 2020 can blame COVID-19. Usually, company managers are liable under both criminal and civil law for failing to file for bankruptcy within three weeks of becoming over-indebted or cash-flow insolvent.

Similarly, Czechia has proposed a law that, among other things, abolishes the management's obligation to file for insolvency until six months after the country's emergency measures lapse. Only insolvencies that occurred because of COVID-19 are eligible for this relief and the government will have to pass a law to extend this policy if the emergency measures are still in effect at the end of 2020. Usually, Czechia takes a discretionary approach to punishing those who fail to file after knowing they are insolvent. The law normally [specifies that](#) insolvent debtors have to file without undue delay after learning of the insolvency or "after it should have learned of its insolvency if it had exercised due care."

Case Studies and Policy Changes

UK, EU Move to Ease Impact of Accounting Rules for Borrowers Affected by COVID-19

By Greg Feldberg

Original post [here](#).

On March 20, the Bank of England and European Central Bank (ECB) provided guidance to banks on how to follow accounting rules in evaluating loans to borrowers affected by the COVID-19 crisis.

The new IFRS 9 accounting standard, implemented in most of the world outside the U.S., requires banks to set aside loan loss allowances against all future expected losses for loans to borrowers who are categorized in high-risk groups. For borrowers in the low-risk group, the standard only requires banks to set aside allowances for 12 months of expected losses.

Most borrowers are now in the low-risk group. But IFRS 9 could require banks to downgrade borrowers into a high-risk group if they miss payments because of the crisis. Such downgrades would affect banks' capital negatively, making it harder for them to keep lending or provide forbearance to affected borrowers.

In different ways, UK and EU regulators gave guidance to banks to be flexible in such cases. Specifically, they said that banks should take into account government relief measures in evaluating borrowers and calculating expected losses on their loans. The guidance says that those relief measures, such as payment holidays or loan guarantees, should not automatically lead banks to move borrowers from 12 months of expected losses to lifetime expected losses.

The [Bank of England](#) said that, when firms calculate future losses, it expects they will “reflect the temporary nature of the shock, and fully take into account the significant economic support measures already announced by global fiscal and monetary authorities.”

The [ECB](#) said it would “exercise flexibility” regarding the classification of borrowers as unlikely to pay when banks call on new COVID-related public guarantees and on borrowers covered by legally imposed payment moratoria.

In the U.S., the Financial Accounting Standards Board (FASB) implemented the Current Expected Credit Losses (CECL) standard for large banks at the beginning of this year. Like IFRS 9, CECL provides a forward-looking framework for banks' calculation of expected losses. Bankers and some U.S. regulators [this week](#) called on FASB to loosen or delay the standard. FASB has [said](#) that is the regulators' call.

Denmark Plans to Pay Fixed Costs for SMEs Hit by Coronavirus Lockdown

By Alexander Nye

Original post [here](#).

On March 18, the Danish Minister of Finance [introduced](#) a plan to pay a significant portion of the cost of small and medium businesses whose revenues fall by more than 25% during the coronavirus pandemic. The plan, which the Parliament passed on March 19, would cost the government roughly 40 billion Danish crowns (\$5.8 billion or about 1.6% of GDP) for the first three months (see details [here](#) in Danish).

The Minister also announced programs for self-employed people and for owner-operated businesses with 10 or fewer full-time employees. These programs will complement Denmark’s strong existing unemployment insurance program.

Denmark is the latest country to introduce a program to help small businesses struggling with an unprecedented global revenue shock. These programs range from asking banks to voluntarily delay payment dates to broader [tax](#) or debt holidays. In some cases, [governments](#) may ease the cost for banks through regulatory forbearance. In other cases, governments provide direct subsidies to prevent SMEs from missing payments (see [India's vast farm loan waiver programs](#)).

In normal times, such programs may be [criticized](#) for creating moral hazard and raising long-term borrowing costs. During the coronavirus pandemic, though, such programs may not raise moral hazard concerns if they will sunset when the virus has passed. Also, the Danish government, by linking eligibility to dramatically falling revenues, can be relatively assured that the funds will go to companies that need them (See Table 1).

Decline in Expected Revenue (%)	Government Compensation of Fixed Costs under Program
100% (business ordered to close by the government)	100%
80%-100%	80%-100%
50%-80%	60%-80%
25%-50%	40%-60%

In its SME compensation program, the Danish government noted six principles:

- Businesses in any sector should be eligible for compensation;
- Compensation will be targeted at companies with a large decrease in revenues earned domestically;
- The compensation will cover at least 25% and as much as 100% of fixed costs;
- The compensation will cover up to three months of fixed costs and will be dispensed as soon as possible;
- If revenue decreases less than expected, SMEs must repay the government; and
- Companies that are compelled to close due to a ban on staying open will receive compensation for 100% of fixed costs.

The Danish program will seek to keep the administrative costs down by requiring outside accountants to audit the reported fixed costs and the decline in revenues. To receive aid, companies have to send audited statements of their fixed costs for the past three months and hire accountants to confirm that business revenue has or is expected to fall. The government will cover 80% of these auditing costs if a company joins the program. The government will also rely on auditors to identify fraud. Supervisors will conduct random checks, and checks at the end of three months, of auditors' VAT reports. The government will use these VAT reports to adjust its aid to reflect the actual revenue losses these firms eventually suffer.

US Eases Impact of Accounting Rules for Borrowers Affected by COVID-19

By Arwin G. Zeissler

Original post [here](#).

On March 27, the US acted to delay the implementation of a new accounting rule to ease its impact on banks whose borrowers have been affected by COVID-19.

The new accounting standard, known as “current expected credit losses” (CECL), had been set to take effect this year for the largest US banks and over the next two years for other banks. It requires banks to provision for all “expected” losses over the life of a loan. The previous “incurred loss” standard, which is still in place as banks transition to the new standard, requires them to recognize losses only when they become “probable.”

In an [interim final rule](#), US bank regulators on March 27 gave banks the option to delay the estimated effect of CECL on their regulatory capital, relative to the effect of the incurred-loss method, by up to two years. As in an earlier 2019 [rule](#), banks will be allowed a three-year transition period, so the new rule gives them five years to fully implement CECL. Banks that have already adopted CECL can continue with the three-year transition provided by the 2019 rule, or they can change to the longer five-year option announced on March 27.

Also, in the [CARES Act](#), Congress on March 27 offered optional temporary relief from the CECL standard. Banks, other insured depository institutions, and their affiliates will not have to comply with CECL until the national emergency is over or until December 31, 2020, whichever comes first.

US regulators clarified in a [March 31 statement](#) that banks may avail themselves of both the short-term statutory relief provided by the CARES Act and the longer-term regulatory relief contained in the interim final rule. However, the time period of these relief provisions will overlap and not be additive, as the five-year transition option in regulators’ interim final rule still begins January 1, 2020, for the largest US banks.

CECL is similar to the IFRS 9 international accounting standard, which regulators in most of the world outside the US have implemented. IFRS 9 requires banks to set aside loan loss allowances against all future expected losses for loans to borrowers who are categorized in high-risk groups. Several countries have asked banks to be flexible in applying IFRS 9 in the current crisis. On March 20, the Bank of England and the European Central Bank [said](#) banks should take into account government relief measures in evaluating borrowers and calculating expected losses on their loans.

Accounting standard-setters developed both CECL and IFRS 9 in response to the perceived shortcomings in the incurred-loss method that they had required banks to use in the years before the global financial crisis of 2007-09.

As banks and other financial institutions suffered steep credit losses during the global financial crisis, these institutions as well as users of their financial statements expressed concern that the incurred-loss standard limited a financial institution's ability to record credit losses that were expected, but not yet probable. (See the YPFS [case study](#) on the Irish experience with the incurred-loss standard and its transition to the new expected-loss standard).

In the US, the Financial Accounting Standards Board introduced CECL in 2016 in [Accounting Standards Update 2016-13](#) (ASU 2016-13). Under the rule, an entity must estimate lifetime expected credit losses for all of its loans, leases, debt securities, trade receivables, and other financial assets that are measured at amortized cost (as opposed to fair value). Estimated losses are based on past events, current conditions, and reasonable and supportable forecasts of future collections. For public business entities that file with the US Securities and Exchange Commission, ASU 2016-13 is effective for fiscal years beginning after December 15, 2019 (that is, in most cases, starting January 1, 2020).

US bank regulators incorporated ASU 2016-13 into US banking regulations in a [2019 joint rule](#). Since banks only recognized probable losses under the old rules but are required to recognize probable and expected losses under the new rules, regulators have [noted](#) that “various analyses suggest that credit losses under CECL can be expected to be higher than under the incurred loss methodology.” For this reason, the 2019 rule included a transition option allowing banks to phase in the effects of CECL on regulatory capital ratios over three years.

Dividend bans: ECB extends, APRA eases, and BoE promises further analysis

By Junko Oguri

Original post [here](#).

European, Australian, and British regulators took divergent paths on bank dividend guidance this week.

The European Central Bank extended its guidance on dividend suspensions from October to January, the Australian Prudential Regulation Authority eased its guidance, and the Bank of England said it will decide later this year whether to extend dividend restrictions into 2021.

The purpose of dividend restrictions is to ensure banks have enough capital to cover losses while preserving the lending activities essential for households and firms. As of early May, a [BIS report](#) counted 11 jurisdictions that had taken action to suspend or limit dividends or share repurchases in the second quarter of 2020, including Europe, Australia, and the UK. In June, the US [Federal Reserve](#) also limited growth in dividends and banned share buybacks in the third quarter.

On July 28, the European Central Bank (ECB) [announced](#) it has extended its recommendation that eurozone banks suspend dividend payments and share buybacks until January 2021.

The ECB emphasized that the updated recommendation remains “temporary and exceptional” and is aimed at preserving banks’ capacity to absorb losses and support the economy amidst uncertainty caused by the COVID-19 lockdown. The ECB [noted](#) that it would keep evaluating the economic situation and consider whether to further suspend distributions after January 1, 2021.

While the ECB’s recommendation on dividends is not legally binding, Andrea Enria, the head of the ECB’s supervisory board, [noted](#) that the ECB’s Single Supervisory Mechanism (SSM) could issue binding requirements on a bank-by-bank basis.

On the same day, the ECB’s SSM also [published](#) the aggregate results of its vulnerability analysis. The SSM [assessed](#) banks under three scenarios: (i) a baseline scenario that does not consider the impact of COVID-19, (ii) a COVID-19 central scenario assuming an 8.7% decline in gross domestic product (GDP) in 2020, and (iii) a COVID-19 severe scenario with a 12.6% GDP decline in 2020. Under the COVID-19 central scenario, banks were found to be resilient, with an average capital depletion of 1.9 percentage points. But the severe scenario leads to a capital depletion of 5.7 percentage points and the ECB noted that “several banks would need to take action to maintain compliance with their minimum capital requirements.”

Given that uncertainty, the ECB determined the need for its temporary and exceptional recommendation to suspend dividends. The Bank also [asked](#) banks “to be extremely moderate

with regard to variable remuneration payments.” The ECB underscored that banks with sustainable capital position could resume dividend payments “once the uncertainty requiring this temporary and exceptional recommendation subsides.”

Also on July 28, in noting the ECB’s announcement, the Bank of England (BOE) [announced](#) that its Prudential Regulatory Authority (PRA) would undertake in the fourth quarter an assessment of distribution plans at banks beyond the end of 2020. According to the statement, the assessment will be “based on the current and projected capital positions of the banks and will take into account the level of uncertainty on the future path of the economy, market conditions, and capital trajectories prevailing at that time.”

[On July 29](#), Australian Prudential Regulation Authority (APRA) updated guidance on capital management for banks and insurers. Under the updated guidance, banks can now pay out their dividends while seeking to “retain at least half of their earnings when making decisions on capital distributions”. Three of the country’s four major banks (Westpac, ANZ and National Australia Bank) have either deferred or cut dividend payments following the earlier recommendation by the APRA. The APRA notes that decline of the uncertainty in the economic outlook as the reason to ease the dividend restriction policy.

While banks in eurozone and the [UK](#) have followed the supervisory recommendations to suspend dividends, US banks so far have been paying out dividends (see [here](#) and [here](#)). The Fed has acted more slowly than many of its peers. However, the largest US banks voluntarily suspended buybacks in the second quarter. [In June](#), in announcing the results of its annual stress test, the Fed said it would limit third-quarter dividends to the average payout over the prior four quarters or net income, whichever is lower. It also restricted buybacks in the third quarter. The Fed said it will conduct another stress test later this year to determine whether to take additional action on payouts to shareholders.

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

By **Christian McNamara**

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.

U.S. Bank Regulators Modify Liquidity Regulation to Support Participation in Fed Programs

By **Kaleb Nygaard**

Original post [here](#).

On [May 5](#), U.S. bank regulators issued an interim final rule modifying the Liquidity Coverage Ratio (LCR) to support banks' use of the Paycheck Protection Program Liquidity Facility (PPPLF) and Money Market Mutual Fund Liquidity Facility (MMLF).

The Fed established the [PPPLF](#) and [MMLF](#) using its emergency lending authority under Section 13(3) of the Federal Reserve Act. The PPPLF allows financial institutions to use government-guaranteed loans made to small businesses under the Paycheck Protection Program (PPP) as collateral for low interest rate loans from the Fed. Under the MMLF, financial institutions can use high-quality assets purchased from eligible prime money funds as collateral for loans from the Fed. Congress established the PPP in March in the CARES Act.

The [new LCR rule](#) allows banks to exclude PPPLF and MMLF loans, as well as the underlying collateral, from the calculation of total net cash outflows.

The existing LCR rule requires that banks maintain sufficient high-quality liquid assets (HQLA) to cover their total net cash outflows over a 30-day stress period. Without the proposed rule change, all of the inflows and outflows of loans from the PPPLF and MMLF with maturities of less than 30 days would have caused “an inconsistent, unpredictable, and more volatile calculation of LCR requirements,” the regulators wrote in the interim rule. The interim rule will be subject to a 30-day comment period beginning on May 6, the day the rule was published in the [Federal Register](#).

Mortgage Relief

Mortgage and rent costs constitute a major component of many individuals' cashflows. As fixed cost commitments, measures taken to alleviate the payment burden can greatly improve the likelihood of homeowners' staying in homes. Policies targeted to aid these individuals must take account of the duration of financial struggle, underlying financial circumstances of borrowers and renters, and the impacts such policies can have on lenders.

Analysis

Residential Mortgage and Rent Relief During Crises

By **Shavonda Brandon, Vaasavi Unnava, Rosalind Z. Wiggins, and Greg Feldberg**

Original post [here](#).

Cash flows around the world have dropped dramatically as more governments require non-essential businesses to close and individuals to stay at home in order to fight the COVID-19 pandemic. In a fairly short time, such actions have led to [massive layoffs and job losses](#). In the United States, for example, the country has swung from historically low unemployment levels to historically high numbers of claims for unemployment benefits; similar effects can be observed in other countries. As a consequence, individuals are experiencing, and are expected to continue to experience for some time, difficulty in paying their housing costs. Whether mortgage or rent, housing is usually the largest fixed cost for households and many governments have responded by announcing various packages to provide relief. This post begins by examining the fundamental challenge presented by the need to provide residential expense relief on a grand scale. It then details multiple programmatic interventions utilized in crises past and present. Finally, this post provides some key takeaways to consider when implementing residential expense relief policies.

Statement of the Challenge

National or state-wide residential mortgage and rent relief policies in response to broad financial duress date back as early as the [Great Depression](#). Such policies may provide immediate relief to individuals through instruments like mortgage or rental forbearance or eviction moratoria. Governments may also institute longer-term policies, such as mortgage restructuring or repurchasing.

The need to provide respite to individuals during times of crisis places governments in a delicate position in which they must implement policies that provide financial relief to individuals experiencing difficulties making their mortgage or rental payments while simultaneously maintaining the functional integrity of the mortgage lending and servicing system. Difficulty may arise in balancing these two competing objectives as the individual homeowner's or tenant's interest conflicts with that of the landlord, lender, or mortgage servicer. Thus, to achieve a balance, governments that provide short-term or long-term mortgage or rent relief often also provide flexibility or incentives for landlords, lenders, and servicers administering or participating in such programs. Should a government employ one set of relief without the other, or a method of relief that doesn't fit the problem well, then the debt burdens for homeowners (including landlords) may persist unaddressed, further exacerbating the crisis.

To determine policies that optimally address such a problem regarding mortgage and rental payment, governments must consider the following key questions:

- **Type of Problem:** What is the problem that creates the need for residential relief? When is the problem expected to end?
- **Type of Relief:** What are the best tools to address the problem? Who are the various stakeholders?
- **Underlying Borrower/Renter Circumstances:** What is known about the underlying circumstances of the borrowers or renters?
- **Lender Impact:** Can lenders and their servicers execute the program efficiently? What will the impact of the program be on them? What relief might they need?
- **Existing Structural Issues:** How might differing market incentives or structural issues impede the success of the program?

Residential relief programs may address these considerations in different ways based on the circumstances presented. We will discuss these questions further as we review different intervention strategies below.

Types of Programs

- **Mortgage Forbearance** - allows homeowners to temporarily delay making payments
- **Mortgage Restructuring** - permanent modifications to existing at-risk mortgages
- **Mortgage Purchasing** - outright purchase of at-risk mortgages by a government or agency
- **Renter's Aid** - providing forbearance and rent subsidies to tenants
- **Flexibility in Debt Restructuring** - modifications to accounting and regulatory frameworks to aid lenders in restructuring mortgages

Mortgage Forbearance

If decreased cash flows amongst individuals is the only economic problem they face, forbearance may be a suitable relief strategy, since it grants mortgage holders a short period during which they can defer payment and repay the unpaid balance months later. Because of the nature of the current COVID-19 pandemic, where the cash flow issues are expected to be of limited duration—reversing once the wide-spread government-imposed economic shutdowns are lifted—several countries have used forbearance for short 3-6 month durations. In this instance, the period of forbearance may also be extended as needed. Additionally, in connection with forbearance relief, late payment penalties and foreclosures are usually stayed. Credit reporting may also be stayed so that the individual does not experience a drop in creditworthiness after accepting forbearance.

Governments may implement mortgage forbearance by passing legislation that provides direct legal relief for nonpayment, as the [United States](#) has done in the current COVID-19 outbreak. The CARES Act provides homeowners whose mortgages are federally backed (approximately 80% of those outstanding) the right to request a 180-day forbearance. (See a YPFS blog on the US program [here](#)). Officials in the [United Kingdom](#) have instituted a three-month mortgage holiday, during which borrowers do not have to make any payments. [Ireland](#) has implemented a similar payment moratorium on mortgages, as well as on business and personal loans for individuals. Some countries may institute government-mandated forbearance, but with more limited coverage.

Other countries have implemented similar relief through the private sector. [Hungary](#) stopped short of legislating such relief and instead urged banks to provide forbearance for household payments. In Ireland, during the Global Financial Crisis (GFC), the government emphasized [forbearance by lenders](#) but did not require such policies until 2013. In [the Bahamas](#), the government has arranged for lenders to provide a three-month mortgage forbearance to borrowers who were in good standing prior to the pandemic. In this case, missed payments will accrue interest throughout the forbearance period. Private-sector solutions can provide coverage for substantial numbers of individuals if all major banks participate.

It should be noted, however, that forbearance is a delay, not forgiveness. Individuals are still responsible for the deferred payments, and repayment plans must be negotiated with the respective lender or landlord. As discussed below, governments often provide incentives for the lenders to reach agreements that are manageable to the homeowner and keep them in their homes. Depending on the structure of the country's mortgage system, homeowners may have to negotiate this restructuring with a mortgage servicer who represents the lender; either party may have conflicting incentives that impact the ease of agreement.

Mortgage Restructuring

If the perceived problem is with the fundamental economics of the mortgage rather than a short-term cash flow issue, then longer-term solutions provide opportunities for mortgage restructuring in an effort to avoid delinquencies or foreclosures, and maintain people in their homes. These solutions may also need to be employed if forbearance fails to address the problem effectively, as occurred in Ireland during the GFC (discussed below).

Historically, the manner in which debt restructuring is implemented varies widely. Some programs attempt to restructure loans to provide easier paths to pay off extant mortgages. Other programs simply purchase homes outright from the lender, including any outstanding mortgage balances, leaving original owners of dwellings as tenants who pay rent to the new homeowner. The choice between the two programs may depend on whether or not the mortgages are “underwater” – the case in which the outstanding principal payment is greater than the value of the home. Mortgages that significantly exceed the value of the home may be strong candidates for outright purchase rather than restructuring, as there is a lesser incentive for the homeowner to continue payments. By contrast, restructurings or modification programs are aimed at

reworking the mortgage on the assumption that the homeowner will continue to occupy the home and pay the mortgage. However, as discussed below, the methods and objectives sometimes overlap.

The [Home Affordable Mortgage Program](#) (HAMP) instituted by the United States during the GFC, when many mortgages exceeded home values due to a broad market correction, encouraged privately negotiated modifications by incentivizing mortgage lenders and servicers to participate in the program with cash payments and by providing a required modification framework. The required framework expressly reduced all mortgage payments to [31% of an individual's monthly income](#), relying first on a reduction of interest rate for five years, followed by a reduction of principal payments to reach this target. The program thus established an industry standard for modifications which sought to avoid foreclosures. The [Homeowners Support Mortgage Scheme](#) (HSM) in the United Kingdom took a different approach to creating a modification framework. That scheme allowed homeowners to defer up to 70% of their interest payments for two years, with 80% of the deferred interest payments guaranteed by the government for banks participating in the scheme.

Also during the GFC, [Ireland utilized split mortgages](#), a novel restructuring option that split mortgage debt into two pieces: one piece warehoused for later payment, and one piece that the borrower makes payments on until their financial situation improves.

Some restructuring options do not rely on changing the terms of an existing mortgage. During the Great Depression in the United States, a style of lending called “equity of redemption” allowed debtors to re-attain their foreclosed properties if outstanding mortgage debt was paid off within a certain time period after foreclosure. Many states [extended the equity of redemption period](#) to provide relief for mortgage owners.

Mortgage Purchasing

In comparison to private-sector modification programs, government-funded mortgage repurchase programs purchase loans and then offer favorable refinancing if the homeowner can afford it. During the Great Depression, the [Home Owners Loan Corporation](#) in the United States purchased [mortgages directly from lenders and issued new mortgages to the borrowers](#), refinancing many on much more favorable terms.

In some cases, if homeowners could not afford to refinance, they were permitted to stay in their homes as tenants. During the GFC, Scotland created the [Homeowner Support Fund](#), under which a local council purchased distressed houses at 90 percent of their value and then rented them to the former homeowners, allowing families to remain in their homes.

Also during the GFC, the United Kingdom implemented a two-part scheme, called the [Mortgage Rescue Scheme](#), designed to help vulnerable homeowners stay in their houses. Local councils had the ability to purchase a home at market rate and offer a short-term tenancy to those already living in the home at 80% of market rent. The scheme also allowed local councils to make a “shared equity” loan to the household to help it maintain the mortgage by temporarily paying a

reduced amount. The scheme was ultimately criticized for miscalculating demand and completing too many [costly purchase rescues](#); a more balanced usage of the two schemes had been forecasted.

Examples of restructuring or modification frameworks have yet to emerge in the current COVID-19 crisis. However, if the crisis persists, the need for such relief may arise as the prolonged effects of unemployment and economic downturn impair owners' ability to maintain their mortgages.

Renter's Aid

Renters may also face reduced cash flows as unemployment rises during economic crises. Similar to mortgage forbearance, governments may provide rent forbearance to renters, where they are granted a short period during which they may defer payment and repay the unpaid balance months later. Renters also may be protected from late-payment penalties and negative marks on their credit report as a result of utilizing the forbearance benefit. The risks associated with a tenant who takes a rental forbearance differ from those of a homeowner or mortgagor. Rental contracts are short-term commitments and do not carry the possibility of equity. In contrast, a mortgage creates an incentive for the borrower to remain in the home. There may be a greater risk that tenants, especially tenants who have difficulty returning to work or other basic financial difficulties, may not be able to repay the forbearance amount, creating a problem for landlords and their own ability to pay related mortgages and expenses.

Governments may implement rent forbearance by passing legislation that provides direct legal relief for nonpayment, as the [United States](#) has done in the current COVID-19 outbreak. The CARES Act provides a rental moratorium and suspends evictions for the duration of mortgage forbearance for properties that are financed by federally backed multi-family mortgages. (See a YPFS blog on the program [here](#).) [Greece](#) has provided relief using a different method; businesses and individuals directly impacted by the pandemic will be permitted to pay only 60% of their rent for the months of April and May. Both methods increase the flexible cash-flow for renters who choose to take advantage of the benefit and illustrate the differing breadth that such relief can take.

Governments may also implement rental subsidies, aimed at reducing rental costs rather than deferring them. Government subsidies provide the additional benefit of guaranteeing payments to landlords and lenders who may not receive payments if renters are unable to repay outstanding rent after the forbearance period. Some rent subsidies are a direct government payment to landlords. In [British Columbia](#), government-funded rent relief of CAD\$500 per person per month for up to three months is intended to help tenants impacted by the COVID-19 pandemic continue to pay their rent. Related provisions prohibit evictions and rent increases during this period; also, the government has asked banks to work with landlords who may experience a drop in rents. [Malta](#) has also established a new Private Rent Housing Benefit Scheme, through which individuals unemployed due to the COVID-19 outbreak will receive governmental rent subsidies.

Governments may also reduce housing costs that are not typically included in rent. [Bahrain](#) will cover electricity and water payments for three months; [Ukraine](#) has prevented the disconnection of utilities for customers late on utility payments.

Flexibility in Providing Debt Restructuring

When economic shocks demand large-scale residential mortgage relief, lenders face barriers to efficiently carrying out government mandates. These include liquidity issues due to slowed cash flows; an increase in loans classified as “troubled debt,” due to restructurings that reduced principal or interest payments; and other increased administrative costs associated with high volumes of activity.

To provide flexibility for lenders who provide mortgage forbearance, governments may seek to ease the application of accounting principles. For example, restructuring loans to reduce principal or interest payments is typically classified as troubled debt. A government may specify that restructurings in compliance with its mandate will be excluded from this classification. This policy enables lenders to restructure more loans without taking massive losses on their balance sheets.

In response to the COVID-19 outbreak, the [United States](#) provided that mortgages that benefit from forbearance will not be categorized as troubled debt. [Peru](#)’s Superintendence of Banks notified financial institutions that any modifications to loan terms due to the COVID-19 crisis would not change the classification of the loans.

The government may also provide relief to lenders’ cash flows. In the [United Kingdom](#), in response to the GFC, the government guaranteed the interest-only payments of borrowers in exchange for lender participation in the mortgage forbearance program. In response to COVID-19, [Canada](#) has promised to purchase CAD\$150 billion in loans from banks to free up their capital.

In developing economies, it may be necessary to restructure loans denominated in foreign currencies. For example, leading up to the GFC, it was common in many countries in central and eastern Europe for mortgages to be denominated in Swiss francs. As the Swiss franc strongly appreciated after the crisis, many of these loans became non-performing. In response, the governments of [Hungary](#) and other countries allowed foreign-denominated mortgages to be redenominated in local currency or even a third currency, providing relief to borrowers from the pressure of increasing exchange rates on mortgage payments. In the COVID-19 crisis, [Sri Lanka](#) has broadly allowed banks to recover loans in Rupees as a last resort, when recovery of loans in a foreign currency appears remote.

Key Takeaways

Fit the solution to the problem.

When considering whether to provide aid to residents or tenants of a mortgaged property, the nature and expected duration of the problem will be a key question. Mortgage and rent

forbearance programs provide short-term solutions to address cash-flow shortfalls for mortgage owners or renters. They can provide quick relief to individuals having trouble paying their bills because of unemployment or other cash-related issues until circumstances change.

However, forbearance may not adequately address problems with the fundamental economics of a mortgage, as generally existed during the GFC. Then, longer-term solutions are needed to provide opportunities for mortgage restructuring or purchasing in an effort to avoid delinquencies or foreclosures, and keep people in their homes.

Forbearance relief may create secondary problems once the forbearance period ends.

Forbearance is not forgiveness, but this may be fundamentally misunderstood by some individuals, or just disregarded when faced with a balloon payment or larger monthly payments needed to make-up the forbearance amount. Others, just may be financially unable to make up the payments. For homeowners, history has shown that there is no guarantee that restructured loans will not default. But every crisis is different. If the COVID-19 crisis ends sooner and there is no dislocation in the housing market, the effects should be much different than experienced in the GFC under the HAMP program restructurings, when significant defaults on restructured loans with [underwater mortgages but also prolonged unemployment were cited as major factors](#) of the prolonged foreclosure crisis.

There is a similar risk that renters will fail to repay forbearance amounts. Some tenants may have underlying financial difficulties not related to the immediate crisis. Governments should consider that they may be confronted with a mass problem of unpaid forbearance rent and thus, possibly increased evictions and or bankruptcies once the forbearance period ends.

In total, governments should consider the possibility of such secondary impacts and how they might be addressed should they occur. Additional fiscal assistance may be needed.

Some residential relief programs may create moral hazard.

There is some evidence that forbearance policies create moral hazard. In other words, homeowners may take advantage of the opportunity to not pay their mortgage even if they are capable of doing so. In Greece, during the Sovereign Debt Crisis, many homeowners received the benefit of a [foreclosure moratorium](#). It is estimated that as many as [37% of the homeowners](#) utilizing the moratorium to delay payments did so strategically rather than because of need.

Understand the underlying circumstances of homeowners and renters.

For both homeowners and renters who take advantage of forbearance benefits, factors that contribute to the ability and willingness to repay center around issues of income, unemployment, debt load, and credit worthiness. If the assistance provided does not take into consideration the full financial profile of the borrower, then the mortgage assistance program may not succeed in stabilizing the borrower's situation.

Such was the case in Ireland in the aftermath of the GFC. The country's initial response relied on broad implementation of [short-term mortgage forbearance](#), which did not account for the broader underlying problem of excessive mortgage debt that had arisen during the GFC (by 2009, the ratio of mortgage debt to GDP was 92%). With a significant number of mortgages underwater and increased unemployment, many homeowners participated in forbearance but were ill-equipped to resume payments when their forbearance periods ended. The government ultimately encouraged large-scale permanent mortgage restructuring to keep homeowners in their homes, rather than temporarily restructuring for forbearance needs.

Similarly, in the United Kingdom, a miscalculation of the desirability of two options under the [Mortgage Rescue Scheme](#) resulted in budgetary underallocation and undermined the efficacy of the program. Although the shared equity option provided a cheaper alternative for the government, it was far less popular than the mortgage purchase option. More homeowners than expected chose to have their council purchase their mortgages and rent the home back to them than the number of homeowners who chose to take a shared equity loan to help them manage mortgage payments. The first option was significantly more expensive and therefore, the number of homeowners assisted was less than planned, while the cost of assistance received by each was significantly greater than expected. The scheme points out the pitfalls of providing an open choice to the homeowner when trying to also serve as many people as possible. A modification to the plan, such as limiting the budget allocated to each option, could have maintained choice but also better positioned the government to achieve its service objectives.

In particular, the choice to reduce payments rather than the principal of a loan [may not be effective if a borrower's equity is very negative](#). Some argue instead that [programs should focus on ameliorating the immediate consequences of job losses](#) to help borrowers maintain liquidity in the long term.

Lender experience and incentives may affect a program's efficiency and participation rate.

Lenders may struggle with implementation [due to a lack of experience in renegotiating loans](#). In financial environments where a majority of lenders do not regularly restructure debts, the implementation of various loan restructuring policies may take longer than expected. Such was the case with the US Home Affordable Modification Program (HAMP) during the GFC. The experience also highlighted the importance of the government understanding the way the industry is structured and incentivized.

Attempts to correct currency mismatch in loans may not reduce lenders' risks.

In some cases, restructuring foreign-denominated debts to local or third-country currencies can provide the necessary leeway for lenders to properly implement government policies. However, it's unclear that changes to currency denomination [reduce risk](#) for lenders overall. They may reduce currency mismatch in the original currency but create another in the new currency. Such exchanges may also be [difficult to administer](#).

Conflicting policies may hamper the success of residential relief programs.

As discussed above, because of the nature of housing, it is useful to combine forbearance policies with restructuring incentives and foreclosure and eviction moratoria. However, when existing or newly implemented rules do not properly allocate risk among housing market participants, they can hamper efficient enforcement of housing policies aimed at providing residential mortgage relief for both borrowers and tenants.

Protections that overshadow borrowers from the risk of default (or renters from eviction) may affect the ability to enforce residential mortgage relief policies. In the case of Ireland during the GFC, homeowners slipped into default on mortgages for years, as a result of the country's [strong homeowner protections](#) that created a one-sided mortgage forbearance regime. This was facilitated by a repossession law that [effectively made foreclosures impossible](#) and left mortgage lenders with little recourse. By December 2012, about [12% of Irish mortgages were late by more than 90 days](#). In this case, homeowners were incentivized to stop paying mortgages when there were few options to permanently restructure debts with mortgage servicers, exacerbating the mortgage debt problem for both homeowners and lenders.

Structural issues may undermine utilization of residential relief programs.

The degree of separation between mortgage owner and homeowner can lead to difficulties in the enforcement of mortgage aid programs. In the United States, before the GFC, the popularity of securitization of mortgages meant that mortgages would often be sold and resold, creating several degrees of separation between mortgage owners and homeowners. This distance between lender and borrower, as well as the complexity of claims on a mortgage created by securitization, often led to [litigation](#) negatively impacting the effectiveness of relief programs.

Additionally, due to the separation between mortgage servicer and mortgage owner, differing compensation incentives hampered efficient mortgage restructuring. This incentive mismatch manifested under HAMP, where [28% of modified loans defaulted again](#), including half of the loans modified at the height of the financial crisis. While the program required restructuring of loans in a way that supported homeowners – specifically through the introduction of mandatory terms to reduce monthly payments to [31% of the individual's monthly income](#) – the program permitted mortgage servicers to determine which borrowers could restructure. Because the servicer was compensated by the unpaid principal balance of performing loans, servicers had the incentive to reduce interest payments and instead opt for [adding unpaid loan balances to the outstanding principal of the loan](#), which was not effective in ensuring the long-term performance of the loan. As a result, many servicers were incentivized to [deny restructuring to eligible borrowers](#), reducing participation in the program dramatically.

In the case of the HSM in the United Kingdom, also during the GFC, the additional onerous requirements placed on lenders in terms of documentation and reporting lead to only [32 borrowers participating in the program](#). Additionally, few lenders provided forbearance through the HSM program directly, instead opting to offer their own forms of forbearance. However, it was concluded that through such intervention, the government was able to influence most

lenders' forbearance policies, leading to indirect aid for even those not participating in the program.

For more specific information about specific types of programs and their usage in the most recent crisis, see [Mortgage Forbearance and Eviction Moratoria in Response to the COVID-19 Outbreak](#) and [Expanding Debt Restructuring Options for Mortgage Lenders in Response to the COVID-19 Outbreak](#).

Mortgage Forbearance and Housing Expense Relief in Response to the COVID-19 Outbreak

By **Shavonda Brandon, Vaasavi Unnava, and Rosalind Z. Wiggins**

Original post [here](#).

With US unemployment claims at record highs due to the nation's directive to close many businesses and shelter-in-place, many individuals are struggling to pay recurring fixed costs, such as mortgages and rent. In response, the United States instituted the CARES Act, providing opportunities for [mortgage forbearance and moratoria on evictions](#) for all holders of federally backed loans. Other countries have instituted similar policies, but with varying time-frames and coverage for homeowners and renters.

Mortgage and Rent Forbearance

More than 20 countries have instituted some form of mortgage forbearance in response to the ongoing COVID-19 pandemic. The CARES Act endows borrowers with federally-backed mortgages [the right to request forbearance](#). It provides a general framework for mandatory forbearance policies, while leaving the terms of agreement to the original lenders, with flexible windows for forbearance as determined by borrower need. [Canada](#) strongly emphasized that lenders should negotiate directly with mortgage borrowers to determine the terms of forbearance on individual loans. Some countries provide forbearance for a fixed time period. For example, the [United Kingdom](#) provides a fixed window of three months for forbearance.

Forbearance is not restricted to mortgage borrowers. Putting a moratorium on rent payments is one approach to provide temporary relief for renters. [British Columbia](#), in Canada, has promised to pay CAD\$500 a month, for three months, directly to renters' landlords to provide a direct subsidy of rental payments. [Greece](#) has restricted rent payment for those directly affected by the outbreak to 60% of rent for the months of March and April.

To emphasize that forbearance is not forgiveness, lenders offer [flexible repayment options](#). For example, there is the paused payment option, in which borrowers pause payment and either choose to make a balloon payment once their regular loan payment commences, or when the mortgage reaches its term. Borrowers can also opt to reduce their payment by some fraction for a set period. Any individual who seeks repayment accommodations due to the impact of COVID-19 will remain current for purposes of credit reporting.

To fully account for housing-related fixed costs, some countries are paying utilities or providing forbearance for citizens on utility payments. [Argentina](#) has extended forbearance clauses to utility bills for households in arrears in addition to covering mortgages. [Bahrain](#) will pay residents' electrical and water utility bills for three months beginning in April, though it hasn't instituted any form of mortgage forbearance or rent. [Ukraine](#) has outlawed disconnecting utilities for customers late on payments.

Typically lenders use caution when determining if a borrower is eligible for renegotiation of the terms of a loan. Doing so may expose lenders to balance sheet losses and require them to categorize the renegotiation as a troubled debt restructuring (TDR). TDRs require strict reporting, tracking, and accounting requirements that are administratively costly. Since forbearance is a form of term renegotiation, regulators have modified guidance around the reporting of TDR to increase the expediency of the forbearance process in response to the pandemic. To read more on the expansion of loan restructuring options that countries have employed to provide flexibility to lenders, such as changing loan classification or accounting requirements, click [here](#).

Eviction Moratoria

To prevent evictions for individuals who are behind on payments, countries have instituted moratoria on evictions and foreclosures. In some cases, this has not been codified into law. [Barbados](#) has not passed legislation, but has “strongly encouraged” landlords to not evict their tenants during this time; it plans to legally enforce the rule if not upheld without legislation. Other countries have extended the timeline for foreclosures. In the [United Kingdom](#), landlords must now give renters three months’ notice before eviction, through September 2020.

Other governments have implemented stricter tenant protections. [British Columbia](#), in Canada, has placed a ban on evictions for three months. In addition to moratoria, [Ireland](#) has paired a three-month moratorium on evictions with a ban on rent increases for the duration of the COVID-19 emergency in the country. [New York City](#) has placed a moratorium on residential evictions for 90 days; the [United States Congress](#) has prevented eviction for 120 days after enactment of the CARES Act on March 27, and foreclosures for 60 days after March 18, for federally guaranteed mortgages. In addition, US landlords receiving forbearance on their mortgages are prohibited from bringing eviction proceedings against tenants, or charging penalties during the forbearance period.

To read more about debt restructuring for mortgages, click [here](#).

Expanding Debt Restructuring Options for Mortgage Lenders in Response to the COVID-19 Outbreak

By **Shavonda Brandon, Vaasavi Unnava, and Rosalind Z. Wiggins**

Original post [here](#).

With the outbreak of the COVID-19 virus, many countries have instituted some form of right to mortgage forbearance and protection from foreclosure or eviction. Homeowners may request a forbearance of payment for a negotiated or predetermined fixed period. At the end of the forbearance period, lenders work directly with borrowers to recoup the payments missed, by finding alternative payment schedules. Lenders may change the outstanding principal, interest rates, or term of the loan to help the borrower.

Loan Classification

Governments providing forbearance support to borrowers have taken steps to protect lenders who otherwise might experience a dramatic increase in their troubled debt. Typically, such restructuring constitutes a troubled debt restructuring for the lender. When debts are designated as troubled, they are categorized as a loss on balance sheets and a lender must adhere to strict reporting, tracking, and accounting requirements that are administratively costly. Several governments have changed accounting practices so that lenders may avoid classifying restructured mortgages as troubled.

The [United States](#) provides such amnesty for mortgages modified pursuant to the CARES Act. [Peru](#) has pursued a similar strategy, with the Superintendence of Banks notifying financial institutions that any modifications to loan terms due to the COVID-19 pandemic would not change the classification of the loans. [Russia](#) allows banks to restructure loans without impacting their classification, so long as regulatory requirements continue to be satisfied.

Regulatory Requirements

Outside of loan classification, countries have modified regulatory requirements to provide greater flexibility in lending.

[Israel](#) has increased the loan-to-value cap on residence-backed loans from 50% to 70%. Residence borrowers are now eligible for the lowest rate of interest on a home loan at a 30% down payment instead of the original 50% down. Separately, governments are modifying bank capital requirements to improve liquidity conditions; [Russia](#) has specifically reduced risk weighting of mortgages to alleviate the burden of mortgage debt restructuring.

Meanwhile, [Norway](#) has increased the amount of risk banks may take to provide greater flexibility for loan restructuring. Now, 20% of mortgages may deviate from amortization requirements, providing extra room for borrowers to suspend payment or reduce

payment. [Sweden](#) has followed a similar strategy, allowing some loans to be exempt from amortization requirements under recognition of income loss for borrowers.

[Freddie Mac](#), a government-sponsored entity (GSE) in the United States, has also provided more flexible options for its lenders, by extending options for restructuring typically only available to lenders during natural disasters.

Unified Loan Restructuring

Rather than provide individualized opportunities for loan restructuring, some governments have elected to provide broad, prescriptive terms for loan restructuring. The US did this in the GFC by encouraging restructure options. This may restructure loans quickly in an environment with less experienced lenders, who have [trouble restructuring loans in a timely manner](#).

In the [Philippines](#), members of the Government Service Insurance System have been extended the ability to settle debts through the government pension fund. Individuals may also consolidate and restructure debts with the organization without penalty. The broad restructuring does not leave space for individual negotiations, with all participants receiving the same reduced interest rate of 7-8 percent from the original 12 percent interest rate.

The Philippines is not the only country setting unified terms of restructured loans at a national level. In the [United Kingdom](#), mortgage forbearance is mandated for three months, already setting one of the terms for lenders for any relief that may be provided. Similarly, [El Salvador](#) has extended a three-month payment exemption for mortgages and other critical services whose repayment would be spread over two years with no risk of default or interest.

Other countries determined payment terms of the mortgage forbearance restructuring. [Palau](#) requires interest-only payments, rather than forbearance outright. [Bolivia](#), similarly, is suspending only principal payments for mortgage forbearance. [New Zealand](#) is suspending principal and interest payments for six months for all individuals affected by the COVID-19 virus.

Aid to Lenders

By providing flexible options for debt restructuring that do not penalize the lender for borrower non-payment, governments may be attempting to mitigate the sharp drop in capital flows that will soon affect lenders due to the many mortgage forbearance and eviction moratoria that have been instituted worldwide.

Extensive but temporary regulatory changes as well as broader guidances in debt restructuring may help banks, but still leave room for difficulty amongst nonbank lenders. As a team of Fed economists wrote in a recent [paper](#), “Nonbank mortgage companies also need to finance the costs associated with servicing defaulted loans for extended periods of time. Obtaining this financing can be difficult in times of strain.”

It remains to be seen how this liquidity stress will be mitigated as forbearance extends into the future. In the US, lenders have asked for the Federal Reserve to institute a [mortgage liquidity facility](#), though nothing has been created yet. The [Federal Housing Finance Agency director has expressed confidence](#) that private banks will continue to extend credit to lenders for the short term.

To read more about residential mortgage forbearance and eviction moratoria, click [here](#).

Case Studies and Policy Changes

FHFA Relaxes Standards for GSE Mortgage Servicers

By Vaasavi Unnava

Original post [here](#).

On April 21, the Federal Housing Finance Agency (FHFA) [announced](#) that it was changing standards for mortgage servicers in an effort to reduce burdens brought on by drastic increases in mortgage nonpayment. Quickly following, on April 22, the FHFA [announced](#) that Fannie Mae and Freddie Mac would purchase [some mortgages](#) in forbearance due to COVID-19.

[New forbearance policies under the CARES Act](#) are [creating liquidity issues](#) for mortgage servicers. Typically, mortgage servicers collect payments of mortgage principal and interest from borrowers whose mortgages are in mortgage-backed security (MBS) pools and use the funds to make payments to investors who contractually own the rights to the cash flows from the mortgages in the pool. Fannie Mae usually requires that the servicer advance payments of loan principal and interest for up to 12 months, even if a borrower is in arrears. Freddie Mac only requires that servicers advance interest-only payments for up to four months.

The new [changes](#) reduce the required advance period under Fannie Mae mortgages from 12 months to four months. This aligns the advance periods for all Fannie Mae and Freddie Mac single-family mortgages. The new policies apply to all single-family mortgages backed by Fannie Mae or Freddie Mac and to all servicers, regardless of type or size.

While Fannie and Freddie usually buy loans more than four months in arrears out of MBS pools to replace them with performing loans, the FHFA has instructed the GSEs to treat loans in COVID-19 forbearance as if they were subject to temporary [natural disaster relief](#), which would allow the loans to remain in the MBS pool for the period of forbearance. The change in treatment reduces liquidity demands on the two government-sponsored enterprises (GSEs).

Also, as of April 22, FHFA announced that Fannie and Freddie would purchase mortgages that have gone into forbearance almost immediately after closing. FHFA had previously treated such loans as ineligible for purchase. Mortgages originated between February 1, 2020, and May 31, 2020, are eligible for purchase. Mortgages cannot be more than 30 days delinquent. The GSEs will price these purchases to account for the increased risk of the mortgage in forbearance. By relaxing mortgage purchasing standards, FHFA [hopes to encourage mortgage origination](#) in a slow credit market, in which servicers are unwilling to originate mortgages for fear that GSEs may not buy them.

Through the CARES Act, the government made forbearance available to all borrowers with federally backed single-family or multi-family mortgages. The forbearance period for single-family mortgages can extend as long as a year. As of April 19, the share of loans in forbearance

rose to [6.99%](#), up from [0.25%](#) on March 6. [Industry officials](#) expect forbearance requests will continue to rise with unemployment. As COVID-19 continues to depress demand and employment, it remains unclear when homeowners in forbearance may be able to resume mortgage payments. The Mortgage Bankers Association [estimates](#) that in a worst-case scenario, servicers might need to fund as much as \$75-100 billion in advances.

Though these changes in regulation provide a [welcomed](#) and needed reprieve for mortgage servicers, servicers continue to push for a [mortgage liquidity facility](#) to ease strain on cash flows during the forbearance period. Beginning in late March, many called for the Federal Reserve to set up a [mortgage liquidity facility](#) to ease the liquidity pressures on mortgage servicers that emerged as a result of the CARES Act. On April 8, a [bipartisan group of senators](#) explicitly requested that the Federal Reserve set up a mortgage liquidity facility, something the central bank has resisted doing. [Mortgage experts believe](#) that the Federal Reserve will create a funding facility, but not until there is a meaningful increase in forbearance activity.

FHFA Allows Payment Deferral for Forbearance Payments While Extending Foreclosure and Eviction Moratoria

By Vaasavi Unnava

Original post [here](#).

On May 13, the Federal Housing Finance Agency (FHFA) [announced](#) that homeowners who take advantage of COVID-19 mortgage forbearance will have the option to defer payment of the missed amounts until the home is sold or refinanced, or the mortgage matures, once they return to making their normal monthly mortgage payments. The next day, the FHFA [announced](#) an extension of its foreclosure and eviction moratoria to June 30.

The CARES Act, passed in March, [instituted an optional 180-day moratorium](#) period, beginning on March 15, for payments on any federally-backed mortgage in response to businesses' rapid and large furloughs of workers due to social distancing and isolation orders. The 180-day period can be extended for an additional 180 days, for up to a year of forbearance.

The ability to miss mortgage payments provided much-needed relief to homeowners. However, the prospect of widespread non-payment raised liquidity concerns for mortgage servicers who service mortgage-backed securities (MBS) backed by Fannie Mae, one of the two government-sponsored enterprises (GSEs) that support the secondary market for mortgages. Servicers of Fannie Mae securities were responsible for covering 12 months of payments to MBS investors when borrowers have missed mortgage payments.

To help servicers, the FHFA [reduced](#) the number of months of advances to MBS pools that mortgage servicers with Fannie Mae loans were responsible for. Rather than the original 12 months' payments for mortgages in arrears, the FHFA required servicers to pay four months' payments, the same number of payments that servicers with Freddie Mac loans were responsible for.

However, as social distancing guidelines are extended and few Americans return to work, many homeowners may not be able to soon restart their mortgage payments or pay the deferred amounts, which may continue to increase as forbearance continues.

In response, the FHFA announced an option for homeowners to defer repayment of amounts not paid pursuant to the mortgage forbearance. Under this policy, borrowers who can return to normal mortgage payments can pay off unpaid forbearance balances when the home is sold, the mortgage is refinanced, or when the mortgage loan matures. Fannie Mae and Freddie Mac will offer this option on their mortgages beginning July 1, 2020.

Referred to as "payment deferral" by the FHFA, this new alternative is part of a range of options available to borrowers who take advantage of the forbearance. On April 27, the FHFA [announced](#) it would not require lump-sum payments at the end of forbearance. Instead, it proposed that borrowers could set up repayment plans for the forbearance amounts, modify the

loans so that the missed payments are added to the end of the mortgage, or modify the loans so that they have a reduced monthly payment. Now, borrowers can pay the entire missed amount at sale, refinancing, or maturity. However, the choice of payment plan will require agreement between the servicer and borrower.

As mortgage servicers are no longer responsible for making more than four months of payments into mortgage pools, [Fannie Mae](#) and [Freddie Mac](#) will have to fill the funding gap for the remaining duration of forbearance. Freddie Mac wrote in its 10-Q statement, “we expect to advance significant amounts to cover principal and interest payments to security holders for loans in forbearance in the coming months. . . . We had a \$1.2 billion provision for credit losses in 1Q 2020 due to our forecast of higher expected credit losses from our single-family credit guarantee portfolio as a result of the pandemic, but these estimates are subject to significant uncertainty and may increase substantially in the future depending on the depth and severity of the economic downturn caused by the pandemic.” Fannie Mae and Freddie Mac currently account for 62% percent of the market for first-lien mortgages, [according](#) to the Urban Institute.

Other agencies are following similar strategies. In April, Ginnie Mae [expanded](#) its Pass-Through Assistance Program (PTAP), advancing principal and interest payments for mortgage servicers whose loans are in forbearance. Under the COVID-19 PTAP extension, issuers may request PTAP assistance once per month to cover missed principal and interest payments to MBS investors.

The Veterans Administration (VA) also [allowed](#) homeowners to make missed forbearance payments at the end of the loan, rather than immediately at the end of forbearance. In that case, the balloon payment will be non-interest bearing. Homeowners with VA-backed loans can also make modifications to their loans or set up a repayment plan, as established under the CARES Act.

The Federal Housing Administration (FHA) has also [provided](#) repayment options to homeowners. Homeowners can defer paying forbearance balances until the mortgage is paid off. In requesting forbearance, homeowners authorize mortgage servicers to advance funds on their behalf, creating a [partial claim](#): an interest-free subordinate mortgage on the property that homeowners pay off once the original mortgage is paid off.

The Mortgage Bankers Association (MBA) [welcomed](#) the FHFA policy changes, saying that they improved efficiency in the mortgage process. Though the current FHFA foreclosure and eviction moratorium would have expired on May 17, on May 14, the FHFA [announced](#) an extension until at least June 30. As of May 3, 2020, the share of loans in forbearance rose to [7.91%](#), up from [0.25%](#) on March 6th. The MBA [estimates](#) that in a worst-case scenario, servicers and GSEs might need to fund as much as \$75-100 billion in advances.

Though talks to privatize the two GSEs continued as late as [February](#), on May 20, FHFA Director Mark Calabria [said](#) that the two GSEs should hold \$240 billion in capital before exiting government conservatorship--a figure far larger than the current \$23 billion in capital they

collectively hold. If forbearance continues for an extended period of time, it's unclear whether Fannie Mae and Freddie Mac will need to procure funding to continue making payments to MBS pools for forborne mortgages. With the two agencies still under government conservatorship, it is possible that additional funding would come from the Treasury since, pursuant to the [Senior Preferred Stock Purchase Agreements](#) with the GSEs, Treasury in effect pledged to provide funding as needed to maintain the agencies' solvency. Under [both agreements](#), Treasury cannot commit more than \$100 billion to each GSE.

SIGTARP Proposes Using Leftover TARP Funds for COVID Relief

By Vaasavi Unnava

Original post [here](#).

On April 8, the Special Investigator General for the Troubled Asset Relief Program (SIGTARP) [recommended](#) the Treasury use extra funds remaining from TARP's Hardest Hit Fund to provide mortgage relief for unemployed homeowners.

The Obama administration [established](#) the Hardest Hit Fund (HHF) in 2010, in an effort to directly aid unemployed homeowners who were struggling with making payments on their mortgages. The program offered opportunities for unemployed homeowners to receive mortgage payment assistance, principal reductions, and transitions into more affordable homes. It also included funds for blight elimination.

“Many people do not realize that TARP housing programs are still open,” Special Inspector General Christy Goldsmith Romero said. “TARP’s Hardest Hit Fund program could be a strong tool to help with the recent significant rise in unemployment, as there are already existing infrastructures in 19 states that could be quickly employed.”

The Treasury originally targeted HHF to serve five states, but as the effects of the global financial crisis spread, it expanded the program to serve 18 states and the District of Columbia with \$9.6 billion in funding. Treasury selected eligible states based on whether state unemployment rates exceeded the national level or home prices in the states decreased by more than 20 percent during the GFC; it's unclear whether the states eligible to administer the program would change during the present crisis. The program is administered on the state level. Approximately [\\$579 million](#) of the funding is still available through 2022.

Potential COVID relief could also include unspent TARP funds from other housing programs, such as the \$4.3 billion in unspent funds for the Home Affordable Modification Program (HAMP) and other mortgage programs. The Treasury has [already moved](#) \$2 billion in funding from HAMP to HHF, rather than simply deobligating the funding.

The targeted assistance intends to provide states with the flexibility to aid homeowners in the ways they need on a local basis. However, some [found](#) a lack of take-up in such housing relief programs. Barriers to entry included multiple requirements for applications from local agencies and long distances to application centers from homes. Additionally, the program has faced issues managing the spending of local offices. In 2017, [a report](#) found \$3 million in wasted HHF funding, which SIGTARP noted resulted from excessive spending on the state level and lack of accountability on the federal level.

As the pandemic continues and few Americans return to full-time jobs, it's unclear whether the existing fiscal stimulus will be enough to help many individuals through a period of reduced employment or unemployment while businesses struggle to keep afloat. Federal Reserve

Chairman Jay Powell has repeatedly [called for](#) additional fiscal spending, warning of a longer period of weaker economic growth than originally expected. Utilizing existing TARP allocations would enable the Treasury to provide more fiscal relief without waiting for an additional stimulus package.

Most recently, the Federal Housing Finance Agency [also responded](#) to homeowners' troubles making mortgage payments, creating an opportunity for homeowners to defer forbearance payments until the end of their mortgage, or at refinancing or sale.

CARES Act Provides Mortgage Forbearance

By Vaasavi Unnava

Original post [here](#).

The [\\$2 trillion](#) CARES Act, signed by the President on March 27, 2020, provides consumer credit and mortgage forbearance to keep people in their homes while the coronavirus lockdown continues.

For homeowners and renters, Title IV of the CARES Act includes mortgage forbearance and renter protection, a foreclosure moratorium, eviction protection, easing accounting standards for borrowers who miss payments, and changes to credit reporting requirements.

Mortgage Forbearance

Borrowers with federally backed mortgages are eligible for mortgage forbearance under Section 4022 of the CARES Act.

Individuals with single-family mortgages may write to their mortgage servicer requesting forbearance for 180 days due to COVID-19-related difficulties. In such a case, no additional fees, penalties, or interest outside of normally scheduled terms may be levied on the borrower. The servicer may extend the period for an additional 180 days at the borrower's request. The borrower may also request the initial or extended period be shortened. The mortgage servicer may not require any additional documentation of distress outside of the original claim of the borrower.

Landlords with multifamily mortgages are provided 30 days of forbearance with the option to extend for an additional two 30-day periods (Section 4023). These borrowers also cannot charge any fees or penalties related to rent nonpayment, or late payment, for any tenants on properties funded by multifamily mortgages.

Foreclosure Moratorium

With the exception of vacant properties, the servicer of a mortgage may not initiate a foreclosure, move for a foreclosure or order of sale, or execute a foreclosure sale in the 60 days beginning March 18, 2020 (Section 4022).

Eviction Protection

For 120 days after the enactment of the CARES Act, no tenant residing in a federally subsidized housing or in a dwelling covered by a federally backed mortgage loan can be forced to change dwellings through the filing of evictions by the lessor. The lessor cannot issue an eviction notice until the expiration of the moratorium period (Section 4023).

Mortgage servicers may not evict anyone in the 60 days following March 18, 2020 (Section 4022).

Modifications to Generally Accepted Accounting Principles

Banks will not have to recognize loan modifications related to COVID-19 as troubled debt restructurings under the new law (Section 4013). These include forbearance arrangements and changes to interest rates, repayment plans, and other changes in payments. The suspension is applicable for the duration of the modification, but only to the terms directly modified for the COVID-19 outbreak. Loans that were overdue by 30 days as of December 31, 2019 are not eligible.

Credit Reporting Requirements

Between January 31, 2020 and the later of 120 days after enactment of the CARES Act or 120 days after the end of the national emergency concerning COVID-19, if a borrower is accommodated for making late payments, then the creditor must report the obligation as “current” in credit reporting (Section 4021). If the borrower was delinquent prior to this period and brings the account to current during this period, then they will be reported as “current” in credit reporting. This will not apply to consumers whose loans have already been charged-off.

The costs of the mortgage forbearance programs will generally be borne by the federal agencies and government-sponsored entities that own or guarantee the loans. However, mortgage market participants have noted that nonbank mortgage servicers now handle close to half of all mortgages. Also, as a team of Fed and other economists pointed out in a recent [paper](#): “Nonbank mortgage companies also need to finance the costs associated with servicing defaulted loans for extended periods of time. Obtaining this financing can be difficult in times of strain.”

The industry has asked the Fed and Treasury to use other powers in the CARES Act to create a new [liquidity facility](#) to support the forbearance policies included in the CARES Act.

Governments Extend Mortgage Forbearance and Other Relief as Virus Endures

By Vaasavi Unnava

Original post [here](#).

As coronavirus cases continue to rise around the world, governments have started to extend [mortgage forbearance](#) and other relief policies that they launched back in March and April when the crisis began.

These policies, intended as a temporary relief for people facing sudden loss of income, allow homeowners and renters to temporarily suspend payments of mortgages or rent for a fixed duration.

On June 17, the US Federal Housing Finance Agency (FHFA) [extended](#) its foreclosure moratorium for borrowers with mortgages backed by Fannie Mae and Freddie Mac, the major government-sponsored enterprises, and its eviction moratorium for borrowers whose landlords have government-backed mortgages. Set to expire on June 30, the measures will now extend through at least August 31, though there is an opportunity for more extensions. The [CARES Act](#) allows borrowers to ask their mortgage servicer to forbear on payments for six months, extendible to up to one year.

Similarly, the National Bank of Costa Rica [extended](#) its original two-month moratorium on mortgage payments, due to expire in May, through December 31. The Vietnamese government [extended](#) deferral of land taxes for 12 months, lengthening an original term of [five months](#). Greece [extended](#) its rent reductions for an additional month beginning in May.

Italy has [expanded availability](#) of its forbearance vehicle. As part of the Italian government's "Cura Italia" package, through the [Gasparrini Fund](#), individuals can apply for suspended mortgage payments on "first home" mortgages--mortgages taken out for an individual's primary residence. Recently, eligibility expanded to freelance workers and self-employed workers. If an individual has experienced at least a [33% drop](#) in business from the last quarter of 2019 as a result of closures or restrictions on their business activities, they are eligible to suspend payments on mortgages worth up to €400,000.

Forbearance is largely a temporary measure that assumes a quick return to economic normalcy. Balances from extended ongoing forbearance can ultimately become too large to quickly pay off. As these measures extend longer than expected, losses have accrued. In the US, [8.48%](#) of mortgages are in forbearance, up from [0.25%](#) on March 6, prior to the emergency shelter-in-place orders.

Ongoing forbearance has proven [challenging in the commercial real estate sector](#), where payment delinquencies in commercial real estate (CRE) mortgages have caused shortfalls in CRE cash

flows. As forbearance continues as the dominant stability strategy for residential mortgage relief, unpaid balances can loom and remain unresolved when forbearance ends if repayment strategies aren't thoughtfully constructed.

As mentioned in a [previous blog post](#), forbearance relief can create secondary problems once the forbearance period ends. For example, in Ireland during the Global Financial Crisis (GFC), the country's initial response relied largely on the broad implementation of [short-term mortgage forbearance](#). However, the response did not account for the underlying problem of excessive mortgage debt, leaving many residential mortgages underwater. Paired with increased unemployment, many homeowners exiting forbearance did not have the means to repay their accrued unpaid mortgage balances, sending many underwater mortgages into arrears. Only years after the GFC did the government encourage large-scale permanent mortgage restructuring.

One solution [promoted by](#) Fannie Mae and Freddie Mac allows consumers to move lump-sum payments to the end of their mortgage terms. Consumers can set up repayment plans or modify loans to extend the term of the mortgage by adding on missed payments at the end, reducing their monthly payments, or increasing the term of the mortgage permanently. Additionally, homeowners can pay the entire missed amount at sale, refinancing, or maturity.

Rather than continuing forbearance, some countries have attempted to tackle the fundamental economics of a mortgage, providing subsidized interest rates for homeowners facing prolonged cash flow troubles. Mongolia has [resumed](#) its Affordable Housing Finance Program temporarily, to provide subsidized mortgages to prospective homeowners. In Denmark, the government has effectively [banned](#) predatory mortgage lenders by instituting caps on interest rates in mortgage financing.

As phased reopening continues, and in some countries COVID-19 case totals decrease, economic recovery provides promise in mitigating cash flow woes and providing homeowners in forbearance with the ability to begin repayment of unpaid balances. However, with risks of another spike in cases causing shutdowns again in some countries, forbearance periods may be more prolonged than originally expected or intended and we may yet see additional creative solutions to address the potential problems after forbearance.

Multinational Organizations

Multinational organizations comprise the IMF, the World Bank, the European Union, the G-20, and other various regional multilateral development banks. These organizations provide programs and financing facilities to assist governments and the private sector in responding to the COVID-19 crisis. Actions of multinational organizations include loans, grants, guarantees, forbearance, and technical assistance. Many of these actions tend to target vulnerable countries and populations around the world.

Analysis

Multinational Organizations' Efforts to Assist Countries through COVID-19 crisis

By Aidan Lawson, Manuel Leon Hoyos, and June Rhee

The [International Monetary Fund](#) (IMF), [World Bank](#), and other [multinational organizations](#) have announced plans to make hundreds of billions of dollars available to emerging markets in response to the COVID-19 crisis. But their own experts have said these funds will probably be insufficient, and they have collectively released only a small fraction of that amount so far.

Since March, the IMF has doubled the access limit to its existing emergency loan programs, whose [demands could reach up to \\$100 billion](#), and launched a [new liquidity line](#) to help countries meet balance-of-payments needs. The [European Stability Mechanism](#) has announced plans to provide €240 billion to help its members with support in financing healthcare, cure and prevention related to the COVID-19 crisis. Meanwhile, the World Bank and other multilateral development banks have announced more than \$250 billion in COVID-19-related programs.

While resources are being deployed through [credit lines](#), [expanded lending arrangements](#), and [support to developing countries](#), multinational organizations will require additional resources through increased contributions or additional debt issuances to adequately respond to the economic damage caused by the pandemic (see the [YPFS reports](#) here). Table 1 shows the amounts available and deployed in response to the COVID-19 crisis under each organization. It is not meant to be exhaustive and will continue to be updated.

This post discusses different efforts by multinational organizations set forth thus far in response to the COVID-19 crisis and highlights the key elements in these efforts that ensure the support adequately meets the needs of the most vulnerable member countries facing the global pandemic.

1. Purpose: what is the mission and mandate of different multinational organizations?
2. Form of action: loan, grants or forbearance? Other forms of action?
3. Size: how do you determine the size of assistance ensuring a country's needs are covered?
4. Funding for programs: how do multinational organizations fund these assistances?
5. Speediness: how does assistance reach member countries in a timely manner?
6. Eligibility: who is eligible for support – i.e. governments or private entities?
7. Term: how long is the assistance for?

8. Limitations and other conditionalities: are there conditionalities and if there are, what conditionalities accompany the assistance?
9. Coordination and cooperation: how are different multinational organizations coordinating and assisting their efforts?
10. Post-crisis plan: do these actions consider means to rebuild the economy after the crisis has ended?

Table 1: Multinational Organization Resources for COVID-19 and Deployment

Multinational Organization	Available Resources	Deployment (calculated based on YPFS Resource Guide as of April 28, 2020)
International Monetary Fund (IMF)	\$1 trillion (current total lending capacity of the IMF, including amounts already allocated. The IMF allows augmentation and/or rephasing of existing arrangement to respond to COVID-19 crisis)	\$17.6 billion in emergency financing, grants and augmentation of existing arrangements
European Stability Mechanism (ESM)	€240 billion	N/A (expects to open June 1)
Multilateral Development Banks		
World Bank Group	\$160 billion will be made available in the next 15-months (\$14 billion fast-track package)	\$2,73 billion from fast-track \$2.3 billion from broader resources and redeploying existing financing
European Investment Bank (EIB)	€25 billion guarantee €5.2 billion to EU response for outside EU (part of €20 billion Team Europe response to support partner countries)	€16 million (€11 million to outside EU)
European Bank for Reconstruction and Development (EBRD)	€21 billion	€162.5 million
Asian Development Bank (ADB)	\$20 billion	\$5.1 billion

Inter-American Development Bank (IDB)	\$12 billion	\$99 million
Asian Infrastructure Investment Bank (AIIB)	\$10 billion	\$355 million
African Development Bank (AfDB)	\$10 billion	\$50 million

Source: Authors' analysis

1. PURPOSE

The IMF's mandate is [to ensure the stability of the international monetary system](#). This includes the system of exchange rates and international payments that enables countries to transact with each other, and was extended to include all macroeconomic issues relating to global financial stability in 2012. Its main activities to fulfill this mandate consists of (i) economic surveillance, (ii) lending, and (iii) capacity development. The main focus of the IMF's COVID-19 response has been lending, with a focus on solving balance of payment problems to help rebuild international reserves, stabilize currencies, continue paying for imports, and restore conditions for strong economic growth.

The ESM's [purpose](#) is to financially assist euro area countries if it is necessary to protect financial stability of the entire Euro area. Additionally, the [European Investment Bank \(EIB\)](#) is the lending arm of the EU, promoting equality for EU citizens and helping the economy in developing member states.

On the other hand, the [World Bank Group](#) and other [multilateral development banks](#) promote long-term economic development and poverty reduction. The International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) form the World Bank. The World Bank, together with three other organizations - the International Finance Corporation, the Multilateral Investment Guarantee Agency and the International Centre for Settlement of Investment Disputes - makes up the World Bank Group. The IDA focuses on the world's poorest countries, while the IBRD assists middle-income and creditworthy poorer countries.

2. FORM OF ACTION

Actions of multinational organizations include loans, grants, guarantees, and forbearance. As the IMF mainly focuses on solving balance of payment problems, it provides medium-term loans and grants. For example, the IMF's [Rapid Credit Facility \(RCF\)](#) and [Rapid Financing Instrument \(RFI\)](#) disburse emergency loans to meet balance of payments needs and the [Catastrophe Containment and Relief Trust \(CCRT\)](#) provides grants for debt relief so a

country has enough resources to meet exceptional balance of payments needs created by disasters rather than having to assign those resources to debt service.

During the COVID-19 crisis, the IMF has also established a [Short-term Liquidity Line](#) (SLL), which provides 12-month repurchase obligations to serve as a revolving international liquidity backstop. The SLL builds on the framework of the Short-term Liquidity Swap (SLS) discussed [by the IMF Board in 2017](#). At the time in 2017, the SLS did not secure consensus necessary for implementation.

The ESM provides a [credit line designed to serve as an insurance](#) for member countries. If a member country applies for the credit line, funds do not necessarily have to be drawn.

The European Commission's [Coronavirus Response Investment Initiative \(CRII\)](#) allows member states to hold the unspent pre-financing by the European Structural and Investment Funds (ESIFs) for 2019 and this provided the member states with an immediate liquidity buffer of €8 billion. Normally, the member states would have to reimburse the unused pre-financed ESIF funds by the end of June 2020. Additional amounts are also available for member states.

Multilateral development banks, including the World Bank, generally have two major lending windows. One is to provide assistance on market-based terms, in the form of loans, equity investments, and loan guarantees. For example, the ADB provides loan guarantees to partner financial institutions to support [supply chains](#). The other is to provide concessional assistance at below market-based terms, in the form of loans and grants.

Additionally, the IMF and the World Bank [called for a standstill of debt service to official bilateral creditors for the world's poorest countries](#) and the [G-20 responded with a plan to allow requests for forbearance to suspend repayment starting on May 1](#). The World Bank [also called on private creditors to participate](#) in the initiative on comparable terms and asked the IMF to review the debt challenges of middle-income countries and explore solutions to fiscal and debt stress in those countries on a case-by-case basis. For further discussion on debt challenges of emerging markets, see [this YPFS blog post](#).

3. SIZE

The IMF has [doubled](#) the access limit to its two existing emergency facilities, the RCF and RFI, in response to the COVID-19 crisis and it projects that the demand could be as high as \$100 billion. The IMF determines the size of individual assistance using [quotas](#), which are broadly based on a country's relative position in the world economy. In response to urgent COVID-19 related financing needs, the IMF [increased the access limit](#) for the RCF. Normally, the facility is limited to 50% of a member's quota per year and 100% of quota on a cumulative basis, but the IMF temporarily increased the limit from 50% to 100% of quota per year and from 100% to 150% on a cumulative basis. The higher access limits are scheduled to apply until October 5 and may be extended by the Board. Regardless of the increase, this assistance is still based on quotas and not on the need of a country. This may mean countries in dire need of IMF assistance may not be able to receive the necessary amount.

On the other hand, for the IMF's FCL, there is no cap on access; support is based on the member's actual or potential balance of payments needs. For more information on the size of existing IMF measures, see Table 2 below.

The World Bank has vowed to make \$160 billion available for the next 15 months, including \$14 billion of fast-track financing. Support to an individual country under the IBRD's Catastrophe Deferred Drawdown Option is [limited](#) at \$500 million or 0.25% of GDP.

The ESM [grants 2% of the respective member states' GDP](#) as of end-2019 under its pandemic credit line. If all 19 member states were to draw from the credit line, this would amount to a combined volume of around €240 billion.

The ADB's [Supply Chain Finance Program](#) determines the amount of funds partnering financial institutions will receive based on their "risk appetite[s], presence in [Developing Member Countries], and monitoring capabilities." The [EU Solidarity Fund](#) (EUSF) provides assistance as a percentage of total public expenditures on COVID-19-related measures, and successful applicants can request up to 25% of this funding to be advanced immediately.

Table 2: IMF facilities currently used for COVID-19 crisis

Program	Size	Term
Rapid Financing Instrument (RFI)	<ul style="list-style-type: none"> • 100% of quota per year • 150% of quota on a cumulative basis 	<ul style="list-style-type: none"> • 1 to 2 years
Short-term Liquidity Line (SLL)	<ul style="list-style-type: none"> • 145% of quota per year • Revolving access 	<ul style="list-style-type: none"> • 12 months
Flexible Credit Line (FCL)	<ul style="list-style-type: none"> • No outright limit • Determined case-by-case 	<ul style="list-style-type: none"> • 1 to 2 years
Catastrophe Containment and Relief Trust (CCRT)	<ul style="list-style-type: none"> • Approximately \$500 million available for grants to pay debt service owed to the IMF 	<ul style="list-style-type: none"> • Up to 6 months to 2 years
Precautionary and Liquidity Line (PLL)	<ul style="list-style-type: none"> • 125% of quota (can be extended up to 250%) for 6 months; or • 250% of quota for the first year and a total of 500% of quota for the entire arrangement • 500% of quota on cumulative basis 	<ul style="list-style-type: none"> • 6 months (can be extended once); or • 1 to 2 years
Poverty Reduction and Growth Trust		
Rapid Credit Facility (RCF)	<ul style="list-style-type: none"> • 100% of quota per year • 150% of quota on a cumulative basis 	<ul style="list-style-type: none"> • 10 years with 5 ½ year grace period
Extended Fund Facility (EFF)	<ul style="list-style-type: none"> • 145% of quota per year • 435% of quota on cumulative basis <p>(These limits can be exceeded in exceptional circumstances)</p>	<ul style="list-style-type: none"> • 4½–10 years

4. FUNDING

Based on [the projected needs of the emerging markets alone](#), it is clear that further fundraising efforts may be necessary, despite current efforts to maximize available funding.

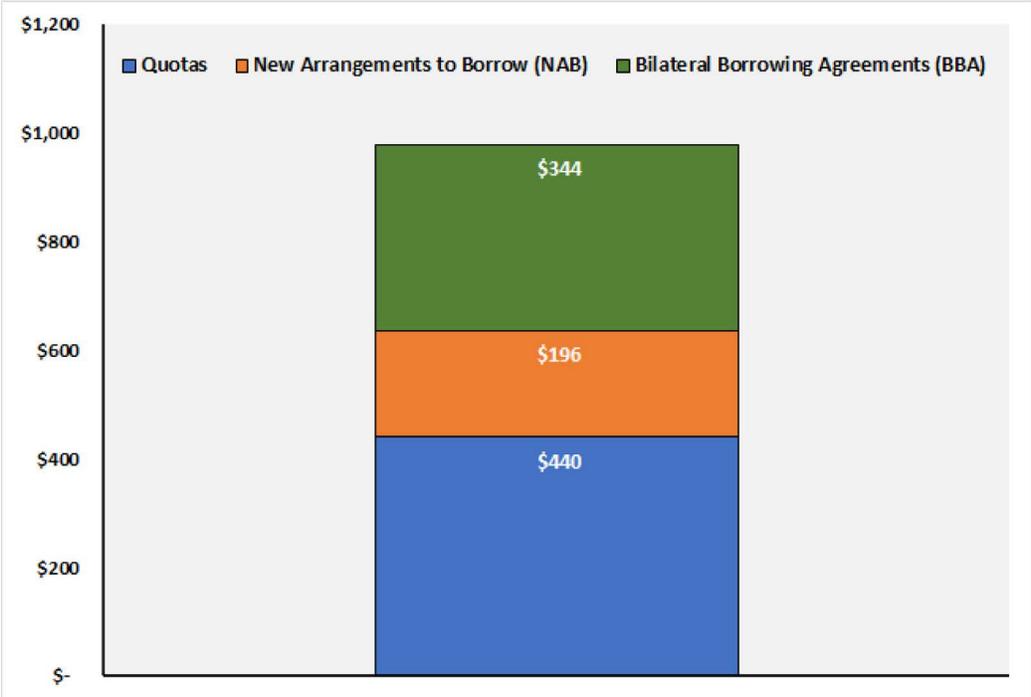
The IMF is composed of 189 member countries and member quotas are their main source of funding. Additionally, the IMF can supplement its resources through the [New Arrangements to Borrow](#) (NAB). Forty higher-capacity members stand ready to lend if member countries representing 85% of committed funds agree to activate the NAB. The IMF last activated the NAB

during the 2007-09 global financial crisis (GFC). At that time, the [US and G-20](#) led an initiative to increase the NAB, and the IMF [tripled its lending capacity to \\$750 billion](#). Under the [CARES Act](#) passed in the US to cope with the COVID-19 crisis, the Treasury may expand the NAB it can provide to the IMF through loans for up to \$28.2 billion. The [leaders of the US response](#) to the GFC have argued that the US plays a leadership role in ensuring international financial institutions have enough resources to vigorously address emerging economic and financial crises.

The third line of defense for the IMF are [Bilateral Borrowing Agreements](#) (BBA), providing additional resources that will only be drawn “after resources from quotas and the New Arrangements to Borrow are substantially used.” Currently, 40 members have agreed to contribute to the BBA; activation requires the approval of creditor countries whose contributions represent 85% of the total. The Board [approved on March 31](#) a framework for a new round of bilateral borrowing by the IMF from January 1, 2021, and this helped the IMF maintain its lending capacity of \$1 trillion.

Lastly, concessional lending and debt relief for low-income countries are [financed through separate contribution-based trust funds](#). For example, the [IMF’s CCRT](#) was able to extend its capacity after the UK, Japan, Germany, Singapore, the Netherlands and China [pledged additional contributions](#). The IMF [hopes to increase the commitment to \\$1.4 billion](#). Figure 1 provides an overview of the IMF’s lending capacity at the end of March.

Figure 1. IMF lending capacity (\$ billions, end-of-March 2020)



Source: IMF & Authors’ analysis

While the IMF reports that total lending capacity sits just shy of \$1 trillion, the amount readily available for lending is lower. The [IIF calculates](#) that the IMF has \$270 billion readily available and can access an additional \$508 billion if members agree to activate extraordinary resources. [Another calculation](#) concludes that \$787 billion is the maximum lending capacity as of March 20 due to the possibility of borrowings by members whose quota is expected to be available for lending and uncertainty around continued availability of funds from borrowed sources.

The ESM's current [lending capacity is €410 billion](#) and the pandemic credit line is expected to take up less than [€240 billion](#). It is also planning to [issue social stability bonds](#) to finance this credit line. The ESM has paid-in capital of €80 billion from the [19 member countries](#) but this cannot be used to make loans. With this backing from member countries, the ESM [raises money](#) from the financial markets to provide liquidity assistance to its member countries.

Multilateral development banks raise funding from international capital markets to make non-concessional loans. They are backed by shareholder member governments and thus are [able to raise funding at very low market rates](#). For example, the World Bank's IBRD, which lends mostly to middle-income developing countries, raises most of its funds from issuing bonds in the capital markets. Additionally, the ADB sold [2-year](#) and [5-year](#) global benchmark bonds in the US dollar bond market to facilitate its capacity and enhance its liquidity in responding to the COVID-19 crisis. The AfDB raised \$3 billion by selling a [Fight COVID-19 Social Bond](#), which was the largest dollar denominated Social Bond ever launched in the international capital markets to date. Moreover, they can increase non-concessional lending by increasing all members' shares through a general capital increase (GCI). Following the GFC all multilateral development banks [simultaneously increased](#) their members' capital allocations. For 2020, the US Congress [authorized](#) the country to participate in a World Bank GCI.

On the other hand, concessional lending windows are [generally funded](#) by contributions of their member countries. For example, the World Bank's IDA, which lends mostly to low-income countries, is financed by grants from donor nations that are replenished every 3-5 years. They also transfer some of the net income from their non-concessional loans to help fund concessional loans and grants. In 2018, however, the IDA started issuing bonds to finance its concessional programs.

5. ELIGIBILITY

Generally, the assistance is provided to member countries of the multinational organizations. Different facilities within the organization have different criteria of eligibility. For example, the IMF's CCRT is exclusively for the most vulnerable low-income countries, while the SLL is available to members with very strong macroeconomic fundamentals and track records of strong policy implementation. Similarly, members eligible for concessional and non-concessional loans in multilateral development banks have different economic backgrounds.

To be eligible for [EU Solidarity Fund](#) (EUSF) assistance, EU member states must sustain economic damage that exceeds the lesser of 0.3% of gross national income or €1.5 billion. On the other hand, the ESM's credit line is available to all EU member countries.

Some multilateral development banks have partnered with financial institutions to support certain industries. The ADB's [Supply Chain Finance Program](#) provides financing to suppliers in developing member countries that have minimum 2-year relationships with any buyers they associate with, and have "solid production and delivery track record[s]." The suppliers obtain financing through partner financial institutions and the ADB either loans funds directly to these institutions or provides assistance in the form of a guarantee.

6. SPEEDINESS

Multinational organizations are responding to the COVID-19 crisis by generally relying on existing facilities and lending arrangements to deploy resources as fast as possible. The IMF is disbursing its emergency funds mostly through its [Rapid Credit Facility \(RCF\)](#) and [Rapid Financing Instrument \(RFI\)](#). Both are designed to deploy resources quickly by providing eligible members with funds where there are urgent balance of payments needs, without the need or capacity to have a full-fledged economic program.

On the other hand, the World Bank rolled out the [Covid-19 Fast-Track Facility](#) on April 2, with the first group of projects assisting 25 countries amounting to \$1.9 billion. The purpose of the facility is to rapidly reach countries with no established funding line. The World Bank's existing [Pandemic Emergency Financing Facility](#) was only activated for COVID-19 response on [April 17](#), which raised [criticism](#) for not responding fast enough. This facility was launched in 2016 as an additional source of financing to the world's poorest countries facing infectious diseases. It had come under [scrutiny](#) when it failed to release funds for a year as the 2018 Ebola outbreak in the Democratic Republic of Congo killed more than 2,000 people. A major reason for the delay was that funds can only be released [12 weeks after the World Health Organization \(WHO\) publishes its first situation report, and complex criteria including outbreak size, growth rate, deadlines and death tolls have to be satisfied](#).

On the other hand, the ADB has revised its policies and business processes "[to respond more rapidly and flexibly to the crisis](#)." For example, it [streamlined internal business processes](#) and [widened the eligibility and scope of various support facilities](#).

7. CONDITIONALITIES AND LIMITATIONS ON THE USE OF FUNDING

The IMF's facilities used for emergency disbursement of COVID-19 funding do not have conditionalities. The [Flexible Credit Line \(FCL\)](#) and RFI provide resources without on-going conditions and RCF support comes without ex-post program-based conditionality or reviews. However, only two disbursements are allowed under the RCF in any 12-month period and repeated use may trigger transition into the [Extended Credit Facility](#), which is a medium-term support for low-income countries with some conditionalities.

IMF conditionality in the past has raised [concerns](#). A [study in 2007](#) found that “a significant number of structural conditions are very detailed, and often felt to be intrusive and to undermine domestic ownership of programs.” Since then, the IMF has reformed its rules around its lending to [do away with “hard” conditionality](#). Hard conditionality for all IMF loans was phased out by May of 2009.

The ESM’s [Pandemic Support Credit Lines](#) utilize the existing [Enhanced Conditioned Credit Lines](#) (ECCL). The ECCL typically requires members accessing the credit lines to adopt specific measures, but for the pandemic support, fewer conditions exist.

Most programs, however, prescribe and limit the usage of provided funds. For example, the ESM only allows countries to use the [Pandemic Support Credit Lines](#) to support direct and indirect healthcare, cure, and prevention costs due to the COVID-19 crisis. ESIFs generally have distinct investment objectives that limit the uses of their funding, but the CRII eased enforcement of these [“thematic objectives”](#) to facilitate a broader range of assistance.

8. TERM

Depending on the mandate of the organization and the purpose of the program, the term of the loan varies. The World Bank and other multilateral development banks have mandates that [promote](#) long-term economic development and poverty reduction. For example, the World Bank provides long-term concessional loans with maturities between 30 and 40 years and additional grace periods ranging between 5 and 10 years for low-income countries.

On the other hand, the IMF, with its mandate [to ensure the stability of the international monetary system](#), generally extends mid-term loans for eligible members. For more information on the term of existing IMF measures, see Table 2. The IMF’s [SLL](#), which aims to be an international liquidity backstop, provides revolving funding through a 12-month repurchase obligation and is only available for member countries with very strong macroeconomic fundamentals and strong policy implementation records that are experiencing moderate capital flow volatility.

The ESM loans under the pandemic credit line currently do not have a limit set on the term. In a recent [interview](#), its managing director stated that there is flexibility around the maturity for these loans, more so than for IMF loans. The amended ESM treaty, the discussion of which was halted by the COVID-19 crisis, had [sought](#) to impose a maximum average maturity of five years.

The EU’s [macro-financial assistance program](#) to 10 neighboring countries operates in tandem with and to complement IMF disbursements to these countries. Therefore, this program will only make two disbursements of loans with shorter terms than those extended by the IMF.

9. COORDINATION AND COOPERATION

Multinational organizations consult and coordinate their response to a crisis. The IMF and the World Bank continue to issue joint statements. The [G-20's debt relief was a response to their](#)

[joint request](#) and they are now [urged](#) to cooperate further in providing mechanisms to coordinate this standstill and ensure that the associated debt relief is directed towards pandemic funding.

The EU's [macro-financial assistance program](#) operates to complement IMF disbursements, as seen above. Additionally, in formulating country-level responses, [the ADB states](#) that it continues to prioritize close collaboration with the IMF, the World Bank, and other bilateral and multilateral development partners. These partnerships include not only co-financing projects but also setting overall strategies responding to the COVID-19 crisis. Furthermore, in its private sector operations, [the ADB collaborates](#) with the [International Finance Corporation](#), the [European Bank for Reconstruction and Development](#), and other development finance institutions and reports that the frequency of communication has been stepped up during the COVID-19 crisis.

Further collaboration and coordination also goes beyond organizations concerning economic development and financial stability. Due to the nature of the pandemic, these institutions are closely coordinating and exchanging information with the United Nations, [including the WHO](#), to ensure alignment in addressing the COVID-19 crisis.

10. POST-CRISIS RECOVERY PLAN

The IMF has yet to announce specifics but its managing director recently acknowledged the importance of [considering how to avoid a prolonged recession emerging from the pandemic](#). For emerging economies, she said the IMF envisions that these measures will include regular lending instruments, including those of a precautionary nature. She acknowledged that this may require considerable resources and stands ready to deploy its full lending capacity and to mobilize all layers of the global financial safety net. For the poorest members, the IMF considers more concessional financing.

She said she was also aware that more lending may not always be the best solution for every country; adding to high debt burdens may lead members down an unsustainable path. Therefore, the IMF is contemplating innovative approaches in collaboration with other multinational organizations and the private sector.

The Limits of the G20's Debt Service Suspension Initiative

By Alexander Nye and June Rhee

Original post [here](#).

As of May 1, G20's [Debt Service Suspension Initiative \(DSSI\)](#) for 76 International Development Association (IDA) countries and least developed countries (LDCs) has become operational. However, it remains unclear whether private-sector creditors will collaborate on such efforts for those countries and the question on what to do about the much larger debts of low- and middle-income countries is still open.

On April 15, the G20 announced the DSSI, which is an eight-month official bilateral sovereign debt payment suspension if requested by International Development Association (IDA) countries and least developed countries (LDCs) that are current on their International Monetary Fund (IMF) and World Bank (WB) obligations. The DSSI allows [76 IDA countries and Angola](#) to suspend principal or interest payments on their debts to G20 members from May 1 through the end of 2020.

Once the eight months elapse, the countries will have to pay the deferred principal and interest over the three years following a one-year grace period. This deferral is net present value neutral, and therefore, does not reduce the total payment debtors will make to participating creditors. The Paris Club, the informal group of official creditors for negotiating sovereign debt restructuring, has [endorsed the DSSI](#) and [is trying](#) to secure China's participation.

The G20 also urged private-sector creditors to participate in this initiative on comparable terms. The Institute of International Finance (IIF) is [leading the discussion](#) on voluntary participation in the DSSI. The IIF is a global association for the financial industry that has historically served the [London Club](#), the once-powerful informal committee of commercial creditors that seeks to build consensus for restructuring syndicated loans to sovereigns.

Some [caution](#) that these efforts may not be enough to address the true debt-relief needs of many low and middle income countries struggling to deal with COVID-19 crisis. Many of these countries simply do not have the fiscal capacity to weather the storm and have a mix of creditors that make them especially vulnerable.

This post highlights the following additional actions that may help to enhance meaningful assistance to the countries in need:

- Create incentives for a wider range of creditors to provide similar suspension as the G20 announced.
- Extend the G20 standstill to more middle-income countries ([non-International Development Association](#) (IDA) countries).

- Address other problems associated with a prolonged standstill.

Overindebtedness in the developing world was one of the main concerns of [2019 IMF Spring Meetings](#). As COVID-19 crisis unfolds, both [low](#) and [middle-income](#) emerging markets have to grapple with increasing fiscal burdens as well as investors' [flight to safety](#).

What does G20 standstill amount to?

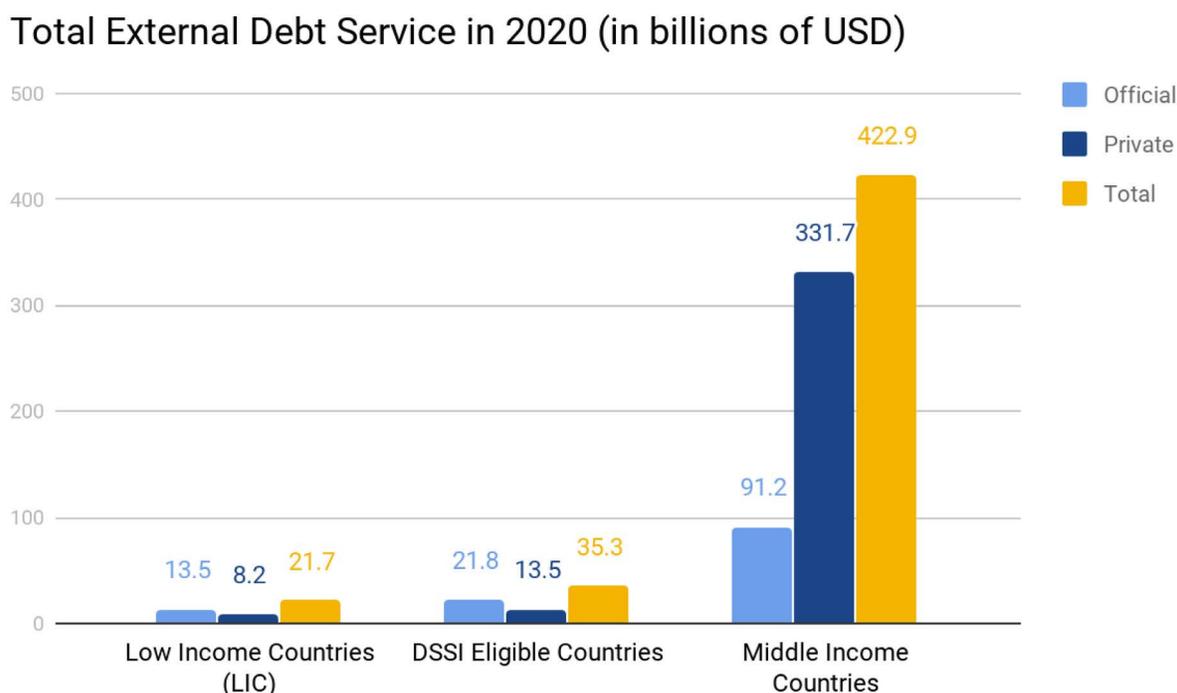
The DSSI is estimated to free up [about \\$11 billion](#) in funds ordinarily used for paying principal and interest to bilateral official creditors, in addition to \$7 billion from multilateral official creditors. However, this is only a portion of the debt payments these 77 countries will be facing through the end of 2020. The uncertain nature of the COVID-19 crisis means that it is difficult to determine whether countries' current sovereign debts are sustainable. A wave of sovereign defaults could be catastrophic for those countries. Although the IMF has helped countries through such temporary crises, [it does not have enough resources](#) to deal with the problem alone.

Additional actions needed

Wider participation in standstill

The IIF [estimates](#) external debt service payments across the DSSI-eligible countries to be about \$35.3 billion this year, as seen in Figure 1 below. It says that private-sector creditor participation would free up an additional [\\$13 billion](#). The [IIF currently is discussing collaboration with private-sector creditors](#). But it acknowledges that negotiating private-sector participation will likely be a lengthy process due to the DSSI's abstract terms and the unique position of each debtor country.

Figure 1



Source: [IIF Weekly Insight: G20 Calls Time Out on Debt Service](#)

Some propose that the G20, by [creating](#) a “Sovereign Debt Coordination Group consisting of sovereign borrowers and representatives of the official and private creditor community,” could make restructuring within the current system more workable. [Some scholars suggest](#) that comprehensive suspension of debt obligations that compels private-sector creditors to accept less than they would receive in a restructuring should be justified on the grounds of necessity. They propose a mechanism by which the private-sector participation is mandatory and immediate through a blanket restructuring of terms. This stands in contrast to the voluntary participation pursued by the IIF, in which creditors would agree on suspension after [lengthy negotiations](#).

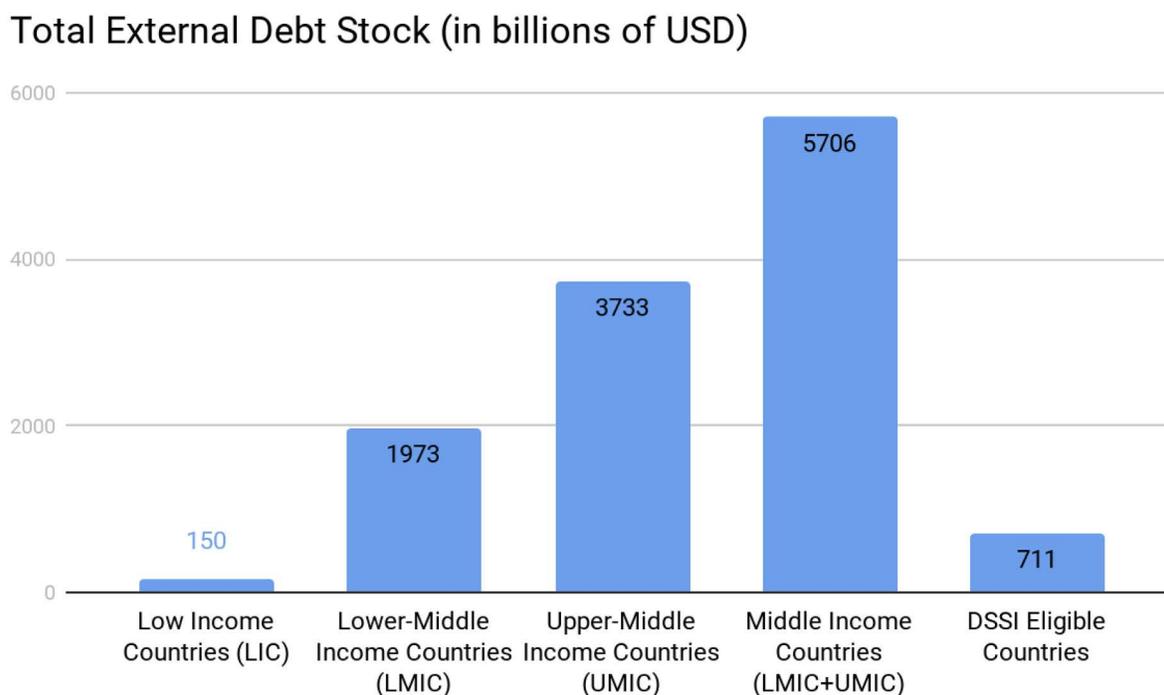
However, the contract-by-contract-approach the [IIF supports](#) means at least a minority of these creditors may become [holdouts](#). A portion of those holdouts may even litigate, further complicating restructuring, as seen in the early days of the IMF’s [Heavily Indebted Poor Countries](#) initiative. Enforcing a blanket standstill, on the other hand, could cause credit rating downgrades, [shutting these countries out of international capital markets](#) and potentially creating incentives for them to default on their obligations to private creditors.

Narrow DSSI-Eligibility

Middle-income countries have significantly more external debt (Figure 2) and are expected to pay \$422.9 billion in debt service in 2020. Only 22% of this is to official creditors (Figure 1).

These countries, like the DSSI-eligible countries, may also be quickly running out of fiscal capacity to deal with the COVID-19 crisis. Capital outflows from emerging markets seem to have [stabilized](#), after foreign investors took [around \\$100 billion](#) out of emerging market stocks and bonds in the first quarter. The IIF [projects](#) that emerging markets may find it hard to borrow large sums internationally this year. It also [expects](#) emerging markets to run unprecedented fiscal deficits this year.

Figure 2



Source: [Bolton et al. 2020](#)

Moreover, a wave of defaults by emerging market economies may pose a threat to the financial stability of advanced economies. The last time a large portion of the sovereign debt market was at risk of default was during the Latin American debt crisis of the 1980s. Large American bank exposures to these debts triggered [financial stability concerns](#) in the US.

However, coordinating a DSSI-like action across all creditors will be even more complicated for middle-income countries. As seen in Figure 1, these countries have a [heavier reliance on private-sector creditors](#), including bonds. This is especially the case for [larger emerging market economies](#). Bonds can have thousands of holders in a given issue and, in spite of collective action clauses (CACs) becoming more common, it can be [extremely difficult](#) to negotiate standstills on an individual basis. CACs are structured to help coordinate the actions of holders of a specific bond issue and countries may have multiple bond issues, raising [another coordination problem](#). [Investors have also been able](#) to amass large enough positions in specific bond issues to

block restructurings. Investment funds holding emerging market bonds may again contemplate [holdout strategies](#).

Another complicating factor in expanding eligibility to middle-income countries is that the IIF's effort to convince private-sector creditors to restructure DSSI debt is based on assurances that eligibility will not be extended beyond the current list of countries. In facilitating the discussion among private-sector creditors to participate in the DSSI, the IIF said that "[comments from IMF and Paris Club officials noting that there is no intention to make the DSSI broader in scope have also been helpful](#)."

Addressing other problems

The purpose of the standstill arrangements is to help debtor countries free up resources to respond to the current pandemic. Creditor states are seeking to create a mechanism to ensure the money freed up from suspension of debt payments will be used for that purpose.

One [proposal](#) is to create a central credit facility (CCF) at the World Bank. The CCF would allow a country requesting temporary relief to deposit stayed interest payments to use for emergency funding to fight the pandemic. Multilateral institutions would monitor it to ensure that payments are used for emergency funding. The CCF would [mix](#) payments to the CCF with aid money from international organizations. To reassure creditors, it would be considered senior to other debt in any debt restructuring. The CCF has some academic support and has received [some positive press](#). Versions of the proposal have been published by the UN's ECOSOC and a number of academic institutions, but it is still not clear whether governments will adopt the policy.

Currently, there is no mechanism like corporate or individual bankruptcy for sovereigns. There were attempts in the past to have a sovereign resolution regime, such as the IMF's [Sovereign Debt Restructuring Mechanism \(SDRM\)](#) proposal in 2002. That proposal [failed to obtain necessary support](#) due to differing views on various design features. The SDRM was proposed in light of a development of a "diverse and diffuse creditor community posing coordination and collective action problems" for sovereigns. Some scholars suggest that a broader reform of the sovereign debt restructuring regime may also be necessary to deal with the problem of [holdout creditors](#).

In the 1930s, [Herbert Hoover's 1931 debt moratorium](#) was followed by a wave of sovereign defaults. Defaulting countries ultimately [recovered from the Great Depression faster](#) than those that resisted default. Nonetheless, defaults contributed to a "[hiatus in private foreign lending of more than twenty years during which few countries had access to commercial financing outside their own borders](#)." Private lending to sovereigns, as well as [discourse](#) on sovereign debt restructuring, had only [begun to return](#) in the 1970s, and sovereign bonds only returned to prominence after the [1989 Brady Plan](#). A wider international effort in responding to sovereign debt may become necessary as the COVID-19 crisis unfolds globally.

Multilateral Development Banks in Latin America and the Caribbean

By Manuel Leon Hoyos

Original post [here](#).

The Americas have become the [new epicenter of the COVID-19 pandemic](#). The crisis has exacerbated the [fall in exports from Latin America](#). South America is one of the regions with the [largest losses in working hours](#).

Multilateral development banks in Latin America and the Caribbean led by the Inter-American Development Bank (IDB) have made over \$40 billion available to address the crisis. This adds to funding facilities available through the International Monetary Fund (IMF) and the World Bank (see [YPFS blog post](#) on overall efforts by multinational organizations).

The [IDB's 2020 Macroeconomic Report](#), published in April, projects that the region of Latin America and the Caribbean will experience a negative contraction of between 1.8% and 5.5% of GDP in 2020. The World Bank expects a deeper [contraction of 7.2%](#), a [far deeper recession than during the 2007-09 global financial crisis](#). A recent presentation from the IDB pointed out that the region is [in a notably weaker position](#) than it was in 2008.

To respond to the crisis, governments are expected to run large fiscal deficits. In regards to IDB's resources, its [President Luis Alberto Moreno recently stated](#) that “it is going to be a drop in the bucket compared to the immense needs the hemisphere has.”

Multilateral development banks usually aim to promote long-term economic development, poverty reduction, and regional integration. In response to the COVID-19 crisis, the IDB focuses on [four main areas](#): the immediate public health emergency, safety nets for vulnerable populations, economic productivity and employment, and fiscal policies.

Table 1 lists resources the multilateral development banks have made available in response to the COVID-19 crisis and their usage as of June 9, 2020.

Table 1: Available resources for the COVID-19 crisis

Multilateral Development Bank	Resources	Use as of June 9, 2020
Inter-American Development Bank (IDB)	Committed \$21 billion for new lending: \$12 billion for governments and \$7 billion for the private sector through IDB Invest – the	Over \$14 billion in loans, of which over \$2 billion has been allocated to six governments (Argentina , Colombia , Panama , Ecuador , El Salvador , and Belize) and over \$12 billion for the private sector.

private arm of the IDB – focusing on MSMEs.

Also, up to [\\$1.35 billion from existing projects can be redirected](#) by governments.

For COVID-19, countries can request up to \$90 million or 0.6% of GDP (whichever is less) through the [recently expanded Contingent Credit Facility for Natural Disaster Emergencies \(CCF\)](#).

Mexico announced [\\$12 billion in loans a year to SMEs](#) provided by IDB Invest in collaboration with the Mexican Business Council.

Over \$100 million from existing projects was redirected to health initiatives in five countries ([Ecuador](#), [Bolivia](#), [Honduras](#), [Panama](#) and [Belize](#)).

Development Bank for Latin America ([CAF](#))

[Emergency regional credit line of \\$50 million per country](#) for health emergency investments

[\\$2.5 billion Emergency Credit Line](#) to support and complement government fiscal measures

Non-reimbursable technical cooperation for up to \$400,000 [per country](#)

Eight countries – [Argentina](#), Bolivia, Colombia, Ecuador, [Panama](#), [Uruguay](#), Paraguay, and [Trinidad and Tobago](#) – [have accessed the Emergency Credit Line](#)

Central American Bank for Economic Integration ([CABEI](#))

[\\$1.96 billion](#) Emergency Support and Preparedness Program for COVID-19:

- \$8 million provided for each country of the Central American Integration System: Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, Panama, Belize and the Dominican Republic.
- Up to \$2.1 million purchase and supply of medicines

Over \$835 million to three countries (Honduras, [Guatemala](#), [Costa Rica](#))

Also, [\\$8 million](#) in non-reimbursable funds – \$1 million

and medical equipment

- \$600 million in emergency sovereign loans to member countries
- \$1 billion to support central banks' liquidity
- [\\$350 million Financial Sector Support Facility for MSMEs](#)

FONPLATA Development Bank	In 2019, total lending capacity was over \$3 billion , with \$883 million available for lending.	Over \$100 million disbursed (Argentina , Brazil and Uruguay). Provided \$1.1 million in non-reimbursable funds to purchase medical equipment (\$300,00 to Brazil and \$200,000 each to Argentina , Bolivia , Paraguay , Uruguay).
Caribbean Development Bank (CDB)	Utilizing \$347 million available for funding approved in 2019: Caribbean countries). \$297 million in loans and \$50 million in grants. \$3 million for medical equipment in response to COVID-19.	Over \$200 million disbursed (\$140 million to borrowing member countries and \$67 million to seven

These resources are generally made available through a combination of existing facilities. Table 2 below provides a summary of facilities that each institution has available to respond to the COVID-19 crisis.

Source of Funding

Multilateral development banks' loans and grants to member countries are funded from member countries' [subscriptions and contributions](#), [borrowings from capital markets](#), equity, and co-financing ventures.

Multilateral development banks also raise funding on international capital markets. On April 21, the IDB, which is rated AAA, launched a [\\$4.25 billion](#) sustainable development bond, its largest ever, with a 3-year term.

Other recent bond issues include:

- On April 13, the IDB launched the [IDB Indonesian Rupiah Sustainable Development Bond](#) at a 3-year fixed rate, valued at 55 billion Indonesian rupiah (\$3.4 million).
- On May 27, the IDB launched an [Australian Dollar Sustainable Development Bond](#) with a 10-year fixed rate, valued at 350 million Australian dollars (\$226 million).
- On April 24, [IDB Invest launched its largest US dollar benchmark bond](#) of \$1 billion to strengthen support for the COVID-19 response.
- On May 7, [CAF issued \\$800 million](#) in 3-year bonds and on May 27, [€700 billion](#) in social bonds.

Table 2: Facilities and programs used for COVID-19 response

Multilateral Development Bank Facilities

Inter-American Development Bank (IDB)	<p>Public sector support: Ordinary Capital (OC), the Fund for Special Operations (FSO), the Intermediary Financing Facility (IFF), trust funds, the IDB Grant Facility (GRF), and the recently expanded Contingent Credit Facility for Natural Disaster Emergencies (CCF).</p> <p>Private sector support: loans, guarantees or capital market products, or in conjunction with local institutional investors.</p>
Development Bank for Latin America (CAF)	Loans: commercial loans (pre-shipment and post-shipment) and working capital loans and limited guarantee loans.
Central American Bank for Economic Integration (CABEI)	<p>Loans: co-financed loans, structured loans, syndicated loans and A/B Loans, loans for investment projects, and refinancing.</p> <p>Credit lines: the Global Credit Line (GCL) to commercial banks and other financial institutions, the Line to Support the Liquidity Management of the Central Banks to central banks of CABEI’s founding countries to support liquidity, and the Credit Line for Decentralized Public Entities and Central American Integration Institutions to meet working capital needs.</p> <p>CABEI also offers guarantees and letters of credit.</p>

[FONPLATA](#) Development Bank Loans and credit lines.

- On April 29, CDBI, with an “AA” rating, executed its largest issuance for a total of [\\$750 million](#) in 5-year bonds. On June 5, it issued [\\$156 million](#) in the Swiss market at a 5-year term, and [\\$375 million](#) at a 5-year term in the Formosa Asian market with dual listing in Taipei and Luxembourg exchanges.

In some instances, multilateral development banks are able to attract resources from non-regional members. For example, in 2019 CDBI welcomed [Korea](#) as its seventh non-regional member with an \$450 million investment for a 7.2% stake. Since the COVID-19 crisis, some of CDBI’s regional borrowing members have received financing [from the Korea Development Co-Financing for Central America](#). On May 27, the [IDB and Sweden established a risk transfer mechanism](#) in which Sweden will provide a \$100 million guarantee to enable the IDB to lend up to \$300 million to Bolivia, Colombia, and Guatemala.

Conditionalities and Limitations

In addition to the IDB’s COVID-19 goals, IDB Invest also prioritizes its lending based on sound credit fundamentals; environmental, social and financial sustainability; their contribution to the UN Sustainable Development Goals; and their ability to have a demonstration effect in local economies.

IDB President Moreno has said that private sector institutions that receive IDB Invest financing [will not be able to distribute dividends](#).

Selected Country Highlights

Argentina, the third-largest Latin American economy, struggles with a debt crisis. This May, the country missed a \$503 million payment in interest on \$65 billion in sovereign debt. It remains in [debt restructuring negotiations](#) with its creditors, with [technical support provided by the IMF](#). In response to COVID-19, the country has received around \$6 billion in financing through multilateral development banks, including the [World Bank](#), [IDB](#), [CAF](#) and [FONPLATA](#).

Ecuador has been hit hard with the fall of commodity prices – particularly crude oil. In April, the country was able to [delay, until August, interest payments of \\$811 million](#) on part of its sovereign debt. [Carmen Reinhart](#), recently appointed World Bank chief economist, said the probability that Ecuador will default on its debt is very high. Ecuador has received financing for over \$1 billion from the [IMF](#), [World Bank](#), [IDB](#), and [CAF](#). On June 4, Ecuador's Deputy Finance Minister Esteban Ferro said the country still faces a [\\$3.5 billion financing gap](#).

Venezuela, similarly, has been hit hard by the fall in crude oil prices. On March 15, the country [requested \\$5 billion from the IMF](#), but was [rejected](#). In late May, the central bank of

Venezuela [sued the Bank of England to release \\$1 billion in gold reserves](#) after the Bank of England refused to release its gold reserves.

The largest two Latin American economies, Brazil and Mexico, have seen their currency depreciate by over 20%. Both central banks have provided extensive measures to support liquidity (see [YPFS blog post](#) on the Bank of Mexico's actions).

Who's afraid of some (not so big or bad) debt relief?

By Alexander Nye

Original post [here](#).

By early July 2020, top officials at the [IMF](#) and [World Bank](#) admitted that the Debt Service Suspension Initiative (DSSI), the G20's debt relief program faced challenges. They hoped to make some progress at the mid-July G20 meetings, but the July G20 meetings [came and went](#) without major action on the program. Considering that the DSSI was supposed to be one of the international community's marquee responses to the most severe instance of capital flight from developing economies [in recent memory](#), it is important for billions of people that they get the program right.

What is the DSSI?

The G20 launched the DSSI in April to help emerging market governments meet the costs of their COVID-19 responses. (See [here](#) for our earlier analysis). The World Bank estimated that the program would free up to [\\$11.5 billion](#) in debt-service payments from the 77 DSSI-eligible governments (though the number of eligible governments has [shrunk](#) to 73) to official creditors in 2020; they would make up those payments over 2022-24.

Countries participating stand to save somewhere [between 0.1% and 8.4%](#) of their 2019 GDP. However, that \$11.5 billion is not distributed evenly among participants. Pakistan and Angola would receive nearly half of the relief. The relief for Angola would amount to 3.1% of its 2019 GDP, but Pakistan's translates to only 1.0% of its 2019 GDP.

Unfortunately, the DSSI is falling short. The program is having a difficult time getting enough debtors to participate, is facing roadblocks from some important official sector creditors, and is having trouble persuading private sector creditors to participate at all. Without support from creditors, the DSSI can at best compliment the IMF and World Bank's COVID-19 aid (see our May 6 [blog post](#)).

Inconsistent creditor participation

Official creditors hold close to two-thirds of the sovereign debt of DSSI-eligible countries. These creditors are government actors (whether coming from the government of a state or an international organization) that extend loans to a country for some government purpose. Bilateral creditors are states that have extended loans to the governments of other states; multilateral creditors are development banks or international organizations like the IMF.

Most bilateral creditors have been willing participants in the DSSI. In some sense this is remarkable, because many of them have a significant proportion of their 2018 debt stock lent to DSSI-eligible countries coming due in 2020. Unfortunately, having a large number of willing

bilateral creditors does not necessarily translate into a participant getting a larger proportion of their potential relief under the DSSI.

It is also particularly difficult to understand how bilateral creditors that are not members of the [Paris Club](#) (an informal, yet important group of creditor countries) will implement the DSSI. Three examples of these are the People's Republic of China (PRC), [the United Arab Emirates](#), and [Kuwait](#).

MULTILATERAL CREDITORS

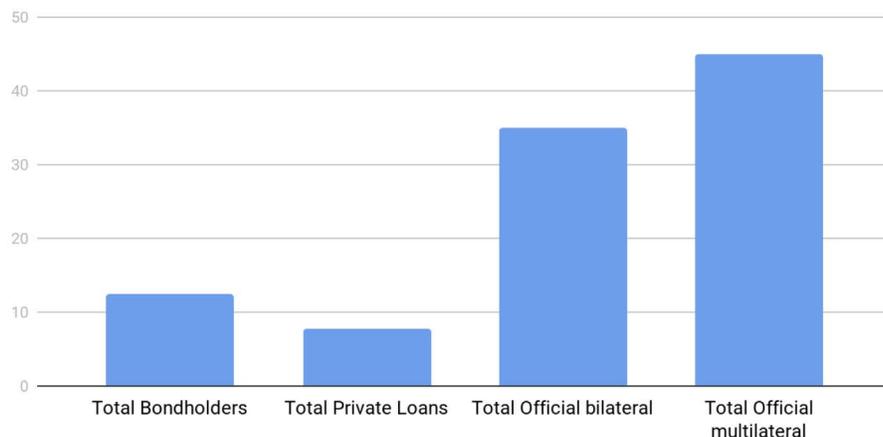
Multilateral creditors usually like to consider themselves lenders that are [de facto](#) senior (in their language, "[preferred](#)") to bilateral creditors and private creditors. They are only [de facto senior creditors](#) because sovereign debt is not subject to a set of laws that formally determine seniority. It is entirely held up by a set of norms. Considering this status, their reluctance to participate in the DSSI themselves would be understandable. This is because they are the creditor group most exposed to DSSI-eligible countries (See Figure 1).

The IMF [granted debt service relief to 25 low-income countries](#) from April to October, though some other multilateral development banks have been less cooperative. However, the [World Bank and other multilateral development banks \(MDBs\)](#) have preferred supporting countries by providing more lending and grants to providing debt relief. In late June, the World Bank president [explained](#) that such relief could "hurt the institution's credit rating and impair its ability to lend because the World Bank depends on current borrowers to repay their loans so it can make new ones." Still, [some countries](#) have criticized the multilateral banks for not practicing what they preach.

One might as well ask all multilateral lenders to join the G20 in providing DSSI relief, but for one significant problem. While maintaining the rest of the DSSI's current form, expanding the DSSI to provide relief from multilateral lenders would effectively give private sector creditors a free ride and run counter to the MDBs' [preferred creditor status](#). It would force international institutions that are supposed to be dramatically increasing their lending right now to increase provisioning or suffer increased borrowing costs.

Figure 1.

% of Total 2018 Debt Stock for DSSI Eligible Countries by Creditor Type



Data Source: World Bank

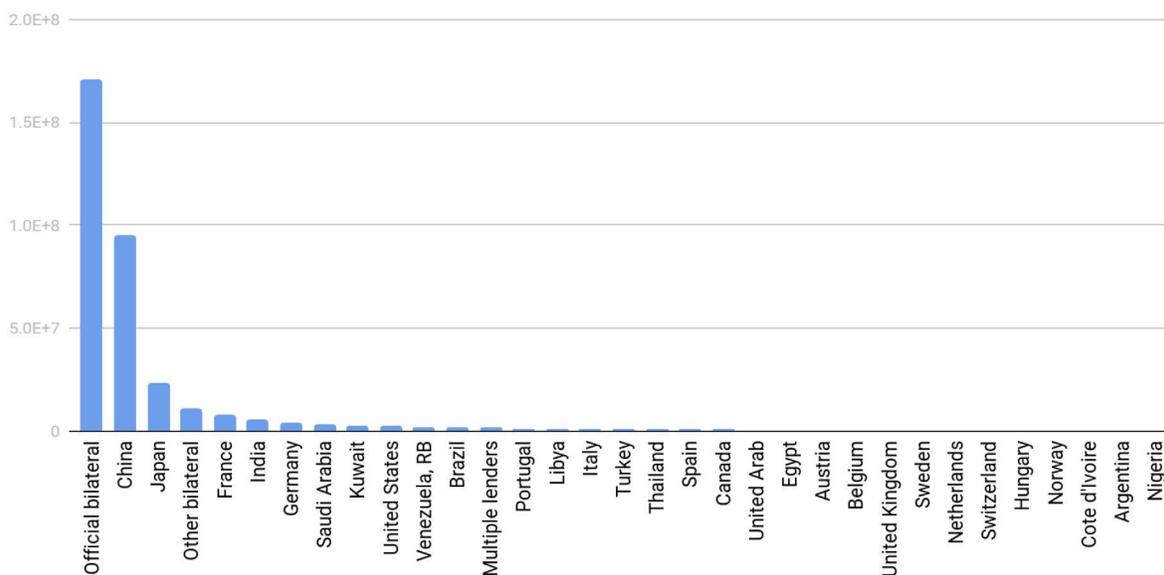
CHINA

The PRC is the most influential bilateral creditor for DSSI-eligible countries. It [accounts for](#) approximately 20% of the total foreign debt owed by DSSI-eligible-governments (and approximately 30% of their 2020 debt service) and has eclipsed the Paris Club in lending (See Figure 2). The PRC's dominance is especially visible in Africa, where PRC lending constitutes [over 25% of the debt stock in seven African countries \(all DSSI-eligible\)](#) at risk of or in debt distress.

Historically, lending from the PRC has been difficult to analyze. [Data has been selective](#), and there have been quality problems, making it difficult to understand the impact of the PRC on the fiscal situations of many least developed countries (LDCs). The [World Bank](#) has been releasing more comprehensive data as part of the DSSI. Most of the PRC's lending is considered "private," so the PRC's participation in the DSSI will not have a major impact. The PRC is only offering relief on a small portion of its lending, but will be able to benefit from an advantageous negotiation position when it comes to this "private" lending.

Figure 2.

Official Bilateral Debt Stock (in \$1000s of USD) of DSSI-Eligible Countries, 2018



Data Source: World Bank

Policymakers are also slowly getting a better understanding of PRC lending policies as a whole. Chinese lending terms and rates vary considerably by lender and project type. [Johns Hopkins University's China-Africa Research Initiative](#) sorts them into six categories: foreign-aid loans from the Ministry of Commerce; export buyers' credits from banks; foreign-aid loans from China Eximbank, a policy bank; suppliers' credits from firms; and other commercial bank loans.

Although there is limited public information on the terms of the PRC's participation in DSSI and on its offers of debt relief, more details have emerged over the past few months regarding lending to Africa. There is still limited data about its lending elsewhere.

Of the six categories, the PRC defines only the [interest-free loans](#) (category 1) to African countries as official lending that would be eligible for relief under the DSSI. The PRC [said](#) it would cancel interest-free loans to African countries that are scheduled to mature in 2020. But [interest-free loans are only 5%](#) of the PRC's lending to Africa, though forgiving those loans would apparently [be useful](#) beneficiary countries trying to expand their fiscal space. [Some commentators](#) have described the measure as “too little too late.”

However, this leaves 95% of the sovereign debt held by Chinese interests formally categorized as private. These debts are largely owed to state controlled and state owned organizations [like policy banks](#). This is reflected in the PRC's guidance for its creditors' participation in the DSSI. The PRC's ambassador to Ethiopia claimed that

[China](#) encourages Chinese financial institutions to respond to the G20's Debt Service Suspension Initiative (DSSI) and to hold friendly consultations with African countries according to market principles to work out arrangements for commercial loans with sovereign guarantees.

This continues the PRC's tradition of negotiating debt restructuring on an informal case-by-case basis outside the view of the Paris Club. Relief from the PRC [does not tend to require](#) that participants refrain from pursuing commercial loans for the rest of the year; and (the PRC [does not require](#) participating countries to pursue relief from private sector creditors based on similar terms. With most Chinese debt categorized as private, the PRC could free-ride on other G20 countries' restructuring efforts. [For example](#), after a country receives debt relief from G20 countries and its official PRC debt, the PRC could impose a more onerous restructuring for its "private" creditors. According to Jan Friederich of Fitch (as well as several other scholars), the PRC should at the very least consider its commercial loans with sovereign guarantees to be [official bilateral debt](#) that is therefore eligible for the standstill. Allowing the PRC count these debt as "private" lending may grant them an advantage in any restructuring process where private creditors are refusing to provide [comparable treatment](#).

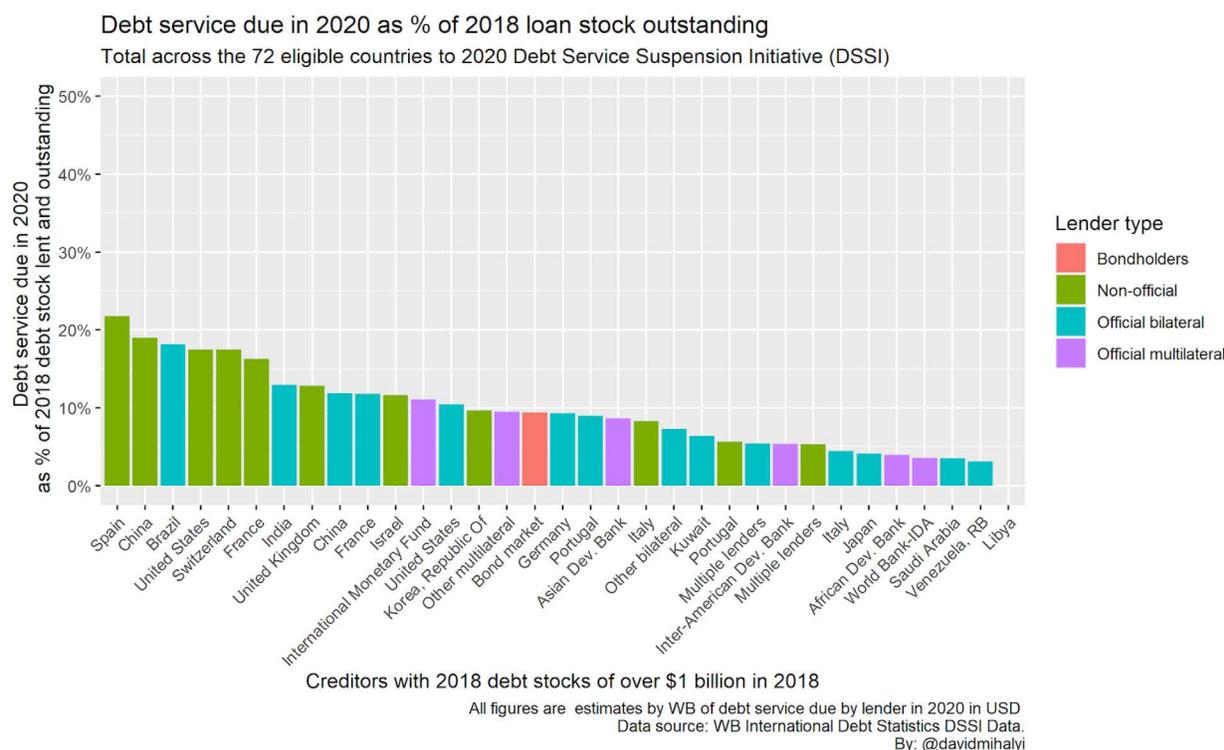
As currently designed, the DSSI leaves [some Western countries worried](#) about PRC participation. While fiscal relief is welcome here, there is a perception that the PRC will use its case-by-case negotiations to control participating countries and ultimately infringe on their sovereignty. Some of these fears, as explained by a [recent paper](#) (and [Webinar](#)) from Johns Hopkins University's China-Africa Research Initiative, are not justified. However, a [June 17](#) statement by Xi Jinping on how the [PRC intends to treat its preferential lending](#) via China Eximbank, raises some concerns. In a June 17 speech, Xi Jinping declared that "any related difficulties regarding repayments could be solved by multiple financial or other approaches, such as the PRC adding grants to help bring projects back to life, conducting debt-to-equity swaps, or hiring Chinese firms to assist operation." Some observers have expressed the concern that debt-for-equity swaps might put state-controlled PRC banks in control of companies that had previously belonged to emerging-market governments.

As for Chinese government or Chinese government controlled creditors, most of the [concerns](#) have been about potential asset seizures that look like something out of the late nineteenth century. Fortunately, it does not look like the PRC is moving toward a policy of taking advantage of countries in debt distress. A [John Hopkins University research team](#) said that "there were no 'asset seizures' in the 16 restructuring cases" involving the Chinese government in Africa and they had "not yet seen cases in Africa where Chinese banks or companies have sued sovereign governments."

PRIVATE SECTOR CREDITORS

Private-sector participation has been limited, although private-sector creditors have a smaller proportion of their lending to DSSI countries coming due this year than a number of the major official creditors (See Figure 3, in which “non-official” refers to private-sector loans).

Figure 3.



The DSSI relies on private-sector creditors to participate voluntarily in the program. While the lack of a bankruptcy code for sovereign debt means that all sovereign debt workouts are technically voluntary, The president of the World Bank [recently called](#) for greater participation.

While [creditor groups](#) have started collaborating on restructuring plans for countries like Zambia, where they already expect a significant debt restructuring. But there is not much public reporting about private-creditor participation in the DSSI. This may be because many of the participating countries are [too afraid](#) of the impact on their credit rating to ask. Countries have thus far [only put forward informal requests](#) to private creditors for forbearance under the DSSI.

Private creditors, particularly bondholders, are an extremely powerful group. Although the PRC is currently the most significant lender to DSSI-eligible countries overall, [bondholders are the largest creditor](#) in ten countries (Côte d’Ivoire, Grenada, Ghana, Honduras, Mongolia, Nigeria, Rwanda, Senegal, St. Lucia, and Zambia) (see Figure 1). Bondholders and private lenders have only offered relief on an [ad hoc basis](#) and [do not release much data](#). It is also difficult to understand whether some of these loans are actually from the private sector, especially for lending by state controlled banks in the PRC. Another set of loans difficult to understand are

those from trade creditors. These are “secured” generally by the proceeds of selling the collateral to the lender at a given price. One recent example of restructuring with trade creditors comes from [Angola](#), which is currently negotiating with its oil importers and [pays some of its debts](#) to the PRC using oil cargo.

A corollary to this issue is that since a large portion of foreign-denominated debt is under New York or London law, many holdout investors might attempt to enforce their claims in domestic legal systems when countries are unable to restructure their debt and default. This could imperil any kind of an effective restructuring and cause problems for future restructurings. The worst case scenario would be a repeat of [Argentina’s tussles with Elliott Capital](#) and NML Capital, where the hedge fund litigated for fifteen years, [seized](#) an Argentine navy ship, and pushed Argentina into [technical default](#).

Lack of debtor participation

Three months into the DSSI, a little under 60% of the 72 eligible countries have said that they will participate. The [World Bank](#) said that 42 of the 72 eligible countries are participating in the DSSI as of July 13, and on June 30, the [Paris Club said](#) that 32 of the eligible countries have officially requested a standstill under the DSSI. Only 18 of the 32 countries mentioned by the Paris Club had signed a MOU implementing the standstill by June 30 (Burkina Faso, Cameroon, Chad, Comoros, Dominica, Ethiopia, Grenada, Guinea, Ivory Coast, Kyrgyzstan, Mali, Mauritania, Myanmar, Nepal, Niger, Pakistan, Republic of Congo and Togo).

Several design flaws in the DSSI hinder participation among eligible countries, box out countries that need the aid, allow some official creditors to stay out of the fold, and incentivize private creditors to stay out of the program. (See our earlier analysis [here](#)).

THE RISK OF A DOWNGRADE FOR A SMALL REWARD

The small size of the program and the prospect of credit ratings downgrade made eligible countries [think twice](#) about participating. The public sector side of the DSSI is not freeing up much fiscal room globally. While creditors seem to be making a huge deal out of the DSSI, Fitch describes the program as follows

[While emergency support](#) from the [...] G20 Debt Service Suspension Initiative (DSSI) provided useful fiscal and external financing, [the program was] [...] "moderate in size" at around 1.2% of GDP.

One Atlantic Council article said “[some African governments](#) are signalling that they prefer to preserve their hard-earned credit ratings by trying to stay current in their obligations.” This is because “[any suspension of interest payments](#) would probably trigger ratings downgrades for borrowing nations and limit future access to private capital,” something that isn’t attractive to states or financial institutions. The stigma may have been enough to make some large economies backtrack from participating in the DSSI. On June 23, [Nigeria backtracked](#) on its efforts to restructure its official debts, which it began back in May. Countries with [outstanding](#)

[Eurobonds](#) are also vulnerable to stigma because of the “strict terms of their Eurobond repayment plans, as well as a fear of losing market access to private creditors for a prolonged period.”

