Connecticut State Treasurer Shawn T. Wooden

Testimony before the Subcommittee on National Security, International Development, and Monetary Policy

"Reviewing the Federal Reserve's Emergency Lending Powers During the Pandemic and Examining Proposals to Address Future Economic Crises"

Chairman Himes, Ranking Member Barr, and distinguished members of the committee, I am Shawn Wooden, Treasurer of the State of Connecticut.

I appreciate the opportunity to testify before the House Financial Services Subcommittee on National Security, International Development, and Monetary Policy regarding the Federal Reserve's emergency lending powers and, specifically, Connecticut's experience with the Municipal Liquidity Facility (MLF), which was established in April of 2020.

As Treasurer of the State of Connecticut, I have three responsibilities related to today's hearing: investment of the State's pension and trust funds; management of the State's borrowing; and management of the State's cash including maintenance of its liquidity. For today's hearing, I am going to focus specifically on liquidity issues and not the more general COVID-19 response issues.

As President-elect of the National Association of State Treasurers (NAST), the bipartisan association of State Treasurers from across the country, and I have worked with my Democratic and Republican colleagues on this topic since the early days of the pandemic; thus, I will also refer you to our NAST recommendations included in letters dated March 20, 2020 and June 23, 2020 that are appended to my testimony.

Our experience in Connecticut, fortunately, was that the State and its municipalities were able to meet these unprecedented circumstances, adeptly drawing on talent, preparation, and prudent action. Those circumstances included prompt and effective federal action and assistance to states and municipalities.

Before the pandemic, the State's fiscal position was in the process of stabilizing after years of chronic budget deficits prior to Fiscal Year 2019. Certain fiscal controls put in place in 2017

were starting to bear fruit and contributed to the rebuilding of the State's Budget Reserve Fund, a strategic component of our liquidity.

When I took office in 2019, I immediately took a number of steps to put Connecticut in a stronger fiscal position, one that could weather an economic downturn.

My first year in office, I worked with the Legislature and Governor to restructure the State's Teachers' pension system. In Connecticut, the State is wholly responsible for managing and funding the Teachers' Retirement System. Previous funding decisions resulted in an unaffordable increase in future state required contributions. Restructuring the Teachers' pension system avoided this spike and created a funding plan that was sustainable in the long term.

We also reduced the risk across our entire pension portfolio and identified and executed on investment opportunities across asset classes. All of these steps significantly reduced the future funding risk for our pension systems and contributed to our improved fiscal position.

In debt management, we consistently exercised conservative debt management practices including refinancing existing debt to lower interest rates, saving taxpayers $190 million – that may not seem like a significant amount of savings at the Federal level, but for Connecticut and our residents and business, it is meaningful.

Additionally, I consistently advocated to protect our Budget Reserve Fund from being used for unintended purposes. I prioritized growing it, giving us greater liquidity and financial flexibility, which has allowed us to maintain a strong cash position and, in turn, has helped us manage through the ongoing pandemic.

Just before the pandemic, the State budget office predicted a modest $58.6 million current year budget deficit and a $2.77 billion Budget Reserve Fund balance for June 30, 2020, the highest in State history. (Source OPM March 20, 2020 letter)

After the pandemic began, the Governor's budget office made assessments of the possible fiscal impact of the pandemic and on April 30, 2020, revised its FY 2020 budget projections to a much larger $934 million budget deficit and much lower $1.9 billion Budget Reserve Fund balance. (Source OPM April 30, 2020 letter)

During this time in early Spring 2020, I participated in weekly calls with State Treasurers from across the country to discuss, in real time, the challenges different states were facing. At that point, all states were revising their budget projections and liquidity positions. Several states moved ahead and put in place lines-of-credit and other short-term borrowing facilities to address what was, at the time, an unknown impact from the quickly spreading COVID-19.

Several major and very timely actions by the federal government provided significant assistance to state and local government budgets and mitigated liquidity concerns. One was Congress's swift action in passing the Coronavirus Aid, Relief, and Economic Security Act, commonly referred to as the CARES Act. Another was the Federal Reserve's establishment of the Municipal Liquidity Facility (MLF) on April 9, 2020, just a few weeks into the pandemic.

