

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

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Original post [here](#).

This post provides an overview of the findings contained in the Commission’s 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.