[Much to the chagrin](#) of the IMF, ratings agencies have amplified the stigma that participants would face. Various statements from [ratings agencies](#) indicated that participation in the DSSI would indicate increasing credit stress (which creditors would then price in by increasing the interest rate they lend to the country at). They were just as unhelpful when it came to private sector debts, [saying that](#) private-sector participation in the DSSI might count as a default (which would effectively lock the country out of the markets).

On the other hand, one commentator from Fitch Ratings said private sector participation that ends up counting as a default was not “[sufficiently likely to affect sovereign ratings](#).”

AVAILABILITY OF CHEAP CREDIT

The [urgency of DSSI relief](#) has faded for some debtor countries that have been able to issue new foreign-currency debt at low rates, thanks to extraordinary liquidity injections by central banks across the world. For example, [Brazil](#) found that the combination of a swap line from the Federal Reserve, large foreign currency reserves, and very limited foreign currency debt was enough to [convince investors](#) to buy its new issue of eurobonds. [El Salvador's](#) comparably expensive recent eurobond issuance indicates that this only really applies for foreign currency denominated debt) instead of participating in the DSSI and suffering a potential ratings downgrade.

The new borrowings have helped participating countries meet their debt payments for the time being. However, if the crisis continues for many months and fiscal costs continue to rise, they may find themselves in need of debt restructuring later in the year

In response to the damage of a second wave, the bond market's exuberance might go away and the cheap financing will dry up. When that happens, a number of debtor countries are going to ask for debt restructurings, and might actually have worse economic fundamentals than they had going into COVID-19. Creating even more leverage today, even if it is more convenient that negotiating a standstill or a haircut, may mean that restructuring is that much more painful for creditors. Those creditors may fight that much harder for each dollar.

Comparable treatment

The DSSI's failure to include the norm of “[comparable treatment](#)” has also been a barrier to the program's effectiveness. This norm holds that private creditors must endure similar (though not necessarily the same) haircuts or restructurings as the official creditors in a restructuring. Comparable treatment helps states keep private sector creditors from free-riding on their relief.

If private creditors were to refuse to abide by the comparable treatment norm, official creditors would effectively lose their informal senior status and would have less incentives to provide debt relief.

It's unclear where the DSSI stands on comparable treatment. The [DSSI's language](#) only [states that](#) "Private creditors will be called upon publicly to participate in the initiative on comparable terms." But the [IIF \(the International Institute for Finance\) interprets](#) this language to mean that "the comparability of treatment mechanism used by the Paris Club customarily will not apply to the private sector response to the DSSI."

Debt sustainability

The DSSI, like any other debt suspension, only solves liquidity problems. While we know that the DSSI was meant only to reduce pressure on sovereigns so they could spend money on their response to COVID-19, [it is becoming clear](#) that the crisis may still create unsustainable debts for many countries in the Global South. The World Bank [has said](#) that the many countries already faced unsustainable debt burdens, which are now growing to "crisis levels."

Some larger emerging market economies that may have such issues have been moving toward structural reforms in order to please the market. This is in spite of the fact that they are going to have to continue spending generously on their response to COVID-19. If the DSSI eligibility were extended for middle income countries [facing major ratings cuts or debt distress](#) and those countries received a sufficient amount of international financial assistance, these additional countries might benefit from participating. For example, South Africa is going through some [major problems right](#) now and announced [R230 billion in cuts over the next two years](#), while the country was still in the midst of major outbreaks. With an assistance like DSSI, South Africa could make up for lacking fiscal room caused by self-imposed structural reforms to respond to the COVID-19 crisis.

The DSSI might not actually offer a net increase in fiscal room for participants if some advanced economies are successful at changing the accounting rules for aid. This would constitute a [backlash](#) to the program from the official sector. If advanced countries start counting forbearance or forgiveness of debts as official development assistance, they might correspondingly decrease the overall amount of aid they give. A [number of EU countries](#) that loan frequently and give most of their aid as loans are considering this change. Under the [revised rules](#), donor countries could also "claim incentives both for offering riskier loans and then for restructuring or writing them off as debt relief." While some might say this is a benign change, others "fear that further watering down rules on debt relief could be used by donor countries to artificially inflate aid budgets" without increasing the amount of support for recipient countries. A meeting was supposed to take place on this topic in late July, but no information on it is available.

Discussion on proposed solutions

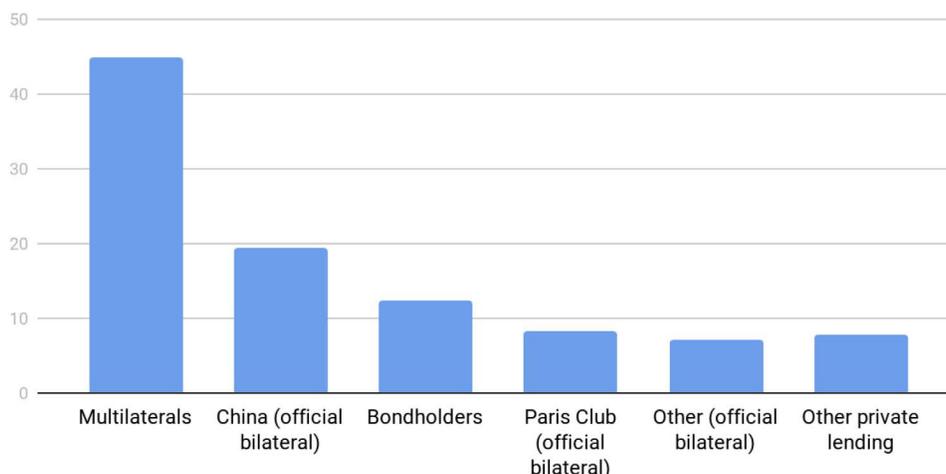
The G20, IMF, and World Bank are [considering](#) revisions to the DSSI. A press kit for a July 8 meeting of G20 finance ministers clarified that countries who request the DSSI from official bilateral creditors will not be obligated to "make the same request to private creditors." This emphasized the idea that "[comparable terms](#)" is significantly more watered down than

“comparable treatment.” That same kit also notes that the G20 is considering having multilateral creditors participate in the DSSI. This signals that the World Bank and the African Development Bank might be changing their position on providing their own debt relief. Additionally, the G20 has pointed to multilateral lenders as actors that could reduce volatility in private sector financing flows by providing co-financing or credit enhancement. The latter could take the form of partial sovereign guarantees by multilateral lenders alongside an SPV that would distribute securitized DSSI sovereign debt. As for the program’s future, the G20 will use IMF analysis to determine the extent that support beyond DSSI is needed.

Another interesting idea would be to categorize certain lending of policy banks or state influenced banks as official-sector lending in exchange for imposing a uniform solution on the bondholders of some of the [lower-middle income countries](#). This might distribute the pain of restructuring equally, as bondholders and Paris Club members together take up a similar share of DSSI-eligible country debt stock to the PRC (see Figure 4). In exchange for the PRC bringing its nominally private lending out of the shadows and into DSSI participation, these other countries would use a combination of legislation, supervisory tools, and regulations to force relevant bondholders to participate in the DSSI. While supervisory tools and regulations could provide a mix of carrots and sticks to facilitate bank participation [as seen in the 1980s debt crisis](#), bondholders are much more difficult to corral.

Figure 4.

Total DSSI-Eligible Country Debt Stock further broken down by Creditor Type (%)



Data Source: World Bank

The IEL Collective, a legal scholarship group at University of Warwick, [proposed a way to bring bondholders into the fold](#) in the UK by amending the Debt Relief (Developing Countries) Act, 2010. [The Debt Relief \(Developing Countries\) Act, 2010](#) limited the debts that can be

reclaimed via litigation if those debts are from countries benefiting from the IMF's [Heavily Indebted Poor Countries \(HIPC\) Initiative](#). The IEL Collective proposes to grant a “statutory standstill to all DSSI-eligible countries on qualifying debt owed by the country that are governed by English law.” Similar to bankruptcy legislation, this amendment would suspend the execution and enforcement of such debt contracts that are under English law. This is important because English law governs a major portion of the sovereign bonds owed by DSSI-eligible countries.

While this does sound straightforward, the IEL Collective's proposal does have some significant flaws. Preventing execution and enforcement does not restrict creditors from declaring a default if a participating country does not pay. It also might actually improve liquidity for these countries' sovereign debt, as the law would bring some sense of certainty to creditors, especially in situations where creditors are already expecting default. This means that countries may, at least temporarily, subject themselves to further ratings downgrades by participating. The political economy of finance in the United States and New York also mean that passing anything like the IEL Collective's proposal in the US would require lots of political will. Unfortunately for the US, such political will is currently in short supply.

Alternatively, as proposed by Sean Hagan of Georgetown University Law Center, the IMF can change its lending policy for the remainder of the COVID-19 crisis. The [IMF could state that it will only lend contingent on a debt standstill](#) for private and official creditors. In circumstances where countries did not really need the standstill, these countries would avoid a more painful debt restructuring. In more pessimistic circumstances, on the other hand, “you would at least have the private sector there, because it would have stood still, and you would be able to use those claims as part of the restructuring process.” This would also artificially boost the IMF's leverage over private and official creditors. With more leverage, the IMF could drive broader creditor participation in the DSSI and eventually reduce stigma for countries that wish to access the program. One bonus is that this approach emphasizes that the IMF is a creditor that has seniority over every other; there should be no circumstance where IMF liquidity funding is being used to bail out financial institutions holding those sovereign loans instead of being used to ameliorate the pandemic in the country. This would require a number of policy summersaults to work. For one, the IMF has to make it clear that the debtors have no choice but to ask for a standstill if they want IMF funding.

The [United Nations Economic Commission for Africa](#) issued its own proposed solution. They wish to have the international community offer credit enhancement along the lines of the [Brady Plan](#) that ended the Latin American debt crisis of the 1980s. The [credit enhancement](#) took the form of creditors fully collateralizing the principal of participants' new sovereign debt issuance with 30-year zero-coupon U.S. Treasury bonds. This reduced the liquidity risk premiums for these sovereign bonds.

The pros of this plan are that we know how to implement it and [there is already some support](#) for it in central banks as well as [think-tanks](#). Unfortunately, it's a little early to go for a Brady plan, as we haven't even gotten to the solvency stage of the crisis. We don't know what

risks governments will be taking on when they provide credit enhancement. During the Brady Plan, governments had some idea of the risk they were taking on and that is a key reason why they were willing to provide credit enhancement for Brady bonds.

One approach from [Eric LeCompte](#) of the Jubilee USA Network is a new kind of financing and debt restructuring process to deal with the needs of countries responding to COVID-19. The new program would essentially build on the foundations of the IMF [Highly Indebted Poor Countries](#) (HIPC) program, which granted participating countries total debt relief from the IMF and other creditors. Based on LeCompte's comments, HIPC would amount to something like a bankruptcy process for eligible sovereigns that would balance the interests of creditors and debtors. This dovetails with decades of calls for a formal sovereign bankruptcy process as well as calls to write off "[odious debts](#)" used to line the pockets of corrupt governments instead of being used to benefit the borrower.

Efforts in the early 2000s nearly brought a [sovereign debt restructuring mechanism](#), an international legal structure for sovereign debt that would look much like an international bankruptcy code, into existence. Unfortunately, the US Treasury as well as a number of developing countries rejected the program.

Instead, the international community opted to start including Collective Action Clauses (CACs) in sovereign bond issues for a more decentralized approach to organizing debtors and preventing holdout creditors from torpedoing restructurings. The CAC approach has been sufficient to keep enough creditors from supporting a sovereign debt restructuring mechanism, but could be threatened by two things. First is the extremely weak fiscal state of the emerging market. In the event of a second wave of COVID-19, the economic impact could be brutal enough to trigger another flight-to-safety, right when emerging market economies need the money to respond. Financial institutions that have stocked up on emerging-market debt will find their balance sheets under such pressure that a number of them may not accept haircuts. This, on its own, is not enough to doom CACs, but recent events in Argentina point to [unhappy creditors and debtors](#) threatening to torpedo the consensus on using collective action clauses. If CACs were to fall by the wayside, a sovereign debt restructuring mechanism could again be an attractive option.

The G20's impasse on Special Drawing Rights (SDRs)

By Alexander Nye

Original post [here](#).

Policymakers have spent four months calling for the G20 to support a new allocation or a reallocation of special drawing rights (SDRs) at the IMF. An SDR allocation would help bolster the reserves of the world's countries. Nevertheless, the G20's latest July communique, much like the [last one](#) in mid-April 2020, barely mentioned the [SDR](#). The only reference to an SDR allocation or reallocation in the communique was an admission that the G20 had indeed discussed it, but could not find a consensus on the issue. The U.S. blocked an allocation and is [also blocking](#) efforts to allow rich countries to donate their SDRs to those in need.

SDR Allocations

SDRs are an international reserve asset issued by the IMF that was created in 1969 to supplement the role of the U.S. dollar. Later, policymakers aimed to make SDRs the new “[principal reserve asset in the international monetary system](#).” The value of the SDR [is currently determined](#) using a basket of the world's five major currencies, the U.S. dollar, EU Euro, the Japanese yen, the UK pound sterling, and the Chinese renminbi. Their valuation [can be changed](#) by a supermajority of the IMF's voting power (70% of the voting power to change the valuation method and 85% to change the [principles](#) underlying valuation).

The IMF issues SDRs by way of general allocations. The IMF can issue an unlimited amount of SDRs to IMF member states through general allocations so long as the issuance is in proportion to member state [quotas](#), a figure based on a country's size and contributions to the IMF. The IMF's articles state that the IMF should conduct allocations only when [needed to](#) meet a long-term global need to supplement existing reserve assets in a manner that will promote the attainment of the IMF's purposes, avoid economic stagnation, avoid deflation, avoid excess demand, and avoid excess inflation.

When the IMF “allocates” SDRs, it essentially creates money for member countries in the form of reserves. This is similar to a central bank creating reserves as a form of stimulus on a national level. As such, SDR allocations can be considered inflationary. Like loans, SDRs also carry an [interest rate](#) that recipients must pay; the interest rate is the higher of 0.050% and the combined market interest rates for the three-month government securities of the currencies in the SDR basket.

SDR allocations also stand in contrast to the other form of funding the IMF offers: lending facilities. The IMF [disburses funding](#) through lending facilities at extremely low-interest rates (currently 0%). This is considered much less inflationary than SDRs (as lending is usually considered less inflationary than helicopter money), but can frequently impose unpopular

conditions on recipient countries. Additional IMF lending also might require mobilizing resources from donor countries, which could make them more difficult to execute.

SDR allocations during the Global Financial Crisis (GFC) and their impact

The SDR was considered a niche feature of the IMF for the first forty years of its existence. As late as 1998, some academics [asked](#) whether the SDR was “simply a relic of the past, less “barbarous” than gold – because it is cheaper to produce – but a relic nonetheless.” There were only two allocations before the 2007-09 Global Financial Crisis (GFC). The first of these was an SDR 9.3 billion allocation in 1970-1972 and the second was an SDR 12.1 billion allocation in 1979-1981. By the time the GFC began, most people in positions of authority “[had never heard of the SDR,](#)” according to Ted Truman, a former Treasury and Federal Reserve official.

Then, in late 2008, when policymakers were trying to respond to the GFC’s impact on the international economy, the SDR crept back into the spotlight.

The G20 approved a \$250 billion allocation of SDRs in April 2008. Largely due to [lobbying by Truman and others](#), the organization wished to bolster international economic confidence. The IMF [allocated](#) the new SDRs in August and September.

A 2018 IMF Policy Brief [states that](#) the SDR allocation increased reserves by about 19% for low-income countries and over 7% for emerging economies (excluding China and fuel exporters). Although SDRs remained a small portion of the world’s international reserves, “[Markets](#) reacted favorably to the allocation, which formed part of the broader G20 crisis response.” [In theory](#), the IMF also believed that the allocation would help countries facing short-term financing shocks adjust more smoothly and that it would also help meet what they projected to be an increasing long-run demand for reserves. The IMF also acknowledged that SDR allocations have targeting problems (as they go to all IMF members regardless of need) and may create moral hazard.

An [August 2010 brief from the U.S. Department of the Treasury](#) reflected on the 2009 allocation. It said that despite limited SDR use between 2009 and mid-2010, the 2009 SDR allocation “helped to restore market confidence and support global recovery,” in combination with other international crisis responses. The brief also noted that some countries used their SDR allocations to weather the storm of the GFC. SDRs helped to close fiscal gaps, meet external obligations, or counteract foreign exchange shortages in these countries. For some countries, the SDR allocation [was especially significant](#); Uganda’s SDR allocation constituted 860% of its international reserves at the time.

While there had been some concerns about [moral hazard and inflation](#) during the GFC, in 2019 Ted Truman [reflected that](#) “The SDR was employed as a crisis management tool without feared ill effects.”

On the other hand, a [2016 study](#) from the European Central Bank (ECB) that looked at the 2009 allocation, was less sanguine about SDRs. It found that countries that received SDRs worth “more than 10% of their international reserves” experienced higher inflation than other

countries. The ECB researchers attributed the results to incentives that encouraged countries to pursue more expansionary fiscal paths with the perceived safety provided by higher reserves holdings.

Still, some have reservations about the impact of SDRs. [Gavyn Davies in the Financial Times](#) said: “The size of the SDR issue had little effect on global growth in the following few years [...] because the entire allocation amounted to less than 1 per cent of the value of global trade in 2009.”

March proposals for an SDR allocation and rejection at the G20

As the world’s economy convulsed due to the COVID-19 crisis, academics started to float the idea of an SDR allocation as a response to COVID-19. What all of the proposals for SDR allocations had in common was the sentiment that the COVID-19 crisis was so significant that the current sources of global liquidity were insufficient. Swap lines and [Treasury repo facilities](#) from the U.S. Federal Reserve can provide countries with access to US dollars, but they do not create reserves and they are not available to all countries. The IMF and multilateral development banks have lending facilities, but these are [under-resourced](#).

The [first proposals](#) were more radical; they saw an SDR allocation as an aggressive program that could work more quickly than the IMF’s lending programs. Proponents noted that the IMF’s \$1 trillion in ready-to-mobilize lending was not enough and had to be supplemented. This is [because](#) only \$50 billion of this figure can go to emerging market economies and only \$10 billion can go to low-income countries. (For more information on the IMF’s response to COVID-19 see our blog posts [here](#) and [here](#)).

Academics and think-tankers quickly followed these first proposals with another set, which [advocated](#) for an SDR allocation and a mechanism allowing developed countries to transfer their existing SDRs to developing countries or [lend excess SDRs to the IMF](#). The latter was accompanied by a proposed policy of having the IMF issue SDRs regularly in proportion to changes in the global demand for foreign exchange reserves and make the SDR the main financing instrument in IMF programs. Together, these would boost the IMF’s lending capacity and would make the SDR a global currency. Truman put forward and elaborated his own proposal for an SDR allocation as part of a larger [G20 COVID-19 response framework](#). The G20 was to meet on April 15, 2020. He recommended that the G20 require the IMF to review a large, one-time SDR allocation of \$500 billion to bolster countries’ reserves. [One reason](#) why he specified \$500 billion is that the U.S. Treasury can vote for an SDR allocation [worth up to \\$649 billion](#) at the IMF without requiring approval from Congress.

Around this time, criticism of an SDR allocation started to emerge. [Ousmène Jacques Mandeng](#) of Economics Advisory argued that SDRs’ inability to be used outside the IMF and a set of designated agencies known as [prescribed holders](#) (examples of prescribed holders are the Bank for International Settlements (BIS) and the European Central Bank (ECB)) has really made their relevance limited.

Perhaps the strongest [critique](#) comes from Mark Sobel, a former IMF hand at the U.S. Department of the Treasury, who wrote that “the last SDR allocation resulted in only a paltry new net conversion of SDRs for currencies by emerging markets.” His criticism mainly revolved around the political infeasibility of redistributing SDRs, the moral hazard created by an allocation, the idea that the SDR is a long-term tool for the short-term problem of COVID-19, and the fact that SDRs impose interest charges. Sobel argued that borrowing from the IMF at a 0% interest rate made it significantly better for low-income countries than SDR allocations, as they need “less debt and more grants.” He also had an unrelated point that would [eventually make it into U.S. government policy](#), however, was that SDR allocations give reserves to countries that have stuck their tongues out at the international community. Venezuela used its SDRs to repay official creditors in 2019.

Christopher Collins and Ted Truman of PIIE rebutted the argument that SDRs’ interest rates made them inferior to IMF lending in an [April 10](#) article. They countered that the [current SDR interest rate was 0.050 percent](#) (it has [now increased](#) to 0.069 percent) and would constitute a low-cost way to bolster IMF members’ reserves in a time of crisis.

By [this time](#), several countries had already asked the IMF about the possibility of a new SDR allocation and SDR supporters modified their proposals in response to criticisms. Some [proposed](#) changing the IMF quotas to solve the problem of only a fraction of the allocated SDRs going to developing and emerging economies. This would, however, face a veto from the U.S. This group also proposed that the IMF allocate SDRs counter-cyclically and establish a multilateral SDR swap facility.

As the April G20 meeting drew closer, support for an SDR allocation expanded to the Financial Times’ editorial board, which on April 12 [said that](#) the G20 should put forward an SDR 1tn (\$1.37tn) allocation. They too waived away concerns about inflation and proposed setting up a special purpose trust run by the IMF, WHO, and World Bank that countries with too many SDRs can donate to. By [April 14](#), crisis veterans Gordon Brown and Larry Summers came out in favor of an SDR allocation of over \$1 trillion.

The April 15 G20 meeting ended at an [impasse regarding SDRs](#). The U.S. said that it [would not approve of an SDR allocation, backed by India](#) and several other countries. An SDR allocation might not have looked impressive to the U.S. delegation when they saw the [country that would benefit most](#) from a \$500 billion SDR allocation was Iran (followed by Turkmenistan, Zimbabwe, and Venezuela). Adam Tooze [echoed](#) this potential explanation in Foreign Policy. One paper from the Observer Research Foundation, a well-known Indian think tank, posits that the U.S. did not support an allocation because, as crises are frequently used to speed up reforms: [crises are](#) an opportunity to accelerate reforms. An expansion in SDRs could have been combined with a reallocation of voting rights as in 2010, thereby increasing the voice of emerging markets in the governance of the IMF. It is obvious why the U.S [...] would want to avoid this – particularly as it risks losing its veto.

[Truman](#) and [Tooze](#) also criticized the delay. Government talks of an SDR allocation slowed down significantly until July 2020.

China tries to spark a conversation in the run-up to the July G20 meeting

Policymakers and academics continued to make SDR-related proposals after the April G20 meeting. In the weeks leading up to the July 18 G20 meeting, the Managing Director of the IMF [said that](#) the IMF was working with its members to use advanced economy SDRs to help “low-income countries and tourism-dependent small island economies.”

This was followed by a July 16, 2020, op-ed from the governor of the [People’s Bank of China \(PBOC\)](#), which advocated for the G20 to take up an SDR allocation at their next meeting. The article again countered critics of an SDR allocation by arguing that COVID-19 represented an exogenous shock to the world economy whose responses, like the SDR, should not require conditional reforms or create concerns about moral hazard. One interesting portion of the article, [later noticed](#) by economist Anthony Elson, was the governor’s comment that “developed countries can use their SDR allocations to ease domestic fiscal pressures, leaving more resources for international aid.” It is not clear how exactly an SDR allocation would relieve China’s fiscal pressures, but this does reveal that the PBOC was not contemplating donating the SDRs it would receive in such an allocation.

This push did not lead to a change in the U.S. position and the July G20 meeting communique only contained this [single sentence on SDRs](#):

The G20 International Financial Architecture Working Group also discussed the possibility of an Special Drawing Right (SDR) allocation or of countries that have excess SDRs granting or lending them to countries that need them.

Sobel, a critic of a COVID-19 SDR allocation, [reflected](#) that an IMF program that could redistribute already issued SDRs from rich to needy countries was not mentioned in the G20 communique.

Potential solutions to the impasse

There have not been major policy proposals aimed at breaking the impasse since July. China may go on advocating for an SDR allocation and the U.S. will continue blocking it. The main issue that academics and think-tankers seem to agree on is that SDR allocation would work best if it goes hand-and-hand with a facility for lending or donating developed countries’ excess SDRs to those in need. The more conservative version utilizing SDRs to help out those needier countries would be closer to Sobel’s proposal, in which existing SDRs are voluntarily distributed from SDR-rich to SDR-poor countries.

Since the G20 failed to reach an agreement on SDRs early enough in the crisis, we are now left with the policy question of whether it is better to distribute funding through an SDR allocation, through (concessional, low-conditionality, low-interest) lending facilities, or through both. The

next G20 meeting is scheduled for October, but one may have to wait until at least November to see a real change in the U.S. position on this issue.

Case Studies and Policy Changes

Asian Development Bank Increases Funds for Producers of Critical Medical Supplies

By Aidan Lawson

Original post [here](#).

On March 12, the Asian Development Bank (ADB) said it would make \$200 million available to companies that make and distribute medicines and medical supplies to fight the coronavirus.

The ADB will disburse this aid through its Supply Chain Finance Program, which was originally developed in 2012 to “unlock financial resources caught in the supply chain.” Suppliers were sometimes waiting for up to six months to receive payment from buyers, and the SCFP provides short-term funding so they don’t have to wait (see [here](#), pp. 3).

The primary objective of the SCFP is to ensure that, as demand increases for medical equipment and other critical products to fight the coronavirus, suppliers will be able to expand their production without encountering any supply-chain related disruptions.

The SCFP provides financing to suppliers in developing countries that are experiencing cash-flow difficulties and unable to access financing elsewhere. Traditionally, these businesses, which are normally small and medium-sized enterprises (SMEs), faced two obstacles in obtaining financing: weak financials and lack of collateral (see [here](#), pp. 5). The financing is obtained through partner financial institutions (PFIs), who receive predetermined amounts of money from the ADB and then lend it to suppliers.

The program requires PFIs to contribute funding equal to or greater than the amount that the ADB provides to the supplier (see [here](#), pp. 3). After receiving the commitment to pay for the goods from buyer, the supplier asks the PFI for the money they would have received from the buyer, and the PFI finances the transaction so the supplier experiences no disruption. At the invoice date, the buyer would pay the PFI, who then remits the ADB’s part of the financing (and fees) back to them. In the event of default, the ADB shares the losses with the PFI servicing the loan, up to a maximum exposure of 50%, but never exceeding the PFI’s amount. The ADB can either loan funds directly to PFIs or provide assistance in the form of a guarantee; the term of either can be up to 180 days. Thus, the facility could provide upwards of \$400 million in financing in one year. With full loss-sharing from PFIs, this amount could be as high as \$800 million annually (see [here](#)).

Steven Beck, the ADB’s head of Trade and Supply Chain Finance, stated that they were working to map out “the entire supply chain for these types of goods, including the companies that are involved at each and every component phase” so that investors would be able to support

companies at all steps of the supply chain (see [here](#)). Additionally, he stated that there would be a substantial increase in the capacity of the ADB's [Trade Finance Program](#) in the near future.

The SCFP takes a buyer-centric approach, assisting suppliers that are often considered “unbankable” by examining the credit ratings and financial strength of their regular counterparties, which are often large, corporate buyers. Suppliers can now receive much cheaper financing since the SCFP's risk evaluation methods emphasize the strength and longevity of supply chain relationships between businesses. (see [here](#); [here](#), pp. 5).

Suppliers must be from developing member countries, have minimum 2-year relationships with any buyers they associate with, and have a “solid production and delivery track record.” Buyers can be located domestically or internationally and are required to be at least BB rated (or equivalent). PFIs are required to have a global credit rating of at least A- and a supply chain finance portfolio rating of at least BB, conduct sound risk management practices, have a default rate of less than two percent on their supply chain portfolio, and report at least quarterly to the ADB about their SCFP activities. PFIs would receive varying amounts of funds from the SCFP based on their “risk appetite[s], presence in [Developing Member Countries], and monitoring capabilities.” However, the ADB stated that it would “seek to include as many PFIs as practicable” (see [here](#), pp. 5).

The SCFP is similar in structure to the Automotive Supplier Support Program (ASSP) created by the U.S. during the Global Financial Crisis. Suppliers of automotive goods found it more difficult to obtain credit due to the precarious financial positions of and uncertainty surrounding GM and Chrysler. The ASSP used bankruptcy-remote Special Purpose Vehicles (SPVs) – funded jointly by the U.S. Treasury, GM, and Chrysler – to purchase receivables from suppliers so they would experience no supply-chain disruptions. In this case, the SPVs served essentially the same function as PFIs do for the SCFP, though the SPVs had to take any losses first, whereas PFIs jointly share any losses (up to a 50%) with the ADB. For further discussion on the ASSP, see the [YPFS case](#).

The IMF makes funds available in response to the COVID-19 crisis

By Manuel Leon Hoyos

Original post [here](#).

On March 27, IMF's Managing Director Kristalina Georgieva revealed that [over 80 countries](#) had requested emergency financing from the IMF. The IMF expects the financial needs of emerging markets will be at least \$2.5 trillion, and many of these countries already face significant burdens of debt.

About 50 of the requests came from low-income countries and over 30 from middle-income countries. Emerging markets have seen an \$83 billion capital outflow, shortages in foreign exchange liquidity, and declines in commodity prices. The IMF aims to expand its emergency financing capacity under its existing facilities and is considering the launch of a new short-term liquidity swap line.

On [March 26](#), Ms. Georgieva asked the G-20 to double the IMF's emergency financing capacity. Under the recently passed [CARES Act](#), the U.S. Treasury may expand the [New Arrangements to Borrow \(NAB\)](#) it can provide to the IMF through loans for up to \$28.2 billion. During the 2007-2009 Global Financial Crisis, through strong efforts by the G-20, the International Monetary Fund (IMF) tripled its lending capacity to \$750 billion. Since then, the IMF has expanded its mandate to play a more active role in preventing and fighting crises and preserving financial stability. Currently, the IMF forecasts a global recession in 2020 and a rebound in 2021.

During the current Covid-19 crisis, the IMF is increasing its role. Since March 26, the IMF has provided emergency financing and disbursed amounts to over ten member countries. In the IMF's [first press release for COVID-19 emergency financing, in relation to the Kyrgyz Republic](#), the IMF stated that it aims to provide a backstop, increase buffers, and shore up confidence. It also attempts to preserve fiscal space for essential COVID-19-related health expenditures.

The IMF is composed of 189 member countries and its [current lending capacity is \\$1 trillion](#). A quota is assigned to each IMF member based on its relative position in the global economy. Member quotas are the main source for IMF's members financing. Additionally, through the New Arrangements to Borrow (NAB), a number of members lend to the IMF and supplement IMF financing in order to cope with shocks to the global monetary system.

On March 27, the IMF announced an [enhancement](#) of the [Catastrophe Containment and Relief Trust \(CCRT\)](#), which was established in 2015 during the Ebola crisis. The changes expanded the qualification criteria for the facility, which is available to low-income countries and allows the IMF to deliver grants for debt relief during catastrophic natural disasters and major public health emergencies. The IMF asked the stronger members to help replenish the CCRT, which had only

\$200 million at disposal. The UK, Japan, and China have already made commitments to contribute.

The IMF discussed [on a conference call on April 1](#) its available resources to help countries combat COVID-19. Existing IMF lending facilities include the [Flexible Credit Line \(FCL\)](#), which is uncapped in principle and provides large-scale financing without policy conditions for members with sustained track records of strong policy implementation. The [Rapid Credit Facility \(RCF\)](#) provides financial assistance with limited conditionality to low-income countries facing an urgent need for balance of payments. And the [Rapid Financing Instrument \(RFI\)](#) is available to all members facing an urgent need for balance of payments. Under the RCF and RFI, members are allowed to borrow up to 50% of their quota. The RCF lends at very low interest rates and provides a longer repayment period. The IMF has said that to be eligible for emergency financing, members need to commit to target health policies to combat the COVID-19 pandemic and to remain on a sustainable debt path.

The IMF is considering the launch of a new facility, the [Short-term Liquidity Swap \(SLS\)](#), which was initially [discussed in 2016](#). This facility would operate similarly to existing central bank swap lines. The SLS could be launched upon approval of the IMF Board and would be available for members eligible for the FCL for up to 145% of their quota. This facility would serve members with short-term capital account volatility to obtain resources on a short-term and revolving basis.

World Bank Support to Developing Countries

By **Pascal Ungersboeck**

Original post [here](#).

The World Bank (“The Bank”) has deployed a number of programs to support developing countries during the ongoing COVID-19 crisis. Since March, over [65 countries](#) have received financial support in amounts ranging from USD 2 million to USD 1 billion. The programs aim to assist governments experiencing severe fiscal constraints and support healthcare infrastructure during the pandemic. Overall, the Bank committed to provide [up to USD 160 billion](#) in long term loans and grants to be deployed globally over the next 15 months. This post describes the channels, size of support, lending conditions and the way governments use funds for different World Bank programs.

Channel

There are two channels through which the Bank has provided support: through preexisting programs and through newly established programs. Preexisting programs include the [Catastrophe Deferred Drawdown Option](#) (“Cat DDO”). Cat DDO is a contingent financing line that allows approved countries to access liquidity “to address shocks related to natural disasters and/or health-related events.” The program has been used as a channel for immediate support in [Romania](#), [Morocco](#), [Colombia](#), the [Dominican Republic](#) and [Samoa](#). Other programs were used in countries where public health projects had been previously established. Examples include the [Disease Prevention and Control Project](#) in Armenia, [Health Resilience Project](#) in Lebanon and the [Health System Resiliency Strengthening Project](#) in the West Bank and Gaza. By April 2, the Bank had provided USD 1.7 billion in additional funds to preexisting projects. The use of established programs as funding channels allowed for immediate support to participating countries.

To guarantee rapid support to countries with which the Bank had no established funding line, the Bank rolled out the dedicated [Covid-19 Fast-Track Facility](#) (“FTF”) that is expected to deploy USD 14 billion. The program allows a rapid allocation of funds to countries affected by the pandemic. The first round of projects, announced on April 2, provided support to 25 countries for a total of USD 1.9 billion.

Conditions

Countries have received support on different terms through the Bank’s two lending arms: the International Bank for Reconstruction and Development (“IBRD”) and the International Development Association (“IDA”). The IBRD provides loans to middle-income or creditworthy low-income countries based on market rates under its programs, including the Cat DDO implemented in the current crisis. IDA programs focus on concessional, low to zero interest loans and direct grants to low-income governments. IDA extends [long-term credit](#) with maturities

between 30 and 40 years and additional grace periods ranging between 5 and 10 years. Both the IDA and IBRD have used the newly established FTF to guarantee rapid support to the governments that need it.

Size

The total amount of funds allocated to a specific country largely depends on the size of its economy. The programs implemented at the time of writing provide loans and grants for up to 0.5 percent of GDP. Some programs impose an upper bound on the funds that can be allocated to a specific country. For instance, funding provided through the Cat DDO is limited to the lower of USD 500 million or 0.25 percent of GDP.

The Bank's largest program at the time of writing is the IBRD's USD 1bn loan to the government of India through the country's [Emergency Response and Health Systems Preparedness Project](#), the largest health sector support to India in the Bank's history. The largest grant has been provided to the government of [Afghanistan](#) with a USD 100.4 million commitment from the IDA, USD 19.4 million were provided immediately through the FTF.

Use

The Bank emphasizes that under current conditions the support programs are focused on one objective – [saving lives](#). Many of the recipient countries are in the early stages of the pandemic; funds are to be used to strengthen healthcare infrastructure and provide emergency equipment. Funding will cover such measures as: provision of laboratory equipment, personal protective equipment and portable ventilators, expanding intensive care units, and building systems to prevent and limit local transmission.

In response to the COVID-19 pandemic, other international institutions are implementing and extending policies to provide support to member countries. For an overview of different types of programs, see "[International Support for Governments in Response to COVID-19](#)."

The IMF Expands and Expedites Lending in Response to the COVID-19 crisis

By Manuel Leon Hoyos

Original post [here](#).

Since March, the International Monetary Fund (IMF) has expanded existing lending programs and introduced new ones to help countries bear the costs of the COVID-19 crisis. As of April 21, it had approved a total of \$8.7 billion in emergency financing for over 40 member countries, of the more than [100 countries](#) that have requested assistance. (See the updated list [here](#)).

But those outlays represent a small fraction of what the IMF expects countries will need. Emerging markets will need at least [\\$2.5 trillion](#) in financing needs. The IMF has committed to utilize its current lending capacity of [\\$1 trillion](#) to support their member countries.

Prior to the crisis, the IMF had various lending facilities to help countries facing temporary shortfalls in their balance of payments. On April 15, the IMF announced a new revolving credit line, the [Short-term Liquidity Line \(SLL\)](#), to help eligible countries with moderate short-term balance of payments needs. It also revamped its [Catastrophe Containment and Relief Trust \(CCRT\)](#), which helps low-income countries bear the costs of natural disasters and public health emergencies.

About 50 of the initial emergency requests came from low-income countries; 31 from middle-income countries. Starting in early 2020, emerging markets have seen [large capital outflows, shortages in foreign exchange liquidity, and declines in commodity prices](#). In its [April 2020 World Economic Outlook](#), the IMF forecasts a global recession in 2020 of a 3% decline and a rebound in 2021 of 5.8% economic growth.

Existing IMF lending facilities [include](#):

- The [Flexible Credit Line \(FCL\)](#), which is uncapped in principle and provides large-scale financing without policy conditions for members with sustained track records of strong policy implementation.
- The [Rapid Credit Facility \(RCF\)](#), which provides financial assistance with limited conditionality to low-income countries facing an urgent need for balance of payments.
- The [Rapid Financing Instrument \(RFI\)](#), which is available to all members facing an urgent need for balance of payments.

Under the RCF and RFI, members are allowed to borrow up to 50% of their quota. The RCF lends at very low interest rates and provides a longer repayment period. The IMF has said that to be eligible for emergency financing, members need to commit to target health policies to combat the COVID-19 pandemic and to remain on a sustainable debt path.

Funds disbursed through April 21 include:

- \$2.5 billion for 14 countries under the RCF. The largest recipient is Ghana with \$1 billion.
- \$5.8 billion for 15 countries under the RFI. The largest recipient is Pakistan with \$1.4 billion.
- \$240 million for 24 countries under the CCRT. The largest recipient is Guinea with \$24.1 million.

April 15 announcements

On April 15, the IMF's Executive Board approved [immediate debt service relief to 25 members](#) under its [revamped Catastrophe Containment and Relief Trust \(CCRT\)](#), which was established in 2015 during the Ebola crisis. The revamp expanded the qualification criteria for the facility, which is available to low-income countries and allows the IMF to deliver grants for debt relief during catastrophic natural disasters and major public health emergencies. The IMF had asked the stronger members to help replenish the CCRT, which had only \$200 million at disposal. The UK, Japan, and China have already made commitments to contribute.

Also on April 15, the IMF [established the Short-term Liquidity Line \(SLL\)](#). The new facility will operate on a revolving basis as a renewable backstop for eligible member countries. The [design of the new SLL](#) aims to address potential, moderate, and short-term balance of payments needs. It provides a reliable and renewable credit line, without ex post conditionality and has a qualification criteria in-line with the FCL to ensure that the facility is mainly used by members with very strong macroeconomic fundamentals and track record of strong policy implementation. The SLL can provide financing for up to 145% of each member's quota. Managing Director Kristalina Georgieva said that "the SLL will strengthen further a country's liquidity buffers and thus help in managing liquidity pressures. Complementing other instruments during the current crisis, the facility will fill a critical gap in the Fund's toolkit and help to facilitate a more efficient allocation of resources."

The SLL builds on the framework of the Short-term Liquidity Swap (SLS) discussed by the IMF Board [in 2017](#). At the time in 2017, the SLS did not secure consensus necessary for implementation. Although most Directors considered the SLS to be broadly reasonable, a number of Directors had reservations about some key features that, in their view, "[depart significantly from current Fund principles and policies, and hence warrant further reflection.](#)" The SLL aims to further support the [Global Financial Safety Net \(GFSN\)](#). The GFSN comprises international reserves, central bank bilateral swap arrangements, regional financing arrangements, IMF resources, and market-based instruments. It aims to provide insurance against crises, supply financing when crises hit, and incentivize sound macroeconomic policies. The SLL has a 12-month repurchase obligation and a fee structure to support its revolving nature (e.g. 8 basis points to set up). The IMF estimates that overall SLL demand could reach up to \$50 billion.

The IMF is composed of [189 member countries](#). A quota is assigned to each IMF member based on its relative position in the global economy. Member quotas are the main source for IMF's members financing. Additionally, through the New Arrangements to Borrow (NAB), a number of members lend to the IMF and supplement IMF financing in order to cope with shocks to the global monetary system. Under the recently passed [CARES Act](#), the U.S. Treasury may expand the [New Arrangements to Borrow \(NAB\)](#) it can provide to the IMF through loans for up to \$28.2 billion. During the 2007-09 Global Financial Crisis, through strong efforts by the G-20, the IMF tripled its lending capacity to \$750 billion. Since then, it has expanded its mandate to play a more active role in preventing and fighting crises and preserving financial stability.

IFC Provides \$8 Billion in Fast-Track Financing to Private Sector

By Mallory Dreyer

Original post [here](#).

The [International Finance Corporation \(IFC\)](#) will be providing fast-track financing of \$8 billion to support companies impacted by the COVID-19 pandemic. On [March 3](#), the World Bank Group approved \$6 billion in fast-track financing through the IFC. It approved an additional \$2 billion on [March 17](#).

The IFC is the private-sector arm of the World Bank Group. It is the largest private-sector-focused global development institution for developing countries. It provides loans, equity investments, and advisory services to over 2,000 clients around the world. The fast-track financing, which is the first phase of the IFC's COVID-19 response, allows it to provide immediate and direct support to existing clients.

Of the \$8 billion pandemic response, \$2 billion is for the [Real Sector Crisis Response Facility](#), which the IFC will use to support existing clients with loans or equity investments. The support will go to companies in the infrastructure, manufacturing, agriculture, healthcare, and services industries. It will help companies increase working capital, reschedule existing debt, or cover the cost of delays in project implementation. Instruments under the facility include medium to long-term senior and subordinated loans and equity, though equity is capped at \$400 million. The IFC can provide no more than 20% of the funding to a single country and no more than 10% to a single borrower.

The IFC will channel the remaining \$6 billion through four different programs that leverage bank lending. Through the [Financial Institutions Response Envelope \(FIGE\)](#), the IFC will provide support to financial institutions in order to maintain trade flows and lending to micro, small, and medium-sized enterprises (MSMEs). It will allocate \$2 billion of the FIGE for the [Global Trade Finance Program](#), which covers payment risks of financial institutions in emerging markets so they can provide trade financing to importers and exporters. It will direct another \$2 billion through the [Working Capital Solutions Program](#), which provides funding to banks in emerging markets for the provisioning of working capital loans. Working Capital Solutions Program loans can be in US dollars or the local currency, and the financial institution can use the funding to provide new working capital loans or refinance existing loans. The remaining \$2 billion will flow through the [Global Trade Liquidity Program](#) and the [Critical Commodities Finance Program](#). These programs offer risk-sharing support to financial institutions for continued financing of companies involved in the trade of commodities or essential trade in emerging markets.

The approval process will be made under delegated authority from the Board, except for Real Sector Crisis Response projects exceeding \$100 million or those with a potential significant adverse environmental or social impact. The IFC plans to closely monitor projects and will

develop a new section for reporting on the COVID-19 initiatives in the quarterly Investment Operations Report.

The \$8 billion IFC phase one response is part of a \$14 billion fast-track financing from the World Bank. The [broader World Bank](#) response could provide up to \$160 billion over 15 months. (See here for [YPFS post](#) on broader efforts of the World Bank).

The IFC committed more than [\\$40 billion in funding](#) in response to the Global Financial Crisis of 2007-2009. Similar to the COVID-19 response, the IFC increased funding for the Global Trade Finance Program and the Global Trade Liquidity Program. It also established facilities for infrastructure projects, microfinance lending, and bank recapitalization. The [IFC also launched](#) the Distressed Asset Recovery Program (DARP), which focuses on the [resolution of distressed assets](#) and restructuring and refinancing of viable entities. During the Ebola outbreak in 2014, the IFC provided support to West African countries through Working Capital Solutions Program loans.

EU Programs Supporting non-EU Countries

By Priya Sankar

Original post [here](#).

On [April 22](#), the European Commission approved a €3 billion macro-financial assistance (MFA) program to ten neighboring countries outside the European Union for a period of one year to help them cover their immediate financing needs. Like the €20 billion [Team Europe](#) strategy announced earlier, this helps demonstrate the EU's solidarity with other countries in tackling the COVID-19 pandemic.

The MFA program still requires the approval of the European Parliament and the EU Council. The first installment of the MFA aid will happen shortly after approval, whereas the second installment could happen in Q4 2020 or the first half of 2021, [if recipients fulfill conditions](#) to maintain macroeconomic stability.

If adopted, the MFA will issue 12-month loans on favourable terms. EU MFA programs typically are for 2.5 years and disbursed in multiple tranches. Allocations to individual countries correspond to estimates of their external financing needs, accounting for their capacity to finance themselves internally and externally, for example from the International Monetary Fund (IMF). The MFA program may be available to other countries on a case-by-case basis.

The MFA is intended as an exceptional crisis response instrument for countries experiencing balance-of-payments problems. Countries must meet certain requirements to be eligible. These include democratic principles in their political systems; support for human rights and rule of law; and participation in an IMF financial assistance program. The EU usually disburses MFA funds on a case-by-case basis. The EU [used the program to support](#) multiple countries in the wake of the Global Financial Crisis. An MFA program must be proposed by the EC and approved by both the EU Council and Parliament. [However](#), in 2003 it became clear that this case-by-case and lengthy decision-making process was inefficient, and a new framework for expediting it was implemented in the Lisbon Treaty.

[The MFA](#) is a complement to IMF financing and aims to restore sustainable external financial situations, while encouraging economic adjustments and structural reforms. It takes the form of loans or grants paid directly to recipients' central banks and can be used as they see fit. Most MFA funding is in the form of loans, though grants did become popular in the [early 2000s](#), due in part to funding for the Balkans. Per capita income, repayment capability, and other financial factors help the EC decide whether to use loan funding, grant funding or a blend of the two.

The assistance is financed through a European Commission borrowing operation, and the budgetary impact of this assistance will be 9% of the amount disbursed in the [Guarantee Fund](#) for External Actions of the EU, to be provisioned in two years--in other words, loans disbursed in 2020 will be in the 2022 budget.

EU MFA operations are subject to an ex-post evaluation two years after the end of the availability period. So far, the [EU has found MFA operations](#) to benefit the recipient countries' external sustainability, macroeconomic and fiscal stability, structural reforms, and balance of payments. An important and unique benefit of the EU MFA is its generous terms, which help contribute to sustainable public debt. Coordination with the IMF and the World Bank programs ensures the MFA is implemented efficiently and delivers good results. Some have [criticized](#) the MFA program for lack of transparency and a long negotiation processes.

TEAM EUROPE

[Team Europe](#) is a broader EU effort totaling €20 billion, of which the EU itself is directly contributing [€15.6 billion](#). It [seeks to support](#) the most vulnerable countries, such as in Africa and the Balkans, and at-risk populations, particularly women and minorities. It promotes coordinated multilateral responses alongside the United Nations, international financial institutions, and the G7 and G20. The [EU will ensure](#) the flow of goods and prevent supply chain disruptions; promote and uphold democratic governance principles; and commit itself to transparency, communication, and fighting disinformation.

The majority of funds (€15.6 billion) will be allocated to several regions including neighboring countries, Africa, Asia and the Pacific, Latin America and the Caribbeans. Of the €15.6 billion, €507 million will go to immediate needs, €2.8 billion will go to research and health aid and €12.2 billion will go to mitigating the economic and social impacts of the crisis. A list of specific actions to support these goals can be found [here](#).

The [funding for Team Europe](#) comes primarily from reorienting existing funds and programs to address the COVID-19 crisis, and includes €5.2 billion of accelerated European Investment Bank (EIB) loans. To complete the Team Europe package, these funds also mobilize private resources through budgetary guarantees, and will be supplemented with resources from member states, the EIB, and the European Bank for Reconstruction and Development.

This [complements](#) the European Commission's existing €25 million allocation from the European Development Fund to support the World Health Organization's response to African, Caribbean, and Pacific countries as well as €30 million from ECHO (European Civil Protection and Humanitarian Aid Operations) budget reserves. Private involvement will be encouraged through the use of €500 million of the EU External Investment Plan (EIP)'s €1.55 billion guarantee. This will prioritize financing for SMEs, local currency financing, and healthcare pandemic responses.

A significant portion of EU crisis assistance will be channeled through the UN, to which the EU and its member states provide 30% of total funding. The EU has [already committed](#) to provide €114 million to the UN Strategic Preparedness and Response Plan led by the WHO, and committed €1.3 billion to global health initiatives.

Country receiving MFA assistance	Amount (EUR)
Republic of Albania	€180 million
Bosnia and Herzegovina	€250 million
Georgia	€150 million
Hashemite Kingdom of Jordan	€200 million
Kosovo	€100 million
Republic of Moldova	€100 million
Montenegro	€60 million
Republic of North Macedonia	€160 million
Republic of Tunisia	€600 million
Ukraine	€1.2 billion

EU Programs in Support of Member Countries

By Aidan Lawson

Original post [here](#).

The European Commission (EC) is still working out the details of a [€37 billion plan](#) and further extension of this initiative to support member states using existing funds to provide emergency support for distressed member states. EU leadership has also [agreed in principle](#) to a much larger recovery fund that would provide approximately €1 trillion.

The €37 billion emergency support was mobilized through the Coronavirus Response Investment Initiative (CRII). The CRII became operational on April 1 and consists of three main elements:

1. Up to €37 billion in funding for distressed member states
2. Increased flexibility for Coronavirus-related expenditures
3. Up to €800 million from the EU Solidarity Fund

Coronavirus Response Investment Initiative Plus that came into effect mid-April further extends the CRII. The operational details of these initiatives, which are designed to free up funds available from other programs to provide medium and longer-run relief to member states that are most affected by the virus, are currently being discussed by the EC.

Coronavirus Response Investment Initiative

Up to €37 billion for distressed member states

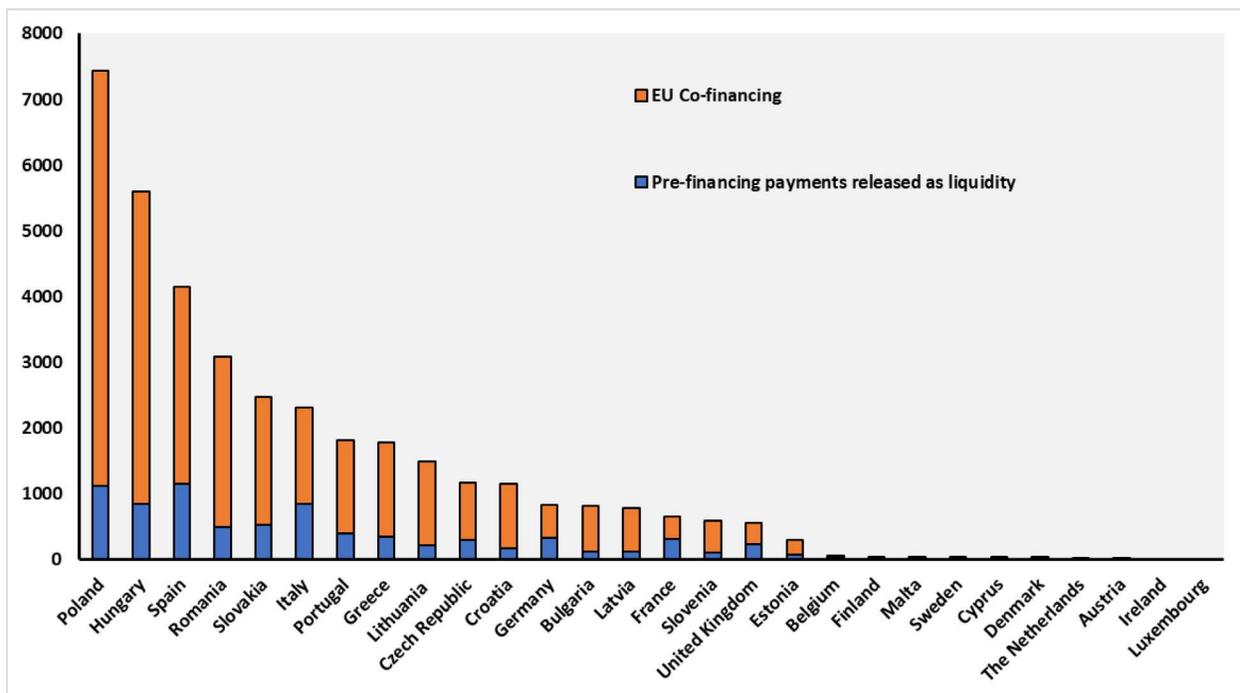
€8 billion of this funding comes from unspent pre-financing given to member states for programs approved in 2019 under agreements with European Structural and Investment Funds (ESI-Funds). ESI-Funds, which are a conduit for over half of the funding in the EU, “invest in job creation and a sustainable and healthy European economy and environment” (see [here](#)). The ESI-Funds are managed jointly by the EC and member states and are financed through the EU budget. Every funding period, which lasts six years, member states prepare general [partnership agreements](#) with each of the funds to determine how their allocations will be spent. The current funding period lasts from 2014 to 2020.

Unused [pre-financing payments](#) normally scheduled to be remitted by June 2020 can now be retained by each member state for COVID-19 relief. The EC states that reimbursement of €8 billion would not be required “provided the funds are fully spent in accordance with the relevant rules” (see [here](#)).

As this immediate liquidity of €8 billion is depleted, the member states will have an additional [€29 billion](#) financed from the EU budget available, maintaining and increasing member states' capacity to respond to the COVID-19 crisis.

Figure 1 (below) breaks down amounts available to member states from the immediate liquidity, EU co-financing, and unallocated ESI-Fund measures. The stacked column represents both the €8 billion in repurposed pre-financing payments, as well as additional €29 billion in potential EU co-financing as discussed above. Poland and Hungary, despite having relatively [low levels \(a combined total of about 18,000\) of cases](#), have the [largest allocations](#) (€13 billion) under CRII (see [here](#)). In contrast, Italy and Spain, which have had a combined case total of about 437,000, are allocated about 6.5 billion. This discrepancy has prompted [criticism](#) about the design of the program. Hungary's allocation has been especially controversial due to increasingly autocratic behavior on the part of prime minister Viktor Orban in response to the pandemic (see [here](#)).

Figure 1. EU budget and ESI-Fund Amounts available, by country (€ millions)



Increased flexibility for Coronavirus-related expenditures

Each of the five ESI-Funds have distinct investment objectives, ranging from providing general support for small and medium-sized enterprises (SMEs) to providing more targeted funding for developing specific sectors such as agriculture and fishing. The extent of the damage caused by COVID-19 crisis prompted the EC to allow expenditures made in response to the pandemic to be eligible for ESI-Fund assistance. A total of €28 billion in unallocated funds for any investment

programs from ESI-Funds can now be used for various forms of new COVID-19 programs. After submitting aid plans to the EC, member states are awarded an envelope of aid. They are expected to come up with investment programs to use this money by the end of the funding period (2014 – 2020).

These unallocated funds under the European Regional Development Fund (ERDF) and European Social Fund (ESF) can be used to purchase personal protective equipment, medical devices and expand health care access, among others. ERDF and ESF money can be used to provide short-term relief to SMEs experiencing cash flow issues and support national [short-time work schemes](#), respectively (see [here](#)). Funding through the European Maritime and Fisheries Fund (EMFF) can be used to support mutual funds and stock insurance for fisherman and aquaculture farmers (see [here](#), pp. 4, 10 - 11).

Access to the EU Solidarity Fund

Finally, the EC [expanded](#) the scope of the EU Solidarity Fund (EUSF) to include major financial aid of up to €800 million for public health emergencies created by COVID-19. Originally created in 2002 to respond to severe floods across Central Europe, the EUSF has provided a total of €5.5 billion in disaster support since then (see [here](#)).

Since its inception in 2002, the EUSF has provided assistance to 24 countries for 87 disasters (see [here](#)). Italy has used about half (€2.52 billion) of this amount. Coincidentally, Italy is the only country that has [applied](#) for EUSF aid for COVID-19. Each year the EC grants the EUSF a set amount of funding and it retains any leftover funding from the previous year in the current year. From 2002 to 2016, yearly disbursements by the EUSF were about 38% of total resources (see [here](#), pp. 49). According to an official [ex-post report](#), the EUSF has been successful in providing emergency financial assistance to distressed institutions after natural disasters and national emergencies, although its capacity is limited.

The EC will collect all coronavirus related applications until June 24 and then assess them all together, [ensuring](#) that the available resources are being distributed in a fair and equitable manner. The EC will then propose a total amount of aid to the Parliament and Council of the EU and, if approved, it will award the aid fully to each member state that is accepted.

Countries wishing to apply for COVID-19 aid under the fund must have sustained economic damage that exceeds a certain threshold, which is calculated either as a percentage of national income or as a general amount (see [here](#)). The application requires member states to estimate their total expenditures for emergency operations related to the COVID-19 crisis during the four months following the date when they first took official action. The EC will disperse funding as a percentage of the total amount of (projected or actual) public spending over the four months. Funding can be applied to programs that are still in development, or to re-finance expenditures already made.

Member states must disclose any funds they received from other institutions or public programs. Member states can request advance funding of up to 25% of the expected total EUSF

contribution, and all funding must be used within 18 months of disbursement (see [here](#), pp. 29).

Coronavirus Response Investment Initiative Plus

A day after the implementation of CRII, the EC proposed a second set of support measures, called the [Coronavirus Response Investment Initiative Plus](#) (CRII+), which [became operational on April 24](#). CRII+ expands on the initial steps taken by the original package by enhancing flexibility across ESI-Funds, simplifying administrative requirements, and providing additional assistance to some of the most vulnerable groups.

This proposal includes the ability to transfer funds between the [European Regional Development Fund \(ERDF\)](#), European Social Fund (ESF), and Cohesion Fund (CF) as well as across categories of regions (see [here](#), pp. 29). This allows funds to flow more freely across institutions and regions to the areas where assistance is needed most. The EC also exempts countries from having to mobilize resources under ESI-Fund agreements in accordance with the investment objectives. CRII+ also provides regulatory relief by deferring and simplifying various reporting and auditing requirements. CRII+ grants member states the ability to request 100% EU co-financing for existing COVID-19 programs.

As part of CRII+, the [EMFF](#) provides relief to the fishing industry by compensating out-of-work fishers and aquaculture farmers and increasing its budgetary flexibility to address new shocks. The [EAFRD](#) will begin offering loans or guarantees of up to €200,000 to “farmers and other rural development beneficiaries” and allow its funds to be used for healthcare centers and infrastructure in rural areas.

Finally, the CRII+ aims to help the most impacted by increasing the flexibility of the [Fund for European Aid to the Most Deprived \(FEAD\)](#), which normally provides food, clothing, and other essential goods and services to vulnerable European populations (see [here](#)). About €3.8 billion were set aside for FEAD operations for the current funding period.

Recovery Fund Under Consideration

EU leaders recently agreed to the creation of an approximately €1 trillion recovery fund that would be used to offset the damage caused by the crisis. Member states are still [debating](#) the exact operational details of the program, including the exact amount, financing, and through what means aid will be disbursed (see [here](#)). On May 13, President of the EC [proposed](#) to the European Parliament that recovery fund will be financed both by EU budget resources as well as state-guaranteed borrowing arrangements in the capital markets. The money would be channeled across three pillars:

1. A new recovery and resilience tool for public investment in the hardest-hit member states.
2. A new solvency instrument that will revive private investment and “match the recapitalization needs of healthy companies who have been put at risk as a result of the lockdown”

3. A new dedicated health program, as well as strengthening existing programs

It is still unclear what the total amount for these measures will end up being, but President reiterated that the funding may be front-loaded short-term loans and grants to member states that need the most.

Update on the progress of the World Bank’s COVID-19 response efforts

By Aidan Lawson

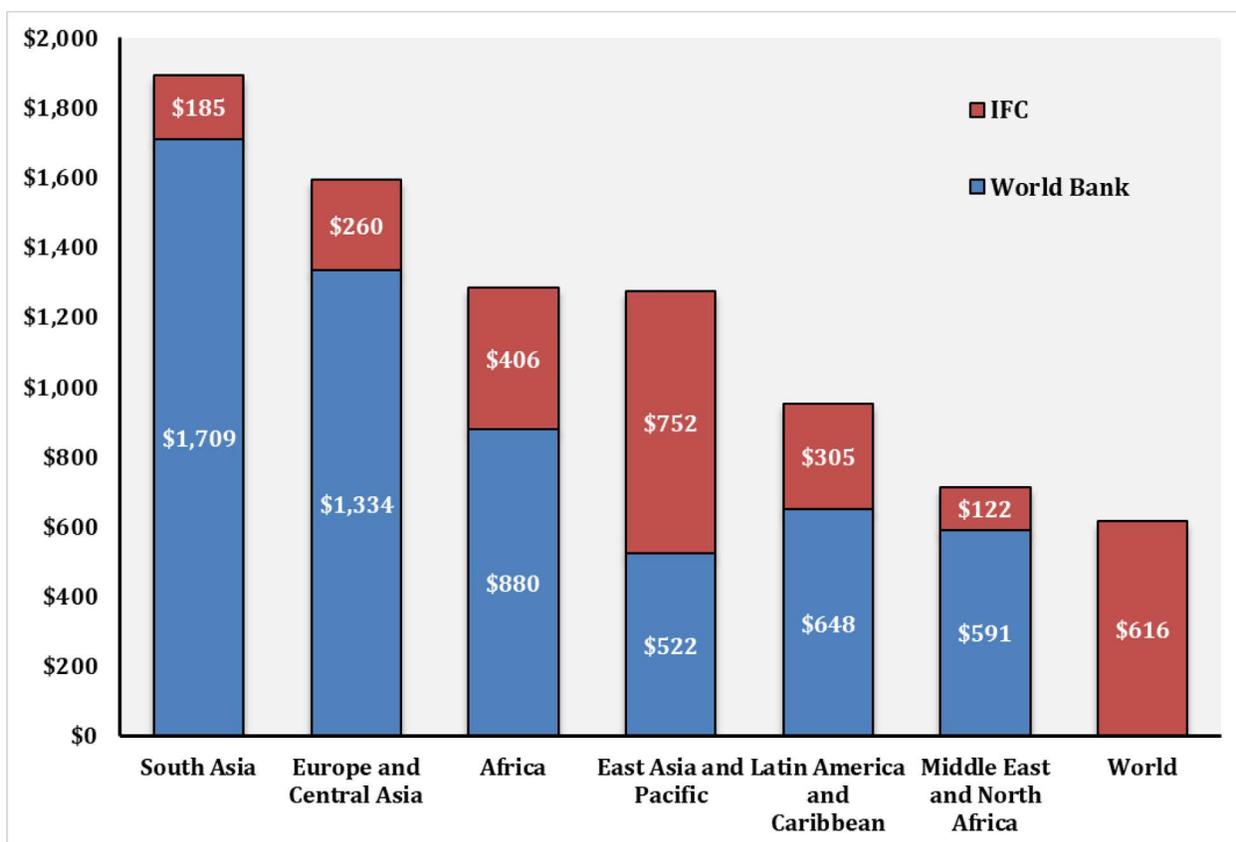
Original post [here](#).

In March the World Bank Group (WBG) [announced](#) \$14 billion in fast-track financing to help countries respond to the COVID-19 pandemic. Since then, the WBG has provided approximately \$8.3 billion in both fast-track and other financing for 339 projects across 117 countries (see [here](#)). The following lists the elements comprising the package.

- \$8 billion from the [International Finance Corporation](#) (IFC)
- \$2.7 billion from the [International Bank for Reconstruction and Development](#) (IBRD)
- \$1.3 billion from the [International Development Association](#) (IDA)
- \$2 billion reprioritized from existing World Bank projects towards COVID-19 relief

This package is specifically designed to rapidly strengthen national health systems to facilitate “disease containment, diagnosis, and treatment, and support the private sector.” The WBG also has stated its intention to make some [\\$160 billion](#) available over the next 15 months. This blog post summarizes the WBG’s current and proposed efforts.

Figure 1: Total New World Bank Group Commitments, by region (As of 2020/07/21, \$millions)



Source: [World Bank Projects List](#), [IFC investment program disclosures](#)

The WBG has concentrated its aid in regions that are less developed. Nearly half of its current assistance has gone to countries in Latin America and Africa. A majority of the 86 countries that have been approved for new WBG programs are located either in Africa or Asia. Most new programs thus far have come through the IBRD, which provides loans, guarantees, and other financial assistance to middle and lower-income countries, and the IDA, which provides concessional financing to some of the poorest.

Table 1. Summary of World Bank Group COVID-19 Programs (as of 2020/07/21, \$millions)

Region	Countries Assisted	Number of Programs	Average Program Size	Largest Commitment
Africa	42	107	\$12.1	Nigeria - \$180.4
East Asia and Pacific	17	50	\$25.5	Indonesia - \$250
Europe and Central Asia	17	42	\$37.9	Romania - \$570.1
Latin America and Caribbean	23	54	\$17.7	Colombia - \$265
Middle East and North Africa	10	31	\$23	Morocco - \$288
South Asia	8	52	\$36.4	India - \$1,035

Source: [World Bank Projects List](#), [IFC investment program disclosures](#)

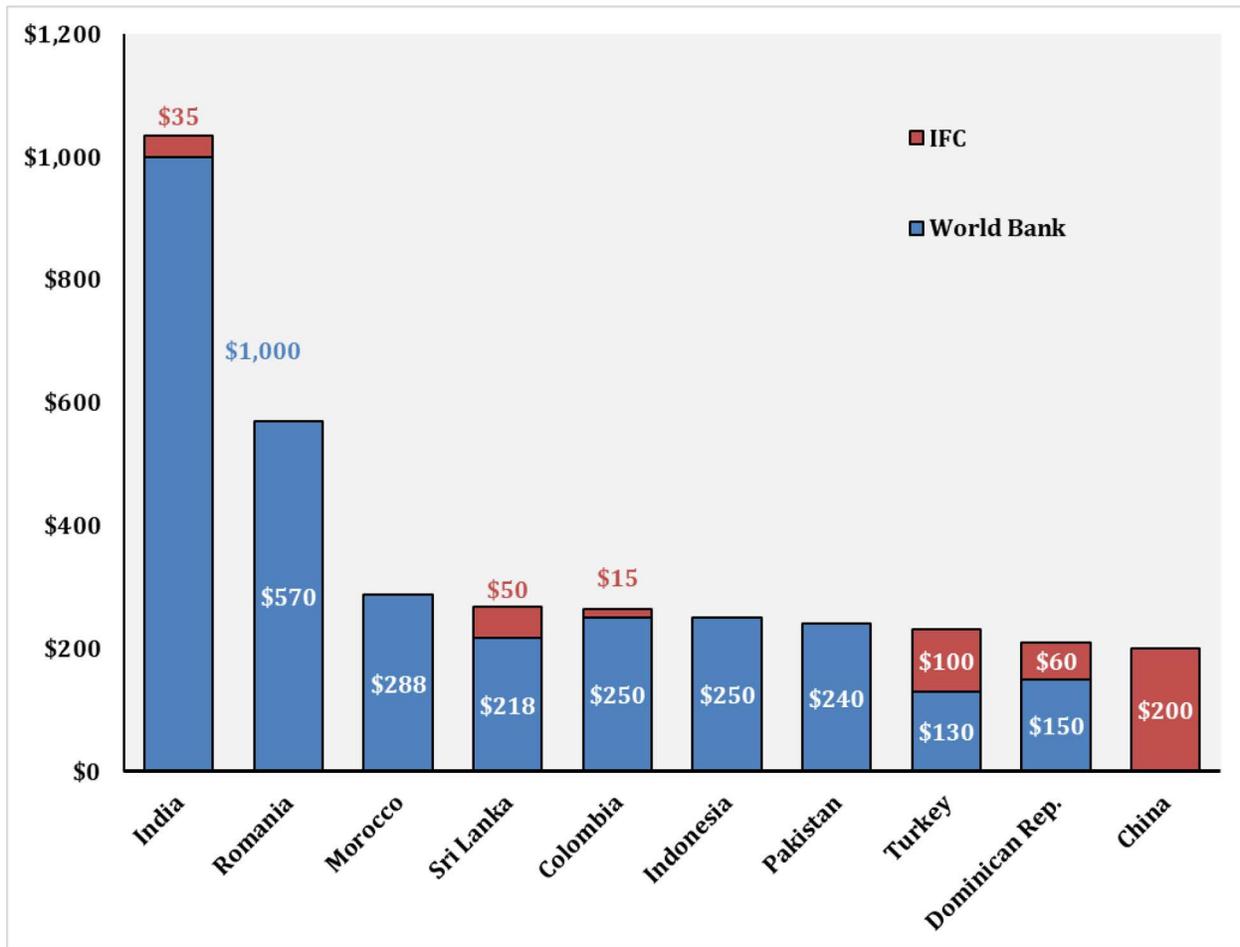
As seen in Table 1, average program size varies dramatically, likely due in part to the level of development in each country. Some South American and East Asian economies that received assistance, such as Colombia and Indonesia, are much larger than those in Africa, which necessitates larger packages of assistance. The single largest disbursement thus far has been for \$1 billion for a program in [India](#). See Figure 2 for more information.

In addition to its new funding, the World Bank has also relied on existing public health programs and [Catastrophe Deferred Drawdown Options \(CAT DDOs\)](#) for COVID-19 relief. CAT DDOs provide immediate access to pre-approved funds after a trigger event - normally the declaration of a state of emergency. To receive pre-approval, nations must have an “adequate macroeconomic policy framework” and either be preparing or have a sufficient disaster risk management program (see [here](#)). Currently, 13 countries have triggered about \$1.3 billion in CAT DDO assistance. Romania has drawn about €493 million from its CAT DDO, the largest of any nation. The World Bank has also repurposed a number of existing programs for COVID-19 response. These repurposed programs are included in the data shown above.

In the WBG’s \$14 billion fast-track financing program the IFC has the largest commitment. The Corporation serves as the private-sector arm of the WBG and focuses on economic development and poverty reduction by investing in developing markets. Its initial [\\$8 billion investment](#) has been broken up as follows:

- \$2 billion via the Real Sector Crisis Response Facility to provide loans and equity investments in companies affected by COVID-19.
- \$2 billion via the Global Trade Finance Program to support import-export financing to Small and Medium-sized enterprises.

Figure 2. Countries with the largest World Bank Group commitments (As of 2020/07/21, \$millions)



Source: [World Bank Projects List](#), [IFC investment program disclosures](#)

- \$2 billion via the Working Capital Solutions Program to encourage financial institutions in emerging markets to provide credit to businesses.
- \$2 billion via the Global Trade Liquidity Program and the Critical Commodities Finance Program to provide investment and risk-sharing support to financial institutions in emerging markets.

Thus far, the Corporation has initiated 39 investment programs worth approximately \$2.6 billion. Its two largest programs, however, are not targeted investments towards individual countries and instead are focused globally. The [first](#), under the Working Capital Solutions Program, is a first-loss guarantee of up to \$216.1 million for the IDA’s Private Sector Window (IDA PSW) program. The guarantee will be used to help support working capital loans to companies in some of the poorest countries in the world. The [second](#), under the Global Trade Finance Program, is a two-tiered, \$400 million guarantee for the IDA PSW for trade finance in countries that are “fragile and conflict-affected” and would be acutely vulnerable to COVID-19-

related disruptions. The first tier of the guarantee is a pooled first loss of up to \$150 million, and the second is a revolving guarantee limit enhancement of up to \$250 million to ensure that trade finance can be facilitated even in periods of exceptional stress. It is unknown how the IFC plans to operationalize the remainder of the \$8 billion that it pledged in March.

As the WBG continues to unveil new programs to support developing nations, YPFS will provide additional updates. For more information on the mechanics of World Bank lending, see this YPFS [blog post](#). For more information on what international institutions generally have been doing to combat COVID-19, see our [survey](#) and accompanying [resource guide](#).

European Stability Mechanism Establishes Pandemic Support Credit Lines

By Vaasavi Unnava

Original post [here](#).

On April 9, the European Council approved the establishment of a new series of pandemic credit lines that will make up to €240 billion in loans available to euro area countries through the European Stability Mechanism (ESM).

In 2012, the European Council established the ESM, which [provides help](#) to euro area countries in severe economic distress. The ESM was instrumental in providing aid to euro area countries troubled during the sovereign debt crisis, and is one of the largest issuers of euro denominated debt, which funds its operations. It provides support through credit lines constructed for country-specific needs.

The ESM structures credit lines as either Enhanced Conditioned Credit Lines ([ECCLs](#)) or Precautionary Conditioned Credit Lines ([PCCLs](#)). ECCLs differ from PCCLs in that they provide access to credit for countries that do not meet the stricter requirements of PCCLs. Each pandemic credit line will be an [ECCL](#). Typically, countries accessing an ECCL are required to adopt specific measures to prevent difficulties accessing PCCLs in the future; however, for the pandemic support ECCLs, few conditions to access exist.

Unlike previous lines of credit, the ESM will only allow countries to use the pandemic lines to support direct and indirect healthcare, cure, and prevention costs due to the COVID-19 crisis. Countries may request up to 2% of their 2019 GDP from their respective pandemic support credit lines.

All EU member countries can access the credit lines – an estimated [€240 billion in loans](#) – based on the maximum credit available to each through their respective lines; however, it is unlikely that countries utilize all €240 billion (the ESM currently has a lending capacity of [€500 billion](#), as set by its governing treaty). The credit lines will be available until the COVID-19 crisis is over.

The lines are established under Article 14 of the [ESM Treaty](#), which provides for the Board of Governors of the ESM to grant precautionary credit assistance if necessary to the stability of the Euro area. All precautionary credit lines through the ESM must follow an [established set of guidelines](#). The precautionary credit lines require each member to enter into a Memorandum of Understanding (MoU) with the ESM. The ESM Board of Governors and the Board of Directors will jointly determine standardized terms of the MoUs for pandemic credit lines.

This standardized approach differs from any of the individualized lines the ESM has extended during the nearly eight years of its existence. Previously, the ESM extended lines of credit to

[individual countries](#) to provide aid during the sovereign debt crisis or more generally for country-specific difficulties. This series of lines will be the first of its kind to provide aid to all countries simultaneously.

The ESM will finalize the terms of the credit lines [within the next ten days](#) as it prepares to make the pandemic credit support lines available by April 23.

For EU countries that do not use the euro, the EU's Balance of Payments Facility (BoP Facility) will extend pandemic lines. The [EU funds](#) the BoP Facility through EU-issued bonds in capital markets; in turn, the BoP Facility provides support to Euro area members facing trouble maintaining balance of payments through aid offered in conjunction with the World Bank and the International Monetary Fund. It has aided [Latvia](#), [Romania](#), and [Hungary](#) in 2010, 2008, and 2009, respectively.

It is not clear that the terms negotiated with for the Pandemic Crisis Support Lines will be extended to countries seeking aid from the BoP Facility. Presently, [the European Council writes](#), “[The BoP Facility] should be applied in a way which duly takes into account the special circumstances of the current crisis.” However, the statement does not note an explicit requirement that the terms match terms negotiated for member states requesting support directly from the ESM's Pandemic Crisis Support Lines.

The ESM Pandemic Support Credit Lines are part of a larger [package](#) to provide aid to countries' fights against the coronavirus pandemic in the Euro area. The package also includes the creation of [an unemployment insurance scheme](#) and increased lending capacity of the European Investment Bank.

The ESM's provision of credit lines joins the International Monetary Fund's utilization of credit facilities to aid countries combating the coronavirus epidemic. See this [YPFS blog post](#) on the IMF's policy responses to the COVID-19 pandemic for more information.

EU Member States Reach Unanimous Deal on Historic EUR 750 billion Fiscal Stimulus Package

By Lily Engbith

Original post [here](#).

On July 21, the 27 Member States of the European Union (EU) brokered a deal for a comprehensive stimulus package to combat the economic fallout of the COVID-19 pandemic.

The announcement, which also included details on the long-term Multinational Financial Framework (MFF), laid out the terms and conditions for a collective fiscal response under the EUR 750 billion (USD 857 billion) Next Generation EU (NGEU) program. In the resulting Conclusions from the Special meeting of the European Council, leaders reaffirmed their commitment to sustainable solutions that would integrate the interests of all Member States and be “significant, focused, and limited in time” ([see here](#)).

Borrowing by EU

Perhaps the most important feature of the NGEU package is the novel provision authorizing the European Commission to borrow funds on behalf of the Union. It plans to raise EUR 750 billion on the capital markets, with new net borrowing to stop by the end of 2026. The raised funds will be used to provide EUR 360 billion in low-cost loans and EUR 390 billion in grants to combat and mitigate the effects of the pandemic, without regard for Member States’ previous economic conditions or commitments.

The repayment of debts by the Union will be scheduled in order to ensure “steady and predictable reduction in liabilities” until 2058 ([see here](#)). Outstanding amounts not used for interest payments can be used for early repayments before the end of the MFF 2021-27. The specific details of repayment have yet to be decided; it was only agreed that the Commission will establish a yield curve of debt issuance that may strain future EU budgets.

Although Member States will most likely be unwilling to increase their individual contributions, the Commission plans to levy new environmental and digital taxes to help allay the costs ([see here](#)). Principal repayments due to the Union in a specified year will not exceed 7.5% of the maximum EUR 390 billion allocated for expenditure. Finally, leaders agreed on a temporary increase in their own resource ceilings by 0.6 percentage points in order to “create sufficient budgetary space,” which will be “available (i) for the contingent liabilities from loans to Member States and (ii) for the repayment of the debt from borrowed funds for spending programmes in the future” ([see here](#)).

Funding for each Member State

Although the Commission has yet to release specific country-by-country allocations, it decided on a series of stipulations that will help guide the future disbursements that are expected to begin in 2021.

For instance, the Commission reserves, as a last resort, the right to “call more resources” from Member States as it deems necessary, without increasing the ultimate liabilities of the collective ([see here](#)). Such requests will be determined on a pro rata basis and will be limited to the Member States’ share of the temporarily increased resources ceiling (i.e., 0.6% of Member States’ gross national income (GNI)). In addition, funds distributed through the NGEU program will be considered external assigned revenues and therefore fall under the political jurisdiction of the Budgetary Authority, in consultation with the European Parliament, the Council, and the Commission. The legal commitment of top-up funds to a given program will be made by December 31, 2023, and related payments will be made by December 31, 2026. In the meantime, the programs will utilize existing funding to make disbursements starting in 2021. Table 1 below shows NGEU disbursements through various EU programs.

Table 1: Next Generation EU Disbursement by EU Programme

Facility or Fund	Main Purpose	NGEU Disbursement
Recovery and Resilience Facility (RRF)	Provides “large-scale financial support to reforms and investments undertaken by Member States, with the aims of mitigating the economic and social impact of the coronavirus pandemic and of making the EU economies more sustainable, resilient and better prepared for the challenges posed by the green and digital transitions.”	Loans: EUR 360 billion Grants: EUR 312.5 billion Total: EUR 672.5 billion
ReactEU	“Continues and extends the crisis response and crisis repair measures delivered through the Coronavirus Response Investment Initiative and the Coronavirus Response Investment Initiative Plus (see here). It will contribute to a green, digital and resilient recovery of the economy.”	EUR 47.5 billion
Horizon Europe	Supports “European partnerships with EU countries, the private sector, foundations and other stakeholders. The aim is to deliver on global challenges and industrial modernisation through concerted research and innovation efforts.”	EUR 5 billion

<u>InvestEU</u>	Builds “on the successful model of the Investment Plan for Europe, the Juncker Plan. It will bring together, under one roof, the European Fund for Strategic Investments and 13 EU financial instruments currently available.”	EUR 5.6 billion
<u>Rural Development</u>	Reinforces “the market measures and income supports of the CAP with strategies and funding to strengthen the EU’s agri-food and forestry sectors, environmental sustainability, and the wellbeing of rural areas in general.”	EUR 7.5 billion
<u>Just Transition Fund (JTF)</u>	Supports “Small and Medium-sized Enterprises, the creation of new firms, research and innovation, environmental rehabilitation, clean energy, up- and reskilling of workers, job-search assistance and active inclusion of jobseekers programmes.”	EUR 10 billion
<u>RescEU</u>	Enhances “both the protection of citizens from disasters and the management of emerging risks.”	EUR 1.9 billion
		Total: EUR 750 billion

As illustrated in Table 1 above, Member States will be able to access EUR 672.5 billion in funds through the Recovery and Resilience Facility (RRF). It is hoped that 70% of grants will be committed in 2021 and 2022 and 30% will be fully committed by the end of 2023.

Additionally, the 2015-19 unemployment criterion for allocation will be replaced in proportion to the loss in real GDP observed over the course of 2020 and cumulative loss in real GDP observed over 2020-21, to be calculated by June 30, 2022. The maximum volume of the loans for each Member State is not to exceed 6.8% of its GNI, and pre-financing for the RRF will be paid in 2021 and should amount to 10% ([see here](#)).

Another significant outcome of the NGEU proceedings was the requirement that all Member States prepare national Recovery and Resilience plans for 2021-23. These schemes will then be assessed by the Commission within two months of submission for consistency with country-specific conditions, including plans for strengthening green and digital economies. Upon the Commission’s proposal, countries will need to obtain approval from the European Council by qualified majority (55% of Member States, which represents 65% of the EU’s population). Payment requests will thus be contingent upon successful fulfillment of these strategic goals, which will be reviewed and adapted in 2022 in order to determine final allocations for 2023.

Member States may request that the President of the European Council refer matters of other States’ “serious deviations from the satisfactory fulfillment of relevant milestones and targets” to the next European Council ([see here](#)). Dutch Prime Minister Mark Rutte, a staunch advocate of austerity, was primarily responsible for the inclusion of the oversight mechanism. However,

there is a three-month statute of limitations on such formal complaints, and the Commission retains final approval.

Reactions and concerns

Beyond the much-needed economic aid, pro-Europeanists hope that the MFF and NGEU package will act to mutually reinforce solidarity among Member States. This political signaling is particularly important, given the initially fractured and chaotic response to the pandemic. However, many questions still remain about the checks on leaders who are believed to be in violation of the EU's rule-of-law standards. Hungary's President Viktor Orbán and Poland's Prime Minister Mateusz Morawiecki have been criticized for their crackdowns on freedom of expression in the media and the judiciary, among other issues ([see here](#)). While the NGEU framework outlines a general process for levying official complaints against other Member States, it is unclear how effective the European Commission will be in dissuading deviations from EU values. Furthermore, the imposition of sanctions - considered to be the most consequential penalty for non-adherence - would require unanimity among the group of 27 nations. Hungary and Poland, along with the Czech Republic and Slovakia, have already promised to protect each other in such cases.

Many details have yet to be sorted before Member States see the tangible benefits of the NGEU stimulus package. Apart from the allocation of funds, each country's government will have to individually ratify the agreement and begin to draft their Recovery and Resilience proposals for Commission and Council approval. This process is expected to last at least until the end of 2020; the facility will open in January 2021, and no new bridge funding will be provided beforehand.

Despite the contentious political debates surrounding oversight and debt mutualization, the agreement reached by Member States is an important step forward toward the creation of a European fiscal union and provides, at the very least, an architecture for collective responses to future crises.

European Council finalizes Multiannual Financial Framework and Additional COVID-19 Response Measures

By Aidan Lawson

Original post [here](#).

On July 21, the European Council unveiled its latest plans for the region's economic recovery from the ongoing COVID-19 crisis. The hotly debated package contains approximately €1.8 trillion in assistance for EU member states. Council members redesigned and reiterated the package multiple times since discussions began back in late April (see [here](#)).

Discussions about revamping the EU's long-term budget, called the Multiannual Financial Framework (MFF), and the creation of a COVID-19 recovery plan began on April 9. On that day the Council published a report that outlined the region's economic policy response to the COVID-19 pandemic thus far (see [here](#)).

In that report, the Council endorsed repurposing existing budgetary resources and augmenting the capacity of the European Investment Bank (EIB) to address the pandemic. It stated that it would discuss operationalizing a new recovery fund (see [here](#)). The Council also agreed on immediate relief through existing mechanisms totaling about €540 billion, to be deployed on June 1 (see [here](#)).

The MFF has two components: a multiannual financial framework regulation, which details how much the EU can spend, and an own-resources decision, which shows where the revenue comes from (see [here](#)). The European Council and Council of the EU negotiate the MFF in advance, and it typically covers a period between five to seven years. The recovery fund would be "temporary, targeted and commensurate with the extraordinary costs of the current crisis." There would be heated debate over the structure, amount, and type of aid that this fund would give.

On April 23, the Council had its first meeting to discuss the MFF and recovery fund. Member states had opportunities to bring forth their proposals, and France, Italy, and Portugal strongly endorsed a Spanish plan to provide up to €1.5 trillion in grants to distressed nations. However, other nations - the Netherlands, Germany, and Sweden - argued against financial transfers and stated that they would prefer loans instead. President of the European Commission Ursula von der Leyen said that the eventual recovery fund would likely contain a mixture of the two (see [here](#)).

On May 13, von der Leyen provided more details about the recovery fund in a proposal to the European Parliament (see [here](#)). The proposal stated that the money in the fund would be spent across three major pillars:

1. A new recovery and resilience tool for public investment in the hardest-hit member states.

2. A new solvency instrument that will revive private investment and “match the recapitalization needs of healthy companies who have been put at risk as a result of the lockdown”
3. A new dedicated health program, and efforts to strengthen existing programs

Von der Leyen went on to say that the recovery fund would be short-term, focused on areas that were most in need, and include grants, as well as the possibility to frontload some of the investment if needed. The proposal did not include specific amounts, however.

Two weeks later, von der Leyen announced the name of the €750 billion recovery fund: Next Generation EU (see [here](#)). The European Commission would fund this separate program by issuing bonds on behalf of the EU on financial markets, something that has never been done before.

The majority of this borrowing would take place from 2020-24 (see [here](#)). The EC would distribute €500 billion of the aid as grants, and the other €250 billion as loans. Additionally, the revamped MFF would total about €1.1 trillion from 2021-27.

Under this plan, a total of €2.4 trillion in assistance would be available via Next Generation EU, the MFF, and the aforementioned aid passed in April. Member states generally reacted positively to the proposal, although some (namely the “frugal four” group of Austria, Denmark, the Netherlands, and Sweden) professed the importance of budgetary discipline and advocated for a more even balance between grants and loans (see [here](#), pp. 2)

The Council discussed the Next Generation EU and the MFF in a meeting on June 19. While difficulties remained, Council President Charles Michel stated that there was an “emerging consensus” and that the Council would further discuss the plan in July (see [here](#)). In a special session from July 17-21, the Council agreed to a proposal that was largely similar to the one in May (see [here](#)).

The final package of aid is broken up as follows:

1. A total of €750 billion for Next Generation EU. This would be funded through borrowing in financial markets by the European Commission on behalf of the EU. Up to €390 billion can be given in the form of grants, and up to €360 billion as loans (see [here](#), pp. 3).
2. A revamped MFF totaling €1.074 trillion. Additional flexibility has been added to help the EU tackle exceptional circumstances created by the COVID-19 crisis. Annual GNI-based contributions of the frugal four and Germany have been reduced for the years 2021-2027 (see [here](#), pp. 8).

For more details on the final package, see [this YPFS blog post](#).

The nearly €1.1 trillion in the MFF will not go entirely towards COVID-19 economic relief. The primary goal of the MFF is to “allow the EU to fulfill its long-term objectives and preserve the

full capacity of [Next Generation EU]” (see [here](#)). To this end, the MFF also includes funds to tackle climate change, gender equality, digitization, and other key areas. However, the Council has increased health expenditures and introduced spending flexibility to “address new priorities in light of the rapidly changing situation following the COVID-19 pandemic” (see [here](#), pp. 12). For more information on the EU’s immediate response to COVID-19 see this YPFS [blog post](#).

The passage of this plan represents a dramatic shift in the dynamics of EU funding and debt mutualization efforts. Large contributors such as Germany have [recently](#) and historically opposed burden sharing, even when the region was rocked by a [sovereign debt crisis](#) barely a decade ago.

However, bonds issued and guaranteed jointly by European states are in fact not a new instrument and have been used in extraordinary times [since the 1970s](#). They were used first during the 1973 oil crisis as part of the Community Loan Mechanism, which issued its first bonds to Italy and Ireland in 1976 (see [here](#)). Much like today, the EU budget was used to guarantee repayment to private creditors, with a second set of quota-based guarantees from each European nation in case there weren’t enough budgetary resources.

The European Central Bank (ECB) and European Stability Mechanism (ESM) have already provided relief to some of the most heavily indebted nations, such as Italy and Greece. Both the ECB and ESM have helped keep funding costs low for these nations by [purchasing](#) hundreds of billions of euros in sovereign debt or providing [low-cost credit lines](#) as an alternative to issuing expensive debt. While this isn’t direct burden-sharing in the same way that issuing joint European debt is, the shareholders of the ECB - that is, euro-area members - would ultimately be liable for any losses.

It has taken several months, but a combination of Next Generation EU, the revamped MFF, and the efforts by the ECB and ESM may prove to be a potent enough mixture to provide substantial relief from the economic damage wrought by COVID-19.

Small and Medium Enterprises (SMEs)

The majority of workers in many economies are employed by SMEs, and these firms account for more than 90% of total businesses worldwide. Due to the COVID-19 pandemic, many SMEs were forced to shut-down. Government programs in response to the COVID-19 pandemic vary with some focused on providing access to finance, supporting employee wages, providing grants to cover various expenses, among others. In many cases, especially in emerging markets, governments are also providing support to informal economy workers and firms.

Analysis

Credit Guarantee Programs for Small and Medium-Sized Enterprises

By Christian McNamara with Research Support from Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

With the economic fallout from the coronavirus pandemic likely to have a particularly significant impact on small and medium-sized enterprises (SMEs), countries around the world have adopted or are considering measures intended to support such businesses. One common tool for doing so, even in non-crisis times, is an SME credit guarantee, a program pursuant to which governments encourage banks to lend to SMEs by at least partially guaranteeing those loans. While evaluations of these programs are [somewhat limited and the evidence mixed](#), when an event like the Asian Financial Crisis or the Global Financial Crisis occurs, countries often expand existing SME credit guarantee programs to make them more responsive to crisis conditions and/or develop new programs specifically targeted to the crisis.

When designing an SME credit guarantee program, the following four categories of design decisions are of particular importance to policymakers:

1. Underwriting - who will be responsible for approving the guaranteed loans?
2. Risk sharing - how much of the loans will be guaranteed?
3. Fees - how much will borrowers have to pay in guarantee fees?
4. Eligibility - what borrowers will be eligible to participate and what type of loans will they be able to receive?

Below is a summary of how policymakers have approached these questions in the past.

Underwriting

Typically, the decision to extend particular loans has been made by the banks themselves, often with the rationale that they are better positioned to engage in credit analysis than the government. This decision is closely tied to how risk sharing is structured. If the banks are determining which borrowers get loans, fully guaranteed loans could give rise to a moral hazard problem because the banks won't suffer any losses from non-performing loans.

Less frequently, governments have decided which loans to extend. Japan's [Special Credit Guarantee Program](#) (SCGP), adopted in 1998 during its banking crisis, involved the government making underwriting decisions (while also providing a full guarantee). In its screening process for borrowers, it relied on a short list of negative characteristics such as tax

delinquencies and previous bank loan defaults. The SCGP typically accepted any borrower not possessing one of the listed characteristics, with the result that the approval rate was very high. However, this limited credit analysis [has been criticized](#) as having contributed to misuse by borrowers. Government involvement in underwriting may also result in high program administrative costs, as appears to have been the case with South Korea's [Credit Guarantee Fund](#).

Risk Sharing

As noted above, the question of how much of a loan should be guaranteed introduces the issue of moral hazard. For that reason, SME credit guarantee programs have typically provided partial guarantees (often in the range of 70%-80%). This leaves banks with some of the loss associated with a non-performing loan and therefore offers better incentives to conduct effective credit analysis. The portion guaranteed is not always fixed. In the Czech Republic, the [Czech-Moravian Guarantee and Development Bank](#) provides a gradual guarantee whose percentage increases over the duration of the loan up to a cap of 80%.

Some countries have sought to preserve these incentives while still fully guaranteeing loans, particularly in times of crisis. In Thailand, the [Thai Credit Guarantee Corporation](#) established during the Global Financial Crisis provided a full guarantee, but only if a participating bank's portfolio of guaranteed loans did not have non-performing loans that exceeded 16% of the total.

Chile's [FOGAPE](#) takes a unique approach to risk sharing, determining the percentage of a loan to be guaranteed pursuant to an auction in which banks bid for the right to provide a certain amount of guaranteed loans. Bids with the lowest guarantee percentages are selected first until the total amount of guarantee rights has been allocated. Such an approach may be consistent with research by [Yoshino and Taghizadeh-Hesary \(2016\)](#) arguing that guarantee percentages should vary by bank based on soundness (and based on macroeconomic conditions).

Fees

In determining the guarantee fees to be charged in connection with an SME credit guarantee program, countries typically seek to balance the desire to fund the programs with the need to avoid pricing out participants. Flat fees of approximately 1% to 2% of loan amounts [seem common](#). A reduction in such fees is often a way that existing programs are adapted in the face of crisis.

Eligibility

SME credit guarantee programs can either be broadly available or, less commonly, limited to borrowers meeting specific criteria. In the UK, the [Enterprise Finance Guarantee](#) adopted during the Global Financial Crisis required borrowers to demonstrate that they had first been denied a loan outside of the program. Programs in the US, Brazil, and Turkey had similar features. The Greek [Credit Guarantee Fund of Small and Very Small Enterprises \(TEMPME SA\)](#) limited participation to firms that had been profitable over the previous three years. In [Italy](#) and [Chile](#),

rather than acting directly, programs have provided guarantees to mutual guarantee associations that in turn provide guarantees to their SME members.

What types of loans will be eligible is also an important consideration. To ensure that guaranteed loans are not used to refinance existing non-guaranteed loans, many programs contain a prohibition on this practice. Programs often specifically include shorter-term working capital loans. In Canada, a Global Financial Crisis-era initiative called the [Canada Small Business Financing Program](#) excluded working capital loans despite a subsequent survey that showed over half of all SMEs intended to use debt financing for that purpose. This exclusion was seen as limiting the program's effectiveness.

Loan Guarantee Programs May Include Nonbanks

By Mallory Dreyer

Original post [here](#).

Loan guarantee programs that involve nonbank lenders may be more effective than bank-only programs at getting credit quickly to small businesses that need it during the coronavirus crisis.

Small and medium-sized enterprises (SMEs) play a [major role in the world economy](#), representing roughly 90% of businesses and 50% of employment worldwide. Many countries operate credit guarantee programs to encourage lending to SMEs. These programs are typically limited to bank loans. For example, the UK launched a [Coronavirus Business Interruption Loan Scheme](#) this week, taking advantage of existing programs, but the program is limited to forty previously accredited bank lenders.

This may [limit](#) its value. Since the Global Financial Crisis, other types of financing beyond traditional bank lending--such as [online sources of alternative lending](#) and short-term loans from non-financial corporations--have become increasingly important for SMEs. Expanding the scope of eligible lenders for guarantee programs could be a valuable tool for credit guarantee programs developed or expanded during times of crisis.

Some guarantee programs involve nonbanks already. The Netherlands expanded the [BMKB program in 2012 and GO facility](#) in 2013 to include other types of financial institutions, such as credit unions, SME funds, and crowdfunding as eligible lenders. The [Growth Facility](#) offers banks or private equity firms a 50% guarantee on newly issued equity or mezzanine loans. Mezzanine loans are a hybrid instrument, which gives the right to convert debt to equity if the loan is not paid back.

Making SME Credit Guarantee Programs Affordable: Subsidized Interest Payments for an Initial Period

By Mallory Dreyer

Original post [here](#).

The coronavirus pandemic has severely affected small businesses across the world and forced many to close temporarily. Several countries have provided relief to help them cover their fixed costs until social conditions return to normal. Government-guaranteed loans can help, but a small business may hesitate to take on new debt that only adds to its monthly fixed costs.

For that reason, the U.K. government's new temporary [Coronavirus Business Interruption Loan Scheme](#), announced on [March 17, 2020](#), includes a full government subsidy of the first 6 months of interest payments on guaranteed loans. This feature appears designed to address the issue of providing liquidity to small and medium-sized enterprises, while removing the immediate burden of interest payments, allowing for viable SMEs to survive until macroeconomic conditions improve.

In our March 19, 2020 post, [Credit Guarantee Programs for Small and Medium-Sized Enterprises](#), we highlighted key considerations in the design of SME credit guarantee programs, especially how these programs have been modified in response to crises. [Literature](#) suggests that crisis-focused guarantee programs can help solve immediate liquidity problems, although their effectiveness ultimately relies on improving macroeconomic conditions.

A prior example of interest payment relief can be found in the Greek response to the Global Financial Crisis, during which it established the [Credit Guarantee Fund of Small and Very Small Enterprises \(TEMPME S.A.\)](#). The interest costs on guaranteed loans under the first phase of the program, between December 2008 and April 2009, were fully [covered by the government](#). In the second phase of the program, the interest rate for guaranteed loans was set at a [fixed privileged rate](#), based on negotiations between TEMPME S.A. and the banking sector, which was lower than the going market rate.

In 2008-2009, some programs also temporarily decreased or suspended guarantee fees, including programs such as those in [Hungary](#), [Finland](#), and other EU countries, as well as the [US Small Business Administration \(SBA\)](#). Other programs, such as [Malaysia's SME Assistance Guarantee Scheme](#), did not charge a guarantee fee at all. Decreasing or eliminating the cost of the guarantee can also relieve the immediate financial burden on SMEs.

Large-Scale Assistance Programs for Small Businesses

By Mallory Dreyer, Christian McNamara, Alexander Nye, Kaleb Nygaard, and Priya Sankar

Original post [here](#).

With the economic effects of the coronavirus pandemic likely to be particularly devastating for small and medium-sized enterprises (SMEs), countries around the globe are faced with the task of determining how best to support such businesses. A number of potential intervention types exist and are already being deployed, many of which have also been used in response to earlier financial crises. This post begins by describing the fundamental challenge: to provide SME assistance quickly and on a large scale. It next examines each of the primary tools governments can use to extend assistance to SMEs on such a scale. In so doing, it provides examples of the use of these tools drawn from the current situation and previous crises. The post then presents a detailed analysis of the framework for SME assistance established in the United States by the recently adopted CARES Act as one example of how interventions can be combined to support SMEs. It concludes by offering some takeaways about why certain SME assistance interventions may be preferable to others in given contexts.

Statement of the Challenge

Confronted with a crisis that threatens to result in widespread failure of SMEs, governments have an interest in keeping such businesses afloat, even if their activities are temporarily suspended. While failed companies can restart post-crisis, costs can arise from the need to rehire employees and reestablish business relationships. Some of these costs could be avoided if companies can remain in business in a suspended state. Government assistance to SMEs may be justified to avoid these costs.

Governments may have the funds available to provide assistance. The fundamental challenge is to get those funds into the hands of SMEs quickly and on a large scale. But there is a tradeoff between speed of distribution and the amount of due diligence that can be done on potential recipients. Governments generally lack the capacity to engage in due diligence at scale. For that reason, they often turn to private financial institutions to perform this role, given such institutions' expertise and existing relationships with SMEs.

Thus, key questions that must be answered in designing an approach to SME assistance include:

What is the right balance between speed of distribution and due diligence on potential recipients?

To what extent should private financial institutions be utilized to help achieve the right balance?

If private financial institutions are to be utilized, how should the SME assistance be structured so as to provide them with adequate incentives to actually perform their intended role?

Types of Large-Scale SME Assistance

1. Grants - government payments to or on behalf of SMEs
2. Forgivable Loans - loans extended to SMEs that they do not have to repay under certain circumstances
3. Direct Lending - government loans to SMEs
4. Credit Guarantees - government guarantees to induce private firms to lend to SMEs
5. Funding for Lending - funding for private lenders to induce them to lend to SMEs
6. Payment Forbearance - delays on amounts SMEs owe to creditors
7. Tax Policy Changes - waivers of/revisions to the tax code to reduce or delay taxes owed

Grants

Arguably the most direct way to assist SMEs is by providing them with funds they do not have to repay. Other tools such as loans and payment delays are provided in the expectation that SMEs' ability to service loans and meet other obligations will improve over the duration of the intervention. If this does not occur, SMEs will be saddled with loans that they cannot repay and payments they cannot make. Given the severity of the pandemic's effect on SMEs and its uncertain duration, it is perhaps not surprising that grants play a key role in many countries' approach to SME assistance, despite their cost.

In Denmark, for example, the government [established a program](#) that pays a portion of the fixed costs of eligible businesses for up to three months. Businesses that expect to lose at least 25% of their revenues will see the government pay at least 40% (and up to 100% for businesses that lose all revenue) of fixed costs, including payroll and rent. The program's initial three months are expected to cost 40 billion Danish crowns (\$5.8 billion or about 1.6% of GDP). In Australia, the government is providing [grants of up to AUD \\$100,000](#) (\$59,960) based on a business's employment tax withholdings. It is distributing these grants via the system businesses use to make their withholdings.

Other grant-based programs have focused on providing fixed, relatively small amounts of money to SMEs quickly while more substantial support is pending. The United States has appropriated \$10 billion so that applicants for coronavirus economic disaster loans can receive advances of up to \$10,000 per potential borrower while loan applications are pending. Recipients do not have to repay the advances, even if a loan application is ultimately rejected. In Austria, the government established a [€1 billion hardship fund](#) to provide immediate payments of up to €1,000, with the possibility of monthly payments of up to €2,000 for three months following an application process. A German program provides [€50 billion in grants](#) to support SMEs and self-employed individuals in all sectors. SMEs with the equivalent of up to five full-time employees will receive €9,000 over the course of three months, while SMEs with the equivalent of up to 10 full-time employees will receive €15,000 over three months.

Many governments are using grants to subsidize wages. For example, businesses and nonprofits that have lost 30% or more in revenue due to COVID-19 are eligible for the [Canada Emergency Wage Subsidy](#). It supports 75% of the first CAD \$58,700 of each employee's salary for three months. Similarly, Australia's wage subsidy provides SMEs that have lost 30% of revenue relative to 2019 a fixed grant of AUD \$1,500 per employee every two weeks for up to six months. Large businesses are also eligible for this grant, administered through the [JobKeeper program](#), which is expected to cost the government AUD \$130 billion (approximately 7% of GDP). Singapore's [Job Support Scheme \(JSS\)](#) co-funds different amounts of employee salaries in different industries for a period of nine months: 25% of the first SGD \$4,600 (\$3,200) of monthly wages for all employees, 50% for food service workers, and 75% for aviation and tourism workers. A notable feature of the Singapore program is that employers [do not need to apply](#); the government will calculate the subsidy based on their tax withholdings and dispense it in three installments that are estimated to cost SGD \$15.1 billion total (approximately 3% of GDP).

In some programs, only furloughed or laid-off employees qualify. For example, the United Kingdom's [Coronavirus Job Retention Scheme](#) explicitly prohibits employees receiving the subsidy from undertaking work for their employers. Programs with these types of restrictions operate more like a form of unemployment insurance than direct assistance to the businesses themselves. The primary benefit to SMEs appears to be continued ties to an idled workforce that can be quickly reactivated once conditions improve. Germany's existing [kurzarbeit](#) policy allows employers to furlough workers in periods of economic hardship; during that time, the government pays 60% of their pre-crisis salary or 67% of their pre-crisis salary if they have children. Germany recently expanded eligibility for this program to companies with at least 10% (previously 30%) of their workers under furlough. Estonia and Belgium, among others, also have similar temporary unemployment programs.

Forgivable Loans

Other types of support can function like a grant. The cornerstone of the United States' assistance for SMEs is a \$349 billion program that guarantees loans that can be forgiven in an amount equal to eight weeks of the borrowers' key expenses, including payroll, mortgage interest, rent, and utilities. Following forgiveness, borrowers will have received a grant covering these expenses similar to that provided by Denmark's program. Austria has developed a program with a similar structure -- a €15 billion (\$16.2 billion) ["corona crisis fund"](#) that provides loans, of which the portion used for a borrower's operating costs, such as energy costs, insurance or rent, can be 75%-forgiven. Under the [Canada Emergency Business Account program](#) established in response to the pandemic, SMEs can borrow up to CAD \$40,000 (\$28,000), of which CAD \$10,000 will be forgiven, conditioned upon timely repayment of the remaining balance.

Direct Lending

Some countries lend directly to SMEs through public institutions such as state or development banks. An example of direct lending to SMEs is the [Business Development Bank of](#)

[Canada](#) (BDC). The BDC serves a counter-cyclical role, as its lending activities increase during periods of economic instability. During the Global Financial Crisis, BDC lending was a key component of the Canadian government's approach to providing assistance to SMEs, as the government provided additional funding for new or existing programs. Through the Business Credit Availability Program (BCAP), the government allocated additional funds to the BDC for working capital loans, term lending, and loan guarantees. In 2010, the BDC expanded its offerings with the Emergency Recovery Loans Program, which provided 3,700 businesses with pre-approved financing for working capital needs up to CAD \$100,000.

Ireland is using an existing institution to lend directly to a specific subgroup of SMEs. The Irish government established [MicroFinance Ireland](#) in 2012 to provide liquidity support to microenterprises that do not meet the lending criteria of private banks. This year, MicroFinance Ireland launched an [emergency lending program](#) for microenterprises negatively impacted by the pandemic. In order to be eligible for the program, applicants must demonstrate through financial projections that the pandemic is expected to decrease turnover by 15%. The loans are interest-free with a payment moratorium for the first six months, which eases the initial debt burden on microenterprises during the period of economic uncertainty.

Countries such as [Spain \(Instituto de Crédito Oficial\)](#), [France \(OSEO\)](#), and [Japan \(Japan Finance Corporation\)](#) also have institutions that lend directly to SMEs. But direct lending programs for SMEs are rare in comparison to other interventions, likely because direct lending programs require the government to utilize an existing vehicle or create a new vehicle from scratch during a crisis.

Credit Guarantees

Rather than providing loans to SMEs directly, governments can encourage private lenders to do so by at least partially guaranteeing those loans. Some governments use credit guarantee programs to promote SMEs' access to credit even during non-crisis times. But they often expand these programs or develop new ones during crises. That has happened in the current pandemic and also during earlier events such as the Global Financial Crisis and the Asian Financial Crisis.

Typically such programs involve the government guaranteeing loans approved by private lenders, often with the rationale that such lenders are better positioned to engage in credit analysis than the government. Less commonly, governments themselves have been responsible for the loan underwriting process. In Japan's [Special Credit Guarantee Program](#), adopted in 1998 during its banking crisis, the government made underwriting decisions based on a short list of negative characteristics such as tax delinquencies and previous bank loan default. But the program [has been criticized](#) as having contributed to misuse by borrowers. Government involvement in underwriting may also result in high program administrative costs, as appears to have been the case with [South Korea's Credit Guarantee Fund](#).

SME credit guarantee programs have typically provided partial guarantees, often in the range of 70%-80%, to leave banks with some of the loss associated with a non-performing loan to

incentivise effective credit analysis. Some countries have sought to preserve these incentives while still fully guaranteeing loans, particularly in times of crisis. In Thailand, the [Thai Credit Guarantee Corporation](#), established during the Global Financial Crisis, provided a full guarantee, but only if a participating bank's portfolio of guaranteed loans did not have non-performing loans that exceeded 16% of the total. Chile's [FOGAPE](#) takes a unique approach to risk-sharing, determining the percentage of a loan to be guaranteed pursuant to an auction in which banks bid for the right to provide a certain amount of guaranteed loans and bids with the lowest guarantee percentages are selected first, until the total amount of guarantee rights has been allocated.

Borrowers typically pay a fee for the guarantee. Flat fees of [1% to 2% of loan amounts are common](#). A reduction in such fees is often a way that existing programs are adapted in a crisis.

SME credit guarantee programs can either be broadly available or, less commonly, limited to borrowers meeting specific criteria, such as [those who can demonstrate that they have been denied a loan outside of the program](#) or [those with a history of profitability](#). What types of loans will be eligible is also an important consideration. Programs often specifically include shorter-term working capital loans. In Canada, a Global Financial Crisis-era initiative called the [Canada Small Business Financing Program](#) excluded working capital loans, an omission that was seen as limiting its effectiveness.

For more information about Credit Guarantee Programs for SMEs, please see [YPFS's analysis of this topic](#).

Funding for Lending

An additional means for encouraging lending by private banks to SMEs involves providing banks with the funding to do so. Under such funding-for-lending programs, the government, frequently via the central bank, provides low-interest-rate funds to the banking system, while requiring or incentivizing banks to use the money to support SMEs. In response to the COVID-19 pandemic, the [Bank of England](#) (BoE) and the [Reserve Bank of Australia](#) (RBA) are each conducting funding-for-lending programs. To incentivise banks to lend to SMEs, both central banks offer two tranches of money to eligible banks. All eligible banks have access to the first tranche, but banks can only access the second tranche if they use the first tranche to increase their loans to SMEs. The BoE ran a similar program in 2012, and although the multi-tranche structure was not included in the initial phase, it was added when the program was [extended](#) in 2013.

The BoE set no upper limit on the overall size of either the 2012 or the current program. Banks borrowed £42 billion (roughly \$67 billion, 2.5% of the UK GDP in 2012) through the original program between June 2012 and April 2013. Other central banks have announced a maximum size for their funding-for-lending programs. The RBA set its program at AUD \$90 billion (\$52 billion, or 4.8% of GDP); [Hungary's](#) 2013 program, HUF 750 billion (\$3 billion, or 2.2% of GDP); [Saudi Arabia](#), SAR 13.2 billion (\$3.5 billion, or 2.5% of GDP); and [Taiwan](#), NT 200

billion (\$6.6 billion, or 1.1% of GDP). Still, the amount of funds available to each bank depends on the size of its loan portfolio.

Typically, only companies with prior access to a central bank's discount window are eligible to participate in funding-for-lending programs due at least in part to the pre-existing technical and operational capacity of institutions already in the central bank system. Central banks are finding ways to expand eligibility, however. For example, the RBA said in announcing its program that it had developed a [complementary program for nonbank lenders](#).

To encourage banks to begin lending to SMEs as soon as possible, funding-for-lending programs can reward banks for the lending they had extended to SMEs even before the central bank had made the funding available. This is accomplished by using a date before the crisis began as the date by which the central bank will begin counting new lending. For example, in the current crisis, the BoE used December 31, 2019 and RBA used January 31, 2020. This ensures that banks can benefit appropriately if they were already lending to SMEs before the central bank announced its program but after the crisis began.

Funding-for-lending programs are not exclusively conducted by central banks. For example, [South Korea](#), [Saudi Arabia](#), [Ireland](#), and the [EU](#) (via the European Investment Fund) have each established funding-for-lending programs where the fiscal authority provides the funds to banks and sets similar stipulations and/or incentives for banks to lend to SMEs at favorable rates.

For more information about Funding for Lending for SMEs, please see [YPFS's analysis of this topic](#).

Payment Forbearance

Assistance to SMEs focused on increasing the funds coming into a business can be complemented by programs aimed at delaying or reducing outflows. Payment forbearance allows businesses to simply delay paying amounts owed. Creditors sometimes implement these programs during normal times, especially when the institution in question thinks a business is suffering but is viable as a going concern. During economic downturns, governments are more likely to step into the picture and create their own programs by incentivizing or outright requiring forbearance.

Which creditors should offer forbearance and for which types of obligations is a critical question. SMEs can have payment obligations to entities in the public sector, financial private sector, and nonfinancial sector. Public-sector payment obligations can include government-owned utilities and other services, government-sponsored entities, and, of course, taxes (discussed in more detail below). It may be relatively easy for a government to waive such payments for a short period. On March 18, for example, Dubai and Abu Dhabi reduced [15 different customs fees, taxes, and other costs for businesses](#).

In the financial sector, banks typically have procedures for working with borrowers who are experiencing temporary financial stress. In the current crisis, some of the largest banks [voluntarily created forbearance programs](#). A broad, government-initiated moratorium on loan payments to banks and other financial institutions could offer relief to small businesses during a crisis. On March 17, Italy adopted such a plan as part of the “[Cura Italia Decree](#)”. Under this plan, amounts owed by Italian SMEs with no non-performing exposures on financings to banks, financial intermediaries, and other entities authorized to carry out lending activity in Italy are suspended until September 30.

SMEs also may have obligations to creditors in the nonfinancial private sector, such as landlords and suppliers. A French program adopted in response to the current crisis allows SMEs to apply [to defer rent and utility payments](#).

Which businesses will receive forbearance must also be considered. On March 19, Korea’s Financial Services Commission (FSC) announced a [forbearance program](#) that appears to offer blanket eligibility. Under the program, SMEs can access a six-month minimum extension on existing loans and guarantees from both banks and nonbanks. Blanket eligibility may be the most efficient policy in a pervasive crisis such as the current one, in which the sheer number of affected SMEs is so large as to challenge systematic efforts to distinguish the truly needy. However, blanket eligibility, as seen in some of India’s [farm loan waiver programs](#), can also be susceptible to abuse [due to moral hazard](#). Recent small-business programs in Europe have tended to limit eligibility to borrowers that meet certain criteria related to the impact of the coronavirus on their businesses.

Governments can negotiate forbearance programs with creditor associations for institutions like banks and non-banks, then bind them to the program. The Central Bank of Ireland announced [one such agreement](#) in response to the COVID-19 pandemic. Authorities can also outright require forbearance. In some cases, governments pass laws that require creditors to restructure SMEs loans. The Japanese government [passed such a law](#) during the Global Financial Crisis.

Typically, payment forbearance programs operate for a short and specified time period tied to the nature of the crisis. In cases of natural disasters, these programs can last for just a few months, as affected regions return to normalcy. Financial crises can be different. Governments that introduce temporary programs can end up extending them under political pressure or simply because the economic stress has continued longer than expected. During the Global Financial Crisis, for example, the Italian government, in collaboration with a creditor association, imposed a loan forbearance program for SMEs in August 2009 that Italy continued to [extend and modify through at least 2014](#).

A challenge associated with forbearance programs is that they have the potential to negatively affect the creditors who were to have received the payments that are now being delayed. For this reason, forbearance programs are sometimes paired with measures intended to support affected creditors. Under the Italian debt moratorium discussed above, lenders are entitled to a

government guarantee equal to 33% of suspended payments if 18 months after the end of the moratorium a debtor remains unable to pay. In Saudi Arabia, [a program delaying SME payments to banks and financing companies for six months](#) also includes financing from the Saudi Arabian Monetary Authority for such banks and financing companies.

For more information about Payment Forbearance for SMEs, please see [YPFS's analysis of this topic](#).

Tax Policy Changes

Some governments choose to lessen SMEs' tax burdens as a way to provide them with relief during a crisis. Unlike some of the other tools for assisting SMEs, governments may change tax policies to benefit SMEs just as frequently during normal times as during crises. These programs have a tremendous range, but all tend to alter the corporate tax code. They can encompass everything from delays on employers' social contributions to tax cuts and changes in how tax deductions work.

One of the most common tax policy tools, regardless of whether times are good or bad, is altering tax deductions for SMEs. Governments usually deploy these kinds of tax policies to encourage or discourage different kinds of investment by SMEs. In 2005, while the United States economy was still in expansion, the government passed the [Gulf Opportunity Zone Act of 2005](#). This law contained a provision that increased the size of the deduction small businesses could take on property expenditures, which encouraged businesses to improve their properties. One Australian response to the COVID-19 pandemic operates on a similar logic. Australia's [Backing Business Investment \(BBI\)](#) program allows businesses with turnover of less than AUD \$500 million to deduct 50% of the cost of a business's investment in a new asset. Programs like this provide cash flow relief and incentivize increased capital expenditures during the COVID-19 crisis.

Another common tool, especially during a recession, is cutting or delaying taxes for SMEs. The most common variant of this tool, which in some ways is similar to payment suspension, is the VAT (value-added tax) or sales tax deferral, in which payment of the VAT is merely delayed for a specified period of time. One can find a recent example of this policy in the [Republic of Korea](#), which suspended the VAT for companies earning 60 million won or less per annum. [Vietnam](#) announced a five-month VAT deferral, during which businesses would not be punished for late payments.

Given the circumstances in which tax policy changes are being introduced, it is important that they be on taxes that are "[profit insensitive](#)" (i.e. taxes that are paid regardless of whether the SME is profitable). A break on a tax that a business pays only when it is making a profit is unlikely to be of much use during a crisis.

CARES Act

On March 27, 2020, the United States passed the [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#), which establishes a number of measures to combat the economic impact of the COVID-19 pandemic, including aid to SMEs.

Forgivable Loans and Grants

Section 1102 of the CARES Act allocates \$349 billion to the Paycheck Protection Program, which guarantees Small Business Administration (SBA) sponsored loans made by financial institutions of up to 250% of an employer's pre-pandemic average monthly payroll (up to a maximum loan value of \$10 million each) to businesses with up to 500 employees. The CARES Act also expands eligibility to sole proprietors, independent contractors, eligible self-employed individuals, certain nonprofits, and certain tribal business organizations. Borrowers can use the proceeds of the guaranteed loans to fund payroll costs, employee benefits, mortgage interest payments, rent, utilities, and interest on existing debt, in addition to other allowable SBA uses. SBA fees typically associated with such loans are waived, and the interest rate lenders can charge is capped at 4% with a minimum payment deferment of six months. The Treasury [has set this rate](#) at 1%. The CARES Act also waives requirements borrowers must typically meet to receive an SBA loan, including providing a personal guarantee and/or collateral and demonstrating an inability to obtain credit elsewhere. Any loan not entirely forgiven as described below can have a maximum maturity of 10 years from the forgiveness application date.

Under Section 1106, guaranteed loans provided pursuant to Section 1102 will be forgiven in an amount equal to the borrower's spending on payroll (including salaries, wages, and benefits), mortgage interest, rent, and utilities in the eight weeks after the origination of the loan. This forgiveness amount is subject to reduction (a) in proportion to the reduction in the number of employees during this eight week period as compared with pre-pandemic periods and (b) based on the amount salaries and wages are reduced beyond 25% during this eight week period as compared with pre-pandemic periods. Rehire provisions incentivize businesses to bring back staff and restore salaries and wages by enabling borrowers to avoid loan forgiveness reductions if certain previously adopted job or pay cuts are reversed.

The CARES Act also expands other loan opportunities for SMEs. Section 1102 increases the maximum amount of the SBA's Express Loans to \$1 million from \$350,000. Section 1110 expands eligibility and loosens requirements for the SBA's Economic Injury Disaster Loans (EIDL) program and establishes emergency grants in amounts up to \$10,000 per potential borrower to be paid while loan applications are pending, with no repayment required even if a loan application is ultimately rejected. Section 1112 provides for six months of payment subsidies on existing SBA loans.

Funding for Lending

SMEs may also benefit from the \$500 billion in loans, loan guarantees, and other investments the CARES Act makes available to assist businesses, states, and municipalities under Section 4003. Section 4003 requires the Treasury Secretary to "endeavor to seek" to establish a

program providing financing to lenders who make loans to eligible businesses with between 500 and 10,000 employees on favorable terms including a maximum annual interest rate of 2% and at least six months of deferred payments. Section 4003 also allows for the creation of a “Main Street Lending Program” aimed at small and mid-sized businesses that are [too big for SBA lending but not big enough for capital markets](#). On March 23, 2020, the [Federal Reserve announced](#) that it would soon establish a Main Street Business Lending Program, which would provide support to SMEs and complement SBA lending. Further information about this potential program is not yet available.

On April 6, the Federal Reserve [announced](#) that it would establish a new lending facility to offer term financing backed by loans in the Paycheck Protection Program. Further information about this program is not yet available.

Tax Policy Changes

SMEs may also benefit from a number of the tax provisions contained in the CARES Act. Section 2301 establishes an employee retention tax credit for businesses fully or partially suspended as a result of a government order stemming from the coronavirus or that otherwise suffer a more than 50% decline in revenue. Eligible businesses will receive a refundable credit against employment taxes equal to 50% of qualified employee wages (up to \$10,000 in wages per employee). For businesses with more than 100 employees, only wages paid to employees not performing services due to coronavirus suspensions are included. Section 2302, meanwhile, allows businesses (although not those who have received the loan forgiveness provided by Section 1106 described above) to delay payment of 2020 employment taxes until December 31, 2021 (50% due) and December 31, 2022 (the remaining 50% due). There are also provisions for relaxing restrictions on net operating losses, providing corporate alternative minimum tax credits, and business interest expense deductibility.

Key Takeaways

Evaluations of SME assistance interventions are [limited and/or mixed](#). Nonetheless, it is possible to identify several key takeaways associated with their use.

In order for assistance to be effective, SMEs must receive it in time

Speed is often essential when seeking to support SMEs during a crisis because of SMEs’ limited reserves and reduced access to other forms of financing. Which intervention type or types will enable a country to respond most quickly can depend on what resources, programs, infrastructure, etc. it had in place heading into the crisis. Many countries expand existing SME support programs in response to crisis conditions. An intervention like direct lending seems difficult to introduce during a crisis absent such a pre-existing program given the resources and infrastructure it requires, but where institutions like state banks exist, they may be able to provide lending on favorable terms more readily than the private banking system.

Grants, while costly, can be relatively easy to implement, particularly where there is an existing mechanism like the withholding system that can be used for their distribution. Even relatively small grants given quickly may afford countries adequate time to adopt interventions that are more difficult to implement.

Funding for lending can potentially be implemented under existing central bank authority, meaning that no legislative or executive action would be required. Tax policy changes and payment suspensions involving government-controlled creditors, meanwhile, can be accomplished without the involvement of third parties such as private banks and private creditors.

In the developing world, credit guarantee programs may be the intervention type most easily adopted because they leverage the expertise of private banks in a context of limited government capabilities. Guarantee programs have the added benefit of not requiring a large upfront expenditure, as costs are incurred only after loan defaults.

Due diligence on potential recipients is also an important consideration

While speed of distribution would be improved by conducting no due diligence on potential recipients of SME assistance, such an approach runs the risk of widespread waste, fraud, and losses to the government. Governments generally lack the capacity to engage in this sort of diligence. The experience and existing relationships theoretically possessed by private financial institutions may make them well-suited for this role. However, the extent of the diligence must still be balanced with the desire for speed, and the incentives of private financial institutions to perform the role must be addressed.

Assistance to financial institutions does not automatically result in greater lending to SMEs absent the right incentives

The experience of past crises suggests that merely providing assistance to the banking sector doesn't ensure that such assistance will be used to increase lending to SMEs. During the Global Financial Crisis, capital injections for banks did not necessarily improve SMEs' access to bank credit. Even guarantees on SME lending may not result in such lending [where banks are reluctant to take them up](#). The Paycheck Protection Program under the CARES Act in the US is an example. It may be similar to a grant for borrowers whose loans are forgiven, but the role of banks as intermediaries means that the government can't control how much lending actually occurs. Elected officials followed the announcement of the program with strong language urging banks to participate. Additional tools such as credit mediators, timely reporting of SME lending, and SME lending codes of conduct may be necessary.

Actual sources of SME credit must be considered

SMEs are increasingly obtaining financing from outside the traditional banking sector. Programs that operate solely through this sector (e.g., a guarantee program available only on bank lending or a funding-for-lending program targeted at just those institutions with

discount window access) may be insufficiently broad. Some programs are being tailored with this new reality in mind by [including non-bank lenders alongside traditional banks](#).

Interventions may have effects on other parts of the system that must be considered

Payment forbearance programs can be attractive as they provide immediate relief to SMEs without any government outlay. However, the suspension of payments to creditors may have a negative impact on those creditors who themselves in turn may require government intervention.

Ultimately macroeconomic conditions will need to improve relatively quickly for most intervention types to be successful

Programs that provide SMEs with loans or that delay payments otherwise owed can meet the short-run liquidity needs of businesses. However, absent an improvement in macroeconomic conditions they [may only postpone insolvency](#).

Lessons Learned in Designing and Implementing Support for Small Businesses

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

One month into the biggest global bailout of small businesses in history, countries have started to adjust their initial programs to make them more effective. Small and medium sized enterprises (SMEs) account for [90 percent of businesses](#) and a majority of employment opportunities across the world. Even during non-crisis times, many SMEs face constraints in accessing financing. Governments are working to provide exceptional support during the COVID-19 pandemic in order to prevent bankruptcies, unemployment, and a deeper recession.

All countries face the same challenge: how to quickly get funds to the businesses that need them. In response to the challenge, governments have adopted a variety of interventions (see the YPFS blog [here](#)). In this post, we evaluate interventions designed to support SMEs and present nine lessons learned.

Lessons Learned

1. Demand has far exceeded most programs' initial budgets
2. Aligning incentives can encourage more private-sector lender participation
3. Leveraging existing agencies can get money to SMEs faster
4. Including both bank and nonbank lenders can account for multiple sources of SME financing
5. Targeting assistance too narrowly can slow down the provision of support
6. Streamlining the application process can speed up distribution of funds
7. Small businesses may face challenges meeting fixed costs that programs don't cover
8. Some programs inherently require, or benefit from, additional programs
9. Businesses will likely need further government support

1. Demand has far exceeded most programs' initial budgets

In many countries, demand from SMEs for assistance has outstripped the amount governments initially made available. In response, governments have increased the overall allocation of funds to these support programs. In some instances they have also increased the amount available to individual SMEs.

Overall allocation

[Italy](#), a country that suffered particularly early and deeply from COVID-19 has dramatically increased the amount of funds available for loan guarantees. On March 17, the Italian government announced a EUR 100 billion (\$109 billion) loan guarantee program. On April 14, the EC approved a four fold increase (up to EUR 500 billion) of the original program and announced a new program for the self employed and smaller companies with an unspecified allocation.

In less than two weeks, on April 16, the United States [expended](#) the full \$349 billion Paycheck Protection Program (PPP). On April 22, congressional leaders [reached a deal](#) with the administration to infuse the PPP with an additional \$310 billion.

[Switzerland](#) doubled its initial loan guarantee program allocation from CHF 20 billion (\$21 billion) to CHF 40 billion. [Spain](#) increased its original EUR 100 billion SME support program by EUR 20 billion.

Participation limit

Many countries have increased not only the amount of total funding available in a support program, but also the individual business participation limit. For example, the government of [Singapore](#) increased the maximum loan amount available under its Temporary Bridging Loan Program from SGD 1 million (\$700,000) to SGD 5 million. When [Italy](#) added a new program specifically targeting smaller companies and the self-employed it increased the size of loans eligible for a 100% state guarantee from EUR 25,000 under the previous program to EUR 800,000 in the new one.

2. Aligning incentives can encourage more private-sector lender participation

When the government channels funds through the financial system, it has to ensure that the lenders are properly incentivized to lend the funds to the SMEs.

Guarantee Percentage

Many countries have had to increase the government guarantee rate on the loans they are asking the banks to offer to SMEs. When [Germany](#) expanded its loan guarantee program, it increased the guarantee rate from between 80% and 90% up to 100% after banks were reluctant to take on new risks in the current economic environment. [Singapore](#) increased guarantee rates on a variety of its programs from 80% to 90%. [Colombia](#) increased its guarantee rates from 60% to 90%.

Interest Rate Ceiling

Many governments set interest rate ceilings on the loans that banks offer to SMEs under credit guarantee programs. However, setting this rate ceiling too low can make banks unwilling to participate. The US's PPP [initially](#) set the interest rate at 0.5% but later had to increase the rate to 1.0%.