Once the MLF program was established, I quickly convened a working group consisting of Treasury experts, bond attorneys, and the Governor's budget office. We considered the potential impact on the liquidity needs of Connecticut and our local governments resulting from policies enacted to mitigate the economic impact of the pandemic, as well as the potential use of the MLF and its effect on the municipal market.

Shortly after the declaration of the pandemic in mid-March 2020, the municipal market experienced tremendous volatility that prompted both base municipal bond index yields to rise by more than 225 basis points in just nine trading days, a rise not seen since the Great Depression. It also spurred dramatically wider credit spreads to the benchmark indices as mutual fund investors pulled over $41 billion of assets out of the municipal market in less than three weeks.

Market function deteriorated to the point that buyers and sellers had difficulty determining price. Tax-exempt rates decoupled from Treasuries as investors were concerned about state and local governments' ability to withstand COVID-related liquidity and revenue shocks. The primary market was essentially shuttered for two weeks in mid-March, but municipal bond yields and credit spreads would remain elevated even as markets slowly reopened. Based on the strong positive correlation between the municipal spread and the weekly unemployment rate, it appeared that spreads would have continued rising in step with the unemployment rate absent intervention from the Federal Reserve.

The Federal Reserve's initial actions helped shore up market liquidity. The creation of the MLF provided critical support for issuers' solvency by standing ready to purchase short-term notes from state and local governments in an extremely uncertain environment, thereby helping states and local governments better manage the cash flow pressures associated with the pandemic. The MLF's $500 billion of lending capacity exceeded estimated revenue shortfalls, which limited the perception of default risk in state and local governments and boosted investor confidence market wide. Municipal-Treasury spreads abruptly stopped rising in the week when the MLF was first announced, well before the facility actually opened in late May and despite a rising unemployment rate.

After the creation of the MLF, municipal markets began to stabilize for issuers in the higher rated "A" to "AAA" rating categories. Analysis by the Dallas Federal Reserve suggests that, particularly for more distressed municipal credits, the MLF had the impact of containing credit spreads in the months after the initial COVID liquidity crisis and helped stave off systemic risk to and collapse of the entire municipal market:

> "That these effects occurred far in advance of the opening of the MLF and given the very modest borrowing by municipal entities at the MLF together imply that the announcement of this new facility had a pronounced and rapid backstop effect. These results along with others imply that there was systemic risk in the muni bond market in the Covid-19 pandemic, that was not the case for the isolated, but prominent, muni defaults in the prior half century."

There were some inquiries in Connecticut at the local level about this program for short-term borrowing as well as other programs. In another case, a bank that provides lending to local governments contacted the State with their concerns about local cash flow borrowing needs that may be coming and inquired how the State could assist its local governments.

Initially, no municipalities in the State would have been able to borrow directly from the MLF because of the 250,000 minimum population requirement for municipalities. Connecticut's largest municipality, Bridgeport, has about 144,000 people. Moreover, we do not have a county form of government. The Federal Reserve eventually allowed states to designate two municipalities or counties as additional direct borrowers on June 3rd. Because the MLF's potential use by Connecticut municipalities was so limited, we also developed proposed legislation to provide a mechanism for local governments to access the MLF or other liquidity funding indirectly through the State. Ultimately, we did not pursue any legislative changes as the impact on our municipalities were less than expected.

Following federal and State tax deferments, the Governor issued an executive order requiring cities and towns to either cap their low interest rate programs for tax delinquencies at 3% or offer residents a property tax deferral for 90-days. These relief measures obviously would have had a negative impact on the liquidity of cities and towns across the State. Despite our initial concerns, we did receive favorable reporting in August 2020 that property taxes in Connecticut were mostly being paid on time. One of the factors that contributed to this outcome is that homes with mortgages usually have a prefunding of property taxes through escrows and property taxes are paid directly by those mortgage providers.

The way the MLF was designed and implemented, it served as a "lender of last resort." The rates were above market and not significantly tied to market movements. Borrowers were required to certify that they were unable to secure adequate credit accommodations from other banking institutions. Despite the limited utilization of the program, the MLF provided a necessary backstop to a very large market without replacing the normal municipal market mechanisms for raising capital to alleviate liquidity concerns.