Waiver for Individual Bank Participation

[Wells Fargo](#) had been lending under the PPP, but it was constrained by an outstanding restriction on balance sheet growth due to previous misconduct. The Federal Reserve temporarily waived the growth restriction on Wells Fargo to allow Wells to issue more loans under the PPP. Because Wells Fargo is an important lending channel for small businesses, this waiver incentivizes it to continue to participate, which will help its small business customers that need funding receive it.

3. Leveraging existing agencies can get money to SMEs faster

Some governments avoid the challenge of structuring programs to appropriately incentivize private sector banks by leveraging pre-existing government agencies that provide loans directly to small businesses without needing to use the banking system as an intermediary. This can lead to quicker delivery of emergency funds.

In response to the COVID-19 crisis some of these countries have increased funding to these agencies to allow them to provide substantially more loans directly to small businesses. For example the [Business Development Bank of Canada](#) announced a CAD 10 billion program that will provide up to CAD 2 million working capital loans with flexible repayment terms to small businesses. [MicroFinance Ireland](#) initiated a new program that provides loans to businesses with less than 10 employees if they have been rejected for financing by a bank. The [European Investment Bank](#), the lending arm of the European Union, has announced a EUR 25 billion credit guarantee program, part of which will be distributed by European countries' development banks.

The US [tasked](#) its Small Business Administration (SBA) agency with the administration of much of its support programs. This includes the PPP as well as direct grants and loans under the SBA's Economic Injury Disaster Loan program. The SBA deployed more than \$350 billion in support to SMEs in two weeks and is expected to deploy a similar amount in the coming days.

4. Including both bank and nonbank lenders can account for multiple sources of SME financing

Because many SMEs do not have existing loans, credit lines, or relationships with traditional banks, some programs include lenders beyond traditional commercial banks or target lenders with expertise to lend to small businesses.

For example, many SMEs in Switzerland do not have bank loans and only bank with [PostFinance](#), the financial services subsidiary of the national postal service, which does not traditionally lend. The Swiss government is temporarily allowing PostFinance to issue loans under its credit guarantee program.

In the PPP, the Small Business Administration (SBA) provides the guarantees, but the financial system issues the loans. Eligible lenders of SBA loans now [include](#) non-bank-entities like PayPal, Square, and Intuit. In the proposed emergency legislation, which appropriates an additional \$310 billion for the PPP, \$60 billion is earmarked for small, midsize, and community lenders, as

these lenders typically reach [more of the smaller businesses](#) compared to the large national lenders.

On [April 17](#), the British Business Bank (BBB), which administers the United Kingdom's Coronavirus Business Interruption Loan Scheme (CBILS), announced that a new lender was accredited to lend under the scheme. The new lender, Funding Circle, is the first newly accredited marketplace lending platform in CBILS and is the largest online small business loan provider in the UK. The BBB has accredited additional lenders since the launch of CBILS and will continue to accept applications from new lenders in order to expand the funding options for SMEs.

5. Targeting assistance too narrowly can slow down the provision of support

Policymakers face a trade off between specificity and efficiency in providing support to SMEs.

In general, programs that target specific types of firms require more administrative processes. For example in the United Kingdom, the CBILS was initially limited to borrowers who had failed to secure standard commercial financing. This not only limited the scope of the support but also added administrative burden for lenders and prolonged the process. [Some firms](#) complained that banks were offering standard financing with high interest rates instead of loans under the scheme. In the first two weeks of the program, 130,000 inquiries were received but only 983 loans were approved. The amendment to CBILS eliminated the requirement, thus expanding the eligibility criteria. The UK also announced a credit guarantee scheme for larger companies when the CBILS program was amended, in order to fill the [financing gap](#) for companies that could not participate in CBILS or access the Covid Corporate Financing Facility (CCFF).

Many countries limit programs to firms up to a certain size or maximum turnover. For example, the [Paycheck Protection Program](#) in the US restricts usage to employers with 500 or fewer employees. However, the SBA released additional guidance regarding eligibility to clarify that firms that meet the statutory and regulatory definition of a “small business concern” with more than 500 employees are eligible. The [US program](#) has faced backlash after some larger companies were reported to have received loans under the program, and [Financial Times analysis](#) shows that eighty publicly-traded companies, with ability to raise capital elsewhere, received aid.

6. Streamlining the application process can speed up distribution of funds

By eliminating complexity from the application process, programs can distribute funds to small businesses quickly.

In the United States, small businesses apply directly to their lender. These institutions are responsible for the application process and can utilize their existing interface and online systems though the SBA provides a template application. Thus, borrowers approach the lender, and lenders then [submit information to the SBA](#). However, speed will depend on existing bank infrastructure, system, and staff. In the US where the PPP operates on a “first-come-first-serve”

basis, the speed at which an individual lender can process applications influences which small businesses receive aid.

In Switzerland, the government provides a standardized application online which applicants fill out and then take to the lender. The government anticipates that the application should take approximately 10 minutes to complete. In some cases, applicants have reported receiving funds less than an [hour](#) after completing the application. Because credit risk assessments are waived, the Swiss government announced actions to prevent fraud on [April 3](#). The Swiss [guarantee organizations](#) confirm that the loan agreements comply with the requirements and cancel loans that are duplicates or wrongly applied. The loans are also checked systematically by linking VAT and other data to the information provided by companies.

In contrast to the 10 minute application in Switzerland, some countries require more detailed documentation in applications and feature more complex processes. Applications vary across lenders, but in programs with less than a 100% guarantee, lenders bear a portion of the risk. Because of this, credit and risk assessments are often required, but these processes are more time consuming. In Italy, this is cited as a reason why funds are not flowing quickly. Thus, the application process can be a bottleneck to distributing funds

7. Small businesses may face challenges meeting fixed costs that programs don't cover

Some countries establish criteria and restrictions on how funds can be used, which can leave some small businesses with the challenge of finding financing to cover the gap. In the United States, the [Treasury](#) requires that at least 75% of the value of a forgivable loan issued under the PPP will be used for payroll expenses. Some [firms worry](#) that this support does not go far enough, especially for firms with high rent costs. Employee compensation is capped at an annualized \$100,000 per employee under the PPP. Other countries developed or expanded wage subsidy programs which are specifically designed to cover payroll costs.

In Denmark, the government [announced a program](#) to cover a certain percentage of fixed costs of companies that have been impacted by the COVID-19 pandemic. The government will cover between 25 to 100% of fixed costs. Denmark also announced a wage subsidy program for firms forced to decrease work hours of employees or temporarily lay them off. By providing support for fixed costs in addition to payroll expenses, Denmark addresses a gap faced by other programs.

8. Some programs inherently require, or benefit from, additional programs

Providing support to one type of business or one sector of the economy sometimes disadvantages a different business or sector. Governments have had to introduce a number of complementary programs in tandem or introduce new programs in response to outcomes from previously announced programs.

Funding for Lending and Guarantees

A number of countries have paired credit guarantee programs with funding for lending programs. These programs are designed to increase the incentives to lenders to issue the guaranteed loans. In general these programs work by accepting loans to small businesses (often the very ones issued under the credit guarantee programs) as collateral for funds from the central bank or ministry of finance.

In the US, the Federal Reserve has two sets of programs that serve this purpose: the [Paycheck Protection Program Lending Facility](#) and the [Main Street Lending Program](#). The Bank of England introduced the [Term Funding Scheme](#). The [Australian](#) government introduced two such programs, one administered by the Reserve Bank of Australia for depository institutions and another administered by the Office of Financial Management for non-bank lenders.

Debt Moratoriums and Guarantees

By introducing debt moratoriums, the government effectively shifts the risk from the SME to the lender, who in turn often requires assistance. In [Italy](#), the government paired its six month debt moratorium with a government guarantee equal to 33% of suspended payments if 18 months after the end of the moratorium a debtor remains unable to pay.

9. Businesses will likely need additional government support

To a larger degree than seen in past crises, many countries are providing direct grants for businesses in response to the COVID-19 crisis. Recent [research](#) from the Federal Reserve Bank of New York shows that fewer than 1 in 5 small businesses in the US can continue normal operations with their cash reserves if they experience a two-month revenue loss. Credit guarantee programs and additional lending can assist businesses with immediate cash flow needs, but the programs will only be effective if underlying macroeconomic conditions improve quickly; otherwise, they only [delay insolvency](#). Beyond increased adoption of grants, credit guarantee programs are more generous, with the [EU allowing](#) 100% credit guarantees and multiple countries waiving risk assessments. Generous loan guarantee programs have similar characteristics to grants in terms of limited diligence but still increase the overall debt burden for firms, which some firms may not be inclined to accept given the uncertainty of long-term economic conditions and future revenues.

Countries Provide Support to Workers in the Informal Economy

By Kaleb Nygaard and Mallory Dreyer

Original post [here](#).

In response to the COVID-19 crisis, countries have begun to help informal sector workers through safety-net programs, cash transfers, and public-works programs.

Workers in the informal economy are especially vulnerable to negative impacts from the COVID-19 pandemic. Informal workers are those in jobs without social insurance in sectors of the economy that are neither taxed nor regulated. The [International Labor Organization](#) (ILO) estimates that 1.6 billion of the approximately 2 billion informal economy workers globally will be significantly impacted by the COVID-19 pandemic, with [workers experiencing](#) an average earnings decline of 60%. Without an alternative income source, the ILO [estimates](#) that the proportion of informal economy workers in low-income countries living in relative poverty will increase from 18% to 74%. Informal workers are already twice as likely as formal workers to belong to poor households.

In general, [informal economy](#) workers have higher exposure to occupational health and safety risks. COVID-19 increases risks for workers, and many who become infected do not have a source of income security or healthcare coverage. Policies targeting informal economy workers are thus an important component of the government policy response to COVID-19, but policymakers face additional challenges in designing policies. Informal workers are not officially registered, making them harder to reach, and the informal economy varies widely across countries and regions.

In response to the COVID-19 pandemic, [countries have implemented](#) support programs for informal sector workers using the following:

- Existing unemployment insurance or social safety net programs
- New direct cash or in-kind transfers
- Public works programs
- Support to micro, small and medium-sized enterprises (including informal businesses)

Existing unemployment insurance or social safety net programs

Many countries have existing social safety net programs, such as cash and in-kind transfer, social pension, and school meal programs. In response to the COVID-19 pandemic, these programs can be expanded or enhanced to include more vulnerable and high-risk individuals. By utilizing existing programs, policymakers can quickly respond to the urgent needs of informal workers.

In the United States, the [Pandemic Unemployment Assistance](#) (PUA) provision of the CARES Act expands unemployment insurance eligibility to include self-employed individuals or those

who may otherwise be excluded. Though low-income countries have higher proportions of the workforce in informal jobs, industrialized countries, including the US, also have an informal labor force. The share of workers in informal jobs in the [US](#) has steadily increased in the past decade, and the ILO estimated that informal employment accounted for 30 million jobs in 2018, or 19% of the total labor force. States are permitted to provide unemployment benefits to self-employed, gig economy, or other informal workers through PUA for 39 weeks. The benefits include what the state provides and \$600 through the Federal Pandemic Unemployment Compensation (FPUC) program under the CARES Act.

[North Macedonia](#) expanded its existing unemployment insurance system to include informal sector workers, with an additional 20,000 households expected to benefit. These informal workers can receive 7,000 denars (USD 125) in April and May. [Lesotho](#), [Kazakhstan](#), and [Vietnam](#) have also expanded social protection programs to include informal sector workers.

New direct transfers or grants

Other countries have introduced new cash transfers for informal workers in response to the COVID-19 pandemic. Identifying eligible individuals can be a challenge, as many informal workers are not registered, and policymakers also face the challenge of providing access to benefits quickly.

On March 25, Thailand introduced a cash transfer of 5,000 baht (USD 153) per month for three months for informal workers. The government initially committed to support 3 million workers, but demand far exceeded the commitment size. The Thai government has since announced that [14.5 million](#) individuals are eligible to receive support. Individuals are required to submit applications online to claim the benefits. The website to submit applications opened on March 28, and despite a system crash, 8.5 million individuals were able to submit applications on the first day. However, not all individuals are approved automatically, and some applicants are asked to provide additional information, such as a picture of their workplace, and others have been rejected.

In [Egypt](#), workers in the informal sector are eligible to receive a one-time payment of LE 500 (USD 32) to recoup some lost income due to the COVID-19 shutdowns. This one-time payment was initially expected to go to 400,000 individuals. Like Thailand, the actual demand exceeded the announced size, as 1.2 million people applied for the grant in the first week. These benefits will be provided to individuals who are registered in government workforce databases and distributed through post offices.

Identifying informal workers can be a major challenge, as these workers may not have formal employment contracts or be officially registered. In [Guatemala](#), the government determines eligibility based on [electricity consumption](#) to provide the emergency cash grant of GTQ 1,000 (USD 130) to informal and self-employed workers. Individuals receive emergency grant payments electronically, either through smartphones or ATM withdrawals. Similarly, in [El Salvador](#), the government's new cash transfer program targeted households using electricity.

Households with usage between 0-250 kilowatts/hour received the transfers. In [Ecuador](#), informal workers who earn less than USD 400 per month are required to register to receive the emergency cash benefit. After registering for the benefit, individuals receive a text message with information regarding nearby payment locations where the USD 60 benefit can be collected. In [Brazil](#), informal workers, including domestic workers, can receive an emergency cash transfer of USD 115 per month for three months. The government identifies beneficiaries through the social registry, but individuals who are not registered can apply online.

In addition to cash transfers for vulnerable individuals, some countries have launched programs that provide training support to informal workers. Indonesia's Kartu Pra-Kerja (pre-employment card) program provides vouchers for training and re-skilling to unemployed workers in addition to unemployment benefits. The program is estimated to benefit 5.6 million informal workers impacted by COVID-19, and [eligible recipients](#) receive benefits through bank transfers or through e-wallet platforms.

Public-works programs

Many governments have announced programs that provide financial aid to unemployed workers, some of whom come from the informal economy, in exchange for participation in a public-works program. Government-sponsored public-works programs have traditionally consisted of infrastructure projects. The US's Public Works Administration is often cited as an important part of the government's response to the Great Depression in the 1930s. To varying degrees, many countries are also hiring people to do COVID-19 testing or sanitation.

Many countries have increased funding to existing public-works programs. In [Nepal](#), the Prime Minister's Employment Program was originally introduced in early 2019 and guaranteed 100 days of work per year to work on infrastructure projects. In [April](#) the government extended the program; it also announced that informal sector workers who had lost their jobs due to the crisis would receive 25% of a local daily wage if they chose not to participate in the public-works projects. The [Philippines](#) added an additional sub-program to its broader TUPAD public-works program that provides between 10 and 30 days of work to displaced, underemployed, or seasonal workers. In [Kenya](#), the government introduced a new program, Kazi Mtaani, focusing on unemployed workers in informal settlements in poor countries.

Other countries have provided public-works projects in health and hygiene. For example, [South Africa's](#) program provides work in essential services and waste collection but also includes a new initiative to hire 20,000 people to support the distribution of sanitizers and hygiene education as well as to work in disinfection and sanitization. [Kenya's](#) program includes street cleaning, garbage collection, bush clearance and drainage unclogging services, as well as fumigation and disinfection. The emergency expansion of the existing Philippines program provided 10 days of employment in sanitation and disinfection activities to eligible workers.

Beyond infrastructure and sanitation, governments have looked to hire many contact tracers. These [contact tracers](#) "work with patients to help them recall everyone with whom they have had

close contact during the time-frame while they may have been infectious, then contact the individuals to let them know of their potential exposure.” In the US, according to one [survey](#), state governments plan to hire at least 36,000 people to work in contact tracing. Similarly, the [UK](#) will hire 18,000 contact tracers. Though some countries have leveraged existing surveillance technologies or mobile apps, there is likely going to be a high demand in other countries for contact tracers, which a government could fill using a public works program.

Support to micro SMEs and informal businesses

The [ILO](#) predicts that the informal economy will grow as workers are pushed out of small businesses that close, in some cases permanently, due to economic shut-down measures taken by governments to help prevent the spread of the disease. Some countries have introduced measures to support these micro SMEs and informal businesses.

The government in [Burkina Faso](#) has suspended fees charged on informal sector operators for rent, security, and parking. In [Gabon](#), the government has a lending mechanism with approximately USD 375 million in funding to facilitate access to commercial bank financing for both formal and informal companies. In [Malaysia](#), the government introduced a special, one-time MYR 3,000 (USD 690) grant program for micro SMEs with less than 5 employees (excluding the owner) and less than MYR 300,000 in turnover. Support to micro SMEs and informal businesses will be important as governments begin to lift stay-at-home orders and restrictions.

Governments Provide SMEs with Relief for Non-Wage Fixed Costs

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

As countries adopt measures to respond to the ongoing COVID-19 crisis, many are providing support to businesses for fixed costs. Fixed costs are those that do not change with the amount of product or services a firm provides. Though a small business may be able to decrease variable costs in response to diminished demand or a government-mandated suspension of operations, small and medium-sized enterprises (SMEs) still face the ongoing burden of fixed costs.

Instruments vary across countries, with some countries providing waivers, grants, deferrals, moratoriums, loans, or even negotiation tools and eviction protection. Most fall in one of the following categories:

1. Multiple fixed costs
2. Rent
3. Property taxes
4. Utilities

We have covered programs that support wages, salaries, and other personnel costs earlier. See our posts on the [Paycheck Protection Program](#), [small business support in the United States](#), and [short-time work schemes](#).

Programs Covering Multiple Fixed Costs

The Netherlands, Austria, and [Denmark](#) have all announced fixed-cost subsidy programs to cover a specified amount of fixed costs for companies. Unlike programs that cover specific fixed costs, these programs cover multiple fixed costs.

In [the Netherlands](#), the government announced a EUR 1.4 billion (USD 1.6 billion) support package for fixed costs of SMEs on May 20. On May 28, the government expanded the maximum amount of support and extended the time frame. The program will provide up to EUR 50,000 per company for reimbursement of fixed costs for four months. The size of the grant depends on the size of the company, level of fixed costs, and amount of the revenue loss. Eligible companies are those with at least a [30% decrease in revenue](#). Wage costs are not eligible under the program, but rent, insurance premiums, lease, and maintenance costs are.

The [Austrian government](#) has allocated EUR 8 billion in funding for its fixed-cost subsidy program, which reimburses up to 75% of a company's [fixed costs](#) for up to three months. Eligible costs include rent, insurance premiums, financing costs for leases, utility costs, spoiled

goods that have lost at least 50% of their value due to the crisis, and interest expenses; including interest expenses as eligible for reimbursement appears to be unique to the Austrian program. Support is provided in the form of direct grants to companies that experience at least a 40% decline in turnover compared to the same quarter in 2019.

Rent

One significant fixed expense many SMEs face is rent payments. In response to COVID-19, governments at all levels have provided direct support to SMEs in the form of rent waivers, deferrals, and subsidies, as well as eviction protection.

Government as landlord

For some SMEs, their landlord is the government. In these cases, governments have been able to provide rent payment relief quickly and efficiently. [St. Lucia](#), for example, waived rental payments for six months for all small entities renting properties from the government. [Bahrain](#) and [Burkina Faso](#) instituted similar waivers. Other countries have waived rent payments owed to the government from certain sectors, like tourism-related businesses in [Bhutan](#). In [Malaysia](#), the government's rent waiver extends to government-linked companies such as the state-owned oil and gas company (Petronas), highway construction company (Plus), and urban-development company (UDA), among others.

The [Russian](#) government introduced a support program that waives three months of rent owed to the federal government for SMEs in affected sectors. The measure also defers all rent payments to all levels of government in the country through the rest of 2020.

Private landlord

Governments also provide support for SMEs whose landlord is not the government. These programs are more challenging to implement and often shift the burden from small businesses to landlords; however, many more SMEs rent from private landlords and therefore the impacts of these programs can be significant. These support programs come in two broad categories: (1) moratoriums and payment deferrals and (2) government subsidies of all or part of payments.

Government-mandated payment moratoriums have ranged in duration from a few months (e.g. [Albania](#), [Oman](#), and [Slovak Republic](#)) to six months (e.g. [Qatar](#)) to even a full year (e.g. [Vietnam](#)).

The government of [Singapore](#) passed a SGD 2 billion program (USD 1.4 billion) offering grants to SMEs to use for rent payments. For SME tenants of commercial properties, the program will cover two months of rent, and for SME tenants of industrial and office properties, the program will cover one month of rent.

Other programs seek to distribute the costs between the landlord, tenant, and government. The governments of [Lithuania](#) and the [Czech Republic](#) have each introduced programs whereby landlords of properties with small-business tenants will waive 30% of the rent, the tenant will pay 20%, and the government will pay the landlord the remaining 50%.

Lease negotiation and eviction protection

Many governments have passed laws restricting the actions of property owners in dealing with small business tenants who do not pay rent. In [Russia](#), SMEs may simply terminate their lease

without penalty. [Spain](#) introduced a mechanism whereby small businesses can renegotiate leases. In the [Netherlands](#) and the [Democratic Republic of the Congo](#) (DRC), the governments have prohibited eviction during the COVID-19 pandemic (the DRC explicitly defined this period as March through June).

Support through property owners

Rather than provide support directly to SMEs for rent expenses, some governments channel support indirectly through landlords and property owners.

The [Canada Emergency Commercial Rent Assistance](#) (CECRA) program provides support to property owners. The support comes in the form of unsecured, forgivable loans. The loans to eligible property owners are forgivable if they reduce rent for small business tenants by at least 75% for the months of April, May, and June. Small businesses eligible for the reduction include those who pay less than CAD 50,000 (USD 37,000) gross rent per location, generate no more than CAD 20 million in gross revenue, and have experienced at least a 70% decline in pre-COVID-19 revenue.

Many governments offer tax breaks to incentivize property owners to reduce rent expenses. For example, [Mongolia](#) and [Malaysia](#) offer tax rebates or reductions equal to the amount by which rent was reduced. In [Russia](#), the government offers tax deferrals to property owners that defer rent payments.

Property Taxes

Some governments provide property-tax relief to SMEs and other companies through deferrals, penalty waivers, and discounts.

In the [Czech Republic](#), the government is waiving penalties for companies that do not file and pay property taxes on time. This provides an extended window for repayment, but it does not impact the total amount owed. Similarly, [Chile](#) provided a property-tax deferral of the first quarter payment to companies with less than UF 350,000 (USD 12 million) in sales. The government is not charging interest on the deferred amount and requires the amount to be repaid with the remaining quarterly payments.

Some countries are targeting specific sectors and industries through property-tax relief. [Georgia](#) is providing a property-tax holiday for hotels through November 1. [Egypt](#) is providing companies in the industrial and tourism sectors with a three-month extension on tax payments.

[Israel](#) has allocated NIS 2.8 billion (USD 806 million) for property-tax discounts for businesses. Businesses will be eligible for a 25% discount on the property-tax bill. Because local government authorities are impacted by a decline in property taxes, the federal government is transferring funds to local governments to make up for the lost revenues. In other countries, local governments have deferred the payment of property taxes, but not always with a federal backstop.

[Japan](#) has also reduced property taxes for SMEs. The measure impacts the property-tax bill for 2021, unlike measures in other countries which typically decrease or defer the 2020 amount. SMEs can benefit from a 50% decrease in the tax due if their gross income falls between 30% and 50% for a three-month period between February and October, 2020; SMEs whose gross income declines more than 50% will be exempt from paying property taxes during that period.

Utilities

Some countries are also providing relief for utility payments to SMEs. Relief varies across countries and can take different forms.

In [Romania](#), some SMEs are eligible for utility-payment extensions, which include electricity, gas, water, phone, and internet services. [Guinea](#), [Brunei](#), and Israel provide temporary deferrals for companies that are most impacted by the COVID-19 crisis.

In some countries, state and local governments provide direct support to SMEs for utility payments. For example, [San Francisco](#) suspended shutoffs of water and power for 60 days for residential and business tenants and waived interest and fees on late payments. [South Carolina](#), [Kentucky](#), and [Massachusetts](#) have also temporarily stopped shut-offs for small businesses during the crisis.

Governments Encourage SMEs to Adopt New Technology

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

In response to the COVID-19 pandemic, governments around the world are adopting measures to encourage small and medium-sized enterprises (SMEs) to implement new technology.

Mandatory stay-at-home orders significantly impact foot traffic and revenue for many small businesses. Governments are encouraging firms to use new technologies to promote objectives such as establishing e-commerce sales channels, enabling employees to work remotely, increasing internet access, and moving to cashless payment systems.

Instruments to encourage digitalization vary across countries but include the following:

1. Grants
2. Loans
3. Free online platforms
4. Consulting and advisory services

Grants

Some governments are providing direct financial support in the form of grants or subsidies to small businesses to encourage the adoption of technologies to enable remote working, online sales, or cashless payments. The design of such grant programs vary, with some programs targeting firms of specific sizes or stipulating specific usage while other programs have a broader range of eligible uses.

In Ireland, eligible SMEs can receive grants of up to EUR 2,500 (USD 2,827) to develop an e-commerce platform or online trading platform. The [Trading Online Voucher](#) is available to SMEs with up to 10 employees and annual revenue of less than EUR 2 million. Firms are required to cofund 10% of the cost of the new technology. A firm could be eligible for a second voucher of up to EUR 2,500 if upgrades are required.

Japan is offering multiple subsidies to firms as a part of the SME Productivity Revolution Promotion Project. These include a sustainability subsidy, a manufacturing subsidy, and an IT introduction subsidy. Specifically, the [IT Introduction Subsidy](#) provides grants to small businesses for projects to improve labor productivity by at least 3% after one year and 9% after three years. Size requirements vary across sectors, with manufacturing companies eligible if they have less than 300 million yen in capital and less than 300 full-time employees while retail companies are eligible if they have less than 50 million yen in capital and less than 50 full-time employees. Firms can receive up to 4.5 million yen (USD 42,118), which in addition to supporting new technology adoption, can retroactively cover the costs of leasing computers and other hardware to April 7.

[Singapore's Ministry of Finance](#) announced total measures of SGD 500 million (USD 359 million) to support businesses in digital transformation. These measures target firms of different sizes. The first measure, which targets sole traders and microenterprises, provides SGD 300 per month for five months to stall holders in “hawker centres, wet markets, coffee shops, and industrial canteens” to adopt e-payment platforms and avoid handling cash. The second measure expands an existing support program for SMEs, the SMEs Go Digital program, which assists SMEs in the adoption of new technology. The government is augmenting this program with a Digital Resilience Bonus of up to SGD 5,000. The bonus is available to firms that adopt electronic payment and invoicing solutions, in addition to business process and e-commerce solutions. Furthermore, food and beverage and retail firms that have already adopted such technologies can be eligible for SGD 5,000 if they adopt advanced solutions. The government also has announced a package that covers 80% of the value of remote working equipment, such as laptops, under the [SMEs Go Digital Program](#).

[South Korea](#) is also encouraging small businesses to go online. Under the government's proposed “Digital New Deal” package, it will provide 160,000 SMEs with [4-million won](#) (USD 3,315) vouchers for accessing remote work platforms, such as videoconferencing.

Loans

Rather than providing direct grants to small businesses, some governments have announced lending programs for SMEs, with the requirement that firms use the loans exclusively for the adoption of new technologies.

Bank Negara Malaysia, Malaysia's central bank, announced multiple credit facilities for SMEs, one of which is the RM 300 million (USD 70.6 million) [Automation and Digitalization Facility](#) to improve productivity and efficiency. Eligible SMEs can obtain up to RM 3 million in financing at a 4% interest rate with a maximum term of 10 years. These funds are to be used exclusively for the purchase of equipment, machinery, hardware, software, and IT solutions and services. The facility is available through the end of 2020.

Spain's government announced the [SMB Accelerate Plan](#) which is a package designed to incentivize small businesses to adopt new technologies. One component of the plan is a EUR 200 million credit line through the Official Credit Institute (ICO) to lend to SMEs for the purchase and leasing of equipment and services for digitalization. Specifically, the government encourages companies to use the funding to purchase equipment and services for remote work.

Other countries have similarly established lending facilities to encourage technology adoption. [South Korea](#) announced that it would increase total funding for small business loans to 1 trillion won, with 200 billion specifically allocated to encourage businesses to go online. [Argentina](#) also announced a 7.2 billion credit line for SMEs, with funds to be used exclusively for the purchase or lease of remote working technologies or products.

Free online platforms

To help SMEs navigate government support programs, shift to remote working, and improve general business management or technical skills, many countries offer free online training courses and materials. In some cases, the governments themselves provide the training, and in other cases the training is provided by private companies (often technology companies) and facilitated by the government. Such platforms can assist SMEs in making the transition to new technologies, in order to resume operations, expand sales channels, or provide safer working conditions for employees.

Ireland's [eiLearn](#) platform provides learning resources and hosts training programs, workshops, and networking events online for SMEs affected by the crisis. The platform is operated by [Enterprise Ireland](#), a government organization responsible for development and growth of Irish enterprises. Another Irish government agency, [Skillnet](#), brings together private businesses and provides training support to SMEs.

The governments of [Italy](#) and [Austria](#) both provide subsidized use of remote working technologies like videoconferencing, collaboration tools, internet access, and cloud computing. [Austria](#) also announced the creation of a virtual department store that would allow retailers to become more visible to existing digital stores like Amazon and Google. [Spain's](#) SMB Accelerate Plan provides similar resources through its online portal.

In [Greece](#), the government announced a digital solidarity platform where large technology companies provide free online marketing and account management training to SMEs. The government also announced an initiative to help SMEs establish an online presence.

The government of [New Zealand](#) created an online calculator tool that helps small businesses forecast their cash flow in the COVID-19 context.

Consulting and advisory services

A question that many SMEs face in response to the COVID-19 pandemic is how to adjust their business models for the short and long-term. Many governments have introduced programs that supplement, or fully pay for, advisory services for SMEs.

On April 3, the [German](#) government announced an [assistance program](#) that would cover up to EUR 4,000 in consultancy services to help SMEs find solutions for coping with the crisis and economic shutdown. SMEs quickly drew down the full amount allocated to the program and the government agency running the program [announced](#) that the program had closed sooner than anticipated.

Korea included significant support for consulting services as part of its recently announced [Digital New Deal](#). One measure of the plan is to provide 25,000 SMEs with free security testing and consulting services. The plan also includes funding for consulting services for companies looking to introduce remote working.

In [Spain](#), the government expanded its Digital Transformation Office program and improved its personalized advisory services. As part of a March 20 announcement, the government

of [Finland](#) indicated that it would dedicate EUR 500,000 to subsidizing counselling and support services for entrepreneurs. The government of [Costa Rica](#) announced support for business development services to help companies navigate returning to economic activity once the crisis is over.

Countries Continue to Adopt and Update Credit Guarantee Schemes for Small Business Lending

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

For prior analysis, see [Credit Guarantee Programs for Small and Medium-Sized Enterprises and Lessons Learned in Designing and Implementing Support for Small Businesses](#). The [SME Credit Guarantee Resource Guide](#) catalogs features of past and present guarantee schemes and provides evaluation and general resources.

In response to the COVID-19 pandemic, many countries quickly announced credit guarantee schemes to support lending to small and medium-sized enterprises (SMEs). Under a credit guarantee scheme, the government fully or partially guarantees the value of a loan to an SME, which minimizes the risk to the lender, incentivizing the lender to provide credit. According to [recent data from the World Bank](#), 41 countries have launched 57 credit guarantee schemes for SMEs this year.

Under normal economic conditions, SMEs are more constrained than larger firms in accessing finance. In the context of the COVID-19 pandemic these constraints are exacerbated and they face severe liquidity shortages. Without support, many SMEs could begin to face a solvency crisis.

Credit guarantee schemes are one tool available to governments to support SME liquidity, but they are not without [design and implementation challenges](#). Guarantees can encourage banks to lend to riskier borrowers by limiting the downside risk, but guarantees will not be as helpful when lenders are limited by balance sheet constraints. Similarly, many SMEs are in a position where any new debt, even inexpensive, fully guaranteed debt, isn't financially feasible. Guarantee programs leverage existing lender-borrower relationships, but the total amount of lending will be influenced by the coverage ratio - the percentage of the loan being guaranteed. If a ratio is set too low, banks may not lend to riskier, high-need borrowers, and the program will not support those it is intended to aid. However, if the coverage ratio is 100% and a program fully protects banks against default risk, banks may lower their lending standards. Other design considerations include size, loan terms, eligible firms and lenders, and duration.

In response to the Global Financial Crisis in 2008-2009, many countries adopted credit guarantee schemes that were never closed. Countries and the responsible authorities that maintained such programs could quickly respond in the face of the pandemic. However, initial responses were often inadequate and have since been expanded. Many other countries have since adopted new programs.

In this post, we provide an update on credit guarantee schemes in response to the COVID-19 crisis. Specifically, we review how governments continue to adapt and expand existing schemes and create new schemes, and how program utilization and demand compare across countries.

Updating and Expanding Existing Credit Guarantee Schemes

Many countries have announced changes to their initial credit guarantee schemes, most of which were introduced in the second half of March and early April.

Coverage Ratio

The coverage ratio is one feature of credit guarantee schemes that can be changed in response to changing economic conditions and demand. Since the beginning of the COVID-19 pandemic, 100% guarantees have increased in prevalence; our [initial analysis](#) of credit guarantees for SMEs noted that only Japan, South Korea, and Hong Kong provided 100% guarantees. Initially, the European Union's [Temporary Framework for State Aid](#) permitted Member States to provide a [guarantee on up to a maximum of 90%](#) of a loan. In an [April 3 update](#) to the Temporary Framework, the limit was loosened, and Member States can now provide a 100% credit guarantee. [Italy](#) initially announced a tiered credit guarantee system, with decreasing coverage ratios based on loan and company size, but later announced a 100% guarantee. Other countries have increased the coverage ratio to a higher level, though not to a full 100% guarantee. [The Netherlands](#) increased the coverage ratio for SMEs from 50% to 90%, and [Finland](#) increased its coverage ratio from 80% to 90%.

Total Funding

Depending on fiscal availability, countries can increase total funding for guarantee schemes. Often, increases in total funding are multiple times the size of the initial scheme, as evidenced by [Israel](#), which increased funding for its guarantee scheme on several occasions, from NIS 4 billion initially up to 22 billion (USD 6.4 billion or 1.7% of 2018 GDP) in the latest version. On [June 17](#), the European Commission (EC) approved amendments to Italian credit guarantee scheme. The changes include an increase to the budget of the scheme to EUR 25 billion (USD 28.1 billion or 1.2% of 2019 GDP) from EUR 1.7 billion. Other countries have similarly increased total funding for credit guarantee schemes, including Romania, [South Korea](#), and Tunisia, among others.

Maximum Guarantee Amount

Increasing the maximum guarantee amount per beneficiary is another step governments have taken to expand access and increase usage. In Italy, the June 17 amendment increased the [maximum guarantee](#) amount for SMEs from EUR 25,000 to EUR 30,000. The [Peruvian government](#) amended the [Reactiva Peru](#) Program, a tiered guarantee system, to provide a 98% guarantee on loans up to S / 90,000 from S / 30,000.

Duration

Extending the duration of the credit guarantee scheme is another way countries have updated their programs. Countries have both amended the length of the guarantee period and extended the application period. Under the June 17 changes to the Italian guarantee scheme, the loan term is now 10 years, up from the previous 6 years. [Norway](#) has extended its guarantee scheme to include loans made after [June 1](#). New Zealand extended the term of its [Business Finance Guarantee Scheme](#) from 90 to 180 days.

Eligibility

Other countries have expanded eligibility for credit guarantee schemes. For example, Bpifrance, the French national investment bank, modified eligibility criteria on [May 7](#) to include some companies that were previously excluded. Significantly, it now allows companies that were in bankruptcy proceedings since January 1, 2020, to benefit from the guarantee, and includes some property companies. [Peru expanded](#) eligibility for the MYPE Business Support Fund, which specifically targets microenterprises, to include companies in any sector; the modification also lowered required credit ratings to ensure that more firms would be covered by the scheme.

Phased Approach

Spain has taken a step-by-step approach to its credit guarantee scheme; by releasing funding over an extended duration, it adapts to changes in the macroeconomic conditions in order to better target assistance. The [EUR 100 billion](#) guarantee fund is activated in tranches, and the fifth and final tranche was released on [June 16](#). Of the EUR 15.5 billion of the final tranche, EUR 7.5 billion is allocated for SMEs and the self-employed, EUR 2.5 billion for SMEs in the tourism industry, and EUR 500 million for the automotive industry, with the remaining funding open to all firms.

Creating New Credit Guarantee Schemes

The total number of credit guarantee schemes has grown since the start of the pandemic. The growth can be attributed to countries without such programs announcing the creation of a new scheme and to countries that had schemes but created new, supplementary schemes with different eligibility or a higher coverage ratio.

Eligibility

Switzerland's initial 100% [guarantee scheme for SMEs](#), the "COVID-19 credit" program, served as a model for other countries. However, many startups were ineligible for aid, so the Swiss [government created](#) the "Guarantee Scheme for Startups." The new scheme leveraged the existing process and infrastructure from the initial program, but the terms of the startup scheme are different. The federal government provides 65% of the guarantee while 35% is provided by the canton to jointly guarantee 100% of the loan up to CHF 1 million (USD 1.1 million). The scheme will guarantee up to CHF 154 million total, whereas the COVID-19 credit program can guarantee up to CHF 40 billion (approximately 5.8% of 2019 GDP).

Similarly in South Korea, the government recently [announced](#) a smaller, more targeted credit guarantee scheme, the “Win-Win Special Guarantee to Support Auto Parts Industry.” This new, 420 billion won (USD 348 million or 0.02% of 2018 GDP) credit guarantee scheme specifically targets SMEs in the automotive industry. The scheme is partially funded by the government, which is investing 29.5 billion won, while large automotive companies, such as Hyundai and GM Korea, are together contributing 24 billion won. Beneficiaries are determined based on performance, technological capabilities, and supplier availability, rather than credit rating. The scheme is administered by the national Technology Guarantee Fund.

Coverage Ratio

Other countries have announced new credit guarantee schemes with more favorable terms than their initial schemes. For example, Germany, Italy, and the UK all announced 100% credit guarantee schemes, after initially launching credit guarantee schemes with lower coverage ratios. The creation of new schemes, rather than the modification of an existing scheme, could be due to multiple factors such as the complexity of updating guarantees already made, new eligibility criteria, streamlined application processes, or different infrastructure. Brazil announced a 100% credit guarantee scheme, the [Operations Guarantee Fund](#), on June 10 to guarantee loans for microenterprises and SMEs. Eligible companies must make a commitment to preserve the number of employees at least 2 months after it receives the last instalment.

Demand and Utilization Across Countries

Demand for and utilization of loan guarantees have varied across countries. With many countries increasing funding for guarantee schemes, demand from eligible firms appears to be high. For example, Switzerland doubled the funding for the “COVID-19 credit” program from CHF 20 billion to CHF 40 billion. Despite the increase in funding, the total value of loans guaranteed as of June 18 was CHF 15.2 billion. Of this, CHF 13.3 billion was lent under a 100% guarantee on a loan of less than CHF 500,000. Switzerland’s program also allows for guarantees on loans greater than CHF 500,000, but the government only guarantees 85% of the value while the bank retains the remaining 15% risk.

Media reports indicate that Spain is [considering](#) a EUR 50 billion increase to its [current](#) EUR 100 billion credit guarantee program (approximately 8% of 2019 GDP). As described above, the Instituto de Credito Oficial (ICO) designed the program to release the money in five tranches. The SME loans carry an 80% guarantee and the larger corporation loans carry a 70% guarantee. As of [June 17](#), the ICO had released all five tranches and had made EUR 84.5 billion in guaranteed loans, EUR 60 billion of which had gone to the self-employed and SMEs.

On March 17, the Italian government announced a EUR 100 billion credit guarantee program. It was exhausted within a few weeks and the European Commission [approved](#) a significant increase of EUR 400 billion in the second week of April. However, media reports [indicate](#) that a [small](#) portion of the EUR 400 billion has actually been lent to SMEs. The reports point to bureaucratic infighting, low staff levels at the responsible agencies due to the pandemic, and

concerns by banks about receiving timely reimbursements as causes for the low utilization of the new credit guarantee funds.

The United Kingdom releases [weekly data](#) regarding the utilization of its credit guarantee schemes. Under the Coronavirus Business Interruption Loan Scheme (CBILS), which provides an 80% guarantee, the government has supported 50,482 small businesses with GBP 10.5 billion (USD 13 billion) as of June 21. The [Bounce Back Loans Scheme](#) (BBLs) provides a 100% guarantee on loans up to GBP 50,000. This program was launched on April 27 and has guaranteed 921,229 loans worth a total of GBP 28 billion. Applications for the BBLs exceed 1 million while applications for the CBILS are less than 100,000. A [recent industry taskforce](#) report includes a projection that one-third of debt under government guarantee schemes will be unsustainable by March 2021. It should be noted that credit guarantee schemes are not without risk to the government, and losses are inevitable, especially given the uncertainty of the duration of the COVID-19 crisis. Credit guarantee schemes and other government-supported lending programs that do not have borrowers that default are likely too narrow. Guarantees are intended to encourage lending to borrowers that are higher-risk, and even during normal economic conditions, borrowers can and will default.

To date in France, approximately one third of the [EUR 300 billion \(USD 336 billion or 10.7% of 2018 GDP\) in guarantees](#) for companies of all sizes have been used. Most of the guaranteed loans have been made to firms with less than 250 employees and less than EUR 50 million in revenue. It is likely that more firms will benefit from the facility as the crisis continues. Bpifrance, which administers the guarantee, [has recommended](#) that firms do not borrow the total entitled amount at once.

Utilization of credit guarantees varies across countries and depends on multiple factors. Utilization is one measure of the success of a credit guarantee scheme, but other measures, such as the increase in lending to borrowers that were unable to access market finance, the default rate, and others should also be used to evaluate if the credit guarantee scheme met the objective of ensuring SMEs had access to finance. Credit guarantee schemes are dependent on broader macroeconomic conditions as well, and if the economy enters another decline or if the recovery is prolonged, governments will face higher losses due to defaults.

Governments Support Businesses through Equity Investments

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

In response to the economic shutdown caused by COVID-19, many countries have announced plans to take equity stakes in private businesses. Germany and Poland have announced large-scale programs focused on relatively large companies that the government determines are systemically important. Other countries, like the U.S., have announced equity programs that target critical industries, which we cover in a separate survey. Several countries -- including the U.K., France, and Germany -- have also announced much smaller programs dedicating small sums to startups or small and medium-sized enterprises, as part of broader efforts to support small businesses.

In this post we outline some of the key design features of equity-support programs.

- Purpose of the Program
- Capital Characteristics
- Eligibility
- Use of Private Investors
- Existing Program or New
- Size
- Funding
- Individual Participation Limits
- Other Considerations

Purpose of the Program

All of the programs evaluated are designed to support companies facing difficulties due to the COVID-19 pandemic, though different programs target different types of companies. In Germany, the government can recapitalize large nonfinancial companies that are considered critical to the economy through the Economic Stabilization Fund. The government modelled the fund on the Financial Market Stabilization Fund that Germany created in 2008 to support financial companies during the global financial crisis of 2007-09 (see the YPFS case study [here](#)). The [Polish Financial Shield](#) includes measures to recapitalize or lend directly to large companies, while [smaller companies](#) are eligible for forgivable loans.

Other programs are designed to support smaller companies, specifically startups or innovative firms. The UK and France have such programs, and Germany also has a EUR 2 billion program to support startups.

Capital Characteristics

The type of capital provided through an equity program varies across countries. The UK, Belgium, and France provide support through convertible loans. The [UK's Future Fund](#) scheme issues convertible loans with a value between GBP 125,000 and 5 million. The loans automatically convert to equity at a minimum conversion discount of 20% to the price of the next qualifying funding round, which is the discount rate. To qualify, the amount of equity capital raised must be at least the size of the convertible loan. [At maturity](#), the loans must either be repaid or convert into equity at a discount of at least 20% to the price in the most recent funding round. In the case of a sale or initial public offering (IPO), the loan either converts to equity at the discount rate or is repaid at a premium of 100% of the principal. Only the principal will convert at the discount rate, while the accrued interest will convert without the discount rate. Loans convert into the most senior class of shares in the company.

In Germany, the [Economic Stabilization Fund](#) can acquire subordinated debt, hybrid bonds, profit participation rights, silent participations, or convertible bonds. Poland's [Capital Shield for Large Companies](#) allows the Polish Fund for the Development of Capital Instruments to provide support [through](#) shares, subscription warrants, bonds, or convertible loans.

In Mauritius, the State Investment Corporation launched the [Equity Participation Scheme](#), which provides financing through redeemable preference shares. Redeemable preference shares receive a fixed dividend distribution and the repayment period is predetermined.

The EU's ESCALAR Program provides investments into venture capital funds, thus providing funding for equity indirectly, as the investment does not go directly to companies. New Zealand relaxed its rules to allow companies to raise more new capital without shareholder approval, thus enabling companies to more easily access financing.

Eligibility

In order to channel the funding to the targeted companies or sectors, governments establish eligibility criteria, often based on size, revenue, or previous capital raises.

In the UK, the Future Fund scheme is available to unlisted, registered UK companies that have previously raised at least GBP 250,000 in equity (USD 310,000). In Poland, the equity program is available to companies with at least 250 employees and PLN 50 million in turnover or at least 150 employees and PLN 100 million in turnover. Companies could not be in arrears as of December 31, 2019 and must have had a 25% decline in business due to COVID-19.

In [Germany](#), recapitalization under the Economic Stabilization Fund is available to companies that meet at least two of the following size requirements:

- At least EUR 43 million in total assets
- At least EUR 50 million in turnover
- More than 249 employees on average

Germany allows exceptions for smaller companies if they are determined to be critical infrastructure or essential to economic or national security. In addition, companies with a valuation of at least EUR 50 million since January 1, 2017, can be recapitalized through the Economic Stabilization Fund. Germany also has a EUR 2 billion package to support smaller startup companies through equity investments.

In [Mauritius](#), the State Investment Corporation's program is available to companies with annual turnover of at least Rs 250 million (USD 6.3 million). A separate Equity Financing Program through the SME Equity Fund is available to companies with annual turnover of less than Rs 250 million.

Use of Private Investors

How the government partners with private investors is another consideration. Some programs do not require private financing; in other programs, the government will provide up to a certain percent of the support.

In Germany, support through the Economic Stabilization Fund is available to companies that cannot access other financing; thus, there is no required private investor match. However, support to startups through the EUR 2 billion package allows public venture capital funds to provide up to 70% of the financing while private investors take at least 30%. In both the UK and France, the government will match investments from third-party investors one-to-one.

Existing Program or New

In many cases, government equity programs utilize existing programs or infrastructure. In Germany, public venture capital firms and the investment arm of the national development bank, KfW Capital, can provide financing through the support package for startups. Other countries, including Angola, Denmark, Mauritius, France, and Belgium, utilize existing public investment companies or funds. The EU's ESCALAR program, a new program in its pilot phase, partners with existing funds and new funds that focus on financing startups. In the UK, the newly established Future Fund will be delivered in partnership with the British Business Bank, the state-owned development bank.

Size

In most countries, the equity-support programs represent a very small portion of the government's economic support to businesses.

In Germany, the government allocated EUR 600 billion in funding for the Economic Stabilization Fund, of which EUR 100 billion is earmarked for recapitalization purposes. The

government also allocated [EUR 2 billion](#) in funding for startups. Other countries have allocated much less to equity programs. The UK's Future Fund has GBP 250 million in funding, less than 0.1% of the more than [GBP 330 billion](#) the government provided in credit guarantees and other support. France has made EUR 80 million in funding for equity available through the public investment bank, Bpifrance, out of more than [EUR 110 billion](#).

Funding

Most governments we reviewed did not specify a unique funding source for these equity programs, but rather structured the programs to pull from the general fiscal budget. However, the Solomon Islands [issued](#) a special COVID-19 Domestic Development Bond for SBD 120 million (USD 14.5 million), from which the funds for its equity program were to be pulled.

Individual Participation Limits

In the [UK](#), the government has defined the limits of the equity investments at between GBP 125,000 and GBP 5 million. Similarly, [France](#) set the limits at between EUR 100,000 and EUR 5 million. In both of these countries the actual size of the government's investment is determined by the amount of funds invested from private investors. In [Mauritius](#), the government will invest an amount that will keep the government's ownership at 49% or below the business's total equity capital.

Other Considerations

Details from the [UK's](#) Future Fund program provide insight into two additional design features of equity-support programs.

Restrictions on use of funds

Businesses that receive equity investments under the Futures Fund cannot use the money to “pay off previous debts or make dividends or bonus payments to staff, management, shareholders, or consultants.” The funds cannot be used to repay existing debt.

Government voting rights

The government indicated that it would have “limited corporate governance rights during the term of the loan and as a shareholder after conversion.”

78% of US Small Businesses Negatively Impacted by the COVID-19 Pandemic

By Mallory Dreyer

Original post [here](#).

On August 20, the U.S. Census released updated data for its [Small Business Pulse Survey](#). This release marks the beginning of the second phase of the survey and covers the week between August 9 and 15.

The first phase of the survey launched at the end of April and lasted nine weeks, covering the period between April 26 and June 27. After pausing the survey, the Census launched the second phase on August 9 and will continue to release new weekly Phase 2 data in the coming weeks. The survey seeks to determine the impact of the COVID-19 pandemic on small businesses in the U.S. and their participation in federal relief programs. It covers nonfarm, single-location businesses with between 1 and 499 employees and receipts of \$1,000 or more in all 50 states, the District of Columbia, and Puerto Rico.

Nationally, 78.7% of surveyed small businesses responded that the COVID-19 pandemic has had a negative impact on their business. 34.2% of businesses responded that impact has been large while 44.5% of businesses responded that the impact has been moderate. The remaining businesses responded that the pandemic either had little or no effect, a moderate positive effect, or a large positive effect. Based on the [questionnaire](#), it appears that each business is open to interpret the difference between a large and moderate impact, as there is no specific threshold or measure to differentiate between large and moderate.

During the week of August 9 to 15, 6.7% of firms reported increasing the number of paid employees while 10.9% of firms decreased the number of paid employees. 5.7% rehired employees that had been furloughed while 38.9% did not rehire furloughed or laid off employees.

The Census also surveyed businesses on their future needs. Over the next 6 months, businesses reported the following:

In the next 6 months, the business will need to:	% of Survey Respondents
Obtain financial assistance or additional capital	26.8%
Identify new supply chain options	14.1%
Develop online sales or websites	13.9%

Increase marketing or sales	32.8%
Learn how to better provide for the safety of customers and employees	19.3%
Identify and hire new employees	23.4%
Permanently close the business	5.5%
None of the above	32.7%

With the Paycheck Protection Program (PPP) closed as of August 8, the 26.8% of firms that expect to need additional financial support will likely watch the government closely to understand what additional financial support may become available.

The survey also provides a picture of how the pandemic has had a disproportionate impact on firms in certain industries and sectors. For example, 47.3% of surveyed businesses in the accommodation and food services industry reported that they would need to obtain financial assistance or increase capital, compared to the national average of 26.8%. 12.2% reported that they may need to permanently close in the next 6 months, compared to the national average of 5.5%. Accommodation and food services firms are more likely to report missing a loan payment since March 13, with 10.1% reporting compared to the national average of 3.5%.

The Census was not collecting survey responses when the PPP closed, nor was it collecting responses when the Federal Reserve’s Main Street Lending Program (MSLP) became [fully operational](#). As of [August 13](#), the MSLP had \$226 million in loan participations, but the program has been criticized for its [slower start](#).

In addition to the recent data from the Census, Facebook, the World Bank, and the OECD released the Wave II survey report for their [Global State of Small Business Survey](#). Wave II responses were collected between June 24 and 30 and covered over 25,000 businesses across 50 countries. The updated report focuses on small businesses’ access to finance. The survey finds that fewer small businesses globally received financial assistance during Wave II, which could be due decreased need for financial support as businesses reopen or because financial assistance may no longer be available. However, the report notes that policies related to increasing access to finance and covering expenses continue to be the most-needed policies cited by small businesses.

Both the Census survey and the Facebook survey seek to provide near real-time information about how the COVID-19 pandemic is impacting small businesses in order to better inform policy making and support programs. The Census Small Business Pulse Survey will be updated weekly and Facebook, the World Bank, and the OECD will publish monthly reports.

Case Studies and Policy Changes

MicroFinance Ireland: Targeted Lending for Microenterprises Impacted by COVID-19

By Mallory Dreyer

Original post [here](#).

Ireland is expanding an existing direct lending program to help small businesses deal with declining revenues during the coronavirus crisis.

The coronavirus pandemic is projected to have a large and detrimental impact on small and medium-sized enterprises (SMEs). Many countries have established government credit guarantee programs to ensure that SMEs can access liquidity. Some countries, like Ireland, have programs for direct government lending to SMEs in addition to or in lieu of guarantees.

[MicroFinance Ireland](#) was established in 2012 by the [Microenterprise Loan Fund Act](#). Its lending activities are limited to microenterprises with no more than 10 employees and less than €2 million in revenue that do not meet the risk criteria of private banks. Applicants are [required](#) to prove that they have been refused financing by a bank before their applications are considered. Thus, the fund was designed so that it does not replace traditional bank lending.

In response to Covid-19, MicroFinance Ireland has launched an [emergency lending program](#). Microenterprises must demonstrate that they are facing a negative impact on their business from the coronavirus pandemic, with a minimum expected impact of 15% in lost profits or revenue. Applicants submit financial projections in a template showing expected monthly cashflows for six months.

The lending limit for loans under the emergency program is €50,000, an increase from the normal €25,000, with a maximum three-year term limit. Microenterprises that apply directly to MicroFinance Ireland will be charged a 7.8% interest rate while those that apply to a local enterprise office will be charged a 6.8% interest rate. A key feature of the loans is that for the first six months they will be interest-free and have a payment moratorium, which is designed to address [cash flow uncertainty](#) due to the coronavirus pandemic.

Because MicroFinance Ireland has been operational since 2012, it is already equipped to offer emergency lending to microenterprises impacted by Covid-19. The program could serve as a crisis-response model for other countries with institutions similar to MicroFinance Ireland, although it could be difficult for countries without similar institutions to replicate given the need for an urgent response.

Direct Lending to SMEs - Canada's Business Credit Availability Program

By Priya Sankar

Original post [here](#).

Canada has reintroduced a program from the Global Financial Crisis of 2007-09 to provide government loans directly to small businesses to help them deal with the economic consequences of the COVID-19 pandemic.

Countries across the world are adopting measures to support small and medium-sized enterprises (SMEs) during the COVID-19 crisis. They often use credit guarantees to facilitate lending to SMEs by guaranteeing their bank loans. This post discusses a less common tool, direct governmental lending to SMEs, illustrated by Canada's programs both during the Global Financial Crisis, and today.

Direct Lending to SMEs

Some countries have implemented programs for direct lending to SMEs in both the Global Financial Crisis and the COVID-19 crisis, though it remains a less common tool, and one often paired with credit guarantees for SMEs. Often these direct loans are made through a bureaucratic agency focusing on small businesses or a government bank focused on development of specific industries. Several countries have created loan programs for SMEs funding innovation or new technology. A partial list of countries adopting these interventions during the Global Financial Crisis can be found on page 20 of the OECD report found [here](#).

Canada's COVID-19 SME Lending Program

On [March 13, 2020](#), the Canadian government re-established the Business Credit Availability Program (BCAP), allowing the Business Development Bank of Canada (BDC) and Export Development Canada (EDC) to provide CAD 10 billion to businesses. As of [March 16, 2020](#), the BDC will now offer small business loans of up to CAD 100,000 that can be obtained in as little as 48 hours from the time of approval. It will also offer flexible working capital loans of up to CAD 2 million, with potential payment postponements for six months, to bridge cash flow gaps and support daily operations. The BDC will also provide purchase order financing to increase flexibility in fulfilling domestic or international orders.

SMEs seeking to access the BCAP will first contact their financial institutions. The financial institutions will then assess SMEs with liquidity needs beyond what the private sector can meet, and refer them to the BDC or EDC. Thus, although Canada will be engaged in direct lending to SMEs, it will do so in consultation with those SMEs' existing financial institutions. The BDC and EDC are [paying particular attention](#) to sectors that are heavily impacted by the crisis, like oil

and gas, and tourism. Farm Credit Canada is also increasing short-term credit available to farmers and the agri-food industry.

Canada's GFC SME Lending Program

Prior to the Global Financial Crisis, the BDC, EDC, and the Canada Small Business Financing Program provided direct loans and guaranteed loans to SMEs.

The BCAP was first established in response to the GFC. It allowed the BDC and EDC to work with private lenders to finance viable businesses. It [disbursed](#) over CAD 10.1 billion in 2009 and 2010, of which CAD 3.44 billion went to SMEs with under CAD 25 million in annual revenue. The BCAP's Economic Recovery Loans Initiative, established in early 2010, made small working capital loans of up to CAD 100,000, and constituted much of BCAP's 2010 activity, despite expiring in October of that year.

[Feedback](#) on the BCAP's countercyclical activity during the GFC was positive. The Conference Board of Canada commended the BDC and EDC on their role in providing credit support during a crisis, and credited them with speeding up the healing of the Canadian financial system.

Federal Reserve Announces Main Street Lending Program

By Mallory Dreyer

Original post [here](#).

On April 9, the Federal Reserve announced the details of its new [Main Street Lending Program](#) to purchase up to \$600 billion in small business loans.

The program consists of the [Main Street New Loan Facility](#) (MSNLF) and the [Main Street Expanded Loan Facility](#) (MSELF). The Fed established the facilities under its emergency lending authority under [Section 13\(3\) of the Federal Reserve Act](#) and [approved by the Treasury Secretary](#). In support of these facilities, the Treasury will make a \$75 billion equity investment in a special purpose vehicle (SPV) using funds appropriated to the Exchange Stabilization Fund under the [CARES Act](#). The Fed will in turn provide recourse loans to the SPV. The SPV will purchase a 95% participation in eligible loans while lenders retain the remaining 5%. The SPV will purchase up to \$600 billion in loans.

Eligible lenders include United States insured depository institutions, bank holding companies, and saving and loan holding companies. Lenders may originate new loans (MSNLF) or expand the size of existing loans to eligible businesses (MSELF). Both facilities have a minimum loan size of \$1 million.

Under the MSNLF, the maximum size is the lesser of either \$25 million or the amount that does not bring the borrower's total existing debt to four times its 2019 EBITDA (EBITDA measures a company's earnings before interest, tax, depreciation, and amortization). Under the MSELF, the maximum loan size is equal to the lesser of \$150 million, 30% of the borrower's existing outstanding and committed but undrawn debt, or the amount that does not bring the borrower's total existing debt to six times its 2019 EBITDA.

Lenders can set loan interest rates at the Secured Overnight Financing Rate (SOFR) plus 250-400 basis points. Loans will have a maturity of four years. Principal and interest payments can be deferred for one year. Loans purchased pursuant to the MSNLF must be unsecured, while those purchased under the MSELF may be collateralized.

Businesses with up to 10,000 employees or up to \$2.5 billion of revenue in 2019 are eligible for loans under the program. Eligible businesses must be organized in the United States with significant operations and a majority of their employees in the country. Businesses eligible to receive forgivable loans under the Paycheck Protection Program through the Small Business Administration (SBA) can also participate. A borrower cannot participate in both the program and the Primary Market Corporate Credit Facility (PMCCF). Borrowers also cannot utilize both the MSNLF and the MSELF.

Eligible borrowers must commit to making "reasonable efforts" to maintain payroll and retain employees over the life of the loan. Borrowers must follow compensation, stock repurchase, and

dividend restrictions set forth in the [CARES Act](#) for direct loan programs. Businesses with conflicts of interest, as defined in Section 4019(b) of the CARES Act, cannot participate. Borrowing under the program cannot be used to pay off existing debt, including pre-existing portions of eligible loans that are extended under the MSELF.

The Federal Reserve defines fees for participating in the facility, as well as origination and servicing. Under the MSNLF, eligible lenders will pay the SPV a facility fee of 100 basis points of the principal amount of the loan participation purchased by the SPV, though the lender can require the borrower to pay. Borrowers pay an origination fee of 100 basis points of the principal for loans under the MSNLF. Under the MSELF, borrowers will pay a fee of 100 basis points on the increase in principal under the expanded loan. The SPV will pay lenders 25 basis points of its participation in the principal amount per year for loan servicing under both facilities.

The program is set to purchase loans through September 30, though Chair Jerome Powell, in an [interview](#), said that the end date is tentative and will be extended if necessary, depending on the state of the economy. The Federal Reserve Board of Governors and the Treasury Department will be required to approve a proposed extension.

Federal Reserve Introduces Paycheck Protection Program Liquidity Facility

By Kaleb Nygaard

Original post [here](#).

On April 9, the Federal Reserve released the details of its new [Paycheck Protection Program Liquidity Facility](#) (PPPLF), through which financial institutions can use eligible loans made to small businesses as collateral when borrowing from the Fed. The purpose of the program, authorized under [Section 13\(3\) of the Federal Reserve Act](#), is to facilitate such lending to small businesses.

The [CARES Act](#) rescue package, signed into law in the United States on March 27, includes in Section 1102 the establishment of the Paycheck Protection Program (PPP). The PPP [allocates \\$349 billion](#) of taxpayer funds to guarantee Small Business Administration (SBA) loans made by financial institutions to certain small businesses with up to 500 employees. The Fed had made a brief [announcement](#) on April 6 indicating that it was developing a program to provide term financing backed by PPP loans.

Under the PPP, financial institutions originate loans to eligible businesses. The SBA fully guarantees these loans. By accessing the PPPLF, the financial institutions can now use these PPP loans as collateral for loans at their regional Federal Reserve Bank. Such loans will be made on a non-recourse basis, meaning that the Fed is limited to recovery of collateral in the event loans are unpaid.

The PPPLF is available to all depository institutions that originate PPP loans. Under section 1102 of the CARES Act, a PPP Loan will be assigned a risk weight of zero percent under the risk-based capital rules that apply to depository institutions. The Fed has indicated that it will work to expand eligibility to other PPP lenders in the near future.

The Fed will not apply a haircut to the principal value of the PPP loan, which means it will accept the collateral at face value. The Fed will charge an interest rate of 35 basis points, but there is no participation fee. The maturity of the Fed's loan to the financial institution is set to match the maturity of the financial institution's loan to the small business, subject to acceleration in the event the underlying PPP loan defaults or is forgiven under the terms of the PPP.

The Fed announced that it will not extend new credit via the PPPLF after September 30. However, in an [interview](#), Fed Chair Jerome Powell said, "we will be in no hurry to pull back...on these programs. They are tentatively scheduled to stop lending on September 30. If they have to go longer, then of course they will. We'll be looking to make sure the economy really is on a solid footing before pulling back. And then, as we start pulling back, we will do so very gradually."

Germany Launches New Support Program After Partial Guarantee Insufficient to Promote Lending to Small Businesses

By Mallory Dreyer

Original post [here](#).

On April 6, Germany introduced a fully guaranteed loan program to support small businesses after an earlier partial government guarantee did not achieve its intended results. The [Quick Loan Program](#) will provide fully-guaranteed “instant” loans of up to EUR 800,000 to eligible businesses.

The earlier [KfW 2020 Special Program](#) (KfW-Sonderprogramm 2020), launched on March 23, provides 80% or 90% credit guarantees to companies experiencing financing difficulties due to the COVID-19 pandemic. It is available to companies of all sizes, and features lower interest rates. However, as [Bloomberg reported](#) on April 1, banks were reluctant to take on new risk given the economic circumstances, and private lenders requested full government guarantees on lending.

The new Quick Loan Program (KfW-Schnellkredit 2020) provides SMEs with loans that are fully government guaranteed. KfW, the state-owned development bank, will provide banks with 100% liability waivers backed by the government. Firms are eligible for the loans if they have been active since at least January 1, 2019, were profitable in 2019, and have more than 10 employees. Firms can receive loans for up to three months of 2019 revenue. Loans are capped at EUR 800,000 for firms with 50 or more employees and EUR 500,000 for those with between 10 and 50 employees. Loans will carry 3% interest for terms of 10 years and include two years of payment deferral. In order to expedite approval, applications will be approved without risk assessment by banks or by KfW. Applications will be available starting [April 15](#).

The European Commission (EC) [approved the program](#) on April 11, as it aligns with the EU’s amended Temporary Framework for state aid. The amended framework allows Member States to provide zero-interest loans or guarantees on loans covering 100% of the risk for loans up to EUR 800,000 per company.

Support to SMEs in Germany in response to the COVID-19 crisis is not limited to the Quick Loan Program and the new KfW 2020 Special Program. Small and mid-sized businesses, the Mittelstand, make up 99.5% of firms, generate 35% of total revenue, and employ approximately 60% of workers in Germany. Thus, according to the Economic Affairs Minister, Peter Altmaier, the government is working to “safeguard this unique, broad-based cornerstone of [the] economy.”

On March 23, Germany [announced a EUR 50 billion package](#), the Immediate Assistance Program, to provide direct cash assistance to small firms, including self-employed individuals and freelancers. The program provides taxable grants, not loans, to small businesses in all sectors

of the economy with up to 10 employees. One-time payments of up to EUR 9,000, to cover a period of three months, are available to firms with up to 5 employees while firms with up to 10 employees can receive one-time payments of up to EUR 15,000. [Firms must be facing](#) financial distress due to the COVID-19 pandemic and declare in the application that their business is at risk of collapse or experiencing liquidity shortages. The program is financed by the federal government, but the state (Länder) level handles the granting of aid. On [March 29](#), the German Länder and the federal government announced that an agreement was reached to begin implementing the program. The [program processed approximately](#) 140,000 applications in a handful of days and has paid out approximately EUR 1.3 billion. Some firms received the money within 24 hours.

Two additional measures to provide support to SMEs include expanded export-credit insurance guarantees and a package to provide venture capital financing to startups. On [March 30](#), the government announced an expanded scope for export-credit guarantees. This allows the federal government to issue export guarantees for transactions with short-term payment obligations within EU and OECD countries. Germany announced a [EUR 2 billion package](#) on April 1 to support venture capital financing for startups, technology companies and small businesses during the Covid-19 crisis.

Federal Reserve Waives Restriction on Wells Fargo to Allow Lending to Small Businesses

By Kaleb Nygaard

Original post [here](#).

On April 8, the Federal Reserve temporarily [waived](#) a growth restriction on Wells Fargo & Co. so that it can provide additional lending to small businesses.

The growth restriction is part of an enforcement action that the Fed originally issued on February 2, 2018. It [forbids](#) Wells Fargo from expanding its balance sheet. It also removed a third of the company's board of directors.

The enforcement action outlined widespread consumer abuses, [including](#) opening millions of unauthorized customer accounts, forcing people to buy unnecessary auto insurance, and overcharging members of the military for their mortgages. The enforcement action is still in effect and will be “until [Wells Fargo] sufficiently improves its governance and controls.”

Wells Fargo, the nation's fourth-largest bank holding company by assets, [announced](#) on April 5 that it had committed \$10 billion to lend under the [Paycheck Protection Program](#) (PPP). It said this amount was the upper limit of what it believed it could lend without exceeding the growth restriction. [Some have argued](#) that Wells Fargo could have reduced lending in other areas to make funds available to issue additional PPP loans.

Congress created the PPP in the [CARES Act](#) to provide small businesses with access to inexpensive, fully-guaranteed, forgivable loans to help replace cash flow and pay expenses during this period of social-distancing-caused closures. Section 1102 of the CARES Act allocates \$349 billion to the program. For comparison, on April 7, Bank of America [indicated](#) that it had received applications for \$40 billion in PPP loans.

The Fed's April 8 announcement stated that the waiver will be narrow. Loans issued under the PPP or the [Main Street Lending Program](#) (another support program that is available to a wider range of businesses) will not count against the growth cap. The Fed also [required](#) that economic benefits from the PPP and the Main Street Lending Program be transferred “to the U.S. Treasury or to non-profit organizations approved by the Federal Reserve that support small businesses.” These benefits include processing fees that other banks are allowed to keep as part of the loan origination process under these emergency lending programs.

Shortly after the waiver was issued, Wells Fargo [committed](#) to expanding its participation in the PPP. However, [media reports](#) have indicated that it has not been able to process the large quantity of applications. The company sent a letter to small business customers who had applied but had not yet received funds indicating that they may want to apply elsewhere.

The waiver will last for the duration of the PPP and Main Street Lending Program.

Italy Expands and Updates its Credit Guarantee Programs

By Kaleb Nygaard

Original Program and its Expansion

Amount of total committed funds

On March 17, the Italian government set aside EUR 100 billion for loan guarantees. This amount proved insufficient to meet the demand, so in two communications on [April 9](#) and [April 10](#), the EC approved an increase in the amount of funds available for the guarantees of EUR 400 billion. It indicated that the guarantees would be [administered](#) by two groups within the state lender Cassa Depositi e Prestiti. The state SME-guarantee-fund Fondo di garanzia per le PMI would administer 60%, targeting domestic companies, and the state export agency Servizi Assicurativi del Commercio Estero (SACE) would administer the remaining 40%, targeting companies working in international markets.

Guarantee structure and credit analysis

In both the initial allotment as well as the addition, the government [created](#) a tiered system of guarantee ratios based on company size. This complex structure (outlined below) [allows](#) the government to more narrowly target the support, but some market participants say it has also [increased](#) the loan origination time and burden for the banks.

- 100% for loans up to EUR 25,000
- 90% for companies with less than 5,000 employees and turnover less than EUR 1.5 billion
- 80% for companies with more than 5,000 employees and between EUR 1.5 billion and EUR 5 billion in turnover
- 70% for companies with turnover of more than EUR 5 billion

The cost of the guarantee also changes based on the size of the company, reaching as high as 2% for larger companies.

Although state agencies administer the guarantees, the banking system ultimately is responsible for making lending decisions for new and refinanced loans. Since a large portion of the loans are not 100% guaranteed, banks take on a portion of the credit risk and therefore conduct extensive due diligence reviews before issuing the loans.

New Program for Small Businesses

Although the programs outlined above are open to companies of all sizes, on April 14, the EC [approved](#) an additional, much more generous, Italian credit guarantee program specifically targeting the self employed and small businesses with up to 500 employees. This program

includes grants in the form of waivers on the guaranteed loan application fees. For loans up to EUR 800,000 the program guarantees 100%, for loans larger than this amount the program guarantees 90%. The program's EUR 800,000 threshold for a full guarantee is significantly higher than the previous EUR 25,000. Italy now has three major guarantee programs: (1) for entrepreneurs and small businesses, (2) for medium and large businesses in domestic markets, (3) for medium and large businesses in international markets.

Usefulness of Loans

[Many businesses](#) simply cannot afford to take on debt, even inexpensive debt. For them, revenue lost during the economic shutdown may never be recovered and new revenue generated after the economy is reopened may not be enough to cover regular expenses and additional debt repayments. One Italian restaurant owner's [open letter](#) to the prime minister explaining this dilemma has received a lot of attention. Other countries provide direct cash grants to small businesses instead of or in conjunction with credit guarantees

UK Expands Support for Small Businesses After Limited Impact of Initial Program

By Mallory Dreyer

Original post [here](#).

The UK is no longer requiring would-be borrowers in its crisis-lending program to confirm that they tried and failed to find funding from a commercial bank. This requirement slowed loan approvals during the first two weeks of the program.

On [April 3](#), the United Kingdom announced updates to the Coronavirus Business Interruption Loan Scheme (CBILS) for small and medium-sized enterprises (SMEs) after the initial program failed to provide widespread liquidity support. On the date of the announced updates, over 130,000 inquiries had been submitted, but only 983 loans had been granted. The updated scheme became operational on April 6.

The amendment opens the scheme to more borrowers. Initially, the program was limited to small businesses that were unable to receive standard commercial financing. The guarantee was designed to incentivize lenders to provide financing to these small businesses. As originally designed, firms that met a lender's requirements to receive standard commercial financing were unable to participate in CBILS, but the government eliminated this requirement as part of the update, expanding the number of borrowers who can benefit. This appears to alleviate some of the administrative burden on lenders, as [banks considered](#) the process of determining eligibility to be difficult.

[UK based firms](#) with annual turnover less than GBP 45 million are eligible for CBILS. The program excludes banks, insurers and reinsurers, public sector bodies, grant-funded educational institutions, and state-funded primary and secondary schools. Firms must certify that they have been adversely impacted by COVID-19 and have a borrowing proposal that the lender would consider viable during normal times.

The British Business Bank (BBB), a government-owned business development bank, operates CBILS through more than 40 accredited lenders. These include traditional banks, but also asset-based lenders, challenger banks (small, recently-created banks competing with longer-established institutions), and smaller specialist local lenders. On [April 11](#), the BBB announced the addition of four new lenders under the program. It will continue to review applications to accredit more lenders under CBILS.

CBILS provides 80% guarantees on credit facilities up to GBP 5 million. Lending can be in the [form of term loans](#), overdrafts, invoice finance, and asset finance. Loans can have terms of up to 6 years.

The government made other changes. First, the amendment prohibits lenders from taking personal guarantees on loans less than GBP 250,000. For loans greater than GBP 250,000, personal guarantees are permitted based on the lender's discretion but are capped at a maximum of 20% of the facility after applying the proceeds of the business assets. Principal private residences cannot be taken as security for the facility. Second, lenders are to [retroactively apply](#) the updates to firms that received CBILS facilities prior to April 6. The government also requested that lenders bring non-CBILS facilities offered since March 23 onto CBILS when possible.

The government will make a Business Interruption Payment to cover the first 12 months of interest payments and any lender fees. However, this does not include principal repayments. In addition, the Treasury has [not capped the interest](#) that banks can charge. For some SMEs, specifically those that have been forced to temporarily close, a loan increases the debt burden at a time when no revenue is collected.

By April 15, [more than GBP 1.1 billion](#) was lent to approximately 6,000 small businesses under CBILS. UK Finance reported that state backed lending to SMEs had risen by GBP 700 million (150% increase) and loan approvals doubled in the week leading up to April 15.

Despite the updates and increase in lending, some remain [concerned](#) that the scale and speed of the rollout are not sufficient, given delays, administrative complexity, and demand for liquidity.

In addition to updating CBILS, the government announced the creation of a new credit guarantee scheme for larger businesses, the [Coronavirus Large Business Interruption Loan Scheme](#) (CLBILS) on April 3. Under CLBILS, the government provides an 80% guarantee to banks for lending to firms with an annual turnover between GBP 45 million and 500 million. Loans will be capped at [GBP 25 million](#) and offered at commercial interest rates. However, this program remains limited to borrowers that are unable to secure regular commercial financing. The Treasury [announced](#) that the program will begin lending on April 20.

In addition to credit guarantee schemes, the Bank of England (BOE) announced on [April 6](#) that the Term Funding Scheme with additional incentives for Small and Medium-sized Enterprises (TFSME) would begin operations on April 15, which is earlier than anticipated. As of the BOE's April 15 [Weekly Report](#), no lending under the facility had been recorded on the bank's balance sheet. The TFSME allows eligible banks and building societies to access four-year funding at rates very close to the bank rate to incentivize credit provision to businesses and households. For more information on the TFSME, see [Central Banks Launch Funding for Lending Programs](#).

Switzerland Programs Serve as Model for Quick Support to Small Businesses

By Mallory Dreyer

Original post [here](#).

In response to the COVID-19 crisis, the Swiss government quickly established a program to provide small businesses with rapid access to funds. Some [countries, including Italy, are looking](#) to Switzerland as a model for how to provide immediate relief to small businesses.

The [Federal Council of Switzerland](#) approved an emergency package to provide support to small and medium-sized enterprises (SMEs) on March 25, and the program became operational on March 26. The package provides SMEs with fast access to guaranteed loans to bridge liquidity shortages caused by the COVID-19 pandemic. The application process is streamlined, as the government provides a standardized loan application [online](#), which firms submit to their bank, and requires minimal documentation. Loans of up to CHF 500,000 carry a 100% government guarantee, and lenders are not required to perform credit risk assessments for these smaller loans. Borrowers must attest that turnover has been impacted by the COVID-19 pandemic, unlike other [countries](#) which require a level of expected or actual losses.

Between [March 26 and April 2](#), 76,034 credit agreements worth an estimated CHF 14.3 billion (\$14.8 billion) were approved under the program. Based on the total amount of aid and the number of agreements, it appears that smaller loans are more common. Given the high demand, the Federal Council approved increasing the funding for guarantees from CHF 20 billion to CHF 40 billion on April 3.

Loans are limited to 10% of annual turnover and capped at CHF 20 million. Loans have a 5 year term but can be repaid as soon as the firm returns to profitability. Loans that are less than CHF 500,000 carry zero interest and are fully guaranteed by the government while loans that exceed CHF 500,000 have an 85% government guarantee. These larger loans require more rigorous credit assessments, and the interest rate is currently set at 0.5%. Firms with more than CHF 500 million in turnover are not eligible.

Implementation of the program appears to align with the government's objectives of minimum bureaucracy and rapid access to liquidity. The [Financial Times reports](#) that the Swiss “were able to roll out the scheme almost overnight” as it leveraged existing infrastructure and bank-client relationships. 121 banks in Switzerland are participating lenders, and the largest, UBS, processed 10,000 applications in the first two days.

The scheme also temporarily allows PostFinance, the banking arm of the country's postal service, to provide eligible SME business clients with access to credit up to CHF 500,000. This ensures broad accessibility of the program for financially constrained SMEs, as many SMEs in

Switzerland do not have bank loans and only have a bank account with PostFinance, which is otherwise banned from providing credit facilities based on [current law](#).

While other countries elected to provide grants or forgivable loans to SMEs, Switzerland opted to provide support through guaranteed loans. The Federal Council believes that the program will aid SMEs during the COVID-19 pandemic without requiring non-repayable advances.

Congress Expands Support to Small Businesses

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On April 23, the U.S. Congress passed [emergency legislation](#) to appropriate an additional \$310 billion for the Paycheck Protection Program (PPP), \$50 billion for Economic Injury Disaster Loans (EIDL), and \$10 billion for EIDL Emergency Advances. Congress created the PPP and EIDL Emergency Advance programs on March 27 in the [CARES Act](#).

The PPP began operating on April 3 and exhausted its initial \$349 billion in funding by April 16. The emergency legislation brings its total funding to \$659 billion. Despite the increased funding, [lenders are calling for more](#) as they anticipate that the new appropriations will be exhausted in a matter of days.

Unlike the [original CARES Act](#), the new legislation earmarks a portion of the funds for smaller financial institutions. It sets aside \$30 billion for depository institutions and credit unions with between \$10 billion and \$50 billion in consolidated assets and \$30 billion for those with less than \$10 billion in consolidated assets. It appears that the \$60 billion for community, small, and mid-sized banks is designed to target smaller businesses that do not have pre-existing relationships with larger commercial lenders.

Under the PPP, lenders extend forgivable loans to small businesses. They may use the funds to cover eight weeks of payroll expenses and other eligible expenses, such as mortgage interest, utilities, and rent. The Treasury has not changed its guidance on the use of the loans. The government will forgive the loan on the condition that a business uses at [least 75% for payroll](#) expenses.

Between April 3 and 16, the [SBA guaranteed](#) approximately one million loans. The overall average loan size was \$206,000. Many small business owners have [complained](#) that lenders prioritized larger borrowers and their existing customers. All but two of the top 15 lenders had average loan sizes greater than the overall program average, and the largest lender by total approved dollars had an average loan size of \$515,000. Still, 74% of the loans made to date were \$150,000 or less.

The EIDL program offers loans of up to \$2 million to small businesses affected by COVID-19. [Payments](#) on the loans are deferred for one year. As of [April 20](#), the SBA had approved nearly 27,000 loan applications worth a total of \$5.6 billion. Media [reports](#) indicate approximately 4 million businesses have applied. The SBA has [stopped](#) accepting new applications and said they were processing the applications already submitted on a first-come, first-served basis. The April 23 bill appropriated an additional \$50 billion to the loan program. The bill also expanded eligibility to agricultural enterprises, which had previously been eligible for PPP but not EIDL funds.

SMEs that apply for EIDLs are also eligible to receive additional support in the form of an [Emergency Advance](#) of up to \$10,000. The initial March 27 law allocated \$10 billion for these advances that effectively serve as grants and do not need to be paid back even if the loan application is not approved. However, if the SME receives a PPP loan, the amount of the loan that is forgiven will [be reduced](#) by the amount of the advance. On April 23, Congress extended the program by \$10 billion. As of [April 20](#), the program had made over 750,000 grants worth a total \$3.3 billion.

The bill also makes an additional \$2.1 billion available for SBA salaries and expenses until September 30, 2021, to be used for COVID-19 related activities. For comparison, the SBA's most recent [budget request](#), issued before the crisis, was for \$819 million.

Germany Provides Public Funding for Recapitalization and Startup Equity

By Mallory Dreyer

Original post [here](#).

In response to the COVID-19 pandemic, Germany has announced two programs that would use public funds to purchase equity in domestic companies. EUR 100 billion is available for recapitalization of companies impacted by COVID-19 and EUR 2 billion is available for startups.

A central component of the German fiscal response is the [Economic Stabilization Fund](#) (Wirtschaftsstabilisierungsfonds or “WSF”), which the Bundesrat (the German federal council) approved on March 27. The WSF has EUR 600 billion in funding, of which EUR 100 billion is earmarked for recapitalization of nonfinancial companies, EUR 400 billion is for loan guarantees, and EUR 100 billion is for direct lending. The new legislation amends a 2008 law that authorized the government to [recapitalize financial institutions](#).

The Federal Ministry of Finance and the Federal Ministry of Economic Affairs and Energy will decide measures for companies that apply for support under the WSF. The agencies will consider the importance of the company in the German economy, the urgency, and the impact on the labor market and competition.

Using the EUR 100 billion earmarked for recapitalization, the WSF can acquire subordinated debt, hybrid bonds, profit participation rights, silent participations or convertible bonds. The WSF can also acquire shares or other components of equity. Recapitalization measures can be implemented until December 31, 2021, and will be based on market terms. The recapitalization measures must ensure that the company is a going concern after the pandemic.

In order to benefit from recapitalization under the WSF, a company must require financial support because of the COVID-19 pandemic and could not be considered in difficulty (per the EU’s definition) as of December 31, 2019. Eligible companies must be unable to access other sources of finance in order to benefit from the WSF funds. Eligible companies must also meet two of the following size requirements:

- At least EUR 43 million in total assets
- At least EUR 50 million in turnover
- More than 249 employees on average

However, exceptions can be made for smaller companies, on the condition that they are important for critical infrastructure or economic and national security. Companies that have been

valued at minimum of EUR 50 million in a financing round since January 1, 2017, can also receive support.

On [April 1](#), Germany announced a EUR 2 billion package to support startups during the COVID-19 pandemic. The [package is designed](#) for companies that are unable to receive assistance from the other government support measures. The package has three elements which will be implemented gradually and will leverage existing programs.

[First](#), a portion of the EUR 2 billion in funding will be available for public venture capital investors. These include KfW Capital, the investment arm of the national development bank; the European Investment Fund (EIF); the High-Tech Startup Fund (High-Tech Gründerfonds); and [Coparion](#), a co-investment fund established by KfW and Federal Ministry for Economic Affairs and Energy. These state-owned venture capital investors can co-invest alongside private investors in financing startups. The public funding cannot exceed 70% of the total co-investment. KfW Capital and the EIF will receive additional public funding in order to take over the stakes of funds that pull out. Also, venture capital financing and equity replacement financing will be facilitated for small businesses and new startups that do not have existing venture capitalist shareholders.

The government will also continue to work on a [EUR 10 billion](#) “future fund” for startups. Additional information about this fund is not yet available.

During non-crisis times, Germany provides various financing instruments to support startups, as they are less likely to secure traditional bank financing. The [Federal Ministry for Economic Affairs and Energy](#) provides grants, equity investment, promotional loans, and guarantees to startups. The German Micro-Mezzanine Fund (Mikromezzaninfonds Deutschland) and the High-tech Startup Fund (High-Tech Gründerfonds) are sources of direct investment, while other programs offer incentives for private investors to provide equity to startups, such as the INVEST Grant for Venture Capital.

ECB Considers Adopting EU Bad Bank

By Mallory Dreyer

Original post [here](#).

On April 19, the [Financial Times reported](#) that the European Central Bank (ECB) had discussed the creation of a bad bank, or asset management company (AMC), for the eurozone with European Commission (EC) leaders.

Bad banks acquire and manage distressed assets, including non-performing loans, from financial institutions in order to remove toxic assets from a lender's balance sheet to allow them to provide new loans. The idea faces opposition within the EC, and the Financial Times reported that the discussions have stopped. However, officials did not rule out future discussions later in the COVID-19 pandemic.

During the Global Financial Crisis, [many governments](#) established bad banks, including some European countries such as Ireland, Spain, and Germany. However, the [Bank Recovery and Resolution Directive](#) (BRRD), adopted in 2014, restricts EU Member States from creating bad banks unless it is part of the official process to resolve a failing bank. In 2017, a European Banking Authority official, who is now chair of the ECB supervisory board, proposed a eurozone bad bank, but it was met with similar resistance by EU officials.

For more information and the working drafts of detailed case studies on previous AMCs, see the [YPFS Resource Library](#).

UK Announces Support to Innovative Firms

By Kaleb Nygaard

Original post [here](#).

On April 20, the United Kingdom (UK) announced a GBP 1.2 billion (\$1.49 billion) [support package](#) for “innovative firms.” The government, in partnership with private investors in some instances, will deploy the money through a new program called the Future Fund and the expansion of an existing program called Innovate UK.

Future Fund

The package allocates GBP 250 million to the [Future Fund](#), a new partnership between Her Majesty’s Treasury and the [British Business Bank](#), a wholly-government-owned development bank. Only unlisted UK businesses that have raised at least GBP 250,000 in aggregate from third-party investors in previous funding rounds in the last five years [may participate](#). The government will partner with third-party investors to issue the convertible loans to eligible businesses. The government’s portion of the loan will consist of between GBP 125,000 and GBP 5 million. The third-party investors will match at least one-to-one the government’s investment. The government will have limited corporate governance rights during the term of the loan and as a shareholder after conversion.

The loans convert at a minimum conversion discount rate of 20% on the next funding round. If the business is sold or goes public, the loan must be repaid at a premium of 100% of the principal or converted to equity at the discount rate, whichever is higher for the lenders. The program forbids businesses from using the money to pay off previous debts or make dividend or bonus payments to staff, management, shareholders, or consultants.

The initial phase of the program is expected to [launch](#) in May and accept applications through September. The government left open the option to extend the timing beyond September and to increase the total allocation.

Innovate UK

The GBP 750 million commitment to the government’s innovation, Innovate UK, will [target](#) support to research and development intensive small and medium size firms through Innovate UK grants and loans.

The announcement indicated that GBP 550 million will be made available to businesses with existing loans or grants with Innovate UK. The program will also provide 1,200 businesses without a current relationship with Innovate UK with up to GBP 175,000 each. Innovate UK expects to deliver the first payments in mid-May. In addition to the newly allocated money, the government will accelerate delivery of GBP 200 million in grants and loans already approved for

2,500 businesses with existing relationships with Innovate UK. Participation in the acceleration of delivery of funds will be optional to the eligible businesses.

Other measures

Before the COVID-19 pandemic, the government had a number of programs designed to support innovative and high growth businesses as part of an [initiative](#) to double overall public investment in research and development from GBP 11 billion to GBP 22 billion by 2025. The programs include the GBP 2.5 billion government venture capital fund [British Patient Capital](#) and other measures from the British Business Bank, like the GBP 600 million [Life Sciences Investment Programme](#).

Federal Reserve Announces Changes to Main Street Lending Program

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [April 30](#), the Federal Reserve Board announced updates to the Main Street Lending Program, after receiving more than 2,200 comments from individuals, businesses, and nonprofits on the initial terms of the program announced on [April 9](#). Major changes include creating a third facility that accepts riskier borrowers, lowering the minimum loan size, lowering the interest rate, and expanding the pool of eligible borrowers.

The Main Street Lending Program is an attempt to encourage lending to small and medium-sized enterprises (SMEs) by having the Fed purchase up to \$600 billion in such loans. Initially, the program consisted of two facilities: the [Main Street New Loan Facility](#) (MSNLF) and the [Main Street Expanded Loan Facility](#) (MSELF).

The newly-announced [Main Street Priority Loan Facility](#) (MSPLF) is for new lending, like the MSNLF; MSELF is for increased lending under existing loans or revolving credit facilities. MSPLF requires that lenders retain 15% of the loan, compared to 5% under MSNLF and MSELF. This higher-risk sharing ratio is for borrowers that may be more highly leveraged, as the maximum loan size under the MSPLF is six times 2019 adjusted EBITDA (earnings before income, tax, depreciation, and amortization) compared to four times 2019 adjusted EBITDA for MSNLF.

The earlier term sheets for the Main Street facilities referred only to EBITDA. The reference to “adjusted” EBITDA represents a significant concession to the [industry](#). It allows a lender to calculate EBITDA under the same methodology it used previously for the borrower or similarly situated borrowers. In recent years, lenders have inflated EBITDA by as much as a third by adding back transaction costs and expected savings that are often [not realized](#).

Businesses with up to 15,000 employees or up to \$5 billion in annual revenue are now eligible for all three facilities, compared to the prior limit of 10,000 employees or \$2.5 billion in revenue. The new MSPLF has a minimum loan size of \$500,000. The Fed also lowered the minimum loan size from \$1 million to \$500,000 for the MSNLF. This change opens the program to smaller businesses that were unable to participate under the initial terms.

The Board raised the minimum loan size for MSELF to \$10 million from \$1 million. The maximum is now the lesser of \$200 million, 35% of the borrower's outstanding and undrawn available debt, or six times the 2019 adjusted EBITDA. The program originally had a maximum of \$150 million or 30% of the borrower's outstanding and undrawn available debt. The limit of six times 2019 EBITDA remains the same. Similar to the reduced minimum loan size under

MSNLF and MSPLF, the increased maximum loan size under MSELF expands the pool of eligible borrowers.

The Main Street Lending Program is broad-based and does not target specific industries. Industry groups responded during the window for comments to lobby for access to the program. [Retail and hospitality groups](#) expressed concerns regarding the debt requirements, and investment professionals sought guidance surrounding EBITDA calculations. [Oil and gas](#) groups also lobbied for changes such as allowing companies with higher debt to borrow under the program and permitting companies to use the funds to pay down existing debt.

[All three facilities](#) have the same eligible lender criteria, which now includes US branches of foreign banks, and the same borrower eligibility criteria. Loans all have the same 4-year maturity and the same interest rate. Initially, the interest rate was set at the Secured Overnight Financing Rate (SOFR) plus 250 to 400 basis points. The new guidance sets the interest rate for eligible loans at LIBOR (1 or 3 month) plus 300 basis points. All loans also have a deferral of principal and interest for a year and no penalty for early repayment. For MSNLF loans, one-third of the principal will be due at the end of each year. Loans under MPSLF and MSELF will have 15% of principal due at the end of the second and third years with the remaining 70% due at the end of the fourth year.

Borrowers under the program are also permitted to borrow under the Paycheck Protection Program (PPP), provided that the borrowers meet the eligibility criteria of the PPP. All borrowers must make “commercially reasonable efforts” to retain employees and maintain payroll in order to borrow under the program. In contrast to PPP lending, these loans are not forgivable.

The Board has not yet announced the start date for the program. The program end date is currently set for September 30, 2020. The Federal Reserve Bank of Boston will administer the program and will establish and operate the Main Street Special Purpose Vehicle (Main Street SPV). The Department of the Treasury will make a \$75 billion equity investment in the Main Street SPV, which will be used to purchase up to \$600 billion of participations in eligible loans under the three facilities. These facilities are established under the Federal Reserve’s authority under Section 13(3) of the Federal Reserve Act.

Once operational, the Board will disclose information regarding the operations of all three facilities including the names of lenders and borrowers, amounts borrowed, interest rates charged, overall costs, revenues, and other fees. Aggregated values of balances under each facility will be published weekly. One year after terminating the program, the Board will disclose more details about participation in the program, including the name and identifying details of each borrower, the amount borrowed, and information about their collateral or pledged assets.

The Board is evaluating a separate program for nonprofits. They are currently ineligible.

Comparison of Main Street Lending Program Facilities

Loan Details	MSNLF	MSPLF	MSELF
Term	4 years	4 years	4 years
Minimum Loan Size	\$500,000	\$500,000	\$10M
Maximum Size	Lesser of \$25M or 4X 2019 adjusted EBITDA	Lesser of \$25M or 6X 2019 adjusted EBITDA	Lesser of \$200M, 35% of outstanding and undrawn available debt, or 6x 2019 adjusted EBITDA
Lender Risk Sharing	5%	15%	5%
Repayment	Year 1: 0% Year 2: 33.33% Year 3: 33.33% Year 4: 33.33%	Year 1: 0% Year 2: 15% Year 3: 15% Year 4: 70%	Year 1: 0% Year 2: 15% Year 3: 15% Year 4: 70%
Rate	LIBOR + 300 bps	LIBOR + 300 bps	LIBOR + 300 bps

Source: [Federal Reserve](#)

UK Announces New 100% Loan Guarantee Program Targeted at Smallest Businesses

By Kaleb Nygaard

Original post [here](#).

On April 27, the United Kingdom (UK) announced a new loan guarantee program called the [Bounce Back Loans Scheme](#) targeted at the smallest of small businesses. In contrast to the 80% coverage offered in the UK's existing credit guarantee program, the government will guarantee 100% of Bounce Back Loans.

The [new program](#) widens eligibility to any UK-based business that has been affected by the COVID-19 pandemic and was not an “undertaking in difficulty” on December 31, 2019. Businesses can apply for guaranteed loans between GBP 2,000 and up to 25% of turnover with a limit of GBP 50,000 (\$62,948). The term of the loans will be up to six years. In the first year, no payments will be required, and the government will cover any fees and interest. The government also indicated it will work with lenders to agree on a low rate of interest for the loans. The government did not announce a maximum number of loans or the total amount of money that would be available in the program.

A business cannot access the Bounce Back Loans Scheme if it already has a loan under the earlier loan guarantee program called the [Coronavirus Business Interruption Loan Scheme](#) (CBILS). The government guarantees 80% of CBILS loans. If a business already took out a CBILS loan that is less than GBP 50,000, it can work with the lender to convert the CBILS loan to a Bounce Back Loan. Businesses have until November 4 to make this conversion.

Accredited lenders will issue the loans, though the list of lenders has not been released yet. Similar to a loan guarantee program in [Switzerland](#), the government has created a short, simplified, standard online application that businesses will fill out and take to the lenders. The government expects businesses to have access within days, often within [24 hours](#).

The government indicated that the Bounce Back Loans Scheme would be open and operational on May 4.

Federal Reserve Expands Access to Paycheck Protection Program Lending Facility to Non-Depository Institution Lenders

By Kaleb Nygaard

Original post [here](#).

On April 30, the Federal Reserve (Fed) [announced](#) that it had expanded access to its Paycheck Protection Program Lending Facility (PPPLF) to allow non-depository institution lenders to participate.

The Fed's PPPLF compliments the Small Business Administration's (SBA) Paycheck Protection Program (PPP), which guarantees loans made by financial institutions to small businesses with less than 500 employees. Eligible lenders can use the PPP loans as collateral to borrow from the Fed. On April 23, Congress [expanded](#) the size of the PPP to \$659 billion.

The SBA had [approved](#) non-bank lenders like Paypal, Square, and Intuit to issue PPP loans, but the PPPLF was [originally](#) only open to depository institutions. In its first PPPLF [term sheet](#), effective April 9, the Fed indicated that it was working to expand access to other lenders. With the expansion, the PPPLF is now open to all lenders that are eligible to issue PPP loans. Beyond financial technology companies, new lenders also include Community Development Financial Institutions, members of the Farm Credit System, and SBA-licensed small business lending companies.

Whereas the PPPLF originally only accepted PPP loans that lenders had originated as collateral, it will now accept PPP loans that the lender either originated or purchased.

The Fed also updated, as outlined in the table below, the Reserve Bank through which the newly eligible lenders will access the program.

Eligible Borrower Type	Reserve Bank
Depository institution or credit union	The Reserve Bank in whose District the eligible depository institution is located (see Regulation D, 12 CFR 204.3(g)(1)–(2), for determining location)
Community development financial institution as defined in 12 U.S.C. § 4702 and certified by the U.S. Treasury (that is not a depository institution or credit union)	Federal Reserve Bank of Cleveland
Member of the Farm Credit System (that is not a depository institution or credit union)	Federal Reserve Bank of Minneapolis

Small business lending companies as defined in 13 CFR Federal Reserve Bank of Minneapolis 120.10 (that is not a depository institution or credit union)

Other eligible borrower type not listed above

Reserve Bank of San Francisco

PPP Rules Changed to Better Target Funds

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

The Paycheck Protection Program (PPP) has undergone multiple revisions and updates since its launch at the beginning of April in order to better target funds to high-need small businesses and clarify program eligibility and operations.

The PPP is a key component of the US response to the COVID-19 crisis and provides forgivable loans for eight weeks of payroll and other expenses to eligible small businesses that retain or rehire employees. The program launched on April 3 and expended the initial \$349 billion in funding by April 16. Congress appropriated an additional \$310 billion in funding to the program, and the Small Business Administration (SBA) began accepting applications for the second round on April 27.

Rule changes and updates issued during the second round of the program include guidance to target small businesses through smaller lenders, exclude larger companies, manage application volumes, and clarify program requirements.

Targeting Small Businesses Through Lender Eligibility

On April 26, the day before it began accepting applications again, the [SBA announced](#) that it would cap the total amount that a single bank could lend at \$60 billion (approximately 10% of the total). According to the SBA, no lender accounted for more than 5% of the total in the first round. The SBA also announced on April 26 that it would allow lenders to submit applications in bulk, with a 15,000 loan minimum. The SBA lowered this to 5,000 on April 27.

The [SBA also expanded](#) a previous interim final rule which allowed non-bank lenders and non-insured depository institutions to lend under the PPP if they originated, maintained and serviced at least \$50 million in commercial loans for at least a 12-month period in the past three years. Lenders who perform only one of the origination, maintenance or servicing activities, subject to the same volume and time period requirements, are now eligible. Lenders that have originated, maintained and serviced at least \$10 million in commercial loans are eligible to lend under the PPP if it is a community development financial institution (other than federally insured banks or credit unions) or if its lending portfolio includes a majority of businesses that are women, minority, or veteran/military-owned.

On April 29, the [SBA announced](#) that it would only accept loans from lending institutions with asset sizes less than \$1 billion between 4:00 p.m. and 11:59 p.m. ET. These lenders can also submit applications during normal operations. This eight-hour period was designed to ensure that the smallest lenders and their customers have access to the program.

Excluding Larger Companies and Types of Firms

On April 28, the [Treasury and SBA](#) announced that all PPP loans greater than \$2 million will be reviewed by the SBA in order to verify that the businesses receiving such loans need the funds to continue operations. In order to receive a PPP loan, a borrower is required to make a good faith certification that the loan is necessary for the business to continue operating. The loans are subject to review prior to the amount being forgiven. In an [interim final rule](#) on April 24, the SBA clarified that borrowers that certified that they needed the funds due to economic uncertainty but then fully repaid the loan prior to May 7 would be considered to have made the certification in good faith. According to [press coverage](#), multiple larger companies, including Shake Shack, received funding under the PPP but have announced plans to repay their loans. [On May 1](#), Treasury Secretary Steven Mnuchin tweeted that some private K-12 schools with large endowments received loans under the PPP, and he argued that they should return the funding, although he did not take any formal action against these schools.

On April 28 the Treasury also explicitly [prohibited](#) hedge funds and private equity firms from accessing PPP loans. No reporting had indicated that they had accessed the funds.

On [April 30](#), the SBA and Treasury released an interim final rule which limited the maximum loan size for a single corporate group to \$20 million. The limit became effective immediately. A business is considered a part of a corporate group if it is majority owned, either directly or indirectly, by a common parent. The maximum loan size for a single beneficiary remains \$10 million. Previously the SBA had not set a limit on corporate groups.

Managing the Application Process and Volume

The SBA began accepting applications again on April 27 at 10:30 a.m. ET. In order to manage the expected load on the online system, the [SBA informed](#) lenders that it would pace the submission of applications into the system at 350 loans per bank per hour. Despite the limit, [lenders reported](#) issues with accessing the system. In response to the burden on the online system, the SBA informed lenders on [April 28](#) that they could no longer use robotic processing automation (RPA) to submit PPP loans. The SBA claimed that this would allow the processing system to become more reliable and equitable for small businesses.

Adding Lender Requirements for Disbursement and Processing Fees

The Treasury and SBA also released an [interim final rule](#) on disbursements on April 28. This rule requires lenders to distribute the loan funds within 10 days of approval in a single disbursement. Multiple disbursements are not permitted. The rule also formalizes the process through which the SBA will refund lenders' processing fees. To receive the refund, the lenders will be required

to upload a SBA Form 1502 to report on PPP loans. Once the SBA makes the form available, lenders will be required to submit the form within 20 calendar days of loan approval and upload the form for loans made prior to the form becoming available by May 18.

Calculating Seasonal Employment Payroll

The SBA released an [interim final rule](#) on April 27 allowing seasonal employers to use an alternate method to calculate the maximum loan amount. Because these employers have seasonal variation in their total employment and payroll expenses, the SBA guidance allows the borrower to elect a prior 12-week period between March 1, 2019 and June 30, 2019.

Lending to Date

By [April 29](#), the SBA had approved 960,000 new loans amounting to \$90 billion. Of these loans, lenders with assets less than \$10 billion made 587,000 loans totalling \$43 billion; lenders with assets between \$10 and \$50 billion made 206,000 loans totalling more than \$20 billion; and lenders with total assets more than \$50 billion made 167,000 loans for more than \$25 billion.

Denmark Extends Duration of COVID-19 Support Programs and Introduces New Measures

By Mallory Dreyer

Original post [here](#).

On April 18, [Denmark announced](#) two new credit facilities to support small businesses and extended previously announced temporary support programs which will increase total spending by [DKK 100 billion](#) (US\$15 billion).

Introduction of New Measures for Lending Based on VAT and Payroll Taxes

The government announced a new credit facility for businesses based on value-added tax (VAT) payments. [Companies with fewer](#) than 250 employees can apply to the government for a zero-interest loan based on the amount of VAT paid in 2019. Companies with revenue less than DKK 5 million can receive a loan based on VAT paid in the second half of 2019, while companies with revenue between DKK 5 million and DKK 50 million can receive a loan based on the VAT paid in the fourth quarter of 2019. [These loans](#) must be repaid by April 1, 2021, or interest will be charged.

The government also made a [lending facility](#) available to small businesses that are exempt from VAT based on their payroll taxes. This is open to businesses including dentists, doctors, and taxis. These firms can access a loan with a value of the payroll tax paid for the first quarter of

2020 and a quarter of the payroll tax paid in 2019. Similar to the loans based on VAT payments, these loans will carry no interest and must be repaid by April 1, 2021.

Extension of Wage Subsidy Program

The announcement also extended existing temporary support measures, including the wage subsidy program. It will be available through [July 8](#), a month longer than initially planned. The wage subsidy program provides 75% of total salary expenses or 90% of total wages for non-salaried employees to companies, with a maximum of DKK 30,000 per employee per month. Under the wage subsidy program, [95% of the companies](#) that applied for the program as of May 1 received support, with more than DKK 6 billion paid.

Extension and Modification of Fixed Cost Compensation Scheme

The fixed cost compensation scheme will also be available through July 8. In addition to extending the program, the government modified terms and criteria. Companies can now [receive compensation](#) of 25% of fixed costs if revenue falls between 35-60%, compared to the prior requirement of 40-60%. The [government lowered](#) the minimum fixed cost criteria so that companies with fixed costs of DKK 12,500 over a three-month period are eligible, compared to the prior DKK 25,000 requirement. The government raised the [limit](#) on support to DKK 110 million per company, up from DKK 60 million.

The [government also introduced](#) a new eligibility condition for the fixed cost compensation scheme that prohibits companies that receive more than DKK 60 million from the scheme from paying dividends or buying back shares in 2020 and 2021. A company that intends to either buy back shares or pay dividends in 2020 or 2021 must repay funds in excess of DKK 60 million.

Extension and Modification of Compensation Scheme for Self-Employed

The government also extended the compensation scheme for the self employed and freelancers and increased the compensation rate [from 75%](#) to 90% of lost income or revenue. For those who are unable to open due to the government ban, the compensation rate is 100%.

FHFA Allows Federal Home Loan Banks to Take PPP Loans as Collateral

By Vaasavi Unnava

Original post [here](#).

On April 23, the FHFA [announced](#) that Federal Home Loan Banks (FHLBs) could take Paycheck Protection Program (PPP) loans guaranteed by the Small Business Administration as collateral for their advances providing some financial institutions two channels through which to finance such loans.

The FHFA (the Federal Housing Finance Agency) implements this new policy through its supervisory responsibilities over the 11 regional FHLBs that make up the FHLB system. The FHLBs are each separately chartered, member-owned institutions. The system as a whole has over [6,000 financial institutions](#) as members. Most members are banks and credit unions, but the membership also includes 60 community development financial institutions and nearly 500 insurance companies.

The FHLB system provides liquidity to its members to promote housing finance. It acted extensively as a “[lender of next-to-last resort](#)” during the Global Financial Crisis. A YPFS blog noted, based on [discount note and bond utilization rates](#), that the system is stepping into a similar, though smaller, role now during the COVID-19 crisis.

The PPP, authorized by the Coronavirus Aid, Relief, and Economic Security (CARES) Act, was originally established as a \$349 million program pursuant to which the SBA guaranteed loans to small businesses whose operating expenses were affected by COVID-19 due to social distancing guidelines. The principal of the loans may be forgiven if certain criteria are met, e.g., if borrowers maintain payrolls for employees. The U.S. government recently [expanded](#) the PPP with an additional \$310 million allocation.

On April 9, the Federal Reserve established the [Paycheck Protection Program Lending Facility](#) (PPPLF), meant to provide liquidity to depository institutions that originated PPP loans by permitting the use of such loans as collateral when borrowing from the Fed. In the PPPLF term sheet, the Fed stated that it was working to [expand the group of eligible borrowers](#). On April 30, the [Fed announced](#) that nondepository institutions originating PPP loans would also be eligible to participate in the PPPLF providing two channels for such lenders wishing to finance their PPP loans.

[FHLBs’ PPP collateral terms](#) differ from the Fed’s [PPPLF terms](#). FHLB members seeking advances from an FHLB by pledging collateral must have at least a CAMELS rating of 3 or higher or a credit rating in the top 60% of all members; the lower rating of the two is used to determine eligibility. (Bank examiners use CAMELS to rate banks’ condition). In comparison, all originators of PPP loans may borrow from the PPPLF.

Bank regulators said they will not require banks to hold capital against PPPLF loans. The FHFA did not mention capital forbearance in announcing its PPP policy.

While the Fed doesn't require any haircuts on collateral, FHLBs must apply at least a 10 percent haircut on any unpaid balances of PPP loans pledged as collateral (a rate [lower](#) than the FHLBs apply to other collateral). However, the haircut increases should a member lose eligibility. If an FHLB member loses eligibility to use PPP loans as collateral by either receiving a CAMELS rating of 4 or falling into the bottom 20-40% of members by credit rating, the lending FHLB must apply an 80 percent haircut to the collateral. If an FHLB member receives a below 5 CAMELS rating or falls into the bottom 20% of members by credit rating, the lending FHLB must apply a 90 percent haircut to the collateral.

PPP loans may only constitute 20% of a member's collateral with its FHLB, and a member may not pledge more than \$5 billion of PPP loans as collateral.

As FHLB banks may accept agency securities as collateral for FHLB advances, FHFA [interpreted](#) PPP loans as agency securities, given that the Small Business Administration (SBA) guarantees the principle on all unpaid balances of PPP loans. The SBA [published](#) an interim final rule clarifying that lenders could pledge their PPP loans to the Fed or an FHLB as collateral, without the SBA's prior consent. The FHFA [determined that](#), in the event of default, FHLBs could sell any PPP loans received as collateral to another SBA lender, with the SBA's consent, preserving the benefit of the SBA guarantee.

Non-depository institutions originally ineligible for the PPPLF may utilize the FHLB system to finance PPP loans and improve liquidity. However, with the PPPLF's [new expansion](#) of eligibility, such institutions have two channels to choose between in financing PPP loans, with the PPPLF's terms being less restrictive, as shown in the table:

	PPPLF	FHLB System
Haircut	0%	10%
Eligibility	All institutions originating PPP loans	All FHLB Members originating PPP loans
Required Supervisory Rating (banks)	CAMELS Rating < 5	CAMELS Rating ≤ 3
Rate	35 bps	Determined by FHLB Banks
Limit	N/A	\$5 billion
Capital Risk Weighting (banks)	0%	N/A

In explaining the new policy, FHFA [said](#) that “accepting PPP loans will provide additional liquidity for small and community banks to borrow from their FHLBank to support the small businesses in their communities.” The FHFA earlier [relaxed standards for mortgage servicers](#) facing liquidity constraints. By permitting the FHLBs to take PPP loans as collateral,

FHFA can increase liquidity for small community financial institutions, providing additional support to small businesses.

US Businesses Navigate Multiple Government Support Programs

By Mallory Dreyer

Original post [here](#).

In response to the COVID-19 pandemic, the United States has adopted multiple programs providing support to businesses, specifically targeting job retention, while at the same time expanding unemployment insurance benefits and eligibility. Programs to support businesses vary across types of benefit and eligibility criteria. This post summarizes government support options available to businesses in the United States and some potential considerations for employers and employees.

Available programs include the following; however, the list is non-exhaustive, as state and local governments have also announced programs:

- Paycheck Protection Program
- Employee Retention Tax Credit
- EIDL Loans and Grants
- Short-time Compensation
- Main Street Lending Program
- Unemployment Insurance

In determining how to respond to the COVID-19 pandemic, firms may evaluate the following:

- What support is the firm eligible to receive?
- When will the business receive support and how easily can it be accessed?
- How do wages compare to unemployment insurance benefits?
- What are the restrictions on using the support?
- When will the business be able to reopen and how will operations change upon reopening?

Available Programs

Paycheck Protection Program

On March 27, Congress passed the [CARES Act](#) which established the Paycheck Protection Program (PPP). Under the program, small businesses apply for SBA-guaranteed loans from eligible lenders, and the government forgives up to 100% of the value of the loan if it is used primarily for payroll expenses. The PPP will cover up to \$100,000 in annualized salary or wages per employee, and the maximum loan amount is \$10 million.

The program incentivises small businesses to maintain their payroll, as a decrease in the payroll numbers proportionally decreases the amount of the loan that can be forgiven. If an employer rehires an employee it laid off earlier, the payroll expenses can be forgiven. [If an employer](#) attempts to rehire an employee and the employee declines, the amount of forgiveness will not be reduced.

The SBA exhausted the \$349 billion in appropriations by [April 16](#), but Congress allocated an additional \$310 billion in funding through emergency legislation on [April 23](#). The SBA began accepting applications again on April 27. The Small Business Administration and Treasury have released [multiple](#) interim final rules, clarifying eligibility criteria and operations.

Employee Retention Tax Credit

The [Employee Retention Tax Credit](#) (ERTC) is a refundable tax credit to employers that are required to fully or partially suspend operations in 2020 (during any calendar quarter) due to a government mandate or that experience a 50% decline in gross receipts compared to the same quarter in 2019. The credit amount is determined based on the number of employees. For firms with more than 100 full-time employees, only the wages paid to employees who are not working are considered qualified wages. For firms with fewer than 100 employees, all employee wages are considered qualified wages. Only wages paid between March 13 and December 31, 2020 are eligible. Employers will receive a fully refundable tax credit of 50% of up to \$10,000 in qualified wages per employee. Firms borrowing under the PPP cannot claim the ERTC.

EIDL Loans and Grants

The SBA has another lending program for small businesses, the Economic Injury Disaster Loan program (EIDL), which provides grants of up to \$10,000 and loans on favorable terms. Similar to the PPP, initial appropriations were expended in mid-April, but the emergency legislation made additional funds available. The [SBA announced](#) on May 4 that EIDL loans and grants would only be available to eligible agricultural businesses going forward. Applications that were submitted prior to the temporary suspension of application submissions will be processed in the order received.

Short-time Compensation

The [CARES Act](#) also provides federal funding for short-time compensation (STC) programs. States with new or existing short-time compensation programs will receive [100% federal funding](#) for payments under these programs through December 31. Short-time compensation is a program within the unemployment insurance system that provides benefits to workers whose hours are reduced. Employers can reduce hours of work for employees rather than laying off some employees, and those whose hours are reduced will be able to collect a percentage of unemployment compensation benefits to replace some of their lost wages.

Twenty-six states currently have operational programs, but there is variation across state administration and requirements. For example, [Connecticut](#) allows for a 10-60% reduction in work hours, while [Michigan](#) allows for a 15-45% reduction.

In order to receive support, an employer must submit the work plan to the responsible state agency and obtain approval. Employers are required to maintain health, retirement and other benefits for employees in the program. During the covered period, an employer cannot lay off employees who are receiving short-time compensation.

Short-time work schemes are common in Europe, and the [European Commission](#) announced a temporary initiative to support short-time work schemes in Member States.

Main Street Lending Program

The Federal Reserve Board announced the Main Street Lending Program on [April 9](#) and updated terms on [April 30](#). Under the program, the Federal Reserve will purchase participations (either 85 or 95%) in eligible loans to companies with up to 15,000 employees or less than \$5 billion in revenue.

Unlike the PPP, these loans are not forgivable and will carry a higher interest rate. [Borrowers must](#) make “commercially reasonable efforts” to maintain payroll and retain employees. However, the program only requires borrowers to undertake “good-faith efforts” and allows firms that have already laid off or furloughed workers to apply for Main Street loans. The Federal Reserve Board has not yet announced the start date of the program.

Unemployment Insurance

Some employers are laying off or furloughing workers in response to COVID-19. The CARES Act expanded unemployment insurance in the United States through three components.

- The [Pandemic Unemployment Assistance \(PUA\)](#) makes benefits available to individuals who are self-employed, seeking part-time employment, or who otherwise do not qualify for unemployment insurance benefits under state or federal law.
- The [Federal Pandemic Unemployment Compensation \(FPUC\)](#) program provides an additional \$600 in unemployment benefits per week to eligible individuals through July 31, 2020.
- The [Pandemic Emergency Unemployment Compensation \(PEUC\)](#) program allows individuals to receive 13 additional weeks of benefits.

The [Bureau of Labor Statistics](#) reported in the April employment report that the unemployment rate increased by 10.3 percentage points to 14.7%. Temporary layoffs accounted for 18.1 million of the 20.5 million job losses in April.

Potential Considerations For Employers and Employees

What support is the firm eligible to receive?

Eligibility criteria differ across programs. The PPP targets small businesses, though it has received heightened [press coverage](#) and [criticism](#) as [some larger companies](#) have received aid. The SBA and Treasury have released [interim final rules](#) regarding eligibility to attempt to limit larger companies with access to public financing from accessing the program. Private equity firms and hedge funds are explicitly excluded from the program.

The Main Street Lending Program is available to companies with up to 15,000 employees or \$5 billion in revenues, making it available to companies of larger sizes, though nonprofits are not eligible.

The ERTC does not have a size restriction, though companies with more than 100 employees can only claim the tax credit for employees who are paid but not working in the quarters it is applied. The ERTC is available to companies that experience a 50% decline in gross receipts compared to the same quarter of 2019, thus targeting firms that have experienced a significant decline in revenue.

The EIDL program is only available to agricultural businesses as of May 4.

When will the business receive support and how easily can it be accessed?

For many small businesses, containment measures have led to an urgent need for support.

According to a [recent survey of small businesses](#), approximately 25% of firms surveyed did not have enough cash to cover more than one month of expenses. Approximately 50% had enough cash to cover between one and two months of expenses. Recent Federal Reserve Bank of New York [research](#) found that less than 20% small businesses in the US can continue normal operations with their cash reserves if they experience a two-month revenue loss. Thus, the speed at which a program provides support to businesses is an important consideration.

A week after announcing the PPP, the SBA began administering the program. Businesses that are able to submit applications through their lenders and receive approval can quickly receive funds. However, in the first phase of the program, many borrowers were not able to receive funds due to the first-come-first-serve nature. The SBA has not yet announced details regarding the process for loan forgiveness.

For businesses that need immediate support, the Main Street Lending Program may not provide quick relief, as the Federal Reserve Board has not yet announced the start date.

The ERTC provides support through a tax credit, which can provide immediate benefits. Employers report the total qualified wages for the ERTC in quarterly federal employment tax returns. These employers can fund the qualified wages by accessing withheld federal employment taxes or requesting an advance for the credit from the IRS. Short-time compensation programs vary across states but an employer's plan requires approval from the responsible state agency.

How do wages compare to unemployment insurance benefits?

According to another [recent survey of small businesses](#), many firms surveyed had already laid off workers in response to the economic shock of COVID-19.

Reducing payroll can provide immediate relief to firms, and individuals who are laid off can apply for unemployment insurance, which is augmented by an additional \$600 per week from the federal government.

[Some have](#) noted that unemployment benefits exceed the prior earnings of some individuals, as the \$600 addition averages to \$15 per hour for a 40-hour work week, which is above [state minimum wages](#). It is important to note that [employees generally cannot](#) quit a job in an attempt to receive unemployment benefits. The Department of Labor released recent guidance that workers who quit a job without good cause in an attempt to receive UI will have [committed fraud](#). Additionally, some employers and employees may find that reduced hours as opposed to layoffs may be [preferable to unemployment](#) as relationships remain intact. Workers in job-protected leave or in partial unemployment status may be able to retain healthcare coverage or other benefits.

The CARES Act also waives the one-week waiting period for unemployment benefits, which is standard in many states. The speed at which individuals are able to receive unemployment benefits depends on the state unemployment system and infrastructure. Many systems are overburdened in response to the more than [33 million](#) new claims since the start of the COVID-19 pandemic.

What are the restrictions on using the support?

Some programs place restrictions on how the funds can be used. For example, [75% of PPP](#) forgivable loans have to be used on payroll expenses. This has been criticized by firms with high non-payroll expenses, [such as rent](#). PPP loan forgiveness also decreases in proportion with reductions in the number of employees, which is designed to incentivize employee retention. [Some firms](#) are awaiting clarification on loan forgiveness from the Treasury and SBA.

The Main Street Lending Program is not targeted at microenterprises, as the minimum loan size is \$500,000. Under the Main Street Lending Program, payroll retention is encouraged but not required explicitly, as borrowers must make a good faith certification that they will attempt to retain employees.

PPP participants cannot claim the ERTC. Businesses that meet criteria for both the Main Street Lending Program and the PPP are able to use both. STC programs supplement an employee's wages through the unemployment insurance system, thus directly providing support to the individual.

When will the business be able to reopen and how will operations change upon reopening?

Uncertainty regarding the timeframe for reopening remains. The PPP provides eight weeks of payroll support, which some worry [may not be adequate](#) if current containment measures

remain. Other countries, such as [Denmark](#), have already announced extensions of programs to support businesses and individuals.

UI benefits are available for an additional 13 weeks, but during the [Global Financial Crisis](#), the eligibility period was extended multiple times so that individuals could receive up to 99 weeks of UI benefits.

As the economy reopens, [some argue](#) that the increased unemployment benefits will make it challenging for businesses to rehire workers that are collecting more in unemployment insurance benefits than they would be working. However, workers that refuse a work offer generally will not be able to continue to collect unemployment insurance benefits.

Some companies may not be willing to take on debt given the economic uncertainty; thus programs that operate as grants may be more appealing. Given the likelihood of a long period of [economic recovery](#), businesses that reopen may not see an immediate return to pre-COVID-19 operations. This may impact an employer's ability to rehire all employees and may make borrowing unattractive.

STC programs may be attractive to employers who want to adjust operations in response to the COVID-19 pandemic while retaining employees and maintaining relationships. Businesses will also need to take safety precautions and modify operations in order to account for [government guidance](#) related to testing, sanitation, and physical distance.

The Philippines Provides Support to Workers in the Informal Economy

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

The Philippines government has included a temporary short-term work program that aims to employ close to 1 million workers in the informal sector in its COVID-19 response package. The [TUPAD #BKBK](#) program provides temporary employment opportunities to workers in the informal sector, as these workers are particularly vulnerable to economic hardship due to the COVID-19 pandemic.

[Informal sector workers](#) are those who do not have secure employment contracts and generally do not have benefits or access to a social safety net. [According to the International Labour Organization](#), the informal economy in the Philippines consists of independent, self-employed small scale producers and distributors of goods and services. Nearly 40% of the workforce in the Philippines is considered employed in a “vulnerable” source of employment, which is a proxy measure for the informal economy.

The Department of Labor and Employment (DOLE) manages the TUPAD #BKBK program (Tulong Panghanapbuhay sa Ating Disadvantaged/Displaced Workers, Barangay Ko, Bahay Ko). The TUPAD #BKBK program provides the minimum wage to unemployed informal sector workers to perform disinfection and sanitation work of their dwellings and the surrounding areas for 10 days. Individuals will also undergo an orientation on safety and health and be enrolled in group [micro-insurance](#) (insurance policies specifically targeted to disadvantaged individuals).

The [TUPAD](#) program is an existing DOLE program that provides short-term employment opportunities to displaced, underemployed or seasonal workers for a minimum of 10 days and a maximum of 30 days. Individuals work on infrastructure projects such as repair or maintenance of public facilities or bridges, and agro-forestry projects such as reforestation. The TUPAD #BKBK program is an emergency measure specifically designed to support individuals during the COVID-19 pandemic. [Funding](#) for the TUPAD #BKBK program comes from the DOLE's 2020 budget, with more than PHP 1 billion spent as of [April 29](#).

As of May 10, [337,000 workers](#) received benefits from the TUPAD #BKBK program, with a total of 540,000 expected to benefit from the TUPAD #BKBK program and a total of 962,000 expected to benefit from all TUPAD measures.

The DOLE is expanding the emergency program to allow local government units to provide short-time employment for delivery of essential goods and services, including PPE. Local governments can also hire workers for the packaging of support equipment, transportation of front-line workers, and sanitation and disinfection of communities.

[At the end of April](#), the DOLE announced that it planned to continue to leverage the TUPAD program during the COVID-19 recovery phase. The post-COVID [TUPAD](#) program, which has PHP 4 billion in funding, is set to operate in May and June in regions under the general community quarantine.

Providing short-term public employment appears to be a relatively uncommon emergency measure to support informal sector workers. However, the Philippines is also providing financial assistance in the form of cash grants to individuals, including those in the informal sector. The [Emergency Subsidy Program](#) is a PHP 205 billion emergency subsidy program for 18 million low-income families. Families with low incomes, including those who work in informal sector jobs, are eligible. Families receive between PHP 5,000 and 8,000 for two months. By [May 2](#), PHP 60.6 billion had been distributed to 11.3 million beneficiaries, and the government added an additional 5 million families on [May 4](#). The Department of Social Welfare and Development will also provide [Livelihood Assistance Grants \(LAGs\)](#) to beneficiaries of the existing Sustainable Livelihood Program, who have at least one family member who works in the informal sector who is displaced by the lockdown measures. LAGs will be granted after the quarantine ends.

EU Expands Temporary Framework For State Aid to Allow Recapitalization

By Mallory Dreyer

Original post [here](#).

On [May 8](#), the European Commission (EC) approved new measures under the [Temporary Framework for State Aid](#), which allow Member States to purchase equity and subordinated debt from non financial companies. The EC will allow recapitalization measures through June 30, 2021, a time period six months longer than other measures under the Temporary Framework.

The European Commission adopted the [Temporary Framework for State aid](#) on March 19. The [initial framework](#) allows Member States to provide direct grants, selective tax advantages, and advance payments to companies, in addition to allowing public guarantees on loans and subsidized public loans to companies.

The EC adopted the [first amendment](#) to the framework on April 3. The first amendment allows Member States to grant aid for coronavirus-related research; or provide support for construction of testing facilities or production of supplies related to the COVID-19 outbreak. Member States can provide targeted support to companies through tax or social security contribution deferrals and wage subsidies.

The second amendment allows Member States to provide public support to companies in the form of equity or hybrid capital instruments. Recapitalization can be in the form of equity or hybrid capital instruments. This includes new common or preferred shares, profit participation rights, silent participations, and convertible secured or unsecured bonds.

Under the Treaty on the Functioning of the European Union (TFEU), Member States that take equity stakes in strategic companies by buying existing shares at market price, or invest *pari passu* with private shareholders, are not considered to have provided State aid.

The EC established a set of conditions for the use of recapitalization measures related to appropriateness, remuneration, exit strategy, governance, and cross-subsidization or acquisition of competitors.

Appropriateness

Recapitalization should only be used if there is no other appropriate solution and should only be used to ensure the viability of the company. In order to be eligible for recapitalization aid, a beneficiary must not be able to find affordable financing on the market. Aid should not go beyond restoring the company's pre-COVID-19 capital structure, and companies that were considered in difficulty as of December 31, 2019, are not eligible.

Remuneration

Member States must be sufficiently remunerated for the risks assumed through recapitalization.

Equity Instruments

For equity instruments, the price paid by the Member State cannot exceed the average share price of the beneficiary over the 15 days prior to the request for assistance. If the company is not publicly traded, the price will be based on an estimate of the market value established by an independent expert.

Recapitalization measures should include a step-up mechanism to increase the remuneration of the State to incentivize a beneficiary to buy back the State's equity investment. The step-up mechanism can be in the form of additional shares or other mechanisms. The step-up mechanism will be activated if the State has not sold at least 40% of its participation after four years for publicly-listed companies or five years for private companies. If the State has not sold its participation in full after six years for publicly-listed companies or seven years for private companies, the step-up mechanism will be activated again. The step-up mechanism will increase the State's share by at least 10%. For example, if the State's stake is 40% after four years, the participation will increase by at least 4 percentage points. Hybrid capital instruments converted to equity will also be subject to the step-up mechanism.

Hybrid Capital Instruments

Remuneration for hybrid capital instruments must take into account the level of subordination, risk, payment modalities, incentives to exit, and an appropriate benchmark interest rate. Hybrid capital instruments must pay a minimum of the 1-year interbank offered rate (IBOR) plus the rate from the following table:

Recipient Type	Year 1	Years 2-3	Years 4-5	Years 6-7	Year 8 and after
Small and medium-sized enterprises	225 bps	325 bps	450 bps	600 bps	800 bps
Large Companies	250 bps	350 bps	500 bps	700 bps	900 bps

Hybrid capital instruments can be converted to equity.

Governance

Companies are banned from share buybacks and dividends for as long as the Member State has an equity share. In addition, companies must adhere to a strict limitation on management compensation, including a ban on bonus payments, as long as 75% of the recapitalization is outstanding. Companies are also banned from t

Member states will be required to report the identity of the beneficiaries of recapitalization measures within three months. The EC encourages but does not require Member States to incorporate a focus on green or digital transformation in recapitalization measures. However, large companies will be required to annually report on how the aid is used, specifically related to the EU objectives of green and digital transformation.

Preventing Distortion of Competition

If recapitalization of a single beneficiary with significant market power exceeds EUR 250 million, the Member State will be required to take additional action to preserve competition in the market. In addition, large companies receiving recapitalization support are not permitted to acquire more than a 10% stake in competitors, companies in the same line of business, or upstream and downstream suppliers, as long the State retains at least 75% of its stake.

Exit Strategy

A Member State can sell its equity stake at market prices to buyers other than the beneficiary at any time after the initial investment.

Large companies that receive recapitalization equal to at least a 25% equity stake must develop and submit an exit plan for the participation of the State unless the State's stake is reduced to less than 25% after one year. The exit plans must include a planned payment schedule for the remuneration and the redemption of State investment. Beneficiaries are required to submit plans within 12 months of receiving aid, and the Member State is required to approve the plan.

If the Member State's stake is 15% or greater after six years for a publicly-listed company or seven years for all other companies, the EC will require a restructuring plan for the beneficiary.

Subordinated Debt

The second measure in the amended Temporary Framework allows Member States to buy subordinated debt. In such cases, the State's position is subordinated to that of ordinary senior creditors in insolvency proceedings. Subordinated debt provided to companies above the established limits for aid to a beneficiary will be subject to the conditions for recapitalization. For large companies, aid in excess of two-thirds of the annual wage bill or 8.4% of the total turnover in 2019 will be subject to the recapitalization conditions. For small and medium-sized enterprises, the limit is either the full annual wage bill or 12.5% of the total turnover in 2019. Subordinated debt cannot be converted to equity while a company is a going concern.

The following table provides a summary of the measures of the Temporary Framework for State Aid, which was adopted on March 19 and amended on April 3 and May 8.

Date	Included Measures
March 19	<ol style="list-style-type: none"> 1. Direct grants, selective tax advantages and advance payments up to EUR 800,000 2. State guarantees for loans taken by companies from banks 3. Subsidized public loans with favorable interest rates to companies 4. Safeguards for banks that channel State aid to the real economy 5. Short-time export credit insurance
April 3	<ol style="list-style-type: none"> 1. Support for COVID-19 related research and development 2. Support for the construction and upscaling of testing facilities 3. Support for the production of products relevant to the COVID-19 outbreak 4. Targeted support in the form of deferral of tax payments or social security contributions 5. Targeted support in the form of wage subsidies for employees 6. Expands the provisions in the initial temporary framework, allowing companies to receive up to EUR 800,000 in aid through zero-interest loans, 100% guarantees
May 8	<ol style="list-style-type: none"> 1. Recapitalization of nonfinancial companies through equity and hybrid equity instruments 2. Support to companies through subordinated debt at favorable terms

Nepal Expands Public-Works Program

By Kaleb Nygaard and Mallory Dreyer

The Nepali government [introduced](#) the [public-works program](#), called the Prime Minister Employment Program, in early 2019, “to create job opportunities within Nepal and end Nepal youth dependency on jobs abroad.” Unemployed persons between the ages of 18 and 51 are eligible to apply. They are assigned jobs based on their qualifications and interest areas, and receive vocational and skill-oriented training.

The jobs [include](#) traditional infrastructure projects like tree planting, public toilet construction, road construction and improvements, drainage repair, playground improvements, soil irrigation, drinking water and irrigation projects, and trekking trail building.

Originally, the program guaranteed a minimum of 100 days of work along with a subsistence allowance; however, due to a relatively slow start, the guarantee was [reduced](#) to 30 days. For the first year, the government [allocated](#) NPR 3.1 billion (USD 25.6 million) for the program, NPR 100 million of which was to be spent on administration. Each project, administered at the local level, could receive [up to](#) NPR 500,000. The program faced [accusations](#) of malpractice and fraud. Government statistics show that 175,909 were hired for these public-works projects but only for an average of 13 days per person.

On December 30, 2019, the Nepali government [announced](#) an expansion of the Prime Minister Employment Program. The government allocated an additional NPR 5.01 billion for the fiscal year. The larger total was made possible by a loan from the World Bank worth NPR 2.62 billion. This year’s program saw a number of amendments. Localities now must submit their project proposals first before funds will be given; local units must spend at least 70% of the allocated budget on payment for work to the registered citizens; and projects like rearing stray animals and gardening are no longer allowed.

In addition to the employment program, on [April 26](#) Nepal announced that informal sector workers who had lost their jobs due to the crisis would receive 25% of a local daily wage if they chose not to participate in the public-works projects.

Bank of Japan Introduces New Facility to Support Bank Lending to Small and Medium-Sized Firms

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [May 22](#), the Bank of Japan (BOJ) announced a new, 30 trillion yen (\$279 billion) facility to support bank lending to small and medium-sized enterprises (SMEs).

The [Japanese government announced](#) an emergency program to support lending to SMEs in early March. [Under this program](#), small businesses can take out zero-interest, unsecured loans of up to 30 million yen from financial institutions, including the Japan Finance Corporation, Shoko Chukin Bank, local banks, shinkin banks, and credit unions. The terms allow banks to defer principal payments for up to five years.

Through the new facility, the BOJ will offer loans for up to one year at a 0% interest rate to financial institutions. However, the BOJ will also pay financial institutions 0.1% interest on the amount of loans made under the new facility. Thus, the loans effectively carry a negative 0.1% interest rate, which is the same rate the BOJ pays (charges) on excess reserves. As collateral for the loans, the financial institutions may post loans, or pools of loans, made under the emergency government programs or loans with similar terms and counterparties.

The BOJ will begin extending loans under this new facility in June, taking into account loans made by financial institutions as of end-May. The new facility will operate through March 31, 2021.

The BOJ's new facility is similar to the Federal Reserve's [Paycheck Protection Program Liquidity Facility](#) (PPPLF). Under the [PPPLF](#), eligible lenders can use PPP loans made to small businesses as collateral when borrowing from the Fed.

Prior to the May 22 announcement, the BOJ announced separate facilities to support lending to corporations through commercial paper or corporate bonds. This facility has 45 trillion yen in funding, which brings the BOJ's total support for lending to businesses to 75 trillion yen.

Poland's Financial Shield Provides Support to Businesses

By Mallory Dreyer

Original post [here](#).

In response to the COVID-19 pandemic, on March 31, the Polish government [announced](#) its “Anti-Crisis Shield,” which includes the “Financial Shield” to support microenterprises, small and medium-sized enterprises, and large companies. The Financial Shield has PLN 100 billion (USD 24.8 billion or approximately 4.5% of 2019 GDP) in total funding. The Polish Development Fund (PFR), a state-owned financial group, is responsible for the administration of the Financial Shield.

As of [June 1](#), more than 222,000 companies (both microenterprises and SMES) with 2.1 million employees benefited from the Financial Shield, and the PFR has paid out more than PLN 42 billion (USD 10.7 billion). Support to microenterprises and SMEs is in the form of a repayable advance with partial forgiveness.

Support to large companies will be in the form of liquidity financing, preferential financing, or equity financing. The European Commission (EC) approved the liquidity financing component of the Financial Shield targeting large companies on [May 26](#). The equity and preferential financing components are under EC review and awaiting approval. After receiving approval, the PFR will begin administering the support measures for large companies.

Financial Shield for Microenterprises and SMEs

[Support to microenterprises and SMEs](#) will be in the form of repayable advances, which are similar to forgivable loans. These advances carry the possibility of redemption (forgiveness) of up to 75% after 12 months, contingent upon the firm maintaining employment and business operations. Eligible microenterprises have 1 to 9 employees and eligible SMEs have 10 to 249 employees. These firms must have been in operation as of December 31, 2019.

Under the Financial Shield, PLN 25 billion (USD 6.2 billion) is allocated for repayable advances to microenterprises, and PLN 50 billion is allocated for repayable advances to SMEs. To be eligible, firms must report a revenue decline of at least 25% compared to the same month of 2019. The scheme explicitly requires beneficiaries to have a tax residence in the European Economic Area, and firms cannot have a tax residence in a “tax haven” as defined by the EU. [Funds granted](#) to firms under the measure are not taxable.

On April 27, the [European Commission approved](#) the Financial Shield measures for microenterprises and SMEs. The PFR began accepting applications from eligible firms on April 29. Repayable advances to microenterprises and SMEs are channeled through commercial banks, but banks cannot charge fees or commissions to beneficiaries or to the PFR. Commercial banks are not responsible for the lending decisions or eligibility conditions, as the PFR carries those

responsibilities. Participation in the program is voluntary, and more than 15 banks have registered.

Aid to microenterprises and SMEs can be granted through July 31; the government may extend the scheme through December 31. Funds are granted to firms based on the order in which applications are received.

Microenterprise Advance Size and Forgiveness

The amount of the advance for a microenterprise is determined by the amount of revenue lost and the number of employees. The amount per employee ranges from PLN 12,000 to PLN 36,000, depending on the revenue lost, and advances are capped at PLN 324,000 per firm.

The amount a firm is required to repay is dependent on its continued operations and employee retention. A firm will be required to fully repay the advance if it suspends business activity, begins a restructuring process, or undergoes liquidation. If the firm maintains the business activity over the 12 months following the advance, it will be required to repay the first 25% of the advance. The remaining 75% of the advance can be forgiven based on the number of employees maintained; firms that maintain full employment will be forgiven the full 75%.

SME Advance Size and Forgiveness

The size of the repayable advance for an SME is determined by the firm's revenue in 2019 and its revenue decline. The advance size, which is dependent on the scale of the revenue decline, ranges from 4% to 8% of 2019 revenue. The maximum advance amount, regardless of the revenue lost, is PLN 3.5 million.

Similar to the scheme for microenterprises, an SME will be required to fully repay the advance if it suspends business activities, liquidates, or begins restructuring activities. All other SMEs will be required to repay the first 25% of the advance. The next 25% will be decreased by the total cash loss during the year after the advance was received. Thus, if the cash loss exceeds 25% of the size of the advance, the SME will not be required to repay the next 25% of the advance. The remaining 50% of the advance will be forgiven based on employee retention; firms that maintain the same employment numbers will be forgiven the full 50%.

Financial Shield for Large Corporations

[Support for large corporations](#) can be through liquidity financing, preferential lending, or equity financing. The government has allocated PLN 25 billion in total funding to support larger corporations, with PLN 10 billion for liquidity financing and PLN 7.5 billion each for preferential financing and equity financing.

	Liquidity Financing	Preferential Financing	Equity Financing
Total Funding	PLN 10 billion	PLN 7.5 billion	PLN 7.5 billion

Instruments	Loans, bonds, purchase of receivables, or warranties	Partially forgivable loans (up to 75%)	Shares, subscription warrants, or convertible loans
Maturity	2 years with option to extend for 1 year	3 years with option to extend for 1 year	N/A
Maximum Amount per Firm	PLN 1 billion	PLN 750 million	Capped at either 50% of shares or the amount of loss due to COVID-19

The liquidity financing instruments contain a “cash sweep” mechanism to accelerate repayments if the company’s financial situation improves.

Firms receiving preferential financing are prohibited from using the funds to make payments to the owner or acquire shares. Additionally, firms cannot use the funds for mergers or acquisitions, or for the refinancing or early repayment of existing debt.

The measures are available to firms with at least 250 employees, turnover of at least EUR 50 million (USD 55 million), or a consolidated balance sheet of at least EUR 43 million. However, the government has also established criteria to allow some SMEs to participate in the scheme. Eligible SMEs have at least 150 employees and annual turnover of at least EUR 100 million. To participate, SMEs must either be in a specific sector affected by COVID-19, such as medicine or personal protective equipment production; or project a funding gap that exceeds PLN 3.5 million.

Beyond size criteria, large companies must either operate in a specific industry or meet at least one criteria related to inability to operate or access financing, revenue decline, or nonreceipt of payments. Similar to the support to microenterprises and SMEs, eligible companies must have a residence in the European Economic Area and cannot be registered in a “tax haven.”

The PFR is accepting initial applications from eligible companies prior to EC approval of all three financing options. After receiving a decision from the EC, the PFR will begin operations.

Bank of Mauritius Granted Permission to Make Equity Investments in Companies

By Kaleb Nygaard

Original post [here](#).

On [May 16](#), in response to the economic downturn caused by COVID-19, the government of Mauritius passed a law granting permission to the Bank of Mauritius (BOM), the country's central bank, to make equity investments in companies.

As announced by the BOM on [May 22](#), it will establish a special purpose vehicle called the Mauritius Investment Corporation (MIC) to make the capital investments. The announcement indicated the purpose was to “mitigate contagion of the ongoing economic downturn to the banking sector, thus limiting macro-economic and financial risks.”

The MIC will operate independently and be [governed by](#) a board of directors consisting of the first vice-governor and the second vice-governor of the BOM as well as three other independent members chosen from the private sector. A committee of professionals and advisors from the private sector will conduct in-depth analysis on the funding requests from companies and then submit their recommendations to the board of directors, who will have the final say on investments made by the MIC.

The MIC will make investments through a range of equity and quasi-equity instruments. The funds will be [directed to](#) “domestic systemic economic operators.” The announcement said this would help preserve jobs. In a [press interview](#), the BOM Governor expanded, “by helping the economic operators who have a systemic importance, the MIC intends to avoid these companies from being in an irreversible financial situation and to provoke a shock wave which will affect the banking system and, by extension, the whole economy.”

The law allowing the BOM to initiate these new equity investments indicated that funding for the MIC would come from the BOM's foreign reserves. As of [April](#), the BOM held MUR 280 billion (USD 7 billion), roughly half of the country's GDP. No additional details are available at this time.

The same law that allowed BOM to establish the MIC also allowed BOM to make a one-time grant of MUR 60 billion to the government to be used “to assist it in its fiscal measures to stabilise the economy of Mauritius.” The grant was issued on [May 22](#).

United States Congress Passes Amendments to Paycheck Protection Program

By Kaleb Nygaard

Original post [here](#).

On [June 3](#), the United States Congress passed the Paycheck Protection Program (PPP) Flexibility Act of 2020. The update includes three significant changes to the PPP.

First, Congress reduced to 60% the portion of a government-backed loan that a company must spend on payroll to be eligible for forgiveness. Under the [original law](#), Congress listed a number of expenses that a small or medium size enterprise (SME) could cover with a loan from the PPP. These expenses included payroll costs, payments of interest on any covered mortgage obligation, payments on any covered rent obligation, and covered utility payments. The Treasury later [stipulated](#) that 75% of the funds must be spent on payroll expenses for the government to forgive the loan. In the PPP Flexibility Act, Congress added a paragraph to the law that explicitly defines the portion of the loan that must be spent on payroll to be eligible for forgiveness at 60%. This was in response to many [complaints](#) noting that SMEs face significant other fixed expenses beyond payroll and that supporting the employees will only be useful if the company is able survive the downturn.

Second, the PPP Flexibility Act extends, from 8 weeks to 24 weeks, the timeframe within which the SMEs must use the funds to be eligible for forgiveness. Reports [indicate](#) that lawmakers made this change because the COVID-19 pandemic and economic shutdown have lasted longer than originally anticipated. This change highlights the importance of not underestimating the potential duration of a crisis. Doing so can result in relief efforts that are designed to handle short-term disruptions, but that leave limited ability to respond if the disruptions become longer-term.

Third, the law moved the last day on which a SME can use PPP funds to hire back employees previously laid-off from June 30 to December 31. Congress passed the original PPP law a few weeks into the COVID-19 pandemic and by that time many SMEs had already been forced to lay-off employees.

Congress outlined the PPP in section 1102 and 1106 of the CARES Act, which was signed into law on [March 27](#). The law originally allocated \$349 billion (expanded to \$659 billion on [April 23](#)) for the forgivable, government guaranteed loans to SMEs with up to 500 employees.

As of [June 3](#), 4.5 million loans had been approved worth \$511 billion.

SBA and Treasury Issue Guidance on PPP Loan Forgiveness

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [June 8](#), the Treasury and Small Business Administration (SBA) announced greater flexibility for loan forgiveness in a joint press statement on the Paycheck Protection Flexibility Act.

Prior to the passage of the [Paycheck Protection Flexibility Act](#) on June 3, Treasury guidance required borrowers to spend [at least 75%](#) of the loan amount on payroll expenses in order for their loan to be eligible for forgiveness from the federal government. In the Act, Congress set that level at 60%.

Even after Congress passed the Act, potential borrowers expressed concerns about the [“60% cliff”](#) effect: borrowers who spent less than 60% of their loan amount for payroll expenses would receive no forgiveness.

In the June 8 joint press release, the Treasury and SBA loosened the loan forgiveness requirements so that borrowers who use less than 60% of their loan amount on payroll expenses can now receive partial loan forgiveness. Their forgiveness will be calculated such that 60% of the forgiven amount has been used for payroll expenses.

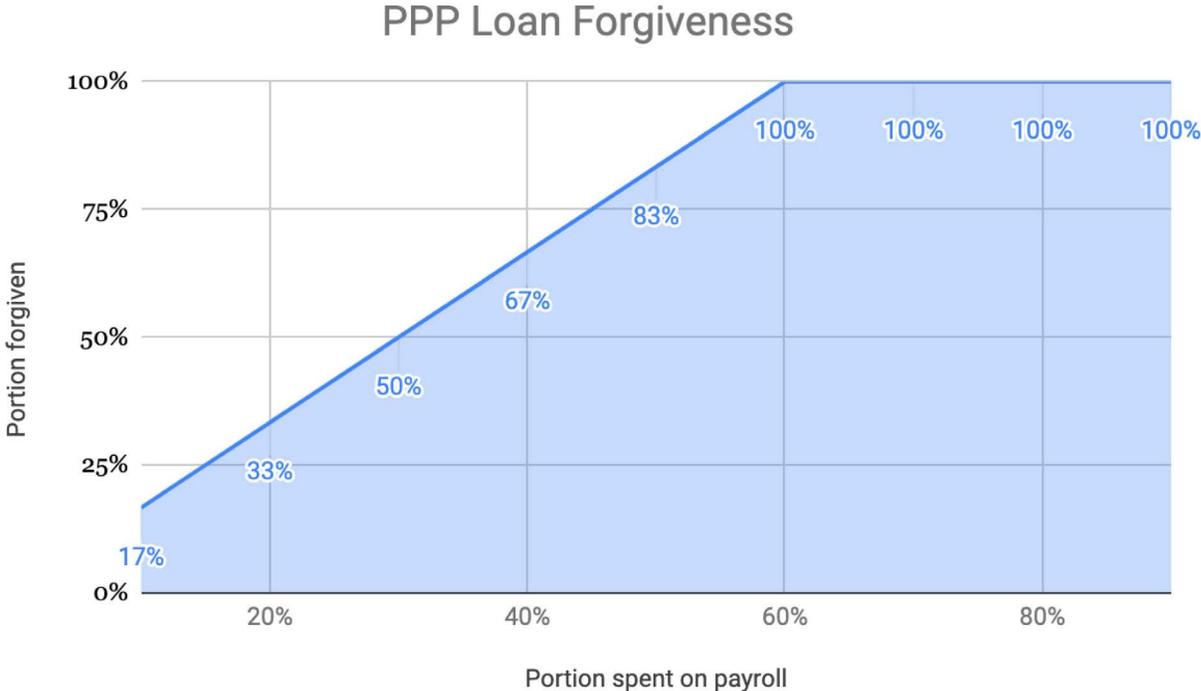
For borrowers that use less than 60% of the loan for eligible payroll expenses, the formula to calculate the total amount eligible for forgiveness is the amount of the loan spent on payroll multiplied by $1 \frac{2}{3}$.

The following table provides two example scenarios based on a \$100,000 loan, one which is eligible for full forgiveness and the other which is eligible for partial forgiveness:

	Partial Forgiveness (Less than 60% on payroll)	Full Forgiveness (60% or more on payroll)
Total loan amount	\$100,000	\$100,000
Amount spent on payroll	\$50,000	\$60,000
Amount spent on other eligible expenses	\$50,000	\$40,000
Total amount forgiven	\$83,350 (Calculation: \$50,000 x $1 \frac{2}{3}$)	\$100,000

Other eligible expenses include payments of interest on any covered mortgage obligation, payments on any covered rent obligation, and covered utility payments.

The following chart shows the portion of the loan eligible for forgiveness based on the portion spent on eligible payroll expenses.



Federal Reserve Amends Main Street Lending Program

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [June 8](#), the Federal Reserve announced significant changes to the Main Street Lending Program, a new facility designed to support lending to small and medium-sized businesses. The changes include decreasing the minimum loan amount for some loans, increasing the maximum loan amount, amending the loan repayment schedule, and extending the loan term.

Through the Main Street Lending Program, the Fed will purchase up to \$600 billion of participations in loans to so-called “main street” businesses, which are firms with up to 15,000 employees or \$5 billion in annual revenue. The Fed has not yet launched the program.

The [Main Street Lending Program](#) has three facilities: the Main Street New Loan Facility (MSNLF) and Main Street Priority Loan Facility (MSPLF) are for new loans while the Main Street Extended Loan Facility (MSELF) is for increases to existing loans or credit facilities. The Fed will purchase a 95% participation in all loans under the program; previously, it had announced that it would purchase a 95% participation in loans under both the MSNLF and MSELF and an 85% participation in loans under the MSPLF.

The June 8 announcement increased the term of each loan option to five years, up from the previous term of four years. The announcement also delays the principal repayment for two years, up from the prior one-year deferral.

The table below summarizes the three different loan facilities with previous guidance in parentheses.

With the changes announced on June 8, the MSPLF and MSNLF have very similar terms, despite the MSPLF being designed for more highly leveraged borrowers. The Fed retained a measure to mitigate risk for MSPLF lending by requiring these loans to be secured if the borrower has other secured debt. A secured MSPLF loan must have a collateral coverage ratio of at least 200%; if not, then a loan’s collateral coverage ratio must be not less than the aggregate collateral coverage ratio for the borrower’s other secured loans, excluding mortgage debt. However, the Fed does not prohibit borrowers from using MSPLF loans to refinance existing debt to other lenders, unlike MSNLF loans, which cannot be used for refinancing.

Unlike the Paycheck Protection Program (PPP), loans made under the Main Street Lending Program are not forgivable. Businesses cannot participate in more than one of the three Main Street facilities and are also prohibited from accessing the [Primary Market Corporate Credit Facility](#) (an emergency facility to purchase corporate bonds). However, PPP borrowers can also borrow under the Main Street Lending Program if they meet the eligibility criteria.

The Main Street Lending Program appears to be the only Federal Reserve program under the CARES Act that is subject to the full set of restrictions on share buybacks, executive compensation, and dividend payments outlined in the CARES Act. [Other programs](#) appear to have received waivers from the Treasury Secretary under [4003 \(c\)\(3\)\(a\)\(iii\)](#) (p. 519).

On May 27, the [Federal Reserve Bank of Boston](#) (FRBB), which will administer the program, released additional documentation for borrowers and lenders. These include the lender

	MSNLF (New Loans)	MSPLF (Priority Loans)	MSELF (Extended Loans)
Purpose	Initial facility for new loans to borrowers	Announced on April 30 for new loans to highly leveraged borrowers	Increased lending (upsized tranche) to existing borrowers
Term	5 years (previously 4 years)	5 years (previously 4 years)	5 years (previously 4 years)
Minimum Loan Size	\$250,000 (previously \$500,000)	\$250,000 (previously \$500,000)	\$10M
Maximum Loan Size	The lesser of \$35M, or an amount that, when added to outstanding and undrawn available debt, does not exceed 4.0x adjusted EBITDA (previously \$25M)	The lesser of \$50M, or an amount that, when added to outstanding or undrawn available debt, does not exceed 6.0x adjusted EBITDA (previously \$25M)	The lesser of \$300M, or an amount that, when added to outstanding or undrawn available debt, does not exceed 6.0x adjusted EBITDA (previously \$200M)
Participation	95%	95% (previously 85%)	95%
Principal Repayment	Year 1-2: Deferred Year 3: 15% Year 4: 15% Year 5: 70% (Previously deferred for year 1, 33.33% due in years 2-4)	Year 1-2: Deferred Year 3: 15% Year 4: 15% Year 5: 70% (Previously deferred for year 1, 15% for year 2, 15% for year 3, 70% for year 4)	Year 1-2: Deferred Year 3: 15% Year 4: 15% Year 5: 70% (Previously deferred for year 1, 15% for year 2, 15% for year 3, 70% for year 4)
Interest Payments	Deferred for 1 year	Deferred for 1 year	Deferred for 1 year
Interest Rate	LIBOR + 300bps	LIBOR + 300bps	LIBOR + 300bps

registration documents, loan participation and servicing agreements, and borrower covenants. The Fed also updated the [FAQs](#) to provide more information about program

requirements. [Changes made on May 27 include](#) rules about affiliation, foreign subsidiaries, documentation, and specific updates to each facility related to security and subordination, among others.

The Fed has faced criticism for the amount of time it has taken to establish the Main Street Lending Program and begin operations. [Others consider](#) the program to be “heading for trouble before it even gets under way” as some potential borrowers view the interest rates as too high. Others considered the previous four-year term too short. In a [webinar on May 29](#), Federal Reserve Chair [Jerome Powell](#) called the Main Street Lending Program “far and away the biggest challenge of any of the 11 facilities” the Fed set up in response to the COVID-19 pandemic. [The Fed](#) “expects that Main Street program” to be open for lender registration soon and to be actively buying loans shortly afterwards.”

The FRBB chose State Street Bank and Trust as the third-party vendor custodian and accounting administrator for the Main Street Lending Program.

The Fed announced the Main Street Lending Program on [April 9](#) and accepted comments through April 16. Following the 2,200 plus comments, the Fed announced modifications to the program on [April 30](#). The Fed will operate the program until September 30, unless the Federal Reserve Board and Treasury Department decide to extend its operations.

Germany Introduces Fixed Cost Support for SMEs

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [June 12](#), the German government's executive cabinet provided new details on the EUR 130 billion (USD 146 billion) round of fiscal stimulus measures meant to support the economy during the COVID-19 pandemic. The measures include a EUR 25 billion fixed-cost subsidy scheme for small and medium-sized enterprises (SMEs).

The [fixed-cost subsidy scheme](#) is available to businesses that experience a sales decline of at least 60% in April and May of 2020 compared to the same period in 2019. Non-public companies across all sectors are eligible, including nonprofit organizations.

The aid is provided in the form of a grant that is available for a maximum of three months. The grants reimburse a portion of fixed costs that a company incurs between June and August. These grants will be required to be repaid if the company ceases operations before August 2020. Companies can apply for aid through August 31.

Funding can be used on a broad range of fixed costs. These include rent and lease costs, interest expense on loans, financing costs for leases, utility expenses, maintenance costs for fixed assets, property taxes, insurance, licensing fees, training expenses, tax consultant or auditor fees for aid applications, and other personnel expenses that are not covered by [short-time compensation](#), or Kurzarbeit.

The maximum funding available to a firm is EUR 150,000. Reimbursement rates are based on the percent decline in revenue:

- 80% reimbursement of eligible fixed costs for firms with a decline of 70% or more
- 50% reimbursement of eligible fixed costs for firms with a decline between 50% and 70%
- 40% reimbursement of eligible fixed costs for firms with a decline between 40% and 50%
- Companies with up to five employees can receive up to EUR 9,000 for three months, and those with up to ten employees can receive up to EUR 15,000 for three months. The maximum reimbursement for firms with up to five or ten employees can be exceeded only in exceptional cases, such as when the total eligible reimbursable fixed costs are more than two times the maximum reimbursement amount.

Companies are required to prove the revenue decline and fixed cost expenses in a two-stage process. The first stage, or the application stage, requires the company to provide a forecast or estimate of the sales decline based on the sales decline in April and May of 2020. In addition, the

company is required to provide an estimate of the fixed costs over the period it is requesting aid. This first stage of the process is required to be completed by a tax advisor or consultant and submitted to the government application system. The second stage of the process is the verification process in which the actual sales decline is compared to the forecasted decline. If the sales decline is less than forecasted, and thus a company receives more in subsidies than it was eligible for, it will be required to repay the excess. If too little was paid because the forecasted decline in sales was too low, the subsidy will be increased.

The government also included other, smaller support measures in the stimulus package. For example, it committed to facilitating an electromobility fleet exchange program for electric utility vehicles for craftsmen and other SMEs.

The measures are based on the [June 3](#) Coalition Committee's comprehensive stimulus package. The measures will go through the parliamentary legislative process before becoming law. This new stimulus package follows a previous one from [March](#) worth EUR 750 billion.

Main Street Lending Program Opens for Lenders

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On June 15, the [Federal Reserve Bank of Boston](#) (FRBB) announced that lender registration for the Main Street Lending Program is now open.

The Main Street Lending Program is designed to support lending to small- and medium-sized enterprises (SMEs). Through a special purpose vehicle (SPV) established by the FRBB, the Fed will purchase a 95% participation in loans made by eligible lenders to eligible borrowers with up to 15,000 employees or \$5 billion in annual revenue. The Treasury injected \$75 billion in capital into the SPV, allowing the SPV to purchase up to \$600 billion in loan participations.

To [register for the program](#), lenders must complete the required registration certifications and covenants. These documents must be signed by the principal executive officer and principal financial officer. Lenders must also register through the FRBB's lender portal. The FRBB estimates that the lender registration process could take several business days.

Once the [program is operational](#), eligible borrowers can apply for loans through an eligible lender.

For more information about the Main Street Lending Program, see previous YPFS blog posts:

- [Federal Reserve Amends Main Street Lending Program](#)
- [Federal Reserve Announces Changes to Main Street Lending Program](#)
- [Federal Reserve Announces Main Street Lending Program](#)

Small Business Administration Announces Updates to Small Business Support Programs

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

The Small Business Administration (SBA) and Treasury recently released guidance related to the Paycheck Protection Program (PPP) to clarify that they will forgive loans to employers that are unable to rehire or maintain employment levels. The agencies also released a simplified forgiveness application.

At the same time, the SBA and Treasury removed a restriction on Economic Injury Disaster Loans (EIDL) and Advances to allow all small businesses, not just agricultural businesses, to benefit.

Clarifying forgiveness rules for business owners that cannot rehire employees

On [June 16](#), the SBA released an amended interim final rule on the PPP that clarifies that borrowers that demonstrate an inability to rehire employees will not face a proportionate decline in the amount of the loan forgiven. This clarification is based on the PPP Flexibility Act, which was signed into law on [June 5](#). Congress indicated that if an employer is unable to rehire employees or individuals that are similarly qualified due to compliance with requirements or guidance issued by health authorities, then the employer will not be penalized by a reduction in the proportion of the loan amount forgiven. This loosens a key requirement of the program, as the program was designed to incentivize employers to maintain employment levels and salaries.

As of [June 17](#), the SBA had approved 4.6 million PPP loans worth a total \$513 billion.

Changes to simplify the PPP forgiveness application forms

On [June 17](#), the SBA and Treasury released a new, streamlined loan forgiveness application form for borrowers under the PPP.

For eligible loans under the PPP, borrowers can benefit from full or partial forgiveness of the borrowed amount. The new forgiveness application, the “EZ” application, is available to borrowers that meet one of the following criteria:

- Borrowers that are self-employed with no employees
- Borrowers that did not reduce employee salaries or wages by more than 25% and did not reduce the number of hours of the employees
- Borrowers that experienced a reduction in business activity as a result of government health directives that did not reduce employee salaries or wages by more than 25%

This [application](#) requires less documentation from borrowers than the standard full forgiveness application. The application is three pages and requires fewer calculations than the standard, five-page [application](#).

The SBA also modified the standard application, which was initially released on [May 15](#).

Both applications now give borrowers the option of using the 8-week covered period or the 24-week covered period, as amended by the Paycheck Protection Program Flexibility Act (PPPFA) on [June 5](#). The extension of the covered period under the PPPFA allows borrowers to use the loan proceeds to cover eligible expenses over a longer period of time. For borrowers that elect the 8-week covered period, the maximum payroll covered per employee is \$15,385, which is equivalent to 8 weeks of pay under a \$100,000 salary. Under a 24-week covered period, the maximum amount per employee is \$20,833, which is equivalent to approximately 24 weeks of pay under a \$45,000 salary.

Reopening of EIDL Loans and Advances and to all small businesses

The CARES Act, signed into law on [March 27](#), included an expansion of the SBA's EIDL programs. Qualified small and medium-sized enterprises (SMEs) could apply for loans on favorable terms and grants of up to \$10,000. Within a few weeks of launching, the SBA announced that it had exhausted the programs' funds. On [April 24](#), Congress allocated additional funding for the EIDL programs in the law that expanded the PPP.

On [June 15](#), the SBA reversed a prior decision to limit the EIDL loans and advances to agricultural businesses. It announced that it would begin to accept applications for EIDL loans and advances from small businesses and agricultural businesses.

On [May 4](#), the SBA and Treasury had restricted the EIDL support to agricultural businesses. The same May 4 announcement also clarified that non-agricultural businesses that had submitted applications by [April 15](#) (the day the SBA stopped accepting new applications under the initial funding allotment) would continue to be processed, but other non-agricultural firms could not apply for the EIDL loans and advances.

As of June 12, the SBA had issued 3.2 million [advances](#) worth \$10.7 billion and 1.3 million [loans](#) worth \$90.9 billion.

According to the US Census [Small Business Pulse Survey](#), as of June 11, 74% of surveyed businesses had requested support from the PPP and 28% had requested support under the EIDL program. 71% of respondents had received support from the PPP by June 11 while 18% had received support under the EIDL programs. Overall, 24% of respondents had received no financial assistance from the federal government since March 13, 2020, with 18% of respondents not requesting any financial assistance.

SBA Will Disclose Certain Recipients of Paycheck Protection Program Aid

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [June 19](#), the US Treasury and Small Business Administration (SBA) announced that certain recipients of Paycheck Protection Program aid will be disclosed to the public.

For each business that receives a loan of \$150,000 or more, the SBA will disclose the business name, address, industry, zip code, business type, demographic data, non-profit information, and jobs supported by the PPP funding. The SBA will not disclose the exact size of the loan; rather, it will report the loan amount based on the following ranges:

- \$150,000 to \$350,000
- \$350,000 to \$1 million
- \$1 million to \$2 million
- \$2 million to \$5 million
- \$5 million to \$10 million

Given the reported ranges above, it is not clear how the SBA will report a loan of exactly \$350,000, \$1 million, \$2 million or \$5 million.

Loans of \$150,000 or more account for approximately 75% of approved funding; however, nearly 86% of the total number of borrowers took out a loan worth less than \$150,000. For loans below \$150,000, the SBA will release totals aggregated by zip code, industry, business type, and demographic categories. The Treasury and SBA have not yet announced the specific demographic data that will be released in the public reports.

To date, PPP recipients have been identified through voluntary information sharing or through SEC filings.

The Treasury and SBA have not yet provided timing regarding the public reporting, including when the first report will be made public and the frequency of disclosure.

Prior to the announcement, the Treasury Secretary, Steven Mnuchin, had indicated that the administration [would not](#) release names of borrowers or loan-level information. Disclosure had received full support from Democrats in both houses of Congress and had received some Republican support. In late May, a bill in the House called the [TRUTH Act](#) received support from all Democratic members and 38 Republican members. The bill would have required the SBA to publish recipients, the number of employees, the lender, and demographic data for each loan under the PPP. Because the bill was put on a fast-track approval process, it required a two-

thirds majority in the House, which it did not get. On June 3, the Chairman (a Republican) and Ranking Member (a Democrat) of the Senate's Committee on Small Business & Entrepreneurship [sent a letter](#) to Secretary Mnuchin asking that the SBA release loan-level information, including demographic breakdowns.

As of [June 19](#), the SBA had approved 4.7 million PPP loans worth \$514.5 billion. The program, as expanded on [April 23](#), has \$659 billion in total allocated funds.

European Commission Expands Eligibility for SME Support and Increases Incentives for Private Recapitalization

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [June 29](#), the European Commission (EC) announced it will extend support to SMEs that were previously ineligible for state aid and amended recapitalization measures to incentivize private investor participation.

This is the EC's third [amendment](#) to the Temporary Framework for state aid. The EC adopted the Temporary Framework on March 19 with the first amendment approved on April 3 and the second amendment on May 8. Through the Temporary Framework, the EC defines how Member States can provide aid to companies in response to the COVID-19 pandemic while preventing competition distortion across companies in the EU.

Support for SMEs, specifically startups

The amendment permits Member States to provide aid to SMEs that were already financially troubled on December 31, 2019 provided they are neither insolvent nor have outstanding, non-COVID-19 related rescue aid. The Temporary Framework previously prohibited Member States from providing aid to companies whose [capital had shrunk by half or more](#) prior to the pandemic due to accumulated losses. This was because governments did not want to use COVID-19 rescue funding to help firms that were already “in difficulty” and would have been likely to go out of business in the short or medium term absent government intervention.

This amendment allows Member States to introduce support programs for small, young companies, like startups, that traditionally run losses in the first few years as they grow their businesses. It will also allow Member States [like](#) Germany and France to expand startup support programs.

Several technology trade groups had urged the EC to be more flexible in its approach to state aid. [Many companies](#) in the tech industry are classified as being “in difficulty” under the rules as they operate at a loss in order to achieve fast growth or have taken on significant debt as a result of private equity investments. These companies were unable to benefit from state aid under the rules that the EC put in place for traditional SMEs in March.

Recapitalization Aid Measures

In its [May 8](#) amendment to the Temporary Framework, the EC defined the procedures and requirements for the recapitalization of nonfinancial companies through equity, hybrid equity, and subordinated debt at favorable terms. The June 29 amendment modifies the conditions to encourage private investor participation.

The May 8 amendment established restrictions on share buybacks and management compensation for companies that are recapitalized through State aid. It banned share buybacks and dividends as long as 75% of the State's recapitalization aid was outstanding. However, if the recapitalization measures meet the new criteria under the June 29 amendment, the acquisition ban and cap on management compensation will be limited to three years. Recapitalization measures must meet the following criteria to be eligible for the three-year limit:

- 1) private investors contribute at least 30% of the new equity injected by the State
- 2) the State injects new equity under the same conditions as private investors
- 3) the new equity is pro rata or below to existing shareholdings.

The EC also lifted the dividend ban for the holders of new shares. The dividend ban is lifted for owners of existing shares as long as the existing shares are diluted to less than 10% of ownership. If the existing shares are not diluted to below 10%, the dividend ban applies for three years. However, any remuneration due to the State for hybrid capital and subordinated debt instruments is to be paid before any dividends are paid to shareholders.

The amendment also allows companies with existing public shareholders to raise capital from shareholders like private companies. If the State is an existing shareholder before the granting of COVID-19 recapitalization aid and the participation of private investors meets the three new criteria, the EC will not impose specific conditions on the State's exit.

The EC expects that the amendments related to recapitalization measures will incentivize firms to seek market and State contributions for capital needs.

Relocation

In the June 29 amendment, the EC also clarified that States cannot provide aid to a firm on the precondition that it relocate to the State's territory.

Table 1. Summary of Temporary Framework and Amendments

Date	Included Measures
March 19	<ol style="list-style-type: none">1. Direct grants, selective tax advantages and advance payments up to EUR 800,0002. State guarantees for loans taken by companies from banks3. Subsidized public loans with favorable interest rates to companies4. Safeguards for banks that channel State aid to the real economy5. Short-time export credit insurance
April 3	<ol style="list-style-type: none">1. Support for COVID-19 related research and development2. Support for the construction and upscaling of testing facilities3. Support for the production of products relevant to the COVID-19 outbreak4. Targeted support in the form of deferral of tax payments or social security contributions5. Targeted support in the form of wage subsidies for employees6. Expansion of the provisions in the initial temporary framework, allowing companies to receive up to EUR 800,000 in aid through zero-interest loans, 100% guarantees
May 8	<ol style="list-style-type: none">1. Recapitalization of nonfinancial companies through equity and hybrid equity instruments2. Support to companies through subordinated debt at favorable terms
June 29	<ol style="list-style-type: none">1. Support for SMEs “in difficulty” under specific circumstances2. Recapitalization measures amended to encourage private investor participation3. States prohibited from conditioning aid to firms on relocation to their territory

US Treasury Extends \$700 Million Loan to YRC Worldwide Inc. under CARES Act Provision

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [July 1](#), the US Treasury announced it would make a \$700 million loan to YRC Worldwide Inc., a heavyweight equipment transportation [company](#) that was deemed by the US Secretary of Defense to be critical to national security. Treasury will receive a 29.6% equity stake in the company in connection with the loan.

Under the CARES Act, the [Department of the Treasury](#) is authorized to make loans, loan guarantees, or other investments in eligible businesses that are facing liquidity constraints as a result of COVID-19. Section 4003(b) of the CARES Act allocated \$17 billion for businesses critical to maintaining national security.

YRC was determined to be critical to maintaining national security, as it provides 68% of the less-than-truckload transportation services for the US Department of Defense. In a [statement](#), the company said it and its operating subsidiaries have been “significantly impacted” by the pandemic.

The [loan](#) is divided into two tranches of approximately \$350 million each. The first will be used to cover short-term contractual obligations and certain other obligations including pension and healthcare payments. It will carry an interest rate of LIBOR plus 3.5%, consisting of 1.5% cash and 2.0% payment in kind. The second tranche will be used for essential capital investment in trailers and tractors and will carry an interest rate of LIBOR plus 3.5%, payable in cash. Both loan tranches mature on September 30, 2024.

The CARES Act prohibits the Treasury Department from issuing a loan to a borrower that has issued securities that are traded on a national securities exchange unless the Treasury Department receives a warrant or equity interest in the borrower.

YRC will issue to the Treasury shares of common stock that, after the issuance, will constitute approximately 29.6% of YRC’s fully diluted common stock outstanding. YRC will use a COVID-19-related exception from the NASDAQ stock exchange to issue the new shares without current stockholder approval. The Treasury will hold these shares in a voting trust that will be required to vote the shares in the same proportion as all other unaffiliated shares of YRC’s common stock are voted.

The company’s stock rose [as much as 92%](#) today on NASDAQ after the Treasury’s announcement.

The CARES Act also imposes requirements in the loan agreement. YRC will be prohibited from share buybacks and dividend payments until 12 months after the loan is no longer outstanding.

YRC has committed to maintain its employment level and cannot reduce the employment level by more than 10%. It is also subject to the executive compensation limits established in Section 4004 of the CARES Act.

Consistent with the CARES Act, the term of loan to YRC is below the maximum duration of 5 years. Under section 4003(d)(3) of the Act, the principal amount of loans made under this provision of the CARES Act cannot be forgiven.

The Treasury Department announced that it would begin accepting applications from businesses critical to national security on [April 27](#) with a deadline of May 1; however, the [application portal](#) is still available online.

The loan to YRC appears to be the first Treasury announcement of CARES Act support to a business deemed critical to national security.

The Treasury also has the [authority](#) to lend to air carriers, as Section 4003(b) allocated up to \$25 billion for passenger air carriers and \$4 billion for cargo air carriers. One component of Treasury support is the [Payroll Support Program](#) for passenger air carriers which assists eligible businesses with employee wages, salaries and benefits. As of [May 12](#), the Treasury had approved over \$25 billion in response to 352 applications. The Treasury reports recipients, agreement dates, the total anticipated payroll support, anticipated principal, number of warrants, and warrant exercise price [here](#).

US Extends Paycheck Protection Program by 5 Weeks

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On July 1, the US Congress [passed a bill](#) to extend the Paycheck Protection Program (PPP) to August 8, 2020. The Small Business Administration (SBA) [stopped accepting](#) applications on June 30 with \$134 billion in [funding remaining](#).

As of June 27, nearly 4.8 million loans were made under the PPP for a total of \$518.9 billion.

Beyond extending the program deadline, the new law makes no other changes to the PPP.

Senator Ben Cardin (D-MD) [indicated](#) that the August 8 date was chosen because it is the end of the Senate's next work period, and lawmakers expect to pass the next economic stimulus package by then.

On [June 23](#), the SBA and Treasury announced they will publicly release information about the recipients of PPP loans. Rather than disclosing the loan amount, the SBA will report loan sizes in ranges for recipients of loans of more than \$150,000. Loans of \$150,000 or less account for 86% of the total number of loans made and 27% of the total dollar value of lending, as of June 27.

In a June 25 [letter](#) to the Chair of the House's Committee on Ways and Means, the Treasury and SBA indicated that the SBA would provide detailed PPP loan information, including exact loan amounts, to the relevant Congressional committees. They said that they will treat nonpublic personally identifiable information about individuals and commercially sensitive business information as confidential.

Fed Expands Main Street Lending Program to Include Nonprofits

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

On [July 17](#), the Federal Reserve expanded eligibility for the Main Street Lending Program (MSLP) to include nonprofit organizations such as educational institutions, hospitals, and social service organizations. The Fed will purchase 95% participations in loans to nonprofits under terms that are similar to terms it previously announced for for-profit companies, with additional criteria tailored to non-profit organizations.

The Fed sought public comment on making this expansion in an announcement on [June 15](#).

There are two facilities under the MSLP for nonprofit organizations: the [new loan facility](#) and the [expanded loan facility](#). The terms of the nonprofit organization loan facilities are similar to the terms of the for-profit business loan facilities. The interest rate for nonprofit loans, like for-profit loans, is set at LIBOR plus 300 basis points. Nonprofit loans will also have a five-year term, with principal deferred for two years and interest deferred for one.

In order to be eligible for the MSLP, a nonprofit organization must be US-based and operational since at least January 1, 2015. Organizations must have more than 10 employees. An eligible organization must also have either less than 15,000 employees or have 2019 revenues of \$5 billion or less. The organization's total non-donation revenues must be equal to or greater than 60% of its expenses between 2017 and 2019. Eligible nonprofits must have an endowment of less than \$3 billion. These organizations must have a ratio of adjusted 2019 earnings before interest, depreciation, and amortization (EBIDA) to unrestricted 2019 operating revenue of at least 2%. The table below provides more details regarding the terms of the loans.

The Fed announced the MSLP for for-profit businesses on [April 9](#). The program began accepting lender registration on [June 15](#) and the Federal Reserve Bank of Boston, which manages the program, announced that the program was fully operational on [July 6](#).

As of [July 16](#), the MSLP SPV had purchased its first \$12 million participation in a loan through the for-profit loan facilities. This loan went entirely to 15 medical practices in Wisconsin, according to the Treasury Secretary in Congressional testimony on [July 17](#).

The Boston Fed has updated the MSLP FAQs six times. On [June 20](#), it clarified what actions are required of borrowers and lenders to certify that the borrower is not a covered entity, which is a firm that is more than 20% owned by government officials. The [June 26](#) update included clarifications about calculating compensation and the financial information required from borrowers. The [July 15](#) update clarified rules for businesses established in 2020, among other changes.

Proposed Main Street Lending Program Nonprofit Loan Options	Nonprofit New Loans	Nonprofit Expanded Loans
Term	5 years	
Minimum Loan Size	\$250,000	\$10M
Endowment Cap	\$3 billion	
Years in Operation	At least 5 years	
Eligibility Criteria	<ul style="list-style-type: none"> • Minimum employees of 10 and less than 15,000 • Total non-donation revenues equal to or greater than 60% of expenses for the period from 2017 through 2019 • 2019 operating margin of 2% or more • Current days cash on hand 60 days • Current debt repayment capacity – ratio of cash, investments and other resources to outstanding debt and certain other liabilities – of greater than 55% 	
Maximum Loan Size	The lesser of \$35M, or the borrower’s average 2019 quarterly revenue	The lesser of \$300M, or the borrower’s average 2019 quarterly revenue
Risk Retention	5%	
Principal Repayment	Principal deferred for two years; years 3-5: 15%, 15%, 70%	
Interest Payments	Deferred for one year	
Rate	LIBOR + 3%	

Utilization of Credit Support Programs for SMEs

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

In response to the COVID-19 pandemic, governments have implemented a variety of programs to support small- and medium-sized enterprises (SMEs). A large portion of these programs are designed to facilitate credit access. These programs range in size, eligibility, and terms. YPFS has begun to compile usage information on 26 major programs across 16 countries. The information can be found in this [spreadsheet](#).

According to the data compiled across the 26 programs as of July 15, the countries have committed at least USD 3 trillion¹ in funding for credit support programs with a total utilization across the programs of USD 1.8 trillion, meaning nearly 40% of overall capacity is still available. Utilization varies significantly across countries, as the UK's Future Fund and the US Paycheck Protection Program have seen 84% and 79% utilization respectively, while the US Main Street Lending Program has not purchased a single participation in a loan. With respect to credit guarantee schemes, utilization is higher in Spain and Italy while total utilization of credit guarantee schemes in New Zealand and Denmark is less than 2%.

Comparing utilization across programs in the UK shows the limited demand for the initial 80% government guarantee scheme, as the Coronavirus Business Interruption Loan Scheme (CBILS) guaranteed 54,538 loans and drew down 4.4% of the total funding available in a GBP 330 billion package of support to businesses. The UK government later announced a 100% guarantee scheme, the Bounce Back Loans Scheme (BBLs), which has guaranteed 1,047,611 loans, nearly 20x the number of loans made under CBILS. Some of the difference in demand can likely be attributed to the loan size, as the BBLs fully guarantees loans with a maximum size of GBP 50,000 while the CBILS provides an 80% guarantee on a loan with a maximum size of GBP 5 million.

The relative size of the programs varies significantly. Total funding for the UK's CBILS and CLBILS programs combined represent nearly 15% of GDP; two of Spain's programs combined represent nearly 12%; and France's program represents nearly 13%. Significant programs in the US like the Paycheck Protection Program and the Main Street Lending Program are larger in absolute terms, USD 659 billion and USD 600 billion respectively, but make up a smaller percentage of GDP, approximately 3% each. Denmark's program, which has seen relatively little utilization, is a comparatively small program as a portion of GDP, though it should be noted that credit support is only one of many Danish initiatives to support SMEs.

According to the [ECB's Bank Lending Survey](#), released on July 14, banks reported a net tightening of credit standards for loans to SMEs so far in 2020. During this period, borrower demand for loans and credit lines surged, highlighting the need for emergency liquidity. Banks

reported that government guarantees on lending played a key role in maintaining favorable credit standards for overall business lending.

However, banks in different countries reported different effects of government guarantees. Banks in Germany noted that demand for government guaranteed loans was lower than they had expected. Banks in France, Spain, and Italy, where credit guarantee program utilization rates were relatively high, reported that the government guarantees were a significant factor in their ability and willingness to lend.

The SME Credit Support Programs Usage spreadsheet is one of many resources maintained by YPFS under the heading [Key Program Summaries](#). The spreadsheet is not comprehensive, as many other countries provide credit support, and additional programs will be added as necessary. Utilization data will be periodically updated.

[1] Some programs do not have explicit sizes as they are either part of larger support packages or the respective government has not announced a size limit. This USD 3 trillion total does not include programs with an undefined size but does include total funding for support packages in which the credit support program is only one component of the overall package (UK CBILS / CLBILS and Austria).

Portugal Announces SME Debt Securitization Program

By Wyatt Wolfram

Original post [here](#).

On June 4, the Portuguese government announced plans to create a special purpose vehicle to acquire debt issued by small- and medium-sized enterprises (SMEs) and sell [debt securities](#) on capital markets.

The program builds on an existing program, “Obrigações Turismo 2019” (OT 2019), that focuses on the tourism sector, but it will be more broadly available to SMEs across industries. The new program is part of an extensive [package of economic relief policies](#) known as the “Economic and Social Stabilization Program.”

Obrigações Turismo 2019

The existing initiative, OT 2019, is [designed to diversify](#) financing sources for SMEs in the tourism industry by making capital market financing available. The program is [jointly operated](#) by Turismo de Portugal, a state agency responsible for the promotion, enhancement, and sustainability of the tourism industry; and SPGM, the coordinating entity of the Portuguese Mutual Guarantee System, whose mission is to provide financial guarantees to the benefit of national companies.

The government guarantees 30% of the total issue amount with a maturity of seven years. OT 2019 originally intended to make available EUR 100 million in bonds to the capital markets.

All SMEs and middle-capitalization companies (mid-caps) – those companies with less than 3,000 employees – operating in the tourism industry are eligible to apply for debt issuance through OT 2019. Companies must meet specific financial requirements, including for liquidity (current assets / current liabilities > 1), profitability (EBITDA margins > 15% or return on assets > 5%), and indebtedness (financial debt / EBITDA < 5). EBITDA is earnings before interest, taxes, depreciation, and amortization.

Companies that meet these criteria may issue up to EUR 15 million in debt through the program. Approved issuers will be grouped such that the bonds obtain a minimum rating of BBB-, which takes the public guarantee into account, and all participants are subject to the same interest rate and terms. [Bonds will then be shopped](#) to institutional investors and made available to the capital markets.

New SME Program within the “Economic and Social Stabilization Program”

Details of the new program have not yet been announced. It will be based on OT 2019 and it will allow for the creation of a new special purpose vehicle to acquire SME debt, but with an expanded mandate.

A [2020 OECD Report](#) noted that debt security issuance is an insignificant source of finance for SMEs in Portugal, as most companies rely solely on bank financing. Companies surveyed cited low liquidity in the debt market, high issuance costs, and complex regulations as the main reasons for not issuing debt. The government's new debt purchase program aims to reduce these issues, thus opening additional financing options for Portuguese SMEs and mid-caps.

Other countries have adopted similar programs with the goal of increasing access to capital markets for SMEs. In late 2018, [Australia announced](#) the formation of the Australian Business Securitization Fund (ABSF), an AUD 2 billion fund to support the provision of finance to SMEs. The fund made its first investment in securities worth AUD 250 million in April 2020. However, at that time the Australian Office of Financial Management, which oversees the ABSF, stated that it needs to assess the currently challenging market conditions before initiating additional ABSF investment proposals. Separately, in 2016 the European Investment Fund (EIF) [launched the EIF-NPI Securitization Initiative](#) (ENSI), a cooperation and risk-sharing platform partnered with European National Promotional Institutions (NPIs). NPIs are European legal entities which are given a mandate by a member state to carry out financial, development, and promotional activities. ENSI provides funding and capital relief, defines standard procedures and minimum criteria for lending, and broadly acts as a catalyst for the development of the SME securitization market in Europe.

One-Quarter of SMEs Closed During the COVID-19 Lockdown

By Mallory Dreyer and Kaleb Nygaard

Original post [here](#).

One-quarter of small- and medium-sized enterprises (SMEs) globally, and as many as half in countries like India and Bangladesh, closed between January and May due to the COVID-19 lockdown, according to the Global State of Small Business Report.

On [July 15](#), Facebook, the OECD, and the World Bank released the report, which draws on the Future of Business Survey with more than 30,000 SMEs responding in more than 50 countries and regions. The survey compiles data regarding the impact of the COVID-19 pandemic on SMEs and their top policy needs to survive the pandemic, which include salary subsidies, tax deferrals, and credit guarantees.

The Future of Business Survey was launched as a biannual survey in [2016](#) to provide more up-to-date and global data regarding challenges and expectations of online SMEs. In response to the COVID-19 pandemic, the survey will take place monthly in order to better monitor the impact of the pandemic on SMEs. The survey covers SMEs with Facebook Business Pages in specific countries. Therefore, the data don't reflect the state of SMEs in an entire country or region, but can provide policymakers with some key insights.

In response to the COVID-19 pandemic, SMEs have been forced to close, faced declining revenue, and reduced employment. According to the survey, 26% of SMEs reported closing between January and May of 2020, though there is significant variation across countries. South Asian countries, such as India and Bangladesh, were particularly affected as 47% and 50% of SMEs in each country closed. In both Germany and Sweden, less than 10% of SMEs reported closing.

Among the SMEs that continued to operate, 62% reported that they generated lower sales in the prior month compared to the same month in 2019. The transportation and hospitality sectors were most likely to report a decline.

One third of SMEs reported cutting staff. Employment reductions vary widely across sectors and regions. SMEs in European countries, where there are strong government support measures for employment, were less affected. Employment reductions were more severe in low- and medium-income countries.

During normal times, SMEs have limited access to financing. This challenge has been exacerbated by the pandemic. Government support programs seek to alleviate SME financing constraints, but only a quarter of businesses surveyed had received such support. The degree of support varied greatly across countries and regions, with around 50% of SMEs in countries like Australia, Belgium, and Ireland receiving government support and just 10% of SMEs in regions

like Latin America, South Asia, and Africa receiving support. Of the total support provided, government grants represented 49% of the SME support.

SMEs said the government assistance they most desired were salary subsidies, tax deferrals, and access to loans and credit guarantees. SMEs cited other important support measures like rent and loan repayment deferrals, utility subsidies, and social security exemptions.

Of the SMEs that reported closing, 28% expected to reopen within a month and 54% expected to reopen within three months. The remaining businesses were uncertain when or if they would be able to reopen. SMEs reported that the top three near-term challenges they faced were: lack of demand (cited by 47%), cash flow constraints (cited by 37%), and repaying outstanding loans (cited by 19%). Some SMEs reported that they were adapting to the pandemic by increasing their online presence, with 41% of SMEs surveyed in Ireland and 32% in Brazil reporting such action.

The full survey data can be found [here](#).

Paycheck Protection Program spread loans widely, if not evenly

By [Corey Runkel](#)

Original post [here](#).

Congress charged the Paycheck Protection Program (PPP), enacted under the Coronavirus Aid, Relief, and Security (CARES) Act on March 27, with lending to small businesses stricken by the effects of COVID-19, and authorized private lenders to facilitate an unprecedented flow of Small Business Administration (SBA)-guaranteed loans. On this first objective, the program delivered, approving nearly 4.9 million loans with a total volume just north of [\\$521 billion](#). But its performance, its efficacy, and its efficiency remain unsettled questions.

To address these concerns, the SBA released [loan-level data](#) comprising each approval during the PPP's initial run from [April 3](#) to June 30. This data offers a low-resolution picture of how the program performed against several objectives specified by the CARES Act, such as targeting rural and underserved markets, including single-person businesses, supporting hotel and restaurant franchises, and – its most important function – retaining jobs.

PPP data fall into two categories: loans smaller than \$150,000; and loans at least \$150,000 in value. For small loans, exact dollar figures are given, but borrower information is anonymized to the zipcode, legal structure, and 6-digit [NAICS](#) code of the business. For large loans, only ranges of loan values are given, but the borrower information is precise, with names and street addresses listed. The vast majority of applicants also reported the number of jobs that would be retained should an application be approved.

The utility of the PPP data is limited by the aggregations that the SBA has chosen to perform, which it considered necessary to [keep](#) confidential the salaries of employees in smaller businesses. The decision came after a [back-and-forth](#) between Treasury, [oversight bodies](#), and Congress. One of the most controversial situations cropped up early, after reports that large and financially sound companies took PPP loans (though more than \$38 billion has been [returned](#)). Calls are still being sounded to release the names of smaller creditors and the loan amounts given to larger creditors.

Additionally, a Bloomberg team led by Mark Niquette found that the dataset is [sprinkled with errors](#). While no single type of error seems to be significant in the scope of 4.9 million loans, their frequency casts doubt on the precision of SBA data. But where these data are limited, we consider several studies carried out since the program's establishment.

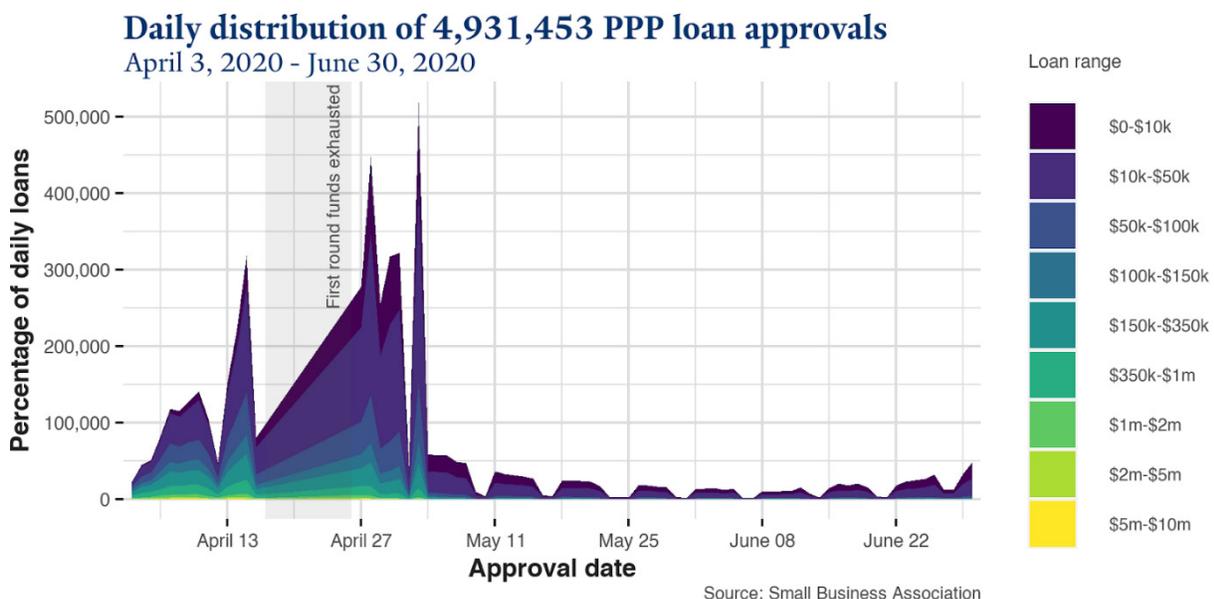
In short, access to loans was widely distributed across nearly 5,500 lenders. However, the pool of loan recipients looks quite similar to the pool of business owners. Though demographic data are subject to self-reporting, the available data indicate a lack of priority for women, minorities, and veterans contrary to CARES Act mandates (Fig. 2). This may have resulted from the SBA's delay in issuing guidance prioritizing these underserved and rural markets. Rural markets,

however, seem to have fared better in spite of this delay. Rural markets were overrepresented due to the ability of small lenders to [ramp up](#) loan approvals compared to large banks with specialized loan departments, though the number of loans in an area were roughly proportional to a zipcode’s number of businesses (Fig. 5).

The PPP seems to have been effective in another feature, its explicit inclusion of nonemployers, those “sole proprietors, independent contractors, and eligible self-employed individuals” who have been traditionally excluded from stimulus. Just over one million nonemployers were approved for loans. That also means the total number of loans approved is not representative of the number of jobs retained: 37% of loans saved just one or two jobs.

The hospitality industry more often reported retaining higher numbers of jobs than any other sector (Fig. 7), despite [concerns](#) about the ability of restaurateurs and hoteliers to keep employees on during lockdowns. Changes to the design of PPP, and the belief by some that blanket loan forgiveness is on its way, have prompted concerns over its efficacy. Though research has just begun, economists estimate that the program spared less than 5% of imperiled jobs.

Figure 1.



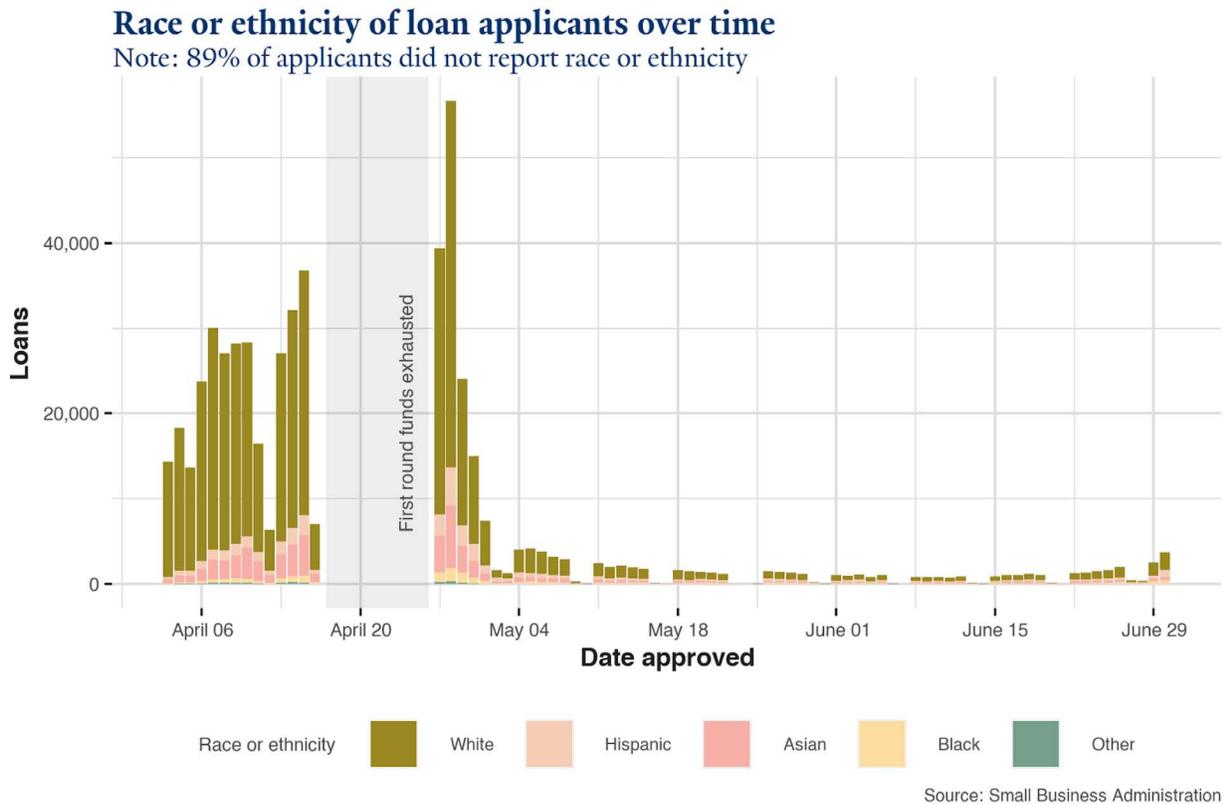
An earlier YPFS [blogpost](#) discussed the fact that more large borrowers were approved earlier.

Helping rural markets, but not the underserved

The SBA Office of Inspector General [wrote](#) in a June report that no guidance had been issued to lenders prioritizing small business concerns run by “veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals [...], women, and businesses in operation for less than 2 years” (4). The CARES Act stipulated that the SBA issue such guidance.

As may be expected, what demographics that are available show that the pool of approved applicants closely resembles those of US business owners (Fig. 2). This finding should be taken with a grain of salt, as loan applications made demographic questions optional, resulting in only 24% of approved applicants answering in one of three fields on the application: race or ethnicity; sex; and veteran status. Information about the other groups included in those “underserved” markets was [not collected](#) during the PPP’s initial run.

Figure 2.



Approved borrowers closely resemble [business owners](#).

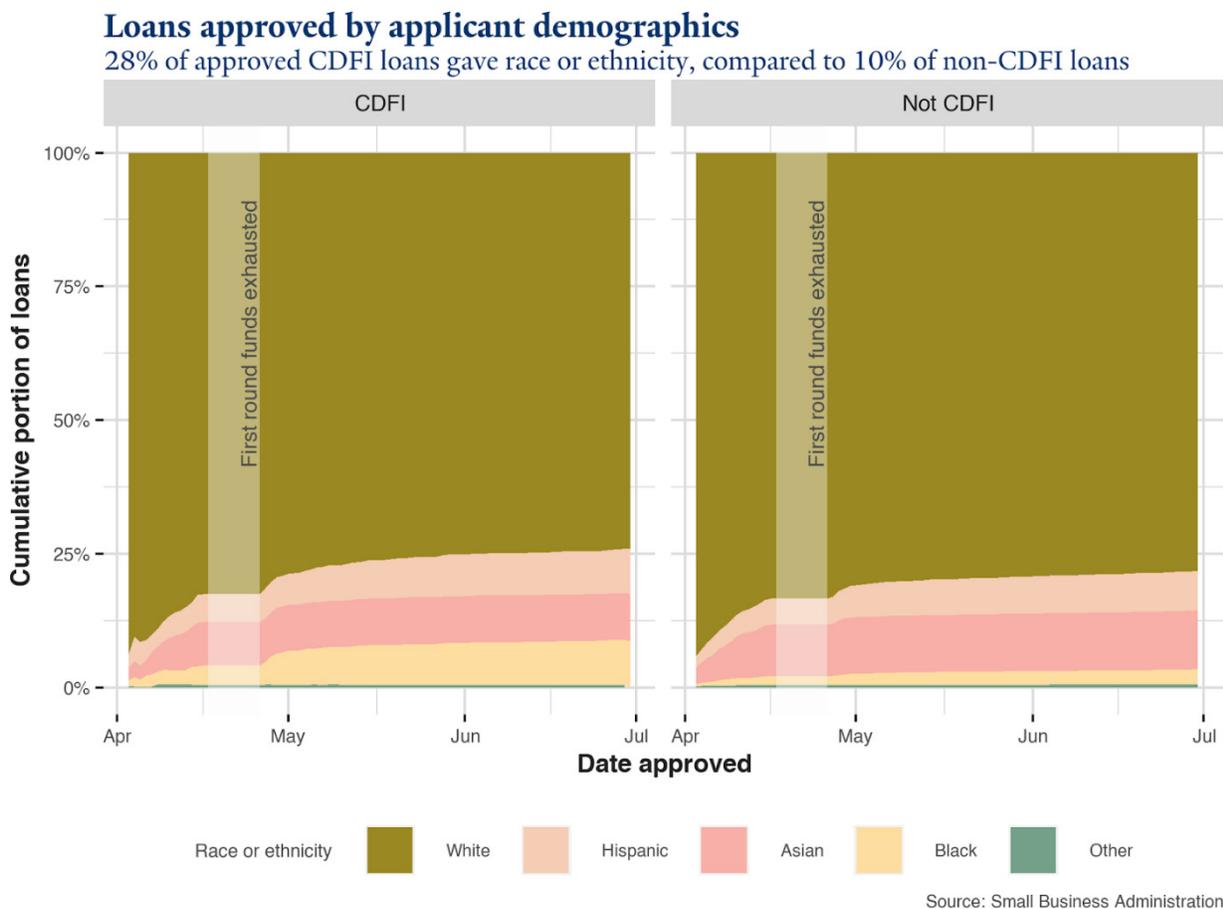
A small [study](#) by the National Community Reinvestment Coalition, which has conducted several studies to investigate discrimination against Black and women loan applicants, can offer more granular information. Their method pairs white and Black small business owners with similar credit profiles applying for credit at the same banks, and compares the differences in outcomes. In line with previous studies of SBA lending, they found that PPP lenders treated white applicants better than Black applicants, and men better than women.

To address these concerns, in late May the SBA [designated](#) \$10 billion of PPP funds for community development financial institutions (CDFIs). The country’s 1,129 CDFIs are [certified](#) by the Treasury, and “provide critically important capital and technical assistance to small businesses from rural, minority and other underserved communities.” According to the press

release, CDFIs had already approved \$7 billion in loans during the program’s first round of funding, which was exhausted on April 16.

Though self-reported data may bias the reported statistics, CDFIs seem to have slightly increased the racial diversity of PPP borrowers, though differences in borrower gender and veteran status appear to be negligible between CDFIs and non-CDFIs. In particular, CDFIs appear to have significantly boosted loans to Black applicants. From the beginning of the program, more borrowers who applied through CDFIs reported their race as “Black or African American” than did borrowers from other lenders (Fig. 3). To some extent, the presence of CDFIs addressed the fact that, during the first round of funding, approved borrowers were more often white than in subsequent rounds.

Figure 3.

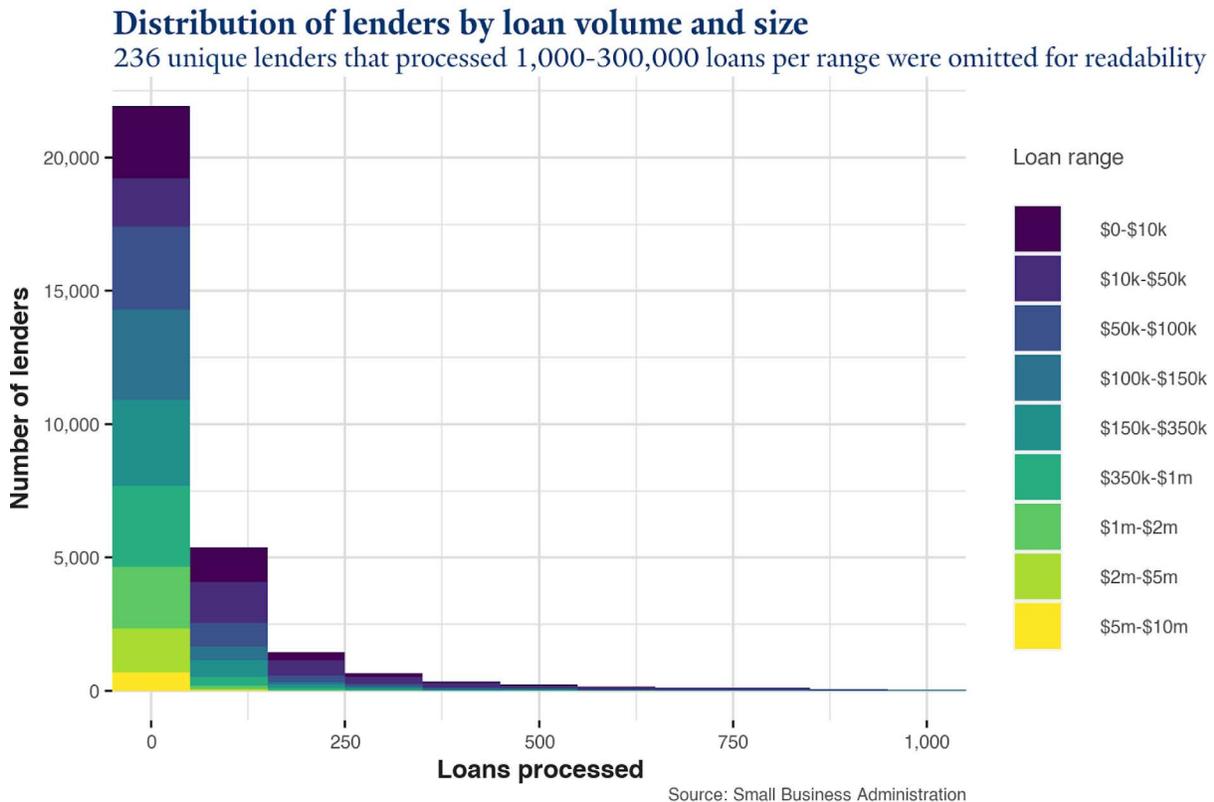


Comparison of CDFIs with rest of PPP approvals.

This “head start”, as termed by [Bloomberg](#), may be due to the outsize impact of small lenders (Fig. 4), most of which are not CDFIs. While the four largest US banks engaged in 36% of small business lending before the PPP, they only shared 4% of loans in the first round. Smaller lenders

-- [more often](#) located in rural markets, which tend to be whiter -- made up the difference. Without dedicated small-business lending departments, the smallest of these lenders were more able to redirect resources to loan approvals. Hence, the key to accessing rural markets may not have lay in the guidance, but in the type of lender authorized.

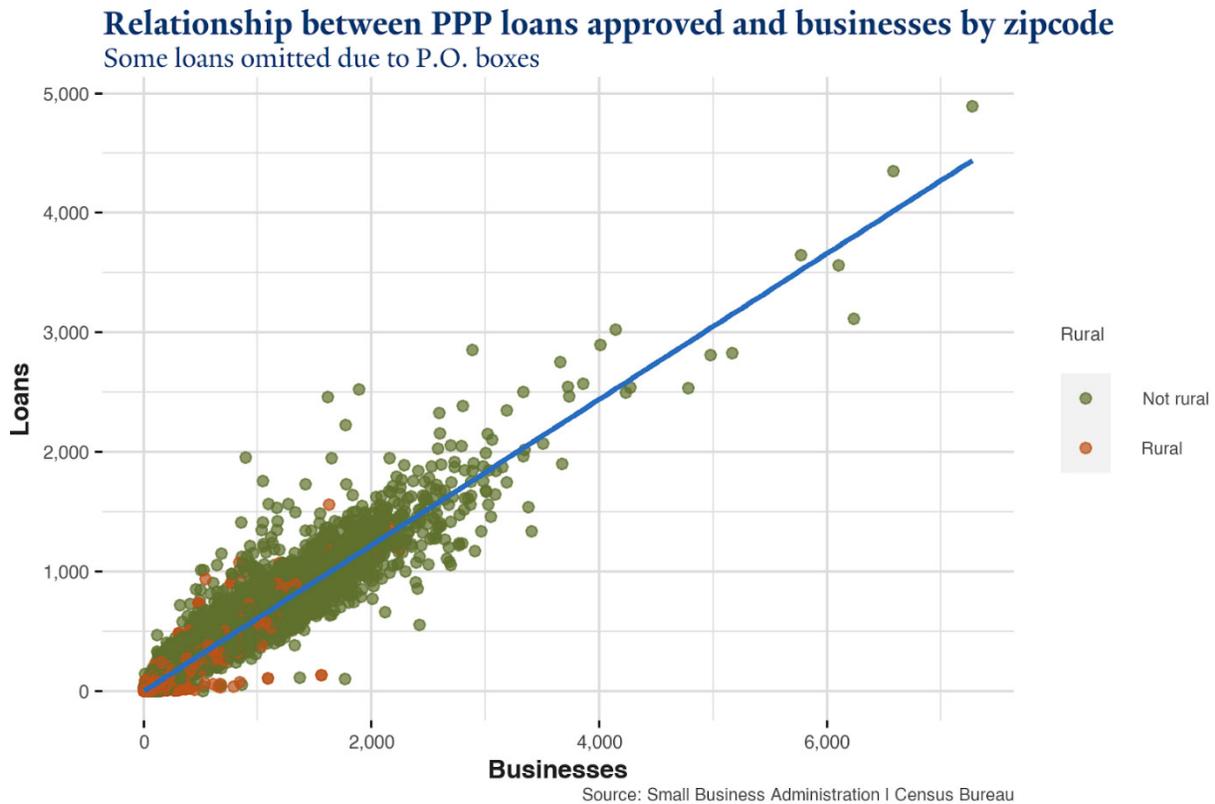
Figure 4.



Many tiny lenders.

Research using first-round SBA data [argues](#) this point, that, despite delayed SBA guidance, the wide diffusion of loans among lenders meant that more loans went to small banks and rural areas. But the paper questions the value of early relief to rural markets. In retrospect, it is clear that urban areas faced much more severe outbreaks earlier than did rural areas. The authors write that the first-round “funds flowed to areas less hard hit” by the coronavirus, a relationship which held when both the value and number of loans were considered. This research does not evaluate the PPP’s rural-markets mandate per se, but it illustrates how such guidance may not have allocated aid where it was most needed. And in general, it illustrates how speedy and equally-distributed lending (Fig. 5) may not have made for efficient allocations.

Figure 5.

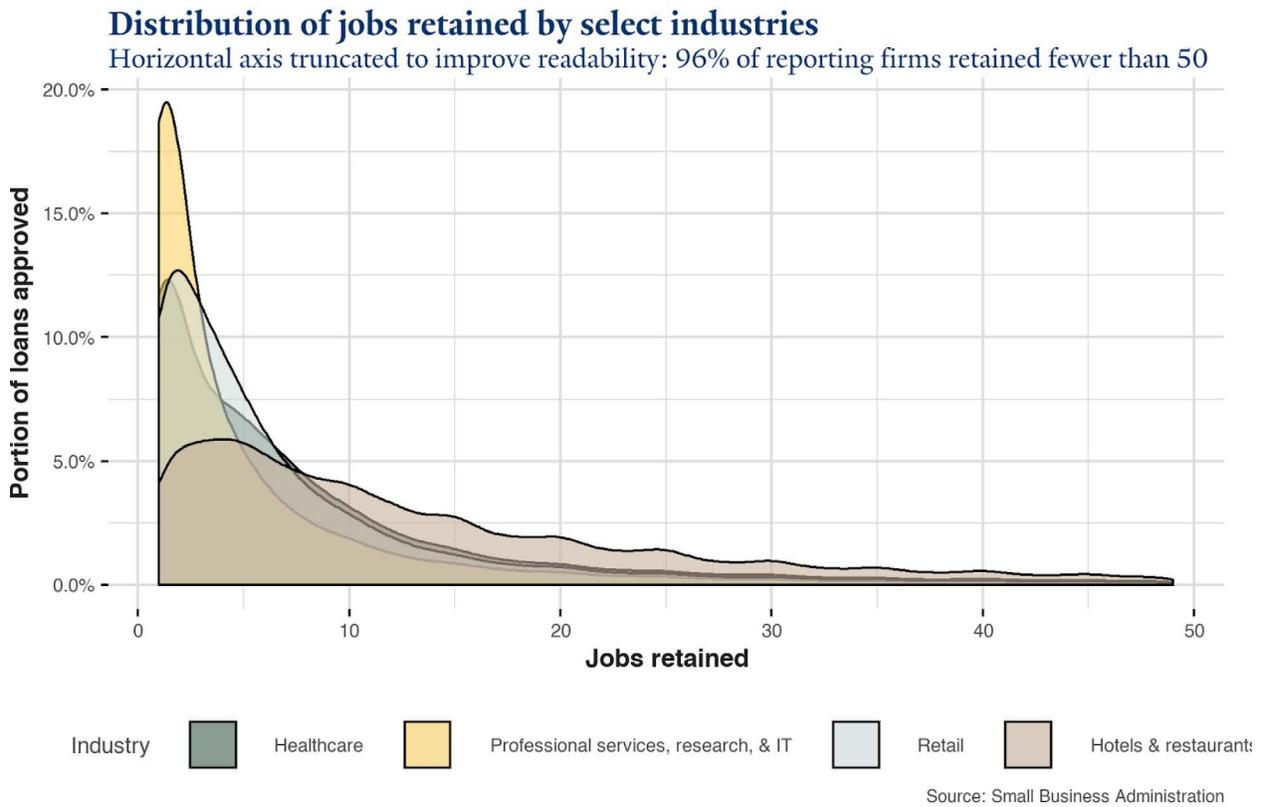


Loan approvals were roughly proportional to the number of businesses.

Different sectors also varied in their usage of the PPP. Restaurants and hotels have reported retaining comparatively more jobs than other sectors (Fig. 8). Subsections 1102(a)(2)(36)(D)(iii-iv) targeted franchisees classified under NAICS as [Accommodation and Food Services](#) to apply for PPP loans by temporarily exempting them from federal regulations prohibiting certain affiliations between businesses. Hotels and restaurants were approved for the sixth-most loans among all industries, but the most jobs retained per loan (Table 1).

Academic research on restaurants and hotels have yet to be published, but the PPP received [criticism](#) early on for strict loan terms. The original terms required borrowers to spend funds within eight weeks to retain or rehire workers in order for the loan to be forgiven; this proved difficult for many restaurants that were closed or limited in the service they could offer due to government restrictions. Others [waited](#) until the term lengthened to 24 weeks before reopening, forestalling employment gains.

Figure 8.



Restaurants and hotels report flatter job retention curves.

Nonemployers score big

Sole proprietorships, independent contractors, and self-employed individuals constitute an unknown amount of the US workforce. The conservative [estimate](#), based on the Census Bureau's Nonemployer Statistics series, put the number north of 25 million in 2017. However, these people have traditionally been excluded from stimulus measures since their numbers are difficult to track and their political power largely unorganized. The self-employed have traditionally been left out of the mix by US relief programs, and are [usually](#) not eligible to collect unemployment benefits. Nonemployers responded to the PPP inclusion by borrowing \$15.5 billion across more than 1 million loans.

Table 1. Loans made, jobs retained, and jobs per loan by industry.

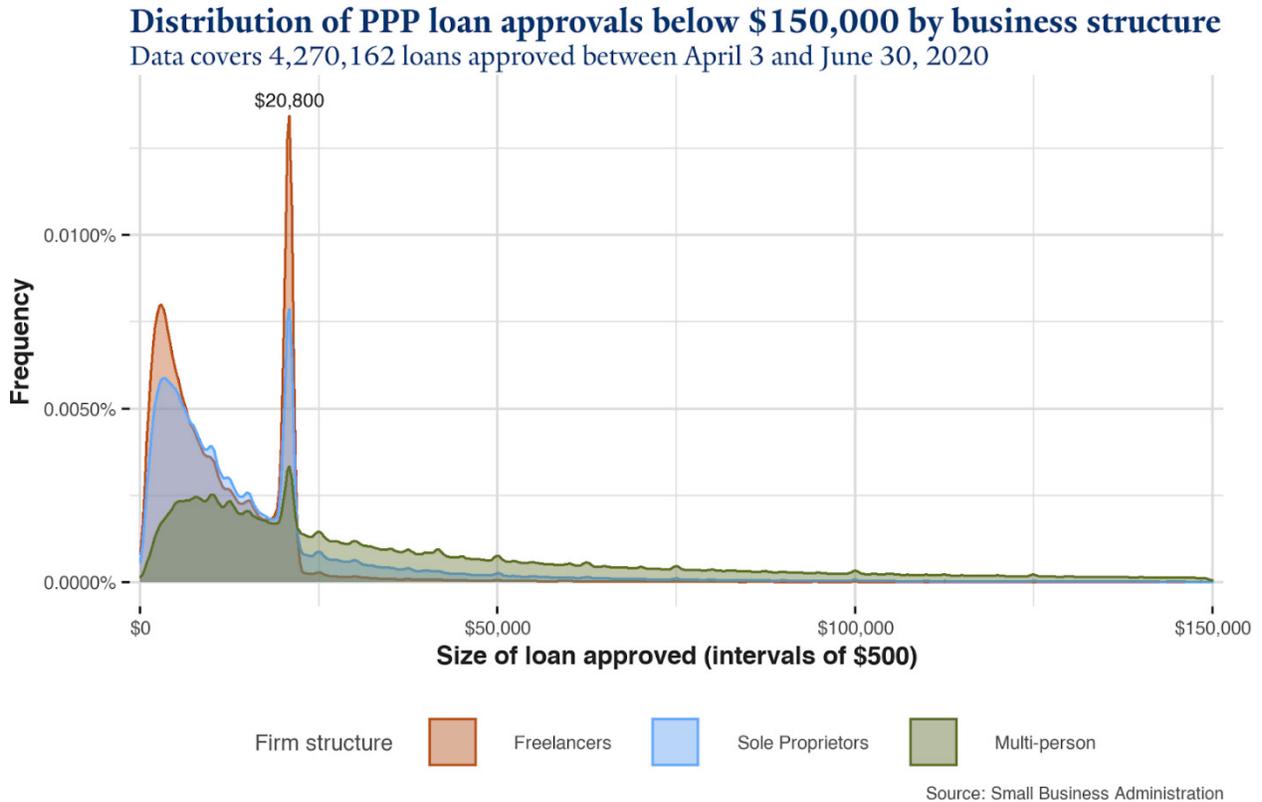
Industry	Loans	Jobs retained	Jobs per loan
Professional services, research, & IT	528,391	4,558,974	8.6
Other	497,728	4,425,858	8.9
Healthcare	422,974	7,052,331	16.7
Construction	387,810	4,777,952	12.3
Retail	381,133	4,466,217	11.7
Restaurants & hospitality	311,805	7,133,099	22.9
Real estate	204,003	1,379,370	6.8
Administrative support	198,557	2,851,569	14.4
Manufacturing	195,958	4,316,136	22.0
Logistics	150,690	1,561,370	10.4
Wholesale trade	141,282	2,200,202	15.6
Finance & insurance	139,727	935,968	6.7
Agriculture	120,658	982,294	8.1
NA	100,882	791,337	7.8
Entertainment & recreation	95,425	1,244,052	13.0

This level of uptake skews the distribution of loans heavily toward smaller amounts. But this distribution does not drop off exponentially, as the distribution of lenders does (Fig. 4). Rather, almost 177,000 loans fall between \$20,800 and \$20,833 – while only 3,000 approvals fall in the next \$33 of loan amounts (Fig. 6). This phenomenon is sharpest for sole proprietors, contractors, and the self-employed, and reflects the [maximum](#) forgivable value of net profits. This measure is how nonemployers typically compensate owners, and is what owners of such businesses report as taxable income. Owner-operator businesses may also be approved for sums above \$20,833 to cover costs such as rent and utility, so long as 60% is spent replacing owner compensation.

Due to the impact of nonemployer borrowers, many loans saved a single job. This distribution attenuates the PPP’s headline performance. Disentangling the nonemployer loans from loans to employers (such as restaurants) yields a more useful picture of the PPP. Focusing just on nonemployers exposes the [tradeoff](#) many owner-operators face between applying for the PPP and

taking unemployment insurance, as individuals cannot seek both. For nonemployers with small overhead costs, that decision comes down to pre-pandemic income and state of residence. Unlike loans to businesses that face high fixed non-payroll costs, PPP loans to many nonemployers more closely resemble supports for individuals, which [helped](#) the personal savings rate touch 33% in April before [dropping](#) somewhat in May.

Figure 6.



Note that the Nonemployer Statistics series reports large numbers of S-Corporations and Partnerships as non-employers; the SBA data are unable to discriminate between nonemployers within business structures.

Overall, job retention appears low, but is consistent with loan approvals

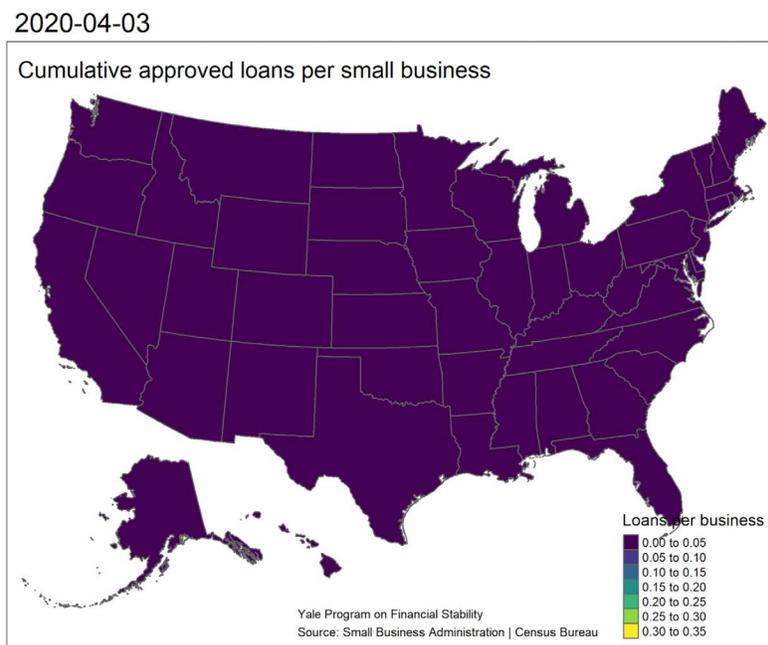
Likely the most valuable study in terms of data quality to be released thus far is a preliminary paper [published](#) on July 22 by researchers from MIT, the Federal Reserve, and payroll software company ADP. Using several million pairs of employee-employer payroll data from ADP, authors evaluate employment levels just below and above the 500-employee general small business cutoff used by the SBA. They control for tempestuous business conditions brought by changing health regulations, as well as for variance among states. Like the above study conducted on the PPP's first round, the authors find that the number of jobs saved is less than the number of loans made, a far cry from the 51 million jobs claimed on loan applications.

This finding would also run contrary to expectations that, at minimum, each loan saved at least one job. But that first study questioned whether the PPP had any positive employment effects at all. In contrast, this second paper estimates gains of 1.4 to 3.2 million jobs. The speed of the program was hampered in some cases by its terms, described above for restaurant owners, but applicable to many consumer-facing businesses. And, the ADP analysis cannot capture the gains of tiny firms, since it limits its analysis to 50-employee firms and larger. 96% of reporting borrowers listed fewer than 50 jobs retained. While a 60-employee business may choose to retain only 40 jobs, for instance, the ADP data are likely not fully representative of PPP borrowers.

What is clear is that nearly 4.9 million small businesses across the country (Fig. 9) received loans that they attested would help with the impacts of the coronavirus crisis. But the decoupling of loan amounts from job retention raises important questions about the efficiency of the Paycheck Protection Program with regards to protecting paychecks. Important to note is that the intent of the program has changed slightly. Legislation passed on June 3 [altered](#) the PPP's loan forgiveness terms to include a larger portion of non-payroll costs, such as rent and utilities, crucial to basic operations.

In June, the Brookings Institution [published](#) an opinion along these lines, speculating that the PPP's easing of loan terms – the very same that some inside the restaurant industry claimed were necessary – would help creditors of small businesses more than workers. However, these tensions, central to the [oversight](#) of the PPP as a crisis response measure, cannot be resolved before further research is conducted, and possibly more disclosures are made on the part of the SBA.

Figure 9.



Direct Lending to SMEs - Canada's Business Credit Availability Program

By Priya Sankar

Original post [here](#).

Canada has reintroduced a program from the Global Financial Crisis of 2007-09 to provide government loans directly to small businesses to help them deal with the economic consequences of the COVID-19 pandemic.

Countries across the world are adopting measures to support small and medium-sized enterprises (SMEs) during the COVID-19 crisis. They often use credit guarantees to facilitate lending to SMEs by guaranteeing their bank loans. This post discusses a less common tool, direct governmental lending to SMEs, illustrated by Canada's programs both during the Global Financial Crisis, and today.

Direct Lending to SMEs

Some countries have implemented programs for direct lending to SMEs in both the Global Financial Crisis and the COVID-19 crisis, though it remains a less common tool, and one often paired with credit guarantees for SMEs. Often these direct loans are made through a bureaucratic agency focusing on small businesses or a government bank focused on development of specific industries. Several countries have created loan programs for SMEs funding innovation or new technology. A partial list of countries adopting these interventions during the Global Financial Crisis can be found on page 20 of the OECD report found [here](#).

Canada's COVID-19 SME Lending Program

On [March 13, 2020](#), the Canadian government re-established the Business Credit Availability Program (BCAP), allowing the Business Development Bank of Canada (BDC) and Export Development Canada (EDC) to provide CAD 10 billion to businesses. As of [March 16, 2020](#), the BDC will now offer small business loans of up to CAD 100,000 that can be obtained in as little as 48 hours from the time of approval. It will also offer flexible working capital loans of up to CAD 2 million, with potential payment postponements for six months, to bridge cash flow gaps and support daily operations. The BDC will also provide purchase order financing to increase flexibility in fulfilling domestic or international orders.

SMEs seeking to access the BCAP will first contact their financial institutions. The financial institutions will then assess SMEs with liquidity needs beyond what the private sector can meet, and refer them to the BDC or EDC. Thus, although Canada will be engaged in direct lending to SMEs, it will do so in consultation with those SMEs' existing financial institutions. The BDC and EDC are [paying particular attention](#) to sectors that are heavily impacted by the crisis, like oil

and gas, and tourism. Farm Credit Canada is also increasing short-term credit available to farmers and the agri-food industry.

Canada's GFC SME Lending Program

Prior to the Global Financial Crisis, the BDC, EDC, and the Canada Small Business Financing Program provided direct loans and guaranteed loans to SMEs.

The BCAP was first established in response to the GFC. It allowed the BDC and EDC to work with private lenders to finance viable businesses. It [disbursed](#) over CAD 10.1 billion in 2009 and 2010, of which CAD 3.44 billion went to SMEs with under CAD 25 million in annual revenue. The BCAP's Economic Recovery Loans Initiative, established in early 2010, made small working capital loans of up to CAD 100,000, and constituted much of BCAP's 2010 activity, despite expiring in October of that year.

[Feedback](#) on the BCAP's countercyclical activity during the GFC was positive. The Conference Board of Canada commended the BDC and EDC on their role in providing credit support during a crisis, and credited them with speeding up the healing of the Canadian financial system.

Support for Individuals

Support for individuals includes all policies implemented to reduce the economic impact of a downturn on households. These measures support households by offsetting the decline in disposable income they face as a result of adverse economic conditions. Policies implemented to achieve this include direct payments, expanded unemployment benefits, or income tax cuts.

Analysis

Government Support to Individuals and Households During Crises

By Kaleb Nygaard, Pascal Ungersboeck, Mallory Dreyer, Rosalind Z. Wiggins, and Greg Feldberg

Original post [here](#).

Many countries are adopting programs to provide support to individuals in response to the COVID-19 pandemic, which has entailed unprecedented government-directed curtailment of economic activity. These programs are designed to provide cashflow support for individuals and households who may be struggling due to economic uncertainty and hardship. Measures to support individuals vary and either enhance cashflows or decrease required expenses. In the former category, countries have adopted measures to provide enhanced income support to the unemployed, direct payments to individuals, and favorable access to retirement savings. Tax cuts and filing extensions are examples of the latter.

This post begins by describing the challenges facing policymakers in designing support for individuals, provides an overview of options to support individuals, outlines a few examples of countries implementing a mix of these policies, and concludes by offering some key takeaways about why certain interventions to support individuals may be preferable in different scenarios

Statement of the Challenge

Governments must determine how to structure and implement effective, targeted support to individuals. With businesses shuttering in response to the COVID-19 pandemic, millions of individuals across the world are losing jobs and sources of income. Though the shock from the pandemic is expected to be temporary, many face immediate financial hardship with limited savings. Governments face the task of determining which tools to use to quickly provide large-scale, targeted support to individuals.

Policymakers must consider who will be eligible for support. Some tools are broad by nature, while others provide support to a specific subgroup. Eligibility can be complicated by immigrant and resident status. Funding for individual support is generally fiscal in nature, either through unemployment insurance, direct payments, tax measures, or housing relief, but the mechanism for funding is important. Some support programs require large, upfront expenditures, such as increased unemployment support or direct payments to individuals, while tax deadline extensions and tax cuts impact the timing or amount of revenue the government ultimately collects. Some programs, such as increased unemployment support, rely on existing systems, while others require that new processes be established.

In order to design policies to optimally target individuals, governments must consider the following:

1. How quickly will individuals receive aid under the program?
2. How much support should be provided?
3. Who will receive support?
4. How long should support be provided?
5. How will the government fund the program?
6. How should the tools be combined in the policy mix?

Options to Support Individuals

1. Unemployment Insurance and Wage Subsidies
2. Direct Payments
3. Income Tax Cuts
4. Other Tax Cuts
5. Deadline Extensions and Penalty Waivers
6. Access to Retirement Savings
7. Housing Relief

Unemployment Insurance and Wage Subsidies

Many countries provide support to employees who lose their jobs or who are at risk of losing their jobs. Two common approaches are unemployment insurance and short-time work schemes or wage subsidies. Unemployment insurance replaces some of an individual's lost income through direct benefits. Short-time work schemes and wage subsidies provide income support to individuals who are temporarily laid off or working reduced hours. Governments can utilize these systems to address individual hardships during times of economic downturn by increasing the amount of the usual support, lengthening the term of the support, or broadening the group of individuals who are eligible for the support.

Under unemployment insurance, governments provide direct benefits to individuals who meet qualifying criteria. During crises, countries can expand or provide additional support through their existing unemployment insurance system. The United States [CARES Act](#) temporarily increases the weekly unemployment benefit by \$600 (about 50% of GDP/capita, annualized), prolongs the covered period, and expands eligibility criteria. [During the 2007-09 Global Financial Crisis](#) (GFC), the United States extended the entitlement period multiple times, with unemployed workers eligible to receive up to 99 weeks of benefits. The [Coronavirus](#)

[Supplement](#) in Australia provides an additional AUD 550 in unemployment benefits to eligible individuals every two weeks, on top of the [JobSeeker Program](#). Greece will provide EUR 800 (58% of [GDP/capita](#), annualized) to individuals who lose jobs due to the economic impact of COVID-19, while Belgium provides [additional daily allowances](#) to individuals whose job loss is due to a “force majeure” such as the COVID-19 pandemic.

Under [short-time work schemes or wage subsidy schemes](#), an employer that is experiencing economic difficulties may temporarily reduce the hours worked by employees or temporarily furlough them, while paying employees some portion of their wages that is subsidized by income support from the government. These schemes help employers retain employees rather than lay them off, helping to [keep unemployment levels down](#) and presumably fuelling a quicker recovery.

Short-time work schemes are common in many European countries, and many are expanding short-time work schemes in response to the COVID-19 pandemic. The duration of Germany’s program has been expanded to provide support for up to 12 months. Since the onset of the pandemic, [650,000 German employers](#) have notified the government that they intend to use the country’s Kurzarbeit scheme. The French system has seen dramatic increases since the onset of the crisis and is so far covering a third of the country’s private-sector workers, at an expected cost of [EUR 24 billion](#) over the next three months. The United Kingdom has announced a new scheme under which it promises to pay employers 80% of workers’ pay, as long as they don’t lay them off. The EU recently [approved](#) an initiative, the [Support to Mitigate Unemployment Risks in an Emergency \(SURE\)](#), to lend up to EUR 100 billion to Member States to [support increased public spending](#) on short-time work schemes.

During the GFC, usage of short-time work schemes increased. The German Kurzarbeit [supported 1.4 million individuals](#). The [Czech Republic, Hungary, the Netherlands](#) and several other countries adopted new schemes. [Other countries](#) extended the duration of short-time work scheme support or increased the benefit amount.

Governments must determine what percentage of lost income to provide in benefits. This can be a flat rate amount. For example, the JobKeeper wage subsidy program in [Australia](#) provides AUD 1,500 (49% of [GDP/capita](#), annualized) every other week; the [New Zealand](#) wage subsidy provides NZD 585 (47% of [GDP/capita](#), annualized) per week for full-time workers and NZD 350 for part-time workers. Other countries provide benefits based on a percentage of each individual’s average earnings, with a cap on the benefit amount. The percentage of lost income covered, or the replacement rate, is typically 60% to 80%. For example, [Belgium](#) reimburses 70% of lost wages up to EUR 2,750 per month (82% of [GDP/capita](#), annualized); [Canada’s](#) wage subsidy covers 75% lost wages, up to CAD 847 per week (73% of [GDP/capita](#), annualized).

Governments may also choose to expand unemployment or wage support benefits to individuals not usually covered by such programs. and many have expanded the scope of programs in response to the COVID-19 pandemic. The [CARES Act](#) provides benefits to self-employed

individuals and sole proprietors through the existing state-administered system, although such individuals would not normally be eligible. Unlike the existing program, which is state-funded, this coverage is fully-funded by the federal government. The government estimates it will cost [\\$250 billion](#). Other countries are similarly expanding coverage. The Austrian program now includes apprentices, and temporary workers are eligible in Germany. The EU SURE initiative permits funds to be used for short-time work or similar schemes for the self-employed.

Similarly, during the GFC, [some countries](#) expanded eligibility to part-time workers or fixed contract workers. [The Netherlands and Slovenia](#) required that participants undergo training during the hours not worked in order to receive benefits. Other countries incentivized participation in training programs by providing greater income support.

In the European short-time work and wage subsidy programs, benefits are typically provided through the employer. In such cases, the business must meet a set of criteria; many COVID-19 related programs are available only to businesses in hard-hit sectors or that have experienced large declines in sales or workforce. In [Australia](#), companies with more than AUD 1 billion in revenue are eligible for the JobKeeper wage subsidy program if revenue decreases by 50%; smaller companies are eligible if revenue decreases by 30%. In the [United Kingdom](#), the wage subsidy program is available to furloughed workers who do not provide revenue-generating services for their employer. Some countries, such as [Estonia](#), require employers to contribute a certain amount of employee wages, while other [countries](#) request, but do not require, employers to try to cover the difference between the subsidy and the employee's standard wages

Some countries are waiving criteria and application materials in order to expedite the approval and payment process. In [France](#), the government must make a decision on an employer's wage subsidy application in two days; otherwise, it will be automatically granted. Other countries, such as [Australia](#), are waiving application materials for individuals applying for unemployment insurance.

For more specific information about Unemployment Insurance and Wage Subsidy programs, see [Support to Individuals through Unemployment Insurance and Short-Time Work Schemes](#)

Direct Payments

To address financial distress and cash-flow issues, some governments send money directly to residents. The [US](#) and [Hong Kong](#) have the largest and broadest of such programs. The US will send \$1,200 (approximately 1.9% of GDP/capita) to adult residents and \$500 per child. The Hong Kong government has announced that it will send a similar amount of HKD10,000 (\$1,290; approximately 2.7% of GDP/capita) to all adult permanent residents. For comparison, the [US](#) conducted a direct payment program in 2001 and 2008 with maximum payments to adults of \$300 and \$600, respectively. In March of this year, the [Australian](#) government introduced a program that provides up to two payments of AUD750 (\$482; approximately 0.8% GDP/capita) to approximately 6.5 million Australians described as [all welfare recipients and concession card holders, including all pensioners](#).

In the current US program, for those who filed taxes previously and included bank account information, the Internal Revenue System (IRS) will directly deposit the stimulus funds. The IRS is working on a website portal where eligible individuals will be able to provide bank account information. If no bank account information is available and where physical address information is available, the IRS will mail checks. By sending payments via direct deposit, the quickest distribution seems assured for most recipients; the government estimates that the first monies will arrive within three weeks.

The choice of administrative process affects the timing of the payment and thus how effective it is in implementing the intended policy. Eligible Australians were groups that already received government welfare payments and began receiving the COVID payments [within three weeks](#).

Hong Kong and [Singapore](#) announced direct payment plans, in February and March, respectively, but the payments are not expected to be distributed until summer. The reasons for the delay in the Hong Kong payment include approval of the budget, legal and technical issues, and the requirement that residents register for the benefit. Distribution is expected to begin [in August](#). In contrast, Singapore, subsequently announced that it would distribute part of the payments as early as April using known resident information and direct deposits in a manner similar to the US.

Direct payments programs often, though not exclusively, target those at lower income levels. Australia's program is designed with this objective. Funds are targeted at groups who need the funds and would spend them, thus [assisting the individuals and the economy](#). A number of other countries announced direct payments to lower income groups as follows: “1,500 vulnerable families” in Barbados, “12 million low-and modest-income families” in Canada, and “3 million of the poorest” in both Iran and Thailand.

The US and Canadian direct payment programs target a significant portion of the population. The payments begin to taper as income increases above a specified threshold, eventually reaching zero. The \$1,200 payment for a single adult in the United States begins to taper as income rises above \$75,000 (approximately 120% median income) and reaches zero at \$99,000. In a similar program in [Canada](#), the taper begins at around \$20,000 (approximately 80% of median income). [Hong Kong](#) is unique in offering stimulus payments to all adult permanent residents regardless of income level.

In some countries, including the [US](#) and [Canada](#), parents of dependent children are eligible for additional funds, \$500 and CAD300 per child, respectively. The 2001 [US](#) program did not include additional funds for children, but the 2008 US program in response to the GFC included an additional \$300 per child. [Australia](#) conducted a direct payment program in 2008 that included AUD1,000 per child.

As of the time of this writing, most programs announced have been single payments; however, Thailand and Barbados offer monthly direct payments. The program in Thailand is expected to last three months, and Barbados did not announce an end date to its program. [Australia](#)'s current

direct payment program has two installments; the second is [available](#) to fewer residents than the first. Recurring payments provide additional flexibility and scalability that one-time payments do not.

For more specific information about Direct Payments programs, [see Support to Individuals through Direct Payments and Tax Cuts](#)

Income Tax Cuts

Some governments are providing stimulus funds to individuals via general income tax cuts. However, it is important to note that income tax cuts only allot funds to those who still have jobs, and therefore income. (However, sometimes individuals have to pay income tax on unemployment insurance payments).

[Indonesia](#) and [Kenya](#) have passed some of the largest income tax cuts. Indonesia's program decreases the income tax rate by 30% [for workers in most sectors](#), and cuts the rate to 0% at certain low-income levels. Kenya's program cuts the tax rate to 0%. [Hong Kong](#) has taken a different tactic and exempted the first HK\$20,000 of income from tax for all workers. The cost to the government of such programs is less clear, as it represents a loss of future income as opposed to an increase in immediate expenses. The [US](#) cut income taxes during the 2001 recession.

Although income tax cuts also increase household disposable income, the increase is often not as perceptible as direct payments. [Surveys of past tax cuts](#) have shown that they often go unnoticed by the beneficiaries. However, this may be a more viable method for countries with limited resources with which to fund direct payments or augment unemployment support.

Other Tax Cuts

Governments can also lower taxes on certain goods and services so that households experience a relative increase in purchasing power. By cutting taxes other than income taxes, more individuals potentially benefit, whether or not they have income. For example, decreasing sales taxes benefits consumers across the country. But governments can also target tax cuts to certain hard-hit sectors. There are three broad categories of taxes that have been cut in response to the COVID-19 crisis:

1. Sector specific: many countries cut taxes on goods and services related to the tourism and travel industry, which has been hit particularly hard by the virus, including: El Salvador, Indonesia, Norway, and Turkey.
2. Basic food items: countries cut taxes on basic food items, including El Salvador and Gibraltar.
3. Healthcare and medical related items: many countries cut taxes on goods and services related to the medical, emergency, and hygiene industries, including: Colombia, Curacao, and Greece.

This type of specific, targeted tax cut appears to be a relatively new policy option in response to the current COVID-19 pandemic. Note that our resource guide focuses almost exclusively on national programs and therefore does not capture actions related to taxes below the national level.

Deadline Extensions and Penalty Waivers

In response to the COVID-19 crisis, many countries have extended the filing deadline for income taxes, or waived the fees, penalties, and interest associated with late payments, even if they have not decreased their tax rate. Both measures allow households to temporarily delay their tax obligations and thus, may provide liquidity support to a significant portion of households in a country. While more countries have adopted explicit deadline extensions, both measures have seen widespread application. Deadline extensions have been used for short horizons, some as short as two weeks, as in [Egypt](#), but most have been for between one and three months. The [US](#) extended the deadline to file and pay personal income taxes by three months. Penalty waivers have been used to provide longer-term relief. [Switzerland](#) implemented a penalty waiver for any federal taxes due between March and December 2020, providing up to nine months of relief. On average, these programs provide taxpayers with an additional three months to meet their income tax obligations.

Deadline extensions can be implemented on a targeted or universal basis. While many countries, like the US, chose to extend the deadline for all taxpayers, other countries offer relief on the basis of need with defined eligibility criteria. This is the case in [Germany](#), where taxpayers have to be “directly and not insignificantly affected” by current conditions to defer their tax payment. In such cases, targeted programs require taxpayers to submit an application to the tax authority to establish eligibility. Such application systems have also been implemented in [Belgium](#), [Singapore](#), and [El Salvador](#). Singapore follows the German approach and targets taxpayers who are experiencing financial difficulties. El Salvador provides relief to all taxpayers who owe less than USD 10,000 in taxes. For taxpayers employed in the tourism industry, this cap is increased to USD 25,000. In general, tax authorities can grant penalty waivers to eligible taxpayers without requiring an application.

These programs provide relief to taxpayers by allowing postponement of tax payments while the government bears a cost in the form of delayed fiscal revenue. To find a balance, some countries permit taxpayers to opt into installment plans to spread the tax burden over time, instead of simply delaying payment. [Portugal](#), [Singapore](#), [El Salvador](#), and [Belgium](#) have implemented such programs.

Extending filing tax deadlines (and the related penalty relief) provides an easy-to-implement and readily available tool to provide liquidity support to taxpayers. The actual benefit for an individual, however, varies and may be limited, especially in countries where taxes are collected throughout the year through payroll deductions. The benefit would be the greatest for individuals who have under-withheld or who are required to make direct installment payments to the revenue agent. By making extended deadlines optional, taxpayers entitled to refunds

would still be able to file earlier in order to secure them. Also, it should be noted, there may be taxes, other than income taxes, for which this type of deadline extension and penalty waiver treatment would also apply.

For more specific information about Deadline Extensions and Penalty Waivers programs, see [Support to Individuals through Tax Deadline Extensions and Penalty Waivers](#)

Access to Retirement Savings

Some countries - including the [US](#), [Australia](#), and Malaysia - have temporarily suspended the taxes, penalties, and fees associated with early withdrawals from tax-advantaged retirement accounts. Many programs have an explicit cap on the amount that can be withdrawn.

Retirement accounts typically offer special tax treatment and other incentives to encourage individuals to save money for retirement. To discourage withdrawals from these accounts before retirement, the government charges a penalty for early withdrawals. Suspending these penalties and fees provides impacted households with improved access to liquidity. In the US, individuals impacted by the COVID-19 crisis may withdraw up to \$100,000 from a tax-deferred account without having taxes or the 10 percent penalty withheld. Provided that the individual contributes an amount equal to the withdrawal to the account within three years, the taxes and penalty will be waived. To facilitate the return contribution, yearly contribution caps have also been waived. Taxes will still be owed on any amounts not repaid within three years. A similar eight percent penalty was waived in Malaysia. In Australia, individuals may withdraw up to AUD 10,000 without penalty.

The US did not waive the 10 percent tax on early withdrawals during the GFC. [Empirical evidence](#) suggests that individuals still tapped into their retirement accounts to absorb income shocks. The policy currently in place substantially lowers the cost of this option and thus makes it viable to a wider range of liquidity-constrained households. However, the benefits of such policies remain limited to middle- and higher-income individuals who are more likely to have contributed to a retirement account. A 2019 [Federal Reserve study](#) found that only around 60% of US households had a retirement account.

Housing Relief

Since housing costs are often the largest fixed costs of households, during a crisis governments may provide targeted support for homeowners and renters through mortgage and rent forbearance and debt restructuring. Some governments have funded mortgage purchase programs and changed accounting rules to provide flexibility for debt restructuring in order to provide relief for individuals. For information about government policy options targeting homeowners and renters, see [Residential Mortgage and Rent Relief During Crises](#).

Illustrative Examples

In a separate post, we outlined the combination of individual support measures taken to date in the [United States](#) in response to COVID-19. We briefly outline two additional countries' policy actions to support individuals below.

Germany

Germany, like many other European countries, made use of its established welfare infrastructure to provide support. Through its short-time work scheme, [Kurzarbeit](#), the government was able to provide rapid relief to underemployed individuals, preventing lay-offs and the associated cost of mass unemployment. As a result, Germany has not provided emergency support to individuals, which would have entailed an additional administrative burden. Use of the short-time work scheme increased in March, with nearly 650,000 businesses notifying the government that they intend to use the program.

Similar to a majority of OECD countries, the German government also offered the possibility to [defer individual income-tax payments](#). Only households directly affected by the current crisis are eligible.

Thailand

One of the first actions the Thai government took in this crisis was to delay the deadline for income tax filings. In early February, it [pushed the deadline](#) from March to the end of June. On March 24, the government [approved a direct payment](#) of THB 5,000 (\$154) per month for three months for three million of the country's poorest residents. The Thai government also [cut the income withholding tax](#) from 3 percent to 1.5 percent for six months, from April to September.

Key Takeaways

Below we outline a number of important considerations that policymakers review in providing support to individuals and households.

How quickly will individuals receive aid under the program?

The amount of time it takes financial support to reach eligible individuals varies across programs and across countries.

Traditional unemployment insurance programs and short-time work programs are considered automatic stabilizers, as they are preexisting programs designed to support individuals through their normal operations without additional government legislation. In times of crisis, some countries expand or modify such programs to increase the speed of support or expand reach. For example, the United States waived the one-week waiting period for unemployment benefits. Many European countries with short-time or wage subsidy programs have in the current and past crises utilized existing infrastructure and thus appear to be able to quickly deliver benefits to individuals through employers.

In a crisis, countries can also increase the amount of support or provide supplemental benefits. These expansions can be implemented as quickly as funds are made available by the legislature and processed through the administrative infrastructure. Of course, a significant influx of new applications, as the US has experienced with its unemployment insurance programs during the COVID-19 crisis, may create administrative log-jams that slow the delivery of funds.

Cutting taxes, extending tax deadlines, and waiving penalties can all be implemented with relatively little administrative burden. The main challenge is to clearly communicate the decision and its terms. Therefore, the support can arrive fairly quickly. However, as noted above, the support this tool provides in terms of cash flow can be limited.

Direct payment programs may require new programs to be passed by the legislature, as in the US and Hong Kong, or may rely on augmenting an existing program, as occurred in Canada. Once approved, individuals receive support only as quickly as the government can get financial information or physical addresses for all eligible individuals. Where an existing program is used as a means of distribution, as in Canada, payments may be quicker to implement, but administrative times vary greatly. In the US, where the government is using available taxpayer information, the money is scheduled to arrive within three weeks. However, in Hong Kong, the money is not scheduled to arrive until five months [after](#) the announcement of the program, which requires that individuals register for the benefit.

How much support will be provided?

The size of individual support programs varies across countries, as economic activity and per capita GDP differ. Some variation in policy mix appears to be based on preexisting, non-crisis support programs. For example, direct payments in the US appear necessary to support individuals; in contrast, several European countries have large existing safety net programs and have not chosen to create new direct-payment programs.

Certain interventions have an explicit, predetermined size, such as direct payments, while other interventions, such as unemployment insurance, are dependent on exogenous variables such as labor market demand. For example, a country can determine how large direct payments to individuals will be and the total number of individuals eligible to receive the payments, and thus estimate the total size of the support program. For example, the [direct payments in Hong Kong](#) are estimated to benefit seven million individuals with a total cost of HKD 71 billion. However, unemployment insurance claims will vary based on the number of unemployed, which can be projected, though uncertainty about the total size of the program will remain. Certain countries, including Belgium and Australia, are providing additional benefits to individuals impacted by the Covid-19 pandemic. Countries frequently determine the size of support to individuals based on projected income loss to households.

Who will receive support?

Support to individuals can be targeted or universal. Programs such as unemployment insurance and facilitated access to liquidity from retirement accounts are targeted by design. However,

most programs discussed above can be implemented in various ways depending on the specific subgroups of the population that policymakers want to target. Even unemployment support can be broadened to cover groups not traditionally covered, as demonstrated by various short-term work schemes in Europe, such as temporary workers in [Germany](#) and apprentices in [Austria](#). Eligibility for income tax cuts or direct payments can be assessed based on income to ensure that benefits are allocated following a need-based approach. Tax deadline extensions can be implemented on a universal basis and thus benefit all taxpayers. When implementing an individual support program, policymakers must determine how to deliver support to the segment of the population that needs it. The policy design can be adjusted to ensure benefits are allocated efficiently and match the country's fiscal capacity.

How long will support be provided?

Support programs can be a single instance of support or can be spread out over time. In times of crisis, governments can extend the duration of unemployment insurance and wage subsidy programs. Denmark's new wage subsidy program is available for [three months](#), while Germany's extended short-time work scheme, [Kurzarbeit](#), is available for 12 months. The US CARES Act extends the unemployment entitlement period from 26 weeks to 39 weeks; in the GFC, the US ultimately expanded the entitlement period to 99 weeks.

Most direct payment programs we reviewed were one-time, with the exception of Thailand (three monthly payments), Barbados (monthly payments for an unspecified period of time), and Australia (two installments, although the second is available to a smaller subset of those eligible for the first). Tax cuts provide recurring support to the taxpayer each time they pay the tax at the lower rate. In response to COVID-19, most countries have delayed tax deadlines by a few months.

How will the government fund the program?

Most of the programs for funding to individuals come from public expenditures. Direct payments to individuals are publicly funded through fiscal stimulus measures.

For some wage subsidy programs and short-time work schemes, employers are required to chip in a certain percent of wages to the employee, in addition to what the government subsidizes, normally between 60% and 80%. During times of crisis, employers may face difficulties in meeting the required contribution; thus, not all wage subsidy programs or short-time work schemes require employer contributions.

In the United States, standard unemployment insurance benefits are typically paid from employer contributions to the federal government and to the insurance funds of the states in which they operate. However, the expansion of the US unemployment insurance system in response to COVID-19 is federally funded. Income tax cuts or changes to other taxes impact government revenue, potentially delaying or decreasing total government revenues for the year. With a direct payment, the government spends cash immediately, but with tax cuts, the government foregoes future revenue. Policymakers considering direct support to individuals

should consider how the program is funded, specifically whether direct cash spending is feasible in contrast to forgoing future tax revenue.

How can the tools be combined?

When designing a policy mix to support individuals, it is critical to identify the main policy objectives. These include desired recipients, size, and timing of the support. At the same time, policymakers need to be mindful of a country's policy environment and fiscal capacities. The optimal mix will depend on country-specific variations in these two factors as much as on the policy objectives. For instance, expanding unemployment benefits may be an efficient channel to provide support to a large number of households in countries with a preexisting infrastructure, but may not reach individuals who are ineligible for the scheme. Direct payments may be preferred in countries with less developed or more fragmented unemployment systems or as a way to provide a benefit to the broad citizenry or targeted groups. And different benefits can be combined to deliver different assistance to different groups. For example, a direct payment can be targeted at low-income earners, while greater access to retirement savings is targeted to high-wage earners. Similarly, countries with extensive fiscal capacities can implement programs such as wage subsidies or universal payments and incur a large cost in the present. For governments facing fiscal constraints, it may be preferable to implement support programs by forgoing present revenue through tax cuts, tax deadline extension and various penalty waivers.

Given policy objectives and country-specific factors, the set of programs discussed above can be combined and tailored in many different ways to support households through a downturn.

US Supports Individuals and Households in Response to COVID-19

By Mallory Dreyer, Kaleb Nygaard, and Pascal Ungersboeck

Original post [here](#).

The \$2.2 trillion [CARES Act](#), which the US Congress passed on March 27, 2020, provides direct payments to individuals, temporarily expands unemployment insurance, and eases restrictions on withdrawing money from retirement accounts for those affected by the coronavirus. The government also offered mortgage forbearance to certain households and extended the tax filing deadline. These policies specifically provide support to individuals and households during the COVID-19 crisis.

Direct payments

One of the most widely publicized aspects of the CARES Act is the \$290 billion allocated for direct payments to eligible residents of the country. The [Economic Impact Payments](#) represent 13% of the stimulus in the Act and 1.5% of 2019 GDP. The one-time payment allots \$1,200 for eligible adult tax filers and recipients of Social Security and railroad retirees who are not required to file a return.

The payments begin to taper at an adjusted gross income of \$75,000 (\$150,000 per couple) and reach zero at \$99,000 (\$198,000 per couple). The \$75,000 threshold represents approximately 120% of the median US income. Parents are eligible for up to \$500 extra for each dependent child under age 17. The Internal Revenue Service (IRS) will directly deposit the funds to eligible individuals for whom they have bank account information. It is developing an online system to allow individuals to provide this information outside of a tax filing. The IRS will mail checks to individuals for whom it has no bank account information, if it can locate a physical address. Individuals who did not file a return for 2018 or 2019 have until the end of the year to do so in order to receive the payment. The IRS is developing a simplified form for those who otherwise are not required to file. Social Security recipients, however, will generally not have to file as the IRS will rely on Social Security data for their information.

Unemployment Insurance

The CARES Act supplements state unemployment benefits with [an additional \\$600](#) on top of the state's weekly benefit. Based on an average 40-hour work week, this equates to an average per hour benefit of at least \$15. The temporary expansion also allows individuals to claim an additional [13 weeks of benefits](#), on top of the standard [26 weeks](#).

In the US, the state and federal governments [jointly](#) fund unemployment insurance, and states administer it. The level of benefits differs across states. As of February 2020, benefits range from \$215 in Mississippi to \$550 in Massachusetts and average [\\$387 per week](#) nationally. The

duration of benefits also varies, with most states offering benefits for 26 weeks. During the Global Financial Crisis, the government extended the [number of weeks individuals](#) could claim benefits multiple times.

The Act extends coverage to those otherwise ineligible for state benefits, such as [self-employed individuals and gig-economy](#) workers. It also extends benefits to workers who left their jobs for a [specific COVID-19-related reason](#) and who can't telework or take paid leave. These two groups are eligible for a benefit equal to the state unemployment benefit plus the \$600 per week top-up. The federal government will fully fund the benefit for up to 39 weeks.

Retirement Accounts

For people impacted by COVID-19, the CARES Act temporarily waives the income-tax withholding requirement and temporarily waives the income-tax withholding requirement and [the 10 percent tax penalty](#) for early withdrawals from retirement accounts. Individuals who withdraw early from their retirement account savings can repay the withdrawal back into a retirement account over a [period of three years](#) or pay income taxes on the withdrawal over a period of three years. This provision allows individuals to tap into their retirement savings without penalty.

Mortgage Forbearance

Both individuals with single-family mortgages and landlords with multifamily mortgages are eligible for mortgage forbearance. Individuals are entitled to 180 days with a one-time extension for another 180 days. Landlords can request forbearance for 30 days and two extensions for 30 additional days each.

Mortgage servicers may not foreclose on loans during the 60-day period beginning March 18. Vacant properties are exempt from the policy. Similarly, no tenant residing in a federally-subsidized housing or in housing covered by a federally-backed mortgage loan can be evicted during the 120-day period beginning March 27.

Finally, the act provides that creditors who accommodated borrowers for making late payments must report these obligations as “current” until the later of 120 days after enactment of the CARES Act or 120 days after the end of the national emergency concerning COVID-19.

The federal government or government-sponsored entities generally bear the cost of these programs. However, given that an increasing number of mortgages are serviced by nonbank servicers, the industry has asked authorities to create a liquidity facility to finance the policies.

Tax filing and payment extensions

On March 18, the IRS [said](#) it will allow individuals to defer income tax payments due on April 15 until July 15. The intervention followed the President's emergency [declaration](#) on March 13. The IRS said it considered all taxpayers with payments due on April 15 to be adversely affected

by the pandemic. Under the policy, taxpayers can postpone payments of up to \$1,000,000 regardless of their filing status.

The stimulus in the CARES Act is funded via deficit spending; offsets or other funding mechanisms are not included.

Programs Support Individuals through Unemployment Insurance and Wage Subsidies

By Mallory Dreyer, Rosalind Z. Wiggins, and Greg Feldberg

Original post [here](#).

Governments are providing extraordinary relief to the unemployed during the COVID-19 pandemic. Countries are both extending existing coverage and establishing temporary new income-support programs to help individuals who have been furloughed, lost their jobs, or face an imminent layoff. Key considerations for these programs include:

1. Channel: What is the channel for providing the benefits?
2. Size: What is the monetary value of the benefits provided?
3. Private-sector Funding: Do employers share the cost?
4. Eligibility: Who is eligible to receive the benefits?
5. Length: What is the timeframe for the benefits?
6. Administration: How does the individual receive the benefits?

Channel

Governments can provide income support directly to individuals or through their employers. Standard unemployment insurance programs provide direct support and payments to individuals who are laid off. In response to the COVID-19 pandemic, the US [CARES Act](#) expands existing unemployment insurance benefits. Australia replaced existing unemployment insurance programs with the expanded [JobSeeker Program](#). The Australian government also announced the [Coronavirus Supplement](#), which provides an additional AUD \$550 every other week to eligible individuals.

The other channel is through the employer, which is common in some European countries. The [European Commission](#) for example, has announced a plan based on the [German Kurzarbeit](#), or “Short-Time Work Scheme,” which provides wage support to eligible employers who would otherwise lay off employees due to a forced suspension or reduction of work. During the Global Financial Crisis, this program supported [more than 1.4 million individuals](#). In response to

COVID-19, multiple countries are adopting or expanding temporary short-time work schemes, such as [France](#), [Austria](#), [Australia](#), Denmark, [New Zealand](#), and others. Though the support is based on employer eligibility, the aid ultimately benefits the individual who would otherwise be unemployed.

Size

Governments may base the size of a benefit on an individual's average earnings or pay a flat rate to everyone, regardless of their prior income. Australia's [JobKeeper program](#) pays a flat rate of AUD 1,500 per employee every other week, which is the equivalent of 70% of the median wage in Australia. Greece will [provide EUR 800 per month to all individuals](#) who are unable to work due to the COVID-19 pandemic. The [New Zealand wage subsidy](#) program provides a weekly flat rate payment based on the employee's average weekly hours: \$585 for those working more than 20 hours per week, or full-time, and \$350 for those working less than 20 hours per week.

Most European countries provide benefits based on a replacement rate, that is, a percentage of an individual's average earnings. Replacement rates vary across countries but are typically between 60 and 80 percent. For example, Germany pays [60% of lost wages](#) or 67% for people with children. Belgium provides direct [benefits equal to 70%](#) of an individual's prior average earnings. In Belgium, individuals can also receive [additional daily allowances](#) if they lose work due to a "force majeure" such as the coronavirus or economic conditions. In Bahrain, a parliamentary committee passed a provision on [March 30](#) mandating the unemployment fund to pay the full salaries of all private-sector employees for three months.