As we hopefully move out of this pandemic in the coming months, potential improvements to the structure of the MLF to be shelf-ready for the next financial crisis would include the following concrete changes based on our experience in Connecticut, many of which were officially communicated by NAST to the Treasury and the Federal Reserve.:

1) **Reduce Borrowing Rates and Index to Market** - Reduce the MLF's borrowing rates to more competitive market rates that move with the market. Due to current restriction on tax-exempt cash flow borrowing, most issuers would expect any borrowing from MLF to be taxable. The MLF would be more attractive to borrowers if the rates were set more at competitive taxable market levels and were indexed to track changes in the market.

2) **Remove Required Certification** - Remove the requirement for certification that borrowers are unable to secure adequate credit accommodations from other banking institutions. The above market pricing model makes that certification redundant – an issuer would not need to access the MLF and its higher rates if other credit

accommodations were available. Therefore, I recommend removing this requirement, especially if above market pricing is used again in the future.

3) **More Flexibility for Form of State Guarantee** - Make the requirement that the state guarantee borrowings of local municipalities borrowing through the state more flexible. The Federal Reserve should not be wedded to state-level guarantees but be open to other forms of state level support. In Connecticut, we provide state-level credit support through contract assistance and special capital reserve funds. Another option is for the Federal Reserve to assume some of the credit risk.

4) **Allow for Pooled Borrowings.** The MLF should be available for pooled borrowings, not one-off guaranteed borrowings for particular municipalities. The costs of setting up such a borrowing would prohibit many smaller municipalities from being able to utilize the MLF. Liquidity challenges manifest differently from state-to-state and local government to local government be it unanticipated increases in expenditures, a shortfall in revenues, or a combination of the two. While federal aid should not be the vehicle for financial support to state and municipal governments, the Federal Reserve can be useful in bridging cash flow timing issues during times of crisis.

5) **Longer Credit Terms and Creation of a Purchasing Special Purpose Vehicle (SPV) to Buy a Broad Range of Securities in the Secondary Municipal Market**. The Federal Reserve could provide significant relief for issuers by extending the MLF credit facility to issue longer-term obligations and also create an SPV aimed at supporting issuer access to longer-term borrowing in the primary market and providing relief to the secondary market. Access to affordable lines of credit to state and local governments could also be further enhanced by creating an SPV to lend to banks at the Federal Funds Rate, provided they exclusively use such proceeds to make loans to or purchase securities from small municipal issuers.

6) **Permanent Program**- It would be valuable and forward thinking for the Federal Reserve to put in place a permanent emergency MLF program and set parameters that consider the variety of states' needs and circumstances. In Connecticut, we found that legislative changes to our statutes would have been required in order to enable our municipalities to borrow from the MLF through the State, as only two municipalities could have borrowed directly once eligibility was expanded. Having a permanent program in place would avoid this, and states could make any necessary changes in process, procedure, and statute, thereby setting the stage for ready access to the program if and when the next emergency occurs.

7) **Possible Bank Managed Program -** Another idea to consider is allowing all local governments to borrow directly from the MLF with State supervision and approval, rather than requiring most to borrow through their state. While I appreciate the potential administrative burden of such a program, the Federal Reserve is better positioned to take on this lending function than states.

> In order to mitigate this administrative burden, the banking community, which is structured for this function, could be tapped to administer the MLF cash flow borrowing on behalf of the Federal Reserve. This would be a similar model as the Payroll Protection Program (PPP) where banks administered the lending program for the federal government.

Overall, the MLF was a critical, historic, and necessary creation to support larger issuers with access to credit for cash flow needs, particularly as they faced the potential of delayed and lower income tax revenues. It was very important that there was a market back stop and the MLF provided comfort to investors that there was not going to be a market free fall. Through the MLF program, the Federal Reserve signaled municipal market support to investors, which ultimately resulted in credit spread improvements and market access. If state and local governments could not borrow, they would have been forced into more dramatic spending cuts and layoffs than occurred.

In Connecticut, the State's original projections of very large budget deficits for FY 2020 and FY 2021 at the start of the pandemic did not ultimately materialize, due to the help of the many federal programs including additional unemployment assistance and the payroll protection program, which assisted both businesses and their employees. These efforts, along with smart fiscal policies and budget management, contributed to Connecticut's fiscal year 2020 ending with a modest $38.7 million surplus and is currently projected to end with a more robust $514.6 million surplus for the 2021 fiscal year.