Most countries cap the benefit per individual. Belgium's program has a monthly cap of EUR 2,755. Denmark initially capped monthly government support at DKK 23,000 for salaried employees and DKK 26,000 for hourly employees. It increased the limit to DKK 30,000, regardless of hourly or salaried status a few weeks after announcing the program. [Germany and France](#) limit monthly benefits of wage-subsidy programs to EUR 6,700 and EUR 6,927 respectively, while the monthly maximum benefit in Italy, Spain, and Ireland is less than EUR 2,000 per month.

Private-sector Funding

Some countries require employers to chip in to participate in wage-subsidy programs. The Danish government pays 75 percent of an employee's salary and requires the employer to pay 25 percent; for hourly wage employees, the government covers 90 percent. Estonia [pays 70% of salaries](#), but requires employers to also provide EUR 150 in wages. For employees in [New Zealand](#) whose usual wages are more than the subsidy, their employer must try to pay at least 80% of their usual wages, though employer contributions are not required.

Eligibility

Governments must determine who is eligible. Countries with existing programs already have criteria for eligibility. For example, some countries do not allow people who quit their jobs to

claim unemployment benefits. However, some countries have expanded eligibility in response to the COVID-19 pandemic. Significantly, the United States and Australia now allow individuals who are self-employed or contractors to claim benefits, through expansions of existing programs or under new benefits. The US also includes employees who leave their job for a COVID-19-related reason, such as inability to work due to quarantine or caring for a family member with the virus.

For programs such as short-time work programs that are channeled through the employer, eligibility is based on the company, rather than the individual. In [France](#), wage subsidies are available to employers who are forced to suspend or reduce business activity due to COVID-19. Other countries set more specific criteria. [Bulgaria](#) extends its program to employers in sectors most affected by the pandemic, such as retail, land and air transportation, and restaurants; employers forced to suspend activities because of quarantine; and employers that experienced a 20 percent decline in sales in March. Other countries do not specify sectors but limit their programs to those experiencing a certain percent decline in sales or workforce, such as [Denmark](#) and [Estonia](#). In order for employees to receive wage subsidies in Denmark, the employer must document that it has retained employees during the covered period. Other countries, such as [New Zealand](#), make wage subsidies available to employers who rehire employees they recently let go due to COVID-19.

Most wage-subsidy programs cover all employees, though programs differ on whether or not employees who still work can be covered under the program. In the UK, for example, [employees must be placed on furlough](#) and cannot provide work or services for the employer while receiving the wage subsidy. In Denmark, employees must take [five paid vacation days](#) to be covered under the program. Denmark's program provides coverage for both full- and part-time employees, in addition to self-employed or sole-proprietors. Other countries provide wage subsidies for employees who work reduced hours, such as [Germany and France](#).

Length

Unemployment insurance and wage-subsidy programs are generally limited in duration. For unemployment insurance, many countries have a maximum number of weeks that an individual is entitled to receive benefits. The US CARES Act provides an additional 13 weeks of unemployment insurance, on top of the standard 26 weeks. [During the 2008-2009 crisis](#) in the United States, the government extended the entitlement period multiple times, with unemployed workers eligible to receive up to 99 weeks of benefits. Wage-subsidy programs vary widely. [Italy will provide wage subsidies for nine weeks](#). Denmark's modified wage-subsidy program is available for [three months](#). The wage subsidy in Germany's [Kurzarbeit program](#) can be collected for up to 12 months.

Administration

Many countries will leverage existing infrastructure and systems to pay benefits. These include Germany, France, and Spain.

Some countries are also streamlining application processes to expedite support. For example, the [process in Belgium](#) occurs entirely online and requires forms from both the individual and the employer. In [New Zealand, the employer](#) applies for support on behalf of the employees it plans to cover under the wage subsidy. In [France](#), the government must decide within two business days whether to provide support to an employer through the short-time work scheme. If the employer receives no decision, the support will be granted automatically. Bulgaria similarly requires the government to make timely decisions.

In response to the COVID-19 pandemic, many countries are implementing and extending various policies to provide support to individuals. For an overview of different types of programs, see [“Government Support for Individuals in Response to COVID-19.”](#)

Programs Support Individuals through Direct Payments and Tax Cuts

By Kaleb Nygaard, Greg Feldberg, and Rosalind Z. Wiggins

Original post [here](#).

During this COVID-19 crisis, many countries have provided cash directly to individuals and households through direct payments and tax cuts. Though programs differ across countries, some key considerations for these temporary income support programs include:

1. Channel: What is the channel for providing the benefits?
2. Size: What is the monetary value of the benefits provided?
3. Eligibility: Who is eligible to receive the benefits?
4. Length: What is the timeframe for the benefits?
5. Administration: How does the individual receive the benefits?

Channel

Governments are providing financial support to individuals, whether or not they've lost their job. One channel is via direct payments, where the government sends money to residents. A second channel is via income tax cuts, where the government decreases the amount of money withheld from paychecks or required of contractors and self-employed individuals. Both channels seek to increase the amount of disposable income available to households in need.

The [United States](#) (US) and [Hong Kong](#) are implementing sweeping direct payment programs in response to COVID-19. [Indonesia](#) and [Kenya](#) have made large cuts to their income tax rates. Many countries have implemented one or both of these types of programs; see the [Resource Guide](#) for dozens of examples.

Size

Broadly speaking, the size of a program can be measured by: (1) the amount offered to each eligible individual, and (2) the total size of the program and that total compared to the size of the country's GDP.

The US and Hong Kong appear to have set up the largest and broadest direct payment programs. The US is sending \$1,200 to eligible adults and \$500 per child to eligible parents. The CARES Act, signed into law on March 27, authorizes \$290 billion for this program. This represents 13% of the stimulus in the CARES Act and 1.5% of US GDP. The Hong Kong direct payment program, of similar size, would send HK\$10,000 (\$1,290) to eligible adults.

The [announcement indicated](#) that it would reach 7 million people, providing HK\$70 billion of

stimulus, which represents 21% of GDP. A number of other countries have announced direct payment programs, including [Canada](#), [Thailand](#), and [Barbados](#).

[Indonesia](#) and [Kenya](#) have passed some of the largest income tax cuts. Indonesia's program decreases the income tax rate by 30% [for workers in most sectors](#). Kenya's program decreases the tax rate to 0%. Both programs have cut the rate to zero, up to certain income levels. The cost to the government is less clear as it represents a loss of future income as opposed to an increase in immediate expenses. Although income tax cuts also increase household disposable income, the increase is often not as perceptible as direct payments. [Surveys of past tax cuts](#) have shown that they often go unnoticed by the beneficiaries. However, this may be a more viable method for countries with limited resources with which to fund direct payments.

Eligibility

The direct payments programs often, though not always exclusively, target those at lower income levels. A number of countries announced direct payments to lower income groups as follows: “1,500 vulnerable families” in Barbados, “12 million low- and modest-income families” in Canada, and “3 million of the poorest” in both Iran and Thailand.

The US and Canadian direct payment programs target a significant portion of the population. The payments begin to taper as income increases above a set point, eventually reaching zero. The \$1,200 payment for a single adult in the United States begins to taper as income rises above \$75,000 (approximately 120% median income) and reaches zero at \$99,000. In a similar program in [Canada](#), the taper begins at around \$20,000 (approximately 80% median income). [Hong Kong](#) is unique in offering stimulus payments to all adult residents, regardless of income level.

In some countries, including the [US](#) and [Canada](#), parents of dependent children are eligible for additional funds, \$500 and C\$300 per child, respectively. The US program directly pays [almost all adults](#) with Social Security numbers. The Hong Kong program directly pays [all permanent residents](#) over the age of 18.

Income tax cuts are not a substitute for direct payments. It is important to note that income tax cuts only increase disposable income for those who pay income taxes, and thus are generally employed. This excludes a significant portion of the population that is in the most need during a recession. For this reason, governments often choose not to implement income tax cuts. In response to COVID-19, the government of [Indonesia](#) and [Kenya](#) both cut income taxes to zero, up to a certain income (KES24,000 for Kenya, which represents approximately 25% GDP per capita). [Austria's](#) program allows taxpayers directly affected by COVID-19 to reduce their quarterly income tax, in some instances all the way to zero. [Australia's](#) program increased the “low-income threshold” for families and individuals increasing eligibility for tax offsets that reduce the amount of tax [payable](#).

Length

The duration of direct payment programs come in two categories: one-time payments and recurring payments. The majority of direct payment programs, including those of the [US](#) and [Hong Kong](#), are one-offs; however, programs in [Thailand](#) and [Barbados](#) offer monthly payments. The program in Thailand is expected to last 3 months, and the program in Barbados did not announce an end date. Recurring payments do provide some additional flexibility and scalability that one-time payments do not.

The announced duration of the 30% income tax cut in [Indonesia](#) is 6 months.

Administration

The Internal Revenue Service (IRS) of the US will administer the disbursement of funds to eligible individuals and families and expects to send the first payments by April 9. For those who filed taxes previously and included bank account information the IRS will direct-deposit the stimulus funds. The IRS is working on a website portal where eligible individuals will be able to provide bank account information. If no bank account information is available and where physical address information is available, the IRS will mail checks.

Although the Hong Kong government announced the direct payment program at the end of February, the program will [not be available](#) “until the start of summer.” And because the program will require residents to register it will take even longer to process payments.

Normally, the tax authority simply announces and then administers the tax cuts. A significant advantage to tax cuts is their relative ease of implementing and administering in comparison to direct payments.

In response to the COVID-19 pandemic, many countries are implementing and extending policies to provide support to individuals. For an overview of different types of programs, see [“Government Support for Individuals in Response to COVID-19.”](#)

Programs Support Individuals through Tax-Deadline Extensions and Penalty Waivers

By Pascal Ungersboeck, Greg Feldberg, and Rosalind Z. Wiggins

Original post [here](#).

Several governments have extended the payment deadline for 2019 income taxes or adopted waivers for late-payment penalties as measures to support household income. Among the OECD's 36 member countries, more than half have implemented such measures. In essence, both policies achieve the same objective which is to relieve households from the burden of a pending income tax payment while affected by the current adverse economic environment.

There are two channels through which governments have supported households by momentarily lifting the income tax burden: (a) an explicit extension of the deadline to pay 2019 income taxes, and, less commonly, (b) waivers of fees, penalties or interest payments related to late income-tax payments. The intervention is especially relevant given that in many countries the national tax deadline is scheduled in the spring. These policies extend the deadline for tax filing and payment by 3 months on average.

Both tax deadline extensions and penalty waivers have seen widespread use across the world and constitute a simple tool to provide relief for cash-strapped households effectively addressing cash-flow issues. At the same time, they provide policymakers with flexibility to extend the length of the program or target especially vulnerable households.

Key considerations in the design of a deadline extension or penalty waiver for income taxes include:

1. Channel: What is the channel for providing the benefits?
2. Eligibility: Who is eligible to receive the benefits?
3. Length: What is the timeframe for the benefits?
4. Administration: How does the individual receive the benefits?

Channel

As discussed above two different channels are available to policymakers: explicit extensions and penalty waivers. In general, the decision appears to depend on the intended length of the extension; extensions of deadlines have been used for short extensions with a large majority providing two or three month relief. Penalty waivers have been used for longer horizons.

Eligibility

Some countries' programs require taxpayers to fulfill certain eligibility criteria to obtain the extension or waiver. These criteria ensure that the policy targets high-need households and

eliminate concerns that the policy could lead to tax non-compliance for reasons other than financial need. [German](#) taxpayers, for instance, have to be “directly and not insignificantly affected” by current conditions to defer their tax payments. The tax authority assesses eligibility based on an application that taxpayers submit. Belgium, El Salvador and Singapore implemented similar application systems. In [Singapore](#), as in Germany, the policy targets taxpayers who are experiencing financial difficulties. [El Salvador](#)’s criteria are sector- and industry-based and ensure that only small taxpayers or those employed in particularly affected industries delay payment. The tax authority can assess eligibility for penalty waivers without requiring taxpayers to apply. The US has taken a universal approach automatically extending the filing and payment deadlines for three months for all taxpayers.

Length of the program

The length of the extension is another key feature of the policy. Horizons vary although many countries opted for a relief period between two and four months. Switzerland and Germany provide the longest relief at 9 months. On the other end of the spectrum, Egypt provides the shortest with a two week extension. The following table provides a more detailed breakdown.

Table 1. Length of the program.

Length	Number of Countries	Countries
up to 1 month	8	Egypt, Canada, El Salvador, Japan, Poland, Sweden, Taiwan, Turkey
Between 1 and 2 months	11	Norway, Algeria, Brazil, Bulgaria, Chile, Cyprus, Dominican Republic, Israel, Lithuania, Malaysia, Thailand
Between 2 and 3 months	12	Bosnia-Herzegovina, Czech Republic, India, Iran, Ireland, Montenegro, Netherlands, Peru, Portugal*, Slovakia, United States, Netherlands
Between 3 and 4 months	1	Uzbekistan
Between 4 and 5 months	None	
Between 5 and 6 months	3	Canada*, Ecuador, United Kingdom
Between 6 and 7 months	None	
Between 7 and 8 months	1	El Salvador
9 months	2	Germany*, Switzerland*

*denotes countries that implemented a penalty waiver

Administration

In most cases, the program's direct benefit is an ability to postpone tax payments. However, some countries offer an intermediate solution by allowing taxpayers to opt into installment plans to spread the tax burden over time, instead of simply delaying payment. Singapore, El Salvador and Belgium have implemented such programs. In each case, taxpayers have to submit an application and fulfill their respective country's eligibility criteria.

In response to the COVID-19 pandemic, many countries are implementing and extending policies to provide support to individuals. For an overview of different types of programs, see [“Government Support for Individuals in Response to COVID-19.”](#)

Unemployment Insurance and Short-Time Compensation in the US and abroad

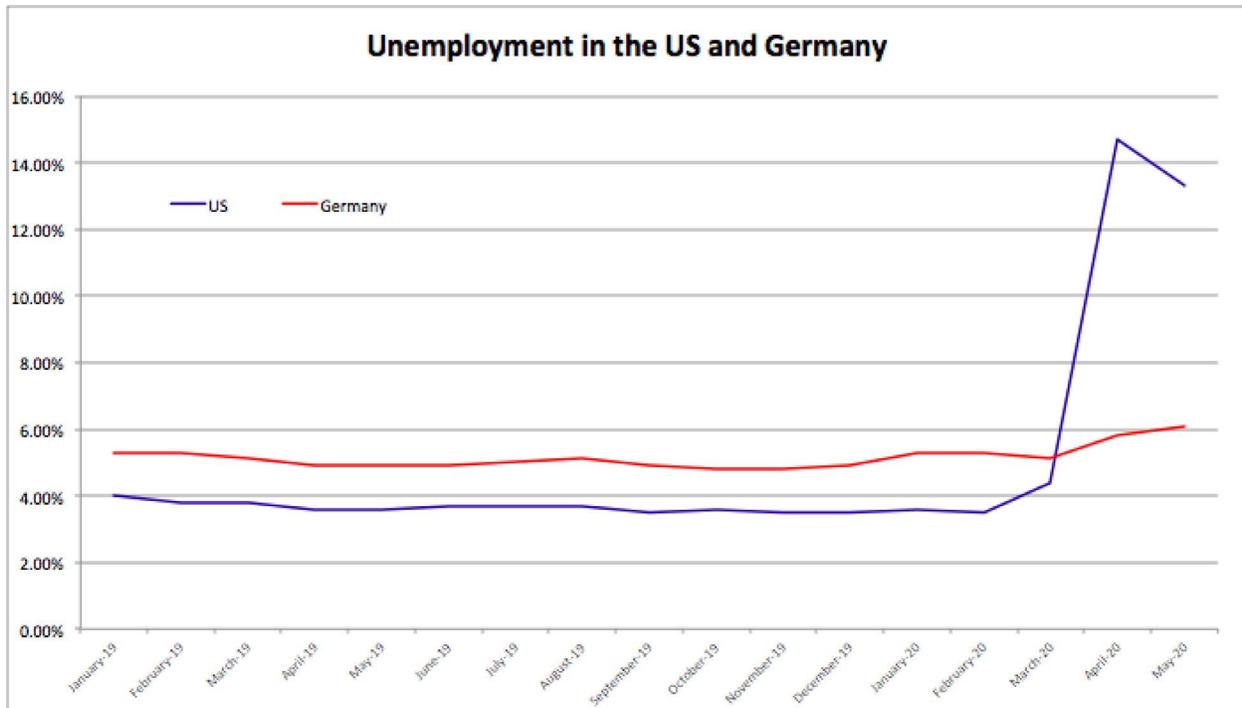
By **Pascal Ungersboeck**

Original post [here](#).

To address the COVID-19 pandemic, governments around the world recently placed restrictions on business activities, in many cases ordering non-essential businesses to close and workers to stay at home. In many countries this led to a rapid decline in labor demand. In the US the Bureau of Labor Statistics (BLS) reported the highest unemployment rate since the Great Depression in April with a national rate of 14.7, an 11 percentage point increase from the historical low of 3.5 percent reported two months before. Nevada reported the highest rate in the country at 28.2 percent, up from 6.3 percent in March, while the lowest rate was reported in Connecticut at 7.9 percent, still more than a twofold increase from 3.7 percent reported in March. In May, the labor market began to show the first signs of recovery as some states reopened their economies; the unemployment rate dropped to 13.3 percent.

Initial jobless claims across the nation peaked at 6.8 million during the [week ending March 28](#), ten times higher than the numbers reported at the height of the 2007-2009 global financial crisis (GFC). Between March 1 and April 30, a total of 28.5 million new claims for unemployment insurance payments were filed. Unemployment insurance provides workers who involuntarily lose their jobs with replacement income based on previous earnings; amounts and terms of benefits vary across states, which fund the benefit. In many states, mass layoffs due to the lockdown resulted in overwhelmed unemployment systems and significant delays in payments. The CARES Act sought to address some of these shortcomings by expanding state unemployment benefits and adding a weekly payment of \$600.

At the same time, many European countries did not experience a similar surge in unemployment as a result of their lockdown. In May, Germany's unemployment rate stood at just 6.1 percent, up from 5.1 percent one month earlier, a stark contrast to the US numbers as shown in the chart below. The country has avoided mass layoffs by relying on its Kurzarbeit or short-time work scheme to maintain workers employed through the downturn. Kurzarbeit allows employers to reduce employees' hours and compensation while maintaining them on payroll; employees then receive government benefits to compensate for the wage reduction. Since March, the [German federal labor agency](#) has received applications to participate in the program from over 750,000 employers, potentially covering 10 million workers. Similar work-share programs exist in other European countries and are also being heavily used during the current downturn.



Note: The unemployment rate in Germany is reported by the Federal Labor Agency (Bundesagentur für Arbeit). The agency does not follow international guidelines defined by the International Labor Organization (ILO) and typically produces estimates above ILO levels. The most recent estimate available rate using ILO standards is 3.1 percent, reported in December 2019.

Short-time compensation (STC) programs that operate similar to Germany’s Kurzarbeit are in place in 26 states and the District of Columbia in the US. However, these programs have not encountered nearly as much utilization as abroad, with American employers resorting to layoffs and furloughs instead. This post discusses different unemployment systems and their use during economic downturns. The discussion is structured in 4 parts:

1. An overview of STC policies implemented in the US and abroad
2. A discussion of the benefits of STC during economic downturns
3. An overview of STC in recent legislation in the US
4. A discussion of the use of STC in the US

1. STC policies in Germany and the US

STC allows employers to keep their employees on payroll in times of low demand. Under the program employers decrease an employee’s hours by a certain percentage and provide wages in proportion to the hours worked; employees then receive government benefits to offset a portion of lost wages. Different programs can be distinguished by the application process for employers,

the calculation of benefits to be paid, restrictions placed on minimum and maximum adjustments to hours worked, and the maximum duration of the program.

[German](#) employers are required to document the cause of a decline in labor demand and submit a justification to the local employment agency; over 163,000 employers did so in March, 587,000 in April. Once the reduction has been approved, companies can apply for STC benefits that replace 60 percent of lost wages for employees working fewer hours, employees with children collect 67 percent of lost income. To be eligible, at least one third of a company's workforce needs to face a decrease of at least 10 percent of hours worked. However, there is no upper bound on the reduction, employers can decrease hours by up to 100 percent.

In response to the COVID-19 pandemic [German authorities](#) have expanded the program. In particular, the minimum reduction to be eligible for STC has been lowered to a 10 percent reduction for one tenth of the workforce, instead of one third. Additionally, the replacement rate for hours lost has been increased to 70 percent after employees received STC for three consecutive months and 80 percent after six months (77 and 87 percent for workers with children). Introduced almost a century ago, the German policy served as a model for many STC programs introduced in other European countries.

US states were first authorized to implement similar STC programs under the Tax Equity and Fiscal Responsibility Act of 1982. Currently 26 states and WDC have a STC program in place. Essentially these programs are designed to fulfill the same purpose of maintaining workers on payroll through a downturn. Employers submit an [application](#) to the state's Department of Labor including a breakdown of the hours to be worked by each employee. If the application is approved, workers collect wages in proportion to hours worked and weekly unemployment benefits in proportion to hours lost. An employee whose hours have been decreased by 20 percent will thus collect 80 percent of his full-time wages and 20 percent of the unemployment benefit he would have been entitled to had he been laid off.

All programs impose a minimum decrease in hours worked to be eligible for the program. Most states require hours to be decreased by at least 10 percent, although some require a 20 percent decrease. Moreover, in most states, hours cannot be decreased by more than 40 percent; a few states allow decreases of up to 50 or 60 percent. In response to the COVID-19 pandemic, some states have loosened these requirements. Arizona and Michigan both recently extended the upper bound on reduced hours to 60 percent.

In the US, usage of STC programs has historically been limited. The dominant system is the unemployment insurance system under which eligibility for benefits is contingent on the loss of employment. The amount and duration of payments vary widely across the 50 states and WDC, with many maximum benefits capped at a level that would be below 100 percent of lost income for many workers.

2. STC during economic downturns

By protecting workers from layoffs STC programs can prevent an increase in unemployment in the immediate aftermath of an economic shock, as reflected in the recent unemployment data discussed above.

If successful, STC programs can alleviate many of the costs of unemployment and offer advantages to both employers and employees. The policy can prevent skill erosion for workers as they maintain part-time employment. Maintaining ties with an employer can also protect workers from psychological costs related to unemployment and prevent discouragement by eliminating the need to engage in a costly job search process following the downturn. Finally, in countries like the US, where many benefits including healthcare are tied to employment, maintaining these benefits can prove crucial for workers and their families. For employers, the policy eliminates search and training costs during recovery. STC also allows employers to flexibly increase their workforce to meet demand as the economy recovers. STC programs in most states allow employers to adjust each worker's hours on a weekly basis.

However, the critical question policymakers must answer is whether STC can prevent job destruction in the long run, rather than just postpone layoffs. Empirical evidence collected from programs used in Switzerland, Italy and France during the GFC indicates that the answer depends on the type of shock firms are facing. STC systems implemented in these countries are similar to the German *Kurzarbeit*, providing employees with a certain percentage of wages lost.

[Switzerland](#) entered the GFC with strong employment and GDP growth, before facing a short V-shaped recession in the final quarter of 2008 and the first half of 2009. The downturn mostly affected exporting firms faced with a decrease in global demand, the recession was milder in domestic sectors. Under these conditions, evidence suggests that the wage subsidies paid under the STC program contributed to preventing permanent layoffs by allowing firms to maintain workers on payroll until global demand recovered.

The conclusions are different for the STC program implemented during the same period in [Italy](#). Evidence from Italian firms indicates that the policy had a large short-term effect on employment but did not prevent layoffs in the long run because firms with low levels of productivity prior to the recession were significantly more likely to select into the program. The authors of the study also measure the policy's effect on reallocation in the labor market. Since participating firms have the ability to hold on to workers through a downturn, the policy can limit non-participating firms' ability to hire, preventing the correction of imbalances and potentially leading to labor market inefficiencies.

In [France](#), researchers conclude that the policy preserved employment during the recession. However, only about 1 percent of French firms participated in the program at the height of the GFC, limiting the program to a small segment of the economy and preventing a larger effect on labor market reallocation.

Overall, the literature suggests that STC is an appropriate tool for firms forced to lay off workers due to a temporary deterioration in conditions. The policy can prevent costly layoffs for firms

experiencing a temporary decrease in demand or credit and liquidity constraints. In cases where an activity is not viable in the long run, STC can only postpone layoffs and may have the harmful effect of limiting or delaying workers' transition to more productive sectors of the economy.

The current global downturn is a result of various lockdown policies implemented by governments to prevent the spread of COVID-19. As such, it provides a textbook example of a temporary downturn resulting from an exogenous shock, rather than an internal imbalance requiring some form of market correction. Currently European economies with a tradition of providing STC to their workers during downturns boast unemployment rates vastly below the rates reported in the US. Although these are still short-term effects, given the nature of the crisis, we can expect these policies to produce a stable labor market as countries exit the lockdown and re-open their economies.

3. STC in recent US legislation

STC has recently received renewed attention from policymakers in the US. Under the expanded unemployment protection in the CARES Act, the federal government covers all payments made to workers under an STC program until December 31, 2020. This offered a strong incentive for states to promote the use of STC over conventional unemployment insurance as these benefits are not covered under the Act. However, as the discussion below shows, this incentive had no sizable effect on participation in the program. In addition to the benefits distributed under their state's STC program, workers are also eligible for [the full \\$600 per week payment](#) provided under the Federal Pandemic Unemployment Compensation (FPUC) while on STC. Under these conditions a worker's income under STC will almost certainly be higher than their full-time compensation. The expanded benefits under the Act thus would provide more than a replacement of lost wages. In the context of STC, the FPUC can be seen as a measure to stimulate economic activity by temporarily increasing the purchasing power of individuals who receive it, similar to the \$1200 direct payment made to all individuals.

The HEROES Act passed in the House and recently introduced to the Senate would extend full federal funding for STC benefits until January 31, 2021. The CARES Act also provides incentives for states without STC to roll out a program. Per the Act the Treasury will fund half of the benefits distributed under a newly implemented STC program until December 31, 2020. The HEROES Act proposes to extend this date to January 31, 2021 as well.

The Paycheck Protection Program (PPP) of the CARES Act is another program intended to replicate some of the benefits of STC for workers employed by small and medium enterprises (SMEs). Although the program excludes large firms with 500 or more employees and/or revenue above \$1mn, the program has the potential to affect employment outcomes for a large sector of the economy as [49.2 percent of private-sector jobs](#) are provided by SMEs. The program, operated by the Small Business Administration (SBA), allows SMEs to obtain loans to cover payroll and other expenses. Initially loans would be forgiven by the federal government contingent on 75 percent of the funds being spent on payroll within eight weeks of the funds being received. [A recent amendment](#) to the program updated these requirements to allow small

businesses with large fixed costs beyond payroll to be eligible for loan forgiveness. Under the amendment loans are forgiven if 60 percent of the total is spent on payroll, the timeframe within which funds have to be used was extended to 24 weeks. If not forgiven, loans have a maturity of two years at 1 percent interest.

The program has been criticized for its [generous terms](#) and inability to allocate funds to the firms that needed it the most. Given the lack of restrictions to participate, the program became widely popular and exhausted its initial funding of \$350 billion less than a month after it was launched on April 3. To allow the program to continue the Senate approved an additional \$310 billion for the program.

As of [May 30](#), the program has given out more than 4 million individual loans totaling over \$510 billion. While the program prevented layoffs at a large number of SMEs, it did so at a high cost for the taxpayer - compared to a program that could have allocated funds to firms most likely unable to meet payroll without support. In order to be eligible, applicants had to certify in good faith that “current economic uncertainty makes [the] loan request necessary to support the ongoing operations of the Applicant.” In [guidelines](#) issued on May 13, the SBA announced that all loan applications with principal amounts below \$2 million will be deemed to have been made in good faith, covering almost 80% of the outstanding balance as of May 30 or more than \$400 billion. With eligibility not being contingent on declines in cash-flows or operating profit, the program provided funds to many businesses with the understanding that a large share of the total will not be paid back, the rest was provided loans under extremely generous terms.

4. STC use in the US

Data on STC claims in the US suggests that participation is more pro-cyclical than conventional unemployment claims with large increases in participation during downturns. Note also that there are strong seasonal fluctuations in unemployment claims while STC claims appear to be less tied to seasonal variations. With over 98,000 first claims in April 2020, STC programs experienced the largest participation in the programs’ history. In absolute terms, however, STC participation remains negligible relative to the size of the labor force. Initial unemployment claims reached 16.7mn over the same period. Given the low participation rate, there are no differences in unemployment rates in states with STC programs, compared to states that don’t have a program.

In the wake of the GFC, Congress passed the Middle Class Tax Relief and Job Creation Act of 2012. The Act was intended to promote adoption of STC programs across the country by providing states with various financial incentives to implement and expand their programs. As required under the act, the Labor Department produced a [report](#) in 2016 and identified various factors that explain low participation. Factors included in the report are:

1. “antiquated IT systems that cannot support STC automation efforts
2. lack of preparation to efficiently manage the spike in STC activity during the recession

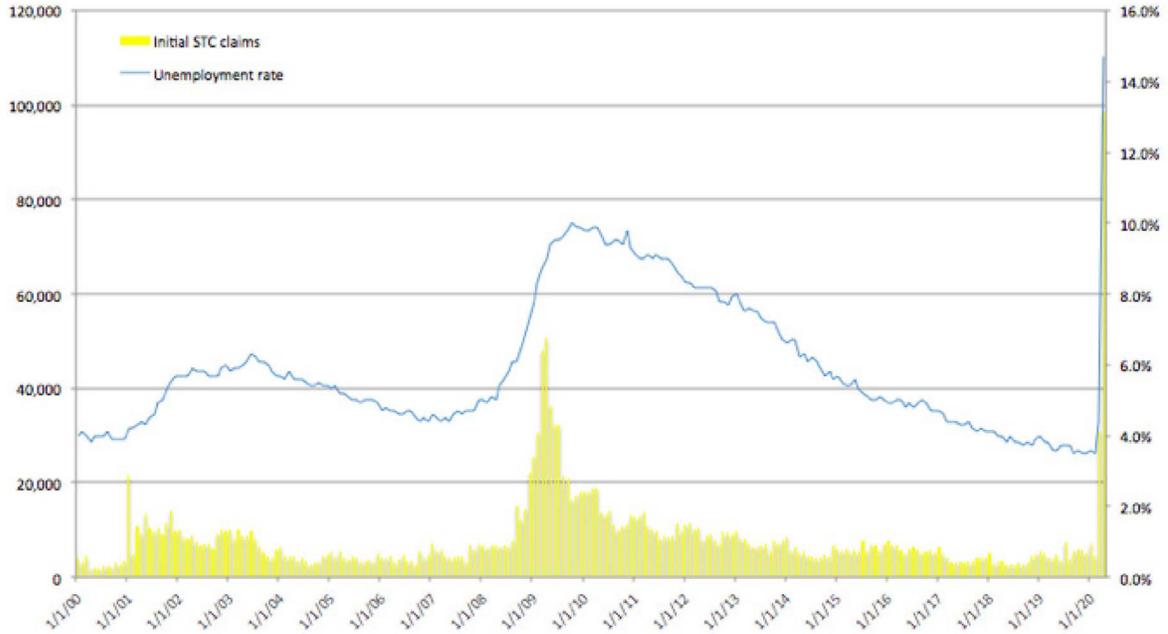
3. need for process improvements to make STC work better for employers and workers
4. lack of a common and recognizable “brand” for the STC program
5. the need for greater flexibility to meet employers’ changing business needs.”

The findings suggest that both operational and communication issues prevent more participation in STC programs. Since STC claims require a weekly review of employee-level data on hours worked, programs can’t reach an appropriate scale if processes are not automated. As of 2016, some states still relied on paper systems to review claims. Combined with a shortage of staff in charge of STC claims, these shortcomings constitute obvious barriers to reaching a scale sufficient to provide the benefits European countries are currently experiencing under their programs.

Beyond operational issues, STC programs suffer from the fact that many employers are not familiar with the program. This is accentuated by the fact that STC programs do not have a nationally recognized brand as states use different names for their programs such as Shared Work or Workshare. A survey among employers in four states with STC programs shows that while around 95 percent of non-STC employers are familiar with unemployment benefits, most are not aware of their state’s STC program. In the four states surveyed, between 28 and 54 percent of employers were aware of the STC program in their state.

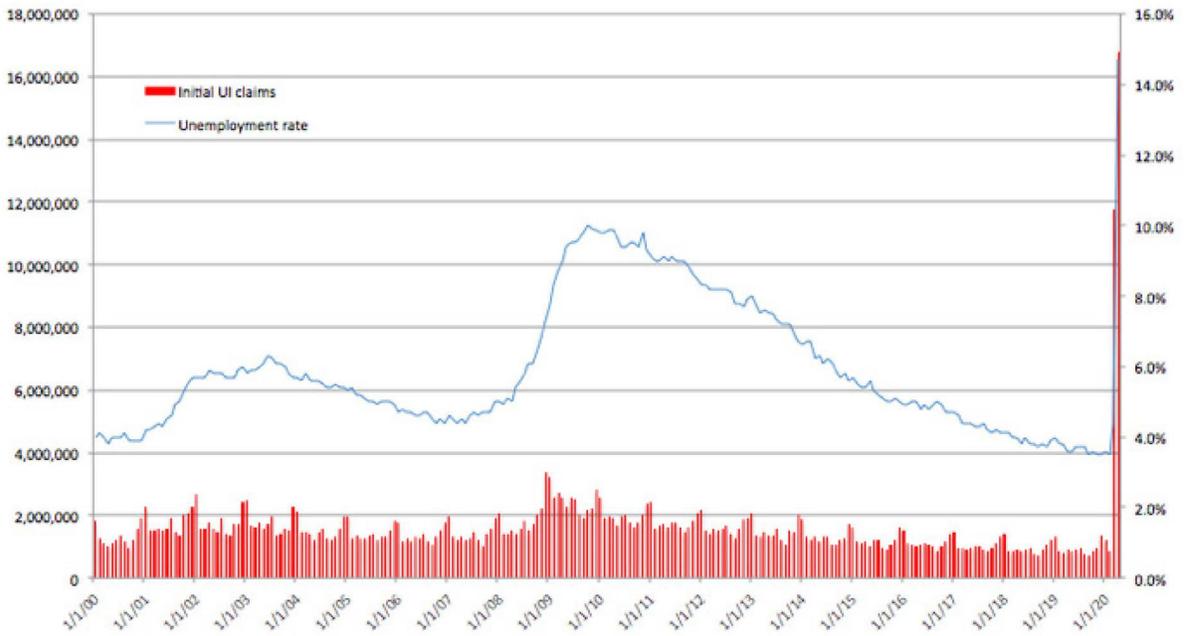
In May, the BLS reported a national [unemployment rate of 13.3](#), indicating that, as restrictions on business activity are lifted, the labor market is on the road to recovery. Meanwhile European countries that made extensive use of STC over the past months appear to weather the downturn without significant layoffs, paving the way for a swift recovery. The early evidence from many countries suggests that STC policies were able to reduce the effects of the pandemic on labor

Monthly initial STC claims and unemployment rate



Source: [BLS](#)

Monthly initial UI claims and unemployment rate



Source: [BLS](#)

market outcomes. However, further analysis of STC programs during the downturn will be necessary to provide a definitive answer. In the US, the experience of the last months could encourage policymakers to renew the effort started in the wake of the GFC, to promote STC programs as an alternative to conventional unemployment benefits during economic downturns.

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Pandemic catalyzes transition to cashless benefits

By **Corey Runkel**

Original post [here](#).

Health concerns and the sudden implementation of economic shutdowns have caused many countries to expedite or expand transitions to the cashless administration of government benefits in order to make their support efforts as effective as possible. Cashless supports for individuals offer speed, security, and availability that far outperform cash in combating the COVID-19 pandemic, given its unique circumstances. In some countries, increased adoption of cashless technology is an escalation of previously-announced long-term policy goals. Other governments have expedited the transition from cash-based systems to digital payment capacities.

In this post we discuss examples of countries that have used digital payments in their responses to the Ebola epidemic in 2014 and now the COVID-19 pandemic.

Sierra Leone: Lessons from Ebola

While payment systems in most countries progress from cash to bank-cards to mobile money, many Sub-Saharan African governments have leapfrogged card-based solutions in favor of mobile interventions.

According to a [World Bank survey](#), 27 of the 35 countries with the highest portion of mobile money account holders in 2017 were in Sub-Saharan Africa. Sierra Leone ranked 35th on the list, with 11% of adults holding mobile money accounts. The country had aggressively promoted mobile transactions. It [issued](#) its first mobile money guidelines in November 2015. At the time, only 4% of adults reported having a mobile money account, but the country had a 90% mobile phone penetration rate and 5,000 mobile-to-cash agents. This [enabled](#) the government's campaign.

The campaign was also prompted by, and a corollary to, [a successful effort](#) undertaken a year earlier by healthcare authorities to quickly set up a decentralized mobile payments system for emergency response workers when the country suffered an Ebola outbreak in 2014 (see pp. 20-21). The effort responded to extraordinary hiring and retention needs, which were made more difficult by a payment system rife with delays and fraud.

On top of reducing contact risks, the digitized system [cut](#) payroll delivery time from a month to a week, and spared the virus response an estimated 800 lost healthcare work days due to strikes that had occurred early in the outbreak. The success of Sierra Leone's intervention depended on prior acceptance of the new media of exchange, its easy convertibility into and out of cash, and a strong government initiative.

A UN-sponsored report concluded that the effort was very successful:

“Sierra Leone was also able to substantially improve the security, transparency, and efficiency of paying Ebola Response Workers [and] also generated major cost savings, compared to the expense of moving cash around during an extremely dangerous time in the country. The combination of these two benefits – saving lives and saving money – stands as a remarkable achievement in the humanitarian field” (p. 6).

The report concluded that Liberia and Guinea, the other two countries hardest hit by the Ebola outbreak, were less successful for various reasons: lower penetration of cell phones, underdeveloped mobile payment networks, and high fees during the conversion to and from cash (p. 21). The contrast among these neighboring countries underscores two factors important to successful digital transitions: existing communications infrastructure and well-integrated payment systems. The UN report urged countries to invest in infrastructure in normal times to be ready for a crisis.

Responses to COVID-19

In the COVID-19 crisis, the immediate problem governments face is to safeguard the health of benefits recipients and administrators in an environment where social contact is limited by necessity.

The pandemic has led governments to swiftly roll out payments to individuals to mitigate the effects of economic lockdowns. In many countries, lockdowns have a particularly negative impact on lower-income populations, who are less likely to be able to work remotely or rely on savings to cover essential costs. They are also less likely to have bank accounts than richer populations, which makes it difficult for governments to deliver benefits quickly without resorting to physical cash. As a result, countries have had to contend with an extra burden: those who receive government-to-person (G2P) payments are rarely at the forefront of medium-of-exchange developments.

Many governments that have been stymied by public demand for cash (Fig. 1, panel 2) are taking advantage of the crisis to aggressively improve their distribution systems. Bank Indonesia, for instance, has rolled out prepaid cash cards for food assistance programs. Meanwhile, states that had card-based systems in place are upgrading to mobile platforms. For example, some of Brazil’s G2P payments, which have been distributed by prepaid debit cards, are beginning to migrate to the Federal Revenue Service’s CPF app, which could serve as the primary contact point both for benefits and the collection of taxes (P2G).

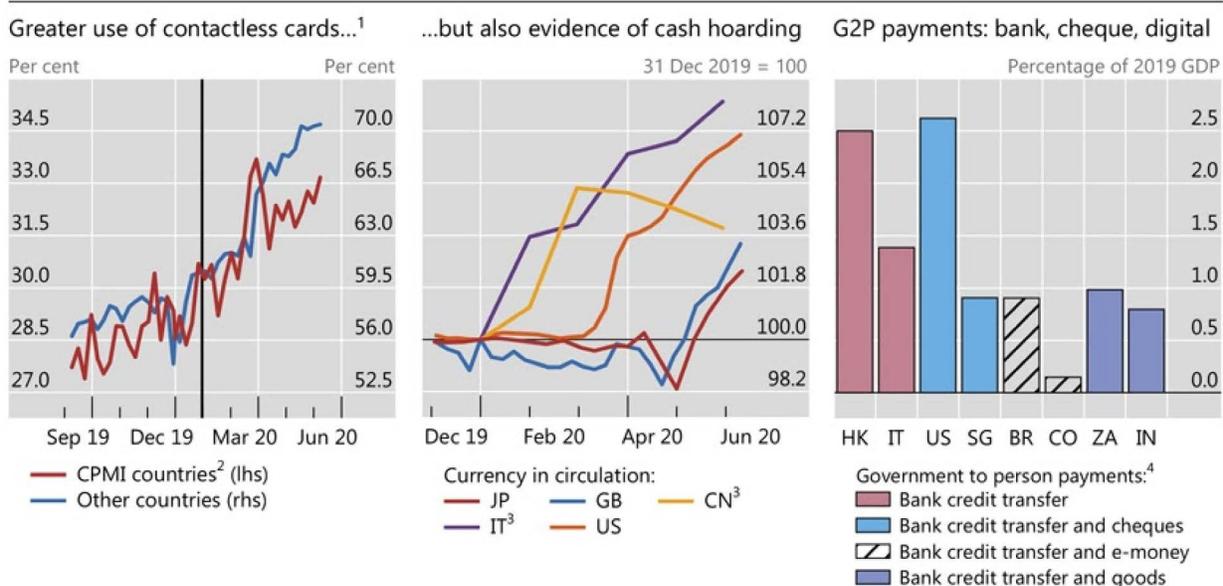
Indonesia: Accelerating from cash to debit

Ineffective government administration of benefits can undermine the public-health response to the crisis. Cash distribution presents problems for countries combatting COVID-19 because recipients must travel to, and gather in, the relatively few places where government officials are

located. Cash can then change hands multiple times in the distribution chain. This problem is particularly visible in Indonesia, where [2017 World Bank data](#) show that 36% of those receiving government payments received them in cash alone.

World Bank data suggest that the government has already had some success in changing how Indonesians deal with their money prior to COVID. From 2014 to 2017, the portion of recipients who received G2P payments into a bank account jumped from 23% to 41%, with nearly half of recipients opening their first bank account in order to collect such payments. In 2019, Bank Indonesia [committed](#) to digitizing the government’s welfare schemes to increase efficiency and transparency.

Payment behaviour is changing in the pandemic Graph III.D



The black vertical line in the left-hand panel indicates 30 January 2020, when the World Health Organisation (WHO) declared the Covid-19 outbreak a “public health emergency of international concern”.

¹ Share of contactless in all card-present transactions by a global card network. In many countries, transaction limits for contactless payments were raised in Q2 2020. ² Excludes MX and TR due to data availability. ³ Monthly series. ⁴ For IN, IT and US, government-to-person (G2P) payments include expanded unemployment benefits. For IN, this includes distribution of grain and cooking gas.

Sources: Federal Reserve Bank of St Louis, FRED; IMF, *World Economic Outlook*; IMF; Datastream; KPMG; a global card network; BIS calculations.

Figure 1. The Bank for International Settlements has followed the digital transition extensively, including in [this June report](#). CPI countries refer to [members](#) of the Committee on Payments and Market Infrastructures; its membership overlaps closely with the G20.

COVID accelerated such efforts. On April 14, 2020, the central bank [announced](#) that it would be “expediting the electrification of relevant social programs, including the Family Hope Program (PKH), Noncash Food Assistance Program (BPNT), Pre-Employment Card and Smart

Indonesian Card (KIP)” in order to “mitigate the COVID-19 impact.” More ambiguously, the central bank on April 14 said it was committed to “increase the uptake of non-cash instruments.”

This language reflected the reality that, for card-based benefits to be successful, merchants must also accept the cards. Unless merchants adopt the cards as a medium of exchange, upgrading the G2P technology will only shift where cash is distributed rather than replace its usage. In other words, recipients will just use the cards to get cash. In 2017, only 11% of Indonesians used a debit card to make purchases, even though 31% owned a debit card (Fig. 2). These two facts suggest that Indonesians use their cards primarily to access ATMs for cash rather than as media of exchange. While cards may allow for more frequent and geographically dispersed access to funds, without widespread acceptance they may not do much for the health of recipients.

Adoption trends in various media of exchange, 2014-2017

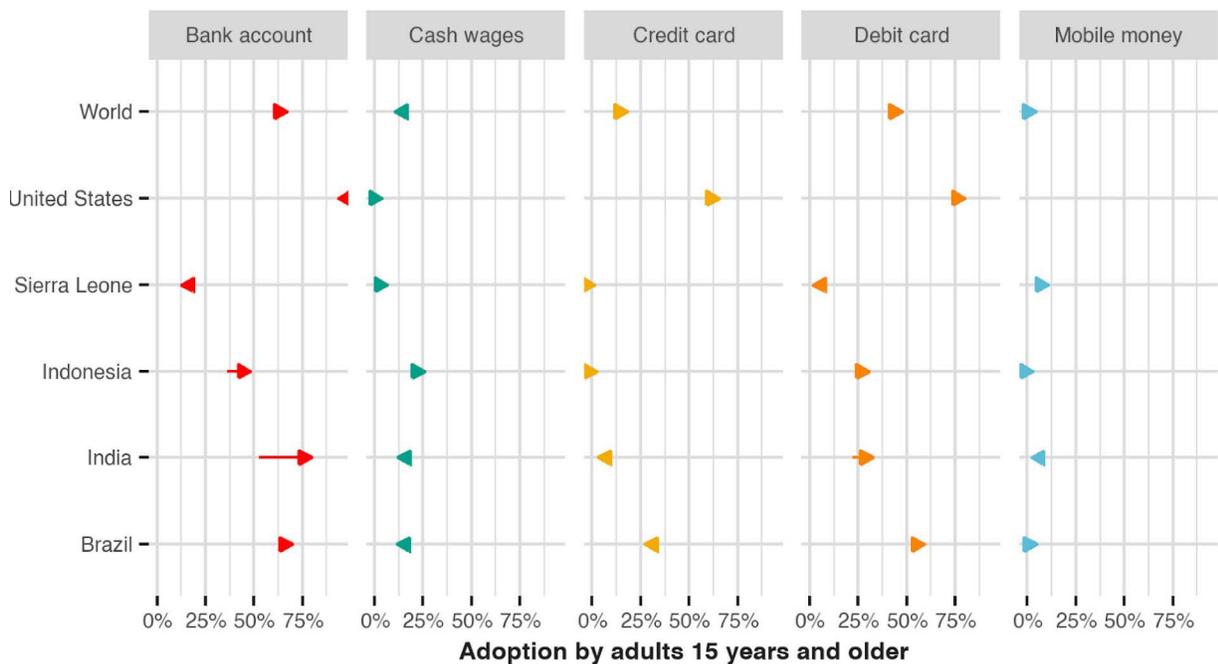


Figure 2. Popularity of various media of exchange in several countries.

United States: Bridging a digital divide

One recent incident in the United States demonstrates the practical implications of the challenges described above. KeyBank, as unemployment vendor to the New York State Department of Labor, provides approximately 500,000 citizens with benefits by prepaid debit card (80% of recipients [receive](#) direct deposit into bank accounts). For days in May and June, as the city was just reopening from the lockdown, lines to withdraw unemployment funds stretched a full block at New York City’s [lone KeyBank ATM](#). Individuals chose to stand in lines for hours where social distancing was not always observed, to avoid withdrawal fees or transaction limits at more

convenient non-KeyBank machines. Some said they did not know that they could have withdrawn funds at more than 1,000 ATMs throughout the city, although such information was available on the KeyBank's website.

The situation served as a lesson about how isolated solutions may do little to address the complexity that medium-of-exchange adoption presents. Though the US has high rates of card acceptance at businesses, World Bank data show that slightly more low-income Americans typically borrow from friends or family -- where transactions likely take place in cash -- than from a financial institution. Without more robust usage of person-to-person (P2P) payment options, transitioning G2P payments from an ultimate cash dependence will prove difficult.

So, in a country where only 56% of low-income adults accessed a financial account over the Internet in 2017, cards retain their position as medium of choice due to the speed of distribution (relative to checks) and wide acceptance (relative to mobile money).

At the federal level, the US Treasury made the vast majority of one-time [Economic Impact Payments](#) (EIPs) via direct deposit into recipients' bank accounts. But the US Treasury also [issued](#) nearly 4 million [Economic Impact Payments](#) by prepaid debit card. The Treasury allowed recipients to choose between the cards and paper checks, which can take weeks to process and deliver. Another primary mode of delivery has been Direct Express card accounts, debit cards used for Social Security payments and a variety of benefits for current and former federal employees. (A previous YPFS [blogpost](#) covered the one-time EIP transfers to eligible tax filers, which have so far totalled \$290 billion of CARES Act-approved funds.)

The IRS [says](#) that collection of bank information in the first round of stimulus will help should more payments be issued, but repeat issuances may not be the largest problem. A Center for Budget and Policy Priorities study [estimated](#) that 12 million Americans have not received a stimulus check since they did not have banking or mailing information on file, a symptom of both ineligibility for [non-pandemic] federal welfare programs and not filing taxes with the IRS. These people can receive their payments if they file a form online, providing deposit information and an email address.

But filing this form will be a barrier for many since reliable Internet access is a problem for low-income Americans, a fact illustrated by the number of New Yorkers who were unaware of the surcharge-free ATM network. As of 2018, at least 29 million Americans lacked both broadband and a smartphone, according to Pew Research [survey estimates](#) and the Social Security Administration. Digital exclusion often [overlaps](#) with the "unbanked," which the FDIC [defines](#) as those lacking a financial institution account. The Federal Reserve [estimates](#) the unbanked comprise 14% of Americans making less than \$40,000 annually. Another 21% are "underbanked" (Table 11), meaning they have an account but also use unregulated services such as payday loans. The un- and underbanked are [more likely](#) to have disabilities, lower education attainment, and are less often white or Asian-American (Table 3.3) -- in other words, the [same population](#) that often qualifies for government benefits (Table 1).

To address the needs of Americans with diverse financial and technological access, these cases have shown how important it may be to use a constellation of payment systems. For those with smartphone access, mobile payments apps [Venmo](#) and [Cash App](#) announced in May that tax filers and non-tax filers alike would be able to receive CARES Act stimulus payments from the IRS through their apps. Both apps allow users to join without linking to any bank and to transfer funds instantly to another user or vendor. This change edges the US closer to Sub-Saharan governments such as Sierra Leone, which, while much less financialized, have the highest adoption rates of mobile money accounts, five times the World Bank average.

India: Millions to provide for

India's national transition to digital systems began 11 years ago with the introduction of the [Aadhaar](#) national identification system. The system facilitates security by verifying the identities of those using the system, and has already [saved](#) India billions of dollars by eliminating fraudulent payments. Digital payment systems built using Aadhaar have grown during the pandemic to [process](#) 60 million transactions a day (Fig. 3), and connect more than 150 banking partners.

But, as with much of India, digital payments are a study in contrasts. The country faces administrative difficulties reaching its poorest populations. Its food ration system for internal migrant workers has traditionally operated only within one's home state. The home-state limit caused huge problems for the estimated 10 million migrant workers, stranded across India by the country's COVID lockdown, who had neither income nor rations. Migrant workers then sparked India's [largest exodus since the 1947 Partition](#) to return to families and claim benefits.

On May 12, the Indian Ministry of Finance [announced](#) an aggressive expansion of its pilot cashless ration delivery service, the [One Nation, One Ration](#) card, as an attempt to distribute food to migrant workers. By August, the pilot program will allow recipients with a ration card to access grain rations in 23 states, potentially covering some 670 million recipients or 83% of the program's beneficiaries. The program [uses](#) the Aadhaar network to verify identities at the [500,000 government-run shops](#) that distribute rations. The expectation is that the program will be available nationwide by January 2021, ahead of its original target date. Here, cashless distribution dovetails with internal freedom of mobility under India's continuing project of integration as the country attempts to span 36 administrative divisions and 447 languages.

The security and control over the money supply afforded by a nationally run digital payment system will be very important to India. In 2016, Prime Minister Narendra Modi [attempted](#) to suddenly demonetize the country's currency in order to crack down on counterfeit bills. The project failed as the central bank reported 99% of value returned to the new bills in circulation, and upended innumerable transactions in cash-loving India. Digital currencies offer improved security against counterfeiting, and provide the detailed data that cash cannot. Additionally, it may allow the country to more strictly enforce taxation as incomes and revenues would be easier to track as they are linked through the Aadhaar network.

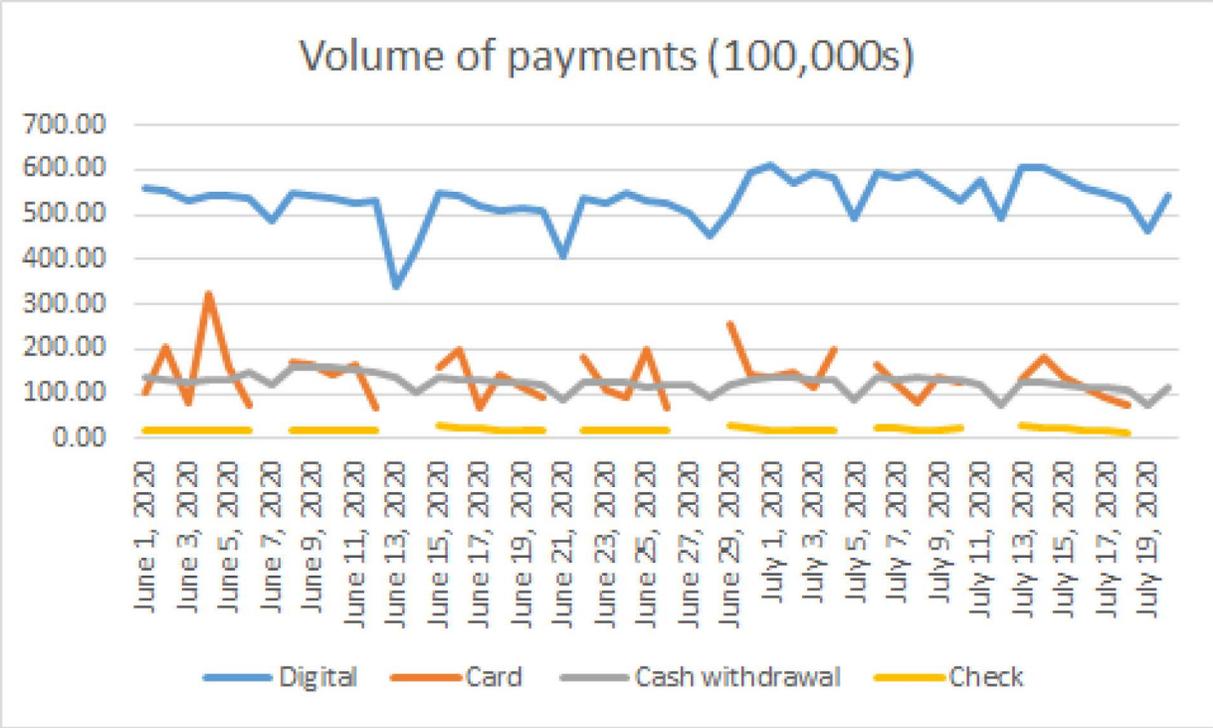


Figure 3. Daily transactions on India's payment systems.

Brazil: Using the crisis to fuel adoption of other technologies

A similar story is playing out in Brazil, where mobile payments of government benefits [grew](#) 22% by volume in the first four months of 2020. The government has long [used](#) prepaid debit cards to deliver benefits (p. 13), but the verification service for such benefits remains unreliable. In April the government [released](#) the CPF app, which builds on the country's year-old national identification framework to facilitate two-way transfers between the Federal Revenue Service and individuals and replace the face-to-face interactions aborted due to COVID.

The release takes advantage of the crisis to introduce what the Secretary says may slowly become a primary interface between the federal government and citizens, providing a platform for the government to send benefits and for citizens to send taxes. This comes ahead of the central bank's roll out in November of its Pix instant payment platform, which has already [secured](#) participation from more than 1,000 banks and merchants.

Conclusion: a variety of problems prompt a variety of tools

Despite significant medium-of-exchange developments, government benefit distribution has remained inferior for governments that continue to rely on cash payments. The Ebola epidemic and COVID-19 pandemic highlighted these disadvantages and propelled public health concerns over the distribution of cash to the forefront of administrative concerns. Pressed by short- and long-term policy goals, governments have taken ambitious steps toward cashless benefits

administration. They have succeeded in expanding benefits delivery options, but have yet to persuade citizens into switching voluntarily. The reasons these transitions have been difficult are the same as they have been for decades: low general acceptance of cashless media of exchange; limited access to technological advances; and a reliance on informal financial markets.

These governments' prospects for success in providing healthier, more effective relief than hard currencies therefore depend on current levels of digital financial integration, the accessibility of such technologies to the unbanked, and levels of general financialization. While some of the interventions are card-based, several countries have used the pandemic to push for the adoption of e-commerce and mobile payment systems. (A previous YPFS [blogpost](#) surveyed how these have worked for small businesses.) Governments that have authorized private-sector partners have succeeded, but have had to build systems – public goods such as India's Aadhaar network and Brazil's CPF platform – that [facilitate](#) interoperability and spur adoption.

If and when governments persuade citizens to switch their means of payment, digital payment systems offer long-term benefits to countries that successfully integrate them. These come in addition to the resilience that future emergencies will require. Often, the very process of integration creates opportunities to link other, non-financial systems that can support policy goals. Singapore's [PASSion card](#) has enabled it to target specific industries and classes of citizens. In this respect, the PASSion card is a scalpel to the [Paycheck Protection Program](#)'s knife, supporting precisely the individuals and sectors that need it most.

In monetary policy, central banks have started to seriously consider central bank digital currencies. CDBC's would be money as much as bills or coins are today, rather than just a medium of exchange. Its status as money would mean that CDBC's could be distributed virtually immediately, [realizing](#) Milton Friedman's famous helicopter drop thought experiment.

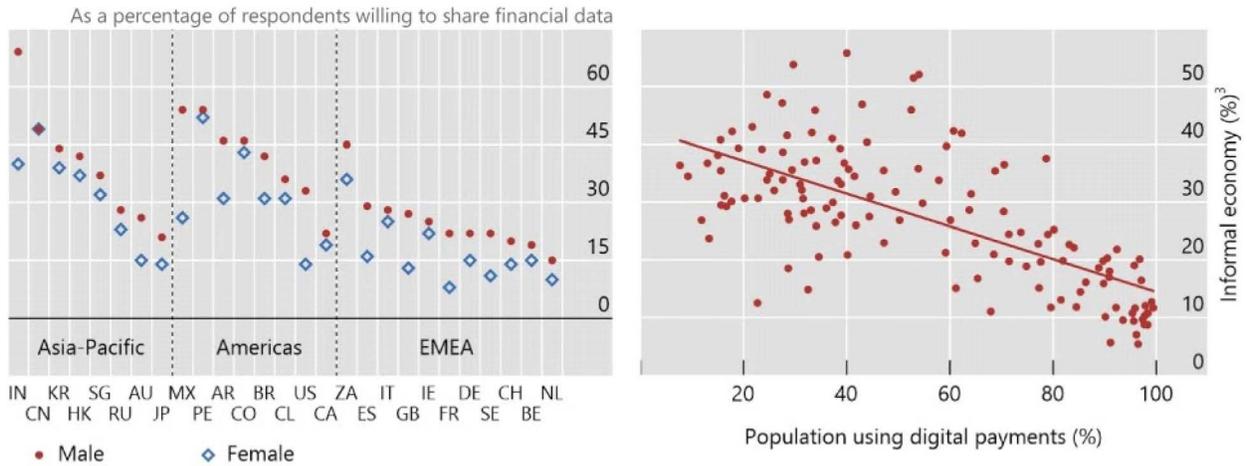
Conversely, digital payments have also enabled funds to flow from citizens to treasuries. A 300,000 person municipality in Senegal saw sevenfold growth in their tax collections when they [transitioned](#) to digital (p. 7). Senegal's public sector has led the private sector in its digitization efforts, and intra-government payments reached 100% digitization in 2016 (p. 4). Indirectly, these transitions can also cut the size of the informal sector, meaning that more transactions can be tracked for excise taxes (Fig. 4).

However, a significant informal sector may resist these changes. Citizens may be [wary](#) of the level of control and feedback afforded by digital payments and the identification backbones on which they operate, especially when low levels of trust exist in government. But the private sector has its own troubles in novel possibilities for [fraud](#) (§2.2) and [data harvesting](#) by private payment vendors.

The cost-benefit tradeoff to welfare recipients and governments could be worthwhile. As they work to roll out digital systems, government investment may end up leading the transition away from their own hard currencies.

Views on data privacy differ across and within societies¹

The informal economy is smaller where digital payments are more widely used²



¹ Based on a survey of 27,000 individuals across 27 countries. The exact question reads: "I would be comfortable with my main bank securely sharing my financial data with other organisations if it meant that I received better offers from other financial intermediaries". For Belgium, the figure covers Belgium and Luxembourg. The dots visualise the percentage of respondents answering the question affirmatively. EMEA = Europe, the Middle East and Africa. ² Data as of 2017. ³ Estimates of the informal ("shadow") economy based on a multiple indicator–multiple cause approach.

Sources: S Chen et al, "Data versus privacy: the role of gender and social norms", *BIS Working Papers*, forthcoming, 2020; EY, "FinTech adoption index", September 2019; L Medina and F Schneider, "Shedding light on the shadow economy: a global database and the Interaction with the official one", *CESifo Working Papers*, no 7981, 2019; World Bank; BIS calculations.

Figure 4. Differing views on data privacy and the significance of the informal sector may hamper digitization efforts by governments. Figure also from BIS report.

Case Studies and Policy Changes

EU Proposes Support for Short-Time Work Schemes

By Mallory Dreyer

Original post [here](#).

On April 2, the European Commission (EC) announced a proposal to extend loans to Member States to preserve employment. The [Support to Mitigate Unemployment Risks in an Emergency](#) (SURE) initiative would provide loans to Member States to support the creation and expansion of short-time work schemes. It is meant to act as a “second line of defence” to back up Member States’ increased public expenditures. The Council of the European Union (EU) must vote on the SURE proposal before it can take effect.

The SURE initiative would complement the European Union Solidarity Fund (EUSF). The EU established the EUSF in 2002 to aid Member States when large-scale disasters occur, and its scope was recently amended to incorporate large-scale public health emergencies such as the COVID-19 pandemic. The EUSF is a permanent facility that provides grants, while the SURE initiative would be a temporary program that provides loans. The SURE initiative joins a series of proposals under the umbrella of the [Coronavirus Response Investment Initiative \(CRII\)](#) which the EU announced on March 13 and implemented on April 1. The CRII allows Member States to benefit from more financial support and targeted assistance particularly in the most exposed sectors, such as healthcare, small businesses, and labour markets; and the most affected territories in Member States and their citizens.

Under the SURE proposal, the EU would extend [loans](#) to Member States to help cover costs directly related to the creation or extension of national short-time work schemes and similar measures for the self-employed. Short-time work schemes allow companies experiencing economic difficulties to temporarily reduce hours of, or lay off, employees while the employees receive income support from the government for hours not worked. The SURE initiative would make up to EUR 100 billion in loans available and would be backed by EUR 25 billion in voluntary guarantees from EU Member States. The EC would be authorized to borrow on the capital markets or with financial institutions on behalf of the EU to fund the program. The United Kingdom will not participate in the SURE initiative as it has left the EU.

The [German short-time work scheme, Kurzarbeit](#), is one of the oldest such programs in Europe, with roots back to 1910. Short-time work schemes [gained popularity and widespread adoption](#) in response to the Global Financial Crisis (GFC), as countries, including the Czech Republic, Hungary, Mexico, the Netherlands, New Zealand, Poland and the Slovak Republic, created new short-time work schemes. Other countries, such as [Denmark, France, Italy, Japan, and Spain](#), operated short-time work schemes prior to the GFC. In Germany during the GFC,

more than [1.4 million individuals](#) received income support. The [OECD credits](#) the German program with preventing unemployment for nearly 500,000 individuals.

[Evidence suggests](#) that short-time work schemes prevent layoffs and enable employers to adjust workers' hours in response to an economic downturn. Short-time work schemes can promote [equity](#) in the labor market, as the burden of adjustment is shared more equally across the workforce. Short-time work schemes also promote labor market [efficiency](#), as they prevent temporary downturns from destroying efficient labor market allocation. These programs allow employers to retain valuable staff and maintain relationships during the downturn. An [OECD analysis](#) concludes that short-time work programs used in response to the GFC had significant positive effects, and that countries without such programs could benefit from their introduction.

However, some note that short-time work schemes could lead to [labor market distortions](#) and [inefficient allocation](#) of labor in the long run. If such programs remain in place indefinitely, workers may not have an incentive to move to more productive firms. During the COVID-19 crisis, when many companies have been forced to close due to exogenous circumstances, there is less concern about inefficient allocation of labor.

In response to the COVID-19 crisis, countries with existing short-time work schemes are seeing an increase in uptake. Between March 1 and March 27, 2020, [470,000 companies](#) applied for the program in Germany, under which the government covers [60% of lost wages and 67% for those with children](#). Denmark announced a [wage subsidy program](#) on March 14, 2020, and over 11,000 companies applied by March 30, 2020. Only employees who do not work are eligible for the Danish program, which covers 75% of wages for salaried employees and 90% of wages for hourly employees, up to DKK 30,000. In Sweden, [employees will receive 90% of their wages](#). The [chômage partiel](#) (partial unemployment) program in France, reimburses 84% of net earnings for employees of companies who reduce or stop operations due to exceptional circumstances. As of April 1, 2020, the Labour Minister in France said that 1 of every 5 employees is on chômage partiel due to the COVID-19 crisis.

Despite increased usage of short-time work schemes, features vary, including eligible reductions in work hours, percent coverage of lost wages, and duration. [Many programs](#) protect employees from dismissal, requiring employers to retain the employees while receiving the benefit and for a set period after.

If the SURE proposal is approved, Member States will be able to request financial assistance from the European Commission to support short-time work schemes and assistance for the self-employed.

Korea Announces New Deal Budget Proposal Aimed at Developing its Post-COVID Economy

By Pascal Ungersboeck

Original post [here](#).

The Korean government recently released a [new proposal](#) to increase the 2020 budget to promote recovery following the economic shock caused by the COVID-19 pandemic. The proposal intends to promote economic growth and employment over the next few years. Total support is valued at KRW 35.3 trillion (\$29 billion), funded through debt issuance (67 percent), restructuring spending and prioritizing the measures outlined in the bill above other government expenses (29 percent) and borrowing from social security funds (4 percent).

The current proposal is the third request for increased support submitted by the Korean government since the onset of the COVID-19 crisis. The [first stimulus package](#) of KRW 11.7 trillion was unveiled on March 4, followed by a [second proposal](#) for KRW 7.6 trillion on April 16. The first two bills were passed within 15 and 20 days of their respective proposal. As of June 22, the current proposal has not officially passed.

While the first two packages were meant to support “disease control efforts, as well as to help businesses and local economies affected [by the pandemic]”, the current proposal is focused on recovery. It is one of the first country post-pandemic plans to be announced. President Moon Jae-in placed the proposal in the context of an [ongoing effort to strengthen the Korean post-recovery economy](#) by creating 550,000 new jobs and spending KRW 31 trillion through 2022 when he leaves office. The plan is to spend an additional KRW 45 by 2025 for total support of KRW 76 trillion (\$62 billion) through 2025. The government has said that it will provide [more details in July](#).

The current proposal includes KRW 23.9 trillion in new spending towards this effort. The funds will serve to support workers, businesses and promote further development of the Korean COVID-19 response model as a global standard. In addition, the proposal provides for a KRW 11.4 trillion revenue adjustment. This post discusses the use of the KRW 23.9 trillion of new spending allocated under the proposal:

- KRW 5 trillion to marginal firms and promote job retention
- KRW 9.4 trillion to improve job security and expand social safety nets
- KRW 3.7 trillion to boost consumption, exports and local economies
- KRW 5.1 trillion for the Korean New Deal
- KRW 2.5 trillion to further develop and promote the Korean Covid-19 response model

(The [bill](#) states that there will be KRW 23.9 trillion in new spending, however, the stated itemized parts amount to KRW 25.7 trillion.)

Although, unlike many countries, Korea did not experience a large increase in unemployment during the pandemic, support for workers in the proposal includes measures designed to fight unemployment, including funding for job retention programs, improved job security and expanded social safety nets. In May, [the unemployment rate](#) stood at 4.5 percent, up from 3.3 percent in February. The shock to the labor market was contained to a small sector of the Korean economy as the government [did not implement a general lockdown](#) policy to contain the spread of the virus.

Under the new budget proposal, job retention efforts are focused on the provision of emergency funds for businesses with a special focus on small and medium-sized enterprises (SMEs), an approach similar to the Paycheck Protection Program implemented in the US. This includes KRW 1.9 trillion to finance the KRW 40 trillion [emergency fund for SMEs](#) established in March. The fund, which provides government guarantees of loans to SMEs, had also been included in the two previous funding bills. Other support for workers includes KRW 8.9 trillion to “expand wage support to help businesses retain jobs and create over 550,000 jobs,... including remote jobs and digital jobs for young adults.” [Some critics](#) have suggested that many of these positions will be temporary and called for the creation of more sustainable jobs. Finally, the proposal provides KRW 500 billion to expand “social safety nets, such as by increasing household emergency reliefs, microcredit and affordable housing.” These measures also include plans to support workers left out of the employment insurance system by expanding job safety to all workers.

Businesses will benefit from the proposal through increased investment. The proposal provides KRW 3.1 trillion to an [emergency fund for key businesses](#) in the “airline, automobile, shipbuilding, maritime shipping, machinery, power and communications” industries. Additional funds are provided to support corporate bond purchase programs established previously. The government also allocated a share of the funds for direct investment in domestic firms, specifically reshoring incentives and support to Korean exporters.

The proposal also provides for KRW 5.1 trillion for the Korean New Deal, including a Digital New Deal, Green New Deal, and various employment protection measures discussed above.

The Digital New Deal focuses on supporting the implementation of a 5G network throughout the country and promoting the use of artificial intelligence by businesses. The government also intends to increase investments in digital infrastructure, including “[setting] up high-speed internet in remote villages and WiFi in public facilities” as well as “[improving] public administration networks with 5G and cloud computing.” Digitizing all public schools and creating 100,000 new AI and software jobs are also part of the plan, which has at its core digitizing the provision of services and facilitating working remotely. [COVID has provided the opportunity to jump-start these initiatives](#), which dovetail with previously announced projects.

The proposal's Green New Deal allocates KRW 1.4 trillion to “eco-friendly management of cities and infrastructure”, “[promoting] green industries and eco-friendly manufacturing,” and “low-carbon and distributed generation.”

Finally, the government expects to spend KRW 2.5 trillion “on further developing the [Korean] COVID-19 response model.” Specifically, officials wish to establish the country's test, trace and treat formula, known as the 3T COVID-19 response model, as a global standard. The country's methods, which relied heavily on wide-spread testing, contract tracing, emergency text messaging and face coverings, succeeded in helping it flatten its curve quickly and [avoid the broad-based economic lockdowns](#) that other countries implemented. To date, South Korea has [recorded](#) only 12,400 cases and 280 deaths – far less than most other developed countries of any size.

Debate over new stimulus plan continues as unemployment benefits near expiration

By **Natalie Leonard**

Original post [here](#).

On [July 20](#), the Senate reconvened after a two-week hiatus and one topic is “front and center:” extending the COVID-19 stimulus.

Many provisions of the CARES Act, signed on March 25, are set to expire July 25. With their expiration will go a number of costly but impactful economic stimulus programs, including the \$600-per-week federal addition to state-provided unemployment benefits for laid-off workers. With more than [32 million Americans](#) on unemployment, [new daily coronavirus cases](#) reaching new heights, and [32% of renters](#) missing July rent payments, America’s second wave of COVID-19 is likely to stall re-opening plans and deepen the economic effects of the pandemic.

What won’t expire?

While the July 25 expiration date will impact a number of economic programs, a few programs will persist. This includes the CARES Act [expansion of unemployment insurance](#) (UI) benefits to typically excluded groups, including part-time workers and sole proprietors. Additionally, CARES act provision that extends the length of UI benefits, from the typical period of 13 weeks to at least 39 weeks, will continue for all workers laid off during 2020. All states but South Dakota have also enacted [Extended Benefits](#) (EB) that add an additional 13 weeks to UI when the unemployment rate exceeds 5.9%. Between typical state UI programs, the federal add-on, and Extended Benefits, all states have benefits lasting at least 30 weeks, and many states’ programs exceed 50 weeks.

The CARES Act also paused payments for [student loans](#), setting interest rates to 0%. This moratorium on interest accrual and loan repayment is set to expire on September 30.

What are House Democrats pushing for?

The House, led by Democrats, passed its own extension bill on May 15, titled [the HEROES Act](#). The \$3 trillion stimulus bill expands on the CARES Act. Highlights include:

- \$1 trillion set aside for local and state governments;
- One-time stimulus check of \$1,200 per person earning less than \$75,000 or \$2,400 for a couple filing jointly earning less than \$150,000, and an additional \$1,200 per dependent (up to 3 dependents);
- Extended federal unemployment add-on of \$600 through January 2021;
- \$200 billion for hazard pay for front-line workers;

- \$100 billion for rental assistance, and \$75 billion for mortgage assistance, on top of a year long foreclosure and eviction moratorium;
- Modifications to remaining [PPP funds](#), requiring 25% be reserved for small businesses with fewer than 10 employees. It will also relax the requirement that [60% of funds](#) be used for payroll purposes;
- Extension of student loan suspension for another year through September 30, 2021.

Senator Mitch McConnell [dismissed the House bill](#) as a “liberal wish-list.” This [YPFS blog](#) further discusses the HEROES Act.

What will Senate Republicans propose?

While the Senate hasn’t reconvened yet, there is some information circulating about what Republicans will likely include in their counter-proposal coming from Senator McConnell, Economic Advisor Larry Kudlow, and Secretary Steve Mnuchin.

- Cost

The GOP proposal will likely have a much smaller price tag, somewhere around [\\$1 trillion](#), with smaller benefits.

- Expanded UI benefit

According to various news reports, GOP senators are pitching a [\\$200 to \\$300](#) weekly UI enhanced benefit, capped at 100% of a recipient’s previous wage in order to avoid any disincentive to return to work. The expanded unemployment benefit has long been [controversial for GOP senators](#). A [University of Chicago paper](#) found that “two-thirds of UI eligible workers can receive benefits which exceed lost earnings and one-fifth can receive benefits at least double lost earnings.” The new bill might also include a [back-to-work bonus](#) to offset work disincentives of increased unemployment benefits.

[Detractors](#) of the enhanced UI benefits estimate that “the U.S. economy has lost 1 million to 2 million jobs” from work disincentives, while [supporters](#) argue that the suspension of the benefits, which constitute four percent of GDP on an annualized basis, would stunt the already sluggish economic recovery. [A group of top former policymakers and economists](#), including former Treasury Secretary Timothy Geithner, supports a reduction in the weekly federal subsidy from \$600 to \$400.

- One-time stimulus checks

The GOP bill will likely include a one-time stimulus check, but with a reduced amount and a strict income cap of [\\$40,000](#).

- Liability protection

Senator McConnell has promised that COVID-19-related [liability protection](#) for nurses, businesses, colleges, and K-12 schools will “be in any bill that passes the senate.” The current proposal involves retroactive protection for these entities from 2019 to 2024. The 2024 date may be a sticking point.

- Payroll tax reduction

President Trump has long been demanding a payroll tax reduction, telling GOP senators that [he will not sign](#) any bill that does not have the provision. Neither party has supported the President’s proposal on this.

- State and local funding

Funding for state and local governments, which are [facing severe budget shortfalls](#) due to the effects of COVID-19, will likely be included in the GOP’s proposal. However, sources indicate that federal dollars might be tied to [schools reopening](#) this fall, a point the President has pushed for.

What can we expect from the new bill?

At this point, it’s uncertain what a new stimulus bill will contain. However, with COVID-19 cases surging, [Republican leaders in the Senate](#) have acknowledged the need for an extensive stimulus package. Reports indicate that it is likely a final bill will include direct payment to individuals below a strict income line, support for local and state governments, and some expanded unemployment benefits program.

Cross-country Comparison of Economic Outcomes and Policy Responses to Support Individuals in June

By **Pascal Ungersboeck**

Original post [here](#).

Since March, countries around the globe have implemented policies to support individuals and households through the downturn that has resulted from the global COVID-19 pandemic. Over the last five months countries have implemented different economic policies in response to various stages of the pandemic. Based on the [YPFS four-phase model of the economic consequences of the pandemic](#), Run-Rescue-Recession-Recovery, this blogpost discusses different policy trajectories and economic outcomes for countries at different stages of the pandemic, with a focus on support to individuals.

The first part of this post discusses countries, such as Austria, South Korea, Germany, and Hong Kong, that have been able to rapidly reduce the rate of infection and control the spread of the virus. As they lift many of the public health measures that were put in place, these countries currently aim to transition to the final phase, recovery, by implementing measures to boost aggregate demand and stimulate the economy. Policymakers in these countries currently face the challenge of returning the economy to pre-crisis levels of productivity while balancing public health objectives and avoiding a new wave of infections.

The second part of this post focuses on two South American countries experiencing significant pandemic activity, Chile and Peru. In both countries, the rate of infection has recently peaked and most public health measures remain in place, shuttering much non-essential activity. These countries are in the recession phase and policies are currently focused on extending previously implemented measures to offer support to individuals in order to stabilize the economies as the pandemic persists and economies are not yet ready to fully reopen

Finally, the post provides a brief discussion of next steps for policy in the US. As the rate of infection in the country continues to rise and support measures implemented in the CARES Act expire in July, the country faces increasing pressure to extend support beyond the measures implemented in March.

Recovery in Asia and Europe

Korea and Hong Kong were among the first countries affected by the virus and the first countries to contain the rate of infection. New infections peaked in early March in Korea and late March in Hong Kong. Both countries managed to control the spread of the disease without the costly lockdown measures implemented in other countries.

Despite the absence of explicit lockdown measures, however, their economies suffered from depressed demand as a result of social-distancing requirements. For both, this translated into the

highest levels of unemployment in a decade. Although unemployment rates in both countries remained low compared to other countries, the policy responses in Hong Kong and Korea included a set of measures to promote employment protection, job creation, and support to vulnerable workers and households.

Korea's most recent support program, announced in early June and adopted on [July 3](#), was the country's third budget increase in response to the pandemic, valued at KRW 35.3tn (\$29.4bn and 1.8 percent of GDP). The [first](#) package was passed on [March 17](#) and offered funding for disease control measures while also providing support to vulnerable households through direct payments and expanded unemployment support. Direct support was provided through vouchers and gift certificates issued to low-income households while unemployment support focused on job retention through wage subsidies. The [second](#) bill, passed on [April 30](#), included funding for emergency support to households in lower income brackets. The three packages together amount to KRW 54.6tn (\$45.4bn and 3.4 percent of GDP).

The June recovery package, labelled the [Korean New Deal](#), focuses on boosting the labor market and promoting recovery. It contains a broad range of measures to promote job retention through wage support and funding for small and medium-sized enterprises. Unlike previous bills, the most recent package also includes funding to promote job creation (see the YPFS [blog post](#)). Although short, the shock to the Korean labor market was severe, with 467,000 jobs lost in April, the largest monthly decline since the Asian Financial Crisis. [Unemployment in Korea](#) stood at 4.5 percent in May.

Similarly, beginning in March, Hong Kong implemented a number of measures to support the most affected households and boost the depressed labor market. At 5.9 percent for the period between March and May, the [unemployment rate in the country](#) was at its highest level since March 2005, when the country was recovering from the 2003 SARS crisis. By comparison, unemployment in Hong Kong peaked at 5.5 percent during the Great Recession.

In Hong Kong the government has provided three support packages. Two packages were extended through the country's [Anti Epidemic Fund](#) (AEF). The [first support package](#) (HKD 30 billion), which created the country's [Anti Epidemic Fund](#) (AEF), was passed on February 21; a [second round of funding](#) (HKD 137.5 billion) passed on April 18. Other measures aimed at addressing the impacts of the virus were included in a broad-based HKD 120 billion [relief package](#) announced by the government on February 26 as part of the new budget. All three packages together amount to HKD 287.5 billion (\$37 billion, 10.2 percent of GDP).

The first round of funding offered through the AEF focused on disease control measures and subsidies for businesses; about HKD 2 billion were offered to support families and students. The second round of AEF funding focused on job retention and job creation, with a set of measures valued at HKD 89 billion. A dominant part of this funding was the [Employment Support Scheme](#) (ESS), which was designed to provide HKD 81 billion in wage subsidies to workers in Hong Kong, an approach similar to the short-time compensation (STC) programs implemented in some European countries. Finally, the HKD 120 billion relief package, which passed in May,

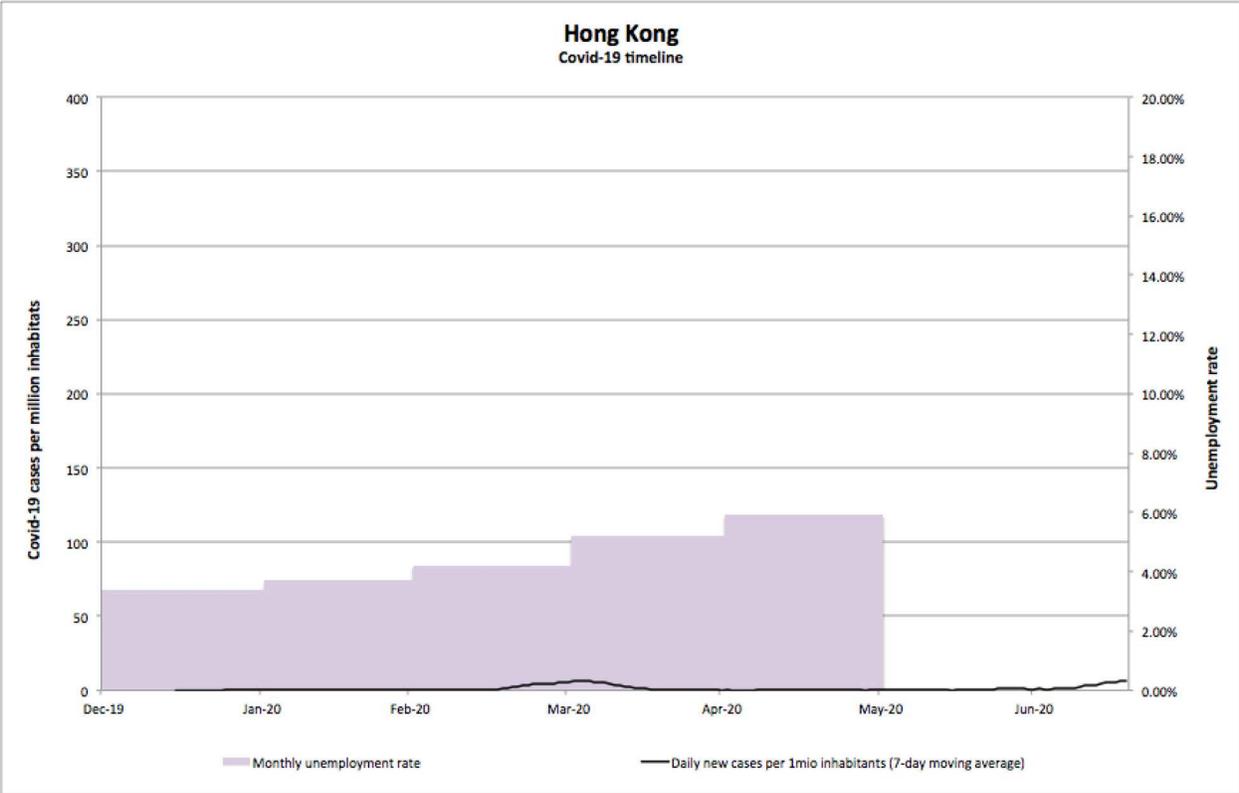
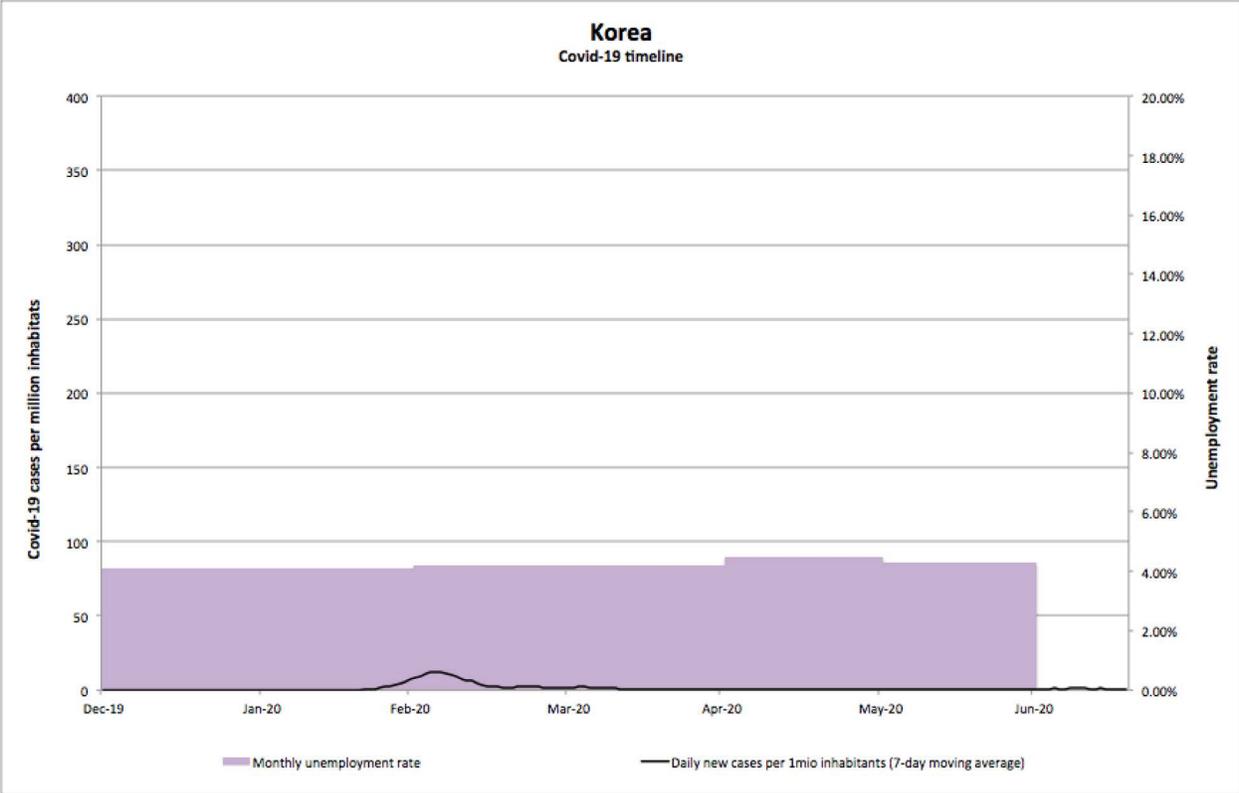
includes two additional measures for households: a direct payment of HKD 10,000 to permanent residents aged 18 or above (HKD 71 billion) and an income tax cut with a ceiling of HKD 20,000, expected to benefit 1.95 million taxpayers.

Although public health policies were implemented rapidly, economic support measures for households announced during the early stages of the pandemic were delayed pending legislative approval and suffered from administrative delays. [Online registration](#) for the direct payout program only opened on June 21, with the first payments made July 8. The [legislation](#) allowing income tax reduction was passed on June 19 and the ESS started accepting applications from employers on May 25. Given the long implementation time, support in Hong Kong acted more as a boost to aggregate demand as the country recovered from the virus than a stabilizer during earlier stages. However, the case of Hong Kong also underlines the uncertainty surrounding countries' ability to transition towards recovery while the virus remains a threat.

Recently, Hong Kong has experienced a new wave of infections as daily case reports rose above their peak in March. The numbers remain low compared to other countries discussed below, with 67 new cases (9 cases per million) reported at the new peak on July 16. Authorities responded with a new [set of public health](#) measures on July 13. The measures include mandatory masks in public transportation and a ban on public gatherings of more than four people.

As the number of COVID-19 cases in parts of Asia began declining in March, rates of infection began increasing in Europe. Germany and Austria were among the countries that were able to rapidly control the spread of the virus. Both countries saw a decline in the rate of infection by early April. Their early support policies focused on expanding public funding of STC programs that European employers traditionally use heavily during downturns. Although unemployment increased, it remained low compared to other parts of the world. In May, the rate peaked in Germany at 6.2 percent and in Austria at 6 percent.

In May, following effective public health measures to contain the virus, Austria began lifting restrictions on economic activity and in June it announced a second wave of support intended to boost recovery. The total value of the new measures is estimated at €12 billion (2.6 percent of GDP). This support comes in addition to €38 billion provided previously for a total of €50 billion, or 10.9 percent of GDP.



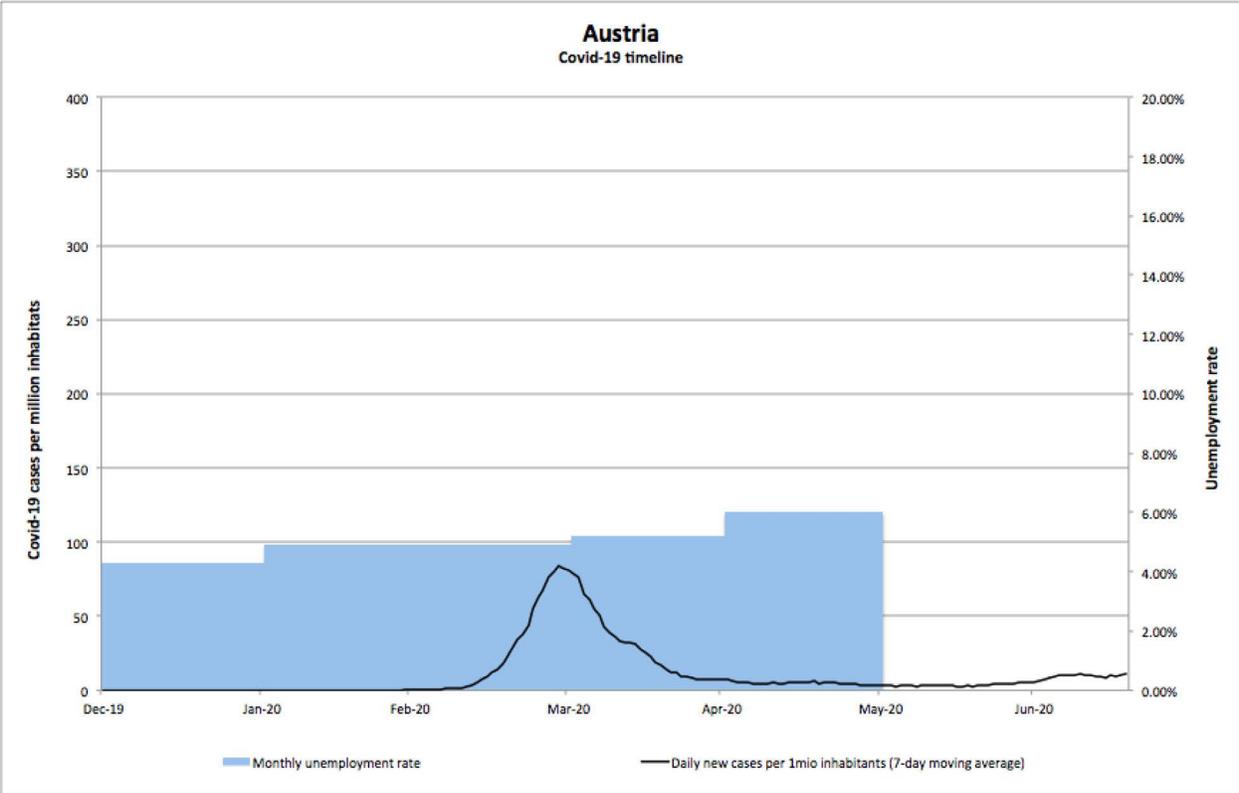
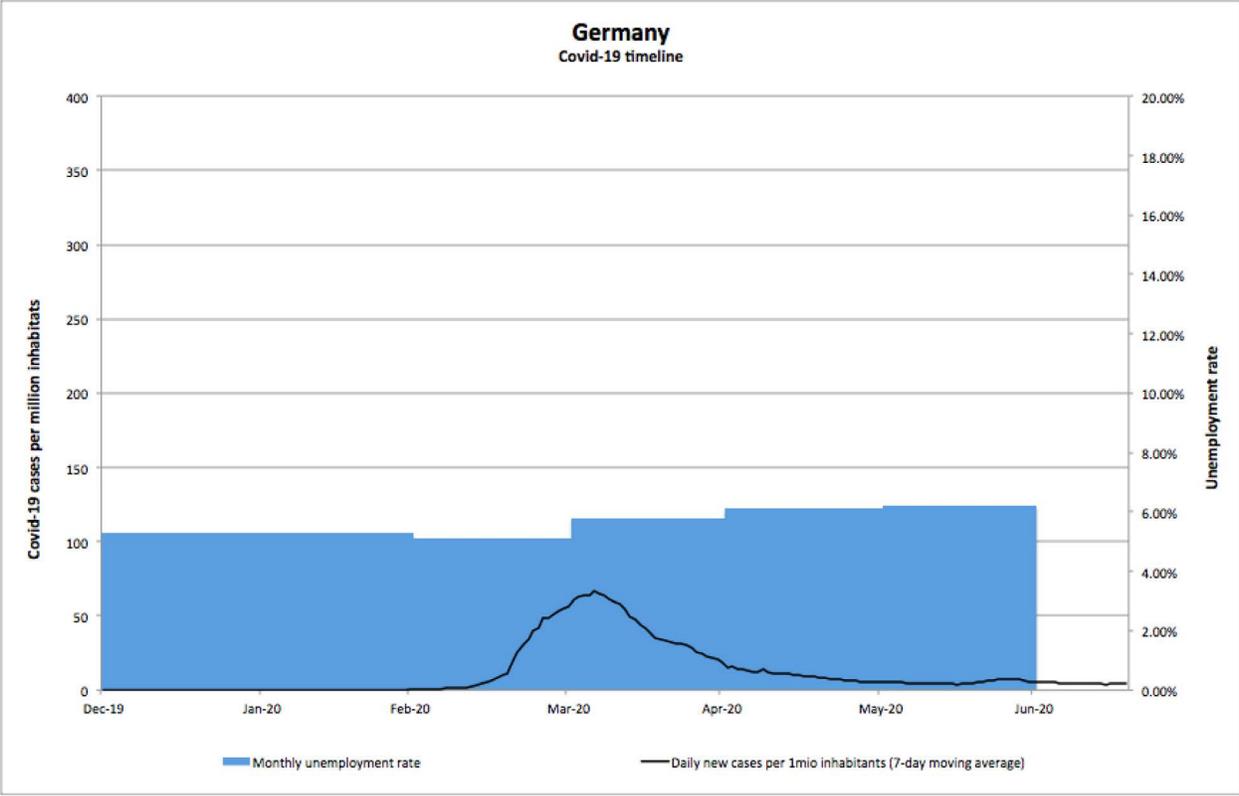
While previous support measures for households had largely focussed on stabilizing the labor market by funding the country's unemployment insurance and STC program ([Kurzarbeit](#)), the [June policy package](#) focuses on families and provides direct support for households in four ways:

- Reduction of the marginal income tax rate in the lowest bracket (€ 11,000 to € 18,000) from 25 percent to 20 percent – a maximum decrease in taxes due of €350
- One-time payment of €100 for taxpayers with annual income below €11,000
- One-time payment of €360 per child for families, and
- One-time payment of €450 for unemployed workers.

In a press conference, Chancellor Kurz noted that the support would amount to a payout of €1,000 for an average household, an amount smaller than the expected payout under direct support programs in the US or Hong Kong (both over \$1,000 per taxpayer).

Similarly, [Germany](#) relied on STC as a stabilizer during the early stages of the crisis. The German government announced its recovery package on June 3. The package is valued at €130 billion (3.7 percent of GDP). New measures to support individuals and households largely focus on families with three main measures:

- One-time payment of €300 per child
- Increase from €1,908 to €4,008 of the income tax credit for single parents, and
- VAT lowered from 19 to 16 percent (and from 7 to 5 percent for goods and services that are taxed at a lower rate; including food, public transport and some medical expenses).



Extended support in South America

COVID-19 infections in South America began to increase in April. Peru and Chile were two of the hardest hit countries and are among the ten countries with the highest number of confirmed infections per million inhabitants--and are higher than in the US. However, rates of infection in both countries have recently declined and Peru has relaxed its lockdown; Chile never had a formal lockdown. Both countries first implemented measures to support households in March and April and are currently expanding previously announced programs, given the continued severity of the pandemic.

Peru reported 1,000 confirmed cases in late March, about the same time as new infections peaked in Europe. The government reacted at the onset of the pandemic with the announcement of a large [economic stimulus package](#) totaling PEN 90 billion (USD 26 billion or 12 percent of GDP) to provide support to households and critical sectors of the economy as the country entered a strict national lockdown. Decades of [conservative fiscal management](#) put Peru in a position where it was able to respond to the pandemic with one of the world's largest fiscal packages relative to the size of its economy. Peru entered the lockdown with one of the lowest debt-to-GDP ratios and highest sovereign bond rating (BBB) in the region. Its government debt-to-GDP ratio currently stands at 27 percent.

The support package included a number of direct support measures for individuals:

- **Economic Benefit for Emergency Social Protection:** an unemployment program that provides monthly payments of PEN 760 (\$219) to workers who are unable to work due to the lockdown. Only workers with gross wages below PEN 2,400 are eligible for support. The support was also initially limited to companies that employ less than 10 workers
- A series of measures meant to provide PEN 760 monthly payment to vulnerable individuals including families, independents workers, rural populations, and
- Employees are allowed to withdraw up to PEN 2,400 from compensation-for-time-of-service (CTS) accounts. CTS accounts collect employee contributions over time to provide payouts when workers are terminated or migrate to a new job, since the Peruvian government does not provide unemployment benefits in normal times.

Peru is currently in the recession phase of the pandemic's economic cycle. Since the lockdown was announced in March, the [unemployment rate in Peru](#) has constantly increased. It reached 16.3 percent in June, more than doubling since January, when it stood at 6.3 percent. The government responded to worsening labor market conditions in June by extending the unemployment support provided under the [Economic Benefit for Emergency Social Protection](#) program to companies that employ less than 100 workers, making the support available to a much larger share of the labor force. Additionally, the government provided PEN 700 million (\$200 million) to [Trabajo Perú](#) (Work Peru), an initiative of the labor ministry launched in 2011 to promote the creation of jobs for low-income Peruvians through public infrastructure projects. The latest funds aim to provide 226,000 temporary jobs.

The progression of the virus in Chile parallels the developments in Peru, with new infections peaking in June. As of July 18, both countries had over 300,000 confirmed cases. The Chilean government initially reacted with a \$11.75 billion support package (4.2 percent of GDP) announced in March.

Measures to support individuals and households included the following:

- \$2 billion for the national solidarity fund to insure sufficient funds for unemployment support to those workers whose individual severance accounts are insufficient to cover payments. The [Chilean unemployment system](#) uses a combination of individual accounts (like Peru) and a solidarity fund.
- Extension of unemployment benefits to workers who are furloughed due to the pandemic. This allows workers to maintain ties to an employer who continues to pay the worker's healthcare and pension contributions. The [replacement rate](#) depends on whether funds are drawn from an individual account or the solidarity fund. The rate decreases monthly until it reaches the floor of 30 percent.
- Monthly payments of CLP 50,000 (\$63) for each member of households who are eligible to receive support under the government's family subsidy program ([Family Income Support Bonus](#)).
- Three monthly payments for vulnerable households and households ([Emergency Family Income](#) - EFI) that do not have a formal income earner. The amount depends on the size of the household. Households of up to four members receive CLP 65,000 (\$82) each. Payments to larger households are smaller.

The [unemployment rate in Chile](#) has also followed a trajectory similar to its neighbor's over the course of the year. The 3-month average rate peaked at 11.2 percent in May, up from 7.4 percent in January. Given the continued severity of the crisis, Chile remains in the recession phase of the crisis. In response, authorities announced a [second round of support](#) of \$12 billion on June 14, more than doubling the total support provided (8.4 percent of GDP combined). The second wave of support [increases](#) to CLP 100,000 the support each member of a household can expect under the EFI payout. The package also provides a replacement rate floor at 55 percent for unemployed workers until August.

Support to expire soon in the US

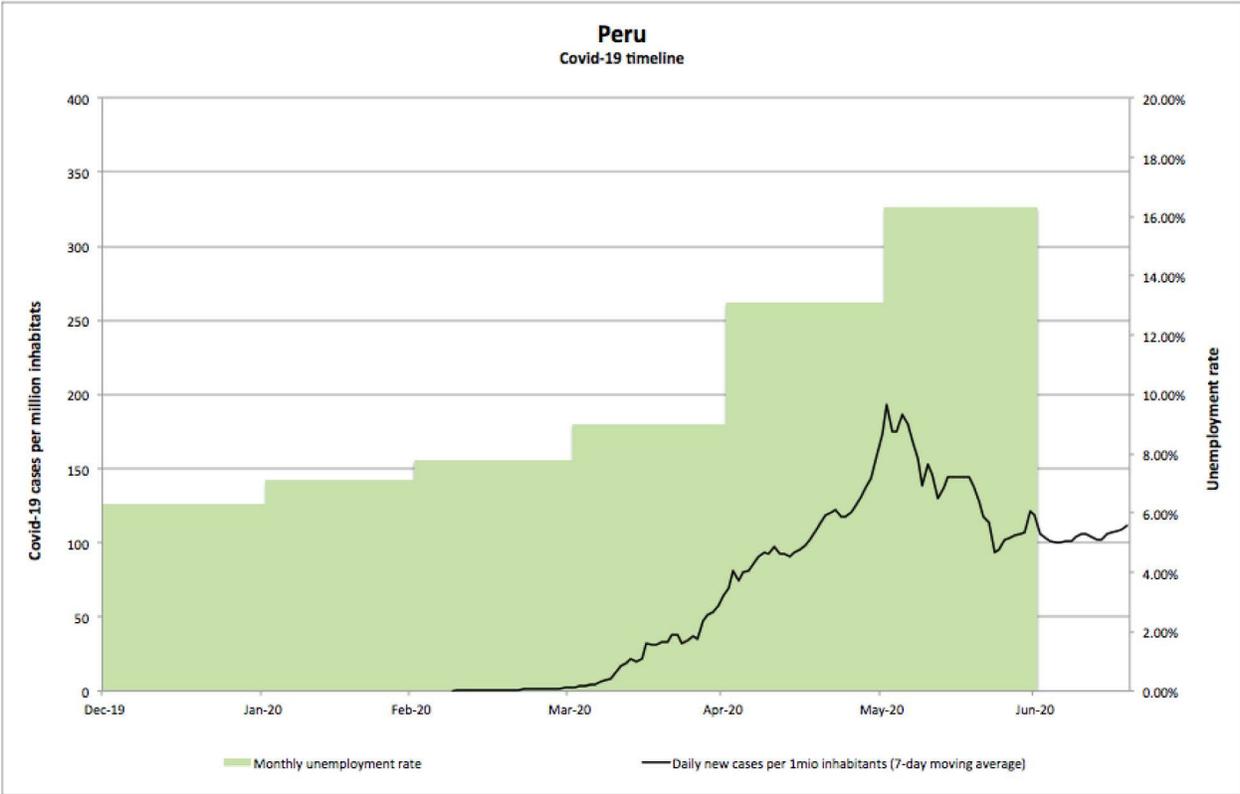
The number of new reported COVID-19 cases in the US increased rapidly in March before slowly declining during the first weeks of April. However, new infections began increasing in June and July as many states began to reopen but at a more rapid rate. The rate of infection has continually increased since early June and the US remains the country with the highest number of confirmed cases globally; it ranks 12th on a per capita basis.

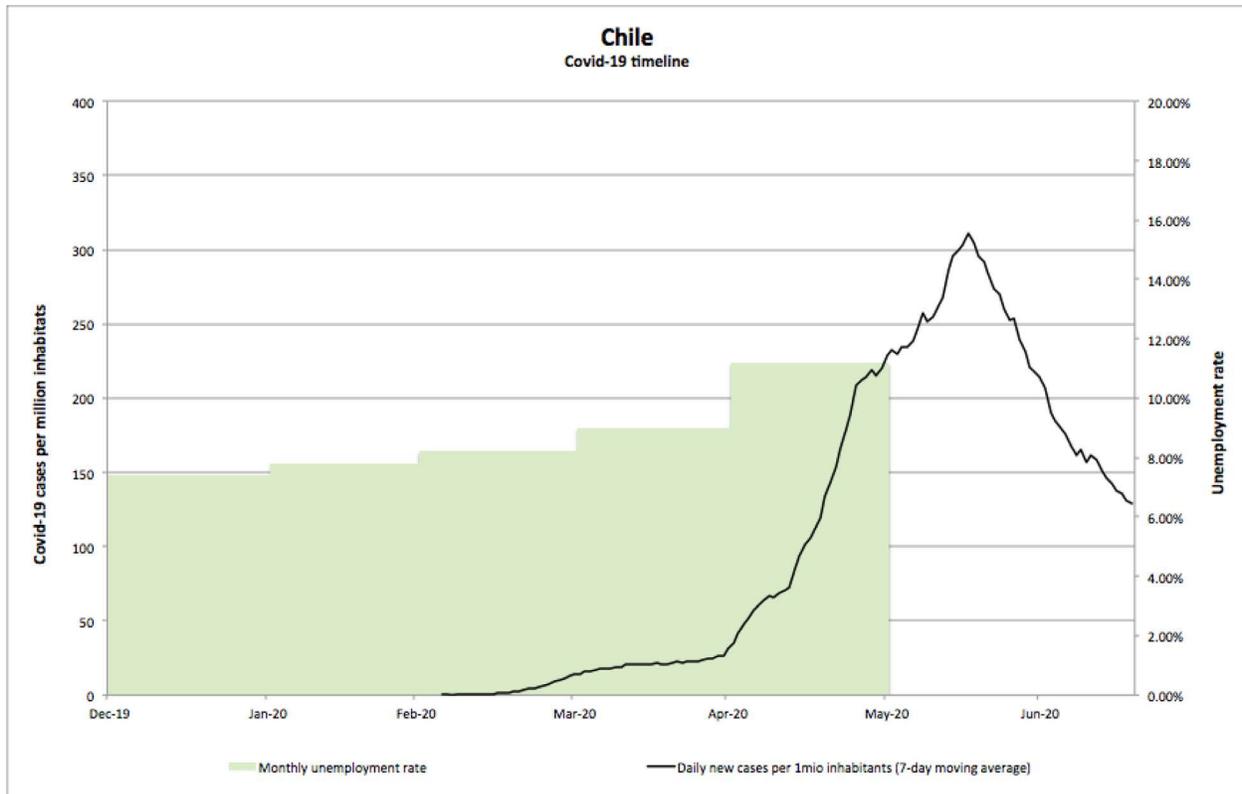
To combat the effects of managing the virus, the US government reacted with the largest economic stimulus bill in the country's history. The CARES Act passed on March 27 provided

total support of \$2.3 trillion (11.2 percent of GDP), including a set of measures to support individuals.

- One-time payments of \$1,200 to eligible individuals. Individuals with an annual income above \$75,000 received a fraction of the total payment.
- \$600 weekly payment to unemployed workers (Federal Pandemic Unemployment Compensation, FPUC). Individuals receive these payments in addition to state unemployment benefits. This measure expires on July 31.

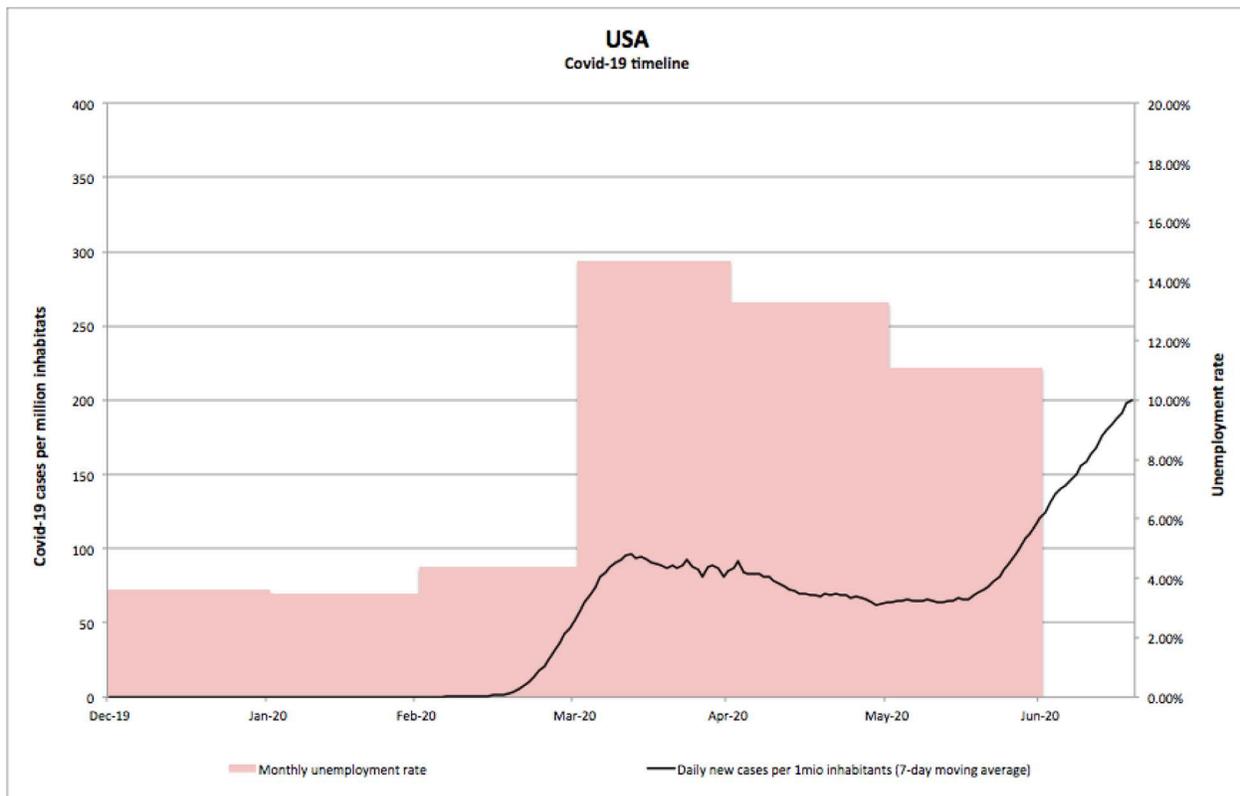
(See [our previous YPFS blog post](#) for a more detailed review).





The two main measures for households included:

The country entered its first recession since the Global Financial Crisis and reported the highest unemployment rates since the Great Depression. The US began the year with an unemployment rate of 3.5 percent in January, the lowest in decades. Unemployment began increasing in March and peaked at 14.7 percent in April as a result of widespread lockdown measures. The June unemployment rate was 11.1 percent. Efforts to augment previous support to individuals, including the \$3 trillion HEROES Act passed by the House on May 15, have so far failed to gain approval in the Senate. (Notably, the Payroll Protection Plan, a program of forgivable loans for small business was reauthorized and extended.) However, Senate majority leader Mitch McConnell has recently mentioned the possibility of a bill containing a [second stimulus payment](#) and there remains debate around a potential [extension of the controversial \\$600 per week unemployment supplement](#).



Concluding remarks

The discussion above highlights the fact that effective public health measures are essential to allow countries to transition from the recession to the recovery phase of the pandemic economic cycle. It also shows that support to individuals and households is a key component of policy responses at both stages.

During the recession phase, some countries successfully implemented measures intended to prevent job destruction and made payments to support vulnerable households through the downturn. The first wave of support in Austria and Germany achieved this by relying on wage subsidies to facilitate partial employment and prevent layoffs. Korea limited the shock to the labor market by gaining rapid control over the rate of infection through proactive public health measures while also providing income support to vulnerable households. This allowed it to avoid shutting down its economy, thus limiting negative economic effects. and

Chile and Peru remain in the third phase of the cycle, recession, as the rate of infection recently decreased - although not yet enough to allow policy to transition to recovery. In response, both countries extended measures implemented previously to support households through the downturn. Their policy mix focuses on support for vulnerable households and unemployed workers as well as preventing further job destruction.

Countries that were able to successfully manage the rate of infection have recently shifted their policy to measures that promote economic recovery. At this stage, support measures aim to boost

household demand and promote job creation. This is the case for the recent measures offering direct support to families in Austria and Germany as well as the job creation measures contained in the Korean New Deal, as well as the Hong Kong direct payments now being made. However, economic output is expected to remain depressed until a vaccine or treatment becomes widely available, as consumers are unable or unwilling to return to pre-crisis consumption patterns. Additionally, the recent deterioration of the public health situation in Hong Kong highlights that recovery prospects remain uncertain until the virus can be defeated through widespread access to treatments or vaccination.

Similar to Peru and Chile, the US remains in the third stage of the process and any prospects to steer policy towards recovery are compromised by the ever-increasing rate of infection in many states across the country. Without a second wave of support, the country faces the risk of further job destruction and a deepening recession before eventually entering the recovery phase as the public health situation improves and stabilizes.

COVID-19 cases - data sources:

- <https://ourworldindata.org/grapher/total-daily-covid-cases-per-million>
- <https://data.gov.hk/en-data/dataset/hk-dh-chpsebctdr-novel-infectious-agent>

With Phaseout of Wage Subsidy Scheme, UK Announces Rehiring Bonus

By Mallory Dreyer

Original post [here](#).

On [July 8](#), to compensate for the phaseout of its wage subsidy scheme for furloughed employees, the UK announced a Job Retention Bonus program that incentivizes firms to return those furloughed employees back to work.

In response to the COVID-19 pandemic, the United Kingdom announced the wage subsidy program, the Coronavirus Job Retention Scheme (CJRS), on [March 20](#). [Wage subsidies](#) are designed to prevent widespread and permanent layoffs by temporarily supporting employers that face challenges paying employees with the expectation that such employers will be able to resume operations and pay employees after lockdown measures end and the economy begins to recover.

As policymakers ease lockdown measures and roll back support for companies and individuals, they face the challenge of minimizing the negative economic outcomes. If a wage support program ends and employers cannot pay employees or return to pre-COVID hours, a surge of layoffs is likely, exactly what these schemes were designed to prevent.

The United Kingdom has announced that its wage subsidy scheme will end on October 31. In order to incentivize employers to rehire employees and mitigate the risk of an increase in layoffs, it has paired the phase out of the CJRS with a rehiring bonus for employers that hire back furloughed or laid-off employees. However, this program has been met with some concern and criticism.

Coronavirus Job Retention Scheme (CJRS)

Under the CJRS, employees that are furloughed receive 80% of their salary, up to GBP 2,500 per month. Furloughed employees are those that take a temporary leave of absence and do not work, but are kept on the payroll. This wage support is channeled from the government through the employer to the employee. During the second phase of the scheme, which begins in August, employees continue to receive 80% of their salary but employer contributions increase every month while government contributions decline. The CJRS is scheduled to end on October 31.

Job Retention Bonus

On July 8, HM Treasury released “[A Plan for Jobs 2020](#),” which includes a GBP 1,000 Job Retention Bonus to encourage firms to return furloughed workers to work. This bonus is a one-time payment for eligible UK employers that rehire furloughed workers as of November and maintain their employment through the end of January 2021.

The [Job Retention Bonus](#) is available only for employees that were furloughed under the CJRS. Such employees must earn at least GBP 520 per month on average between November 1 and January 31, 2021. Employers can claim the bonus for each eligible employee beginning in February 2021. As there are 9.4 million individuals covered under the CJRS, the total expenditure under the Job Retention Bonus could reach GBP 9.4 billion. HM Treasury provided additional information regarding the Job Retention Bonus on [July 31](#) and will publish full guidance in September.

Some have raised the concern that the retention bonus will not be necessary in many cases. In the days following the initial announcement, [some companies](#) pledged not to claim the bonus, as they had already planned to return employees from furlough. A [top official](#) in HM Revenue and Customs [released a letter](#) in which he acknowledged that while there is “sound policy rationale” for such a scheme there is uncertainty regarding the “value for money of this proposal.”

[Others](#) have raised concerns that the bonus amount may not provide sufficient or timely support to struggling companies to rehire workers, as the amount of the scheme and the February 2021 receipt date do not provide immediate relief for firms in hard-hit industries. According to a [recent survey](#), 66% of UK firms view the measure as helpful for the overall economy, while only 54% view the scheme as helpful for their own business.

Seventy-five percent of firms with furloughed staff expect to claim the bonus, but only 20% of these firms expect it to influence the number of employees they rehire from furlough. Those results raise the question whether the aid could be targeted in such a way to have a greater effect on job outcomes and hiring decisions. The survey also asked businesses what further measures they would support. Fifty percent of respondents said they would like a cut in employer social insurance contributions, 31% would like an extension of the furlough scheme, and 24% would like rent support.

It is also important to note that the winding down of programs prematurely is a risk, given the uncertainty of a second wave and other negative public health outcomes. Some countries are currently facing a peak number of cases and are not yet ready to consider winding down such programs. The UK is not currently seeing an uptick in COVID-19 cases or deaths, but uncertainty regarding a second wave of the virus remains. As the bonus is dependent upon rehiring decisions in November and cannot be claimed until February 2021, the scheme may require amendment or updates based on future economic or health data.

President Trump Takes Executive Action as Further Stimulus Bill Talks Stall

By Aidan Lawson

Original post [here](#).

The [first](#) memorandum repurposed existing disaster relief funds for COVID-19 relief. The president allocated an additional \$70 billion from the Disaster Relief Fund (DRF), which has been traditionally used to finance natural disaster support, to be used for COVID-19-related expenditures. President Trump also requested that states make more active use of the \$80 billion in Coronavirus Relief Fund (CRF) allocations that have not yet been used. The CRF funds will be used to support expanded state unemployment programs and ensure that they will continue through the end of the year.

Of the newly appointed DRF funds, \$44 billion of them will be directed to "lost wage assistance." This assistance allows state governors to provide weekly payments of \$400 a week to people that have received expanded unemployment or COVID-19-related federal relief or can demonstrate that they are unemployed or underemployed due to the pandemic. The initial [release](#) said that the federal government will only contribute \$300 a week, meaning cash-strapped states will have to pay the other 25% themselves. The governor of South Dakota has [declined](#) this relief, citing its improving economy as the rationale

The Trump administration [clarified](#) later that states are not required to contribute the 25% to receive the federal aid, which could only last up to five weeks. States have also [expressed concern](#) about the administrative burden the program would place on states and that the onus is on the federal government to pass more comprehensive relief.

The [second](#) memorandum deferred payroll tax obligations from September 1 through December 31 for employees making approximately less than \$4,000 (pre-tax) every two weeks, or about \$104,000 a year. It is important to note that this is simply a deferral, so these taxes will need to be paid back at some point. President Trump has promised, however, that he would make the deferral permanent if re-elected (see [here](#)).

The Center on Budget and Policy Priorities (CBPP) [stated](#) that the action could potentially increase administrative and financial burdens on businesses without providing any short-run economic stimulus. There are a myriad of [logistical issues](#) - payroll tax changes are harder to make than those for income taxes, incomes of employees could vary throughout the year, and a number of firms are still waiting for exact guidance from the IRS. It is unclear if employers would even need to pass on the additional savings to their employees. The CBPP was skeptical that, even if the relief did make it to employees, they are likely to save it since the period will only be for about four months.

Most recently, the U.S. Chamber of Commerce, along with a coalition of more than 30 trade associations wrote a [letter](#) to House Speaker Nancy Pelosi, Senate Majority Leader Mitch McConnell, and Treasury Secretary Steven Mnuchin stating that the payroll tax relief is "unworkable." The group stated that the relief could impose a significant tax liability on employees, and that many of the members of the trade associations would likely decline to offer the deferral.

The [third](#) action, and only executive order, gives general authority to provide relief to renters. The CARES Act provided a four-month eviction moratorium, but this ended on July 24 (see [here](#), pp. 492-493). The Federal Housing Finance Agency (FHFA) also extended a separate federal eviction moratorium, but it is set to expire at the end of August (see [here](#)).

The language in the order is very vague, however. It states that the Secretary of Health and Human Services and the Director of the CDC should "consider" whether an additional eviction moratorium is necessary to curb the spread of COVID-19. It also requires the Secretary of the Treasury and the Secretary of Housing and Urban Development (HUD) to identify any additional funds that could be used for potential financial assistance to renters and homeowners that are struggling to make rental or mortgage payments. The order also directs the Secretary of HUD to and the Director of the Federal Housing Finance Agency to promote and review different ways to prevent evictions and foreclosures.

The order does not provide any concrete relief to renters or homeowners but merely encourages the heads of key agencies to explore avenues that could offer additional relief. The CBPP stated that the order would not help renters at all, given its language. Evictions are still [continuing](#) across the country and as many as 30-40 million Americans are at risk, according to a [report](#) released by a group of housing advocates and researchers.

The [fourth](#) action and final memorandum extends student loan payment relief. The administration previously provided some student loan [relief](#) on March 20 by both introducing payment forbearance and setting interest rates on federal student loans to 0% for 60 days. The CARES Act also suspended all student loan payments until September 30. This executive order suspends all interest and principal payments made on student loans through the end of the year. This relief will likely be automatic and apply to most borrowers that have public loans, but there are some areas of [confusion](#).

Borrowers that are in the federal government's [Public Service Loan Forgiveness \(PSLF\) program](#) may still need to make any deferred payments, just at a later date. The PSLF forgives student loan balances for borrowers that work for the U.S. or tribal government, as well as qualifying non-profit if they make 120 qualifying payments on their loans. The CARES Act relief counts six months of non-payments afforded to borrowers towards the PSLF payment threshold. For example, if you had 120 payments left to qualify for forgiveness after the Act was passed in March, the six months of non-payments would count towards your 120 qualifying payments, meaning you would have 114 left at the end of the relief period in September even if you paid nothing. The executive order, however, does not explicitly discuss student loan forgiveness,

leading many to recommend that, after the CARES Act relief expires at the end of September, PSLF participants resume repaying their loans. The CARES Act also paused debt collection for student loans, but the executive order does not mention this, either.

Generally, the reception towards this relief seems mixed, with some [believing](#) that the president may face legal challenges, as Congress usually holds the purse strings. Congressional Democrats, however, seem to be "unlikely" to take that fight given the logistical limits of the payroll tax deferral and disaster relief reapportionment and that they believe they are "[nearly unworkable](#)." As discussed above, there are a host of problems with each of the orders - ranging from logistical confusion, vague word choice, and heavier burdens on already-struggling state and local authorities. The administration has issued some guidance to clarify some of these concerns, but the real battle is being fought in Congress, where [Democratic](#) and [Republican](#) lawmakers continue to trade plans for more comprehensive relief [back and forth](#) with no end in sight.

Barriers to Wage Replacement Schemes

By **Natalie Leonard** and **Corey Runkel**

Original post [here](#).

Negotiations stalled last week on more federal relief to address the coronavirus crisis. The sticking point seems to have been unemployment insurance (UI).

The Coronavirus Aid, Relief, and Economic Security (CARES) Act included a \$600 weekly federal UI benefit on top of state benefits, called the Federal Pandemic Unemployment Compensation (FPUC). It [gave](#) two-thirds of claimants higher weekly earnings than their previous job paid.

For these workers, Republican lawmakers say that expanded unemployment insurance (UI) offers little incentive to return to work. Republicans have therefore [called](#) for states to implement partial wage replacement rather than the Democrats' proposal, which would simply extend the \$600 supplement for the remainder of 2020. In the GOP's wage-replacement scheme, claimants' benefits would be equivalent to 70% of pre-pandemic wages.

Senate Republicans included the wage-replacement scheme in the HEALS Act, a panoply of proposed bills that constitute the party's response to the HEROES Act that the Democratic-controlled House passed in May.

Lawmakers had proposed this sort of scheme during the negotiations for the CARES Act in March. However, state unemployment administrations were not ready to implement such a program at the time due to fragmented systems, overlapping benefits, and aging information technology (IT). But some states will still struggle to implement a wage-replacement scheme by October, as the HEALS Act proposes.

Perhaps the largest problem is the federal separation of benefits administration. Unlike shared protocols such as the Uniform Commercial Code, where procedures are more or less standard across states, the United States has 52 separate UI systems -- one for each state, the District of Columbia, and Puerto Rico -- with 52 separate benefits calculations.

States also lack the earnings data that would serve as an input to such formulae. For year-round wage earners, funneling tax filings into a state's UI system may solve the problem. But for seasonal employees or independent contractors, eligible for UI for the first time during COVID-19, determining benefit levels poses novel challenges.

UI systems nationwide have long faced disinvestment and tortuous development. Many of the computer programs used to process benefits are brittle -- some systems accept only fixed-dollar amounts, rejecting percentages -- and are written in a nearly-dead language. As a result, coders are scarce and maintenance difficult. States have [reported](#) that these technical problems alone would add up to a five-month timeframe for implementing wage-replacement formulae.

Some states began to overhaul their UI systems in response to failures during the April [spike](#) in unemployment claims and the initial federal UI supplement that the CARES Act provided. Employees in Connecticut’s Department of Labor [worked](#) 32 straight days to resolve its backlog. California’s governor [appointed](#) a “strike team” to modernize the application and distribution of UI benefits, while he prioritized communications with claimants. However, not every administration is able to marshal a timely digital response. Florida, which the New York Times reported has [one of the nation’s worst UI systems](#), briefly reverted to paper applications.

States stand at various levels of readiness for wage-replacement schemes. Surmounting these challenges would require simultaneous (though not coordinated) action by every system. Should a third wave of federal relief mandate such a proposal, it would need to provide flexibility, additional support, or both to salvage cumbersome UI systems weighed down by millions of new and unfilled claims. However, wage-replacement features, such as those required by the HEALS Act, may end up standardizing state systems to some extent, allowing states to avoid some of the problems discussed below in future crises.

Wage replacement proposals

The Senate Republicans’ proposed HEALS Act would reduce the FPUC to \$200 per week until October 5, when it would shift to funding a 70% wage-replacement scheme. The American Action Forum, a center-right Washington think tank, [estimated](#) that the average benefit under such a program would be \$182 per week. The HEROES Act would simply continue the \$600 FPUC through 2020.

The thinking behind the Republican proposal is straightforward: Why return to a job that pays less than UI would provide? As businesses seek to reopen, high unemployment benefits may depress demand for jobs at wages that can’t compete with claimants’ total benefits, which are made up of state and federal components. In contrast, the 70% scheme would aim to make pre-pandemic wages attractive enough that low-income workers will return to their jobs. As the pandemic continues to spread, many workers also may be reluctant to return to jobs that only [exist](#) outside their homes.

In the CARES Act, Congress expanded unemployment benefits. It extended support by 26 weeks and widened eligibility to include part-time and self-employed workers. More than 50 million people have [filed](#) unemployment claims this year.

Data appeared to confirm the Republicans’ argument that the CARES Act subsidy, combined with existing state unemployment benefits, exceeded many workers’ earnings. In a paper published in May, researchers at the University of Chicago [estimated](#) that “68% of unemployed workers eligible for UI will receive benefits which exceed lost earnings,” with a fifth of those eligible receiving more than twice their lost earnings. The authors hypothesized that the \$600 supplement could promote compliance with stay-at-home orders, but would dampen policies that sought to reignite hiring.

However, more recent studies have added to our understanding of the FPUC’s effects. For example, the May paper only compares wages to earnings, where relatively granular data are available. The National Employment Law Project analyzed data on UI recipients to [estimate](#) that claimants’ pre-pandemic compensation was, on average, 28 percent higher than the Chicago researchers had assumed because they excluded non-wage benefits (page 4). If so, then the effects of the CARES Act subsidy on rehiring may not be as important. Early scholarship on hiring and work scheduling fits this conclusion.

By a range of measures – [hours worked](#), [applications per job vacancy](#), [employment probabilities](#) – researchers have shown that the employment effects of the FPUC was likely not significant. This result seems to hold both in the aggregate as well as at the individual level. The first and third papers linked leveraged the Current Population Survey, which tracks tens of thousands of households over a four-month period. In this case, following individual households allowed researchers to distinguish between new hires and rehires; they concluded that higher rates of wage replacement, on average, did not affect decisions to return to work. Rather, they suggested that decreased demand for labor is the limiting factor.

Challenges to implementing a wage-replacement scheme

Even before the COVID-19 crisis, UI benefits faced several challenges. First, the federal structure of UI systems means that each state has its own, idiosyncratic program. Second, the existence of overlapping state and federal systems creates diverse categories of workers, each with distinct benefits programs, funded by different sources. Third, the systems that process unemployment claims are aging and frequently underfunded.

Problems with federalism

Each state administers UI benefits through [its own program](#). This leads to considerable variation among states in the length of UI benefits, the minimum and maximum benefit, the method of calculation, and the data sources. Some states use weekly wages, while some use quarterly wages or annual wages.

The length of the basis period for calculating the highest quarter varies from state to state. Most states count the first four of the last five completed calendar quarters for calculating weekly benefits, but some do not. In 40 states, more recent earnings can be counted towards the weekly benefit calculation, in some circumstances. Forty states do not pay a benefit in the first week of unemployment, while 10 states do. Below is a table of selected states to illustrate the range of formulae.

Table 1: Sample range of formulae for UI benefit calculation¹

Method of calculation	Min benefit	Max benefit	Length of benefits, weeks	% of claims filled by June 15	How long does it take to decide on
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						claim? (% decided on in <21 days)
Arizona	1/25 of highest quarterly wage (HQW)	\$187	\$240	8-26	46.85%	10.8%
Delaware	1/46 of total wages in highest two quarters	\$20	\$400	24-26	6.93%	32.6%
Nebraska	1/2 average weekly wage	\$70	\$440	10-26	51%	53.1%
New York	1/25 to 1/26 of HQW	\$104	\$504	26	64.93%	26.6%
Virginia	1/50 of total wages in highest two quarters	\$60	\$378	12-26	130.82% ²	8.6%

1. States in table chosen at random.
2. States chosen at random. Filings from neighboring DC and Maryland bias the Virginia claims up.

Sources: U.S. Department of Labor, [Significant Provisions of State Unemployment Insurance Laws](#); the Century Foundation, [Unemployment Insurance Data Dashboard](#)

Problems with overlapping systems

The existence of overlapping federal and state UI programs pose unique difficulties to updating the systems and implementing a wage-replacement scheme. Combining pre-existing UI benefits systems and new pandemic-related programs, there are four different programs. The last two programs on the following list were created by the CARES Act:

1. Standard state systems
2. Extended state benefits
3. Pandemic Unemployment Assistance (PUA)
4. Pandemic Emergency Unemployment Compensation (PEUC)

Standard state systems pay benefits for at least eight and not more than 26 weeks. These benefits are funded in full by states. When a state's unemployment rate is higher than a certain level, unemployment benefits can be extended up to 13 additional weeks. The federal government

[pays 50%](#) of extended benefits. Upon the expiration of extended benefits (EB), workers are eligible for [Pandemic Emergency Unemployment Compensation](#) (PEUC), which is funded in full by the federal government but still administered by states.

[Pandemic Unemployment Assistance](#) (PUA) adds an additional \$600 per week for workers who do not typically receive state UI benefits. These include sole proprietors, gig workers, part-time employees, and those furloughed as a direct result of COVID-19. It also pays a minimum weekly benefit equal to 50% of each state's average weekly benefit, although states are mandated to phase in [fuller payments](#).

While state systems vary considerably, all those who qualify for pre-pandemic state-provided UI benefits submit wage records. So, in principle, states could calculate a 70% wage replacement rate for each worker under existing UI programs.

But the CARES Act does not require self-employed workers to supply wage records to state agencies to receive the minimum benefit. Therefore, a wage-replacement scheme would, at present, be impossible to implement for this category of worker.

In [the week ending August 8](#), 831,000 people filed initial claims for state-provided UI, while 489,000 people filed initial claims for PUA.

Technical problems

Technological disinvestment and the state of information technology procurement have afflicted UI benefits programs for decades. Between 2001 and 2020, nationwide funding for UI systems [declined](#) in real terms from \$3.27 billion to \$2.14 billion (p. 4). And much of the remaining funds flow to failed projects: high-profile failures anchor estimates that, worldwide, only 13% of government IT projects larger than \$6 million [succeeded](#). Some states, such as [Michigan](#), have successfully fixed broken systems, but the appropriations process that rules UI funding make iterative development – the core of modern software development – difficult to execute.

A [recent report](#) from the Century Foundation revealed that only 60% of unemployment claims filed between March 1 and June 15 were paid by the end of June. The unprecedented recent strains have laid bare fractures that have grown for years. Between 2007 and 2017, the false denial rate has more than doubled from 8% of unemployment claims to 17%. Michigan's system offers an egregious example: after the system's deployment in 2013, "The MiDAS system [flagged](#) more than 40,000 workers for fraud, and it was 93 percent inaccurate."

Yet, Michigan's commitment to its system [catapulted](#) it to among the fastest states for processing unemployment claims during COVID-19. Governor Gretchen Whitmer's [executive orders](#) early in March are part of the reason for this improvement. Following the spate of false denials that marred the system's deployment, lawsuits and legislation [mandated](#) improvements to the state's system. But continuous improvement is the exception, not the rule, in government-procured IT. Government contract administration [discourages](#) the testing and iterative development [standard](#)

in the private sector. These incentives [result](#) in [big-ticket](#) procurements that [fail](#) when scaled up to millions of users.

The appropriations cycle has also exposed IT procurement to procyclical funding, which poses problems for UI systems that face, by definition, countercyclical demand. Michigan suffered, along with other states, fiscal austerity following the Global Financial Crisis and Great Recession. In that case, the revelation of massive errors in MiDAS spurred pressure to reform. States with quieter failures still languish at the bottom of the claims-processing totem pole. Florida, which [neglected](#) important reforms to its \$77 million system, briefly [reverted](#) to issuing [paper applications](#), and, as of June 30, had paid only 52% of claims filed since March.

Only 16 states have fully modernized their UI systems, according to the [National Employment Law Project](#). Aging systems often rely on COBOL, a 70-year-old programming language used to access mainframe computers. Only 37 schools in the world [offer](#) a mainframe computing course. In April, New Jersey's governor [appealed](#) to retirees fluent in COBOL's syntax to help fix its system.

But, even if states could rewrite their code to define benefits in terms of prior earnings, the PUA has expanded eligibility to self-employed workers and other workers who don't report their earnings. Depending on the level of integration between UI administrations and revenue services, the ease of importing these data will vary. But the case of Virginia shows how technological problems can compound those of federalism: because many Virginia citizens worked in DC or Maryland, the state has handled many claims originating outside its borders; to use the earnings data of these citizens, it would have to coordinate with the DC's and Maryland's UI systems.

Responses to proposal

Taking together the existence of 52 unique state-level unemployment programs and two major federal programs, a 70% wage replacement program is likely to take weeks or months to implement. A [memo](#) from the National Association of State Workforce Agencies (NASWA) estimates that changing FPUC to be tied to individuals wage records would take from "four to twelve weeks or more" to implement.

The debate over the next fiscal spending bill continues, and there is some indication that the final bill won't include the Republican wage-replacement proposal. The President recently signed an [executive order](#) extending a \$300 per week federal benefit through December 2020, and demanding that states cover an additional \$100.

Conclusions

A number of logistical and administrative problems have plagued unemployment benefits programs for decades. State UI systems collectively faced some 33 million claims by the end of May. This strain exposed deep flaws in states' technical capacities and reporting. The federal programs tailored to the pandemic-caused recession have imposed new standards on old,

fragmented systems, further complicating the prospects for a speedy implementation of wage replacement.

Swaps

To ensure that international trade continues during periods of financial stress, central banks establish short-term liquidity swap lines. While many states participate in swap lines, the prominence of the US dollar in global markets makes Federal Reserve swaps particularly useful. These work the same as any swap line: a foreign central bank uses their currency to purchase dollars at the market exchange rate, and agrees to use dollars to purchase back their currency at the original exchange rate, plus interest. The foreign central bank may then freely lend dollars to its domestic institutions. Because the exchange rate does not change, swaps are riskless transactions that effectively support foreign exchange liquidity.

Analysis

Central Banks Use Swap Lines to Maintain the Flow of US Dollar

By Rosalind Z. Wiggins with Research Support from Pascal Ungersboeck

Original post [here](#).

The Yale Program on Financial Stability has produced and will continue to update a spreadsheet to assist those contemplating swap line agreements. The spreadsheet catalogs past and current examples of crisis-focused swap line agreements, identifies interesting program features, summarizes existing evaluations of programs, and shares general resources on the topic. This spreadsheet can be accessed [here](#). (Current version as of 3/26/2020 for those unable to access Google Sheets)

As the world responds to the COVID-19 pandemic, the US dollar funding markets have come under stress. To address this issue, the US Federal Reserve (Fed) and other major central banks have taken a series of coordinated actions to provide more global US dollar liquidity. Swap lines are a powerful and flexible tool when central bank reserves are inadequate or when normal currency markets become distressed. We discuss here: (i) the recent actions regarding the US dollar, (ii) actions relating to prior crises, and (iii) significant features that countries might consider when contemplating entering a swap line.

Under a currency swap agreement, the lending central bank, for example, the Bank of England (BoE), requests US dollars from the Fed. In exchange, the Fed receives an equivalent value of pounds calculated at the market exchange rate. The BoE then lends the dollars to banks in the UK, charging interest. For the life of the swap, the BoE has a dollar liability, which takes the form of an account at the Fed, and the Fed has a pound liability, which is an account at the BoE. When the swap is over, the BoE returns the dollars to the Fed and the Fed returns the pounds to the BoE. The BoE also pays to the Fed the interest earned on the funds lent.

The Fed bears no exchange risk on these transactions. Also, because the receiving central bank determines the banks in its country to which it lends dollars, the Fed has no contractual relationship with those institutions and therefore does not bear any credit risk related to the downstream borrowers. (See [2020 Swap Line FAQs](#)).

The recently established Fed swap lines appear to operate similarly to the standing swaps and those used in the GFC. (See [Frequently asked questions: US Dollar and Foreign Currency Liquidity Swaps](#), which describes earlier programs.)

2020 Actions

On [March 15](#), the Fed and five central banks with which it has unlimited standing swap lines agreed to: (i) lower the interest rate by 25 basis points; the rate is now the overnight index swap

rate (OIS) rate plus 25 basis points; and (ii) offer loans with 84-day maturity in addition to their ongoing weekly operations, beginning on March 16. The five central banks are the Bank of Canada, Bank of England (BoE), European Central Bank (ECB), Bank of Japan (BoJ), and Swiss National Bank (SNB). ([Fed webpage discussing swaps](#)). The Fed calls these the “key banks.” The changes are to remain in place as long as appropriate to smooth the functioning of the US dollar funding markets

On [March 20](#), the Fed and four of the five key banks also announced that, beginning March 23, they would increase the frequency of their 7-day maturity operations from weekly to daily, continuing at least through the end of April.

The Bank of Canada does not currently conduct offerings of US dollars, but agreed to the rate provisions of the March 15 announcement and also announced on March 20 that it would initiate a USD Term Repo Facility (at the new rate), should one become necessary. [See the Canadian announcement here.](#)

[March 19](#), the Fed announced swap lines with nine more countries, bringing the total to 14. Maximum amounts currently authorized under the swaps are shown in Table 1.

Table 1. Federal Reserve US Dollar liquidity swap provisions

Maximum amount available	Country/Region
Unlimited standing facility	Canada, United Kingdom, European Union, Japan, Switzerland
\$60 billion	Australia, Brazil, South Korea, Mexico, Singapore, Sweden
\$30 billion	Denmark, Norway, New Zealand

Source: [Central Bank Swap Arrangements](#), Federal Reserve Bank of New York website

The US dollar is by far the most widely held and transacted international currency. Strains in dollar funding markets outside the US can disrupt financial conditions inside the US as well. If foreign entities were to experience difficulties accessing dollars to settle their transactions denominated in US dollars, the strain could further destabilize the flow of international commerce and roil US financial markets, potentially impacting businesses and households.

Lessons from the GFC and other Crises

The latest actions match the number and country distribution of swap lines that the Fed deployed during the Global Financial Crisis (GFC). Moreover, the scope of the lines established so far closely approximates those the Fed had in place at the peak of the GFC – it did not offer

uncapped capacity to the key banks until October 2008, after the failure of Lehman Brothers. (In recognition of changes to the economic situation, some lines are larger than during the GFC.) During the GFC, the Fed swaps were heavily used; by December 10, 2008, swaps outstanding had risen to more than \$580 billion. ([Fleming and Klaage, 2010](#)). A BIS study considered the Fed swap lines “to be very effective in relieving stresses in US dollar liquidity stresses and stresses in foreign currency markets.” ([BIS, 2010](#)).

The Fed terminated its GFC swap lines as market conditions improved. However, the lines with the key banks were reestablished on a temporary basis in 2010 and converted to permanent standing facilities in [October 2013](#) to act as a “prudent liquidity backstop” to problems that might arise in the availability of a currency. ([Federal Reserve, Oct 2013](#)). The standing agreements allow the Fed to quickly provide US dollars to funding markets as needed.

The Federal Reserve operates swap lines under the authority of [Section 14 of the Federal Reserve Act](#) and in compliance with authorizations, policies, and procedures established by the Federal Open Market Committee (FOMC). Most central banks have a similar authority.

During the GFC, central banks also created swap lines to address shortages in currencies besides the US dollar. The ECB entered into swaps with several countries to address strains in the availability of Euros: Sweden, Hungary, Denmark, Latvia, Poland, and the United Kingdom. ([BIS, see page 30](#)). The SNB entered into Swiss franc swaps with Poland, Hungary and the United Kingdom. ([BIS, page 31](#)). The BOJ entered into Japanese yen swaps with Korea and India. ([BIS, page 32](#)).

Central banks also introduced currency swaps after the 9/11 terrorist attacks in the US and in response to the Asian Financial Crisis. After the Asian Financial Crisis, several Asian countries entered into a multilateral swap agreement under the Chiang Mai Initiative, as well as many bilateral agreements, generally to supply US dollars or yen. ([BIS, page 32](#)). These lines were limited, in that only small amounts could be borrowed without IMF approval. These were augmented to provide for more flexibility and to make them two-way. See the [YPFS Swaps Resource Guide](#) for more information on these and other swaps.

Key Features of Swaps

Swap lines are an important monetary policy tool and have attributes that make them very responsive to changing circumstances. Some of the features which countries contemplating swaps consider are:

Cooperation and coordination

Swaps signal cooperation between the implementing central banks; different levels of cooperation are possible and there can also be a coordinated effort to manage the flow of a currency so as to avoid arbitrage or better meet market needs. The recent March 20 announcement from the Fed and five key banks recognizes a joint need to provide significantly more availability of one-week funding. As another example, in 2008 the ECB and BOE timed

their auctions of US dollars (provided under the swaps) to coincide with the Fed's auctions under its Term Auction Facility. ([ECB Press Release, 12/12/2007](#)). After September 15, 2008, however, the Fed negotiated terms of bilateral arrangements, such as interest rates and timing, with other central banks individually.

Design Flexibility

Swaps usually can be implemented fairly rapidly. After the 9/11 terrorists attacks, the Fed and ECB announced a US Dollar swap line on [September 13](#). The next day a line with the [BoE](#) was announced and augmentation of the standing line with [Canada](#). Standing lines can be activated or expanded very quickly as circumstances change.

Eligibility

In deciding which countries to enter into swaps with, a central bank considers the extent of bilateral capital flows between the two countries and the risk the swap lines could pose. There have been instances where requests for swap line have been denied. However, in such cases, there may still be a way for a country to use a third-party swap to access the needed currency.

Most swaps are one-way or two-way bilateral agreements. One notable multilateral swap agreement is the Chiang Mai Initiative (Multilateralization) (CMIM) among Asian VVV countries to provide for US Dollar support. The CMIM replaced a prior multilateral agreement and a network of bilateral agreements but did not prohibit additional bilateral agreements, which have been maintained by several countries. [Sussangkarn 2010](#). [Chiang Mai FAQs](#).

Swaps enable a country to seek support for those foreign currencies in which its domestic banks have exposure and in amounts that it perceives are needed. The standing swaps that the Fed established in 2013 “constitute a network of bilateral swap lines among the six central banks” and “allow for the provision of liquidity in each jurisdiction in any of the five currencies foreign to that jurisdiction, should the two central banks in a particular bilateral swap arrangement judge that market conditions warrant such action in one of their currencies.” ([Federal Reserve website](#)). Thus far, the US Fed has not utilized its ability to request a foreign currency under these arrangements.

Notably, because of their flexible design properties, swaps can provide increased access to a third currency, such as US dollars, for countries that do not have a swap agreement with the Fed. The bilateral swap agreements established under the Chiang Mai Initiative demonstrate the range of types of agreements and their responsiveness. These agreements were established or renewed after the Asian Financial Crisis (AFC), when a lack of foreign reserves was an issue. They were a way for the countries to make their foreign currency reserves available to each other. Several of these lines have since been extended to include local currency swaps, as well as USD-for-local currency swaps.

Examples of these swaps that incorporate terms tailored to the countries' particular situation include:

- The [\(one-way\) swap line that Japan has established with Indonesia](#) permits Indonesia to swap its local currency for US dollars as well as Japanese Yen.
- The [\(two-way\) agreement between Japan and Singapore](#) which permitted each country to swap its local currency for US dollars from the other was [amended in 2018](#) to also permit Singapore to access Japanese Yen.
- The [\(two-way\) agreement between Japan and Thailand](#) permits both countries to swap their local currencies (i.e., the Japanese Yen and the Thai Baht, respectively) for US Dollars from the other. Thailand may also swap the Baht against the Japanese Yen.

There is also discussion of extending the basic CMIM multilateral agreement to include Yen and Yuan. ([Kyodo 2019](#)).

During the GFC, the ECB set up Euro swap lines with Sweden and Denmark. But it used a different arrangement with the central banks of Poland and Hungary because it did not want to accept their local currencies. Instead, the ECB entered into repo agreements under which the Poland and Hungary central banks exchanged high-quality Euro-denominated securities as collateral for the Euros they received. These central banks would then on-lend the Euros in a similar manner and received their securities back once they returned the Euros. Other countries such as Iceland received access to Euros not through swaps with the ECB, which the ECB denied, but (in a fashion similar to the Asian experience) indirectly through swaps with countries that had such swaps, such as Sweden and Denmark. ([BIS, page 27, 30](#)). Although much smaller than the Fed's dollar lines during the GFC, the ECB believed that their Euro provisions to local banks "helped to achieve the key objectives of the swap lines and calmed markets and funding concerns during the crisis while taking into account moral hazard considerations." ([ECB, 2014](#)). Based on this assessment, the ECB converted some swaps to standing facilities.

While swap lines are established in response to currency strains, they can also serve other objectives. During the GFC, China established swap lines with six countries, which were also thought to have promoted the Chinese central bank's policy objective of promoting non-dollar currencies as trading and investment currency. ([BIS, page 33](#)).

Credit Risk

The receiving central bank determines which of its domestic banks are creditworthy and on what terms (collateral, interest, maturity). Given this, central banks contemplating being on the receiving end of a swap should consider how they would adequately protect themselves through the eligibility, collateral, and other criteria that they establish.

Lending Eligibility and Flexibility

Lending of funds to the domestic banks can be done through various modalities and terms as established by the receiving central bank, although sometimes the loan rate is agreed to with the lending counterparty. Features that can be customized include:

- Setting rates through various methods, e.g., variable-rate tenders, fixed-rate tenders, bilateral transactions;
- Lending against various types of collateral, including both foreign currency and securities denominated in foreign currency;
- Varying and/or changing the maturities of lending;
- Limiting the amount of lending to any one participant or providing full allotment;
- Setting the terms of the program which may be extended.

As demonstrated above, terms can be easily altered to meet situations as they develop. Recent programs have been revised to: (i) lower the cost of funds, (ii) offer longer-term maturities, (iii) provide more frequent offerings, and (iv) expand the flow to additional countries. In the wake of the 9/11 terrorist attacks, funding was lent on an overnight basis. In [October 2008](#), the major European banks (ECB, BoE, and SNB) agreed to lend on a longer term basis (at 7-day, 28-day, and 84-day maturities) to meet market needs.

Preservation of Reserves

Currency swap lines between central banks enable the receiving central bank to obtain foreign currency and redistribute it locally to its domestic banks without having to use its foreign reserves. This can be very valuable, since it allows the central bank to maintain its reserves for its own purposes. Swaps also can augment reserves that are inadequate to respond to an increase in demand.

Scalability

Once in place, swaps are easily scalable to meet changing conditions. Agreements can provide for a maximum amount, which need not be the same for each counterparty. For example, the agreement between Japan and Singapore permits Singapore to swap Singapore dollars for up to US\$3 billion or its equivalent in Japanese yen from Japan, but permits Japan to swap Japanese yen for only US\$1 billion from Singapore.

The amount of funds provided can be increased as the need arises and scaled back as conditions improve. On [October 13](#), 2008, for example, the Fed announced that it would increase the size of its swap line to four central banks (BoE, ECB, SNB, Bank of Canada) so that the respective banks could provide more US dollar funding. The same arrangement was extended to [Japan](#) the next day. The original lines had been established at much smaller levels. For example, the swaps with the SNB and the ECB, as established in December 2007, were originally limited to \$4 billion and \$20 billion, respectively. By October 2008, the Fed had repeatedly enlarged the caps to \$60 billion and \$240 billion, respectively, before removing them entirely. Therefore, countries looking to establish a currency swap need not consider the initial limit binding should circumstances change.

Key announcements discussed herein:

- [March 15, 2020 joint announcement](#)
- [March 19, 2020 announcement with Swap Lines FAQs](#)
- [March 20, 2020 joint announcement.](#)

Case Studies and Policy Changes

Fed Creates Dollar Repo Facility for Central Banks, Extending Liquidity to Central Banks that Don't Have Fed Swap Lines

By **Greg Feldberg**

Original post [here](#).

On March 31, the Federal Reserve [announced](#) a dollar repo facility that will allow it to lend dollars to foreign central banks in exchange for US Treasury securities.

The temporary repurchase agreement facility for foreign and international monetary authorities, or “FIMA Repo Facility,” will allow foreign central banks to exchange US Treasuries for US dollars through overnight repurchase agreements (repos). They can then make those dollars available to companies in their own jurisdictions.

The unprecedented global COVID-19 crisis has intensified demand across the world for US dollars. Earlier, the Fed announced that it was revising and expanding dollar swap lines with foreign central banks. But the swap lines are now available to just 14 central banks (see the [YPFS blog](#)). The new FIMA Repo Facility, available from April 6, will allow the Fed to get dollars to central banks that are not participating in those swap lines. Also, unlike the swap lines, it is not an updated version of a tool used in the global financial crisis in 2007-09.

In [FAQs](#), the Fed said the new facility will help prevent financial stress abroad from elevating risks in US markets: “The facility reduces the need for central banks to sell their Treasury securities outright and into illiquid markets, which will help to avoid disruptions to the Treasury market and upward pressure on yields.”

FIMA account holders are central banks and other foreign monetary authorities with accounts at the Federal Reserve Bank of New York (FRBNY). The Fed must approve applications to use the facility.

While transactions would be on an overnight basis, they could be rolled over. They will be conducted at an interest rate of 25 basis points over the Fed’s rate on Interest on Excess Reserves, which typically exceeds market rates in normal times.

The transactions will pose no foreign exchange risk or credit risk to the Fed. They will occur entirely in dollars and are fully collateralized by US Treasuries. Margins will reflect margins on similar collateral posted to the Fed’s discount window.

The Fed will disclose the amount of activity under the facility in its [weekly H.4.1 release](#).

The Fed has unlimited standing swap lines with five central banks: the Bank of Canada, Bank of England, European Central Bank, Bank of Japan, and Swiss National Bank. On [March 20](#), the

Fed and four of these central banks (excluding the Bank of Canada) announced that, beginning March 23, they would temporarily increase the frequency of their 7-day maturity operations from weekly to daily. As of [March 25](#), the Fed had \$206 billion outstanding in swaps with those four central banks. On [March 19](#), the Fed announced swap lines with nine more countries, bringing the total to 14.

Reserve liquidity facilities shift from advanced economies to emerging markets

By **Corey Runkel**

Original post [here](#).

On June 19, the European Central Bank (ECB) [joined](#) the central banks of England, Japan, and Switzerland in scaling back the frequency of their US dollar liquidity swaps with the Federal Reserve (Fed). [Central bank liquidity swap lines](#) facilitate access to foreign capital during periods of international financial stress. While these bilateral swap operations with the Fed have slowed, the ECB [announced](#) on June 25 the establishment of the [Eurosystem repo facility for central banks](#) (EUREP). The new facility will complement the ECB's current bilateral swap lines by allowing for less stable currencies to participate in repurchase agreements. This post summarizes the recent activity on Fed swap lines and documents the shift in currency facilities from those aimed at the sturdiest reserve institutions to those aimed at central banks with smaller stocks of dollars.

Fed swap lines remain successful

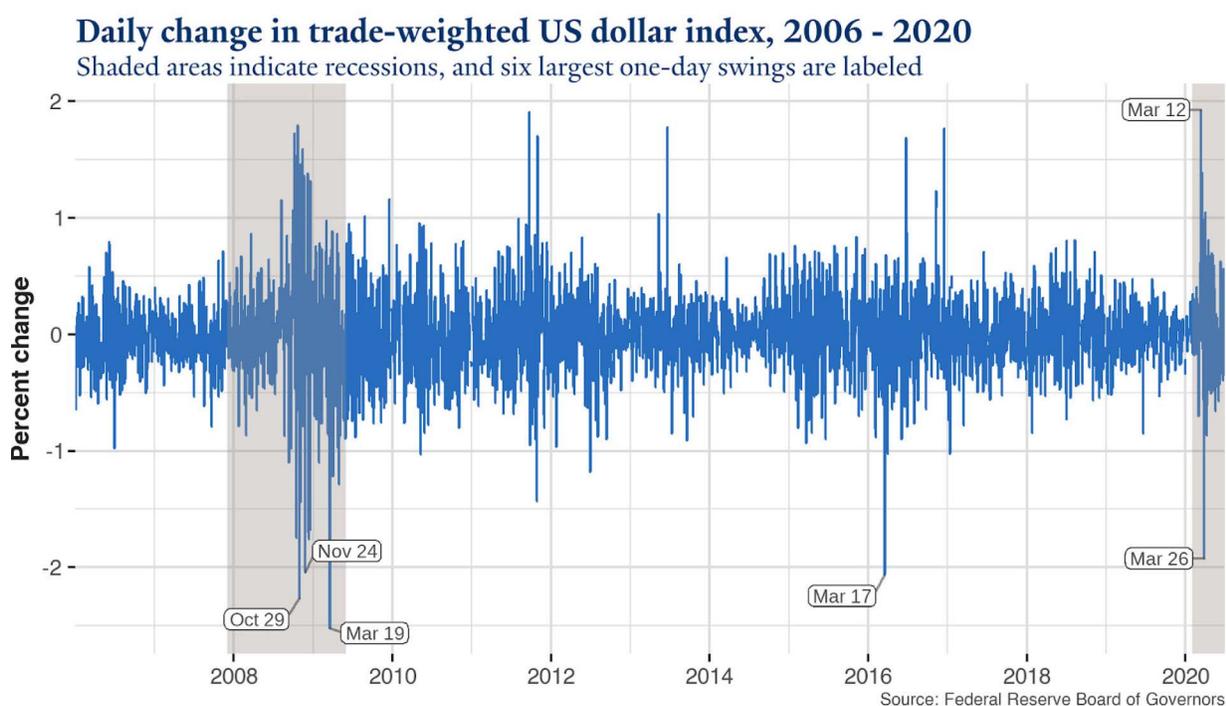
Since the Global Financial Crisis (GFC), the Fed has maintained unlimited swap lines with the European Union, England, Japan, Canada, and Switzerland. On [March 23](#), it began offering daily, 7-day tenor swaps on these unlimited lines. This development came on the heels of a March 19 expansion of bilateral agreements detailed by a [previous YPFS blogpost](#): the expanded facility would provide up to \$60 billion for the banks of Australia, Brazil, South Korea, Mexico, Singapore, and Sweden, and up to \$30 billion for the banks of Denmark, Norway, and New Zealand.

During a dollar liquidity swap, the Fed enters into an agreement with another central bank that maintains an account at the Federal Reserve Bank of New York (FRBNY). The banks agree to perform two actions: first, the Fed's dollars are exchanged for the foreign bank's currency at the prevailing exchange rate; second, at some specified date in the near future, the foreign bank's dollars are re-exchanged for their own currency at the same exchange rate as the original transaction, plus a small interest rate. The FRBNY is [authorized](#) by the Fed's Open Market Committee under [Section 14](#) of the Federal Reserve Act to establish swap lines, and has [emphasized](#) the benefits to American households and businesses by "helping to maintain the flow of credit to U.S. households and businesses by reducing risks to U.S. financial markets caused by financial stresses abroad."

Since the agreements peg both transactions to the same exchange rate, the Fed bears no risk that turmoil in foreign exchange markets translates to a loss of US dollars. Foreign central banks often use swap lines to get dollars that they can use to provide liquidity to domestic institutions in need of dollars. In 2007, the Fed lent money directly to US branches of European banks in

addition to its heavy usage of the swap lines. The upshot of a liquidity swap was that, since the Fed's swap was with the other central bank, it was not exposed to the risk of default by the downstream borrowing institutions; this risk was borne by the central bank, which determined who it would lend to.

Though financial strains among countries with standing dollar swap lines have thus far been much weaker than during the GFC, the rejuvenated lines were equally [effective](#) at quelling turbulent dollar funding markets. [Between March 6 and March 23](#), the US trade-weighted dollar index jumped to an historical high of 126.47, and posted its largest single-day percentage increase since the series was inaugurated in January 2006. With the acceleration of 7-day swaps on March 23, three days later the index subsequently posted its second largest drop since March 2009. It has not fluctuated by more than 1 point since April 7, though the index has remained higher and more volatile than recent, pre-pandemic levels.



The speed and authority with which the Fed provides liquidity for the largest reserve currency market have [bolstered](#) the central bank's reputation. This most recent resurgence of swap lines has led [some](#) to [assert](#) that the Fed is not only a central bank to the US, but also to the world, offering short-term emergency liquidity when central banks -- liquid in their own currency -- are strapped for US dollars. As with domestic lender-of-last-resort operations, the transactions have always been initiated by a counterparty, never by the Fed. Although swap agreements are bilateral, the US [has never drawn](#) on a currency swap line.

Focus shifts to countries with weaker reserves

The Fed's deceleration of currency swaps prompted [praise](#) for the speed and scale of relief. But the facility left unresolved the [plight](#) of weaker, systemically less important currencies. Already burdened by higher interest rates on credit, countries without access to Fed swap lines saw a sharp uptick in the costs of accessing dollar funding markets, a Bank for International Settlements [paper](#) published in May found. Access to dollar funding has been exacerbated by capital outflows at [rates higher than during the GFC](#).

In an attempt to provide reserves for dollar-strapped reserve banks, the Fed and ECB have each established repurchasing (repo) facilities for their currencies. The facilities work similarly to currency swap lines, providing short term liquidity and protecting against credit risk by dealing only with central banks. However, these repo facilities lie one step closer to secured loans, requiring foreign central banks to post collateral should they default on loan repurchasing. To protect against exchange rate risk, eligible collateral consists only of sovereign securities denominated in the lender's currency. For example, the Fed's Foreign and International Monetary Authorities (FIMA) facility -- [detailed in a previous YPFS blogpost](#) -- accepts US Treasury securities of any maturity, while the ECB's EUREP accepts euro-denominated debt from any of its constituent states as well as the central bank itself.

These repo agreements allow foreign central banks to avoid dumping large amounts of sovereign bonds into [illiquid markets](#), ensuring value for both the Fed and the foreign bank in need. But the facilities can be more limited than the swap lines due to shorter maturities and higher interest rates. The FIMA's repo facility only offers overnight maturities. Though such maturities can be rolled over, the repo agreements contrast sharply in this regard with the swap lines, which offer up to 84-day maturities.

Additionally, pricing is slightly steeper in FIMA and [EUREP facilities](#). Where Fed central bank liquidity swaps add [25 basis points to the overnight index swap \(OIS\)](#), FIMA adds [25 basis points to the Interest Rate on Excess Reserves \(IOER\)](#). Currently the benchmark US overnight rate, the Federal Funds rate, stands at 0.05%, with the IOER at 0.10%. These prices potentially mean that liquidity will be cheaper for emerging markets than swap lines were for Singapore, which paid 1.09% for a [March](#) swap, but more expensive than recent swaps with the Fed's standing accounts, which have carried rates around 0.33%.

The ECB has yet to announce pricing for its facility, which will run until June 2021, but Turkey has been mentioned as a potential applicant. Bloomberg [reported](#) that the nation had sought talks with the Group of 20 nations for its inclusion in bilateral swap agreements. For emerging markets, the International Monetary Fund has also been very active in approving emergency fund disbursement and stand-by facilities, and has introduced the new, "swap-like" [Short-term Liquidity Line](#), and may be on track for support more given its [still-large reserves](#).

Federal Reserve extends temporary US dollar liquidity swap lines and FIMA repo facility to March 31, 2021

By Junko Oguri

Original post [here](#).

On [July 29](#), the Federal Reserve announced the extensions of its temporary U.S. dollar liquidity swap lines and the temporary repurchase agreement facility for foreign and international monetary authorities (FIMA repo facility). Now these facilities are set to expire on March 31, 2021.

These deadline extensions follow the extensions of other lending programs to December 31 as announced on [July 28](#). The Fed had previously extended the termination date for the Municipal Lending Facility in April.

When the temporary U.S. dollar liquidity swap lines were established on [March 19](#), the Fed announced that they will be “in place for at least six months” (see the YPFS blog [here](#)). The 9 counterparties of the temporary swap lines are the Reserve Bank of Australia, the Banco Central do Brasil, the Danmarks Nationalbank (Denmark), the Bank of Korea, the Banco de Mexico, the Norges Bank (Norway), the Reserve Bank of New Zealand, the Monetary Authority of Singapore, and the Sveriges Riksbank (Sweden).

The FIMA Repo Facility was announced on [March 31](#) and implemented on April 6. In the former announcement, it was stated that the facility was set to “continue for at least 6 months” (see the YPFS blog [here](#)).

The table below lists the current expiration dates for the Fed’s programs in response to the COVID-19 crisis.

Lending Facility	Original Expiration	New Expiration
Primary Dealer Credit Facility (PDCF)	September 20, 2020	December 31, 2020
Money Market Mutual Fund Liquidity Facility (MMLF)	September 30, 2020	December 31, 2020
Primary Market Corporate Credit Facility (PMCCF)	September 30, 2020	December 31, 2020
Secondary Market Corporate Credit Facility (SMCCF)	September 30, 2020	December 31, 2020
Term Asset-Backed Securities Loan Facility (TALF)	September 30, 2020	December 31, 2020
Paycheck Protection Program Liquidity Facility (PPPLF)	September 30, 2020	December 31, 2020
Main Street Lending Program (MSLP)	September 30, 2020	December 31, 2020
Municipal Liquidity Facility (MLF)	September 30, 2020	December 31, 2020
Commercial Paper Funding Facility (CPFF)	March 17, 2021	n/a
Temporary U.S. dollar liquidity swap lines*	September 19, 2020*	March 31, 2021

FIMA Repo Facility	September 31, 2020*	March 31, 2021
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*In March announcements, temporary U.S. dollar liquidity swap lines and the temporary repurchase agreement facility for FIMA repo facility were set to last to “at least six months”.

The Federal Reserve has also activated its standing U.S. dollar liquidity swap lines with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank. (See [this](#) YPFS blog).

At the press conference [on July 29](#), Chair Powell noted that “the introduction of the swap lines has really restored dollar funding markets around the world to fairly normal levels of activity” and the facilities served their purposes. Meanwhile, he underscored that the purpose of extension is to “facilitate planning by other central banks, and just so people will know that those facilities are still there.” This is consistent with the earlier [Fed’s research](#) showing that simply announcing the facilities helped restore market confidence.

For more information on liquidity swap lines, see our [resources guide](#).

ECB Announces New Eurosystem Repo Facility to Provide Euro Liquidity

By Aidan Lawson

Original post [here](#).

On June 25 the European Central Bank (ECB) [announced](#) a new facility to provide euro liquidity to non-eurozone central banks. The announcement does not specify the total size of this new facility.

The Eurosystem repo facility for central banks (EUREP) is designed as a “precautionary backstop to address pandemic-related euro liquidity needs outside [the] euro area” (see [here](#)). It is intended to reduce both the impacts and risks of sudden sell-offs of euro-denominated assets and any potential confidence-related spill-over effects into the euro area. The EUREP complements the ECB’s standing swap lines with 11 countries (see [here](#)) and one bilateral repo agreement (see [here](#)), addressing the limited access to euros that central banks have.

Any non-Eurosystem central bank can request a EUREP line, even those that already have existing bilateral swap lines or repo arrangements. The ECB’s Governing Council, which consists of 25 total members - 6 from the Executive Board and the governors of the 19 national central banks - makes the final decision. Central banks that are accepted will be able to borrow euros in exchange for euro-denominated debt issued either by euro-area governments or supranational institutions.

While a term sheet has not yet been released, the ECB has specified that the facility will be “slightly” more expensive than its existing bilateral swap and repo lines. The range of collateral will be narrower (see [here](#)). These terms, and the involvement of the Governing Council, reflect the ECB’s desire for the facility to be used exclusively as a backstop, rather than a facility that non-euro central banks turn to immediately.

EUREP may also be seen as a complement to its U.S.-based counterpart: the Federal Reserve’s temporary repurchase agreement facility for foreign and international monetary authorities, or “FIMA repo facility.” The FIMA repo facility, created on March 31, mirrors the EUREP’s function as a liquidity backstop. However, unlike EUREP, it is only available to central banks and other foreign monetary authorities with existing accounts with the central bank. For more information on the FIMA repo facility, see the following [YPFS blog](#). The usage of FIMA repo facility has been low, with \$1.4 billion in dollar repos outstanding as of the week of May 13, and limited activity since then.

However, the Fed’s existing swap lines with 14 central banks have been used extensively, peaking at over \$440 billion at the beginning of May (see [here](#)). The ECB has not published usage data for their swap lines or bilateral repo agreements. Swap lines were an effective tool in meeting demand for widely used currencies, especially during the Global Financial Crisis (GFC).

The Fed's swap lines were used extensively by the ECB, the Bank of Japan, and other major central banks during the GFC (see [here](#)). For more information on usage of swap lines currently and during the GFC, see the following [YPFS blog](#).

EUREP will be active through June 2021, and the exact pricing, collateral eligibility and tenor of the repos are still unknown. We will publish updates as details become available.

Miscellaneous Topics

The FHLBs May Not be the Lenders-of-Next-to-Last Resort during the Coronavirus Crisis

By Chase P. Ross

Original post [here](#).

During the global financial crisis, the Federal Home Loan Banks (FHLBs) were the [lenders of “next-to-last” resort](#), as banks and other FHLB members preferred to use their funding rather than the Federal Reserve’s discount window, the traditional lender of last resort (LOLR). Banks felt using the discount window might stigmatize their image with other market participants.

But it’s unclear whether the FHLBs will play that role this time. Market data suggest that banks are turning to the Fed – partly because the stigma of using the Fed is reduced, partly because of pricing.

The FHLB system is a government-sponsored enterprise operating with an implicit guarantee from the government. The FHLB system provides advances to its members – mostly depository institutions, but also insurance companies – to help finance housing-related assets. The system has a simple leverage multiple of 19.5 and has roughly \$1 trillion in assets as of Q4 2019, of which \$650 billion are advances.

In 2008, the FHLB system financed its LOLR activities by ramping up debt issuance. Auctioned discount notes grew from \$120 billion pre-crisis to almost \$300 billion in May 2008. Money-market mutual funds were important buyers of that debt. However, after the near-failure and government takeover of the other two prominent GSEs – Fannie and Freddie – money funds were less willing to buy FHLB debt. The FHLBs were “[guilty by association](#).” The systems’ debt outstanding shrunk rapidly, and only eventually recovered after the crisis (Figure 1).

In the aftermath of the Reserve Primary Fund breaking the buck in September 2008 and Treasury’s subsequent money fund guarantee, regulators sought to limit the systemic risk of money-market mutual funds. In 2016, the SEC implemented reforms that required funds to report floating net asset values (NAV) unless the fund imposed gates and fees or invested only in government securities. The gate structure allows the fund to temporarily prevent investors’ redemptions to cash in times of stress and would, in principle, limit a run from the money fund.

The effect of the reform has been a marked shift from prime funds, which invest primarily in commercial paper, toward government funds since government funds have a fixed \$1 NAV without gates or fees. Money fund investors clearly prefer the fixed value and the option to run in bad times over the comparatively higher yield offered by prime funds.

In my [recent working paper](#), I show that these post-crisis reforms made FHLBs new crucial safe asset producers. Government money funds can buy FHLB debt – as of late 2017, almost 40% of government money fund assets were FHLB debt. The FHLBs use the proceeds from the debt to

make advances to banks, and banks prefer funding via FHLB advances (rather than issuing commercial paper) because post-crisis liquidity regulations are friendlier to FHLB advances.

During the rapidly unfolding coronavirus pandemic, preliminary and incomplete evidence – based on the public data available so far – suggests the FHLBs provided substantial liquidity in the initial stages of the recent funding market pressures. But it ceded that role when the Federal Reserve boosted its lending operations.

Figure 1: FHLB Discount Note Debt Outstanding



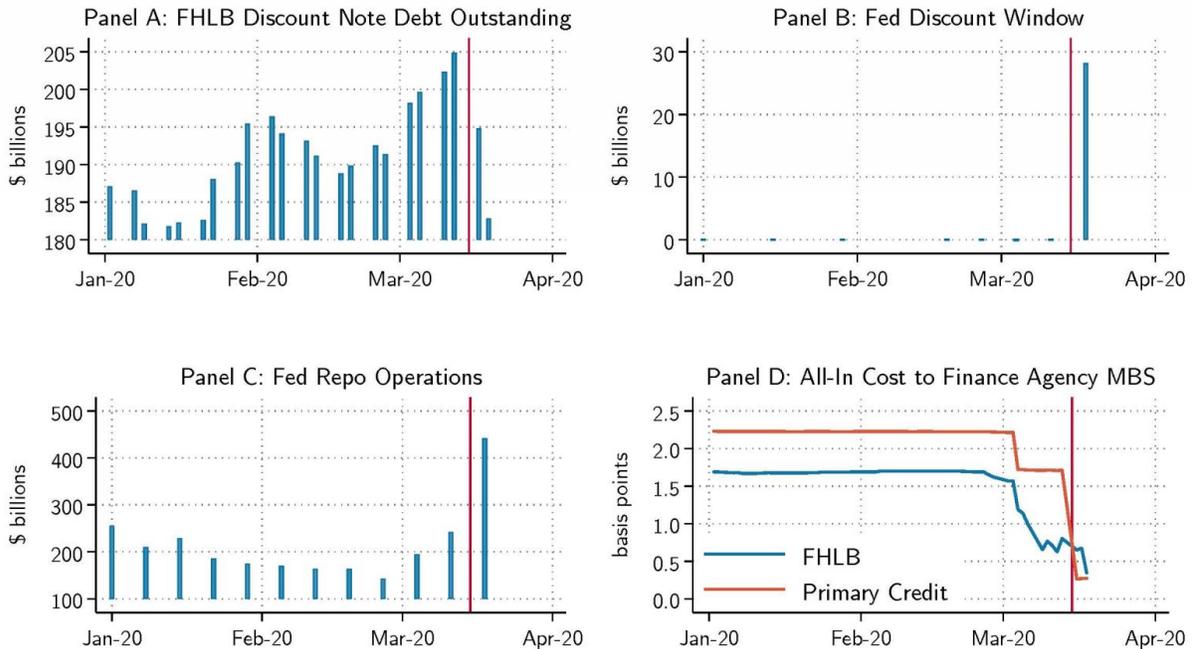
Note: Includes auctioned debt with maturities greater than overnight and no more than 26 weeks.

From February 26 to March 12, government money funds saw about \$150 billion of inflows – a 5% increase in assets under management in just a week. They used a good chunk of these inflows to purchase FHLB debt. From January 1 to March 11, FHLB auctioned debt outstanding (with maturity less than one year, excluding overnight debt) increased about 12%, or \$22 billion (Figure 2, Panel A). Government funds likely bought up the incremental issuance.

For that period, it appears the FHLBs were once again acting as a next-to-last LOLR. They used the proceeds from their increased debt issuance to help banks handle increased financing demands from the real economy. One estimate puts the magnitude of unfunded commitments of the largest banks to COVID-exposed industries via revolving credit facilities at \$125 billion. Compare that to the \$850 billion in cash and \$2 trillion in securities at those same banks. [Fed data shows](#) that over the same time period commercial and industrial loans increased \$16 billion, and loans to nondepository financial institutions also increased \$16 billion.

However, beginning March 12, the Federal Reserve increased its provision of financing to the banking system via repurchase operations, and on March 16 it “encourage[d] banks to use [the] Federal Reserve discount window” after cutting the primary credit rate on March 15. Both actions had significant uptake: from March 4 to March 18, repo lending by the Fed increased from \$200 billion to \$450 billion, and discount window lending increased from \$0 to \$28 billion (Figure 2, Panels B and C).

Figure 2



Note: Line marks Fed discount window rate cut on March 15, 2020.

Beginning March 17, short-term auctioned FHLB debt outstanding began falling quickly. FHLB debt spreads flipped from roughly -20 basis points to 30 basis points, and they’ve stopped regularly auctioning debt at the 4-week maturity.

Why? In part, the Fed’s actions siphoned some flows from the FHLBs. On March 16 – after the Fed cut the discount window rate – the all-in cost to finance a highly rated MBS was 26 basis points with the discount window and 65 basis points with an FHLB advance. This is unusual; advances are typically cheaper than the discount window, as shown in (Figure 2, Panel D).

FHLBs cannot provide a large amount of liquidity now without increasing their debt issuances. In its latest quarterly filing, the system reported \$5 billion in cash holdings, and it seems unlikely they’d pull back their repo lending (\$50 billion in Q3 2019) to make space for more advances. The FHLBs could scale back their fed funds lending – \$55 billion – to finance advances, but the action would have distributional effects. The FHLB system cannot earn interest on its account at the Federal Reserve; it instead [lends in the fed funds market to foreign banks](#), which arbitrage

the difference between interest on excess reserves and the fed funds rate. That is, if the FHLBs shifted from providing liquidity via fed funds to advances, they would be moving liquidity from foreign banks to domestic banks, despite evidence that foreign banks have stronger demand for dollar funding during the coronavirus crisis.

Are the FHLBs a systemic risk right now? Unlike Fannie and Freddie, they do not have risky investment portfolios, and their statutory super-senior lien means they are unlikely to face significant credit losses. The more worrisome problem is the amount of maturity transformation they're doing – half of their advances are longer maturity than one year – and the average maturity of FHLB debt held by money funds is 40 days as of 2018.

The FHLBs provided a valuable lender of next-to-last resort channel in 2008 – and although the Fed has [worked to destigmatize the discount window](#) in the past weeks, the FHLBs will remain important intermediators between banks and money-market mutual funds in the coming weeks. Keep an eye on the FHLBs.

Flight from Maturity during the Coronavirus Crisis

By Chase P. Ross, Sharon Y. Ross, Gary B. Gorton, and Andrew Metrick

Original post [here](#).

The coronavirus crisis has caused significant turmoil in funding markets in recent weeks. Although the Fed unveiled an alphabet soup of aggressive lending programs across many markets, a flight from maturity continues across many money markets, including interbank Eurodollar funding and commercial paper (CP).

Unlike a flight to quality – in which lenders entirely shift to the highest quality safe assets like Treasuries – a flight from maturity occurs when lenders preserve the option to exit quickly by lending at shorter maturities. Risk builds and funding structures grow precarious as lenders place a larger and larger premium on the exit option.

We build on the work of [Gorton, Metrick, and Xie \(2015\)](#) to show the flight from maturity during the coronavirus crisis. We measure maturity shortening using the steepness of money markets' term structures. In normal times, the spread between 3-month and overnight rates are low and flat since the money market instruments are similarly nearly riskless. But in times of stress money markets' term structures steepen, as was the case during the global financial crisis. The steepening reflects the diverse preferences of lenders and borrowers in a crisis. Lenders want to lend at a short maturity so they can quickly exit if borrowers approach insolvency, while borrowers – often banks – want to borrow long to lock in funding and are willing to pay higher term rates.

We look at publicly available high-frequency data on money markets: Libor and US CP. Both measures show flight from maturity at levels approaching the peaks last seen during the financial crisis.

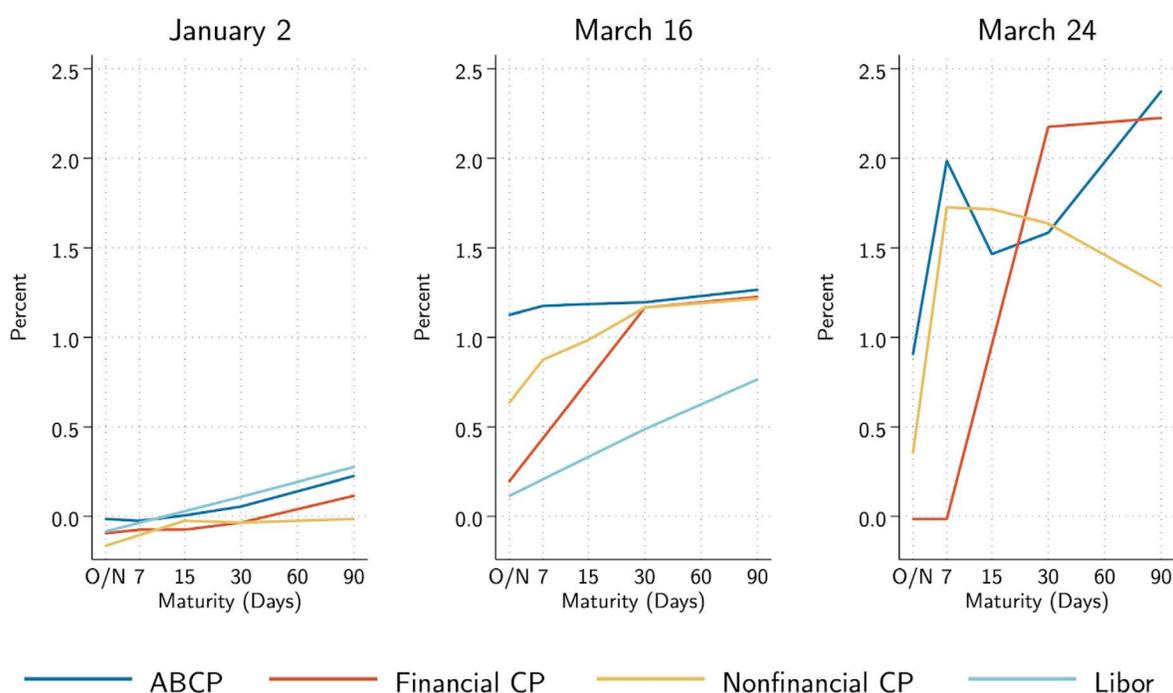
CP spreads remained relatively low as the initial news of COVID-19 arrived in February and early March. Beginning March 16, however, spreads increased very quickly for all flavors of CP as concerns about cash liquidity for corporate borrowers grew. Coincident headlines highlighted large fund outflows from [corporate bond funds](#), [discounts of bond ETF to net asset value](#), and several businesses [drawing down credit lines](#). From 2010 to 2019, the average spread of nonfinancial CP, financial CP, and asset-backed (ABCP) 3-month rates to target fed funds ranged from 8 to 22 basis points. The week of March 16 spreads increased to 185 bps (nonfinancial), 220 bps (financial), and 240 bps (ABCP), – exceeding the peak spreads in the financial crisis of 2008 for financial and nonfinancial CP (ABCP spreads peaked at 310 bps in the financial crisis).

Figure 1 shows the term structure of CP and Libor spreads, calculated as the money market rate less the fed funds target rate. We show this term structure at three points in time: at the start of

the year during “normal times;” on March 16, following the Federal Reserve’s 100 bps rate cut on March 15; and on March 24, the latest day of available data for ABCP.

At the start of 2020, the term structure was fairly flat: overnight ABCP and Libor rates were close to the fed funds target rate, and the 90-day ABCP and 3-month Libor spreads at less than 50 bps above that. But the term structure for both money markets steepened during March. On Sunday, March 15, the Federal Reserve announced a set of macroprudential policies, including

Figure 1: Money Market Yield Curves



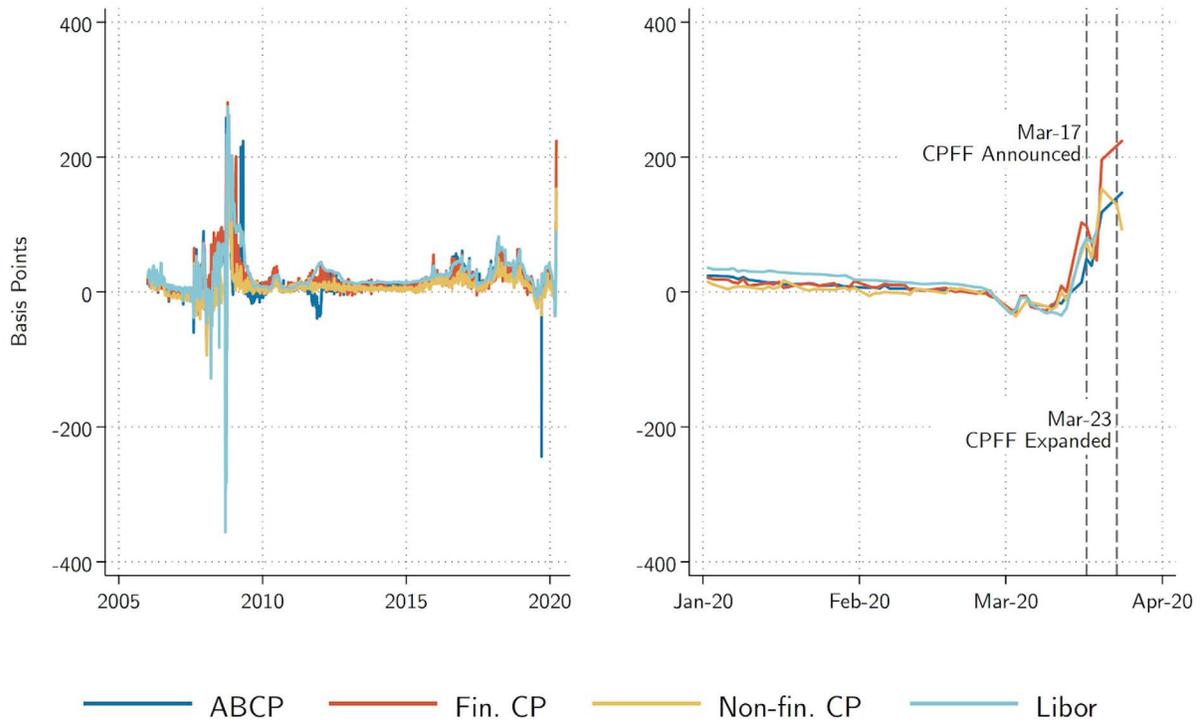
Note: All numbers are spreads to fed funds.

enhancing US dollar swap lines with other central banks and asset purchases of \$500 billion in Treasuries and \$200 billion in MBS. The Federal Reserve also decreased the interest rate target, and the March 16 spreads of ABCP and Libor increased to reflect this change.

These actions did not stop the flight from maturity, which accelerated the following week. On March 16, Libor’s spread steepened over the term structure, with 3-month Libor spread at nearly 80 bps and the overnight rate at 11 bps. As coronavirus cases increased and markets continued to remain volatile, the term structure of CP – across all types of issuers – steepened, too. By March 24, the 3m/overnight spread for ABCP was 150 bps. Financial CP had an even steeper curve of almost 240 bps.

To get a sense of how the funding curves compared to the global financial crisis, Figure 2 shows the slope of the yield curve for CP and Libor by plotting the time series spread between the 3-month and overnight rates. The steepness of these curves is approaching levels last seen during the financial crisis (Table 1).

Figure 2: 3-Month/Overnight Slope



High-frequency CP issuance data makes the freeze in term CP markets clear: the shortest maturity CP, less than 4 days, doubled from \$45 billion to \$90 from March 11 to March 24 (Figure 3). At the same time, term issuance—defined as CP issuance with greater than 4 days maturity—fell. Issuance data obscures the composition of issuers as comparatively riskier issuers pre-coronavirus crisis have likely left the market.

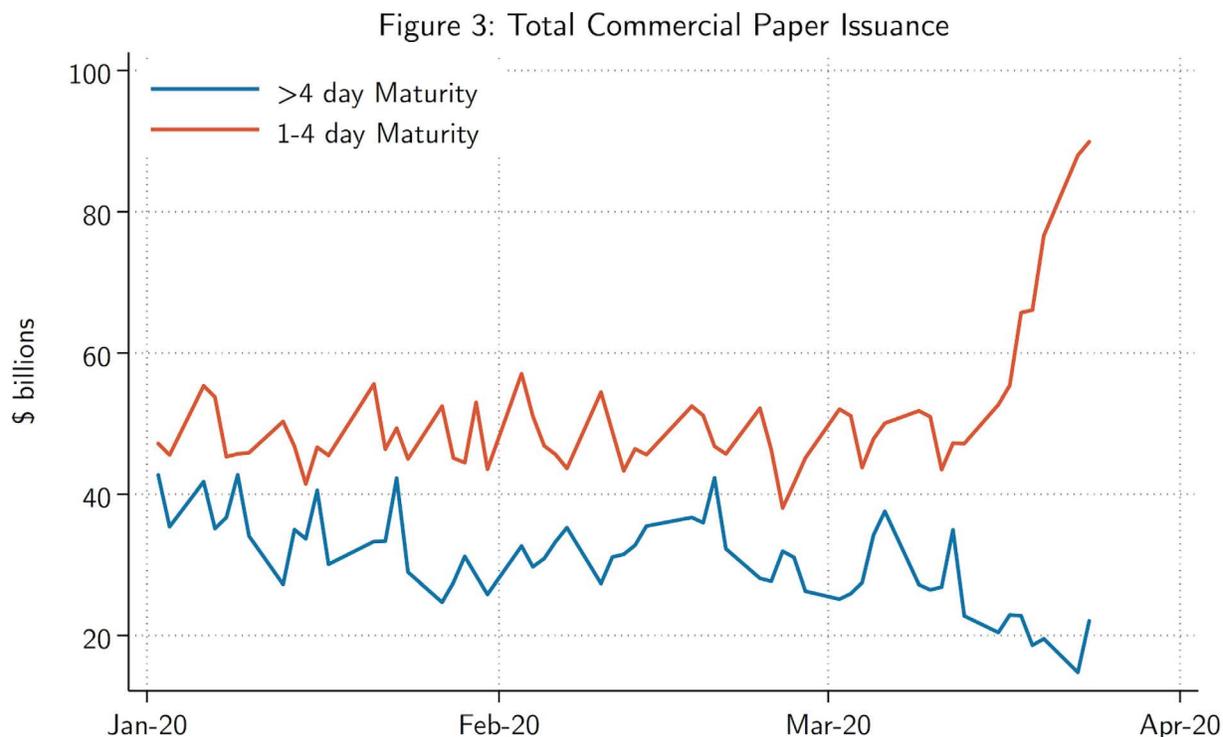
Table 1: 3-month/Overnight Curve Slope

basis points	Global Financial Crisis			Coronavirus Crisis		
	Pre-Crisis Average	Peak	Change	Pre-Crisis Average	3/24/20	Change
LIBOR	10	275	265	24	74	50
Financial CP	7	281	274	15	224	209
Nonfinancial CP	1	205	205	11	93	82
ABCP	5	258	253	15	147	132

Note: AA-rated commercial paper. Slope is difference between 3-month and overnight rate.

Source: Federal Reserve

At first glance, it might be surprising the Federal Reserve’s CP funding facility (CPFF, [announced March 17](#)) had little impact on CP rates. This is partly because the CPFF focuses only on 3-month CP. Although the facility is very similar to the 2008-era program, the pricing is different relative to market conditions. In 2008, the spread was 3m OIS+100 bps plus



a 100 bps credit surcharge, whereas the COVID19 facility is 3m OIS+200 bps. But there was minimal initial takeup during the current crisis because financial, nonfinancial, and asset-backed CP 3-months rates were well below OIS+200bps at announcement. Moreover, there is so little issuance of lower-rated A2/P2 the Fed has not stopped consistently reporting term rates, and the initial CPFF design excluded A2/P2 paper.

On March 23, the [Fed expanded the CPF](#): reducing pricing to OIS+110bps and expanding the facility to lower-rated A2/P2 CP issuers at OIS+200 bps. At the time of writing on March 25, financial and ABCP issuers will likely soon use the program as rates have continued increasing.

The progression of the term structure echoes a similar pattern to that of 2008 with maturity shortening as lenders aim to maintain the ability to make a quick exit. This is concerning given a flight from maturity creates a more fragile financial system. In the current coronavirus crisis, the trend may be particularly problematic: the yield curve for many money markets have steepened even after aggressive action by the Federal Reserve. Although the current crisis is a pandemic – not yet a financial crisis like 2008 – short-term debt holders are ready to run, should something appear to threaten issuers' ability to pay. Work remains for central banks to bend the funding curves down.

CARES Act \$454 billion Emergency Fund Could add up to Much More for Businesses, States and Municipalities

By **Rosalind Z. Wiggins**

Original post [here](#).

The [Coronavirus Aid, Relief, and Economic Security Act \(“CARES Act”\)](#) that President Trump signed into law on March 27th provides \$454 billion (the Emergency Fund) for the Secretary of the Treasury to make direct loans or to guarantee loans made by the Federal Reserve to assist business, states, and municipalities dealing with the pandemic. The Fed may do this through (i) purchasing obligations or other interests directly from issuers or other interests; (ii) purchasing obligations or other interests in secondary markets or otherwise; or (ii) making loans, including loans or other advances secured by collateral.

By providing the ability for the Treasury to guarantee or backstop Fed loans, the provisions create the possibility that the impact of the fund can be leveraged up significantly as stated by Secretary Mnuchin – “We can [lever up to \\$4 trillion](#) to help everything from small businesses to big businesses.” Fed Chairman Powell has echoed the Secretary – “[Effectively, \\$1 of loss-absorption is worth \\$10 worth of loans.](#)” Therefore the Emergency Fund could result in trillions of dollars being made available to the public. See [this YPFS blog post](#) for further discussion on the Treasury backstop.

The legislation creates great possibilities but also raises questions about limitations on the Fed’s authority. Section 4003(C)(3)(B)) of the CARES Act explicitly provides “for the avoidance of doubt” that the requirements of Section 13(3) of the Federal Reserve Act would apply to any Fed program or facility relying on such funds “including requirements relating to loan collateralization, taxpayer protection, and borrower solvency.” We discuss herein the intersection of the Emergency Fund with Section 13(3).

Federal Reserve Act Section 13(3)

Section 13(3) of the Federal Reserve Act, often called the Fed’s emergency lending provision, provides the central bank with authority in “unusual and exigent” situations to broaden its permitted borrowers to include “any individual, partnership, or corporations.” The section was enacted during the 1930s and has been called a “broad and extraordinary authority.” ([Alvarez 05/26/2010](#)). The provision was used several times during the Depression, and although use was authorized twice during the 1960s, funds had not been lent under the provision in the 70 years prior to the 2007-09 global financial crisis (GFC). ([Alvarez 05/26/2010](#)).

Section 13(3) during the GFC

During the GFC, Section 13(3) authorized the Fed to extend credit to any individual, partnership or corporation if certain criteria were met:

- At least five members of the Board members determined that “unusual and exigent” circumstances exist
- The lending must be “indorsed or otherwise secured to the satisfaction of the [lending] Reserve Bank.”
- The borrower was “unable to secure adequate credit accommodations from other banking institutions”
- The credit complied with any limitations, restrictions and regulations prescribed by the Board. ([FRA Sec 13\(3\), 2008](#)).

During the GFC the Fed found that “unusual and exigent circumstances” existed and extensively used the provision, which became one of its most important tools to provide numerous broad-based programs aimed at providing liquidity to markets. The Fed has recently reintroduced versions of several of these programs to address the COVID-19 pandemic: the [Term Asset-Backed Securities Loan Facility \(TSLF\)](#), the [Commercial Paper Funding Facility \(CPFF\)](#), the [Primary Dealer Credit Facility](#), the [Money Market Mutual Fund Liquidity Facility \(MMIF\)](#).

Most recently, on March 23, the Fed and the Treasury reintroduced a modified version of another GFC-era program the [Term Asset-Backed Loan Facility \(TALF\)](#) to support credit flows to households and businesses by maintaining the flow of asset-backed securities markets. Pursuant to the TALF the Federal Reserve Bank of New York (FRBNY) will make loans to a SPV that will in turn make a total of \$100 billion three-year nonrecourse loans to U.S. companies that own eligible ABS. The SPV will be funded by a recourse loan from the FRBNY and an initial \$10 billion equity investment by the Treasury. The Fed again relies on the Section 13(3) authority and the Treasury uses the Exchange Stabilization Fund (ESF) to backstop the program. The TALF is thought to be a good candidate for use of the Emergency Fund to support lending by the Fed because of its demonstrated flexibility. See a YPFS blog on the 2020 TALF and Federal backstop [here](#).

During the GFC, the Fed also relied on its Section 13(3) authority to stabilize systemically important firms such as Bear Stearns and AIG, and to design ring-fencing programs like it did for Citigroup and Bank of America. The extensive use of Section 13(3) programs provided trillions of dollars of liquidity to the financial system and contributed greatly to the effort to quell the GFC. There has generally been little criticism of the Fed’s use and interpretation except for its Maiden Lane facilities in support of Bear Stearns and AIG.

Dodd-Frank Amendments

Following the GFC, in which some of the Fed lending was criticized, particularly assistance to individual companies, Congress enacted changes to Section 13(3) through the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#), which added several significant provisions including:

- the Fed can now only conduct emergency lending through a “program or facility with broad-based eligibility,”
- the purpose of the program must be “providing liquidity to the financial system, and not to aid a failing financial company”
- that the security for emergency loans is sufficient to protect taxpayers from losses
- that for any loan, a Federal Reserve bank must assign, consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for a loan under Section 13(3) in determining whether the loan is secured satisfactorily.
- That credit may not be given to any company that is insolvent.

Prior to introduction of the COVID-19 era programs, Section 13(3) had not been used since the GFC and thus, the Dodd-Frank amendments are untested.

Broad-based Eligibility. The amended provision seeks to prohibit the Fed from customizing assistance to individual firms and focuses on assisting the broad market and financial system. A program or facility has “broad-based eligibility” if it is (i) designed to provide liquidity to an identifiable market or sector of the financial system, not designed to aid one or more specific companies, and (ii) at least five companies would be eligible to participate in. ([FRA Reg. Sec. 201.3\(b\)](#)). Excluded from this definition is any program “structured to remove assets from the balance sheet of a single and specific company, or that is established for the purpose of assisting a single and specific company avoid bankruptcy” or some other insolvency proceeding. ([Fed Website-Sec.13](#)) ([Fed Register vol 80, no. 243, 12/18/15](#)).

Collateral/Security and Protecting Taxpayers. Other Dodd-Frank amendments relate to the section’s requirement that any loan be indorsed or secured to the satisfaction of the lending reserve bank (the “indorsed or secured requirement”) which address issues of collateral/security and with the new amendments, protection of taxpayers’ interest. The Fed was required to establish regulations designed to ensure that (i) the “the security for emergency loans is sufficient to protect taxpayers from losses” and (ii) that require a reserve bank to “assign, consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for a loan.” ([Fed Register vol 80, no. 243, 12/18/15](#)). The regulation adopted by the Fed provides that in determining whether an extension of credit under any program or facility established under Section 13(3) is secured to its satisfaction, a Federal Reserve bank must, “prior to or at the time the credit is initially extended, assign a lendable value to all collateral for the program or facility... to ensure protection for the taxpayer.” ([Fed Register vol 80, no. 243, 12/18/15](#)).

Thus, it appears that through its new regulation the Fed retained much of its traditional discretion. Other than the new requirement to value collateral, it remains committed to its prior position and seems to have conflated the new valuation requirement into the traditional indorsed

or secured requirement. By meeting this standard, it will presumably ensure “that the security for emergency loans is sufficient to protect taxpayers from losses.” This is consistent with the Fed’s long-held interpretation of its authority.

Administratively, the Dodd-Frank changes also require that:

- any such program must be established with the approval of the Secretary of the Treasury
- additional initial notification and ongoing reporting must be made to Congress
- any such program is terminated in a timely and orderly fashion. ([Fed Website-Sec13](#)).

How does Section 13(3) apply to the Emergency Fund?

Broad-based Eligibility. Under the amended Section 13(3), the individual assistance given to Bear Stearns and AIG, including their Maiden Lane facilities would not be permitted. However, it appears that the Dodd-Frank amendments leave intact many of the broad-based plans that the Fed employed in the GFC under Section 13(3) and which it has also chosen to redeploy to address the COVID-19 pandemic.

Collateral/Security and Protecting Taxpayers. It should be noted that the provisions of the original statute, nor the amendments provide guidance as to what constitutes sufficient satisfaction as to endorsement or collateral/security. The matter of what type and how much collateral, or what type of endorsement is sufficient is left to the Fed’s broad discretion. ([Alvarez 2009](#)) ([Mehra 2010](#)). Courts generally have afforded great deference to the Fed’s actions and its interpretations of its authority. ([Alvarez, Baxter, Hoyt 2018](#)).

Traditionally, as expressed by former Chairman Bernanke, the Fed has interpreted its Section 13(3) authority as only permitting it to make loans secured by collateral sufficient to provide [reasonable assurance that they will be repaid](#). This position was thrust into the spotlight during the GFC when the Fed did not lend to Lehman Brother because it concluded that Lehman did not have sufficient collateral to secure a loan of the size that it would need to save itself. The lack of a loan resulted in the investment bank’s filing for bankruptcy. Under the amended section the Fed could reach the same conclusion but would have to assign values to the potential collateral and report on its decision to Congress.

One [Fed legal memo from the GFC discussing the 2008 CPEF](#) and sheds light on how the Fed interprets Section 13(3), and in particular the indorsed or secured requirement. The [CPEF, which the Fed reintroduced on March 18th](#), is a broad-based program under which the FRBNY provides loans to a SPV that purchases eligible secured and unsecured commercial paper from eligible issuers. In discussing the CPEF, the Fed legal staff considered not only if the loan to the SPV would satisfy the indorsed or secured requirement, but also considered whether the requirement would be met if each purchase of commercial paper was considered an extension of credit to the issuer. The staff concluded that in both cases, the standard would be met in several ways:

1. by a third-party endorsement or guaranty (which did not apply to the CPFF)
2. by the commercial paper held by the borrower SPV,
3. by the pools of assets underlying ABCP held by the SPV, and
4. by paying a fee for an insurance premium, which applied to unsecured commercial paper under the CPFF ([Alvarez 2009](#)).

Thus, stated another way, the requirement can be met by a loan being secured by:

1. collateral with legal recourse to the borrower or a third-party guarantor,
2. an endorsement by a third-party guarantor without collateral, or
3. recourse to collateral without an endorsement. ([Alvarez 2009](#)).

In another context, Fed counsel have also considered whether the central bank could extend a loan not expecting to be fully repaid and concluded that it could not – "To be consistent with the purpose of the statute, the security required to satisfy the lending Reserve Bank needed to be at a level sufficient for the bank to reasonably believe it would be fully repaid." ([Alvarez, Baxter, Hoyt 2018](#).)

But there is a not an absolute prohibition on the Fed incurring losses. In providing assistance to Bear Stearns in March 2008 the Fed agreed to purchase a portfolio of Bear's assets to facilitate the merger of the troubled investment bank with JPMorgan Chase (JPMC), an extraordinary transaction for the Fed that became known as Maiden Lane, the name of the special purchase vehicle created to hold the mortgage securities. The loan to the SPV was to be fully collateralized by the Bear portfolio (whose value had been determined to be able to support the loan) and would be non-recourse to JPMC. The lending Federal Reserve Bank of New York (FRBNY) determined that the indorsed and secured standard was met, yet, it also sought an indemnification from Treasury Secretary Paulson for any losses that might be incurred. Legally unable to grant an indemnification, Paulson issued the FRBNY a letter recognizing that there might be losses that would reduce the net earnings transferred by the FRBNY to the Treasury general fund. ([Paulson 3/2008](#)). Paulson issued a similar letter with respect to the Fed's assistance to AIG with respect to securities lending ([Paulson 10/2008](#)). These actions are consistent with the views of then FRBNY President Geithner that "a central bank should be prepared to take losses" and that it is "highly likely ... that the appropriate use of the lender of last resort authority might well result in some losses." ([Geithner 2019](#)).

Thus, a reasonable interpretation would conclude that as long as at the time of lending the Fed had a reasonable expectation of being repaid, either by the borrower, through access to collateral or insurance, or to a third-party guarantor, in this case the Treasury, the indorse or secured requirement would be satisfied. Further, satisfaction of this standard appears consistent with the current requirement under Section 13(3) to protect taxpayers from losses. In the event there was

a loss that had to be absorbed by the Treasury's equity contribution or guarantee, these funds in effect had already been appropriated by Congress.

However, it would be prudent for the Fed to consider not only whether an individual default under a program would be covered by the Treasury backstop but also the likelihood that the total potential losses under a program could realistically be absorbed by the Treasury's guarantee. If they could, then it appears that Section 13(3) would have been complied with. The Fed recently reached a similar conclusion in its letter to Congress regarding the 2020 TALF— "the Board does not expect at this time that the TALF will result in losses in excess of the Department of the Treasury's equity investment. Accordingly, the TALF is not expected to result in losses to the Federal Reserve or the taxpayer (emphasis added)." ([TALF Report](#).)

Insolvency. The Dodd Frank amendments prohibit the Fed from directly or indirectly lending to any firm that is insolvent. Insolvent has been defined to mean (i) in bankruptcy, in a Dodd-Frank resolution proceeding, or in another insolvency proceeding, (ii) generally not paying its undisputed debts as they become due during the 90 days preceding the borrowing under the program or facility, or (iii) as otherwise determined by the Board or Federal Reserve Bank. ([Fed Register vol 80, no. 243, 12/18/15](#)).

Under the second definition above, a company that is generally not paying its undisputed debts as they become due during the 90 days preceding borrowing is considered insolvent and ineligible for a loan. ([Fed Register vol 80, no. 243, 12/18/15](#)). However, government COVID-19 assistance may provide forbearance relief to companies effected by the pandemic. One question in this situation is whether these missed payments, which may be legally excused, could be disregarded by the Fed for purposes of determining insolvency under Section 13(3). If they cannot be then a quirk in the law will constrain potential borrowers to choose which form of relief may be more valuable, a result which was perhaps unintended.

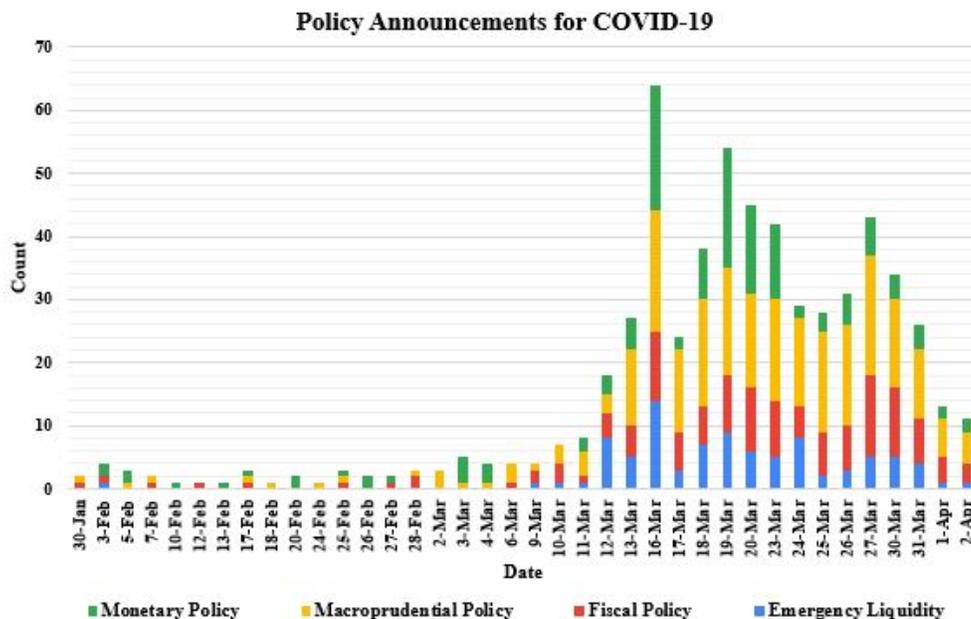
What macroprudential policies are countries using to help their economies through the Covid-19 crisis?

By Sigridur Benediktssdottir, Greg Feldberg, and Nellie Liang

Original post [here](#).

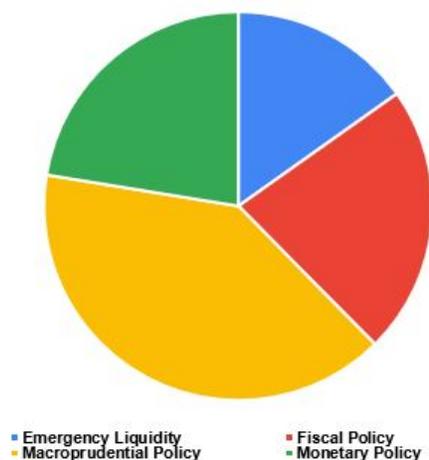
Countries around the world are reeling from the health threat and economic and financial fallout from COVID-19. Legislatures are responding with massive relief programs. Central banks have lowered interest rates and opened lender-of-last-resort spigots to support the flow of credit and maintain financial market functioning.

Authorities are also deploying macroprudential policies, many of them developed or improved since the global financial crisis of a decade ago. In this blog, we describe the main [macroprudential measures](#) that countries have taken recently. We summarize specific actions and factors considered when relaxing bank capital, loan forbearance, and liquidity requirements. Since late January, about 50 countries have made more than 230 announcements, with up to 500 separate actions, based on current entries in the new Yale Program on Financial Stability [2020 Financial-Intervention Tracker](#). Macroprudential announcements represent 40 percent of the announcements in the tracker, which also includes those for fiscal, monetary, and emergency liquidity (see figures).



Note: Announcement data may include multiple actions. Data do not include the Bank for International Settlements, International Monetary Fund, Asian Development Bank, Nordic Investment Bank, or World Bank Group. Data retrieved from the Yale Program on Financial Stability Coronavirus Response Tracker. Graphic created by Adam Kulam.

Share of Policy Announcements



The temporary relaxation of financial requirements with clear guidance should mitigate the immediate economic harm from the pandemic. Banks can absorb more losses and support lending, can help borrowers harmed by COVID-19 by modifying loans, and can work to distribute quickly any funds from fiscal, monetary and emergency liquidity programs to support households, businesses, and market liquidity. Acting swiftly now can lead to better outcomes in the long run.

1. Using capital buffers

Easing bank capital requirements is the most common macroprudential policy that national authorities are using. The Basel III international capital framework included a countercyclical capital buffer (CCyB) that banks can build in good times and draw down to absorb higher losses in bad times to ensure that credit is extended during a crisis. Most countries that had activated their CCyB have released some or all of it during the current crisis. As of March 24, 13 of the 15 countries identified in a recent [Brookings paper](#) as having a positive CCyB before year-end 2019 had cut it. Canada also lowered its domestic stability buffer, which is similar to the CCyB.

Some countries have reduced requirements or given guidance that banks can operate below other capital buffers. The European Central Bank (ECB) [told banks](#) it supervises directly that they can operate temporarily below their tailored (Pillar II) supervisory buffers. The ECB also supported banks partially meeting core capital requirements with non-core capital instruments. The U.S. has encouraged banks to draw on capital buffers during the current crisis; although U.S. regulators had not raised the CCyB, some of the largest banks were operating with capital above levels required by regulations and previous stress tests. The Federal Reserve also recently allowed the largest bank holding companies to temporarily exclude reserves and Treasury securities from their calculation of total assets for determining the supplementary leverage ratio.

In reducing the CCyB or similar buffers, the UK and others, such as Sweden and Norway, have explicitly advised banks to use the additional space created by releasing the buffer to meet increases in expected losses and support credit, rather than to increase dividends or employee

bonuses. In addition, some countries are asking banks to consider cutting dividends to conserve capital to absorb future losses. The ECB asked banks to suspend dividends until at least October. UK regulators asked banks to scrap dividends and review bonuses this year. While Basel III requires automatic reductions in payouts if a bank falls into its capital conservation buffer, regulators are asking banks with capital above the buffers to consider cutting payouts now, given the steep falloff in activity and highly uncertain economic outlook.

U.S. regulators have not imposed a freeze on shareholder distributions. Former Fed Governor Jeremy Stein, at a recent [Brookings forum](#), argued that is a significant policy mistake. While the eight U.S. globally systemically important banks have voluntarily suspended share repurchases through the second quarter, the Fed is currently assessing capital positions in its annual stress tests. The Fed explicitly asked banks, in the proposed rule that eases the leverage ratio, that they not increase shareholder distributions.

2. Easing the approach to nonperforming loans

Many countries are encouraging banks and other financial firms to work with borrowers temporarily affected by the crisis. Some authorities have provided guidance on loan forbearance. It is standard practice for banks to increase loan-loss revenues for borrowers who miss payments. But actions that require banks to increase loan-loss provisions for a system-wide and transitory shock would put a large strain on their capital and not be consistent with macroprudential objectives.

Some authorities have provided [clear guidance](#) that banks should not automatically downgrade borrowers if they cannot make payments for reasons related to COVID-19. [U.S. banking regulators](#) will not require banks that defer payments or extend maturities to automatically categorize these loan modifications as troubled debt restructurings.

Authorities also have asked banks to take government assistance into account when evaluating a borrower's ability to repay a loan. For example, the [Bank of England said](#) it would not be reasonable or supportable to reevaluate a borrower's idiosyncratic risk at this time; if banks do reevaluate a borrower's risk, they should take into account government relief measures, including repayment holidays, in calculating expected losses. The [ECB said](#) that it would "exercise flexibility" regarding the classification of borrowers as unlikely to pay when banks call on new COVID-related public guarantees, and when borrowers are covered by legally-imposed payment moratoria.

3. Using liquidity buffers

Authorities in many countries also are easing banks' required liquidity buffers. Some have argued that the new liquidity rules for large banks put in place after the GFC are "microprudential" policies, because the focus is to keep individual banks liquid. However, if all banks were to try to maintain their buffers in a systemic event, it could starve the broader financial system of liquidity. Thus, in the current situation, the motivation for encouraging banks to use their liquidity buffers is macroprudential.

Most authorities have told banks they may operate below Basel III liquidity coverage ratios (LCRs), the ratio of high-quality liquid assets to short-term obligations. The European Banking Authority issued [guidance](#) to national authorities that the LCR “is also designed to be used by banks under stress. Supervisors should avoid any measures that may lead to the fragmentation of funding markets.” The ECB will [allow banks](#) it supervises to “operate temporarily below” the LCR. The Swedish regulator [expanded this](#) to different currencies by allowing banks to temporarily “fall below the liquidity coverage ratio (LCR) for individual currencies and total currencies.” The Fed said it would [support firms](#) that choose to use their liquidity buffers to “lend and undertake other supportive actions in a safe and sound manner.”

South Africa’s central bank specifically [lowered its LCR](#) to 80% from 100%. But most authorities have not specified precisely how much banks can draw down their buffers. The lack of guidance could potentially limit their usefulness as a macroprudential safeguard, as argued in a recent [Brookings blog](#). Indeed, the use of liquidity buffers during the current crisis should be relatively aggressive, considering the encouragement by many central banks for banks to access the discount window and other central bank funding.

Several central banks have eased foreign exchange LCR requirements. These regulations are similar to the LCR but are focused on foreign exchange liquidity. Similarly, most did not say how much banks could draw down. The Bank of Korea was an exception, lowering its foreign exchange LCR from 80% to 70%.

Some central banks have also lowered the reserve requirement for depository institutions. While reserve requirements are traditionally a monetary policy tool, the purpose this time has been almost entirely to support banks’ liquidity and lending through the crisis. The Federal Reserve lowered its reserve requirement to zero, [stating](#) that this will action “will help to support lending to households and businesses.” The [Reserve Bank of India](#) lowered its cash reserve ratio from 4% to 3%, giving forward guidance that the liquidity released would be available for at least one year. The central banks of the [Philippines](#), Malaysia, and Iceland also lowered reserve requirements to ensure sufficient domestic liquidity.

4. Other measures

Authorities can use other tools to help banks help borrowers. For example, the [CARES Act](#) in the U.S. allows homeowners with a government-backed mortgage to request forbearance for up to a year. Other examples: The [Philippine central bank](#) raised single-borrower limits and the Swedish financial regulator relaxed temporarily a macroprudential rule that required high-loan-to-value borrowers to amortize their mortgage loans.

Banking authorities also are easing the costs of compliance so that financial institutions can focus their limited resources on lending and working with troubled borrowers; such measures can be considered macroprudential. The Bank of England’s and ECB’s decisions to delay 2020 stress tests are in this category. The Basel Committee [delayed implementation of Basel III](#) to “provide additional operational capacity for banks and supervisors to respond to the immediate financial

stability priorities resulting from the impact of the coronavirus disease (COVID-19) on the global banking system.” Canada’s regulator [suspended consultations on regulatory matters](#) until conditions stabilize. The Fed temporarily [reduced exam activities](#) and [delayed some reporting deadlines](#). U.S. regulators will allow banks to delay implementation of the new accounting rule for current expected credit losses and to complete the transition over five years instead of three.

Conclusion

Macroprudential policies are an important complement to the unprecedented fiscal, monetary, and emergency liquidity actions taken to offset the painful economic effects of COVID-19. One lesson is that countries with stronger financial systems can respond in many more ways. That scope for action may greatly improve the ability of national authorities to limit damage to their economies. This is dramatically different from the global financial crisis, when a weak financial system was the primary cause and itself needed government support. A second lesson is the critical role of macroprudential policies in promoting financial and macroeconomic stability, by building buffers when the economy is strengthening so that they can be used to offset contractions in credit when the economy weakens.

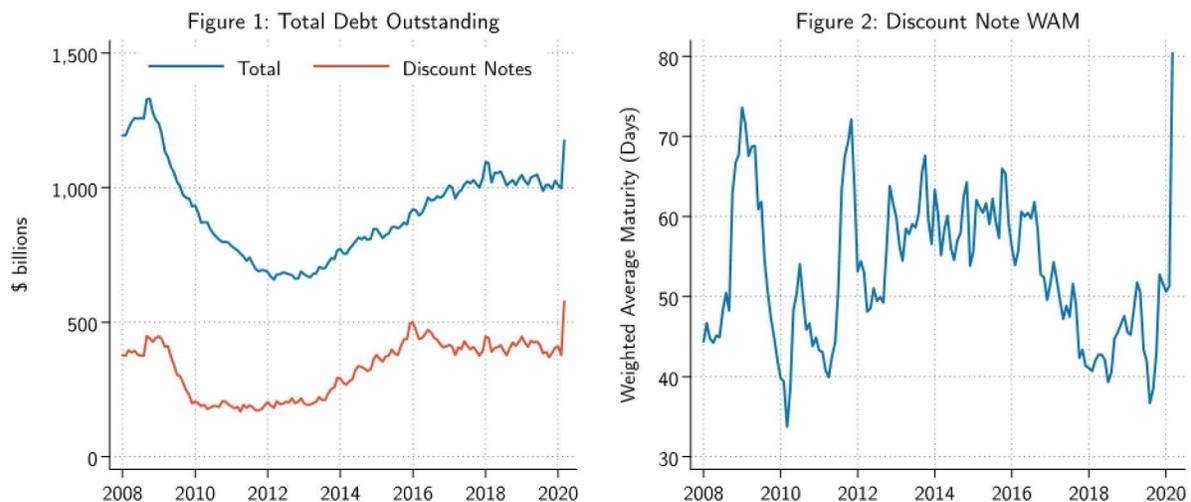
The FHLBs During the Coronavirus Crisis, Part II

By Chase P. Ross

Original post [here](#).

In [my last note](#), I raised the question of whether the Federal Home Loan Banks (FHLBs) would be the lender of “next-to-last resort” during the coronavirus crisis, [as they were in 2007 and 2008](#). [Data released](#) since my last note provides an updated picture of the FHLBs’ actions in the first months of the current crisis.

Total FHLB debt outstanding increased by about \$180 billion from February to March 2020. The increase in debt outstanding came from an increase of discount notes issued through their window rather than via auctioned discount notes. Total discount note debt outstanding increased from \$377 billion to \$577 billion over the same period – roughly a 50% increase (Figure 1). The weighted average maturity (WAM) of the FHLBs’ discount notes increased substantially. From February 2020 to March 2020, the WAM of their discount note debt rose from 51 days to 80 days (Figure 2), the highest value in the sample back to 2008.



Note: Total debt outstanding is the sum of bonds and discount notes. Data through March 2020.

This increased debt outstanding very likely flowed through to increased FHLB advance loans to members. The data available so far suggests the FHLBs have indeed provided lender of “next-to-last” resort-type liquidity to its members in the first month of the coronavirus crisis. After more data comes out over the coming months, including balance sheet data on FHLB advances, we’ll be able to directly compare the amount of liquidity provided by the FHLBs and the Federal Reserve.

Communicating in a Crisis: Lessons Learned from the Last One

By Rosalind Z. Wiggins

Original post [here](#).

It has become a common sight during the current COVID-19 crisis to see Federal Reserve (Fed) Chairman Powell standing at the podium, calmly explaining that the Fed is [using the full range of its tools, including its emergency lending powers](#), to counter the severe economic effects of the actions taken to combat the virus. Powell further [commits](#) that the Fed will “continue to use these powers forcefully, proactively and aggressively” until the virus is under control and the economy is on the road to recovery.

We are witnessing a new, heightened level of communications from the government during this economic crisis when compared to the global financial crisis of 2007-09 (GFC). [Former Treasury Secretary Hank Paulson](#) has said that his one regret was that he and his peers "were never able to convince the American people that what they did wasn't for Wall Street, but was for them."

Arguably, better communications may have headed off the widespread disapproval of government actions during the crisis, and the anti-government populist movements that emerged in its wake. This time, government officials seem more focused on avoiding such a legacy.

While the government cannot program the public's response to a crisis, it can and, [some would argue](#), has a duty to communicate about its actions and words in a manner that is open, honest, and consistent. Doing so will at least maximize the availability of information regarding actions taken and the intent behind them, thereby increasing the likelihood that responses will be based on facts, whatever their nature. The government may not be able to totally avoid errors, missteps, charges of favoritism, or a lack of transparency; however, it can counter these with credibility, accountability, and transparency.

As Former Chairman Yellen stated in 2012, “[The] challenges facing our economy in the wake of the financial crisis have made [clear communication](#) more important than ever before.” This statement is as true today as it was then. Here are some lessons learned from the last crisis that can help:

- Communicate clearly and often
- Be consistent and credible
- Clarify roles
- Foster accountability: Admit mistakes and address them when they arise
- Do not underestimate the public: Speak to all Americans.

Communicate Clearly and Often

Fed and Treasury officials have specialized knowledge about the economy, and when the economy is distressed the markets and public want to hear from them. As early as September 2007, [Fed officials began to signal](#) that the distress in the housing market might spill over to the broader economy. Yet, for months the Fed's plan of attack remained unclear.

If government officials do not communicate, an information gap develops, and uncertainty arises. Other parties will rush to fill in an information vacuum. Once that happens, it may be impossible to regain control of the narrative. In the face of uncertainty, [financial institutions and markets will retreat into defensive modes](#), further aggravating underlying systemic weaknesses. We saw this in the GFC and again in March of this year, when bond markets began to freeze.

But the Fed is now demonstrating that it has learned from the last crisis. At a [January 29 press conference](#), Chairman Powell began speaking publicly about the virus and possible impacts: "There is likely to be some disruption to activity in China, and possibly globally, based on the spread of the virus to date and the travel restrictions and business closures that have already been imposed." Roughly a month later, as [the threat reached the U.S.](#), the Fed said that "the coronavirus poses evolving risks to economic activity" and "will weigh on economic activity in the near term and pose risks to the economic outlook." The Fed also announced that it was ["prepared to use its full range of tools](#) to support the flow of credit to households and businesses (emphasis added)."

The Fed moved quickly to [add additional liquidity to the banking system](#), buying Treasuries and agency mortgage-backed securities to stabilize these markets, and on March 17, it [activated its emergency lending authorities](#) under Section 13(3) of the Federal Reserve Act. Powell assured the country that, "When it comes to lending, [we are not going to run out of ammunition](#)... That just doesn't happen." The swift and aggressive response exceeded, in speed and scope, the extraordinary response levels reached in combating the GFC. The [markets reacted with confidence and trust](#).

The Fed's communications have, at least for the time being, also carved a new normal characterized by frequent and clear communications. The Fed is not only speaking about the programs it is implementing, but also about the expected prognosis¹ and its overall policy stance and plan for supporting the economy.²

One of the many reasons for this change is an evolution of the Fed's communications practices. Writing in 2013, Mark Wynne of the Dallas Fed found that: "Over the past two decades, the FOMC has gone [from being quite secretive in its deliberations to very transparent](#)."

When the television news show [60 Minutes](#) called the Fed for an interview with then Chairman Ben Bernanke, the Fed's representative laughed out loud and replied, "the Chairman never does an interview." To Bernanke's credit, in March 2009, he did sit down [with 60 Minutes](#); it was the first that he had done in his three-year tenure. By contrast, Chairman Powell first [sat down with the popular news show](#) just 13 months after he was appointed Chairman.

During his tenure, Powell has implemented live press conferences after every FOMC meeting rather than just half of them. He has also committed the Fed to a [“plain-English initiative.”](#) The increased visibility at live press conferences and [other appearances](#) allows the Chairman to answer questions and add nuance to his explanations. Plain English potentially increases the likelihood that greater numbers of Americans will come to understand the Fed’s mission and actions.

With respect to the current crisis, such developments seem to be paying off. [Michael Feroli, chief U.S. economist at JPMorgan Chase](#), recently said: “The Fed is playing a confidence game and its communications should continue to repeat the message that it will do whatever it takes to nurse the economy back to health.”

Be Consistent and Credible

Frequency of communication is important, but so is content. It is not enough for government officials to appear to communicate; in order to be perceived as credible, they must speak clearly and consistently about the government’s plan, how it will be applied, and under what circumstances it will be modified. Such [forward guidance is a powerful tool](#) of monetary policy and crisis fighting. When officials speak with one voice and do not contradict each other, credibility is increased.

During the GFC, Secretary Paulson stated that there would be [“No more bailouts,”](#) and the government did not make a loan to Lehman Brothers. However, just days later, [the Fed loaned AIG \\$85 billion](#), and [markets dipped precipitously](#). Some commentators believe that these actions looked inconsistent and [ad hoc](#).

By contrast, since January, Chairman Powell has repeated versions of the same message, especially since the President declared a national emergency on March 13: “The Federal Reserve is committed to using its full range of tools to support households, businesses, and the U.S. economy overall in this challenging time.” ([March 23, 2020](#)).

Those tools include the Fed’s emergency authority under Section 13(3) of the Federal Reserve Act, pursuant to which [the Fed has announced nine programs](#) implemented with the consent of Treasury Secretary Mnuchin, as required by law, and providing potentially up to \$2.3 trillion³ in liquidity. With one exception, these programs are backstopped by Treasury investments totalling \$185 billion from a \$454 billion funding pool provided by the CARES Act.⁴

During an interview on April 9, Powell said: “We do these [programs] with the consent of the...Treasury Secretary and with fiscal backing from the Congress through the Treasury.” He also said: “We’re using that fiscal backstop to absorb any losses that we have.” ([Powell at Brookings](#), 11:45-12:45).

In early statements Mnuchin seemed to agree with Powell, describing the Fed programs as [providing trillions of dollars to the economy](#) with the Treasury [“putting up money to support the credit for the Fed.”](#) However, he later [seemed to retreat](#) from initial statements, calling into

question whether he was willing to let the Treasury's investments absorb losses from the programs: "We are looking at it in a base case scenario that we recover our money."

The lack of clarity added to the debate of whether the programs' terms were liberal enough to ensure that aid reached the broad array of intended participants. It wasn't until May 19 that Mnuchin put the discussion to rest and provided clarity. "The answer is absolutely yes," Mnuchin said in response to questions from legislators in a virtual hearing of the Senate Banking Committee. "By definition that capital is at risk, and we are fully prepared to take losses, in certain scenarios, on that capital." See a related YPFS Blog [here](#).

The Fed has made available trillions of dollars in liquidity using its [traditional monetary policy](#) tools and emergency Section 13(3) powers. Chairman Powell has been clear about the plan for use of these emergency tools, which, prior to the GFC, had not been used for 70 years: "The Fed will use these tools for as long as is necessary until the virus is overcome and when the emergency is over, [those tools will be put away](#)." Secretary Mnuchin has said that he will commit additional funds to the Fed programs if needed.

[Market commentary](#) and a recent Gallup poll indicate that [confidence in the Chairman and the Fed is strong](#). Fifty eight percent (58%) of respondents stated that they had a "great deal or fair amount" of confidence in the Chairman to do what was right for the economy. Secretary Mnuchin garnered a similar confidence rating of 51%. The ratings received by Powell and Mnuchin were higher than those for the President, and the Congress. The current ratings are significantly above [the 30% rating \(excellent/good job\)](#) that the Fed received in July 2009, while still taming the GFC. It was rated the lowest of nine different agencies at the time, including the Internal Revenue Service.

Clarify roles

During the GFC, the Fed had a long lead during which it was the sole authority with the resources to address market distress. It was criticized for consulting with the Treasury when exercising its authority; this was before Dodd-Frank essentially codified this practice. Fed officials have explained this by citing the benefits of governmental coordination, presenting a united front to the public, and a premonition that in a worst-case scenario the Fed's lending authority might be insufficient to quell a full-scale crisis. Fiscal authority ultimately was required, most notably, the \$700 billion [Troubled Asset Recovery Plan](#) (TARP) passed by Congress in October 2008.

In the current crisis, given the compressed nature of its onset, the fiscal authority has been engaged almost from the beginning. Congress passed the CARES Act on March 27, which provided for direct payments and some loans to individuals and businesses, such as the Small Business Administration's Payroll Protection Program, assistance to airlines, and direct payments to individuals. Secretary Mnuchin has been the main spokesperson regarding these supports.

The CARES Act also provided \$454 billion that the Secretary could use in coordination with the Fed to establish programs under its Section 13(3) authority. Under Section 13(3), as amended

by the Dodd-Frank Act, when the Fed triggers its emergency authorities the Chairman is required to consult with and get approval from the Secretary for any proposed program. Mnuchin has approved the nine programs proposed by the Fed and has backed several of them with credit support (\$20 billion) and equity investments (\$195 billion).

Chairman Powell has consistently explained the complementarity between the Fed's role (monetary policy) and that of the Treasury (fiscal)⁵ and the shared responsibility for financial stability. Powell has also stressed that the Fed's emergency Section 13(3) tools were activated with the "approval and support of the Congress and Treasury," that they are "lending tools," and that "it fully expects its loans to be repaid." ([Brookings 2020](#)). Chairman Powell has also emphasized that as powerful as they are, the Fed's emergency authorities may not be able to help everyone. Other lending assistance, and non-lending assistance such as grants and direct payments, come from the fiscal authority of the Congress and Treasury.

At different times we have heard the Chairman toss the ball back over to the Treasury as he did on May 13, 2020, suggesting that more fiscal support might be needed if the economic effects are prolonged: "Additional fiscal support could be costly but worth it if it helps [avoid long-term economic damage](#) and leaves us with a stronger recovery." Ultimately, delineating clear roles can create areas of accountability so that each entity is judged on its responsibilities and what it can do.

Foster Accountability. Admit mistakes and fix them when they occur.

During the GFC the government implemented several programs designed to provide relief to homeowners, by incentivizing mortgage servicers to work with homeowners to refinance mortgages to avoid foreclosure. The administration and results of some of these programs were debated and may have added to an unbalanced view of the government's actions.

Fast forward to the COVID-19 crisis; some programs have likewise been questioned. When it was exposed that numerous large, publicly traded companies had received (forgivable) loans under the [Small Business Administration's Payroll Protection Program \(PPP\)](#), which had been announced as a key resource to keep small and medium-sized businesses afloat, Secretary Mnuchin said that was not what was intended. He [actively sought to have several corporations publicly return the funds](#), supported set-asides for smaller financial institutions in the new PPP tranche of \$310 billion, and threatened to investigate any borrower who abused the program. (See a [YPFS blog on the recent changes to the PPP](#).)

The government has set high expectations for fighting this crisis. The Fed and Treasury have deployed programs of unprecedented number and scope in record speed; there are bound to be missteps and errors. It is not sufficient, however, for the government to lessen diligence once programs are implemented, or hand off the administration of, and responsibility for, programs involving trillions of dollars of taxpayer funds to banks or other third parties who pick the winners and losers according to their interpretation of the government's criteria or administrative ease, at the risk of possibly distorting the intended outcomes.

The clearer such rules are, and the more effort expended by the government to ensure that they are followed as intended, or amended if advisable, the more credible the government and the programs are likely to be perceived.

There are likely to be other areas that may require such attention, for example, the friction between the terms of the PPP and the enhanced unemployment benefits, and the [potential fallout from broad based rental and eviction forbearance](#). The longer shelter-in-place orders and high unemployment persists, it may be impossible for millions of individuals to pay months of back rent once the moratoria expire. How the government addresses such issues has the potential to become a broken promise or a last-minute save; either result could have a long-lasting impact on our socio-economic and political future.

Do not underestimate the public. Speak to all Americans.

Because the current crisis originated from a pandemic requiring government-imposed economic shutdowns to mitigate the health crisis, interventions to support the economy and lessen the economic fallout from those efforts have also been broad-based. For two months, businesses, schools, retail establishments, and entertainment venues have been shuttered and tens of millions have lost their jobs. The government's response has been robust, making trillions of dollars available to businesses, communities, and individuals in record speed. Still, the shut-down has the potential to impact almost every citizen, and many are vulnerable and worried. A [Fed survey recently reported](#) that “[a]mong people who were working in February, almost 40 percent of those in households making less than \$40,000 a year had lost a job in March.” A recent [Pew survey](#) found that 77% of Americans believe the coronavirus will be a threat to their personal financial situations, while a [Gallup poll](#) showed that 48% are worried about experiencing severe financial problems.

The government faces a significant challenge to mitigate the impact of its shut-down order and maintain credibility, while continuing to fight the virus. However, success does not require perfection. Criticisms of the government's actions during the GFC did not focus on errors per se but were aimed at programs (like the bank recapitalization and AIG restructuring) that were perceived as having taken too much risk with taxpayers' money, lacking [a general sense of fairness](#), and failing to provide an appropriate level of transparency. Many felt that they had been betrayed when their government bailed out Wall Street banks while ordinary Americans lost their jobs and homes on Main Street. Had the government been able to convince the American people that the bank rescues were necessary to protect their pensions and maintain their school arts programs, perceptions about government, big business and trust might have been different.

The GFC involved complicated financial issues that were challenging for even Congress and the media to understand and with which most Americans were unfamiliar: mortgage securitization, collateralized debt obligations, shadow banking, and derivatives. Since most of the programs implemented by the Fed were directed at the financial industry, government officials and their press releases used financial industry language. In the heat of the battle, only limited efforts were made to explain to the average citizen the connection among the collapsing financial system, the

massive rescue actions, and the basic credit cycle underpinning car buying, vacations, pensions, and life insurance.

One exception is the government's assistance to General Motors and Chrysler and other industry entities, which involved government commitments [of \\$80 billion](#) and assistance negotiating concessions from unions, pension plans, and investors. The Obama administration communicated the rescue of the auto companies in a more detailed and straightforward manner than it did some of the rescues of large financial organizations; at one point [a video was even made](#). Even though the auto rescue is the only part of the GFC rescues in which the government lost money ([\\$9.3 billion](#)), it has come to be [perceived far more favorably than the bank recapitalizations, which remain highly disfavored](#).

The government's current efforts to prop up the economy and citizenry until economic activity can safely resume are very broad-based and recognize that many stakeholders are impacted. To be optimally effective, the government's communications must do the same. One of the country's foremost experts on crisis communication, Timothy Coombs, writes:

“The goal of crisis communication is to reduce the damage a crisis inflicts on an organization and its stakeholders ...too often there is too much focus on the organization. Crisis teams must ensure the physical safety and psychological well-being to stakeholders affected by the crisis.” [\(Coombs, p. 136\)](#)

If we think of the government as the “organization” and the economy, industry, communities, and individuals as the “stakeholders,” a rubric evolves where one of the guiding principles in managing and communicating crisis-fighting efforts is to minimize harm to the stakeholders. This can be done by adhering to the lessons set forth above and by keeping all stakeholders and the big picture always in mind.

Americans have been asked by their government to make significant sacrifices to defeat the pandemic. The government should do everything in its power to honor those sacrifices and minimize negative impacts on the economy, communities and households in as effective and fair a manner as possible. If it does, it will prove that its current positive Gallup Poll ratings are deserved, and those ratings may even improve. If it does not, it risks criticisms, negative market reactions, and claims of betrayal that may have lasting impact.

1. “The effects of the coronavirus will weigh on economic activity in the near term and pose risks to the economic outlook.” [\(FOMC PR March 15, 2020\)](#)
2. “The Federal Reserve is carefully monitoring credit markets and is prepared to use its full range of tools to support the flow of credit to households and businesses and thereby promote its maximum employment and price stability goals.” [\(Fed PR March 15, 2020\)](#).
3. One of the nine programs is the [Payroll Protection Plan Liquidity Facility](#), which provides loans to financial institutions to fund Small Business Administration-guaranteed Payroll Protection Plan (PPP) loans to small and medium-sized businesses. The Fed accepts the PPP loans as collateral for the PPPLF loans, which are non-recourse. The first round of PPP funding was depleted and Congress authorized a \$310 billion second round of funding to restart the program increasing the potential under the nine programs to \$2.6 billion from the original \$2.3 billion.

4. The [Term Asset-Backed Securities Loan Facility](#), which was established by the Federal Reserve on May 12th prior to the passage of the CARES Act is supported by a \$10 billion Treasury equity investment from the Exchange Stabilization Fund.
5. For example, “The Fed lowered interest rates, provided liquidity to banks and foreign central banks to keep the credit markets open and the flow of dollars steady, and it buys massive amounts of debt.” ([Brookings 2020](#)).

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

By **Pascal Ungersboeck** and **Rosalind Z. Wiggins**

Original post [here](#).

In response to the Covid-19 crisis, Congress has passed four economic stabilization and health funding bills. The Coronavirus Aid, Relief, and Economic Security (CARES) Act enacted on March 27 contains the most substantial relief measures, with \$2.2 trillion to be allocated. Among other programs, Title IV, Subtitle 4 of the Act (subtitled the Coronavirus Economic Stabilization Act (CESA)) provides the Treasury with \$500 billion for direct lending to specified businesses in the aviation industry and businesses critical to national security (up to \$46 billion) and for supporting Federal Reserve emergency lending programs to be established under section 13(3) of the Federal Reserve Act (\$454 billion).

The CESA provides for the establishment of a Congressional Oversight Commission to publish regular reports on the use of these funds. Per the Act, the commission includes 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 the publication of the first report on May 18, the chairman position has not been filled; even so, the commission provided guidance on how it intended to conduct its role and reported on the status of the programs for which it had responsibility, most of which were not yet operational.

Oversight Role

The commission was established to provide oversight regarding the use of the \$500 billion allocated under CESA. It is also charged with overseeing the implementation of related programs by the Treasury and Fed. It is required to report to the Congress every 30 days on the following points:

- The use by the Fed of authority under Subtitle A, including with respect to the use of contracting authority and administration of the provisions of Subtitle A.
- The impact of loans, loan guarantees, and investments made under Subtitle A on the financial well-being of the people of the United States and the United States economy, financial markets, and financial institutions.
- The extent to which the information made available on transactions under Subtitle A has contributed to market transparency.
- The effectiveness of loans, loan guarantees, and investments made under Subtitle A of minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers. (p.5).

In its first report the commission sets out questions that provide insight into the areas that it will seek to explore in undertaking its duty. These questions include inquiry into a number of areas that have seen much discussion since the bill passed and some new areas including: the amount of risk the government is willing to undertake, ensuring the funds reach the intended parties, maximizing the impact of funds on markets and the economy, the effectiveness of direct vs. indirect distribution channels, and accountability for compliance with the terms of the Act. Questions include:

- How will the Treasury and Fed (the “agencies”) assess the success or failure of this program?
- How can the agencies best determine how much of the Treasury’s \$454 billion to allocate among Fed lending facilities and when to allocate such funds in order to help support and stabilize the economy?
- How can the agencies best estimate the risk of loss to taxpayer funds in each Fed lending facility?
- How will the Fed ensure it complies with all restrictions to emergency lending under Section 13(3) of the Federal Reserve Act, including those prohibiting lending to insolvent borrowers?
- Are the agencies prepared to lose taxpayer dollars in an effort to facilitate more lending and support to a broader set of entities?

The full list of questions can be accessed at page 14 of the [report](#), which also includes specific questions regarding the individual programs.

Status of Programs

The commission noted that as of May 18, the Treasury has not disbursed any of the \$46 billion reserved for direct lending; it further noted that the Treasury had published application procedures and requirements for these funds in March and April and that it was processing applications for loans received from airlines and other businesses critical to national security. The commission also noted that the Treasury had disbursed grant funds to airlines under the Payroll Support Program, a program authorized under a different provision of the CARES Act and not under their jurisdiction.

On April 9, the Treasury announced its intention to use available funds under CESA to make equity investments into special purpose vehicles established under Fed lending programs. The commission noted that so far the Treasury has pledged \$185 billion of the \$454 billion available to be invested in these facilities. This includes \$75 billion intended for the Main Street Lending Programs, \$35 billion for the Municipal Liquidity Facility (MLF), \$50 billion for the Primary Market Corporate Credit Facility (PMCCF), and \$25 billion for the Secondary Market Corporate Credit Facility (SMCCF).

The commission noted that on May 11, the Treasury 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. No other of the committed amounts have yet been invested. It also noted that the size of these investments can grow as a large share of the appropriated funds remains unused.

Other Fed facilities, including the Term Asset-Backed Securities Loan Facility (TALF), the Commercial Paper Funding Facility (CPFF), the Money Market Mutual Fund Liquidity Facility (MMLF), and the Primary Dealer Credit Facility (PDCF), do not fall under the commission's jurisdiction according to its report. All but the last of these programs also have the benefit of \$10 billion in Treasury credit support through Emergency Stabilization Act funds that the Treasury agreed to provide prior to passage of the CARES Act.

The commission noted that although the Fed has not started lending through the CARES Act Fed Facilities, with the exception of the SMCCF which was operational by May 12, the announcement of the programs in general has had a positive impact on market conditions, citing recovering equity prices and decreased bond spreads.

A Long Way to Go for Emerging Markets

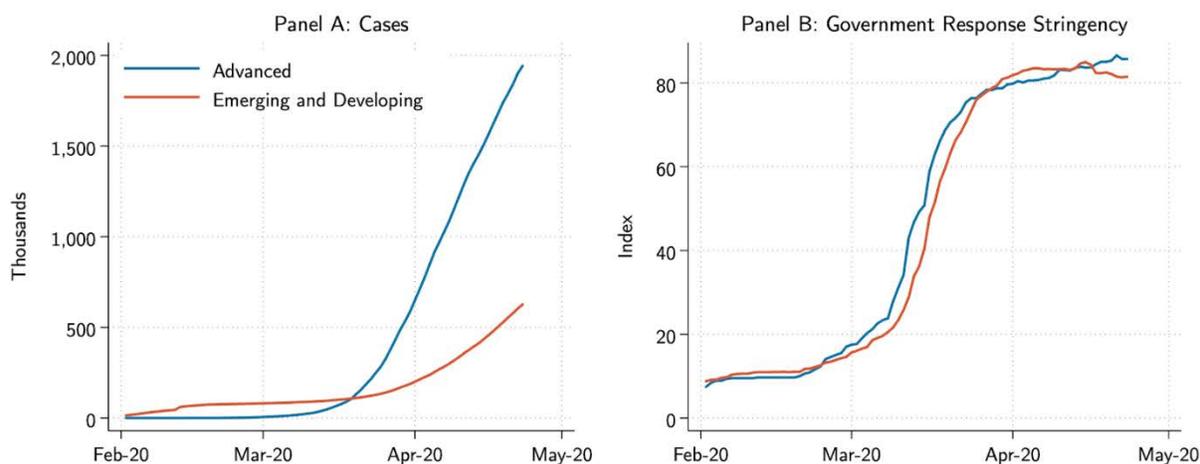
By Ahyan Panjwani and Chase P. Ross

Original post [here](#).

The developing world will soon become the frontlines in the battle against the coronavirus, and markets are bracing for the resulting fallout. The Covid-19 crisis has already had an unprecedented effect on emerging markets – [more than 100](#) of the IMF’s member countries have already asked for aid: Simultaneous health and financial crises add fuel to the linkages between [sovereign debt crises, banking crises, and growth and competitiveness crises](#). In this note, we discuss financial markets’ responses in the first months of the current crisis, the unique challenges EMs face compared to wealthier nations, and reasons for cautious optimism at the present moment.

Emerging and developing economies’ reported cases remained low in the initial stages of the pandemic as the virus migrated from China. However, in the past three weeks, confirmed cases in EMs have tripled to 630,000 cases compared to 1.9 million cases in developed economies (Figure 1, panel A). Looking across several measures – health care expenditures; the number of hospital beds, doctors and nurses; or GDP per capita – it’s clear EM’s health infrastructure is less equipped to manage the virus.

Figure 1: Cases and Government Response Across Advanced and Developing Economies



Source: Authors' calculations from Oxford COVID-19 Government Response Tracker

Despite these looming initial conditions, data from the [Oxford COVID-19 Government Response Tracker](#) show EM governments have moved as quickly as developed economies to impose social distancing policies, like school closures, and travel bans (Figure 1, panel B).

Emerging markets have unsurprisingly taken a financial shellacking. With risk off and hot money running for the exits, equities fell, credit spreads widened across the quality spectrum,

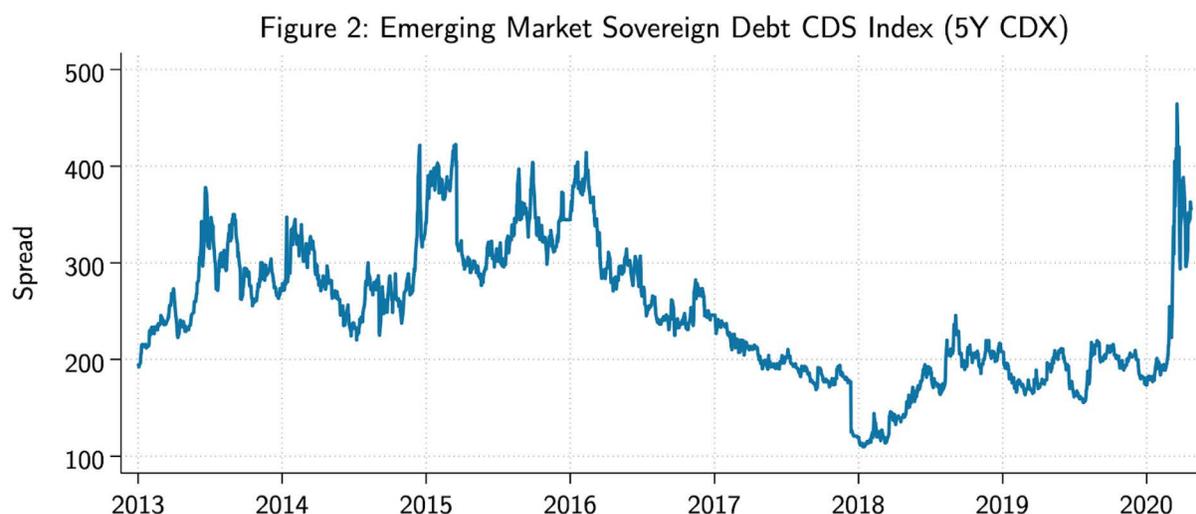
and FX weakened. From peak to trough, equities have fallen by 20% and spreads for EM sovereign spreads have increased by more than 400 bps (Table 1).

Table 1: Peak-to-Trough

		2007/8	Covid-19
Equity (%)	EM	-66.1	-20.3
	LatAm	-64.1	-44.5
	Asia ex. J	-66.4	-14.5
Credit (bps wider)	EM CDX		182
	EM HY	1,173	697
	EM IG	792	160
	EM Sov.	786	421
FX (%)	EM	-14.3	-6.4

Note: Covid-19 is YTD April 23, 2020.

The EM CDX, an index of about 20 emerging market sovereign issuers' CDS spreads, increased almost 300 bps (Figure 2). Compare that to the 10 bps increase in US CDS spreads, despite the US's discretionary fiscal expansion of 7% of GDP compared to EMs' of 3.5%, as estimated by Goldman Sachs.

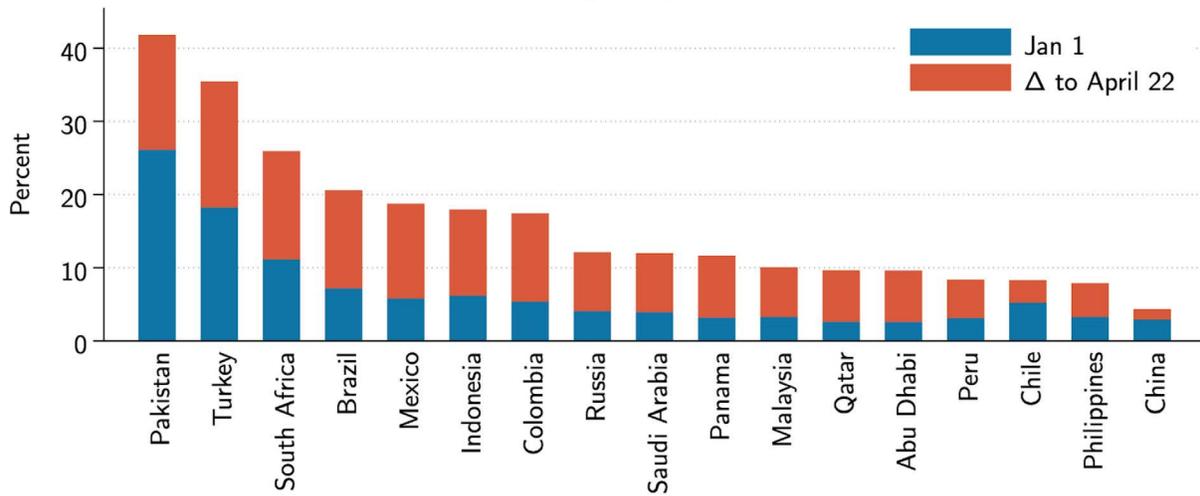


Source: Bloomberg, Markit

We calculate market expectations by imputing sovereign debt default probabilities from CDS spreads. Across our sample of 17 countries, the average market-implied default probability was 6.7% on January 1, increasing to 16.0% on April 22. On the country-level, each country's default probability has increased. However, there is considerable variation across countries: Turkey increased from 18% to 35%, Pakistan from 26% to 42%, South Africa from 11% to 26%, while default probabilities increased by less than 5% for China, the Philippines, and Chile (Figure 3).

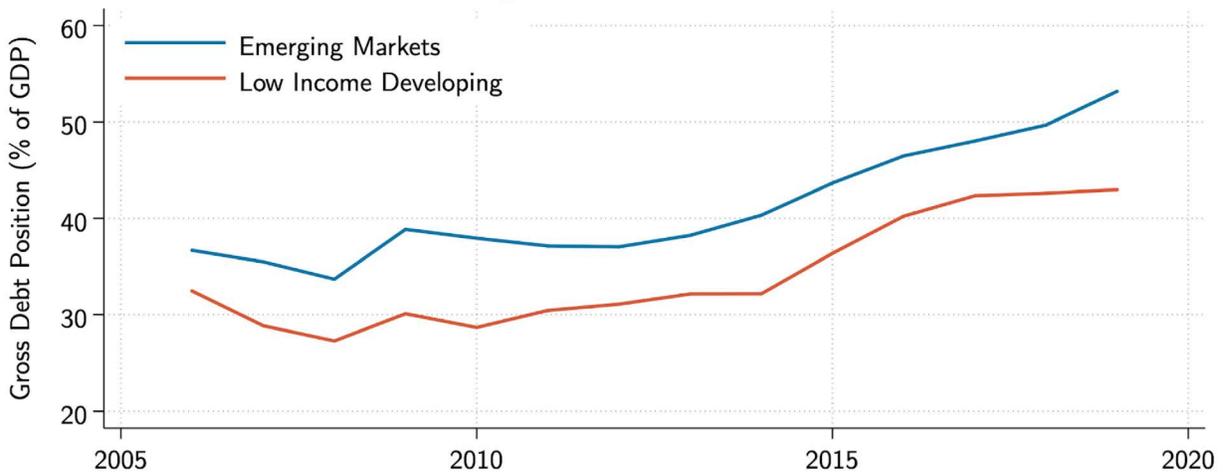
This spike in perceived risk can have dire consequences for public finances in individual countries. Since the financial crisis of 2008, investors from advanced economies have searched farther and farther afield for attractive yields. This Marco Polo-esque search for yield has cushioned the public finances for many emerging markets (Figure 4). On the flip side, international reserves for many emerging economies have increased noticeably; on average,

Figure 3: CDS-Implied Default Probability
April 22, 2020



reserves have tripled in the last two decades. As a by-product, exchange rates have stabilized despite a slow walk towards a floating or quasi-floating mechanism ([Bianchi, Hatchondo, and Martinez, 2018](#)). Now, the public-debt binge is over, and unceremoniously so.

Figure 4: Debt to GDP Ratio

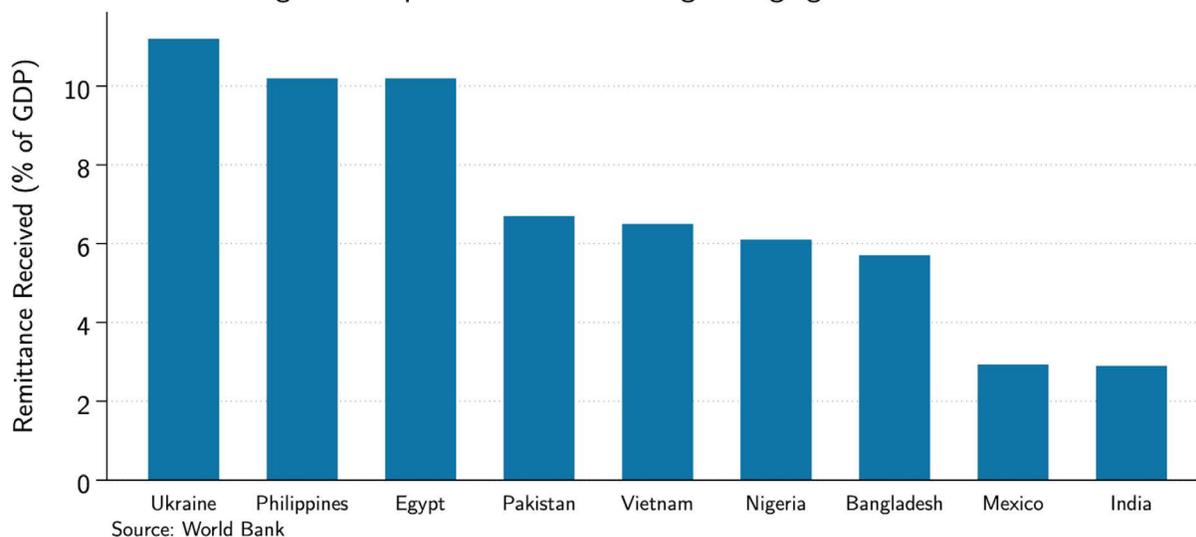


Source: IMF

Central banks in emerging markets are in a peculiar position due to these headwinds. On the one hand, there is an incentive to increase interest rates to compensate for the increase in risk premia. However, the deflationary nature of the crisis and possible political economy factors call for a loosening of monetary policy. While EM central banks have heeded the latter with 113 rate cuts globally this year, the flight to safety is a potent threat to EM public finances, especially with government budgets due soon in many countries.

Another cause of concern for some emerging economies is the possibility that their citizens working in other countries have to return home. This scenario compounds the problem due to the financial shock as it may reduce remittances and increase domestic labor supply, a double whammy. Countries like Pakistan and India with patchy social safety nets would have to grapple with significant unemployment and wage pressure while another source of dollars – remittances – deals a blow to national accounts (Figure 5).

Figure 5: Top Remittance Receiving Emerging Economies in 2018



To complete the nightmarish prospect, a slump in global demand means economies reliant on commodities are in for a rude awakening. Although oil has grabbed worldwide attention prices for zinc, scrap steel, copper, and tin have declined precipitously since January 2020 – dropping by 18%, 17%, 16%, and 13%, respectively. While mine closures in South Africa and the DRC have steadied prices for some metals, the net pressure on public coffers will be significant, feeding into investor concerns mirrored by the CDS spreads.

There is reason for hope yet. The exposure of emerging markets to a Covid-19 outbreak – very roughly proxied by Goldman Sachs’ economists using the countries’ age distributions, prevalence of smoking, access to sanitation and clean water – is no worse than that of advanced economies. Markets have yet to plumb the lows seen during the global financial crisis (Table 1). Although EM credit spreads have widened, especially for high yield corporates, sovereign and high-quality issuers are still trading well below 2008 peaks.

In recent days, the G20 announced a repayment freeze for bilateral loans through 2020. This development is significant, despite an initial outlay of only \$20 billion, as it has set the trend for further easing the debt burden for the most vulnerable societies. However, bringing private creditors on board will be a thorny issue and may blunt the G20 efforts. Moreover, [the IIF estimates](#) the same countries receiving G20 assistance owe about \$140 billion in external debt service payments in 2020, so the relief program is only a first step.

The spike in CDS spreads may prove to be a canary in the coalmine vis-à-vis possible credit events on sovereign debt. Such an event could prove to be regionally disastrous and may prolong the health crisis itself if a government has to direct resources towards litigation instead of public health.

In 2017, the World Bank set up the [Pandemic Emergency Funding Facility](#) wherein a bond would provide funding if a pandemic occurred in certain member countries deemed most vulnerable. After initial hiccups determining whether [the criteria were met or not](#), the securities were adjudged as in the money. While the payoff is less than \$200 million, it is only part of the institution's response to the ongoing crisis. More importantly, this development highlights the importance of financial innovation: state-contingent assets can prove to be an invaluable lifeline for at-risk communities.

Recent decades have marked a comeback of official lending relative to private lending. A wide range of region-specific development banks, bilateral, and multilateral lending agreements are available and ready to act. [Horn, Reinhart, and Trebesch \(2020\)](#) argue today's "global financial safety net is large and diverse." We will find out soon enough.

Federal Reserve to Report Monthly on CARES Act Program

By Priya Sankar

Original post [here](#).

On [April 23](#), the Federal Reserve said it will include additional detailed information in its monthly reports that are released to the public on four lending and liquidity programs it is establishing with Treasury equity under the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

A week earlier, Bharat Ramamurti, member of the COVID-19 Congressional Oversight Commission, [had requested](#) from Chairman Powell enhanced public disclosure for these and other Fed programs utilizing Treasury funds.

The [policy will cover](#) the \$600 billion Main Street Lending Program, [two corporate debt purchasing programs](#) totalling \$750 billion, and its \$500 billion program to purchase state and municipal debt, according to press reports. The Treasury has made available a combined \$185 billion for such programs.

Section 13(3) of the Federal Reserve Act, which governs the Fed's emergency authority and the above programs, requires that it make an initial and then monthly [reports](#) to Congress upon the establishment of a new program. Although the identities of participants and details of loans are required to be included in such reports, the Chairman may request that they be kept confidential. For each of the four facilities receiving Treasury equity support, the Fed's recent announcement states that it will publish the reports without redacting the names and details of participants; amounts borrowed and interest rate charged; and overall costs, revenues, and fees.

Many observers criticized the Fed for not revealing the identities of banks and other companies that it supported during the global financial crisis (GFC). In 2010, through [the Dodd-Frank Act](#), Congress required the Fed to publish transaction data one year after closing an emergency facility.

There are concerns that the disclosure requirement may cause a stigma, leading borrowers to not use the facilities for fear of being perceived as troubled and potentially undermining the goal of the facilities to restore financial stability. [Former Fed general counsel](#) Scott Alvarez is concerned that stigma may be worse in the current crisis. He said, "It could be more discouraging to businesses if that information is disclosed" contemporaneously with the program, revealing financial details that could advantage competitors.

These enhanced public disclosures [will not include information](#) on recipients of Paycheck Protection Plan (PPP) loans, as they are administered by the Small Business Administration, although the Fed has also created a liquidity facility for banks making PPP loans (the Paycheck Protection Plan Liquidity Facility). The enhanced disclosure also does not cover other Fed lending programs directed towards financial markets. However, the Fed will release higher-level

aggregate data on all Section 13(3) programs monthly, and is legally obligated to disclose borrowers one year after the programs end.

“The Federal Reserve is committed to transparency and accountability by providing the public and Congress detailed information about our actions to support the economy during this difficult time,” Chair Jerome H. Powell said in the Fed’s press release.

Mnuchin Clarifies that Treasury is Prepared to Lose Money on Fed Programs

By Rosalind Z. Wiggins and Greg Feldberg

Original post [here](#).

U.S. Treasury Secretary Steven Mnuchin clarified Tuesday that the Treasury is prepared to take losses as it provides unprecedented credit support to the Federal Reserve's COVID-19 lending programs.

“The answer is absolutely yes,” Mnuchin said in response to questions from legislators in a virtual hearing of the Senate Banking Committee. “By definition that capital is at risk, and we are fully prepared to take losses, in certain scenarios, on that capital.”

In March, Congress made a \$500 billion funding pool available to the Treasury Department, part of the \$2 trillion CARES Act. The legislation directed the Treasury to allocate up to \$46 billion of that amount for airlines and other distressed companies. It directed the Treasury to use the balance of at least \$454 billion to support Fed lending programs.

Mnuchin and Fed Chairman Jerome Powell appeared before the Senate Tuesday to present their first quarterly report to Congress on their use of these funds.

On [April 9](#), the Fed announced four joint Fed-Treasury programs under the CARES Act. These included facilities for corporate credit; loans to municipalities; loans to small and medium-sized companies (the “Main Street Lending Program”); and asset-backed securities. In total, these programs would commit \$195 billion of the \$454 billion in taxpayer funds available to the Treasury. Those funds would back up to \$1.95 trillion in Fed lending.

Senators in Tuesday's hearing questioned why so little of the \$454 billion has been used to date. Only one program has launched: On May 11, the Treasury provided [\\$37.5 billion](#) to the Fed to cover half of the promised equity for the [Corporate Credit Facility](#). The Fed had lent the facility only [\\$305 million](#) as of [May 13](#), to buy exchange-traded funds.

Powell said Tuesday he expects all of the new programs to be “stood up and ready to go by the end of this month.” The Fed has released term sheets for each new program, and made revisions in some cases in response to thousands of public comments. The facilities are complex and delve into risk areas that are new to the Fed in its lending operations. “People are working literally around the clock and have been for weeks,” Powell said.

Treasury to take losses?

In earlier posts, we considered how the Treasury's use of the funding pool authorized by the [CARES Act](#) to [backstop Fed programs](#) might leverage the funds into trillions of liquidity for

the economy. In earlier comments, Powell has said the Fed could leverage the whole of the Treasury's \$454 billion to lend as much as \$4 trillion.

The Fed's emergency-lending authority, under [Section 13\(3\)](#) of the Federal Reserve Act, requires the central bank to make sure emergency loans are adequately secured and protect taxpayers. A lingering question has been whether the Treasury's potential absorption of losses was consistent with [Section 13\(3\)](#). Although there seemed to be a common consensus developing between Powell and Mnuchin that this was indeed the case, later statements by Mnuchin raised uncertainty.

During an interview on April 9, Powell said: "We do these [programs] with the consent of the... Treasury Secretary and with fiscal backing from the Congress through the Treasury." He also said: "We're using that fiscal backstop to absorb any losses that we have." ([Powell at Brookings](#), 11:45-12:45).

However, before Mnuchin's statements Tuesday, it wasn't clear whether the Treasury shared this view.

In March, Mnuchin initially echoed Powell's position, describing the program as [providing trillions of dollars to the economy](#) with the Treasury's assistance by ["putting up money to support the credit for the Fed."](#)

But on [April 29](#), Mnuchin seemed to indicate that he might be retreating from his earlier stance. He said he was "looking at it in a base case scenario that we recover our money." At that time, he contrasted the Fed lending programs with spending programs also included in the CARES Act. "If Congress wanted me to lose all the money, that money would have been designed as subsidies and grants as opposed to credit support."

Uncertainty regarding how the Treasury's backstop will operate goes directly to the amount of risk that the Fed might undertake in designing its lending programs. The Treasury's willingness to bear losses might result in less stringent, but still prudent, participation standards that could potentially reach a broader number of participants. Commenters and prospective borrowers have questioned whether some of the Fed programs were initially drawn too narrowly to provide the intended assistance.

At the hearing Tuesday, Mnuchin sought to put the discussion to rest and provide clarity. "For any facility that the Fed believes puts them at risk, I do put up capital, so by definition that capital is at risk, and we are fully prepared to take losses, in certain scenarios, on that capital." While his response was emphatic, the allusion to "certain scenarios" suggests some ambiguity. Mnuchin's prepared testimony is [here](#).

Fed's language evolves

The Fed has consistently said in its required [reports](#) to Congress on the emergency lending programs that it is comfortable that it won't lose money in part because the Treasury has agreed

to take losses first. Powell repeated that in his prepared [testimony](#) Tuesday. But the language has evolved.

In its [March 29 report](#) on the Term Asset-Backed Securities Loan Facility (TALF), the Fed wrote: “As TALF credit is non-recourse to the borrower, the Federal Reserve and the Department of the Treasury, through its equity investment, will bear the risk of loss on the collateral... The Board does not expect at this time that the TALF will result in losses in excess of the Department of the Treasury’s equity investment. Accordingly, the TALF is not expected to result in losses to the Federal Reserve or the taxpayer.” It used similar language in other 13(3) reports in March.

In April, though, the [Fed has used](#) slightly different wording in its reports to Congress. It deemphasizes the loss-bearing nature of the Treasury’s equity investments. But it has also dropped the expectation that programs will not result in losses to the taxpayer. For example, the [April 28 report](#) said, “As described in the Board’s initial report to Congress regarding the TALF, the TALF includes features that are intended to mitigate risk to the Federal Reserve. The Board continues to expect that the TALF will not result in losses to the Federal Reserve” (italics added).

Fed has lent \$120 billion through other facilities in the COVID-19 crisis

The Fed launched its first COVID-19 emergency lending facilities for financial markets in March in the weeks before Congress passed the CARES Act. These facilities mirrored facilities the Fed created during the global financial crisis of 2007-09.

As of [May 13](#), the Fed had roughly \$120 billion outstanding in loans through its discount window and a half-dozen emergency facilities. Two of these facilities – the Money Market Mutual Fund Liquidity Facility and the Commercial Paper Funding Facility – are each backed by \$10 billion in loss-bearing equity that the Treasury agreed to provide prior to the passage of the CARES Act (see the YPFS [blog](#)).

The Fed also has roughly \$450 billion outstanding in swaps with foreign central banks to provide liquidity in dollar-denominated assets.

The video and transcript of the entire hearing can be accessed [here](#).

Usage of the Defense Production Act throughout history and to combat COVID-19

By Aidan Lawson and June Rhee

Original post [here](#).

As the Federal Reserve and the Treasury launch programs to provide relief to individuals and businesses affected by the COVID-19 crisis, President Donald Trump has been using a tool that gives him considerable discretionary authority over private corporations: the [Defense Production Act \(DPA\)](#).

The DPA gives the president the authority to compel the private sector to work with the government to provide essential material goods needed for the national defense. The Act currently includes the following powers:

- Title I: Prioritization and Allocation. This allows the president to designate specific goods as “critical and strategic” and require the private businesses to accept and prioritize government contracts for these goods. Thus far, the government has used this to enhance production of key medical supplies and personal protective equipment (PPE), including \$2.9 billion to purchase over 187,000 ventilators by the end of the year.
- Title III: Expansion of Productive Capacity and Supply: This allows the president to make loans and provide guarantees to businesses, directly purchase critical and strategic goods, and repurpose production facilities in order to increase production capacity. So far, the administration has spent \$208 million under the direct purchase authority in Title III to increase capacity for nasal swabs and respirators in limited amounts. The other powers have not been used.
- Title VII: General Provisions. This allows the president to enter into voluntary agreements with private businesses to coordinate the production of critical and strategic goods. These are subject to some antitrust protection and have yet to be used.

In addition, the CARES Act provided some Title III reporting relief and appropriated \$1 billion to the DPA Fund. However, comprehensive usage is hard to capture; DPA contract awards are kept confidential, since the Act has traditionally been used for military technology.

This post provides background for better understanding of available authorities under the DPA and a full picture of their usage in response to COVID-19 crisis. Additionally, it highlights some criticisms around the current usage of authorities.

Background and Origination of the DPA

While the original DPA was signed into law in 1950 by President Harry Truman, the president’s authority for industrial reorganization and prioritization can be traced back to World War I. The

official declaration of war, signed on April 6, 1917, stated that the president could “employ...the resources of the Government to carry on war against the Imperial German Government” (see [here](#)). President Woodrow Wilson used this authority to create two temporary federal agencies: the National War Labor Board and the War Industries Board. The former was primarily used to mediate labor disputes and the latter allowed the government to settle labor-management disputes, set quotas, and allocate and prioritize the production of critical wartime goods.

The advent of World War II saw the creation of even more expansive emergency authority: The War Powers Act. The [first War Powers Act](#) was passed on December 18, 1941, and gave the president broad powers to reorganize the functions of any executive agency for the purpose of fighting the war. President Franklin Delano Roosevelt issued a total of 75 executive orders under this act (see [here](#), pp. 5710, 5729). The [second War Powers Act](#), signed into law on March 27, 1942, allowed the president to allocate resources, acquire land and property, and compel businesses to take on government contracts for national defense. The second Act also permitted the Federal Reserve to purchase up to \$5 billion in Treasury bonds directly from the U.S. government. Both of the acts expired either during World War II (the second Act), or shortly after (the first Act). While the basis for its authority was sewn in World War I, the two War Powers Acts are the predecessors to the DPA.

Dramatic defense budget cuts followed World War II due to a lack of need and an increased reliance on atomic weaponry. Additionally, demand for housing and consumer products shot up as wartime controls lapsed, culminating in a series of [labor strikes](#) in 1946. The onset of the Korean War amplified the need for dramatic industrial reorganization, and President Harry Truman quickly [pushed](#) for authority similar to what his predecessor had used. As such, the Defense Production Act ultimately was signed into law on September 8, 1950.

What powers does the DPA grant the government over private industry?

The DPA allows the president to “shape national defense preparedness programs and to take appropriate steps to maintain and enhance the domestic industrial base” (see [here, pp. 2](#)).

The Act’s three tools are allocation and prioritization of contracts for critical and strategic goods (Title I), expansion of productive capacity through financial incentives (Title III), and voluntary agreements with private industry (Title VII). The [original act](#) included four other titles that Congress allowed to expire. These authorities allowed the president to requisition private property (Title II), fix wages, prices and ration goods (Title IV), forcibly settle labor disputes (Title V), and control various aspects of consumer credit (Title VI).

The Act also includes a sunset provision that requires it to be reauthorized every few years, which allows changes to be made to ensure the law can account for new developments. When reauthorizing, Congress has occasionally amended the definition of “national defense.” It now extends beyond military application to homeland security and national emergencies, such as those invoked by a terrorist attack or pandemic.

Four major amendments to the definition have been made since the DPA's inception. In 1975, the definition was [expanded](#) to include space activity. The [1980 reauthorization](#) of the Act designated energy as an essential material good. In 1994, the scope of the DPA was significantly broadened to incorporate emergency preparedness during natural disasters or other events that caused national emergencies under Title VI of the [Stafford Act](#) (see pp. 71 - 85). The [fourth amendment](#) in 2003 added "critical infrastructure protection and restoration" to the definition of national defense.

Title I of the DPA gives the president the authority to compel businesses to prioritize and accept contracts for goods that are designated as "critical and strategic" for the national defense, much like in the second War Powers Act. These goods are designated as such by the president, who can allocate, distribute, and restrict their supply as needed. Any contracting decisions made under this must be made with a "strong preference" for small businesses, especially those in economically depressed areas. Title I also includes provisions to prevent the hoarding of materials.

Title III complements Title I's allocation and prioritization authority by providing tools to expand domestic industrial capacity. It allows the president to incentivize private business to expand their production capacity of critical goods if more are needed. These incentives can include loans, loan guarantees, direct purchases and purchase commitments, as well as the ability to outright produce and install equipment in private facilities (see [here](#), pp. 13 - 16). The president can also designate Federal Reserve banks as fiscal agents to administer guarantees (see [here](#), pp. 9).

Generally, the incentives must be:

1. For goods designated as critical and strategic only
2. For institutions that cannot obtain credit elsewhere to produce critical and strategic goods
3. For businesses with sufficient creditworthiness and earning power
4. The most "cost-effective, expedient, and practical alternative"

There are additional requirements based on the form of the incentive. Both loans and guarantees are priced at rates that are commensurate to Treasury yields of similar maturities, while direct purchases of goods will be made at the ceiling price, or domestic market price if no ceiling price has been established. If the aggregate amount of any potential assistance exceeds \$50 million the president must notify Congress and wait 30 days before disbursing any funds. Additionally, an Executive Order passed in 2012 requires an act of Congress for all Title III projects exceeding \$50 million. Historically, very few of these projects were expected to exceed \$50 million (see [here](#), pp. 11).

However, the DPA gives the president a considerable amount of reporting flexibility. The \$50 million congressional reporting threshold can be waived if the actions are taking place during a national emergency or if the president determines that doing so would "severely impair"

capability. This discretion can also be exercised when providing assistance that would prevent a company from becoming insolvent or undergoing bankruptcy proceedings, which is generally not permitted. The president can even set maximum amounts, interest rates, guarantee and commitment fees, and other charges.

The primary difference between Title I and Title III is that the former allows the government to direct industry to prioritize existing resources, while the latter allows the government to direct industry to expand these resources.

The Department of Defense (DoD) is the most frequent user of both Title I and Title III authority. It prioritizes about 300,000 orders each year under Title I and is the only federal agency with a standing [Title III program](#) (see [here](#), pp. 8). It has primarily used Title III to “mitigate critical shortfalls in domestic defense industries;” most recently, it used Title III in July 2019 to expand production capacity for rare earth elements, which are essential components of key military technologies (see [here](#)).

Title VII includes a number of general provisions that grant the president additional reorganization capacity. The most noteworthy of these have to do with the power to create “voluntary agreements” between the government and private industry. During periods of severe stress, the president can consult and create renewable, five-year “voluntary agreements and plans of action” to coordinate the production of goods.

As originally written, Title VII also gave complete antitrust immunity to businesses engaged in these agreements. However, the DPA now provides them special legal defense if their actions violate antitrust laws instead of complete immunity. The government had used similar authority under the [1942 Small Business Mobilization Act](#), which mobilized small business production capacity for World War II and created a Smaller War Plants Corporation that would make loans to these businesses (see [here](#), pp. 6 - 11).

Title VII also includes the authority of the President, generally through the Committee on Foreign Investment in the U.S., to unilaterally review any merger, acquisition, or takeover to assess its impact on national security (see [here](#), pp. 39 - 40, pp. 45 - 46). If the review finds that the transaction could be harmful to national security or is foreign-government controlled, the president can suspend or outright prohibit a transaction from taking place. Title VIII also authorizes the president to establish a National Defense Executive Reserve to train members of private industry to be placed in higher-level government positions during periods of national emergency, though none currently are active (see [here](#), pp 35).

Much of the allocation and spending under the DPA is done through the Defense Production Act Fund, which receives and manages appropriated money for the purposes outlined above. Up to \$750 million may be kept there indefinitely, with any excess amounts from repayments, fees, or premiums being returned to the Treasury at the end of each fiscal year. Other government agencies are allowed to appropriate money to the Fund, with the Departments of Defense and

Energy being two recent examples (see [here](#), pp. 16). [Executive Order 13603](#), the most recent DPA amendment, assigned the Secretary of Defense as the manager of the DPA fund.

The DPA's authority has often been delegated to the heads of government agencies and departments. President Truman was the first to do this through Executive Order 10161, issued a day after the DPA was signed into law (see [here](#)). Under this order the heads of government agencies were given Title I, III, and VII authority for national defense matters that fell within the scope of their respective agencies. The Secretary of Agriculture, for instance, was given prioritization authority over food resources and related facilities. Over the years, the authority given under Executive Order 10161 has been amended as the definition of national defense has developed and the U.S. industrial base has changed.

DPA Usage during the COVID-19 crisis

The Trump administration alluded to using the DPA on [February 28](#) but did not officially invoke it until [March 18](#), five days after the national emergency was declared. Shortly after, the administration issued Executive Orders [13909](#) and [13910](#), which gave the Secretary of Health and Human Services (HHS) Title I prioritization authority, as well as the ability to introduce hoarding restrictions for PPE and critical medical equipment. Management and coordination of all DPA programs were delegated to a White House trade advisor, [Peter Navarro](#).

[Executive Order 13911](#) (EO 13911) delegated Title III authority to the Secretaries of HHS and Homeland Security (DHS) to respond to the COVID-19 crisis. EO 13911 also granted the DHS Secretary Title I and anti-hoarding authority given to HHS in the previous executive orders.

Additionally, the president waived many of the Title III reporting requirements to provide loans and guarantees, or purchase items during the national emergency. Aid packages exceeding \$50 million do not have to be reported to Congress and sales prices for direct purchases were made more flexible. Even goods that are not critical and strategic are eligible for Title III assistance.

EO 13911 also delegated the right to form voluntary agreements under Title VII to both Secretaries with the approval of the president. This may raise some antitrust concerns, but the DPA provides for some antitrust protection and federal regulators [stated](#) that the exceptional circumstances surrounding the crisis may necessitate joint ventures between businesses, and that they would take these into account when enforcing antitrust laws.

[Executive Order 13922](#), issued on May 14, gave Title III authority to the CEO of the U.S. International Development Finance Corporation (DFC). The DFC, formed in October 2018, provides up to \$60 billion annually in investment financing for developing countries across the world (see [here](#)). EO 13922 requires the CEO of the DFC to work with the HHS and DHS Secretaries to make loans that enhance the domestic COVID-19 response or that support “the resiliency of any relevant domestic supply chains.”

Section 4017 of the [CARES Act](#) provided additional Title III relief:

- Two-year exemption from the requirement that Congress approve loans and guarantees exceeding \$50 million.
- Two-year exemption that allows the balance of the DPA Fund to exceed \$750 million.
- One-year reporting relief of requirement to notify Congress and wait 30 days after notification to provide Title III assistance exceeding \$50 million for one year.

On March 31, the Secretary of HHS used Title I authority to designate a number of health and medical resources, such as respirators with an N-95 effectiveness level, portable ventilators, disinfecting devices, and PPE, as “scarce or threatened” (see [here](#)). This designation lasts until the end of July.

The White House has issued a number of presidential memoranda to complement its executive orders. One [memorandum](#), issued on March 27, required the Secretary of HHS to use Title I authority in compelling General Motors (GM) to prioritize contracts for a potentially unlimited number of ventilators. [Another](#) banned the export of scarce or threatened PPE.

Two months after the DPA was invoked, HHS finalized a number of contracts to provide over 187,000 ventilators by the end of the year. See Table 1 for a list of DPA ventilator contracts.

While DPA authority had been delegated to the Secretary of DHS, [existing regulations](#) meant that this responsibility had been delegated to Federal Emergency Management Agency (FEMA), which is the primary federal disaster relief agency in the U.S. (see [here](#)). Under this regulation, FEMA has the role of brokering sales to third parties to obtain critical health and medical supplies and directly prioritizing which businesses receive supplies (see [here](#), pp. 28502, 28504). Additionally, HHS has [worked out](#) an arrangement under the DPA with The 3M Company to produce a total of 166.5 million masks over the next few months.

Table 1: Title I COVID-19 Ventilator contracts (\$millions)

Company	Contract Amount	Ventilators Produced (end of 2020)
Phillips	\$646.7	43,000
Hamilton	\$552	14,115
General Motors	\$489.4	30,000
Vyaire	\$407.9	22,000
Zoll	\$350.1	18,900
General Electric, Ford	\$336	50,000
GE Healthcare	\$64.1	2,410
ResMed	\$31.98	2,550

Hillrom	\$20.1	3,400
Medtronic	\$9.1	1,056

Source: Department of Health and Human Services press releases

The DPA Fund, according to the government’s most recent budget, had an estimated \$228 million available (see [here](#), pp. 276). The CARES Act has augmented this by providing an additional \$1 billion for DPA activities out of \$50 billion that was released for the COVID-19 crisis when the Trump administration declared a national emergency in March (see [here](#)).

Government agencies, such as HHS, have only used Title I authority thus far, but the lack of funding in the DPA Fund may prove to be a limitation if U.S. industrial capacity as a whole needs to be expanded through Title III, rather than repurposed.

Title III has only been used twice by the DoD since the DPA was invoked over two months ago. The DoD used Section 303 to scale up production of both [nasal swabs](#) and [N-95 masks](#), investing an estimated total of \$208 million. However, the loan and guarantee authority in Sections 301 and 302 of Title III has not been used in decades. The projects done under Title III are done each year under Section 303, which allows the government to make direct purchases of goods and repurpose production facilities for national defense matters (see [here](#), pp. 14).

Criticism of the DPA during COVID-19

While the Trump administration has used the DPA to some extent, many have professed that its approach has been too little, too late. Shortly after the national emergency was declared, 57 members of the House of Representatives wrote a [letter](#) to the president imploring him to use the DPA, citing insufficient testing and widespread shortages of critical supplies. Even after activating it, the administration characterized the DPA as a break-the-glass authority, likening it to [nationalization](#) and as unnecessary since they argued businesses were [voluntarily increasing production](#).

On March 30, the U.S. Conference of Mayors, which represents over 1,400 mayors in large and medium-sized cities, sent a [letter](#) to the president requesting full usage of Title III to increase the production of critical medical supplies that cities are having difficulty obtaining. These concerns have even prompted a legislative [proposal](#) to federalize the entire medical supply chain. The proposal would have the Secretary of Defense appoint an Executive Officer for Critical Medical Equipment and Supplies, who would use DPA authority to “oversee all acquisition and logistics functions related to the [COVID-19] response.” All requests for equipment would be directed to the Executive Officer, who would report weekly on the production capacity and supply needs of the U.S. and make recommendations based on these.

Concerns about the lack of medical supplies have persisted for years. A [2015 study](#) by government researchers estimated the number of N-95 respirators that would be needed for a hypothetical flu outbreak. In the more conservative “base” scenario, the researchers found that respirator demand ranged from 1.7 billion to 3.5 billion over the course of the outbreak. A

second [study](#), conducted in 2017, evaluated the responsiveness of the U.S. medical supply chain based on previous experiences, such as the 2009 H1N1 and 2014 Ebola outbreaks. The researchers found that reliance on imported medical goods, a lack of “surge capacity”, and unclear government guidance and monitoring of these goods leaves the U.S. vulnerable. HHS estimated at the beginning of March that the U.S. would need about 3.5 billion N-95 respirators over the next year if COVID-19 developed into a “full-blown” pandemic. At the time, the government had a stockpile of about 35 million (see [here](#)).

The most notable example of the DPA’s usage has been to increase the production of ventilators through Title I authority. Usage of Title III authority, however, has been “[totally inadequate](#)”, according to a letter written by nine prominent U.S. Senators on May 6. There is still approximately \$1 billion that could be used for Title III projects. Lack of fiscal capacity could pose a problem for Title III usage, but several members of Congress stated that they would be willing to advocate for additional funding (see [here](#)). Theoretically, delegating Title III authority to the HHS and DHS Secretaries should promote expediency, but that has not happened so far. Lawmakers have been critical of Title III delegation to the CEO of the DFC, citing its lack of experience in the medical supply chain, domestic markets and relevant industrial reorganization expertise (see [here](#)).

Another concern has been the lack of transparency around DPA contract awards, as there is no requirement for these to be reported. Secrecy is often necessary when discussing and developing military technology during wartime but some COVID-19 contracts have been given to companies that are in [questionable financial status](#) or have [little-to-no background](#) in medical supplies.

The U.S. medical supply chain is built to maximize efficiency and leave little room for excess supply, which slows manufacturers’ ability to scale up production in times of crisis. COVID-19 export restrictions have received some [backlash](#), warning that these could lead to retaliation from trading partners and exacerbate shortages of other medical goods. In one case, a company contracted with the U.S. government [decried](#) the “significant humanitarian implications” associated with the administration’s export restrictions. The U.S. is a net importer of medical goods, and retaliatory trade policy, combined with existing production issues, could exacerbate already-known and serious flaws in the domestic medical supply chain. As the country begins to re-open, it is unclear how much more the administration plans to use the DPA.

Forecasting the Economy During COVID-19

By Chase P. Ross and Sharon Y. Ross

Original post [here](#).

The coronavirus crisis has left economists scrambling to rejigger their forecasts. In this note, we briefly describe how forecasters have updated their outlook for the US economy, what sort of data they use in their projections, and how economists link the public health outlook to the economic outlook.

Even in normal times, forecasters have a tough job but do it well on average. For example, [analysis of a large data set](#) on forecasts – the Survey of Professional Forecasters – shows that forecasters are most accurate looking one quarter ahead, and beat simple model forecasts like no-change forecasts or autoregressive models. Over a longer time horizon, the accuracy of projections declines.

At the beginning of 2020, the Bloomberg consensus saw Q2 real GDP growing at 1.7%, and the unemployment rate at 3.6% (following convention, the quarterly growth numbers we reference are the annualized quarter-over-quarter growth rate). Before the crisis hit, the economy was cooling slowly: growth in 2018, 2019, and 2020 (expected) was 2.9%, 2.3%, and 1.7%, respectively. In a typical recession, the economy gradually adjusts to lower output and higher unemployment via financial channels. But the virus, and especially the government response to the virus, have accelerated the normal process as workers are laid off because they physically cannot work safely.

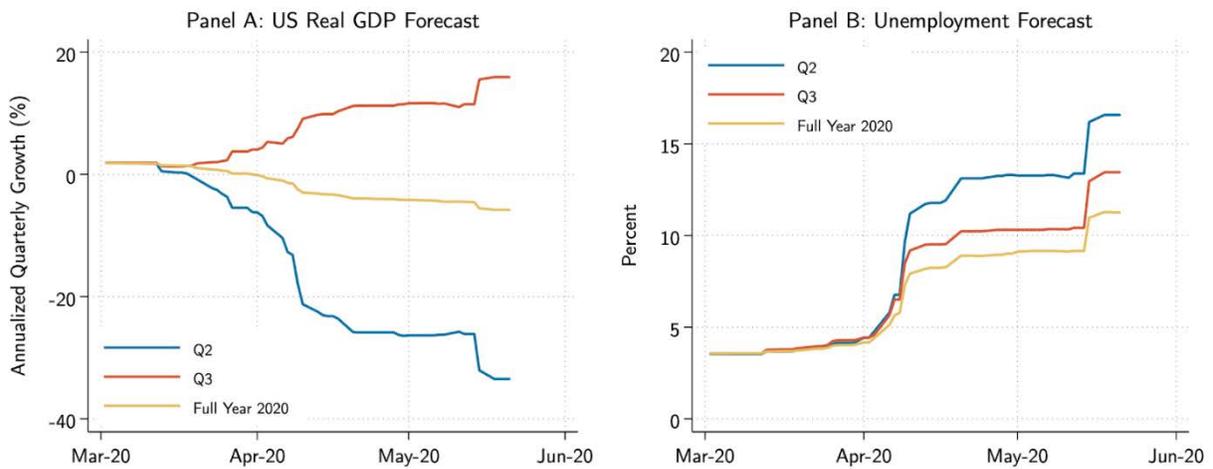
Accordingly, consensus growth estimates quickly fell, as shown in Figure 1. From March 12 to April 12, consensus Q2 growth fell 24 percentage points (pp) from 1.8% to -22%. The consensus unemployment forecast in Q2 grew from 3.6% to 12% over the same period. As forecasters downgraded Q2, they upgraded Q3 – implying a sort of “V” shaped recovery. From March 12 to April 12, Q3 estimated GDP growth grew roughly 8pp to 9.8%. News over the following month revised Q2 forecasts even lower to -33.5% and an unemployment rate exceeding 16.5%. Putting it together, expected growth for the full year fell from 1.7% to -5.8%.

Hidden in these point estimates is a tremendous amount of uncertainty, as shown in Figure 2. The spread between the low and high forecast for 2020 full year growth was 2.9pp on January 1 and rose to 13pp by May. This level of dispersion in forecasts is unprecedented. Even in the worst year (in terms of growth) of the global financial crisis, 2009, the maximum dispersion in forecasts was 7pp.

Several high-frequency data points have become particularly important in recent weeks. A non-exhaustive list of commonly used high-frequency indicators includes: [Google Mobility Reports](#), movie attendance, electricity utility generation, Redbook same-store retail sales, [initial unemployment insurance claims](#), fuel sales to end-users, the Rasmussen Consumer Index,

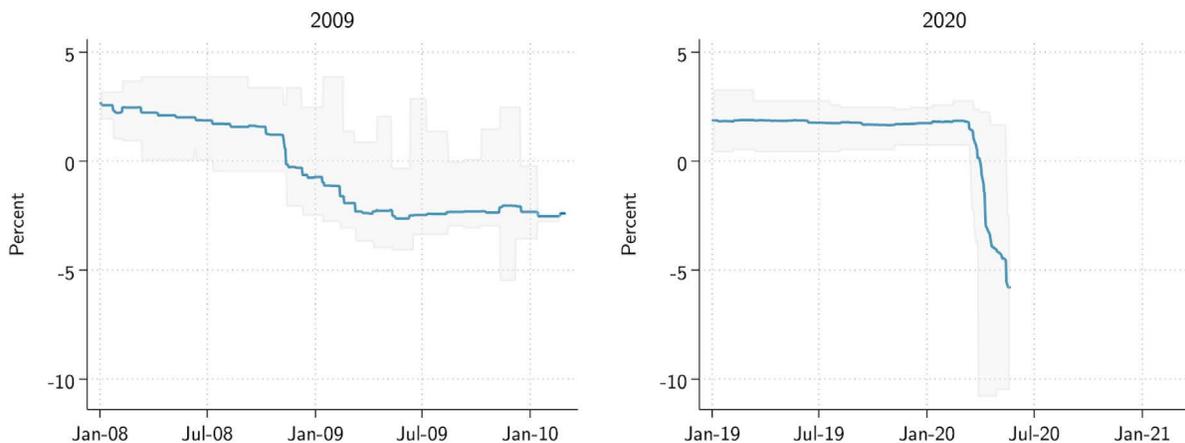
American Staffing Index, raw steel production, [TSA traveler numbers](#), [bankruptcy statistics](#), [San Francisco Fed's news sentiment](#), and the list goes on. Google Mobility data is particularly novel, as it provides granular location data, giving some sense of how strict lockdowns are and what share of the labor force is staying at home. The Federal Reserve Bank of New York now releases a [Weekly Economic Index](#), which aggregates several high-frequency indicators to GDP units.

Figure 1: Consensus Forecasts



Source: Bloomberg

Figure 2: Forecast Dispersion in 2009 vs. 2020



Note: Grey shading reflects range from the lowest to highest forecast.
Source: Bloomberg

While each forecaster's process varies, many use models like the IHS Markit's Macroeconomics Advisors' [MA/US model](#), or the Federal Reserve [FRB/US model](#). Both models are large-scale

structural econometric models and produce estimates for all major categories in the US national accounts. Reasonably, the models do not explicitly account for pandemics, nor do they expressly embed epidemiological assumptions into their forecasts in normal times.

A common approach to producing forecasts during the COVID-19 crisis involves three steps. First, the forecasters use high-frequency data to forecast granular industry-level effects – e.g., hospitals, outpatient care, hotels, food services, and car rentals. The step also involves overlaying the government’s classification of “[essential critical infrastructure workforce](#),” the ability for an industry to work from home, and state-by-state lockdowns. Google Mobility data is especially useful in capacity utilization estimates.

Second, the forecaster aggregates these granular location-industry specific forecasts to produce shocks to aggregate demand components, which themselves can be fed into a model like MA/US. The forecasters also need to make assumptions about fiscal stimulus, global growth (excluding the US), and financial conditions. Often, the latter category includes assumptions about short- and long-term Treasury yields. At banks and broker/dealers – where many private-sector forecasters work – economists often take interest rate forecasts from their “interest rate strategy” team, and so there is a nontrivial effort to make sure the different teams’ estimates are internally consistent.

Third, the forecasters plug their aggregated shocks into the model. Armed with the resultant GDP forecasts, many forecasters will use rules of thumb like Okun’s Law to produce unemployment forecasts. For example, if the GDP projection implies a 10pp output gap, then unemployment would increase 5pp – but the forecaster has to make a subjective judgment about how quickly job losses will occur.

Complicating the forecasting process, official data is subject to more uncertainty now. For example, the net jobs created by births and deaths are roughly stable, and the BLS models account for this typically-flat relationship. The COVID-19 crisis breaks the validity of that assumption, and so the BLS [updated its model](#) specifically in response to the challenges of the crisis. Moreover, whether or not the BLS would impute zero employment for non-responding companies was a first-order question for forecasters. Forecasting with considerable uncertainty about the official data estimates’ methodology is not new, as experienced in the aftermath of Hurricane Katrina and the October 2013 government shutdown. During the 2013 shutdown, the BLS did not release payroll employment (ultimately [releasing](#) the report two weeks later), and the Commerce Department suspended publishing construction spending and factory orders.

As the public health crisis continues and states contemplate relieving lockdown restrictions, we look into what matters for macro forecasts – is it realized deaths, lockdown, or both?

The Goldman Sachs Effective Lockdown Index measures the intensity of virus control measures. The daily lockdown index equal-weights two measures: a government policy measure and a policy effect measure which are constructed using data from Oxford University’s Blavatnik

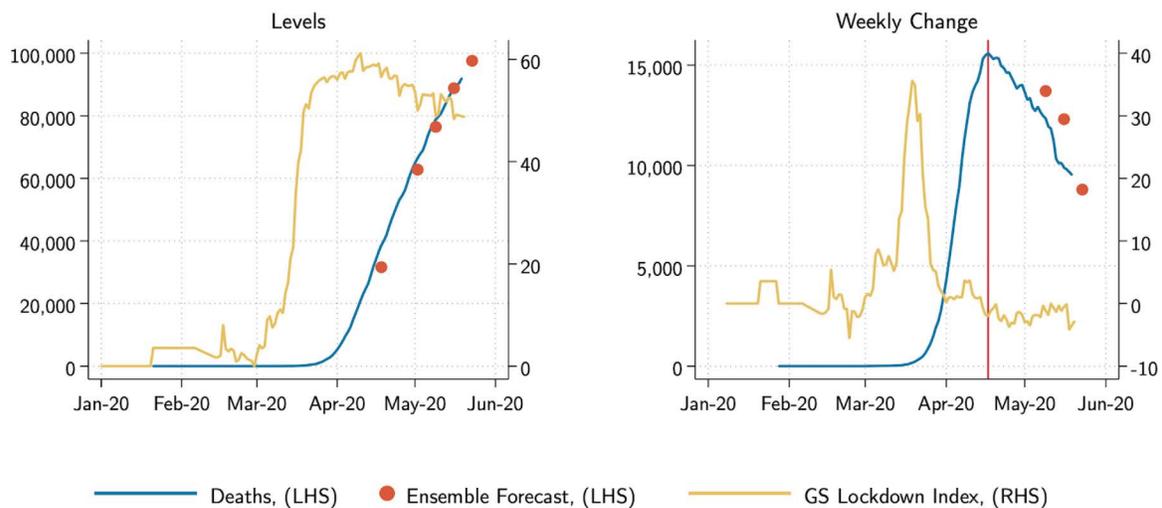
School of Government dataset on government virus policy measures and data from Google on personal smartphone behavior, respectively.

In Figure 3, we plot the time series and weekly change in the lockdown index and actual deaths in the United States, which is compiled by [The New York Times](#) and begins on January 21.

The lockdown index increased rapidly in early March as markets teetered, liquidity became constrained, and the Federal Reserve announced rate cuts and other interventions. The increase in the lockdown index occurred ahead of actual deaths, but since the peak weekly increase in deaths, the weekly differences have been positively correlated: as new deaths decrease, the lockdown index has declined.

Many epidemiology models forecast COVID-19 deaths. As economists, we are not experts in assessing the best model, so we look to the [COVID-19 Forecast Hub](#)'s ensemble forecast, which takes the average estimate across many models. This data includes forecasts for deaths 1- to 4-

Figure 3: US Lockdown Index and Covid-19 Deaths



Source: Goldman Sachs, Oxford University's Blavatnik School of Government, Google, New York Times, COVID-19 Forecast Hub

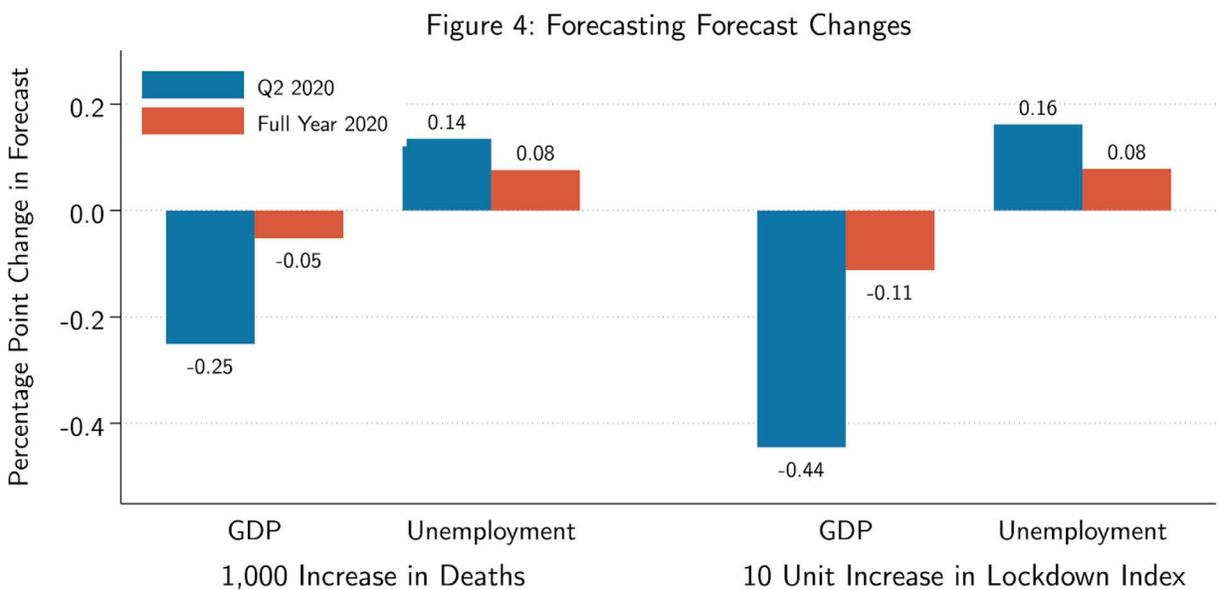
weeks ahead: Figure 3 shows the ensemble 1-week forecasted deaths. The forecasts are plotted by the target date, meaning that the forecast was made one week prior. The ensemble forecast appears to move closely with actual deaths both in level terms and one-week changes. If the ensemble forecast were 100% correct, the red dots would line up on the blue line exactly. Importantly, the ensemble forecast is weekly and only begins in April, but as more data comes out, market participants may look toward how forecasted deaths fluctuate with the Lockdown Index and macro forecasts.

Empirically, both deaths and the degree of lockdown are correlated with macro forecasts. We regress daily changes in consensus GDP and unemployment forecasts on daily changes in deaths, lagged by one day, and we regress daily changes in the macro forecasts on daily changes in the Lockdown Index, lagged by one day. We plot the regression coefficients in Figure 4. Broadly the results highlight that as deaths and the lockdown increased, the consensus GDP forecasts declined, and the unemployment forecasts notched higher.

The regression results coefficient says that for an increase of 1,000 new deaths is correlated with a decline in Q2 GDP consensus forecast of 0.25pp, and a 10 unit increase in the lockdown index is associated with a 0.44pp drop in the Q2 GDP forecast. Meanwhile, the Q2 unemployment forecast increases by 0.14pp when deaths increase by 1,000 and by 0.16pp for a 10 unit increase in the lockdown index.

Over a longer horizon, an increase of 1,000 new deaths is associated with a 0.05pp decline in the 2020 GDP forecast and a 0.08pp increase in 2020 unemployment rate. Unsurprisingly, the coefficients show that lockdown and deaths hurt Q2 macro variables more than growth and employment for the full year.

Of course, this back of the envelope analysis does not suggest that the key to boosting growth and lowering unemployment is simply relaxing lockdowns. Economic outcomes follow the

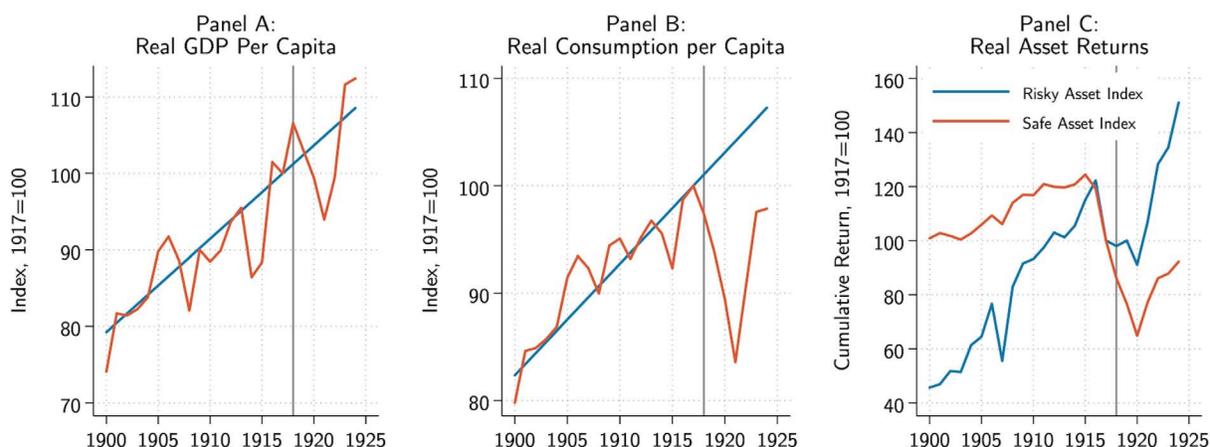


public health crisis; lockdowns may have curbed deaths from ramping even higher. The virus will continue to hamper growth and employment until the general public has confidence in the ability to resume normal life. Thoughtful policy remains critical for both health and growth outcomes.

Pandemics are thankfully rare enough that we have limited data to study the effects of a virus on the economy. Data available from the [Jordà-Schularick-Taylor Macrohistory Database](#) give a

sense of the impact of the most notorious pandemic, the 1918 Spanish Flu, on the US economy. It's not possible, of course, to isolate the effect of the pandemic on the economy as many other important events were simultaneously occurring: namely, the end of the Great War and considerable inflation in the late 1910s.

Figure 5: 1918 Spanish Flu



Note: Vertical line denotes year of Spanish Flu.
Source: Jordà-Schularick-Taylor Macroeconomy Database

We plot real GDP per capita and real consumption per capita relative to their pre-1918 trends in Figure 5, panels A and B. Real GDP fell to a low of 11pp below trend. Consumption dropped considerably from 1917 to 1921, amounting to a fall of about 20pp below trend. We also show the real cumulative return for safe assets, including bonds and bills, and risky assets, including housing and equities. In real terms, safe assets lost 35pp and risky assets 9pp, owing in part to high levels of inflation. It's not possible to ascribe these fluctuations to the 1918 Spanish flu alone, but the exercise provides a useful historical benchmark.

The past 60 days of economic data have been [historic in the worst way](#). An annual growth rate of -6% means there has been, and will continue to be, tremendous human misery at levels unseen in our lifetimes. [Last week](#), Chair Powell noted:

John Kenneth Galbraith famously said that economic forecasting exists to make astrology look respectable. We are now experiencing a whole new level of uncertainty, as questions only the virus can answer complicate the outlook.

Consensus, however, is optimistic and forecasts a quick rebound in Q3 – the “V” shaped recovery. Let's hope.

Lender beware: Emergency relief efforts are inherently risky

By Greg Feldberg and Sabeth Siddique

Original post [here](#).

The coronavirus response puts American bankers in a tight spot.

More so than most developed countries, the government has put bankers in charge of life-or-death decisions about private businesses. Banks and nonbank [lenders have been allocating](#) what are essentially government grants [through the nearly \\$660 billion](#) Paycheck Protection Program.

They will soon be expected to allocate hundreds of billions [more through Fed](#) and Treasury programs that will require them to take more risk.

But banker-as-government-agent is not an enviable role. Lend too conservatively, and the banker will be (or has been) criticized for putting shareholders, or favored clients, ahead of the common good. Lend too freely, and losses may be higher than expected, leading to a need for capital from the government before the end of the year.

To solve this dilemma, bankers and nonbank lenders can rely on the principles of risk management and governance that they relearned the hard way during the last financial crisis.

To protect their institutions, bankers need to, first, provide clear guidance on risk appetite. Even today, bank boards have an important role to play in [reconfirming a bank's strategy](#) and risk appetite – the level of losses that board members can endure and justify to stakeholders – and making sure management prudently follows policies and procedures.

To be sure, risk appetite remains relevant. A bank can do its part to support the real economy even if its board decides it will only extend credit through lending programs in which the government has committed to take much of the risk. Or if it decides not to extend new credit at all, but to focus on helping existing borrowers.

Bank risk managers aren't epidemiologists. They don't have special insights into how long the health crisis will last.

However, their expertise should allow them to differentiate between borrowers with persistent foundational issues and borrowers with only temporary issues. Authorities have acknowledged this with clear guidance that banks should not automatically downgrade borrowers who miss payments.

Lending or restructuring decisions should be based on sound underwriting criteria, with a clear understanding of the board's risk appetite while paying attention to the current environment and the mitigating effects of government assistance.

Management can expect elevated losses and depletion of capital buffers. The challenge is to not allow those losses to put the safety and soundness of the institution at risk. Specifically,

operating at or near the institution’s post-stress capital target should be consistent with the board’s risk tolerance in this environment. Some banks have already warned that capital ratios are likely to decline from recent high levels.

The depth and length of this recession are very uncertain, depending on public-health variables that no one can predict. Banks should be vigilant in identifying, assessing and reporting risks commensurate with the speed and magnitude of the changing-risk environment.

Banks need these ongoing assessments to translate risk appetite into tangible metrics such as exposure limits and underwriting criteria. Risk managers should scrutinize the reliability of model outputs, mitigating model risks with qualitative factors when applicable.

Data on historical loan losses and backward-looking statistical scoring models won’t be very helpful. Judgment will likely play a greater role.

Bankers should also carefully balance “micro” and “macro” pressures. Supervisors have focused increasingly on banks’ [responsibilities to the public](#) since the financial crisis.

In its annual stress test, for example, the [Federal Reserve says it expects every](#) bank’s management to “establish post-stress capital goals that are aligned with its risk appetite and risk profile, its ability to act as a financial intermediary in times of stress, and the expectations of internal and external stakeholders.”

Governments today are striking a delicate balance between their “microprudential” role (to keep banks solvent), and their “macroprudential” role (to support the real sector). In a crisis, the macroprudential role must take center stage. But bankers, backed by good governance, should know best how to strike the balance.

In the early stages of this crisis, no decision of each bank’s board has been more sensitive than the question whether to suspend the payments of dividends to shareholders. In the U.S., supervisors have so far hesitated to tell banks to suspend. And, so far, banks have not done so.

In contrast, there was a diversity of responses to supervisors’ guidance on the allowance for loan losses. Some banks took advantage of the forbearance to conserve capital by delaying their application of the new “lifetime loss” standard.

Others held to the standard, conservatively reserving for the worst. Both answers may be appropriate, based on each bank’s unique business profile.

Finally, don’t forget reputational risk. Of course, bankers entered this crisis with more goodwill than last time. But, like the liquidity and capital buffers they have built since the 2008 financial crisis, that goodwill can be quickly spent if not managed.

Already, it is clear that the public will be very sensitive to credit allocation decisions that appear unfair or prejudicial, especially when bankers are allocating taxpayer funds. There are also the matters of compensation, bonuses and shareholder dividends while so many are suffering.

In summary, banks have the tools to determine their fate this year. Their public-service role — the justification for both the benefits and the costs of their unique regulatory framework — is never more clear than in the depth of a crisis like this.

Following risk-management principles and knowing when to say “no,” bankers may be able to get through this early phase of the coronavirus-triggered recession intact.

It won't be easy. It will require hard-headed analysis of risks amidst extreme uncertainty and constant reevaluation of the conflicts and complements between stakeholder and public interests. It will also require the fortitude to make decisions backed by sound judgment and leadership, consistent with each bank's risk appetite.

Use of Federal Reserve Programs - 05/28/2020

By Pascal Ungersboeck

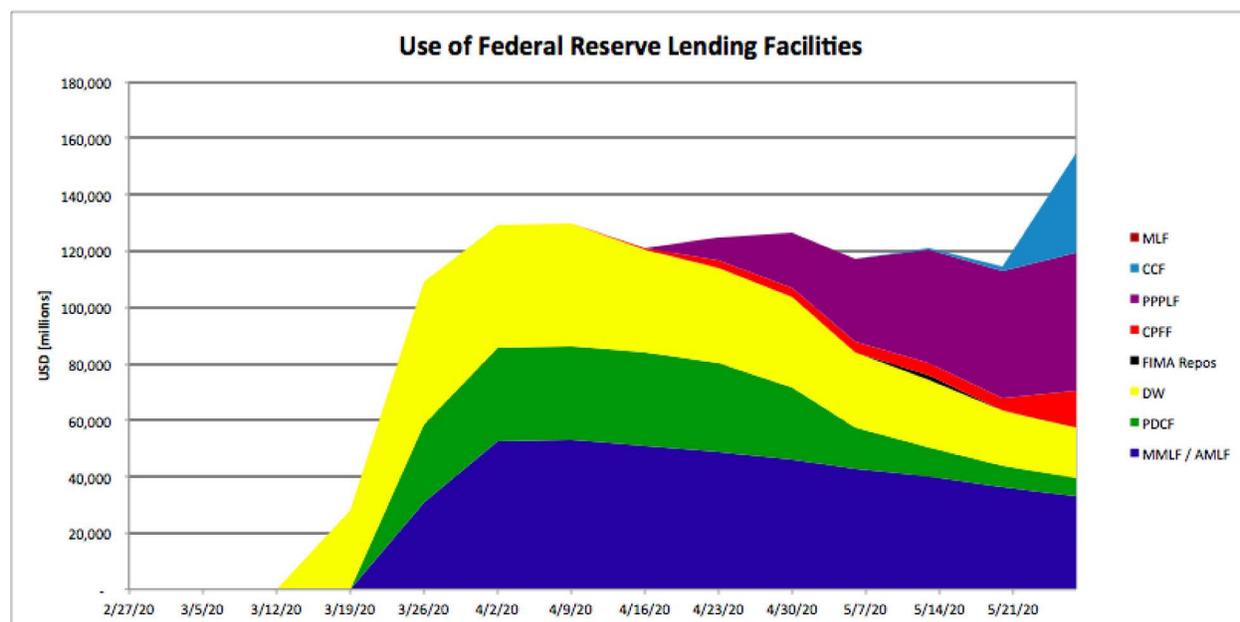
Original post [here](#).

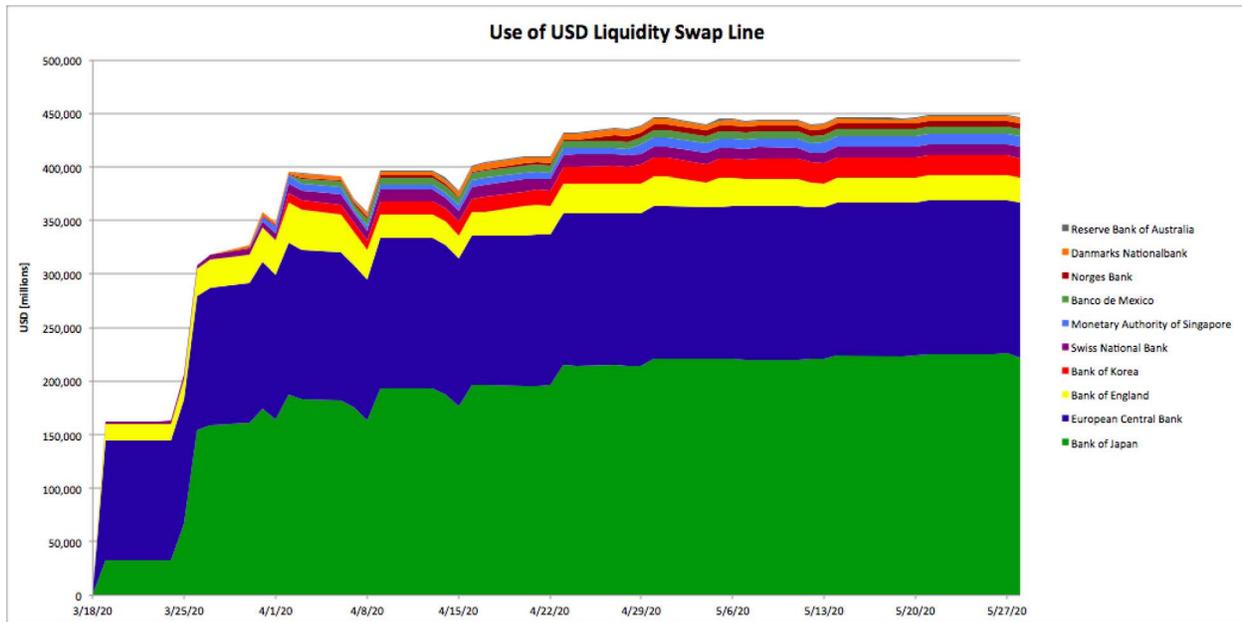
Below we report on operational Fed programs, based on the Fed's weekly [H.4.1 release](#). Since last week the Municipal Lending Facility has started operations; however, no funds have been extended so far. Treasury has contributed \$66.5 billion in CARES Act funds to four Fed lending facilities to date.

Note on Treasury contributions to Fed facilities

The Treasury announced on April 9 that it intended to use funds available under the CARES Act to purchase equity in special purpose vehicles established under Fed lending programs. As of May 28, the Treasury invested a total of \$66.5 billion in four facilities: equity investments of \$10 billion into Commercial Paper Funding Facility LLC II, \$37.5 billion into Corporate Credit Facilities LLC, and \$17.5 billion into Municipal Liquidity Facility LLC; and \$1.5 billion in credit protection for the Money Market Mutual Fund Liquidity Facility.

Per the facility agreements, 85% of the equity contributions to the [CCF](#) and [CPFF](#) have been invested in nonmarketable Treasury securities; \$31.9 billion for the CCF and \$8.5 billion for the CPFF. These investments are reflected in the balance of the CCF and CPFF. This week's increases in the outstanding amounts for the CCF and CPFF thus largely reflect investments in Treasury securities, rather than in corporate bond or commercial paper holdings. The equity contributed to the MLF on May 26 has not been invested yet.





Liquidity Swap Lines

The USD [swap lines](#) are bilateral agreements between the Fed and foreign central banks. They allow foreign central banks to exchange domestic currency for US dollars. The Fed currently maintains swap line agreements with 14 central banks.

Money Market Mutual Fund Liquidity Facility

The [MMLF](#) allows the Fed to fund the purchase of money market mutual fund assets. The program is established under section 13(3) of the Federal Reserve Act. The Fed reported that the U.S. Treasury, to date, has provided credit protection of \$1.5 billion to the Money Market Mutual Fund Liquidity Facility.

Discount Window

The [DW](#) is a standing facility that allows the Fed to provide collateralized loans to depository institutions.

Primary Dealer Credit Facility

The [PDCF](#) allows the Fed to extend collateralized loans to primary dealers. The facility was established under section 13(3).

Paycheck Protection Program Liquidity Facility

The [PPPLF](#) allows the Fed to provide financial institutions with liquidity backed by loans to small and medium businesses extended under the federal government's Paycheck Protection

Program and guaranteed by the Small Business Administration. The Program was established under section 13(3).

CB Swaps				AMLF / MMLF				PDCF			
GFC		COVID		GFC		COVID		GFC		COVID	
9/17/08	62,000	3/11/20	58	10/8/08	139,481	3/11/20	-	3/5/08	-	3/11/20	-
9/24/08	141,900	3/18/20	44	10/15/08	122,763	3/18/20	-	3/12/08	-	3/18/20	-
10/1/08	286,432	3/25/20	206,051	10/22/08	107,895	3/25/20	30,634	3/19/08	28,800	3/25/20	27,718
10/8/08	335,184	4/1/20	348,544	10/29/08	96,010	4/1/20	52,667	3/26/08	37,023	4/1/20	33,050
10/15/08	406,882	4/8/20	358,077	11/5/08	85,097	4/8/20	53,171	4/2/08	34,443	4/8/20	33,018
10/22/08	477,159	4/15/20	378,291	11/12/08	76,546	4/15/20	50,656	4/9/08	26,479	4/15/20	33,409
10/29/08	498,860	4/22/20	409,712	11/19/08	61,923	4/22/20	48,810	4/16/08	25,655	4/22/20	31,526
11/5/08	528,355	4/29/20	438,953	11/26/08	53,309	4/29/20	46,277	4/23/08	18,555	4/29/20	25,504
11/12/08	569,716	5/6/20	444,885	12/3/08	49,234	5/6/20	42,763	4/30/08	17,775	5/6/20	14,903
11/19/08	562,090	5/13/20	440,934	12/10/08	34,425	5/13/20	39,820	5/7/08	16,260	5/13/20	10,288
11/26/08	475,435	5/20/20	446,103	12/17/08	27,421	5/20/20	36,449	5/14/08	14,485	5/20/20	7,501
12/3/08	506,819	5/27/20	448,946	12/28/08	23,993	5/27/20	33,244	5/21/08	13,555	5/27/20	6,241

DW				PPPLF				CPFF			
GFC		COVID		GFC		COVID		GFC		COVID	
9/10/08	23,455	3/11/20	11			3/11/20	-	10/15/08	-	3/11/20	-
9/17/08	33,401	3/18/20	28,224			3/18/20	-	10/22/08	-	3/18/20	-
9/24/08	39,327	3/25/20	50,768			3/25/20	-	10/29/08	144,808	3/25/20	-
10/1/08	49,524	4/1/20	43,744			4/1/20	-	11/5/08	243,305	4/1/20	-
10/8/08	98,107	4/8/20	43,449			4/8/20	-	11/12/08	257,287	4/8/20	-
10/15/08	101,853	4/15/20	36,284			4/15/20	-	11/19/08	270,879	4/15/20	974
10/22/08	107,547	4/22/20	33,742			4/22/20	8,009	11/26/08	294,094	4/22/20	2,732
10/29/08	110,737	4/29/20	31,759			4/29/20	19,488	12/3/08	303,880	4/29/20	3,372
11/5/08	108,567	5/6/20	26,494			5/6/20	29,181	12/10/08	312,414	5/6/20	3,988
11/12/08	99,180	5/13/20	24,239			5/13/20	40,580	12/17/08	318,843	5/13/20	4,292
11/19/08	92,645	5/20/20	19,535			5/20/20	45,090	12/28/08	331,686	5/20/20	4,293
11/27/08	91,725	5/27/20	18,198			5/27/20	49,211	1/1/09	334,102	5/27/20	12,794

DW				PPPLF				CPFF			
GFC		COVID		GFC		COVID		GFC		COVID	
9/10/08	23,455	3/11/20	11			3/11/20	-	10/15/08	-	3/11/20	-
9/17/08	33,401	3/18/20	28,224			3/18/20	-	10/22/08	-	3/18/20	-
9/24/08	39,327	3/25/20	50,768			3/25/20	-	10/29/08	144,808	3/25/20	-
10/1/08	49,524	4/1/20	43,744			4/1/20	-	11/5/08	243,305	4/1/20	-
10/8/08	98,107	4/8/20	43,449			4/8/20	-	11/12/08	257,287	4/8/20	-
10/15/08	101,853	4/15/20	36,284			4/15/20	-	11/19/08	270,879	4/15/20	974
10/22/08	107,547	4/22/20	33,742			4/22/20	8,009	11/26/08	294,094	4/22/20	2,732
10/29/08	110,737	4/29/20	31,759			4/29/20	19,488	12/3/08	303,880	4/29/20	3,372
11/5/08	108,567	5/6/20	26,494			5/6/20	29,181	12/10/08	312,414	5/6/20	3,988
11/12/08	99,180	5/13/20	24,239			5/13/20	40,580	12/17/08	318,843	5/13/20	4,292
11/19/08	92,645	5/20/20	19,535			5/20/20	45,090	12/28/08	331,686	5/20/20	4,293
11/27/08	91,725	5/27/20	18,198			5/27/20	49,211	1/1/09	334,102	5/27/20	12,794

CCF				FIMA Repos				MLF			
GFC		COVID		GFC		COVID		GFC		COVID	
		3/11/20	-			3/11/20	-			3/11/20	-
		3/18/20	-			3/18/20	-			3/18/20	-
		3/25/20	-			3/25/20	-			3/25/20	-
		4/1/20	-			4/1/20	-			4/1/20	-
		4/8/20	-			4/8/20	1			4/8/20	-
		4/15/20	-			4/15/20	-			4/15/20	-
		4/22/20	-			4/22/20	-			4/22/20	-
		4/29/20	-			4/29/20	2			4/29/20	-
		5/6/20	-			5/6/20	-			5/6/20	-
		5/13/20	305			5/13/20	1,404			5/13/20	-
		5/20/20	1,801			5/20/20	1			5/20/20	-
		5/27/20	34,853			5/27/20	1			5/27/20	-

Commercial Paper Funding Facility

The [CPFF](#) provides a liquidity backstop to issuers of commercial paper and was also established under section 13(3). It is operated by the FRBNY through a special purpose vehicle, the Commercial Paper Funding Facility II LLC (CPFF LLC). The Treasury has made an equity investment of \$10 billion in CPFF LLC.

Primary and Secondary Market Corporate Credit Facilities

The [PMCCF](#) and [SMCCF](#) were set up under section 13(3) to support credit to employers through purchases of newly issued bonds and support market liquidity for outstanding corporate bonds. These facilities operate through a special purpose vehicle, the Corporate Credit Facilities LLC (CCF LLC). The Treasury has made an equity investment of \$37.5 billion in CCF LLC.

Municipal Liquidity Facility

The [MLF](#) provides liquidity to states, counties and cities. The facility was set up to purchase up to \$500 billion of short-term notes and was established under section 13(3). The Treasury has made an equity investment of \$17.5 billion in MLF LLC.

HEROES Act would provide \$3 trillion in additional benefits but unlikely to progress

By Priya Sankar

Original post [here](#).

The \$3 trillion Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, which the House of Representatives passed on [May 15](#), is the fourth and largest legislative rescue package proposed by the US Congress in response to the COVID-19 pandemic. It would help to mitigate the economic impact of continued shelter-in-place orders and soaring unemployment rates.

Some [key allocations](#) of the HEROES Act include:

- \$915 billion to state, local, tribal and territorial governments
- \$650 billion for additional Economic Impact Payments to individuals
- A \$200 billion fund for hazard pay to essential workers
- \$100 billion in grants to low-income renters
- \$100 billion in support to state education programs

The HEROES Act allocates \$500 billion in direct, flexible aid to state governments, \$375 billion to local governments, \$20 billion to tribal governments and \$20 billion to US territories.

The HEROES Act calls for a second round of Economic Impact Payments (EIP) to individuals, and would provide \$1,200 for each dependent without regard to age, up to three dependents per family. The bill retains the \$1,200 payment per individual for a potential maximum of \$6,000 per two-parent family. The CARES Act limited dependent benefits to \$500 per child under 18. Both the CARES Act and the HEROES Act reduce the amount of the payment above certain income thresholds. Because its benefits to those with dependents are greater, the HEROES Act would provide a reduced benefit to some persons who would not receive a payment under the CARES Act. The Act appropriates [\\$650 billion for EIP payments](#) as compared to the [\\$292 billion estimated cost](#) of similar payments under the CARES Act.

The HEROES Act also supports families with \$10.1 billion for child care and other services like support for utilities for low-income families. Emergency family medical leave would be extended from December 2020 to December 2021. This is a marked increase from the [CARES Act](#) allocation of \$3.5 billion for the child care development block grant to states.

The bill would establish a \$200 billion “Heroes’ Fund” to provide hazard pay to essential workers. Employers could apply for grants to provide their employees with a \$13 per hour premium in addition to their regular wages, up to a total of \$10,000 per employee, or \$5,000

for highly compensated essential workers. The bill also would appropriate \$850 million so states can provide child care for essential workers; other provisions would increase the production and availability of personal protective equipment.

Supplemental unemployment benefits of \$600 per week, which the CARES Act provided through [the end of July](#), would be extended until January 2021.

The HEROES Act would set aside over \$14 billion in food aid, including \$10 billion to support increased use of SNAP benefits, \$3 billion for child nutrition programs, and \$1.1 in food assistance for women, infants, and children.

The HEROES Act also would set aside funds for renters and homeowners. The CARES Act had provided that individuals could take advantage of forbearance for their rent and mortgage payments for up to one year for properties financed with federal government guarantees. Title II of the HEROES Act would allocate \$100 billion in grants for low-income renters at risk of eviction once that forbearance ends. It also would provide \$75 billion for states, territories, and tribes to distribute to homeowners for mortgage assistance and other housing costs.

The bill also would provide \$10 billion in grants to small businesses that have suffered losses due to the pandemic. It would ease many of the requirements for small business loans, providing flexibility in payment deferrals, waiving fees, and increasing the guarantee provision. It also would increase the employee retention tax credit from 50% to 80% of applicable wages.

The bill also calls for extending the CARES Act student loan payment plans to those who borrowed from private lenders, providing up to \$10,000 in relief to be applied to such loans, paid monthly until September 2021. In addition, \$100 billion would go to states to support education programs.

The HEROES Act would support the United States Postal Service with \$25 billion, as it would otherwise [run out of money](#) this autumn. This money is available until September 2022, and would also support providing personal protective equipment for postal workers.

The bill calls for over \$30 billion to support transportation, both for highways and for support to transit agencies to maintain basic services.

The bill sets aside \$75 billion for additional COVID-19 testing, contact tracing, and treatment efforts, aiming to ensure that all Americans could receive COVID-19 treatment for free. It also supports the National Institutes of Health with \$4.7 billion, the Center for Disease Control with \$2.1 billion, underserved populations with \$7.6 billion, and the Indian Health Service with \$2.1 billion.

The bill proposes \$16.5 billion be set aside for direct grants to agricultural producers.

The bill would allocate \$3.6 billion in grants to states to support election security efforts.

The bill is viewed as partisan, as it passed the House with mainly Democratic support. It is not expected to become law. "Instead of going big, it seems you went crazy. This is a political

messaging bill that has no chance of becoming law," House Minority Leader Kevin McCarthy, R-Calif. [said on the floor](#). The [Trump Administration](#) does not support the bill. The White House issued a statement saying: "This proposed legislation, however, is more concerned with delivering on longstanding partisan and ideological wishlists than with enhancing the ability of our Nation to deal with the public health and economic challenges we face." While [Senate Majority Leader Mitch McConnell](#) has refused to consider the bill, he stated on May 30 that the Senate would likely consider a "4th and final" stimulus bill "in about a month" and that the focus would be on jobs and schools and possibly additional assistance to small businesses.

Allocation	Purpose
\$915 billion	Aid to state, local, territorial, and tribal governments
\$650 billion	Direct payments to individuals and dependents
\$200 billion	Heroes' Fund - Hazard pay to essential workers
\$14 billion	Food aid - including SNAP benefits and child food aid
\$100 billion	Grants for low-income renters
\$10 billion	Grants to small businesses
\$100 billion	Support to state education programs
\$25 billion	Support to US Postal Service
\$30 billion	Support for transportation including highways and transit agencies
\$75 billion	COVID-19 testing, contact tracing, and treatment
\$4.7 billion	National Institutes of Health
\$2.1 billion	Center for Disease Control
\$2.1 billion	Indian Health Service
\$16.5 billion	Direct grants to agricultural producers
\$3.6 billion	Grants to states for election security efforts

Countries Propose Catastrophe Insurance Through Public-Private Partnerships

By Vaasavi Unnava

Original post [here](#).

On May 26, Congresswoman Caroyln Maloney [introduced](#) the Pandemic Risk Insurance Act of 2020 (PRIA). The PRIA would provide a framework for insurers to supply business interruption insurance to businesses affected by the COVID-19 pandemic. Insurance companies that choose to participate would offer pandemic coverage to businesses and, should aggregate insurance industry losses exceed \$250 million, the federal government would cover most of the losses.

Business interruption insurance provides insurance for losses caused by natural disasters or catastrophes. In the context of the PRIA, insurers would provide business interruption insurance for pandemic-related losses. In addition to pandemic-related losses, the bill would also cover event cancellations, including awards shows, film and TV productions, and sporting events.

The structure of the PRIA would closely follow the [Terrorism Risk Insurance Act of 2002 \(TRIA\)](#), which was passed to make terrorism insurance available to businesses in the U.S. economy while protecting insurers' solvency. Like the TRIA, the PRIA federal backstop has an annual cap, though the PRIA's \$750 billion cap far exceeds the TRIA's \$100 billion.

Under the PRIA, insurers would pay a 5% deductible (measured as 5% of direct earned premiums from the previous year) before the federal government provides any aid for losses incurred from business interruption insurance policies. The TRIA has a 20% deductible. After the deductible is reached, the government would pay 95% of additional costs and the insurer would be responsible for a 5% copay; under the TRIA, the copay increased stepwise from 10% in the first year to 15% until ultimately setting a copay of 20%.

Participation in the PRIA would be voluntary. The TRIA required insurance companies to include terrorism insurance in all commercial policies for two years after the legislation passed.

The PRIA complements other proposals in the United States. Congressman Mike Thompson proposed the [Business Interruption Insurance Coverage Act of 2020](#), which would require insurers to make business interruption insurance broadly available to businesses, though the bill has not progressed since its introduction in April. Industry groups have proposed the [Business Continuity Protection Program \(BCPP\)](#). The BCPP would allow businesses to purchase revenue replacement insurance from state-regulated insurance entities. The insurers would participate on a voluntary basis and funding would come from FEMA as a direct subsidy. Viral emergency declarations would automatically trigger payments. While some industry groups have put forth their own plan, [others](#) have endorsed the PRIA..

Similar to the PRIA, other legislative proposals around the world seek to revitalize or revamp frameworks used for catastrophe insurance funding. In the United Kingdom, the insurance industry is working with [Pool Re](#), an insurance pool established in 1993 to act as a terrorism reinsurance fund. The British government established Pool Re to provide policy-level reinsurance to terrorism insurance policies through a government guaranteed reinsurance pool. The program has faced [criticism](#) for its slow administration, its vulnerability to system-wide shocks, and tendency to crowd out private actors.

The Federation of European Risk Management [proposed](#) a similar public-private partnership for insurance companies in the European Union, which would specifically tailor contracts to cover events categorized as “non damage denial of access” events--where businesses have lost revenues due to denial of access to services rather than physical damage--similar to events covered under business interruption insurance in the United States. France is currently developing a [series of proposals](#) for a federal insurance backstop, which includes repurposing the structure of its existing public-private partnership for natural disasters called the [Caisse Centrale de Reassurance \(CCR\)](#). It has provided terrorism insurance since the terrorist attacks of 2001.

In April, economists Samuel Hanson, Jeremy Stein, Adi Sunderam, and Eric Zwick published a [proposal](#) suggesting the provision of “business continuity insurance” targeted to companies in the greatest need. The authors propose to evaluate need by utilizing income reporting from the previous year’s tax documents to examine firm capital stock as well as industry-level shortfalls. Another [proposal](#) of theirs suggests providing low-cost junior subordinated loans to firms based on the same targeting metrics.

These proposals contrast with the [World Bank Pandemic Emergency Financing Facility’s](#) catastrophe bonds, issued in July 2017. Catastrophe bonds are high-interest financial instruments that stop making payments to investors the moment a catastrophe happens. The World Bank’s catastrophe bonds have [faced criticism](#) for their relatively low payout and high financing costs. In addition to other criteria like rolling case totals (rolling daily averages) and number of deaths, only an exponential growth rate of a coronavirus would trigger the bonds’ payout; this year, global statistics met conditions to trigger halting interest payments for the bonds only on April 19, nearly 40 days after the WHO [officially characterized](#) COVID-19 as a pandemic.

Other attempts to hedge the systemic risk of a system-wide catastrophe include the creation of [insurance-linked securities](#), such as sidecars. Sidecars cede premiums to investors with enough capital to ensure that claims are paid should they arise.

Understanding Parametric Triggers in Catastrophe Insurance

By Vaasavi Unnava

Original post [here](#).

In the midst of a global pandemic, many businesses are finding that their [property and casualty insurance policies do not provide protection against business losses resulting from the pandemic](#).

Some property and casualty policies do include business interruption insurance, which provides supplementary coverage against interruptions to revenue flows due to external disruptions. However, business interruption insurance typically excludes coverage for viral perils--that is, threats to revenues due to viral outbreaks that force businesses to close in the interest of public safety.

A small niche has emerged for epidemic insurance in recent years, in the wake of the SARS, MERS and Ebola outbreaks. However, [few businesses purchased it](#). Moreover, even under such policies, businesses may face lengthy litigation attempting to prove coverage or the amount of benefits owed from insurance companies.

Not every catastrophe results in the delays and challenges that characterize a claim under business insurance policies due to COVID-19. For years, insurers have utilized parametric triggers--explicit conditions that, once met, automatically trigger coverage--to provide catastrophe insurance in the event of flooding, hurricanes, or earthquakes. Insurance companies have also used parametric triggers for pandemic and epidemic policies written during the Ebola and zika outbreaks.

Such triggers are especially useful for [quick deployment of payments](#); traditional indemnification claims can take several weeks to process compared to the near immediate payments issued through parametric policies. Additionally, as a bulk of parametric insurance policies payout an already agreed-upon sum, policyholders spend less time attempting to determine the extent to which their policies cover their losses. In the context of pandemics, the quick payments to businesses may provide the necessary capital for businesses to install safety equipment or purchase necessary safety supplies. Quick payments may also keep businesses with high fixed cost commitments afloat during quarantine or social distancing measures.

This blog discusses two types of parametric triggers utilized in business interruption insurance: statistical parameters and civil authority orders. [Many proposals](#) for business interruption insurance in a pandemic landscape rely on parametric triggers that begin payouts by the status of civil authority orders. Other proposals rely on externally generated statistics through statistical parameters to determine when payouts should begin. Both of these triggers may provide a useful framework for building business insurance policies for pandemics.

Statistical Parameters

Statistical parameters require measures to [meet or exceed a specific statistical threshold](#) before coverage payouts begin. These triggers often rely on third-party consultants to determine whether the trigger has been satisfied.

These triggers are typically utilized in catastrophe bonds and insurance-linked securities, instruments connected to insurance-related risks that provide issuers funding for specific events, such as tornadoes or hurricanes, as a type of reinsurance. There are several metrics which insurance companies may use.

Catastrophe bonds, bonds issued with the stipulation that the issuer no longer pays principle or interest to investors if certain conditions are met, may halt payouts based on the strength of the covered catastrophe, such as an earthquake's magnitude or a hurricane's wind speed and barometric pressure.

Insurance-linked securities include mortality swaps, investment products where cash flows depend on a mortality index. Other insurers use parametric triggers for business interruption insurance, such as the rate of hotel bookings in comparison to year-on-year averages or the measures of footfall in pedestrian areas.

For pandemic and epidemic insurance, the epidemic data analytics firm Metabiota developed a pathogen sentiment index to measure the effects of fear on drops in consumption. While some parametric triggers rely on one datapoint, others are based on an index of available data to determine when the policy payouts can begin.

Parametric triggers often utilize externally determined statistics for triggers. For example, the [World Bank Pandemic Emergency Financing Facility's](#) (PEFF's) catastrophe bonds relied on publicly available data to determine how much money the facility would release. According to the World Bank, "[the] [triggers](#) are based on outbreak size (the number of cases of infections and fatalities), outbreak growth (over a defined time period), and outbreak spread (with two or more IBRD/IDA countries affected by the outbreak." Payout occurred after all three conditions were met.

Similarly, Springboard, an independent firm, generates the [footfall metric](#) utilized by Aon, which measures changes in pedestrian traffic. The footfall metric could be particularly helpful in determining unexpected business losses due to drops in consumer sentiment; for example, it could have been used in 2018, when a fake terrorist report caused [£3 million](#) in losses to London retailers.

However, though parametric triggers are unambiguous, they may not necessarily result in timely payouts. The World Bank's pandemic catastrophe bonds, issued in July 2017, utilized a series of parametric triggers to determine when payments would begin. Once trigger conditions were met, funding from the bond issuance was made available to 77 countries through the PEFF's insurance window. Payouts required a slew of conditions: 1) a rolling daily average of at least 250 cases; 2) the virus to exist for at least 84 days; 3) total confirmed deaths to be greater than

250 cases (for class B issuances) or 2,500 cases (for class A issuances); 4) an exponential growth rate; and 5) geographic spread of the virus.

The World Bank's pandemic bonds have [faced criticism](#) for their relatively late payout. With the number of elements making up the parametric triggers, global statistics met conditions to trigger halting interest payments for the bonds only on April 17, nearly 40 days after the WHO [officially characterized](#) COVID-19 as a pandemic.

Used thoughtfully, these triggers hold promise as a means of efficiently triggering payouts to business interruption insurance policyholders in the case of a global pandemic by providing a means of speedy coverage determination.

Civil Authority Parameters

Within pandemic and epidemic insurance, insurers may rely on local decrees to determine payouts. During viral breakouts, cities and municipalities may institute lockdown or social distancing orders. In 2014, during the Ebola outbreak, NAS Insurance, an American insurer, [provided](#) business interruption insurance that would automatically pay out if there was a mandatory shutdown ordered for the area specified in the policy. To account for mobility, the Insurance Services Office (ISO), an insurance advisory organization, proposed a [new policy endorsement](#) in response to COVID-19 that also triggers coverage if civil authorities suspend travel services in the area where the business is located.

The Caisse Centrale de Réassurance (CCR), a French publicly administered reinsurance company, demonstrates an interesting implementation of local decree triggers through a public-private reinsurance program. Like the insurance policies outlined above, insurers (reinsured by CCR) [automatically begin payouts](#) to policyholders once a local government declares an emergency and the policyholder meets a deductible. However, the size of the deductible changes based on the number of times the local government has declared an emergency for the same catastrophe event in the previous five years. The standard deductible will apply for the first two incidents and will rise with each succeeding incident to four times the standard deductible for the fifth incident in a five year period.

Many proposals aimed to protect businesses from losses resulting from a possible second wave of the virus incorporate civil authority response triggers to determine when funding should be provided to businesses. An insurance industry proposal, entitled the [Business Continuity Protection Program](#), only pays out once a state or local government orders a shutdown. As mentioned above, the ISO [COVID policy endorsements](#) trigger payment exclusively based on civil authority decrees. Munich Re's product, Pathogen RX, [triggers](#) if a government orders a shutdown or travel ban.

Civil authority triggers provide a strategy to account for non-physical damages, which most business insurance policies do not currently include in their coverage. [Courts have repeatedly held](#) under common policy wording that the following types of incidents were not covered: government action that negatively impacted the insured without physical damage to the insured

property or an adjacent property, government action predating any physical damage, physical damage not resulting from a covered event, and when government orders did not actually prohibit customers from entering the property. By instituting civil authority triggers, physical damages would no longer be a necessity when responding to the economic consequences of a pandemic.

While civil authority triggers can be indicative of the extent to which pandemics have affected the local economy, some cities may lift quarantines and social distancing guidelines before individuals feel safe enough to participate in the economy again. Cities in a rush to reopen may still experience [depressed sales](#) and slow economic growth as consumers and employees are cautious about returning to normal activities. Fear of the spread of COVID [reduced consumption](#) even before government shutdown orders came into effect, indicating that government shutdown triggers alone may not be enough to define periods of lost revenue due to pandemic fears. Under traditional indemnification, losses due to lack of consumption may not be completely captured if relying exclusively on civil authority triggers. However, automatic payments of predetermined sums common to parametric insurance addresses some of the difficulties in determining the scale of losses.

Debt Mounts for US Retail and Lodging Mortgagors

By [Corey Runkel](#)

Original post [here](#).

Government-mandated shutdowns in response to the novel coronavirus have triggered delinquencies among commercial mortgages as businesses struggle with revenue. The purpose of this article is to characterize the risks to US commercial real estate posed by COVID-19 responses. Due to reporting incentives, data on mortgages packaged into commercial mortgage-backed securities (CMBS) is more accessible and granular than data on the whole commercial mortgage market. Even though CMBS-associated properties constitute just [20% of outstanding multifamily and commercial debt](#), the data generated by such properties can indicate how the whole commercial real estate sector may be affected. On June 4, commercial real estate research firm Trepp [reported](#) its largest jump in delinquencies among mortgages involved in the \$1.4 trillion CMBS market, with the rate spiking from 2.29% to 7.15%.

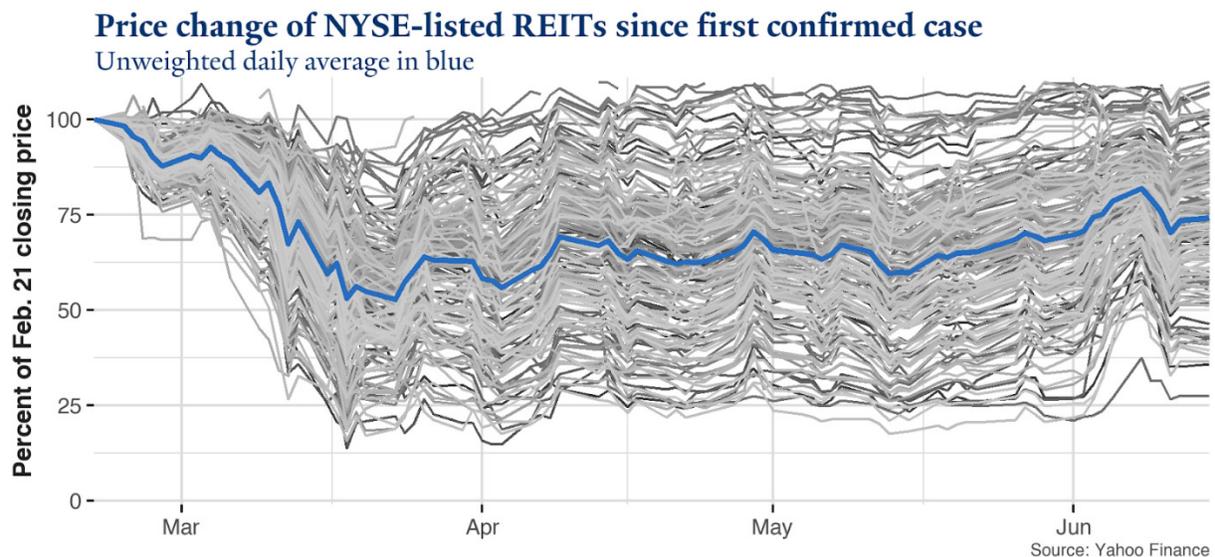
There is real stress on commercial landlords. But that stress sits narrowly within the commercial market. The same Trepp report disaggregated delinquencies, noting nearly 20% of lodging, and more than 10% of retail mortgages were delinquent in May. Less than 4% of multifamily, office, and industrial mortgages were delinquent over the same period. Despite historically high unemployment, government stimulus supports have perhaps helped sustain rental payments. Publicly traded equity real estate investment trusts (REITs) invested in apartments [collected](#) at least 93% of rents in April, with most trusts collecting 95% or more. Meanwhile, offices

continue to operate remotely, and warehousing has become more valuable as delivery services take on new importance.

Retail shows signs of life

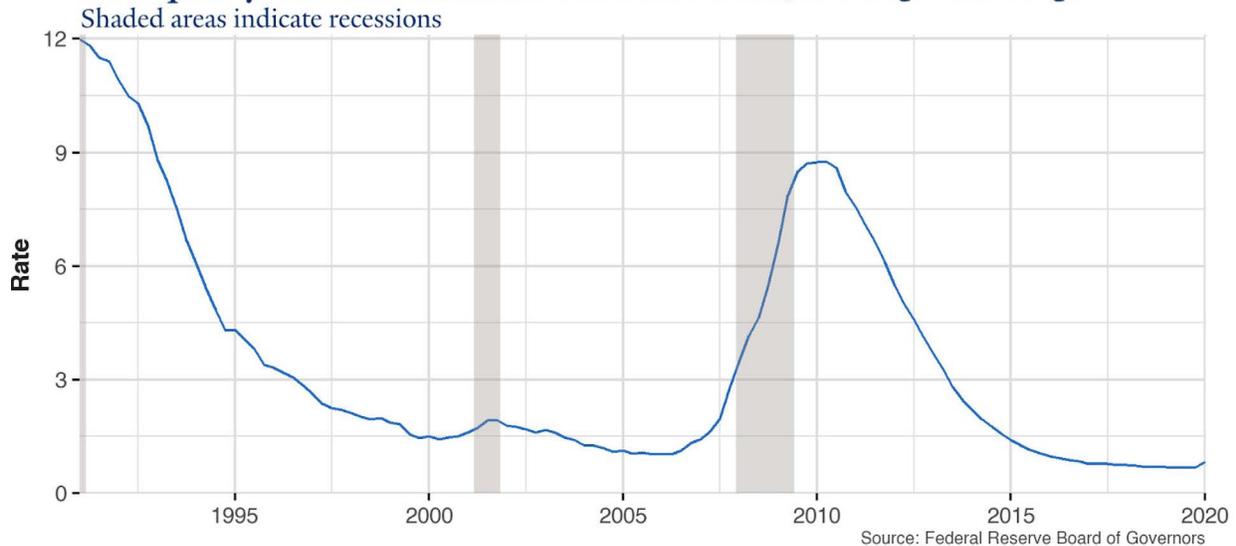
The speed at which consumers return to retail and lodging will factor importantly into the viability of mortgages in those sectors. The same data on publicly traded equity REITs reports rent collection figures for several owners of regional malls and shopping centers. Overall, between 50% and 65% of April rents were collected in shopping centers, while regional malls collected just 26% to 30% of rental payments.

As states re-open, rent payments may increase quite quickly. In Arizona, Florida, Georgia, and Texas, as of June 2, retail foot traffic [had already surged](#) from its April nadir, but only to 38-52% of 2019 levels. Retail nationwide [grew](#) 17.7% in May, beginning to make up for sales contractions in March and April of 8.3% and 14.7% respectively. Further, the distribution of volume among types of businesses is unknown. The lockdowns have already caused the bankruptcy of JC Penney and Hertz, with AMC movie theaters currently being [threatened](#). But stock data indicates that investors believe retail real estate has already bottomed out. After crashing in late February, prices of several large [mall operators](#) and [REITs](#) have stabilized and trended up.



The market's gradual recovery may have been informed by other indicators than the overall delinquency rate. Though 7.15% of securitized commercial mortgages were delinquent in May, 70% of those were only one month late. Trepp noted that a large number of mortgages remained in their 30-day grace period or actually reverted to current on their payments, though historically high delinquencies should still be expected.

Delinquency rate on commercial real estate loans, 1991Q1 - 2019Q4



Despite these expectations of recovery, the woes for commercial real estate may have just begun. Financial Times [pointed](#) to June as a crucial test for businesses, since debt two months late often triggers serious penalties. Moreover, data collected by the Federal Reserve Bank of St. Louis since 1991 [show](#) commercial delinquencies spiking as recessions end (Fig 2). Moreover, bond prices for CMBS exposed to lodging have tumbled. The same Financial Times article noted that BBB-rated tranches exposed to lodging shed approximately 40% of their value since early March. The asset specificity of hotels only lowers the value of real estate already faced with structural devaluation by services such as Airbnb.

Support for commercial real estate must proceed carefully

Landlords and owners are navigating treacherous waters should commercial tenants require serious rent assistance. While CMBS loans tend to be non-recourse, it is [standard practice](#) for loans to feature “bad boy” covenants designed to guard against principal-agent risk. Such covenants provide recourse in the event that borrowers commit actions that (in normal times) are irresponsible. [Real estate attorneys](#) point to two such actions in particular: significant rent renegotiation, and taking on senior indebtedness without investor consent.

US programs have thus far steered clear of these debt covenants, and offer viable channels should further support be authorized. The Payroll Protection Program ([PPP](#)), offering forgivable and unsecured loans to businesses, recently expanded the amount that could be used for non-payroll expenses to 40%, opening the door to support. Borrowing terms for the three programs under the [Main Street Lending Program](#) have also [eased](#). The Priority and Extended lending

facilities ([MSPLF](#) and [MSELF](#), respectively) require loans to be secured, and prohibit subordination, but carve out exceptions for outstanding mortgage debts.

Given that these programs appear to avoid the dangers posed by “bad boy” covenants, it seems likely that strained borrowers are equipped with the resources to secure credit lifelines to at least prolong defaults for several more months. On the other hand, it seems unlikely that the Federal Reserve (Fed) would engage private CMBS markets in a more direct fashion. Thus far only two Fed actions support private CMBS. In March it [included agency CMBS in its plan to make Open Market Desk purchases](#) of \$200 billion of MBS, and in April it expanded the eligible collateral for the [Term-Asset Securities Lending Facility](#) to include AAA tranches of CMBS. A previous YPFS article [found](#) that the Fed’s purchasing announcement had a positive effect on agency mortgage REITs (mREITs) while having only minimal effects on non-agency residential mortgage REITs.

Equity REITs face different issues, principally those of eligibility and restrictions on usage. While property management companies are eligible for both PPP and MSLF loans, it is [unclear](#) as to whether equity REITs are eligible. They may violate the Small Business Administration’s rules making ineligible for loans [“developers and landlords that” generally “do not actively use or occupy the assets acquired or improved with the loan proceeds.”](#) However, equity REITs have applied for, and [received](#) PPP loans, potentially pushing this issue to the oversight bodies [authorized](#) by the CARES Act.

Additionally, the CARES Act prohibits the payment of dividends by corporations receiving support. While several programs have received blanket waivers from the Treasury Department, the Main Street Lending Facility [has not](#). The legal structure of REITs requires the payment of dividends, and many REITs have [opted](#) to pay mostly in stock. REIT trade associations have [already written](#) to the Treasury Department requesting a waiver for this particular case, while the Internal Revenue Service has [revisited](#) rules adopted during the Global Financial Crisis, allowing REITs to hold (and therefore distribute) less cash.

The New York Times [highlighted](#) name-brand tenants--Gap, LVMH, Starbucks--that had stopped paying rent and started renegotiating leases. The article noted that “the strongest tenants – those most able to pay – are driving the hardest for a discount.” When renters know that the options for landlords are either lease renegotiation or a total loss of income, those with the ability to pay may augment the demands of those that cannot pay, further pressuring landlords.

A Deloitte [report](#) noted that real estate development had flagged, with more than half of US construction firms surveyed halting projects. Social distancing rules precipitated decreased demand and [disrupted](#) construction sites. Commercial real estate’s [sensitivity](#) to economic downturns compounded the effects of decreased demand. The Deloitte report suggested that developers adapt rental properties to meet the needs of a changed society and strengthen resilience to future pandemics. The shock to brick-and-mortar businesses is likely to accelerate permanent transitions to online retail, work, and customer service across sectors. While several

large [companies](#) have started these transitions, they will [likely](#) take several years to complete. Such a timeframe would flatten and spread the risks to commercial real estate finance.

In contrast, the greatest short-term risks posed by US commercial mortgages sit narrowly in lodging and retail, though high-turnover coworking spaces have already seen slashed revenues. CMBS-associated mortgages account for one fifth of outstanding commercial debt. While data are more widely and finely available for properties underlying CMBS loans, concerns similar to those discussed above exist with respect to non-securitized commercial mortgages. Where investors are exposed to lodging, prices have slumped, and questions abound regarding the sector's long-term viability as nearly 20% of the CMBS-associated mortgages were reported delinquent in May. Retail activity is growing, but there is concern as to whether the recovery will be fast enough to stave off default in a sector with more than 10% of securitized mortgages in delinquency, which could hamper the real economy's general pace of recovery.

U.S. Banks to Maintain Dividends for Now, Following Pre-COVID Stress Test

By Devyn Jeffereis and Greg Feldberg

Original post [here](#).

Most of the largest U.S. banks announced Monday that they will continue to pay dividends in the third quarter at the same level as the second quarter. This news comes just two business days after the Federal Reserve announced the results of its annual stress test and an unprecedented “sensitivity analysis” estimating the potential impact of different economic recoveries from the COVID recession on bank performance. Based on these scenarios, the Fed announced a number of temporary restrictions on dividends and other corporate actions.

The Fed’s [stress test](#) forecasted \$433 billion in loan losses for the 33 largest banks under a severely adverse scenario that it announced in February, prior to the COVID crisis (see [page 19](#)). The test extends nine quarters, through March 2022.

Losses are much worse under all of the Fed’s scenarios in the [sensitivity analysis](#), which takes COVID into account. The analysis forecasts \$560 billion in loan losses under the most optimistic post-COVID scenario, which assumes a rapid “V-shaped” recovery. Projected loan losses are just over \$700 billion in a “U-shaped” recovery and \$680 billion in a “W-shaped” recovery. For comparison, the 33 banks had \$10.4 trillion in risk-weighted assets and \$1.2 trillion in capital at the end of 2019 (see [page 23](#)).

The Fed uses the results of its stress test to determine large banks’ capital requirements every year. However, it plans to “assess banks’ capital plans more frequently during this time of uncertainty” (see [page 1](#)). It will require banks to re-submit their capital plans later this year based on revised scenarios that the Fed will provide. The results could reveal larger capital deficits and lead to more aggressive restrictions on corporate actions.

Maintaining dividends

On Thursday, the Fed said it would allow banks to pay common stock dividends in the third quarter, but no more than their average income over the prior four quarters and no more than they paid in the second quarter, whichever is less. It won’t allow share repurchases in the third quarter; the eight U.S. global systemically important banks (G-SIBs) voluntarily suspended share repurchases in the second quarter.

All but one of the eight G-SIBs said Monday that they plan to maintain their dividends in the third quarter at prior levels. Wells Fargo, which [appears to be](#) the only G-SIB whose recent dividends have exceeded its average net income, said in a [statement](#) that it expects second-quarter losses will exceed first-quarter losses, and that it plans to reduce its dividend.

Goldman Sachs [hinted](#) that it may have to rebuild capital to maintain its dividends. The company is the only G-SIB whose capital is below the Fed's required buffer based on the stress test results – its common equity tier 1 capital (CET1) ratio was 12.5% at the end of March, compared to the 13.7% the Fed will require it to reach by October 1. However, Goldman said it has recently brought the ratio back over 13%.

“We have a track record of rebuilding capital when necessary,” its chairman and CEO, David Solomon, said in the press release. “We fully intend to continue this dynamic capital management while helping our clients continue to navigate challenging markets.”

As shown in the below table, there have been significant changes in net income over the past four quarters. However, those declines have not translated into changes in the dividends expected to be paid in the third quarter. Analysts forecast that 27 of the 33 banks will report second-quarter net income below the average of the four prior quarters. Twenty-five of the 33 banks have announced, or are forecasted, to pay dividends in the third quarter equal to those they paid in the second quarter.

The Fed's bank dividend policy has been controversial within the central bank. Fed Governor Lael Brainard released a [statement](#) critiquing the policy. “[Dividend] payouts will amount to a depletion of loss absorbing capital,” she wrote. “This is inconsistent with the purpose of the stress tests, which is to be forward looking by preserving resilience, not backward looking by authorizing payouts based on net income from past quarters that had already been paid out.”

Fed Governor Randal Quarles, who is also the Fed's vice chairman for supervision, [explained](#) his support for the measures. “[The] approach builds on our existing standards on capital distributions, which restrict distributions based on recent income,” he wrote. “If the circumstances warrant, we will not hesitate to take additional policy actions to support the U.S. economy and banking system. I support today's actions to ensure banks remain an ongoing source of strength to the U.S. economy.”

Stress test revisions: Setting the new Stress Capital Buffer

The Fed introduced a new method for setting capital requirements for the largest banks in this year's stress test (see the [staff memo](#), page 7). Previously, the Fed required these banks to meet two sets of standards: the Basel III standards (agreed to by international regulators), and the results of its annual stress test. The new method essentially merges the two.

The Fed continues to require the largest banks to hold CET1 equal to 4.5% of their risk-weighted assets, at minimum. G-SIBs are also required to hold an additional buffer based on their systemic importance, currently ranging from 1.0% to 3.5% for the eight U.S. G-SIBs.

The new part is the “stress capital buffer.” It is based on each bank's net loss in the stress test--the difference between the bank's starting and minimum projected capital ratios--plus four quarters of planned dividends as a percentage of risk-weighted assets. The stress capital buffer can't be less than 2.5%, the level of the capital conservation buffer under Basel III.

Any bank whose capital ratio falls below the sum of the 4.5% minimum, the individual G-SIB surcharge, and the individual stress capital buffer will be subject to automatic restrictions on capital distributions.

In its stress test report, the Fed reported each bank's net loss. The Fed confidentially told each bank its individualized stress capital buffer, including projected dividends.

Most of the largest banks publicly disclosed their stress capital buffer on Monday. For five of the G-SIBs, their net losses in the stress test were low and the Fed set their stress capital buffer at 2.5%. The Fed set [JP Morgan Chase's](#) stress capital buffer at 3.3%, [Morgan Stanley's](#) at 5.9%, and [Goldman Sachs's](#) at 6.7%.

Dividend History and Net Income Analysis (Source: Bloomberg)

Firms (USD except as noted)	Q3 2020 Dividend (consensus estimate or announced) (based on paydate)	Q2 2020 Dividend (based on paydate)	Q1 2020 Dividend (based on paydate)	Q2 2020 Net Income (consensus estimate) in millions	Q1 2020 Net Income in millions	Q4 2019 Net Income in millions	Q3 2019 Net Income in millions	Four Quarter Net Income Average in millions
Ally Financial Inc.	0.190	0.190	0.190	37.23	-319.00	378.00	381.00	119.31
American Express Company	0.430 (Announced 5/07)	0.430	0.430	134.67	367.00	1,693.00	1,755.00	987.42
Bank of America Corporation	0.180	0.180	0.180	2,866.38	4,010.00	6,994.00	5,777.00	4,911.84
The Bank of New York Mellon Corporation	0.310	0.310	0.310	814.57	980.00	1,440.00	1,038.00	1,068.14
Barclays US LLC (GBP)	-	-	-	270.38	826.00	866.00	-27.00	483.85
BMO Financial Corp. (CAD)*	1.080 (Announced 5/27)	1.080	1.080	689.00	1,592.00	1,194.00	1,557.00	1,258.00
BNP Paribas USA, Inc. (EUR)	-	-	-	1,549.71	1,282.00	1,849.00	1,938.00	1,654.88
Capital One Financial Corporation	0.400	0.400	0.400	-547.46	-1,340.00	1,176.00	1,333.00	155.39
Citigroup Inc.	0.510	0.510	0.510	898.50	2,522.00	4,979.00	4,913.00	3,328.13
Citizens Financial Group, Inc.	0.390	0.390	0.390	-47.29	34.00	450.00	449.00	221.43
Credit Suisse Holdings (USA), Inc. (CHF)**	-	0.089	-	702.78	1,314.00	852.00	881.00	937.44
DB USA Corporation (EUR)	-	-	-	-400.40	43.00	-1,518.00	-859.00	-683.80
Discover Financial Services	0.440	0.440	0.440	44.86	-61.00	708.00	770.00	365.46
Fifth Third Bancorp	0.270 (Announced 6/18)	0.270	0.240	216.80	46.00	734.00	549.00	386.45
The Goldman Sachs Group, Inc.	1.250	1.250	1.250	1,318.44	1,213.00	1,917.00	1,877.00	1,581.36
HSBC North America Holdings Inc.	-	-	-	304.38	2,248.00	-5,310.00	3,477.00	179.85
Huntington Bancshares Incorporated	0.150 (Announced 4/23)	0.150	0.150	124.49	48.00	317.00	372.00	215.37
JPMorgan Chase & Co.	0.900 (Announced 5/18)	0.900	0.900	3,049.00	2,865.00	8,520.00	9,080.00	5,878.50
KeyCorp	0.185	0.185	0.185	141.50	146.00	469.00	416.00	293.13
M&T Bank Corporation	1.100	1.100	1.100	306.40	268.82	493.07	480.08	387.09
Morgan Stanley	0.350	0.350	0.350	1,597.67	1,698.00	2,239.00	2,173.00	1,926.92
MUFG Americas Holdings Corporation (JPY)***	-	12.500	-	118,600.00	-56,127.00	-25,680.00	218,891.00	63,921.00
Northern Trust Corporation	0.700 (Announced 4/21)	0.700	0.700	297.80	360.60	371.10	384.60	353.53
The PNC Financial Services Group, Inc.	1.150	1.150	1.150	1,310.25	908.00	1,367.00	1,379.00	1,241.06
RBC US Group Holdings LLC (CAD)*	1.080 (Announced 5/27)	1.080	1.050	1,484.00	3,504.00	3,201.00	3,263.00	2,863.00
Regions Financial Corporation	0.155 (Announced 4/22)	0.155	0.155	83.07	162.00	389.00	409.00	260.77
Santander Holdings USA, Inc. (EUR)	-	-	-	1,365.20	331.00	2,783.00	501.00	1,245.05
State Street Corporation	0.520 (Announced 5/20)	0.520	0.520	467.80	634.00	564.00	583.00	562.20
TD Group US Holdings LLC (CAD)*	0.790 (Announced 5/28)	0.790	0.740	1,515.00	2,989.00	2,856.00	3,248.00	2,652.00
Truist Financial Corporation	0.450	0.450	0.450	1,029.80	1,060.00	721.00	825.00	908.95
UBS Americas Holding LLC****	-	0.183	-	983.33	1,595.00	722.00	1,049.00	1,087.33
U.S. Bancorp	0.420 (Announced 6/18)	0.420	0.420	430.78	1,171.00	1,486.00	1,908.00	1,248.94
Wells Fargo & Company	0.200	0.510	0.510	672.20	653.00	2,873.00	4,610.00	2,202.05

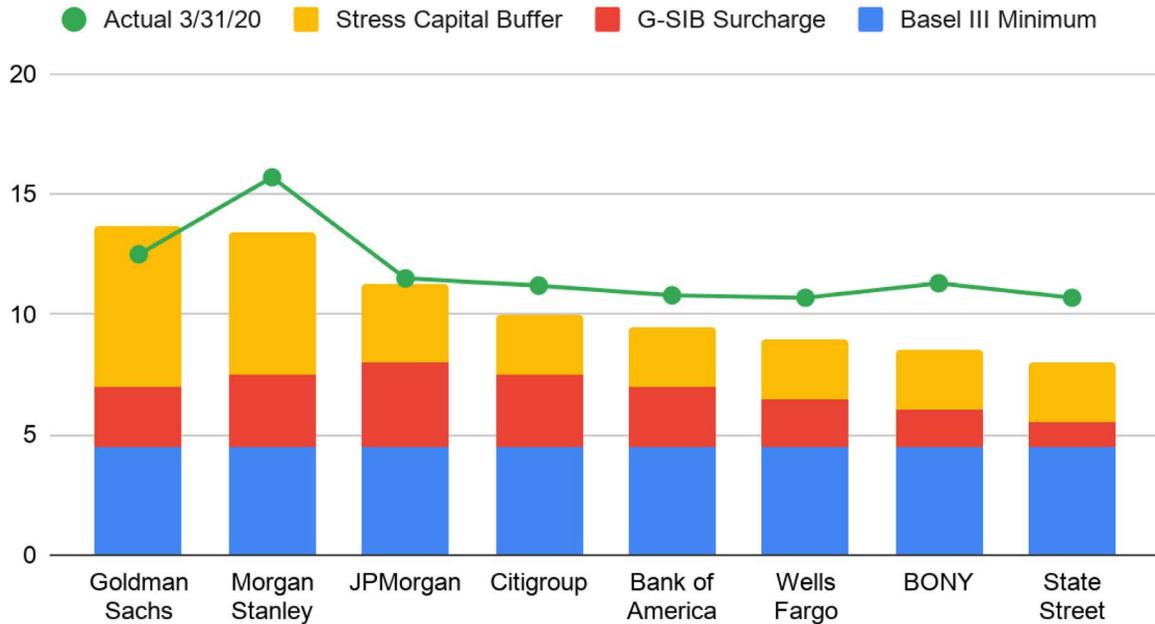
*Due to differences in the Canadian Fiscal Calendar the quarters for these companies end dates are as follows: Q2 2020 (4/30/2020), Q1 2020 (1/31/2020), Q4 2019 (10/31/2019), Q3 2019 (7/31/2019)

**Credit Suisse Holdings (USA), Inc. announced two dividends on 4/09, .0694 CHF payable 5/11 and .1388 CHF that has no paydate

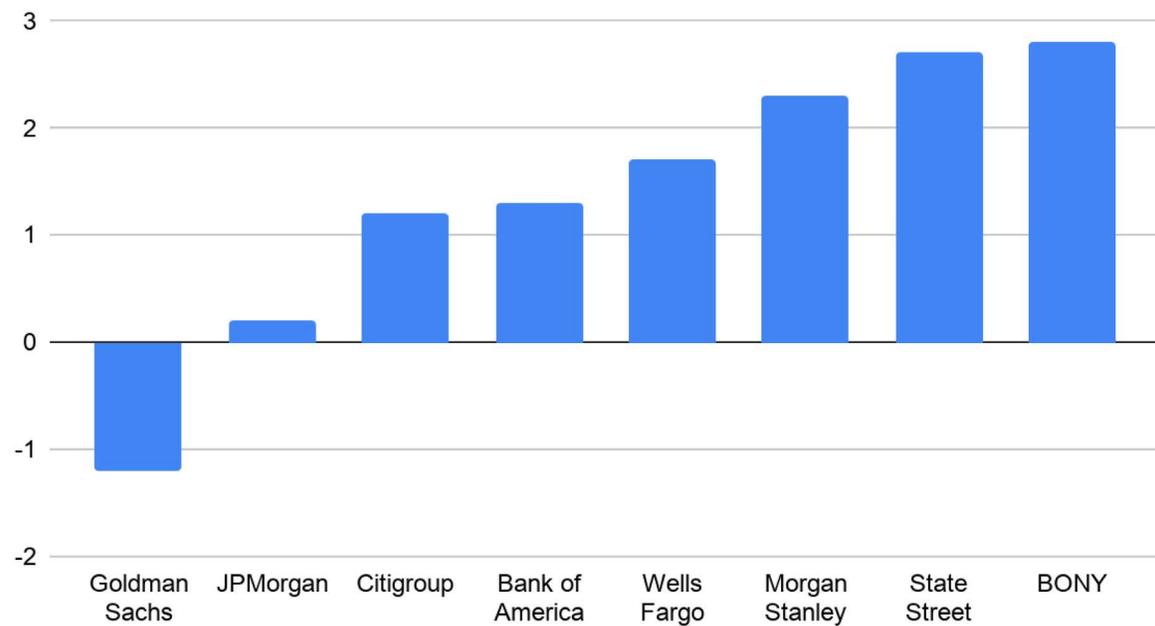
***MUFG Americas Holdings Corporation announced a dividend of 12.50 JPY on 5/15 that has no paydate / Japanese Fiscal Calendar differs such that Q2 2020 is Q1

2021 (6/30/2020), Q1 2020 is Q4 2020 (3/31/2020), Q4 2019 is Q3 2020 (12/31/2019), Q3 2019 is Q2 2020 (9/30/2019)
 ****UBS Americas Holding LLC announced two dividends on 4/09, .1825 USD payable 5/07 and .365 USD that has no paydate

Actual vs Required Common Equity Tier 1 (% risk-weighted assets)



Capital Cushion as of March 31, 2020 (% risk-weighted assets)



The first figure below shows each G-SIB's total capital requirement, based on Monday's announcements, compared to their actual CET1 ratios reported for the end of the first quarter. The second figure shows the cushion or deficit based on those figures. Banks have until October 1 to resolve any deficits.

2020 stress test: Aggregate results

This year, the Fed analyzed 33 firms in its stress test. The severely adverse scenario consisted of 28 variables, including a maximum drop in gross domestic product (GDP) of about 8.5% from the pre-recession peak and a jump in unemployment to a high of 10%.

The results projected aggregate losses of \$552 billion for the 33 firms, including \$433 billion in loan losses, \$6 billion in securities losses, \$85 billion in trading and counterparty losses, and \$29 billion in other losses. Nine-quarter loan loss rates were 6.3% in aggregate. The Fed projected the aggregate CET1 ratio for the 33 companies to fall from 12.0% at the end of 2019 to 10.3% in March 2022, hitting a minimum of 9.9% during the period (see [page 23](#)).

The results aren't directly comparable to the Fed's 2019 stress test, because it now requires smaller banks to conduct the test every two years. But the Fed reported that losses were roughly comparable for the 18 largest banks that participated in both tests. These banks had projected losses of \$410 billion in the 2019 test and \$433 billion in the 2020 test (see [page 1](#)).

The Fed made other important changes in its methodology. It now assumes that a bank's assets won't grow over the projection horizon and that a bank won't pay dividends on common stock, or issue new stock. These changes significantly improve banks' projected capital ratios (see [page 22](#)). Dividends in recent stress tests prior to the change in methodology amounted to about 70 basis points for GSIBs and 100 basis points for other banks, according to a paper last year (see [page 10](#)). To be sure, the new methodology takes back much of that benefit by adding four quarters of dividends in computing the stress capital buffer.

2020 sensitivity analysis: Aggregate results

In addition to the stress test, which uses scenarios that the Fed began constructing in late 2019, the Fed released a supplemental sensitivity analysis to account for the emerging economic impacts of the COVID pandemic.

Due to the uncertain economic implications of the COVID pandemic, the sensitivity analysis includes three hypothetical scenarios based on potential recovery paths. In comparison to the severely adverse scenario outlined in the stress test, each of the pandemic scenarios uses similar methods and analyzes the same 33 firms. Unlike the stress test, the Fed did not disclose firm-specific data about the sensitivity analysis.

The sensitivity analysis also incorporates higher peak unemployment and larger decreases in GDP, along with targeted adjustments. Unlike the stress test, it assumes bank balance sheets will grow: It assumes a 12% increase in outstanding corporate loans and a 30% increase in risk-weighted assets for the first quarter of 2020.

To adjust for industry-specific stress, the Fed incorporated a one-letter-grade credit downgrade for loans in impacted sectors.

The Fed also included temporary amendments regarding tax loss carrybacks and carryforwards in the tax code from the CARES Act into its calculation of post-stress capital.

The three scenarios are “V-shaped,” “U-shaped,” and “W-shaped”:

- The V-shaped scenario begins with a deep recession in the immediate first two quarters, with real GDP contracting by 31.5% (annualized) and unemployment jumping to 19.5%. This is followed by a rapid recovery in the third and fourth quarter of 2020, resulting in above-trend GDP growth in 2021 and 2022 and a decline in unemployment that remains above the low rate achieved before the pandemic. In this scenario, the Fed projects the aggregate CET1 ratio will fall from 12% at the end of 2019 to as low as 9.5% during the nine-quarter period (see [page 2](#)). The Fed projects the aggregate nine-quarter loan loss rate at 8.2%.
- The U-shaped scenario has a prolonged recession in which the unemployment rate peaks at 15.5% and maintains that level for a number of quarters before levelling off above the actual March 2020 rate. In addition, GDP fails to rebound meaningfully and does not reach its previous trend. As a result, the projected CET1 ratio falls as low as 8.1%. The projected nine-quarter loan loss rate is 10.3%.
- The W-shaped scenario has an initial recovery that is stymied by a second outbreak and resulting downturn. In the first phase, real GDP contracts by 37.5% (annualized) and unemployment increases to 16% in June 2020. However, GDP growth rebounds strongly in the second half of 2020, returning nearly to pre-crisis levels. This recovery is halted by a second outbreak and lockdown. In response, GDP falls 12% in the first quarter of 2021 and unemployment rises again as high as 14%. The second recession is more shallow but longer. The projected CET1 ratio falls as low as 7.7% and the projected nine-quarter loan loss rate is 9.9%. Beyond the projection horizon, the loan loss rates are persistently higher and CET1 ratios are lower than in the other scenarios.

Scenario Variables and Aggregate Results

Scenario	Peak Unemployment	Peak-to-trough GDP Change	Lowest 10-Year TSY Rate	Minimum CET1 Ratio**	Loan Loss Rates* (est. Q1 2020-Q1 2022)
Severely Adverse	10.0	-8.5	0.7	9.9	6.3
V-Shaped	19.5	-10.0	0.8	9.5	8.2
U-Shaped	15.6	-13.8	0.6	8.1	10.3
W-Shaped	16.0	-12.4	0.5	7.7	9.9

*Note that projected loan losses across scenarios are the main driving force of differences in the CET1 ratio

**The aggregate CET1 ratio at the end of 2019 was 12.0%

Key takeaways from stress test and sensitivity analysis

The results of the stress test and sensitivity analysis display a broad range of potential outcomes. Banks' projected CET1 ratios remain significantly above regulatory minimums in both the severely adverse scenario of the stress test and the V-shaped scenario of the sensitivity analysis. The bottom 25th percentile firm-level post-stress CET1 ratio is 8.0% for the severely adverse scenario and 7.5% for the V-shaped scenario. Both are significantly above the 4.5% minimum, although some banks may fall below their buffer levels and be subject to automatic capital restrictions under those scenarios.

On the other hand, the Fed projects CET1 ratios will remain above minimum requirements in aggregate but will fall to dangerous levels for many banks in the U-shaped and W-shaped scenarios. The bottom 25th percentile firm-level post-stress CET1 ratio is 5.5% in the U-shaped scenario and 4.8% in the W-shaped scenario. This suggests that several banks could break the 4.5% minimum; many others could break their buffers and be subject to automatic capital restrictions under those scenarios.

Paycheck Protection Program highlights numerous oversight concerns even as the SBA makes first disclosures

By **Corey Runkel and Rosalind Z. Wiggins**

Original post [here](#).

The [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#), which passed on March 27, established the Paycheck Protection Program (PPP), the US government's largest and most controversial program put in place to address the economic impacts of the COVID-19 virus. [Since April 3](#), the PPP has issued nearly [4.9 million loans](#) guaranteed by the Small Business Administration (SBA). As of June 30, banks and other private lenders have extended \$521 billion in government-guaranteed, forgivable loans under the program. The government's support measures have enjoyed [popularity](#) with taxpayers compared to those enacted during the Global Financial Crisis (GFC). However, the PPP has been under constant scrutiny from Congress and industry critics since implementation. In response to such criticism and changing economic conditions, both Congress and the SBA have repeatedly modified the program.

At least seven oversight bodies have responsibility for ensuring that the PPP is administered according to its Congressional mandates. These include the Pandemic Response Accountability Committee (PRAC), composed of [20 standing federal inspectors general](#) (IGs); the SBA IG; and the newly-created Special Inspector General for the Pandemic Response (SIGPR), which is tasked with tracking and evaluating loans and loan guarantees made by the Department of Treasury. The PPP is also subject to oversight by the Government Accountability Office and three congressional committees on small businesses. More detail about the PPP oversight bodies appears at the end of this blogpost.

A number of PPP oversight bodies have criticized the SBA for not releasing sufficiently detailed information about the PPP loans to enable it to properly perform their duties; they have specifically asked for loan-level details so they can properly analyze the efficacy of the program and determine whether it is meeting its statutory mandates. Other issues raised are listed below:

1. disclosure of detailed loan information
2. insufficient incentives for lender due diligence
3. differential accessibility for large and small borrowers
4. failure to implement statutory priorities
5. confusing eligibility criteria and limited application diligence
6. integrity of the loan forgiveness process
7. auditing processes.

This post will elaborate on the issues above, compare PPP oversight thus far with oversight during the Global Financial Crisis (GFC), and discuss greater implications for transparency of the government’s COVID crisis programs.

Design of the Paycheck Protection Program

The goal of PPP is to make loans that help “[businesses keep their workforce\[s\] employed during the Coronavirus \(COVID-19\) crisis.](#)” Eligible SBA-approved lenders facilitate loans to small businesses that the Treasury guarantees. Under the SBA and Treasury’s original rules, the government would forgive a loan so long as the borrower used at least 75% of lent funds for payroll expenses. The program began processing loans [just seven days](#) after Congress passed the CARES Act. After nearly two weeks of loan processing, the SBA had [approved](#) more than 1.6 million loans through nearly 5,000 lenders, a massive increase over its normal volume. As of [June 30](#), lenders have extended more than \$521 billion of the total \$659 billion appropriated for the government guarantees. On that same day, Congress [voted](#) to extend the PPP until August 8. At the time of the vote, the PPP had \$139 billion available.

Major issues and challenges

Disclosure of detailed loan information

The disclosure of loan recipients has been a primary issue raised by oversight authorities. Several PRAC inspectors general wrote a [letter](#) to several members of Congress in early June expressing concern that an opinion from the Treasury General Counsel would exempt PPP loans from PRAC’s inspection, which they argued was contrary to how they interpreted their statutory duties. At stake in disclosure are the specific businesses and activities funded by potentially hundreds of billions of public dollars, some of which are known to have landed in the bank accounts of publicly traded corporations with other viable lending sources, and in small businesses connected to members of Congress.

The SBA made its first [PPP disclosures](#) on July 6; however, it released loan-level data including business names, addresses, NAICS codes, zip codes, business type, demographic data, non-profit information, jobs supported, and loan amount ranges only for loans of \$150,000 or larger. For loans of less than \$150,000, the exact amounts were disclosed, but the borrowers were anonymized and identified by zip code, industry, and business type.

PPP [applications](#) included provisions notifying applicants that loan data would likely be disclosed pursuant to Freedom of Information Act requests. Secretary Mnuchin also originally agreed with this in April, but FOIA requests were rebuffed, triggering a [lawsuit](#) by several media organizations. Secretary Mnuchin’s [position](#), based on a Treasury counsel opinion, was that for small businesses such information is “confidential” and “proprietary.” Following [demands](#) from the House Select Subcommittee, and lagging SBA cooperation noted in the GAO report, the

administration on [June 19](#) retreated from that position, [announcing](#) the current, two-tiered disclosure model.

A June 23 YPFS [blogpost](#) noted that, while 75% of approved funding passed through loans of \$150,000 or larger, 86% of PPP borrowers were lent less than \$150,000. The Treasury's new standard leaves a wealth of information undisclosed despite applicants' acknowledgment that such information would be disclosed. Several oversight bodies and members of Congress continue to push for release of all PPP recipient names and loan details.

The SBA's limited disclosure is problematic for a number of reasons. The failure to collect information and limited disclosure will possibly limit the ability of oversight authorities to properly fulfill their roles analyzing programs and their efficacy. Senator Ben Cardin made this point at the June 10 hearing on the PPP: "One reason we would like to get more granular data is so we can understand the scope of the issues" (2:12). And even after the SBA's recent disclosure of redacted information, Senator Chuck Schumer continues to push for full disclosure of the names of all recipients so that the effectiveness of the program can be properly assessed.

A Treasury OIG report dated May 18 raised a similar point with respect to the Treasury's failure to provide a mechanism for recipients to report regarding use of the funds received from the Coronavirus Relief Fund, which provided \$150 billion to states, tribal governments and municipalities for COVID related expenses: "This position negatively impacts our office's ability to efficiently and effectively carry out oversight responsibilities."

Second, limited disclosure under the PPP and other programs creates two levels of disclosure under programs established with CARES Act funds. The Federal Reserve has established under Section 13(3) of the Federal Reserve Act several lending programs using \$195 billion of CARES Act funds from the Treasury. Section 13(3) requires that the Fed make an initial report, followed by monthly [updates](#) to Congress upon the establishment of a new program. Although the law requires the Fed to include the identities of participants and details of loans in such reports, Fed Chairman Powell may request that they be kept confidential.

For four facilities receiving Treasury equity support with CARES Act funds, the [Fed's April announcement](#) states that it will publish the reports including the names and details of participants; amounts borrowed and interest rate charged; and overall costs, revenues, and fees. See a [YPFS blogpost](#) on this announcement. A month later the [Fed announced](#) that it would make similar disclosures with respect to the Term Asset-Backed Securities Loan Facility and the Paycheck Protection Program Liquidity Facility (PPPLF), programs not covered by the CARES Act disclosure and reporting rules. The Fed stated that it was making these more liberal disclosures because it "remains committed to providing the public and Congress with detailed information about our efforts to support households and businesses during this unprecedented time."

Third, at stake is the question of possible favoritism and impropriety if the names of recipients and other loan details are not made public. A recent Politico [report](#) connected four members of

Congress with PPP loans. And on [July 6 the SBA released its first set of PPP loan data](#); the release revealed more loans to businesses related to members of Congress and senior executive-branch officials, as well as to other entities that did not appear to be the small “mom-and-pop” shops often associated with the program.

To be clear, the CARES Act does not prohibit lawmakers from applying for or accepting PPP funds. SBA standard policy requires lawmakers with significant stakes in businesses applying for SBA loans to receive individual approval from the SBA’s Standards of Conduct Committee. But the Washington Post [reported](#) that in April SBA Administrator Jovita Carranza waived these requirements for members of Congress, SBA officials, and their families.

Section 4019 of the CARES ACT provides a conflict of interest provision that prohibits any company in which the President, Vice President, an executive department head, Member of Congress, or their immediate family member has a substantial interest in from benefiting from programs funded with Title IV funds and programs, which are funds targeted to the aviation industry and used to support Federal Reserve lending programs. The provision doesn’t extend to the PPP and its Title I, under which it is authorized, does not contain a similar provision. Nevertheless, the appearance of impropriety is important.

In response to criticism on the matter, Senator Rubio countered that “Congress plays no role in who gets a loan and who doesn’t.” Since the PPP offers funds to all who meet its eligibility criteria, he argued, it contrasts with competitive contract awards (where award decisions have to be made); such awards have historically been at the center of corruption cases.

However, for any program, a blanket waiver should raise concern. The SBA waiver neutralizes the application of its usual ethics review process. There is no evidence in the statute that Congress intended this. Further, it creates a duality of standards under the Act. Arguably, Congress’s inclusion of section 4019, was meant to do just the opposite--to create a more equal process of ethics review under the Cares Act for companies affiliated with government officials.

On top of the questionable blanket waiver, failure to disclose details of loans only furthers a sense of unfairness and a lack of integrity in the process. Even the disclosure of details that call into question whether the funds have been distributed in accordance with statutory mandate would allow for an airing of the facts and review by oversight authorities and the public.

Insufficient incentives for lender due diligence

PPP loans are distributed to borrowers through SBA-approved lending financial institutions, which receive a fee for each loan processed. Per [Section 1102\(2\)\(36\)\(O\)\(i\)](#), PPP loans receive 0% risk weight in the capital requirements of eligible lenders. In the [June PRAC report](#) (p. 41), the SBA Inspector General expressed the concern that SBA’s 100% participation in the loans would cause lenders to “not exercise due diligence in originating loans, thereby increasing the risk of potential financial losses to SBA.” In other words, the diffusion of loans through thousands of lenders could set up a principal-agent problem whereby lenders are incentivized by the fees on each loan origination to approve as many loans as possible and there were few

incentives to ensure borrower quality. The IG went on to recommend that the SBA implement “proper controls in the loan approval phase to ensure eligibility of participants.”

Differential accessibility for large and small borrowers

As loan approvals began, [reports](#) filtered out that large and publicly traded borrowers had received loans quicker and easier than had small and new borrowers.

Lawmakers inveighed against differential treatment of businesses trying to borrow from the PPP in letters addressed to Secretary Mnuchin and SBA Administrator Carranza. Missouri Senator Joshua Hawley [warned](#) in an early letter that the program was becoming a vector for “corporate greed” with two tiers of borrowers. He alleged that large and existing clients of lenders received loans larger, faster, and easier than small and new borrowers. Democratic Representatives later made [similar claims](#) in letters addressed to the SBA as well as to several of the largest lenders.

Members of the Senate Committee on Small Business & Entrepreneurship raised concerns during a June 10 [hearing](#) that this misalignment would foster a divide of the sort described by Senator Hawley. Committee Chair Marco Rubio defended the PPP, [saying](#) that “these bumps in the road were and are the price of a successful program.” Rubio went on to argue that the need for relief necessitated the velocity of loan approvals.

The eligibility of several publicly traded corporations that applied for PPP funds was controversial. Bloomberg [reported](#) that \$38.5 billion in PPP funds have been canceled since the program’s launch, after a mix of realizations that loans would not be forgiven or that assistance was not necessary. Such [returns](#) came in the wake of press coverage that included Secretary

Steven Mnuchin [insisting](#) that they were not the program’s targeted audience (and could face prosecution). Yet, on other occasions, the Secretary has not addressed why the PPP was not administered in a manner to target the markets prioritized by Congress.

Figure 1. Most approved loans came early in the PPP’s initial run.

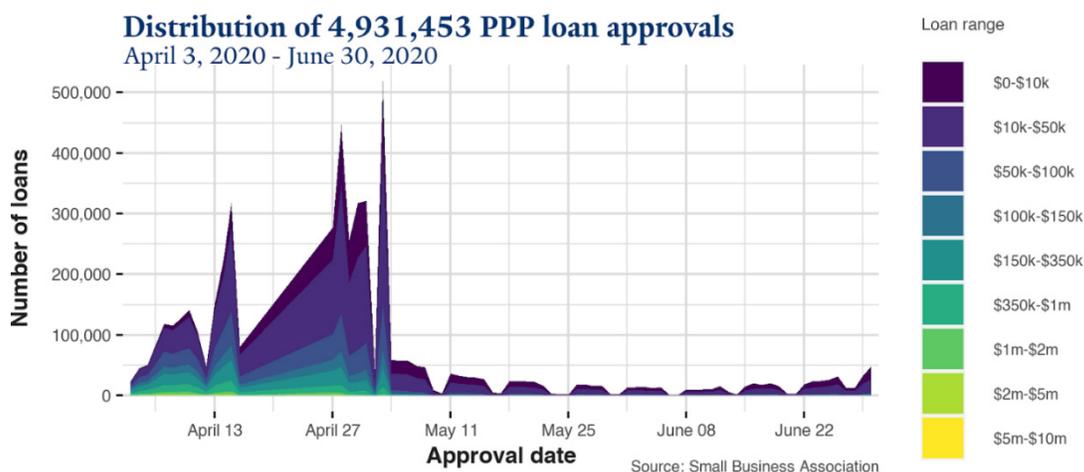
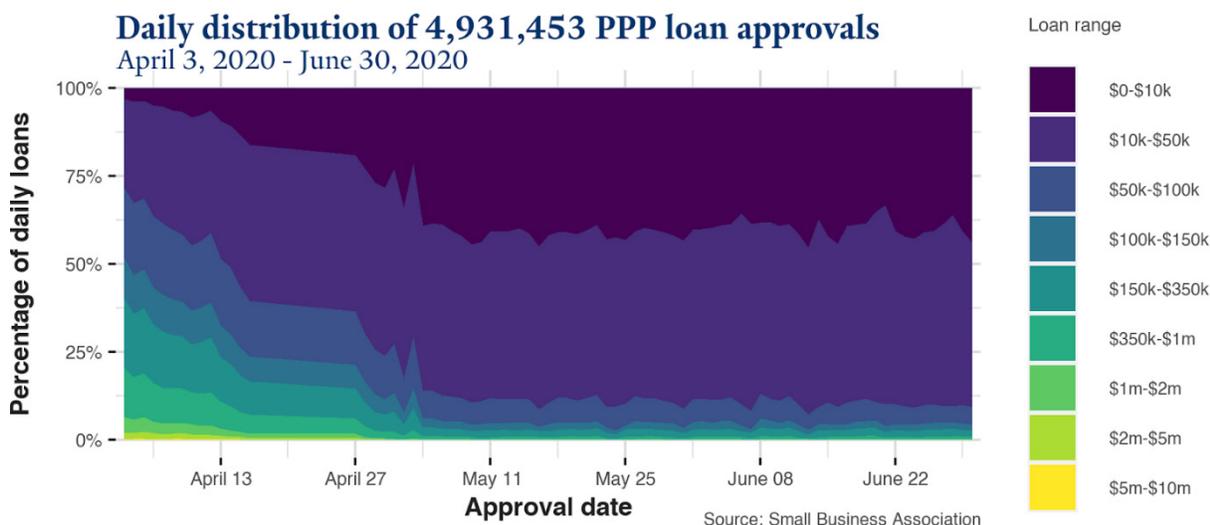


Figure 2. Large loans made up a disproportionate amount of early approvals.



In aggregate, large loans may be closer to the exception than the rule. SBA data show that loans of \$1,000,000 or more makeup just 1.7% of loan approvals. As shown below, the vast majority of loan approvals were for loans smaller than \$150,000.

Number, Dollar Amount, and Distribution of Paycheck Protection Program Loans, as of June 12, 2020				
Amount of loan (dollars)	Number of approved loans	Approved dollars (\$)	Percent of approved loans (%)	Percent of approved dollars (%)
150,000 and less	3,926,477	136,683,699,300	85.8	26.7
150,001 - 350,000	370,507	83,240,884,629	8.1	16.2
350,001 - 1,000,000	197,277	112,238,433,258	4.3	21.9
1,000,001 - 2,000,000	52,586	72,856,742,215	1.1	14.2
2,000,001 - 5,000,000	24,734	73,523,496,712	0.5	14.4
More than 5 million	4,807	33,728,428,031	0.1	6.6
Total	4,576,388	512,271,684,145	100	100

Source: Small Business Administration | [GAO-20-625](#)

Failure to implement statutory priorities

Section 1102(a)(36)(P)(iv) of the CARES Act requires the agency to issue guidance to lenders prioritizing small business concerns and entities in “underserved and rural markets.” In a [May 8 report](#), the SBA Office of the Inspector General (OIG) noted that the SBA had not yet issued guidance to lenders directing them to prioritize loans to these markets. In a June 10 [Congressional hearing](#), members questioned why the SBA had still not issued such guidance, but received no explanation from Secretary Mnuchin or SBA Administrator Carranza (at 52:00).

As a result, lenders were not notified to target these priority areas. The extent to which entities in underserved and rural areas participated in the program is unknown since the SBA [opted](#) not to collect demographic information from prospective borrowers. It did include the option to provide such information on its application for loan forgiveness. The result is that it will be difficult for the agency to determine how much of the PPP funds went to the entities that Congress had intended lenders to prioritize.

Confusing eligibility requirements and limited application diligence

In order to implement the program quickly, the SBA relied on a limited application process, which was shortened after borrowers complained about the burden of the original application. Applicants self-certified that key loan eligibility requirements were met rather than provide detailed documentary evidence to support their claims. Treasury and the SBA say this was done to speed processing of an unprecedented number of applications.

A [June 25 GAO report](#) warned that “reliance on applicant self-certifications can leave a program vulnerable to exploitation by those who wish to circumvent eligibility requirements or pursue criminal activities.” The report also noted that frequent changes in the SBA guidance had led to confusion and “raised program integrity concerns.” It [concluded](#) that the agency should draw up oversight plans detailing how it would address potential risks and review PPP loans of all sizes.

Speed also apparently resulted in confusion regarding the actual criteria for PPP loans, as SBA issued guidance on a rolling basis: “18 interim final rules and 17 updates to its frequently asked questions [FAQs], as of June 15, 2020” (GAO pp.35, 241-2). These rules and FAQs addressed topics such as eligibility, payroll cost calculation, and loan forgiveness, but were at times confusing rather than clarifying and were issued at times that made compliance challenging for lenders and borrowers (GAO pp.241-2). For example, the guidelines for how independent contractors and self-employed persons could borrow were issued only two days before the first tranche of funding was exhausted (GAO pp.243-4).

Legislators [have questioned some of the SBA's decisions](#) to streamline the application process in the interest of speed. A similar point was also considered by oversight authorities who reviewed the government’s decisions regarding assistance to AIG during the Global Financial Crisis. Then, the [Congressional Oversight Panel](#) summarized its conclusion like this:

Through a series of actions, including the rescue of AIG, the government succeeded in averting a financial collapse, and nothing in this report takes away from that accomplishment. But this victory came at an enormous cost. Billions of taxpayer dollars were put at risk, a marketplace was forever changed, and the confidence of the American people was badly shaken. (page 9.)

Likewise, it will be the role of the PPP oversight authorities to consider whether the trade-offs made have been appropriate and effective in getting the PPP funds into the hands of the intended recipients.

Integrity of the loan forgiveness process

Since the start of PPP lending, Congress has significantly expanded eligibility for loan forgiveness.

First, the [Paycheck Protection Program Flexibility Act](#) lowered from 75% (as originally set by the SBA) to 60% the minimum portion of a loan spent on retaining or rehiring employees to qualify for forgiveness. The prior threshold of 75% had also been a forgiveness “cliff” -- that is, if 74.9% of the loan had been spent on payroll, the borrower would receive no forgiveness. The act changed this provision, creating a schedule of loan forgiveness amounts depending on the percentage of funds used for payroll expenses.

A [previous YPFS blogpost](#) details these changes. As revised, the PPP now more closely resembles the [fixed-cost supports](#) that many countries have enacted to help businesses in affording rent, mortgage payments, utilities, and other overhead expenses. Nonpayment of such costs may cause businesses to close permanently, precluding the SBA goal that such businesses maintain their workforces.

The Act also amended the time period borrowers had to use PPP funds in order to qualify for loan forgiveness. Originally, borrowers had to use funds within 8 weeks of receipt. Now borrowers can choose whether to use an 8-week period or a 24-week period to apply for forgiveness. The extension of the covered period under the PPPFA allows borrowers to use the loan proceeds to cover eligible expenses over a longer period of time but also creates a second chance for borrowers that might have failed to comply with the original terms of their loans.

A [YPFS blog](#) discusses this change.

In the same act, Congress indicated that an employer should not be penalized if it cannot retain or rehire employees due to compliance with requirements or guidance issued by health authorities. The policy change responded to feedback from borrowers, but it arguably weakens the incentives for [employers to retain employees](#).

A related concern is that the SBA’s original [five-page](#) loan forgiveness application also relies on extensive self-certifications for key criteria. Additionally, the agency introduced a simplified [three-page](#) “EZ” loan forgiveness application that requires even less information. Without sufficient or verified information being collected, there is the risk that the SBA will forgive some loans that should not be forgiven.

Auditing Processes

Although Secretary Mnuchin originally stated that all loans under the program would be subject to audit, he later reversed this position. The SBA has already [announced](#) that it will likely not look closely at borrower eligibility or forgiveness for loans smaller than \$2 million, which comprise 79.3% of PPP loans as of [June 27](#). Only approximately 30,000 loans that represent about 21 percent of the approved dollar amount of PPP loans (as of June 12) would be subject to audit under this standard.

The [GAO Report](#) has asked what the review plans are for loans of \$150,000 or less and has cautioned that “because of the number of loans approved, the speed with which they were processed, and the limited safeguards, there is a significant risk that some fraudulent or inflated applications were approved.” It also warned that the announced limited review guidelines have “increased the likelihood that borrowers may misuse loan proceeds or be surprised they do not qualify for full loan forgiveness.”

Comparisons with Global Financial Crisis oversight

The oversight approach represented by the PPP is difficult to compare directly to the interventions the Department of Treasury employed during the GFC, reflecting to some extent the different natures of the two crises. During the Global Financial Crisis, the federal government did not provide direct support to small businesses; GFC-era programs focused on providing [market liquidity](#) and on maintaining financial institution solvency. Because of this, most funds went to large, mostly financial, institutions. The majority of funds were disbursed through Federal Reserve programs (and all of which were repaid).

However, oversight committees and observers criticized the Fed during the GFC for disparate treatment of some borrowers, refusing to reveal details of loans -- including borrower identities - - and the absence of written guidance for its loan procedures. Overall, these perceived weaknesses threatened taxpayer acceptance and generated suspicion of the Fed and the programs, despite their arguable success in preserving financial stability. In 2010, through [the Dodd-Frank Act](#), Congress required the Fed to publish transaction data one year after closing an emergency facility; the Fed’s current practices go beyond this requirement.

[Signed into law](#) on October 3, 2008, the other major government intervention during the GFC, Treasury’s Troubled Asset Relief Program (TARP), primarily [funded](#) loans to, and investments in, financial institutions and car manufacturers -- institutions with significant experience in financial compliance. Of the [\\$443.9 billion](#) spent under TARP, only \$368 million was [allocated](#) to small businesses outside the financial sector. Similar to PPP, the federal government’s primary recourse against the financial risks of TARP was audits, fines, and litigation. The Special Inspector General for the TARP launched [criminal investigations](#) that succeeded in recouping monies from TARP recipients that had used the funds as part of accounting and securities fraud schemes (p.7).

But what worked during the GFC may not work for the PPP (or for other COVID-19 programs) due to the difference in borrower sizes. Litigation against the 86% of PPP borrowers that sought less than \$150,000 would likely cost more than forgiving the disputed loan. These policy choices demonstrate the altered cost-benefit calculus of crisis oversight.

While greater loan underwriting and other pre-disbursement policies carry less risk, they are commensurately slower. The SBA leaned towards speed in the current situation, a position approved by some. Senator Rubio said at the June 10 hearing that, “the speed of the lockdown meant we needed to get funds to small businesses with urgency,” and speculated that, “without

PPP's temporary lifeline, tens of millions of Americans would have been permanently separated from their livelihoods and stripped of dignified work." Several other members agreed with him. However, the June PRAC report explored this tension between speed and integrity, noting that "increased loan volume, loan amounts, and expedited loan processing timeframes may make it more difficult for SBA to identify red flags" (p. 41).

The minority of TARP funds that touched homeowners and small businesses can be useful in understanding what might have happened. Then, the [Home Affordable Modification Program](#) was encumbered by embedded oversight mechanisms that effectively reduced risk but also reduced coordination, accessibility, speed, and, hence, efficacy. Requiring only limited loan underwriting, as the Treasury and SBA have functionally done, has arguably allowed the agencies to distribute PPP loans before businesses go bankrupt.

However, it can also be argued that the SBA's reliance on self-certifications, coupled with less stringent forgiveness criteria, and a limited audit processes, have potentially produced a program far from its original statutory intent. Despite the SBA's heroic effort to process thousands of loans in a very short time period, which must be acknowledged, this type of confused administration is not likely to engender confidence in taxpayers that their money has been well-spent.

Major PPP Oversight Bodies

As alluded to in the discussion above, at least seven oversight bodies have responsibility for reviewing the PPP. The CARES Act established two oversight bodies. The Pandemic Response Accountability Committee (PRAC), composed of [20 standing federal inspectors general](#) (IGs), is charged to "prevent and detect fraud, waste, abuse, and mismanagement" in all CARES Act-funded disbursements and guarantees to non-federal organizations. The SBA IG is part of this group. Soon to be added to the PRAC roster is the Special Inspector General for the Pandemic Response (SIGPR), tasked under [Section 4018\(c\)\(1\)](#) of the CARES Act with tracking and evaluating loans and loan guarantees made by the Department of Treasury.

Also overseeing the PPP are the Government Accountability Office, the House of Representatives' ad hoc [Select Subcommittee on the Coronavirus Crisis, and the standing](#) Senate and House committees on small business.

Figure 3. Newly-created PPP Oversight Bodies

	Pandemic Response Accountability Commission (PRAC)	Special Inspector General for Pandemic Recovery (SIGPR)	House Select Subcommittee on the Coronavirus Crisis
Date established	March 27, 2020	March 27, 2020	April 23, 2020
Containing body	Council of the Inspectors General on Integrity & Efficiency	Department of Treasury	House Committee on Oversight & Reform
Scope	Funds disbursed to non-Federal entities used to address the coronavirus crisis	Treasury disbursements via CARES Act programs	“taxpayer funds and relief programs to address the coronavirus crisis”
Basis of authority	H.R. 748 Sec. 15010	H.R. 748 Sec. 4018	H.Res. 935
Mandate	“prevent and detect fraud, waste, abuse, and mismanagement; and mitigate major risks that cut across program and agency boundaries”	“conduct [...] audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments”	report on: efficacy, fraud, and efficiency of federal response; national preparedness; economic and health impacts; cooperation between federal branches and investigators
Funding	\$80,000,000	\$25,000,000	\$2,000,000
Report schedule	Biannually	Quarterly	As needed
Chair	Michael Horowitz	Brian Miller	James Clyburn (D-SC)
Can subpoena?	Yes		
Termination date	September 30, 2025	March 27, 2025	30 days after final report

GAO Report Highlights Opportunities to Improve Federal COVID Response and Recovery Efforts

By Devyn Jefferies

Original post [here](#).

On June 25, 2020 the Government Accountability Office (GAO) provided a comprehensive [report](#) to Congress detailing the US government's response to the COVID pandemic, particularly the four relief laws passed prior to June 2020, and actionable steps to improve those efforts. Within these four laws, \$2.6 trillion has been mobilized (breakdown below). However, the GAO does not have insight into the actual expenditures, only appropriations, as the federal agencies will begin detailing spending in their July 2020 monthly reporting. In regards to the overall federal response, the GAO notes the speed with which the programs were launched. However it faults agencies for “[making] only limited progress so far in achieving transparency and accountability goals.”

The recommendations outlined in the GAO report cover health and economic programs; in this blogpost, our discussion is limited to the economic programs. The report includes suggested legislative actions and program-specific changes to increase the efficiency of the federal response. In addition to providing specific advice, the GAO highlighted lessons which parallel these steps and should be strongly considered during future interventions.

GAO Recommendations for Congressional Consideration

1. Require coordination between the Department of Transportation and relevant agencies

The potential for air travel to be a catalyst for widespread contraction of COVID, as well as its vital economic role, led the GAO to recommend deepening the relationships between the Department of Transportation and agencies such as the Department of Health and Human Services and Department of Homeland Security. The intended outcome of this coordination includes a national aviation-preparedness plan regarding disease outbreaks that “could establish a mechanism for coordination between the aviation and public health sectors and guide preparation for communicable disease nationally and for individual airlines and airports.” Without a unified mechanism for coordination, it is likely that stakeholders will have a fragmented response to outbreaks, including disparate airline policies of ramping up capacity (as we are now experiencing). A unified policy would mitigate potential outbreaks while decreasing consequences for commerce and travel.

2. Give the Department of the Treasury access to the Social Security Administration's death data

The Treasury Inspector General for Tax Administration has reported that almost 1.1 million payments of approximately \$1.4 billion dollars have gone to deceased recipients through economic impact payments as of April 30. These improper payments stem from tension between

a desire to make payments speedily as promised to the public and an initial decision by the Internal Revenue Service (IRS) counsel that the statutory wording compelled payment to individuals who had filed taxes but were deceased at the time of payment. The IRS counsel believed that the "IRS did not have the legal authority to deny payments to those who filed a return for 2019, even if they were deceased at the time of payment." Also, the counsel claimed that decedents were not precluded from the program as the CARES Act required the IRS "to apply the same set of processing rules to recipients who had filed a 2018 return but not yet a 2019 return." After being informed of the situation, the Department of the Treasury coordinated with the IRS to reverse the previous determination and define payments to decedents as improper.

Figure 1. Allocation of Funds for COVID Response as of May 31, 2020 (Source: GAO Report)

Program*	Implementing Government Entity	Summary of Program	Appropriation Amount in billions	Percentage of Total
Paycheck Protection Program	Small Business Administration	Provides funding to guarantee loans – that may be forgiven – to small businesses and other eligible entities to cover payroll and other costs over 8 weeks	670	26%
Economic Stabilization and Assistance to Distressed Sectors	Department of the Treasury	Provides liquidity to support lending to eligible businesses, states, municipalities, and tribes related to losses incurred as a result of the pandemic.	500	19%
Unemployment Insurance	Department of Labor	Provides income support to unemployed individuals by expanding eligibility for unemployment compensation benefits, increasing weekly benefit amounts by \$600, and extending the number of weeks of benefit eligibility.	375	15%
IRS Economic Impact Payments	Department of the Treasury	Provides direct payments of up to \$1,200 per qualifying adult and up to \$500 per qualifying child.	282	11%

Public Health and Social Services Emergency Fund	Department of Health and Human Services	Provides financial assistance for a variety of healthcare-related costs including vaccine development, testing, health insurance costs, among others	232	9%
Coronavirus Relief Fund	Department of the Treasury	Provides payments to states, local, tribal, and territorial governments for pandemic-related spending	150	6%
Other			365	14%
Total			2,574	100%

Additionally, the Social Security Act only provides the IRS access to the Social Security Administration’s death records. However, it does not give access to the Department of the Treasury and Bureau of the Fiscal Service, which handle payment distribution. In response to these improper payments, the GAO suggests an amendment to the Social Security Act to provide access and mandate its use for future payments. Although this would not have stopped the initial payments that resulted from the IRS counsel’s legal decision, it will assist the integrity of future payments and act as a safeguard.

3. Incorporate GAO formula into Medicaid’s benefit calculations

Based on historical observations, the Federal Medical Assistance Percentage (FMAP), which dictates the amount of state funding towards Medicaid services the federal government matches, has been insufficient during economic downturns. Since it is calculated based on the state’s per capita income, the current FMAP formula fails to adequately account for present conditions. Attempts to temporarily increase funds under FMAP in these situations have been slow.

Since the Families First Coronavirus Response Act allocates supplemental temporary funding to states through the FMAP, the GAO has constructed a [formula](#) that aims to assist states early in the downturn and provide sufficient funding based on their individual needs. This formula will initiate when there has been a persistent decrease in the states’ employment-to-population (EPOP) ratio, which is a purposefully easily accessible data point. In addition, its calculations integrate the below variables into its allocation of funding to states, making it more dynamic.

- Increases in unemployment, as a proxy for changes in Medicaid enrollment;
- Reductions in total wages and salaries, as a proxy for changes in states’ revenues

GAO Recommendations for Administration Consideration

1. Mandate the Department of Labor, Small Business Administration, and Department of Treasury to disseminate information to state unemployment agencies regarding the PPP loans and potential for incorrect payments

The interaction between the newly introduced Unemployment Insurance programs and the Paycheck Protection Program (PPP) has resulted in potential improper payments. The PPP provides loans to small businesses that can be forgiven in exchange for rehiring or retaining employees, while Unemployment Insurance programs provide relief to newly unemployed individuals. Situations may arise where an individual receives both wages paid by employers that received PPP loans and payments from Unemployment Insurance. The GAO notes that the agencies have not put any safeguards in place to avoid these situations and that the Department of Labor has failed to provide guidance to state unemployment agencies regarding these risks. Therefore, it recommends that the Department of Labor go beyond its broad disclosure to state unemployment agencies about the potential for fraud in these programs and specifically inform them of the risks associated with these two programs and steps to mitigate their likelihood.

2. Request that the Internal Revenue Service examine low-cost ways for improper recipients to return impact payments

The speed with which economic impact payments were distributed, over \$147 billion consisting of 81 million payments in the two weeks following the CARES Act enactment, led to a number of improper payments. As previously mentioned, there have been issues with these payments being sent to deceased recipients. Other examples of fraudulent payments include payments to incarcerated individuals, false tax filers, and identity theft.

The IRS has worked to instruct incorrect recipients on how to return payments, including advertising the improper payment return procedure on its website, disclosure on the physical letters containing check payments regarding returning payments made to decedents, and working with federal and state prisons to return payments made to incarcerated recipients. However, the GAO notes that the IRS has failed to take further steps and urges greater outreach, including potentially sending letters to a group of identified incorrect recipients containing specific instructions. The GAO notes that the outreach should be based on “intended audience, availability of information, and cost to communicate information.”

3. Require the Small Business Administration to construct plans to increase robustness of the PPP loans aimed to “ensure program integrity, achieve program effectiveness, and address potential fraud, including in loans of \$2 million or less.”

The Paycheck Protection Program (PPP) has been quickly implemented and resulted in the disbursement of \$512 billion, approximately 76% of the entire budget, consisting of 4.6 million loans as of June 12, 2020. However, the speedy deployment of this program has led to a number of significant issues including haphazardly disclosing details of the program such as eligibility, overreliance on borrower certification by lenders, and lack of oversight procedures for loans above and below the \$2 million threshold which states that loans smaller than \$2 million are afforded less oversight regarding eligibility and forgiveness.

These issues as well as other PPP oversight measures are further elaborated in this [YPFS blog post](#).

Evolving Lessons from the Interventions

Stemming from its observations and recommendations, the GAO described four key evolving lessons shown below for consideration during future interventions. The interconnection between the GAO's high-level "evolving lessons" and the aforementioned recommendations demonstrates the shortcomings of current programs, ways to improve current programs, and lessons learned for the future.

1. Establish clear goals and define roles and responsibilities.
2. Provide clear, consistent communication.
3. Collect and analyze adequate and reliable data to drive future decisions..
4. Establish transparency and accountability mechanisms.

Keying off these lessons, the report concludes with analysis of, and recommendations regarding the government's structural framework for responding along with a further detailed analysis of dozens of specific programs.

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

By Steven Kelly and Rosalind Z. Wiggins, with support from Pascal Ungersboeck

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.

No Bank Should Be Paying Dividends Right Now

By Greg Feldberg

Original post [here](#).

This blog was published today in the [American Banker](#) .

In the midst of one of the fastest and deepest economic declines in U.S. history, the largest banks are expected to pay out about \$14 billion in dividends in the third quarter, while remaining under a cap imposed by the Federal Reserve in response to the coronavirus pandemic.

This comes after the same banks paid out about \$17.5 billion in the second quarter, according to an analysis using Bloomberg data.

While the Fed did [somewhat restrict shareholder payouts](#) in late June, it has already missed an opportunity to require banks to conserve more than \$30 billion in capital that could have proven invaluable if any of its recent [economic stress scenarios pan out](#).

Both the economic scenarios and policy on dividend payouts were included in the results of the 2020 [stress test](#) of the 33 largest banks.

The results were not rosy. The Fed forecasted \$433 billion in loan losses through March 2022, under a scenario designed prior to the coronavirus lockdown.

But in a rough [sensitivity analysis](#) that took the coronavirus into account, projected losses ballooned to \$560 billion in a V-shaped economic recovery scenario; \$680 billion in a W-shaped scenario; and \$700 billion in a U-shaped scenario.

Those would be heavy losses compared to the banks' aggregate \$1.2 trillion of capital. In the worst case, a quarter of banks would be near or below their regulatory minimums, although the Fed did not say which banks or how close they would be.

The Fed admitted that its sensitivity analysis was not as robust as its typical stress test. So it took an unusual additional step: it is calling on banks to reassess their capital needs and resubmit capital plans later this year. Those plans could result in further dividend restrictions.

Still, amidst the extraordinary uncertainty that the coronavirus lockdown has induced, suspending dividends would seem an easy way to conserve capital right now. This is exactly the kind of situation for which these forward-looking stress tests are designed, in order to prevent another collapse of the financial system.

The Fed's rule normally prohibits banks from proposed capital distributions while it is reviewing capital plans. But the Fed hasn't prohibited dividends this time.

Note that banks' capital ratios were already elevated by an average of about [30 basis points](#) in the first quarter because regulators allowed them to delay the capital impact of the new expected credit loss accounting framework.

Regulators reasonably justified that forbearance by the need to promote lending during a crisis. But allowing banks to deplete capital through dividend payments seems counter to that purpose.

Regulators' reluctance to suspend dividends may elicit some *déjà vu*. During the last financial crisis, banks were still paying more than \$10 billion in dividends per quarter through late 2008, and didn't cut dividends by [more than half until 2009](#). Regulators raised no objection.

Those same banks ultimately needed hundreds of billions of dollars in government capital through the Troubled Asset Relief Program. One [paper](#) showed that all the banks that received TARP capital paid at least 45% of the amount as dividends in 2007 to 2009. The combination of paying dividends and receiving government capital represented a massive transfer of wealth from taxpayers to shareholders.

The Fed did announce some modest measures this time. For example, a bank's common stock dividends in the third quarter can't exceed what it paid in the second quarter, or its average net income over the past four quarters. The Fed also banned share repurchases for the third quarter entirely.

But these limits are unlikely to significantly affect banks' capital decisions. Net income is falling for most banks anyway, and the largest banks suspended repurchases [voluntarily](#) in March; share repurchases similarly fell sharply in the last financial crisis.

So why not suspend dividends immediately? The Fed's peers in Europe quickly called for a temporary halt to bank dividends and share repurchases in this crisis; and later did [the same](#) for insurers and other financial companies.

The Fed's vice chairman for supervision, Randal Quarles, [argued](#) that banks are much better capitalized this time. He also argued that banks performed well under the Fed's rough sensitivity analysis.

But that's no reason to allow banks to deplete their capital, as Fed Gov. Lael Brainard pointed out in a rare [public dissent](#).

Some argue the [Fed has already gone too far](#), meddling in bank board decisions. But it's the Fed's job to set limits in a crisis.

This is simple macroprudential policy — look out for the system as a whole, by providing cover to bank boards to conserve their capital in case things get worse.

Without that cover, bank boards hardly have autonomy right now. Supervisors may hope banks would reach the same decision through their own capital planning and governance, which have improved since the last crisis. But no bank wants to be the outlier while everyone else is paying

shareholders. So, heading into an extraordinary period of uncertainty, most banks are going to maintain dividends.

However, any dividends paid may look frivolous if the recovery from the coronavirus turns more U-ish than V-ish.

Here's a paper floated by the European Central Bank worth further study: a cyclical [dividend prudential target](#) set by regulators as guidance for banks. Such a policy could allow relatively high payouts in good times but automatically constrain payouts in downturns. Arguably, this would encourage banks to meet regulatory capital ratios during downturns by retaining earnings rather than shrinking assets.

Let's consider ideas like this for next time.

More immediately however, the Fed should require banks to halt dividends until the coronavirus recession has passed, as other central banks have done.

In the very worst case, Fed officials should not want to repeat history by using government funds to recapitalize banks, while justifying in retrospect why they didn't conserve as much capital as they could when the crisis began.

The Bank of Greece proposes a national “bad bank”

By Alexander Nye

Original post [here](#).

On July 16, the Bank of Greece (BOG) [proposed](#) a public asset management company (AMC) to buy non-performing loans (NPLs) from banks using public funds.

Yannis Stournaras, governor of the BOG, [argues](#) that an AMC could help banks clean up their balance sheets and allow them to raise capital.

Unlike the AMCs that governments created during the Global Financial Crisis (GFC) of 2007-09, a Greek AMC would not be able to subsidize banks by acquiring NPLs above market prices. Europe’s [Bank Recovery and Resolution Directive \(BRRD\)](#), passed in 2014, now prohibits European government from providing most forms of the vast majority of state aid to banks outside of the resolution process, including through AMCs. This means the AMC’s purchase of the NPLs would likely subject participating banks to large haircuts, eating into their capital.

The BOG has not put forward a detailed description of the bad bank proposal. In its July 2020 [Financial Stability Report](#) (FSR), the BOG said that a new AMC would not fundamentally change the country’s existing banking infrastructure. Third parties would be brought in to help the bad bank, though this could mean anything from contracting with private asset managers to having private-sector entities take an equity stake in the AMC (as they did in [Ireland](#) during the GFC).

In its FSR, the BOG also suggested the AMC could have a loss-sharing element; participating banks would solely bear any losses. However, that does not seem to be the case. The Greek proposal would have the banks endure those losses, but would only do so upon reaching their minimum capital ratios. If a bank’s capital ratio fell below the minimum allowed level, the Greek taxpayers may help cover the losses. If this is the case, the FSR is contradicting itself. The BOG [wrote](#) that this element of the plan was to keep the government from having to put any of the participating banks into resolution.

Greece does have other tools for dealing with NPLs. One is the [Hellenic Asset Protection Scheme](#), better known as “Hercules,” a program [approved in late 2019](#) by the Greek government and the European Commission. The program removes €30 billion in NPLs from bank balance sheets and places it in SPVs owned by the Greek government, which then securitize the debt into tranches and sell it. The government added up to €12 billion in guarantees to the senior tranche as a way to make them more attractive to investors.

However, Stourarans [has said](#) that creating a bad bank is the only way to get rid of NPLs quickly. He [supported](#) a proposal to create a European AMC or national AMC, explaining either one was acceptable so long as they happened quickly. The European Union spent part of April [discussing the prospect of a bad bank](#), but the idea faced resistance within the European Commission.

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

By **Steven Kelly and Rosalind Z. Wiggins**

Original post [here](#).

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

On July 20 the Congressional Oversight Commission – 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)), and the related programs established by the Federal Reserve (“Fed”) and the Treasury (collectively, “the agencies”) – published its [third report](#). In its third report, the Commission updated the status of the programs under its purview – including the [programs established by the Federal Reserve \(“Fed”\) with equity investments from the Treasury](#) – as well as its concerns about the design and progress of the CESA programs.

Title IV, Subtitle A provides the Treasury with \$500 billion for direct lending to businesses in the aviation industry and businesses critical to national security (up to \$46 billion) and for supporting Fed emergency lending [programs to be established under section 13\(3\) of the Federal Reserve Act](#) (\$454 billion). The Committee is to submit reports every 30 days to Congress on the use, effectiveness and other specified issues of these funds. See this [YPFS blogpost](#) for further discussion of the Committee composition and mission.

Status of Federal Reserve Programs with Treasury Equity Support

On April 9, the Treasury announced its intention to use available funds under CESA to make equity investments into special purpose vehicles established under Fed lending programs. The Treasury has pledged \$195 billion of the \$454 billion available to various Fed programs. See [this YPFS blog post](#) for a description of the allocation of the pledged funds to the various facilities.

Between the June and July reports, the Term Asset-Backed Securities Loan Facility (TALF) and the Main Street Lending Program (MSLP) became operational. The other programs were already operating as of the second report.

As of July 15:

- The Secondary Market Corporate Credit Facility (SMCCF) had made \$11.4 billion of individual corporate bond and corporate bond ETF purchases in secondary markets.
- The Primary Market Corporate Credit Facility (PMCCF) remains unused.

- The Municipal Liquidity Facility (MLF), as was already the case by the June report, had purchased \$1.2 billion of assets, solely from the State of Illinois.
- The MSLP had purchased \$12 million worth of one loan.
- The TALF had lent \$937 million.

As of the July 20 publication date, the Fed had established six facilities with equity from the Treasury. All of these facilities are now operational: the four 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. Between the June and July reports, the TALF and the MSLP became operational. The other programs were already operating as of the second report. See this [YPFS blog](#) for a discussion of usage under these Fed programs as of July 22.

Loans to firms with National Security Interests

Subtitle A allocated \$46 billion to the airline industry and firms essential to national security. The \$29 billion allocated to the airline industry remained unused as of the report. The agency responses and the report note, however, that the Treasury has received 190 applications for such funds and has signed letters of intent to lend funds with ten passenger air carriers so far.

For the \$17 billion allocated to national security interests, the Treasury has received 70 applications, of which 25 have met one of the two possible requirements to qualify for the funds (notwithstanding possible intervention from the Secretary of Defense or Director of National Intelligence). One loan was made with such funds: [for \\$700 Million to YRC](#) Worldwide Inc. (“YRC”) on July 1. Per the report, YRC is “a holding company that provides transportation and logistics services throughout North America via its operating companies, including to the Defense Department.” The terms of the YRC loan (including the Treasury’s equity stake) are described [here](#). The Treasury noted of the applications that it “anticipates approving and disbursing loans in the near future.”

Agency Responses to Questions

The Report also shares the agencies’ responses to the Commission’s so-called “Tier 2” questions – the second section of the Commission’s written questions sent on May 29 to the agencies. Unlike the June report, [which shared the agencies’ responses to the Tier 1 questions](#), the Commission (without explanation) did not share a question-by-question response to the agencies’ answers.

In their Tier 2 responses, the agencies offered little information not already available elsewhere or stated previously in other public settings. The agencies also did not directly respond to the Commission’s last report, in which it [asked for more clarity about some of the agencies’ responses](#). However, the Commission was able to share insights gleaned from a meeting it had

with Treasury Secretary Steven Mnuchin and Fed Chair Jerome Powell on June 24. Some of those insights included indirect responses to the Commission’s June concerns.

Corporate Bond Purchases

[As in June](#), the Commission’s third report questioned the necessity of the secondary market corporate bond purchases. While the Commission acknowledged Powell’s defense of such purchases as necessary to demonstrate the Fed was keeping its commitments, it also noted his comments stating the purchases would taper according to the condition of the market. Given that the secondary corporate bond market has largely returned to proper functioning and PMCCF remains available to directly finance firms otherwise unable to secure usual bond financing, the Commission has pledged to watch the Fed’s scale of corporate bond-buying particularly closely.

Main Street Lending Program

The Commission devoted significant space to a discussion of the newly operational MSLP. The Commission was critical that the program took more than three months from its original announcement to become operational, and expressed expectations that future adjustments to the MSLP be more expedient. Similarly, the Commission expressed disappointment that, given the scale of the economic stress facing small and medium-sized firms, the MSLP had only purchased its share of one loan – and for only \$12 million since becoming operational on July 6.

Secretary Mnuchin and Chair Powell disagreed with the Commission that low utilization was an indication of design flaws. The Secretary and Chair also suggested that MSLP usage may increase over time given the tightening of lending terms for middle market lending and given feedback they are getting from lenders. Furthermore, the Commission conceded that the Fed’s 13(3) authority is limited to providing secured loans on approved terms.

In response to questions about gaps in the reach of the MSLP and the other lending facilities, Chair Powell and Secretary Mnuchin briefly described plans to establish an asset-based lending facility. This facility would lend to firms such as new businesses, inventory-rich retail firms and real estate firms that fail the MSLP’s earnings requirements based on 2019 results but otherwise represent a reasonable credit risk, particularly on a collateralized basis. The Commission suggested that the Secretary and Chair also consider expanding the MSLP to second-lien lending in cases of sufficient cash flow and collateral.

The Commission also noted its intent to hold a hearing on the MSLP “in the coming weeks.”

Municipal Liquidity Facility

As with the MSLP, the Commission expressed a lack of conviction that MLF had been helpful for state and local governments. The facility made no purchases between the Commission’s June and July reports. Illinois remains the only direct beneficiary, and received the bulk of its new financing via private investors.

In response to the Commission questioning the facility's limited uptake, the agencies defended the MLF's three-year maturity limit ([Appendix C, p. 15](#)) and above-market interest rates ([p. 12](#)).

The agencies offered a two-part answer to the question about the maturity limit. First, they invoked the Section 13(3) rules of Fed emergency lending and Regulation A principles of discount window lending which, respectively, require that circumstances be “unusual and exigent” for a loan to be made and encourage disuse of the facility in “normal” times. The agencies noted the limited maturity encourages repayment and disuse of the facility as unusual circumstances recede. The agencies also implied an unwillingness to hold municipal securities longer than necessary, saying: “Short repayment terms also allow the agencies to buy and hold municipal securities and passively exit the market without causing significant disruption as market conditions normalize.” It's not clear why the Fed has set a longer, [five-year maturity limit for its purchases of corporate bonds](#).

Chair Powell and Secretary Mnuchin said of the above-market rates that they are not attempting to compete with the interest rates of a functioning municipal bond market, but are simply seeking to act as a backstop. They once again noted that they do not see low facility utilization as indicative of the MLF's level of effectiveness. The Commission, in its Report, cited [Fed research](#) suggesting that the MLF has restored functioning to the municipals market.

Furthermore, the Commission agreed that, as is noted in that research, new lending does not solve the longer-term financing problems of many state and local governments, particularly as most operate under balanced budget amendments. Municipalities received some direct economic assistance from the CARES Act and are expected to receive more in a new economic relief bill – [currently being debated on Capitol Hill](#).

Section 13(3)

A total of \$259 billion of funds that Congress allocated to Treasury to capitalize 13(3) programs remains unassigned to any facility. The agencies provided more clarity in their Tier 2 answers on their current thinking with respect to the 13(3) facilities. These answers also indirectly responded to Commission concerns noted in June about the unused funds .

The agencies signaled an explicit willingness to use the unused funds to capitalize new facilities or further capitalize existing facilities as needed to support the economic recovery. They also signaled a willingness to resize the Treasury's equity tranche in each facility as needed to support facility goals and efficiently satisfy 13(3) security requirements.

YRC Worldwide's National Security Loan

The Commission's strongest words were reserved for discussing the \$700 million loan to YRC, which was part of the \$17 billion allocated for firms “critical to maintaining national security”.

As noted by the Commission, the Treasury accepts that such standard is met by a firm if it “is at the time of its application performing under a defense contract of the highest national priority or

operating under a top secret security clearance” – unless it otherwise received a recommendation and certification from the Secretary of Defense or Director of National Intelligence. YRC qualified through certification from the Defense Secretary.

The Commission said it intends to investigate this decision and the process leading up to it further: “It is far from clear that the fourth-largest [less-than-truckload] shipping company in the United States is critical to maintaining national defense because it reportedly delivers ‘food, electronics and other supplies to military locations around the country.’”

The Commission noted that YRC “has been rated non-investment grade for over a decade, struggled financially for years before the COVID-19 crisis, and was at risk of bankruptcy before it obtained a loan.” The Commission said it was concerned that the loan does not meet the CARES Act’s standard for taxpayer protection. Under that standard, a loan must be sufficiently secured or charge a rate reflective of the risk of the loan and at least as high as prevailed on comparable obligations pre-pandemic. The Commission noted that [the rate charged to YRC](#) is 4% lower than a five-year loan the firm received in September 2019, and that the Treasury’s 29.6% equity stake it received may not be sufficient taxpayer protection given the firm’s history of consistently nearing bankruptcy.

In light of this loan to YRC, the Commission said it intends to further explore the Treasury’s risk tolerance. Given the Commission’s inference that the Treasury has a higher tolerance for national security loans than other CESA programs’ loans, the Commission said it would like to better understand any justification.

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 the publication of the third report on July 20, the chairman position remains unfilled.

The Mexican government's economic response to the COVID-19 pandemic

By Manuel Leon Hoyos

Original post [here](#).

Mexico, the second largest Latin American economy, has been hit hard by the COVID-19 crisis as the death count surpassed 46,000 – making it [the third highest in the world](#). Unlike other countries in the region, though, its government has kept crisis spending relatively low, at about 3% of gross domestic product (GDP), to avoid massive government debt issuance.

Mexico's sovereign credit rating and the national oil company, Pemex, were downgraded [in April](#) and further again [in June](#). Since February, the Mexican peso has [depreciated by over 20%](#). The country has experienced shortages in foreign exchange liquidity and a sharp fall in commodity prices – particularly [crude oil prices](#). According to the Bank of Mexico, the crisis has brought “the greatest contraction ever recorded of holdings of emerging economies' assets, especially of fixed-income instruments” (see a [YPFS blog post](#) on the Bank of Mexico's liquidity measures). In April, Mexico's economy [contracted by 17.3%](#) as [12 million people dropped out of the labor force](#). The [second quarter contraction was 18.9%](#) in respect to last year. The [IMF currently expects a 10.5% GDP contraction in 2020](#).

While many Latin American countries have increased public debt to boost fiscal expenditures in response to the COVID-19 crisis, the Mexican government has taken a different stance. According to various estimates, economic packages in Latin American countries such as Brazil, Argentina, Chile, and Peru range between 5% and 10% of GDP. In Mexico, it is estimated to be lower at about 3% of its GDP ([Bloomberg](#), [IMF](#), [Statista](#)) including the [\\$7.7 billion \(0.7% of its GDP\) Emergency Prevention and Assistance Fund](#) announced in March through which the federal government directed additional resources to respond to the COVID-19 crisis.

Mexican President Andrés Manuel López Obrador has firmly committed that Mexico would not be issuing public debt to get out of the current COVID-19 crisis, but would rather reallocate resources and take austerity measures.

On [April 5](#), President López Obrador outlined the principles and measures for the Mexican government's economic response to the COVID-19 crisis. These were further outlined on [April 22](#) and established in a decree on [April 23](#).

The principles include an “austerity law” to reduce public expenses for non-priority programs. The President ordered the termination of federal public trusts (fideicomisos) deemed non-strategic and directed these resources for the current health and economic emergency ([April 3](#)). These public trusts are established to support a variety of purposes, including the economy, health, arts, cinema, and sciences. The government's plan is financed with savings coming from the Stabilization Fund of Budgetary Revenues ([Fondo de Estabilización de los Ingresos](#)

[Presupuestarios](#)) and commits to not increase Mexico's public debt, taxes, or gas prices, or to lay off government workers.

The President highlighted that in addition to strengthening social programs to protect the poor and credits for small businesses, the government will concentrate resources to prop up Mexico's national oil company Pemex and pay Mexico's public debt. "We are going to allocate most of the resources to the debt, because we do not want the debt to increase, we want to do everything possible to maintain the commitment to continue to ensure that there is no increase in public debt" ([April 3](#)).

In 2019, the Mexican Congress approved up to [\\$5.3 billion for external debt](#) for 2020. Despite having access to the [IMF Flexible Credit Line for \\$61.4 billion](#), the Mexican government plans not to make use of it. "The commitment is to get out of the crisis without getting into debt" ([April 16](#)).

President López Obrador said that in previous crises such as in 1994-1995, Mexico borrowed funds from international organizations and used those for the Bank Fund for Savings Protection (FOBAPROA), which were accompanied by a great deal of corruption. "The government bought portfolios and gave the banks promissory notes on behalf of the government, and all of this became the enormous public debt that paralyzed and prevented the country from growing for two decades" ([April 28](#)). He has opposed rescue packages and emphasized that his administration will not execute the "recipes of the neoliberal period because they do not solve the problem, but rather aggravate and deepen corruption" ([April 6](#)).

In late April, Mexico did conduct a \$6 billion bond issuance, [one of the country's largest](#), with an average rate of 4.7125%. Finance Minister Arturo Herrera [emphasized](#) that this will help consolidate the government's funding sources and operate programs responding to COVID-19 crisis. The bonds were issued at terms of 5, 12, and 31 years.

In May, Mexico received a [\\$1 billion loan from the World Bank](#). President López Obrador said that the transaction was a routine operation approved last year to manage government finances ([June 8](#)).

The economic measures outlined by the government include:

- A hiring freeze. No government workers will be fired. Wage payments for those unable to work due to lockdown measures are extended until August 1.
- Salaries for high-ranked government officials will be voluntarily reduced by up to 25% and they will not receive bonuses at the end of the year.
- Each government agency will only be allowed to use 25% of the allocated budget for general services, materials, and supplies.
- Government spending is postponed, with certain exceptions for priority social programs and major infrastructure projects.

- The elimination of 10 Under Secretaries. Employees of these Under Secretaries will preserve government employment with the same income.
- Beneficiaries of pension payments will receive two months upfront. These include over eight million senior citizens and 744,000 young people with disabilities, for up to \$2 billion overall ([July 2](#)).
- The government, through the Ministry of Economy and multiple national social institutions, will provide housing loans and four million credits of up to \$1,100 per credit, to small businesses and workers in both the formal and informal sector. By July 12, the government had granted over 1.4 million credits ([July 12](#)).
- Unemployment insurance for three months, for workers that hold a mortgage with [INFONAVIT](#).
- The creation of two million jobs through major infrastructure projects such as the “Maya” train in the Yucatan Peninsula, an oil refinery in the state of Tabasco, and a new airport in Mexico City-Santa Lucía.
- Provide liquidity support through development banks.
- The program of fiscal incentives and low gas and energy prices will continue at the northern border, as well as prompt VAT refunds to taxpayers.

Following the initial announcement of the government’s economic plan in April, [business groups criticized it](#) as “underwhelming” or “incomplete.” This month, a group of 30 Mexican writers and academic scholars criticized the management of the COVID-19 pandemic as “suicidal austerity” ([July 15](#)). President López Obrador has argued that critics seek to restore old neoliberal regimes, characterized by corruption and inequality ([July 16](#)).

A Bank of America report said that [Mexico could lose its investment grade credit rating](#) next year as public debt is expected to rise to [over 60% of GDP](#). The [Bloomberg Editorial Board](#) said that the President is making the crisis worse and that “the government’s indifferent fiscal response is inexcusable.” Minister of Economy Graciela Márquez Colín, has maintained that [Mexico cannot easily increase debt](#). She said that “if at a certain point we need to raise more debt, we will. It is not a closed-off road.” However, taking on debt, she said, could cause problems.

Recently, the Mexican Minister of Finance Arturo Herrera Gutiérrez said that although originally the international consensus estimated lockdown measures to last a couple of months followed by an immediate economic recovery, “the recovery horizon will be much longer, as long as an effective vaccine or treatment is not available, and therefore economic policy, particularly fiscal and financial, must adjust to the new reality” ([July 18](#)). Gerardo Esquivel, Bank of Mexico’s Deputy Governor appointed by President López Obrador last year, estimates that poverty will increase in the country as a result of the pandemic by at least nine million more people. He said that “it is essential that additional measures be taken to alleviate the enormous economic and social costs that this crisis will leave” and urged for action, “let’s learn from history, act smart,

prevent more people from falling into poverty, and help weld the broken pipes of our economy. Let's do it before it's too late" ([July 29](#)).

In contrast, the Bank of Mexico quickly unveiled a series of liquidity measures totaling \$30 billion (3.3% of last year's GDP) in April to "foster an orderly functioning of financial markets, strengthen the credit channels and provide liquidity for the sound development of the financial system." The Bank of Mexico has cut its benchmark rate 225 basis points this year to a 5% target rate (see a [YPFS blog post](#) on the Bank of Mexico's liquidity measures). The Bank of Mexico also holds [swap lines](#) with the US Federal Reserve and US Treasury for \$60 billion and \$9 billion respectively. The peak usage was at [\\$6.6 billion in April and currently about \\$5 billion is outstanding](#).

Other COVID-19 related responses within Mexico include the Mexican Business Council, in collaboration with [IDB Invest](#) – the private-sector arm of the [Inter-American Development Bank](#) – announcing [\\$12 billion in loans a year to SMEs](#).

Senate Republicans introduce HEALS Act, next round of COVID-19 response

By Natalie Leonard and Corey Runkel

Original post [here](#).

On July 27, Senate Republicans introduced components of the Health, Economic Assistance, Liability Protection, and Schools (HEALS) Act. The HEALS Act would extend and alter many of the programs included in the CARES Act, the third COVID-19 response bill. Some key programs, such as enhanced unemployment insurance (UI) benefits, expired on July 25. The bill also introduces new provisions related to education spending and liability protections.

As of August 3, a single HEALS Act is theoretical: the term instead refers to [ten distinct bills and proposals](#) introduced in the Senate. The two bills that constitute the bulk of the fiscal provisions under the HEALS Act are the American Workers, Families and Employers Assistance Act and the Continuing Small Business Recovery and Paycheck Protection Program Act. Read the full text of these bills [here](#) and [here](#), respectively.

In this post we discuss the major provisions of the HEALS Act and, where appropriate, compare it to provisions of the \$3 trillion [HEROES Act](#) passed by the Democratic-led House of Representatives on May 27.

Summary of provisions, by dollar cost:

- \$300 billion for second round stimulus checks
- \$200 billion in tax breaks for businesses
- \$158 billion for loans to small businesses

- \$110 billion for UI benefits extension
- \$105 billion for schools
- \$111 billion for health related expenses
- \$63 billion for domestic industries
- \$39 billion other
- Total: [\\$1.1 trillion](#)

Spending for individuals

Expanded Unemployment Insurance

The HEALS Act would extend the weekly unemployment bonus through July 2020 implemented by the Federal Pandemic Unemployment Compensation (FPUC) under the CARES Act, but lower it initially from \$600 to \$200.

The FPUC payment supplements state unemployment insurance, which varies widely from state to state. The FPUC was controversial, because workers in some situations could receive more than their previous wage. Under the HEALS Act, the added federal UI benefit would be \$200 a week through September; starting October 5, the funding would change to 70% of previous wages, when combined with state unemployment benefits. In most states, state-level [unemployment benefits](#) provide 45-50% of a worker’s previous wages, so the HEALS Act would add an additional 20-25% to UI benefits.

This plan poses some logistical challenges. Each state has [its own unemployment insurance program](#), and states determine benefits differently. It might be technically challenging -- [if not impossible](#) -- to switch from a flat FPUC benefit that augments standard UI payments to a UI payment that is a percentage benefit before October 5. The Senate bill would give states two months to update their UI programs, but there are wide-spread [doubts](#) that the necessary upgrades can be finished in that time frame.

CARES Act	HEROES Act	HEALS Act
Unemployment “bonus” of flat \$600 a week, on top of state unemployment insurance; expired July 25.	Unemployment “bonus” of flat \$600 a week, on top of state unemployment insurance; extended through July 2020.	Unemployment “bonus” of \$200 a week through October 5; then additional federal unemployment benefit such that total benefits equal 70% of former wages.

A second round of Stimulus Checks

The HEALS Act includes a one-time stimulus check that has a nearly identical structure to the stimulus checks under the CARES Act. All single tax filers who have adjusted gross income (AGI) under \$75,000, heads of household with AGI under \$112,000, and joint filers with AGI under \$150,000 will be sent \$1,200 plus \$500 per dependent. Stimulus checks will phase out as AGI approaches \$99,000 for single filers, \$146,500 for heads of household with one dependent, and \$198,000 for joint filers.

Under the CARES Act, dependents over the age of 18 were not included in the stimulus package; the HEALS Act would provide benefits for all dependents, regardless of age. Including dependents over the age of 18 would [expand the pool of dependents](#) by at least 26 million people.

CARES Act	HEROES Act	HEALS Act
One-time stimulus check of \$1,200 per single tax filer with AGI under \$75,000; \$2,400 for head of household with AGI under \$112,000 or joint tax filers with combined AGI of \$150,000; additional \$500 per dependent under 18 (no cap).	One-time stimulus check of \$1,200 per single tax filer with AGI under \$75,000; \$2,400 for head of household with AGI under \$112,000 or joint tax filers with combined AGI of \$150,000; additional \$1,200 per dependent under 18 (up to 3).	One-time stimulus check of \$1,200 per single tax filer with AGI under \$75,000; \$2,400 for head of household with AGI under \$112,000 or joint tax filers with combined AGI of \$150,000; additional \$500 per dependent, regardless of age (no cap).
Family of 5: \$3,900	\$6,000	\$3,900

Funds to Address other COVID-related expenses

State/local funding

The HEALS Act would create the Coronavirus Emergency TANF Fund, an expansion of the pre-existing [Temporary Assistance for Needy Families \(TANF\)](#). The Act would appropriate \$2 billion in grants to qualifying states with significant expenditures on “basic assistance, non-recurrent short-term benefits, and work supports for eligible families.” These funds would also be available to states to update their unemployment insurance systems. The state funding in the HEALS Act is minimal when compared to \$150 billion in direct aid secured by the CARES Act and the [HEROES Act’s](#) proposed \$1 trillion.

CARES Act	HEROES Act	HEALS Act
Established \$150 billion Coronavirus Relief Fund for grants to states/local/tribal governments; \$35 billion to capitalize Municipal Liquidity Facility.	Grants totalling \$915 billion for state/local/tribal governments: including \$500 billion to state governments and \$375 billion to local governments.	Expands Temporary Assistance for Needy Families (TANF), adds \$2 billion in grants to shore up state/local/tribal governments.

Education

The HEALS Act provides \$100 billion for [education](#), with \$70 billion reserved for K-12 education and \$30 billion for post-secondary education. The funds will be disbursed as grants through the Elementary and Secondary School Emergency Relief Fund and the Higher Education Emergency Relief Fund, both established by the CARES Act.

Of the \$100 billion, one third would be distributed for the two funds established by the CARES Act, while two thirds would be reserved for schools that are reopening in the fall. Specifically, two-thirds of the funds' total will be exclusively available for grants to schools with at least 50% attendance for 50% of the school year. Distribution to a state will be based on its percentage of student-aged residents that are under the poverty line.

The HEALS Act also includes [changes](#) to student loan repayment. Normally, student borrowers have nine repayment plan options, ranging in maturity length and rate. The Senate bill would reduce these options to two plans: one with a 10-year fixed annual payment; and one wherein students would pay 10% of their discretionary income for 20 years (in the case of undergraduate debt) or 25 years (in the case of graduate school debt) before the remaining balance is forgiven.

CARES Act	HEROES Act	HEALS Act
\$30 billion for education , with \$13 billion to K-12 schools and \$14 billion to post-secondary schools; suspension of student loan repayment through October 2020.	\$100 billion in direct aid for schools; \$10,000 in student loan forgiveness and suspension of loan repayments through October 2021 for those with “greatest need” (approximately 20 million people).	\$100 billion for schools, with two-thirds reserved for schools that re-open in the fall; income-based payment option for student loans.

Tax credits and deductions

The HEALS Act amends and expands tax credits and deductibles available to businesses that retain employees. It amends the CARES Act Employee Retention Credit to offer a deduction to businesses equal to 65% of a retained employee's wages, up from 50%, and increases the

maximum deduction from \$10,000 to \$30,000 per employee. The bill also introduces a new Safe and Healthy Workplace tax credit. This tax credit gives businesses a deduction equal to 50% of the costs of employee protection and workplace reconfiguration expenses, due to new COVID-19 regulations.

Childcare

The HEALS Act provides \$15 billion for childcare, \$5 billion more than the funding included in the HEROES Act that was passed by the Democrat-controlled House of Representatives on May 15. Read the full text of the proposal [here](#).

Liability Protections

Senator Mitch McConnell has [repeatedly said](#) that liability protections will be in any relief deal that passes the Senate. Liability protections appear in the HEALS Act via the Safeguarding America's Frontline Employees to Offer Work Opportunities Required to Kickstart the Economy Act, abbreviated the SAFE TO WORK Act. The Act would protect healthcare providers, businesses, volunteers, local governments, and administrators from liabilities associated with COVID-19 from December 2019 through October 2024. The [first wave of lawsuits](#) associated with the disease has just begun. [Some argue](#) that the Act would give employers a blanket waiver to skirt protections for workers' health. The CARES Act did not limit legal liabilities. It did [include a provision](#) requiring the Occupational Safety and Health Administration to draft new regulations to protect employees from COVID-19. The HEROES Act does not contain provisions limiting liability for employers, businesses, or schools.

Changes to the Paycheck Protection Program (PPP) and additional small business programs

The [Continuing Small Business Recovery and Paycheck Protection Program Act](#) (PPP) thoroughly revamps the PPP's scope to target the hardest-hit businesses that have experienced revenue losses; disqualifies publicly traded companies and other types of firms that the [original legislation](#) had included; and eases the loan forgiveness process. These changes are headlined by a second round of PPP loans to businesses with fewer than 300 employees, a lower general loan cap of \$2 million, and an expansion of eligible uses for funds that do not jeopardize loan forgiveness.

Much of the language is taken up with clarifying the PPP's intent by patching perceived holes in the program, which has already seen successive legislative and administrative changes. For example, the bill explicitly disqualifies several business structures and industries to address concerns raised when publicly traded companies and lobbying firms were awarded PPP loans.

Finally, the proposed legislation clears paths for loan forgiveness. The CARES Act mandates that borrowers submit evidence to support their loan application such as payroll tax filings, mortgage statements, and utility bills, along with a certification that such evidence is true and correct. The proposed legislation does away with the submission of evidence, significantly lowering the hurdles to both borrower and lender compliance. For loans smaller than \$150,000, which

comprise [87%](#) of approved PPP loans as of July 24 (6), borrowers must attest that they “made a good faith effort to comply with the [forgiveness] requirements” and maintain records relevant to compliance efforts. For loans between \$150,000 and \$2 million, the process is similar, but the Act specifies supporting documents that must be maintained.

By paring borrower eligibility down to only those hardest hit, this bill starts to wean small businesses off a lending program that seems ever more likely to become a grant program. The proposal also introduces two new long-term lending programs -- Recovery Sector Loans and the Small Business and Domestic Production Recovery Investment Facility -- which we summarize at the end of this section. These programs are not designed to deliver short-term relief, but rather to facilitate investments. Taken together, the PPP eligibility adjustments and new programs point toward recovery and away from a relief mindset.

Current program	HEROES Act	HEALS Act
\$659 billion for PPP	No mention of PPP	\$749 billion for PPP
	\$10 billion in small business grants	\$10 billion in 15-year loans to small business investment companies
		\$100 billion in 20-year “recovery sector loans” to hard-hit businesses, manufacturers, seasonal employers, and firms in small business low-income tracts

Targeting the hardest-hit businesses

Congress [extended](#) the PPP’s application period from its original June 30 deadline to August 8, with nearly \$140 billion left in appropriated funds. But the program has seen much less uptake than during its initial run. Rather than expand eligibility, the Senate bill addresses this funding surplus by narrowing its general criteria in two ways. First, the bill allows a second loan to PPP recipients with fewer than 300 employees. Second, businesses must have suffered revenue losses of at least 50%, defined as the change in gross receipts in 2020 from a period in 2019 when that business was open.

These “second draw” loans are limited to the lesser of 2.5 times the monthly value of an applicant’s payroll and \$2 million. This \$2 million cap would also extend to first loans. Finally, the bill further targets small borrowers by requiring at least \$25 billion of second-draw PPP loans to go to businesses with fewer than 10 employees.

A May report from the SBA Inspector General [found](#) that guidance to lenders prioritizing rural and underserved markets had not been issued by the SBA. As this guidance was specified by

CARES Act Section 1102(a)(36)(P)(iv), the report raised concern that the program might not be operating in a manner consistent with Congressional intent. The SBA did [issue](#) such guidance at a later date. The proposed bill does not alter CARES Act language, but would complement it by setting aside \$10 billion for small lenders and community financial institutions. Small lenders, often located in rural markets, delivered PPP loans [faster](#) than large lenders during the program's initial round and there is [some evidence](#) that rural areas were well represented among loan recipients. Data released by the SBA also suggest that community development financial institutions lent to underserved markets -- which the CARES Act defines as women, minorities, and veterans -- at somewhat higher rates than other lenders.

The bill includes \$90 billion of entirely new appropriations for the Paycheck Protection Program's second draw loans. It also combines the existing PPP pool with money already available for [Economic Injury Disaster Loans](#). This consolidation aims to give the programs more flexibility in effectively meeting demand from applicants. The proposal would also extend the application period until the end of the year; the application period is now set to close on August 8, 2020.

Disqualifying specific types of recipients that had raised controversy

The PPP came under fire from [oversight bodies](#) and [media](#) for awarding loans to publicly traded companies, lobbying firms, and insurance agencies. Section 106 of the new bill significantly redefines PPP eligibility, explicitly disqualifying those types of organizations, as well as think tanks, banks, and other lenders.

Media coverage also [focused](#) on loans to businesses owned in part or whole by members of Congress and their family members. Normally, SBA reviews small business loans for any conflicts of interest, but that practice [appears](#) to have been waived by the SBA. While the PPP lends through thousands of retail banks, constructing a buffer between the executive branch and lending, a previous YPFS blogpost [argued](#) that "a blanket waiver should raise concern." Section 117 of the Republican proposal requires members of cabinet and Congress to disclose controlling interests in companies when applying for PPP loans, creating a middle ground between case-by-case review and the blanket waiver.

Finally, the bill wades into the [debate](#) over economic decoupling with China. It introduces novel language that excludes businesses with significant stakes in entities located in the mainland or Hong Kong, and disqualifies those with board members who reside in China. While the executive branch has [led](#) federal efforts to distance US interests from Chinese production, in the last week Senate Republicans have [introduced several bills](#) that would limit American dollars from flowing into the People's Republic. Though inconsequential (few businesses small enough to be eligible for PPP are likely to maintain close ties with China), were this language to be adopted it would be the first mention of China in any of the United States' coronavirus response laws.

Easing the loan forgiveness process

The Senate proposal would also ease the loan forgiveness process. For loans under \$150,000, which have constituted the vast majority of PPP loans by number -- though not by value -- borrowers would be assumed to have made a good-faith effort at adhering to loan forgiveness terms if they attest to, and keep “relevant records” of, such efforts for three years. Loans between \$150,000 and \$2 million require that lenders review and attest to the completion of the loan forgiveness application. Borrowers of these larger loans must also store “relevant schedules, worksheets, and supporting documentation” for three years.

All proposed and enacted legislation related to the PPP has asserted the right of the SBA to audit or review any loan it has made, and this proposal allows the SBA to retroactively modify loan or forgiveness amounts when it finds noncompliance. However, the relaxation of loan forgiveness requirements and compliance is likely to result in most loans becoming grants with the filing of forgiveness applications. Since the [enactment](#) of the Paycheck Protection Program Flexibility Act on June 5, the PPP has allowed loan forgiveness to borrowers that used at least 60% of the loan for payroll expenses, with the rest allowed for covered expenses such as rent, insurance, and public health compliance.

The Senate proposal also clarifies protections for eligible lenders. Despite 100% participation by the SBA, some lenders have [remained](#) skittish about lending and forgiveness due to fears over potential liability and compliance. The Senate proposal codifies SBA guidance on this matter by assuring safe harbor protections to lenders who receive attestations or certifications from applicants.

Other provisions

The bill also introduces two new programs which businesses may apply for as an alternative to the PPP: Recovery Sector Loans and the Small Business and Domestic Production Recovery Investment Facility. These programs are significant in size and scope, costing the Treasury up to \$67.7 billion if enacted. They focus not on short-term relief, but long-term changes to businesses, with long loan maturities, allowances for proceeds to be spent on capital purchases, and a focus on hard-hit businesses and domestic manufacturing. However, these proposals are wholly novel and have no corollaries in the HEROES Act.

The proposal authorizes \$100 billion for recovery sector loans up to \$10 million. These loans are attached to narrower eligibility requirements than the PPP: borrowers must have lost revenues in excess of 50% from 2019, be seasonal businesses (defined in [Subsection 112\(38\)\(A\)\(iii\)](#)), or do significant business inside a new statistical creation, the small business low-income census tract (defined in [Subsection 112\(38\)\(A\)\(v\)](#)). Rather than provide quick relief, these loans can be used for Small Business Act 7(a) covered expenses in addition to fixed capital improvements, upgrades, and debt refinancing. These loans carry 20-year maturities at the Secured Overnight Financing Rate plus 3% and do not include forgiveness provisions.

The proposal would also appropriate \$10 billion for a lending facility to small business investment companies. In this model, the SBA would buy 15-year bonds from investment

companies at an interest rate not exceeding 2%. The proposal would cap loan amounts at \$200 million. Proceeds from the sale would then fund investments into manufacturing supply chain resiliency, small business low-income census tracts, and businesses that lost at least 50% of revenue between 2019 and 2020. The bonds, however, carry some characteristics of equity holdings, notably a condition ensuring some amount of profit flows back to SBA should an investment be successful.

Conclusions

The bills put forward by Senate Republicans alter and extend the provisions of the CARES Act programs, enacted on March 27 but in some cases revised by further legislation.

These provisions seek to accomplish three goals. First, direct payments to individuals would provide [needed](#) support to the unemployed and stimulus for the [battered](#) American economy. Second, the proposal would transition recovery programs to targeting longer-term policies as schools and businesses seek to reopen while upgrading their public health practices. Third, the bills seek to fix problems discovered during the implementation of CARES Act programs. Within the context of the other eight bills that together constitute the GOP spending proposal, it is clear that both Republican Senators and the White House administration are prioritizing re-opening businesses and schools amid [broad disagreement](#) about the fate of fall education.

The HEALS Act will have to be negotiated against the \$3 trillion HEROES Act. (This [YPFS blog](#) discusses the HEROES Act in more detail.) The two acts both include a second-round of stimulus payments, funding for childcare, and enhanced unemployment payments. However, the HEROES Act substantially expands the amount of money available for each of these purposes.

Currently, there is no consensus on when a bill could pass both chambers. Congress is set to adjourn on August 7 for a month-long recess.

U.S. Banks to Maintain Dividends for Now, Following Pre-COVID Stress Test

By Devyn Jeffreis and Greg Feldberg

Original post [here](#).

Most of the largest U.S. banks announced Monday that they will continue to pay dividends in the third quarter at the same level as the second quarter. This news comes just two business days after the Federal Reserve announced the results of its annual stress test and an unprecedented “sensitivity analysis” estimating the potential impact of different economic recoveries from the COVID recession on bank performance. Based on these scenarios, the Fed announced a number of temporary restrictions on dividends and other corporate actions.

The Fed’s [stress test](#) forecasted \$433 billion in loan losses for the 33 largest banks under a severely adverse scenario that it announced in February, prior to the COVID crisis (see [page 19](#)). The test extends nine quarters, through March 2022.

Losses are much worse under all of the Fed’s scenarios in the [sensitivity analysis](#), which takes COVID into account. The analysis forecasts \$560 billion in loan losses under the most optimistic post-COVID scenario, which assumes a rapid “V-shaped” recovery. Projected loan losses are just over \$700 billion in a “U-shaped” recovery and \$680 billion in a “W-shaped” recovery. For comparison, the 33 banks had \$10.4 trillion in risk-weighted assets and \$1.2 trillion in capital at the end of 2019 (see [page 23](#)).

The Fed uses the results of its stress test to determine large banks’ capital requirements every year. However, it plans to “assess banks’ capital plans more frequently during this time of uncertainty” (see [page 1](#)). It will require banks to re-submit their capital plans later this year based on revised scenarios that the Fed will provide. The results could reveal larger capital deficits and lead to more aggressive restrictions on corporate actions.

Maintaining dividends

On Thursday, the Fed said it would allow banks to pay common stock dividends in the third quarter, but no more than their average income over the prior four quarters and no more than they paid in the second quarter, whichever is less. It won’t allow share repurchases in the third quarter; the eight U.S. global systemically important banks (G-SIBs) voluntarily suspended share repurchases in the second quarter.

All but one of the eight G-SIBs said Monday that they plan to maintain their dividends in the third quarter at prior levels. Wells Fargo, which [appears to be](#) the only G-SIB whose recent dividends have exceeded its average net income, said in a [statement](#) that it expects second-quarter losses will exceed first-quarter losses, and that it plans to reduce its dividend.

Goldman Sachs [hinted](#) that it may have to rebuild capital to maintain its dividends. The company is the only G-SIB whose capital is below the Fed's required buffer based on the stress test results – its common equity tier 1 capital (CET1) ratio was 12.5% at the end of March, compared to the 13.7% the Fed will require it to reach by October 1. However, Goldman said it has recently brought the ratio back over 13%.

“We have a track record of rebuilding capital when necessary,” its chairman and CEO, David Solomon, said in the press release. “We fully intend to continue this dynamic capital management while helping our clients continue to navigate challenging markets.”

As shown in the below table, there have been significant changes in net income over the past four quarters. However, those declines have not translated into changes in the dividends expected to be paid in the third quarter. Analysts forecast that 27 of the 33 banks will report second-quarter net income below the average of the four prior quarters. Twenty-five of the 33 banks have announced, or are forecasted, to pay dividends in the third quarter equal to those they paid in the second quarter.

Dividend History and Net Income Analysis (Source: Bloomberg)

Firms (USD except as noted)	Q3 2020 Dividend (consensus estimate or announced) (based on paydate)	Q2 2020 Dividend (based on paydate)	Q1 2020 Dividend (based on paydate)	Q2 2020 Net Income (consensus estimate) in millions	Q1 2020 Net Income in millions	Q4 2019 Net Income in millions	Q3 2019 Net Income in millions	Four Quarter Net Income Average in millions
Ally Financial Inc.	0.190	0.190	0.190	37.23	-319.00	378.00	381.00	119.31
American Express Company	0.430 (Announced 5/07)	0.430	0.430	134.67	367.00	1,693.00	1,755.00	987.42
Bank of America Corporation	0.180	0.180	0.180	2,866.38	4,010.00	6,994.00	5,777.00	4,911.84
The Bank of New York Mellon Corporation	0.310	0.310	0.310	814.57	980.00	1,440.00	1,038.00	1,068.14
Barclays US LLC (GBP)	-	-	-	270.38	826.00	866.00	-27.00	483.85
BMO Financial Corp. (CAD)*	1.060 (Announced 5/27)	1.060	1.060	689.00	1,592.00	1,194.00	1,557.00	1,258.00
BNP Paribas USA, Inc. (EUR)	-	-	-	1,549.71	1,282.00	1,849.00	1,938.00	1,654.68
Capital One Financial Corporation	0.400	0.400	0.400	-547.46	-1,340.00	1,176.00	1,333.00	155.39
Citigroup Inc.	0.510	0.510	0.510	898.50	2,522.00	4,979.00	4,913.00	3,328.13
Citizens Financial Group, Inc.	0.390	0.390	0.390	-47.29	34.00	450.00	449.00	221.43
Credit Suisse Holdings (USA), Inc. (CHF)**	-	0.069	-	702.78	1,314.00	852.00	881.00	937.44
DB USA Corporation (EUR)	-	-	-	-400.40	43.00	-1,518.00	-859.00	-683.60
Discover Financial Services	0.440	0.440	0.440	44.86	-61.00	708.00	770.00	365.46
Fifth Third Bancorp	0.270 (Announced 6/16)	0.270	0.240	216.80	46.00	734.00	549.00	386.45
The Goldman Sachs Group, Inc.	1.250	1.250	1.250	1,318.44	1,213.00	1,917.00	1,877.00	1,581.36
HSBC North America Holdings Inc.	-	-	-	304.38	2,248.00	-5,310.00	3,477.00	179.85
Huntington Bancshares Incorporated	0.150 (Announced 4/23)	0.150	0.150	124.49	48.00	317.00	372.00	215.37
JPMorgan Chase & Co.	0.900 (Announced 5/18)	0.900	0.900	3,049.00	2,865.00	8,520.00	9,080.00	5,878.50
KeyCorp	0.185	0.185	0.185	141.50	146.00	469.00	416.00	293.13
M&T Bank Corporation	1.100	1.100	1.100	306.40	268.82	493.07	480.08	387.09
Morgan Stanley	0.350	0.350	0.350	1,597.67	1,698.00	2,239.00	2,173.00	1,926.92
MUFG Americas Holdings Corporation (JPY)***	-	12.500	-	118,600.00	-56,127.00	-25,680.00	218,891.00	63,921.00
Northern Trust Corporation	0.700 (Announced 4/21)	0.700	0.700	297.80	360.60	371.10	384.60	353.53
The PNC Financial Services Group, Inc.	1.150	1.150	1.150	1,310.25	908.00	1,367.00	1,379.00	1,241.06
RBC US Group Holdings LLC (CAD)*	1.080 (Announced 5/27)	1.080	1.050	1,484.00	3,504.00	3,201.00	3,263.00	2,863.00
Regions Financial Corporation	0.155 (Announced 4/22)	0.155	0.155	83.07	162.00	389.00	409.00	260.77
Santander Holdings USA, Inc. (EUR)	-	-	-	1,365.20	331.00	2,783.00	501.00	1,245.05
State Street Corporation	0.520 (Announced 5/20)	0.520	0.520	467.80	634.00	564.00	583.00	562.20
TD Group US Holdings LLC (CAD)*	0.790 (Announced 5/28)	0.790	0.740	1,515.00	2,989.00	2,856.00	3,248.00	2,652.00
Truist Financial Corporation	0.450	0.450	0.450	1,029.80	1,060.00	721.00	825.00	908.95
UBS Americas Holding LLC****	-	0.183	-	983.33	1,595.00	722.00	1,049.00	1,087.33
U.S. Bancorp	0.420 (Announced 6/16)	0.420	0.420	430.78	1,171.00	1,486.00	1,908.00	1,248.94
Wells Fargo & Company	0.200	0.510	0.510	672.20	653.00	2,873.00	4,610.00	2,202.05

***Due to differences in the Canadian Fiscal Calendar the quarters for these companies end dates are as follows: Q2 2020 (4/30/2020), Q1 2020 (1/31/2020), Q4 2019 (10/31/2019), Q3 2019 (7/31/2019)**

****Credit Suisse Holdings (USA), Inc. announced two dividends on 4/09, .0694 CHF payable 5/11 and .1388 CHF that has no paydate**

*****MUFG Americas Holdings Corporation announced a dividend of 12.50 JPY on 5/15 that has no paydate / Japanese Fiscal Calendar differs such that Q2 2020 is Q1 2021 (6/30/2020), Q1 2020 is Q4 2020 (3/31/2020), Q4 2019 is Q3 2020 (12/31/2019), Q3 2019 is Q2 2020 (9/30/2019)**

******UBS Americas Holding LLC announced two dividends on 4/09, .1825 USD payable 5/07 and .365 USD that has no paydate**

The Fed's bank dividend policy has been controversial within the central bank. Fed Governor Lael Brainard released a [statement](#) critiquing the policy. "[Dividend] payouts will amount to a depletion of loss absorbing capital," she wrote. "This is inconsistent with the purpose of the stress tests, which is to be forward looking by preserving resilience, not backward looking by authorizing payouts based on net income from past quarters that had already been paid out."

Fed Governor Randal Quarles, who is also the Fed's vice chairman for supervision, [explained](#) his support for the measures. "[The] approach builds on our existing standards on capital distributions, which restrict distributions based on recent income," he wrote. "If the circumstances warrant, we will not hesitate to take additional policy actions to support the U.S. economy and banking system. I support today's actions to ensure banks remain an ongoing source of strength to the U.S. economy."

Stress test revisions: Setting the new Stress Capital Buffer

The Fed introduced a new method for setting capital requirements for the largest banks in this year's stress test (see the [staff memo](#), page 7). Previously, the Fed required these banks to meet two sets of standards: the Basel III standards (agreed to by international regulators), and the results of its annual stress test. The new method essentially merges the two.

The Fed continues to require the largest banks to hold CET1 equal to 4.5% of their risk-weighted assets, at minimum. G-SIBs are also required to hold an additional buffer based on their systemic importance, currently ranging from 1.0% to 3.5% for the eight U.S. G-SIBs.

The new part is the "stress capital buffer." It is based on each bank's net loss in the stress test--the difference between the bank's starting and minimum projected capital ratios--plus four quarters of planned dividends as a percentage of risk-weighted assets. The stress capital buffer can't be less than 2.5%, the level of the capital conservation buffer under Basel III.

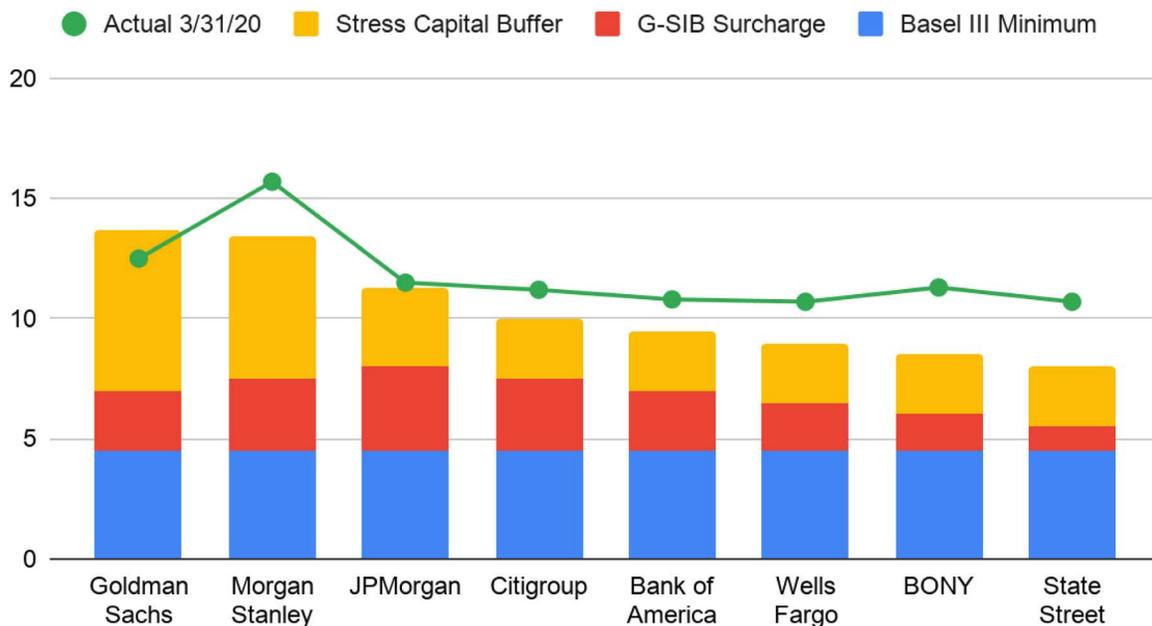
Any bank whose capital ratio falls below the sum of the 4.5% minimum, the individual G-SIB surcharge, and the individual stress capital buffer will be subject to automatic restrictions on capital distributions.

In its stress test report, the Fed reported each bank’s net loss. The Fed confidentially told each bank its individualized stress capital buffer, including projected dividends.

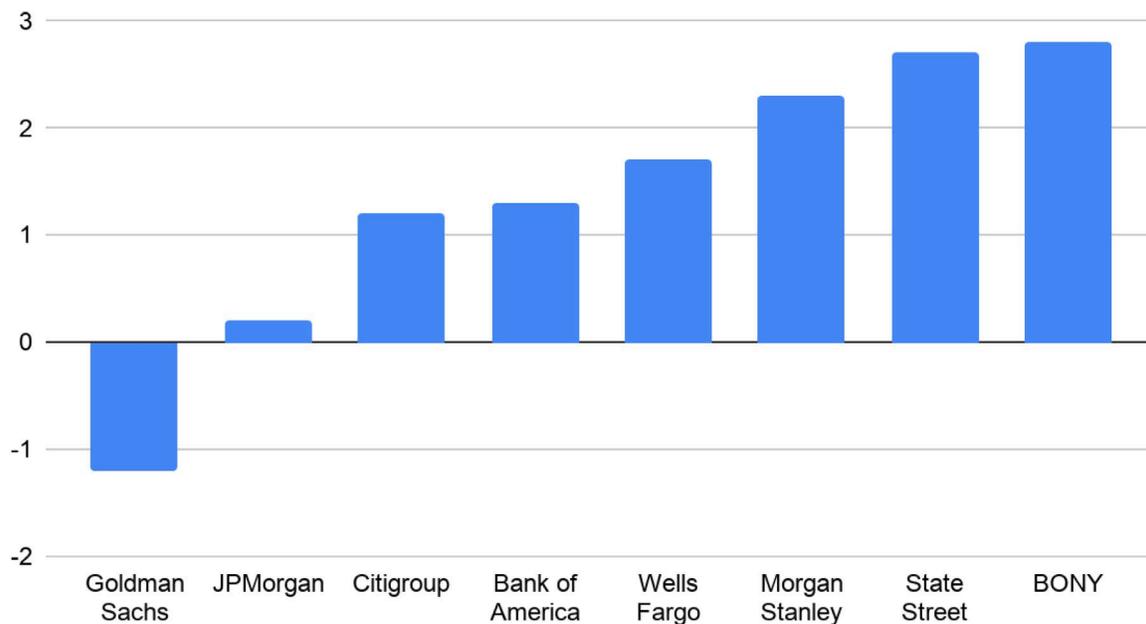
Most of the largest banks publicly disclosed their stress capital buffer on Monday. For five of the G-SIBs, their net losses in the stress test were low and the Fed set their stress capital buffer at 2.5%. The Fed set [JP Morgan Chase’s](#) stress capital buffer at 3.3%, [Morgan Stanley’s](#) at 5.9%, and [Goldman Sachs’s](#) at 6.7%.

The first figure below shows each G-SIB’s total capital requirement, based on Monday’s announcements, compared to their actual CET1 ratios reported for the end of the first quarter. The second figure shows the cushion or deficit based on those figures. Banks have until October 1 to resolve any deficits.

Actual vs Required Common Equity Tier 1 (% risk-weighted assets)



Capital Cushion as of March 31, 2020 (% risk-weighted assets)



2020 stress test: Aggregate results

This year, the Fed analyzed 33 firms in its stress test. The severely adverse scenario consisted of 28 variables, including a maximum drop in gross domestic product (GDP) of about 8.5% from the pre-recession peak and a jump in unemployment to a high of 10%.

The results projected aggregate losses of \$552 billion for the 33 firms, including \$433 billion in loan losses, \$6 billion in securities losses, \$85 billion in trading and counterparty losses, and \$29 billion in other losses. Nine-quarter loan loss rates were 6.3% in aggregate. The Fed projected the aggregate CET1 ratio for the 33 companies to fall from 12.0% at the end of 2019 to 10.3% in March 2022, hitting a minimum of 9.9% during the period (see [page 23](#)).

The results aren't directly comparable to the Fed's 2019 stress test, because it now requires smaller banks to conduct the test every two years. But the Fed reported that losses were roughly comparable for the 18 largest banks that participated in both tests. These banks had projected losses of \$410 billion in the 2019 test and \$433 billion in the 2020 test (see [page 1](#)).

The Fed made other important changes in its methodology. It now assumes that a bank's assets won't grow over the projection horizon and that a bank won't pay dividends on common stock, or issue new stock. These changes significantly improve banks' projected capital ratios (see [page 22](#)). Dividends in recent stress tests prior to the change in methodology amounted to about 70 basis points for GSIBs and 100 basis points for other banks, according to a paper last year (see [page 10](#)). To be sure, the new methodology takes back much of that benefit by adding four quarters of dividends in computing the stress capital buffer.

2020 sensitivity analysis: Aggregate results

In addition to the stress test, which uses scenarios that the Fed began constructing in late 2019, the Fed released a supplemental sensitivity analysis to account for the emerging economic impacts of the COVID pandemic.

Due to the uncertain economic implications of the COVID pandemic, the sensitivity analysis includes three hypothetical scenarios based on potential recovery paths. In comparison to the severely adverse scenario outlined in the stress test, each of the pandemic scenarios uses similar methods and analyzes the same 33 firms. Unlike the stress test, the Fed did not disclose firm-specific data about the sensitivity analysis.

The sensitivity analysis also incorporates higher peak unemployment and larger decreases in GDP, along with targeted adjustments. Unlike the stress test, it assumes bank balance sheets will grow: It assumes a 12% increase in outstanding corporate loans and a 30% increase in risk-weighted assets for the first quarter of 2020.

To adjust for industry-specific stress, the Fed incorporated a one-letter-grade credit downgrade for loans in impacted sectors.

The Fed also included temporary amendments regarding tax loss carrybacks and carryforwards in the tax code from the CARES Act into its calculation of post-stress capital.

The three scenarios are “V-shaped,” “U-shaped,” and “W-shaped”:

- The V-shaped scenario begins with a deep recession in the immediate first two quarters, with real GDP contracting by 31.5% (annualized) and unemployment jumping to 19.5%. This is followed by a rapid recovery in the third and fourth quarter of 2020, resulting in above-trend GDP growth in 2021 and 2022 and a decline in unemployment that remains above the low rate achieved before the pandemic. In this scenario, the Fed projects the aggregate CET1 ratio will fall from 12% at the end of 2019 to as low as 9.5% during the nine-quarter period (see [page 2](#)). The Fed projects the aggregate nine-quarter loan loss rate at 8.2%.
- The U-shaped scenario has a prolonged recession in which the unemployment rate peaks at 15.5% and maintains that level for a number of quarters before levelling off above the actual March 2020 rate. In addition, GDP fails to rebound meaningfully and does not reach its previous trend. As a result, the projected CET1 ratio falls as low as 8.1%. The projected nine-quarter loan loss rate is 10.3%.
- The W-shaped scenario has an initial recovery that is stymied by a second outbreak and resulting downturn. In the first phase, real GDP contracts by 37.5% (annualized) and unemployment increases to 16% in June 2020. However, GDP growth rebounds strongly in the second half of 2020, returning nearly to pre-crisis levels. This recovery is halted by a second outbreak and lockdown. In response, GDP falls 12% in the first quarter of 2021 and unemployment rises again as high as 14%. The second recession is

more shallow but longer. The projected CET1 ratio falls as low as 7.7% and the projected nine-quarter loan loss rate is 9.9%. Beyond the projection horizon, the loan loss rates are persistently higher and CET1 ratios are lower than in the other scenarios.

Scenario Variables and Aggregate Results

Scenario	Peak Unemployment	Peak-to-trough GDP Change	Lowest 10-Year TSY Rate	Minimum CET1 Ratio**	Loan Loss Rates* (est. Q1 2020-Q1 2022)
Severely Adverse	10.0	-8.5	0.7	9.9	6.3
V-Shaped	19.5	-10.0	0.8	9.5	8.2
U-Shaped	15.6	-13.8	0.6	8.1	10.3
W-Shaped	16.0	-12.4	0.5	7.7	9.9

***Note that projected loan losses across scenarios are the main driving force of differences in the CET1 ratio**

****The aggregate CET1 ratio at the end of 2019 was 12.0%**

Key takeaways from stress test and sensitivity analysis

The results of the stress test and sensitivity analysis display a broad range of potential outcomes. Banks' projected CET1 ratios remain significantly above regulatory minimums in both the severely adverse scenario of the stress test and the V-shaped scenario of the sensitivity analysis. The bottom 25th percentile firm-level post-stress CET1 ratio is 8.0% for the severely adverse scenario and 7.5% for the V-shaped scenario. Both are significantly above the 4.5% minimum, although some banks may fall below their buffer levels and be subject to automatic capital restrictions under those scenarios.

On the other hand, the Fed projects CET1 ratios will remain above minimum requirements in aggregate but will fall to dangerous levels for many banks in the U-shaped and W-shaped scenarios. The bottom 25th percentile firm-level post-stress CET1 ratio is 5.5% in the U-shaped scenario and 4.8% in the W-shaped scenario. This suggests that several banks could break the 4.5% minimum; many others could break their buffers and be subject to automatic capital restrictions under those scenarios.

European and Japanese G-SIB Report Second-Quarter Results

By Junko Oguri

Original post [here](#).

In the midst of the COVID-19 lockdown, earnings beat expectations for most European and Japanese banks in the second quarter due to a surge in non-interest income that offset rising loan-loss provisions.

In the blog post “[Banks’ Second-Quarter Results Boosted by Non-Interest Income and Official Support](#)”, we analyzed US large banks’ second-quarter earnings. Recently, European and Japanese banks also updated their earnings. In this blogpost, we analyze the results of 12 European global systemically important banks ([G-SIBs, as of 2019](#)) and three Japanese G-SIBs for the three months through June 30. (This period represents the second quarter of the 2020 financial year for European banks and the first quarter of the 2021 financial year for Japanese banks).

European G-SIBs: 12 financial institutions

Reporting Date Firm name

7/24

[UBS](#)

[Barclays](#)

7/29

[Santander](#)

[Deutsche Bank](#)

7/30

[Credit Suisse](#)

[Standard Chartered](#)

7/31

[BNP Paribas](#)

[Société Générale](#)

8/3

[HSBC](#)

[Groupe Crédit Agricole](#)

8/6

[ING Bank](#)

[UniCredit](#)

Japanese G-SIBs: 3 financial institutions*

Reporting Date Firm name

7/29 [Sumitomo Mitsui Financial Group](#)

7/31 [Mizuho Financial Group](#)

8/4 [Mitsubishi UFJ Financial Group](#)

* Japanese financial institutions have not updated their regulatory capital information.

Given the deep recession and prolonged COVID-19 crisis, earnings reports can serve as a thermometer of the economy and the financial system.

Similar to their US peers, the results were not as devastating as the market expected. While sluggish household and firm borrowing limited lending activities, financial institutions with investment banking businesses benefited from active bond issuance and the strong stock market. Most European banks adopted the new IFRS9 accounting standard and set aside higher expected credit loss (ECL) provisioning for future loan losses. Many of those banks took advantage of the transition treatment to ease the impact of the losses on their capital.

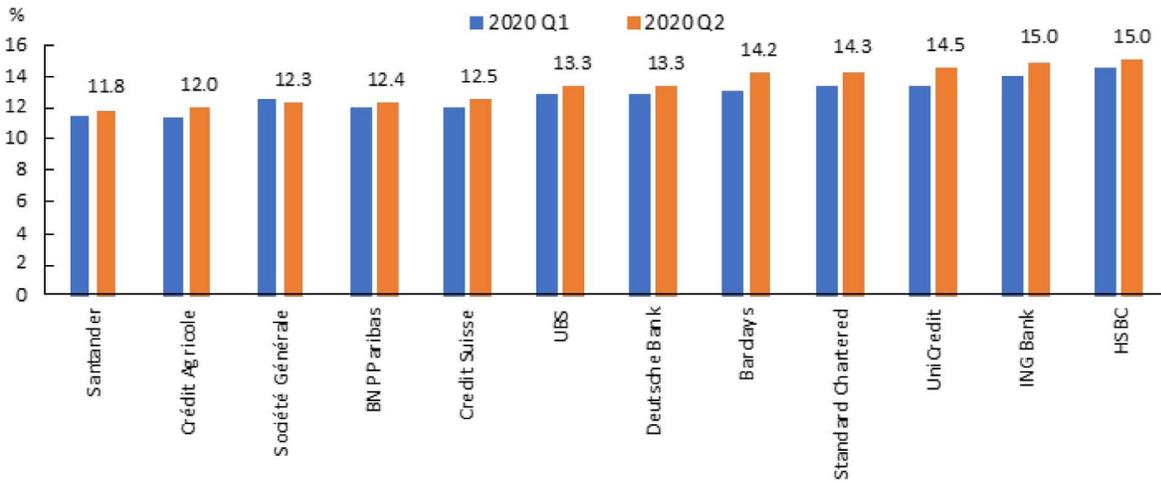
In general, the economic shocks that COVID-19 has created so far in Europe and Japan have been somewhat milder than those in the US. For instance, the [euro area](#) unemployment rate was at 7.8 % in June 2020, compared to 11.1% of [the US](#). In the second quarter of 2020, gross domestic product ([GDP](#)) dropped by 12.1% in the euro area and 32.9% in [the US](#). Although [Japan's GDP](#) dropped by 21.7% and consumer confidence hit its lowest on record, the death rate caused by the COVID-19 has been much milder than the US and the economy has begun to reopen. Still, the outlook may not be promising for Japan's finance sector. Banks have already been challenged by prolonged low interest rates and low profitability.

In this blogpost, we analyze earnings reports in terms of six areas: 1) CET1 capital ratio, 2) Net income and revenues, 3) Non-performing loans, 4) Loan loss provisioning, and 5) Market reaction and equity price.

1. CET1 Capital Ratio

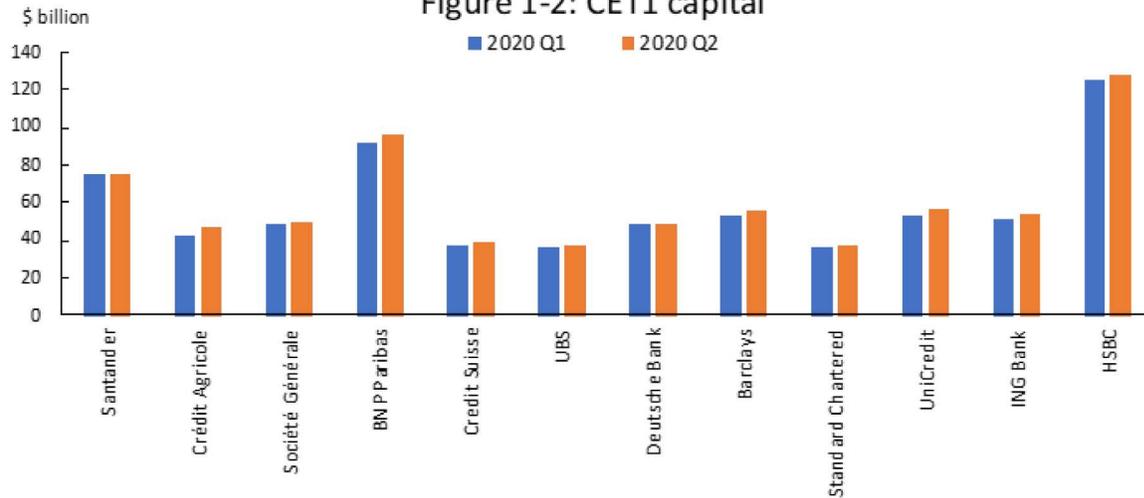
The common equity Tier 1 (CET1) capital ratio, an important regulatory indicator of bank solvency, increased quarter-on-quarter (QoQ) for 11 of the 12 financial institutions; the outlier was Société Générale (Figure 1-1). CET1 capital (the numerator) increased for all firms while risk-weighted assets (RWA, the denominator) decreased for 7 firms (Figure 1-2 and 1-3).

Figure 1-1: CET1 regulatory ratio

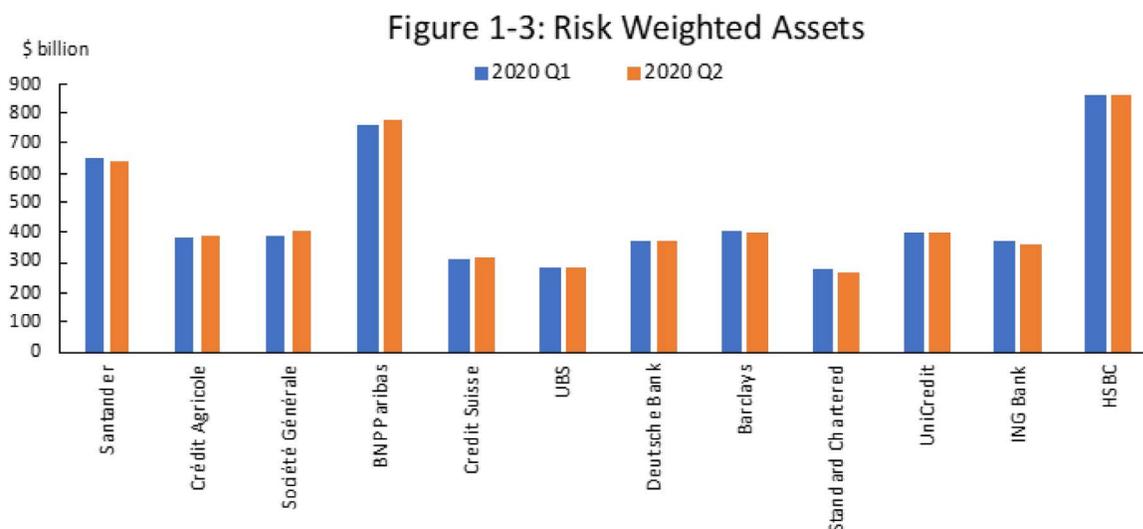


(Sources) Bloomberg, Bank quarterly reports

Figure 1-2: CET1 capital



(Sources) Bloomberg, Bank quarterly reports



(Sources) Bloomberg, Bank quarterly reports

Several European banks attributed the increase in CET1 to the suspension of capital distributions. For instance, HSBC noted that the cancellation of the quarterly unpaid dividend of \$3.4 billion contributed to the increase of its CET1 capital.

As noted in our recent [blog post](#), European and UK regulators have called on banks to suspend dividends and other capital distributions. In the UK, for example, the Prudential Regulation Authority asked the seven largest systemic UK banks to suspend dividends and share repurchases until the end of 2020 and to refrain from paying cash bonuses to senior executives. Switzerland and Japan have not introduced such measures.

Barclays and a few other financial institutions also noted that the IFRS 9 transitional relief contributed to the increase in CET1 capital.

While improved CET1 ratio for most financial institutions were driven by the surge in CET1 capital, some also managed to decrease their risk-weighted assets. For instance, the significant decrease in RWA for ING contributed to a 0.9% boost in its CET1 ratio. ING explained that the adoption of the standardized approach for sovereign exposures (0% risk weights for sovereign debts issued in domestic currency) and the amendments of EU regulations No 575/2013 (CRR) and 2019/876 (CRR II) (so-called “[CRR quick fix](#)”) led to the decrease in its credit risk, particularly for exposures to small business and infrastructure loans.

Some financial institutions attributed the increase in RWA to the surge in market risk.; for example, while overall RWA decreased, Standard Chartered said that its market risk RWA increased by \$2 billion due to higher levels of Financial Markets activity, with increased value-at-risk from elevated market volatility.

Meanwhile, the regulatory required capital ratios have decreased for some banks, mainly due to the release of countercyclical buffers and capital conservation buffers (see the blog post [here](#)).

Some banks reported the resulting declines in their capital requirements. For instance, UBS reported that the buffer release by the Swiss National Bank and several other countries led to a 29 basis-point reduction in its CET1 capital requirement.

Under Basel III, all banks must hold high-quality capital equal to 4.5% of their risk-weighted assets, plus a 2.5% capital conservation buffer (CCB). The purpose of the CCB is to encourage banks to conserve capital. When the buffer is breached, banks must limit bonuses to managers and distributions to shareholders.

Before the current crisis, about a dozen countries had also imposed a countercyclical capital buffer on their banks (CCyB). The CCyB is a buffer under Basel III that countries can build during boom times and draw down during busts to absorb losses and mitigate the increase in risk-weighted assets; they may set it as high as 2.5%. The Basel III CCyB is calculated as the weighted average of the buffers in effect in the jurisdictions to which banks have a credit exposure. Furthermore, jurisdictional reciprocity will be applied in the context of internationally active banks. Among jurisdictions where G-SIBs domicile, France, Germany, and UK have lowered their CCyB while Switzerland lowered its sectoral CCyB targeted at residential mortgage loans from 2.5% (Figure 1-4).

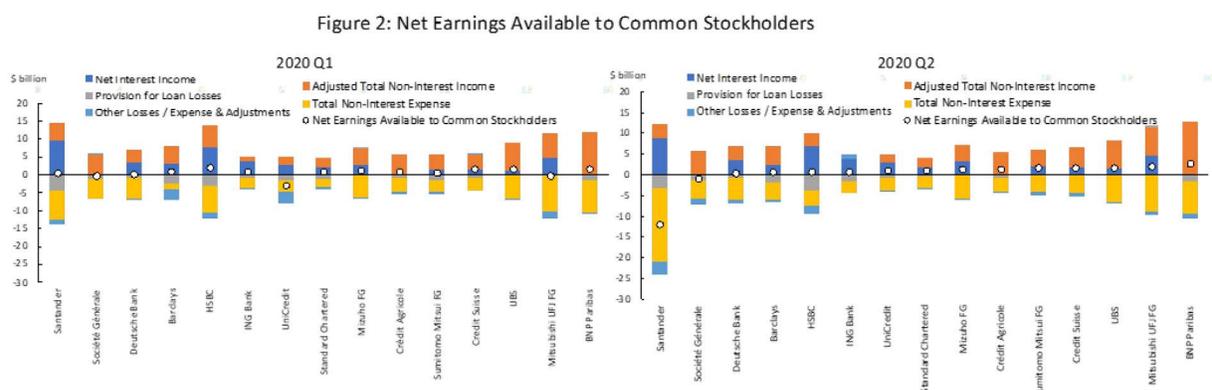
Figure 1-4: Major jurisdictions' actions and statements on CCyB

- | | |
|-------------|--|
| France | <ul style="list-style-type: none">• French authorities to reduce the countercyclical capital buffer from 0.25% RWA to 0% RWA in accordance with the European Central Bank proposal. (March 18) |
| Germany | <ul style="list-style-type: none">• Deutsche Bundesbank announced its regulator intends to lower the countercyclical capital buffer from 0.25% to 0% as of April 1. (March 18) |
| Italy | <ul style="list-style-type: none">• Banca d' Italia has maintained the countercyclical buffer rate at 0% (March 27 and June 26) |
| Netherlands | <ul style="list-style-type: none">• DNB has decided to leave the CCyB unchanged at 0%. (June 19) |
| Spain | <ul style="list-style-type: none">• Banco de España holds the countercyclical buffer at 0%. (March 31) |
| Switzerland | <ul style="list-style-type: none">• Federal Council announced that it would retain the countercyclical capital buffer at 0% and sectoral CCyB targeted at mortgage loans financing residential property located in Switzerland at 2.5%. (February 7)• On 27 March, Federal Council announced that it would release sectoral CCyB (March 27) |
| UK | <ul style="list-style-type: none">• Bank of England lowered the countercyclical capital buffer rate from 1% to 0% to support banks in extending credit facilities to customers. Also reinforced the expectation that all elements of capital buffers can be drawn |

down as necessary to support the economy through the shock. In the statement, BOE noted that the release of the countercyclical capital buffer will support up to £190 billion of bank lending to businesses. ([March 11](#))

2. Net Income and Revenues

Earnings rose for nine of the 15 firms, stayed roughly the same for one firm, and fell for the other five, compared to the first quarter. However, the results were better than market expectations (Figure 2).



(Sources) Bloomberg, Bank quarterly reports

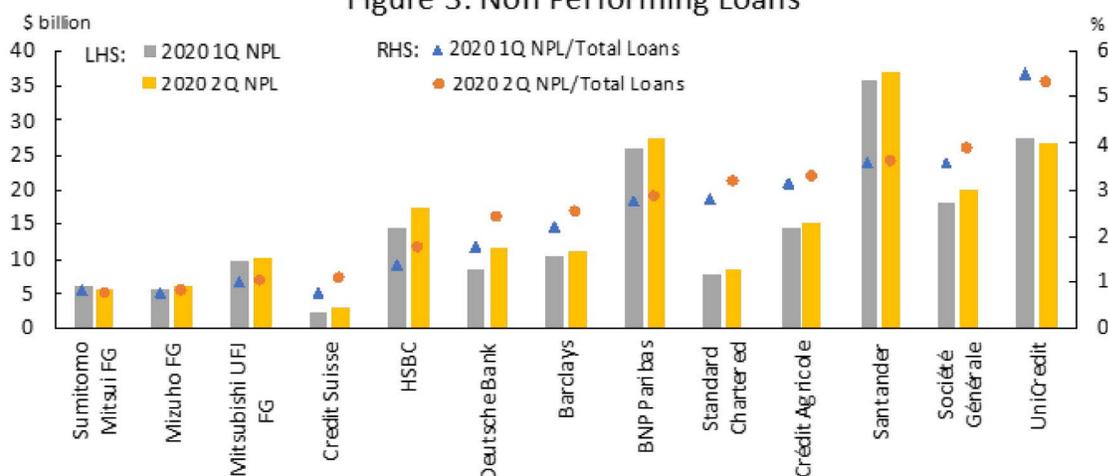
Robust net earnings were backed by strong non-interest income. As well as their European peers, trading profit surged, particularly for the G-SIBs, due to the higher client trading activities induced by wider trading spreads in volatile financial markets as clients repositioned their portfolios.

Some financial institutions noted that their equity and fixed-income underwriting businesses also contributed to the rise in non-interest income; given the attractive low interest rates, clients' demand for bond issuance has been growing. A few banks, including Deutsche Bank, noted the improvement in their cost management as well.

3. Non-Performing Loans

While banks' earnings were stronger than expected, non-performing loans (NPLs) increased 7.0% in aggregate for the 13 banks compared to the first quarter (Figure 3). The ratio of NPLs to total loans increased for nine of the 10 financial institutions. Many banks noted that in addition to small and medium-sized corporate borrowers, commercial real estate, aviation, restaurants and leisure, retail, and energy-sector borrowers face severe challenges.

Figure 3: Non Performing Loans



(Sources) Bloomberg, Bank quarterly reports

However, reported nonperforming loans would have been worse if banks had not provided relief to many borrowers, under the cover of accounting and other forbearance provided by jurisdictions in response to the COVID-19 pandemic. Many loans went under deferral programs or had their terms modified. (See [here](#) for more details on Loan Modifications, Non-Performing Loans, and Accounting relief).

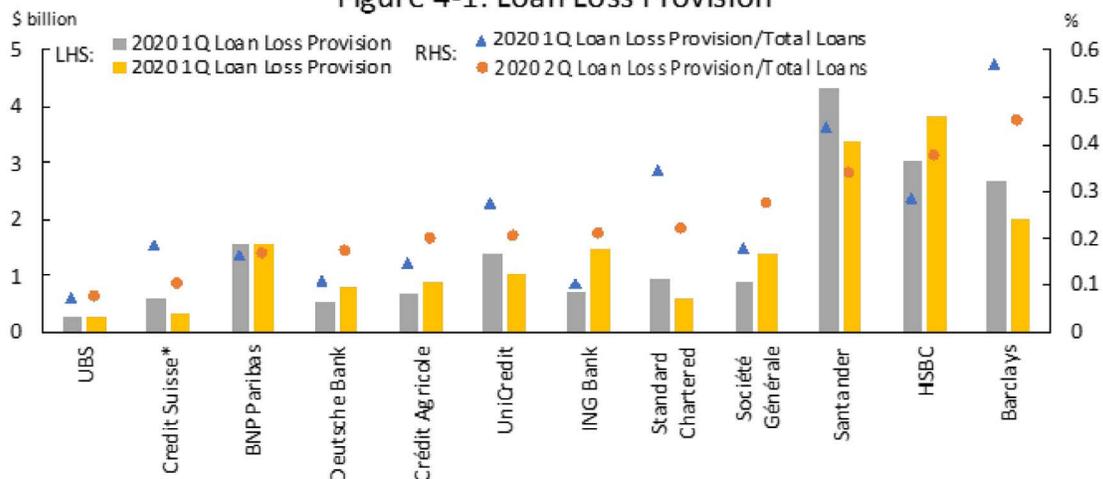
The European Central Bank (ECB) has [confirmed](#) supervisory flexibility regarding the treatment of NPLs. For example, the ECB discourages banks from automatically classifying loans to borrowers who are unable to meet payments because of the pandemic. The ECB expects banks to take advantages of government guarantees. Furthermore, ECB is reportedly considering adopting bad banks, which are asset management companies that acquire bad loans (see our related blog post [here](#)). Other jurisdictions have also adopted similar forbearance and moratorium policies.

Banks varied widely in the details they reported on the impact of payment deferrals and other COVID-19 relief. In general, those with large retail banking businesses were more subject to the supervisory forbearance. For instance, Deutsche Bank reported over €17 billion in loans that were subject to moratoria, forbearance measures, and public-guarantee schemes.

4. Loan Loss Provisioning

For the 12 financial institutions combined, the loan loss provision decreased by 3% compared to the first quarter (Figure 4-1). The ratio of loan loss provisions to total loans increased for half of the banks.

Figure 4-1: Loan Loss Provision



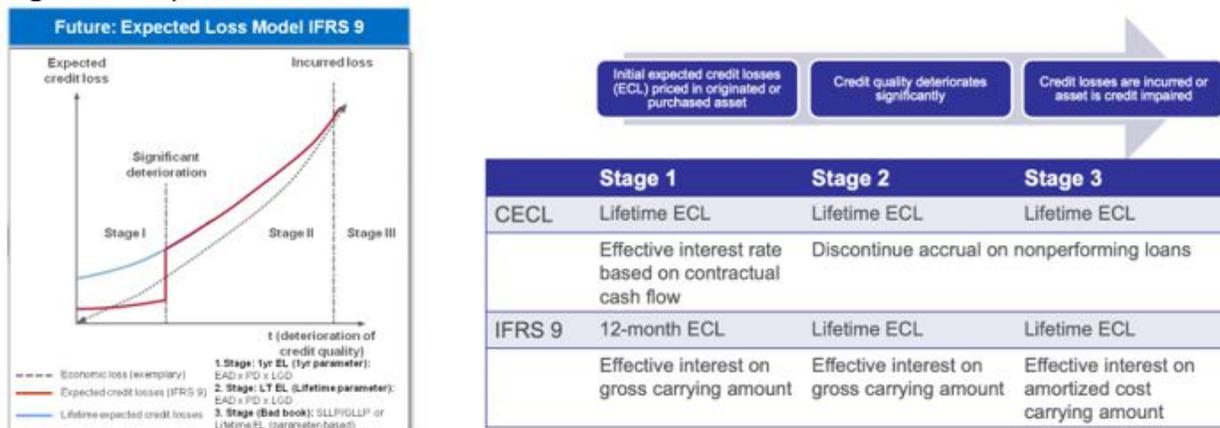
(Sources) Bloomberg, Bank quarterly reports

ING experienced a particularly large increase; its loan loss provision doubled from the previous quarter. According to [the Financial Times](#), ING was one of the largest lenders to Wirecard, a German payment firm that filed for insolvency in late June amidst scandal.

Some of the increases in loan loss provision for 23 European banks could be attributed to the new forward-looking credit loss standard in IFRS9. (Unlike most European banks, Credit Suisse reported its consolidated financial report under US GAAP; thus it adopted the current expected credit losses (CECL) standard, the new forward-looking standard in the US. Japanese banks report their consolidated financial reports under J-GAAP, which has not incorporated a forward-looking standard.)

Under IFRS9, if the credit risk has not increased significantly from the loan origination (Stage 1), banks recognize allowances based on 12 months of expected losses. However, if the credit risk has increased significantly (Stage 2) and if the loan is credit-impaired (Stage 3), the standard requires allowances based on lifetime expected losses (Figure 4-2). [An ESRB paper](#) and others argue that as the exposures transfer from Stage 1 to 2, there will be a “cliff effect” in loan loss provisions due to the changes in time horizon. They worry that this could lead to procyclicality in the financial system.

Figure 4-2 Expected Credit Loss Model in IFRS9



(Sources) [Meyer and Pohlmann \(2014\)](#) and [Maher \(2019\)](#)

Second, the ECL in IFRS9 is forward-looking and “probability-weighted” and require banks to use “reasonable and supportable Information” to quantify credit losses. In 2015 [guidance](#) published by the Basel Committee on Banking Supervision (BCBS), banks are expected to assess and measure credit risk to the particular lending exposure using the information of past events, current conditions, and forecasts of future economic conditions. Under the increased uncertainty in the COVID-19 crisis, combined with the aforementioned stages features, some were concerned about the unpredictable negative impacts on bank capital.

Recognizing these concerns, the International Accounting Standards Board (IASB), the accounting setter of the IFRS9, and various authorities in different jurisdictions have announced measures to mitigate the negative impacts (see related blog post [here](#)). Many jurisdictions and authorities have emphasized that banks should not take a mechanical approach to moving credits into Stage 2 (significant increase in credit risk, “SICR”) in cases where borrowers are affected by the pandemic.

Figure 4-3: Major actions on Expected Credit Loss Accounting

- IASB
 - IASB released a statement clarifying how to apply IFRS 9 during this time of uncertainty. The Board also states that it is working with regulators in the current environment and encourages companies to consider guidance provided by prudential and securities regulators. ([March 27](#))
- IOSCO
 - IOSCO supported professional judgment in applying accounting standards rather than applying in a mechanistic manner. ([April 3](#))
- European Union
 - ECB recommended that all banks avoid procyclical assumptions in their models to determine provisions. ([March 20](#))

- EBA released a statement on the application of the prudential framework with regards to classification of default, forbearance, and IFRS 9. ([March 25](#))
 - European Parliament approved changes to the capital requirement regulation and clarified the treatment of IFRS 9 and expected credit loss. ([June 19](#))
- France
- AMF clarified accounting standards for calculation of expected credit losses in light of recent announcements from ESMA, EBA, and IASB. ([April 7](#))
- Germany
- BaFin and Deutsche Bundesbank shared the view that the current situation does not lead to an undifferentiated, automatic transfer of financial instruments from Level 1 to Level 2 or Stage 3. ([March 27](#))
- Netherlands
- DNB guided banks to avoid excessively procyclical assumptions in their expected credit loss (ECL) estimations during the COVID-19 pandemic ([April 24](#))
- Spain
- Banco de España releases a briefing note stating that they adopt the measures notified by the ECB and extends them to all the financial institutions over which it exercises direct supervisory powers. ([March 30](#))
 - Banco de España disclosed a FAQ about the use of the flexibility provided in the accounting regulations. ([April 3](#))
 - Banco de España allowed for greater flexibility in applying expert judgement for the credit-risk classification of forborne exposures. ([June 16](#))
 - PRA issued guidance on impact of COVID-19 on ECL estimates under IFRS 9. The PRA expects the eligibility for the extension of mortgage repayment holidays should not automatically be a sufficient condition to move participating borrowers into Stage 2 ECL. ([March 20](#))
- UK
- Joint statement by FCA, FRC and PRA including guidance on application of IFRS9 and flexibility on meeting reporting timelines. ([March 26](#))
 - The PRA published a letter to banks including application of IFRS 9 and flexibility in terms of application of loan covenants and recognition of default. ([March 26](#))
 - PRA released a statement on application of IFRS 9 in light of COVID-19. ([May 22](#))

Source: Yale Program of Financial Stability, Institute of International Finance

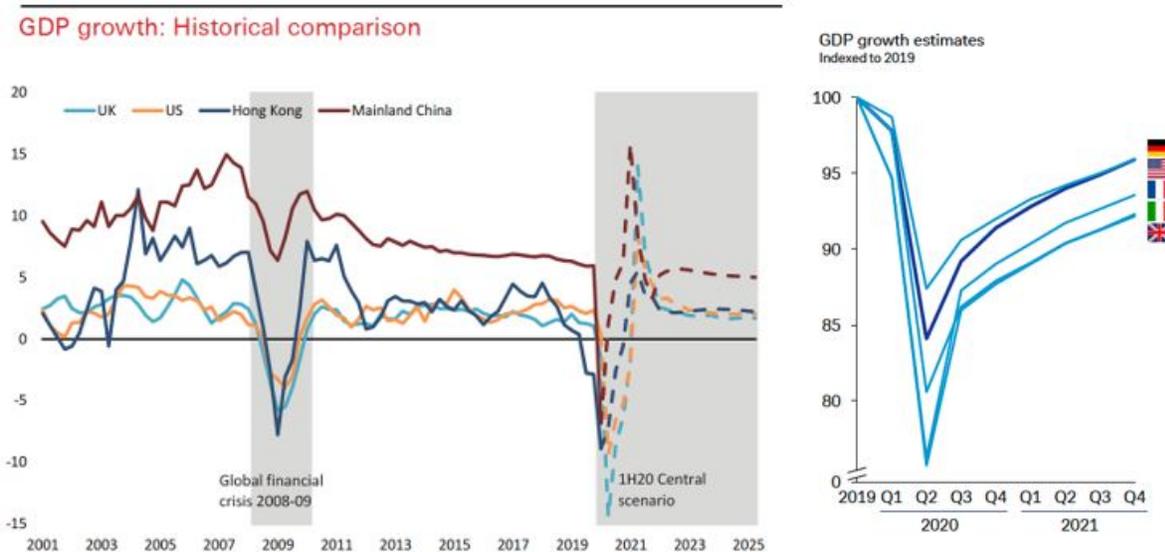
Meanwhile, some bank reports indicated that they expect a “V”-shaped recovery as their central economic scenario in their ECL models (Figure 4-4). For instance, HSBC noted that “[m]inimal long-term damage to economic prospects is expected, allowing economic growth across our key markets to return to forecast trend rates” and noted that the V-shape recovery forecast reflected the unique nature of the pandemic lockdown.

If the actual economic recovery in the third quarter is not as rosy and the recovery takes an “L” shape, banks may have to adjust their forecasts and further increase loan loss provisions.

Figure 4-4: GDP growth estimates by HSBC and Deutsche Bank

(HSBC)

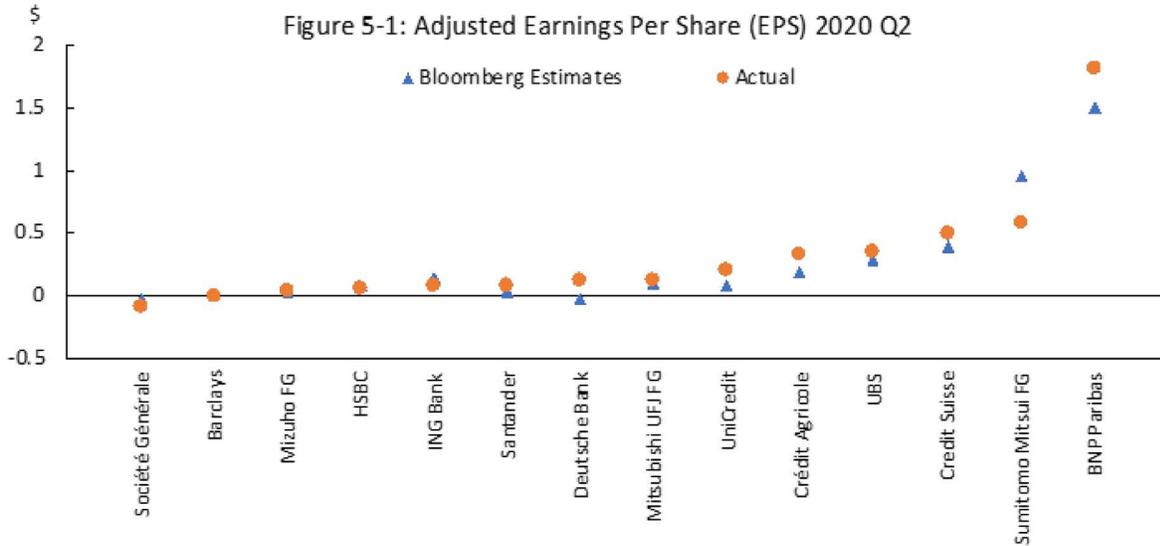
(Deutsche Bank)



(Sources) Bank quarterly reports

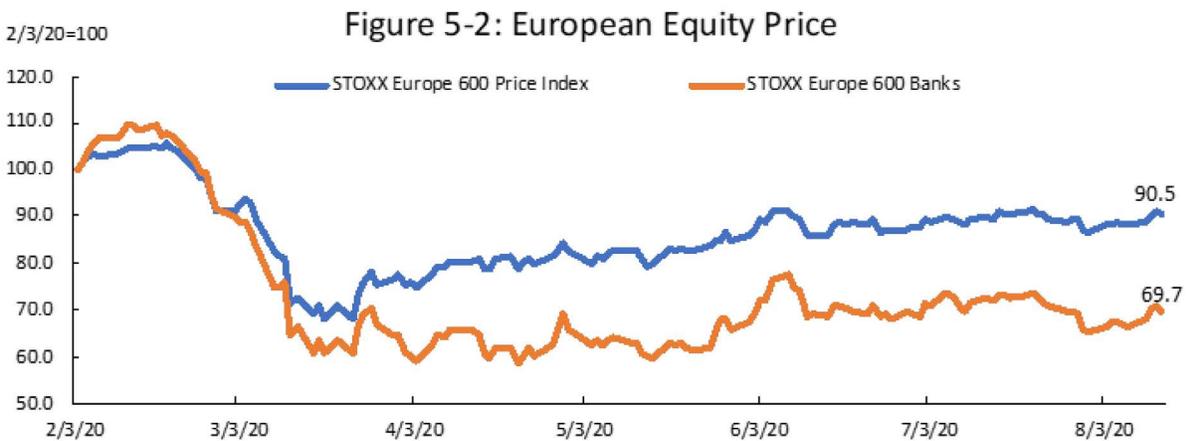
5. Market reaction and equity prices

The earning reports, overall, were better than market participants had expected. Figure 5-1 exhibits the differences between Bloomberg’s consensus estimates and the actual adjusted earnings per share (EPS); most banks outperformed the market estimates, sometimes by wide margins.

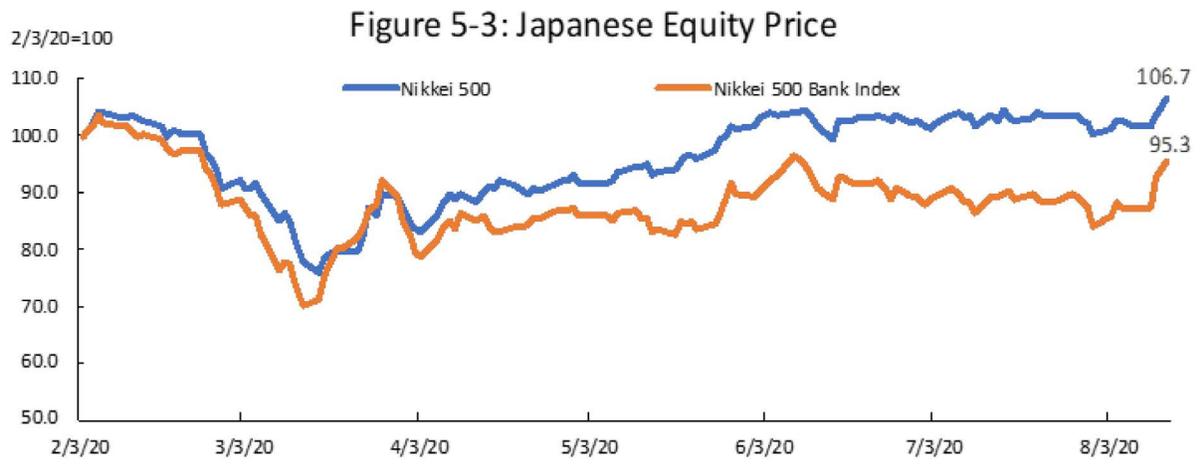


(Sources) Bloomberg

However, market prices suggest that the financial sector still faces many significant challenges. Figures 5-2 and 5-3 show financial firms’ slow recovery in equity prices, while the STOXX Europe 600 and Nikkei 500 benchmark indexes have been showing robust recovery. The low rate that is likely to persist both in Europe and Japan for coming few years will continue to hamper profitability of banks. Even if the economy may recover in a “V” shape for banks, challenges would remain for the banking sector.



(Sources) Bloomberg



(Sources) Bloomberg

Appendix

Coronavirus Financial Response Tracker Project Overview

Past - Where we've been

- Covid-19 Financial Response Tracker (CFRT)
 - Created list of 50 countries/multilateral institutions to track economic interventions with regard to financial stability, covering both emerging and developed markets
 - G20, EU, major economies in Asia and Africa, international financial institutions (e.g. IMF, ADB)
 - Located significant links to identify policies through press releases and primary documents
 - Produced a rough template to categorize interventions based on policy characteristics and targets
 - Designed a Qualtrics survey to migrate CFRT from Google Sheets for more efficient data entry and backend processing
 - Revised and expanded CFRT entry methodology to reflect comprehensive understanding of each intervention
- CFRT-related projects
 - Piped the CFRT Google Sheet to a visualizer
 - Visualizer created through Microsoft PowerBI
 - The file pulls data from the CFRT and refreshes daily
 - Reached out and responded to institutions and other researchers doing similar intervention-tracking work:
 - Professor Allison Hartnett of the CoronaNet Project
 - Pan-government, pan-policy initiative by researchers across the world (notably Yale and NYU-Abu Dhabi) attempting to track all Covid-related government policies around the world
 - Shared materials and guidelines with YPFS (all of which are available for free on their website)
 - Yale's Research, Clinical, and Data-Driven Response Project
 - *"As part of Yale's research, clinical, and data-driven response to the COVID-19 pandemic, researchers in medicine, nursing public health,*

engineering, and the social sciences have teamed up to create <https://covid.yale.edu>. This project includes geospatial maps to visualize large data sets in unique and interesting ways...”

- YPFS has made it past the initial screening

Present and Ongoing - Where we are now

- CFRT
 - Recording daily updates for the live CFRT spreadsheet (currently two-way split)
 - Finalizing taxonomy and stress-testing against backlog
 - Integrating Qualtrics features to support new projects based on the updated framework
 - Figuring out a way to download all the links on the pool drive
 - Checking the daily links email update for quality-control purposes
 - Thinking through systemic overhaul of project management on the backend
- CFRT-related projects
 - Corresponding with the Yale School of Medicine regarding our application for the GIS mapping project
 - Composing a standard operating procedure (SOP) for data entry that's geared toward incoming RAs and MBAs

Future - Where we're going

- Generally
 - Define the scope and timeline of the CFRT and related projects
 - Set daily and long-term expectations against the project plan
 - Delegate and rigorously define roles according to above expectations
 - Conduct quality control checks along the way and at all levels
 - Implement JIRA and Confluence in order to:
 - Streamline backend communications
 - Develop an effective shared filing system

- Manage Qualtrics updates and changes
 - Compose a living SOP handbook for RAs and MBAs
- CFRT
 - Workflow
 - Create a training video on Qualtrics data entry to show the MBA students prior to their start date
 - Make the tracker entry process as efficient and sustainable as possible
 - Code a daily pull from Qualtrics to email the team daily additions
 - Function
 - Decide how to provide the team with access to the Qualtrics data for case writing purposes
 - Decide how to display Qualtrics data on the YPFS COVID site
 - Improve upon Adam's 'Cross-Reference' spreadsheet for clarity and scalability
 - Standardization
 - Add more sources for institutions that we may have missed
 - Fill out the checklist
 - China, Oman...others?
 - Insurance companies and other important regulators
 - Cross-reference
 - Compare and contrast CFRT features and entries to other institution's existing trackers in order to improve our own comprehensiveness and functionality
 - See [Tracker Tracker](#)
- CFRT-related projects
 - Re-work Power BI visualization in order to integrate newly added Qualtrics survey data
- Ideally, we'd like to model our tracker on the robust database created over at [CoronaNet](#)