Despite the initial disruption, the municipal markets stabilized, and investors were reminded that municipal securities are a safe-haven in a storm that provide high credit quality. As a result, after a few months, in large part thanks to actions taken by the Federal Reserve in cutting interest rates and actions taken by Congress, the municipal market improved significantly. By June 2020, as a result of our strong and stable financial position, Connecticut was experiencing record high demand for our bond sales and record low borrowing costs.

Thank you again for the opportunity to submit this testimony today. I look forward to the continued discussion on how we can take the lessons learned during this pandemic and create a framework to support state and local governments in the event of a future major economic crisis.

March 20, 2020

VIA Electronic Mail

The Honorable Steven Mnuchin
Secretary of the Treasury
Main Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable Jerome Powell
Chair of the Board of Governors
The Federal Reserve
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Secretary Mnuchin and Chairman Powell,

On behalf of the nation's State Treasurers and finance officials, we applaud your efforts to keep Americans safe from COVID-19 and to deliver needed assistance to financial markets during this time. We write to you today to request that the Federal Reserve and the Department of the Treasury jointly take emergency action to support the municipal bond market. We urge you to authorize the temporary purchase of a broad base of municipal securities to restore equilibrium to our markets.

The National Association of State Treasurers (NAST) serves as the nation's foremost authority on state finance issues and State Treasury programs, practices, and policies.
NAST's nonpartisan membership comprises all State Treasurers or state finance officials with comparable responsibilities from the United States, its commonwealths, territories, and the District of Columbia, along with employees of these agencies.

The stability of the $3.8 trillion municipal bond market is particularly important during this crisis as state and local governments and the municipal bond market provide critical support for the infrastructure, including hospitals, needed to care for and support our citizens. Issuance of municipal bonds precipitously declined from $10-15 billion per week in early March to zero today. Before the start of this crisis, the market was on track for a record amount of municipal bond issuance, projecting over $450 billion this year. Absent support for the municipal market, state and local government budgets will be further stressed at the most inopportune time, particularly as state revenues decline as a result of business closures and rising unemployment.

The Federal Reserve and Treasury should design a program with the flexibility to support all issuers and credits in the municipal bond market. In this period of economic uncertainty, the sudden rush for cash hampers issuers across the credit spectrum, impacting communities and critical projects and services throughout the country. We are already witnessing the immediate

cost impact on states and localities of resetting floating rates. The closure of the primary market will have an even longer-term negative impact on states. Moreover, a significant percentage of municipal bonds are held by retail investors, either directly or via investments in mutual funds. Continued distress in this market will exacerbate the effect of this crisis on those investors as well.

Without timely and strong federal government support for the municipal bond market, our state governments and other issuers will be forced to take actions that will exacerbate the current economic contraction and offset the vital and unprecedented stimulus that Congress, the Federal Reserve, and the Administration have worked to provide.

We urge you to authorize the purchase of a broad base of municipal securities to counter the unprecedented impacts of these market conditions and thank you for your attention and continued support.

Sincerely,

Shaun Snyder
Executive Director
National Association of State Treasurers

CC: Members of the United States Congress

June 23, 2020

VIA Electronic Mail

The Honorable Steven Mnuchin
Secretary of the Treasury
Main Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable Jerome Powell
Chair of the Board of Governors
The Federal Reserve
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Federal Reserve Actions to Support State and Local Finance through COVID-19

Dear Secretary Mnuchin and Chairman Powell,

On behalf of the state and local government finance officials that we collectively represent, we applaud the actions taken by the Administration, the Federal Reserve and Congress to stabilize our markets through this COVID-19 crisis. We, the undersigned members representing the National Association of State Treasurers (NAST) and the Government Finance Officers Association (GFOA), have formed a joint ad hoc committee on "Federal Reserve Interventions in the Municipal Market" to serve as an issuer-perspective resource as you seek to refine existing facilities and contemplate additional actions in the municipal marketplace.

We now write offering our collective responses to existing Federal Reserve actions to date to stabilize state and local government finances. We also wish to share our thoughts on additional actions the Federal Reserve can take to support our shared goal and Congress' intent to provide "liquidity to the financial system that supports lending to eligible businesses, States, or municipalities."[1] Our comments reflect both our individual opinions and those of the organizations we collectively represent. Furthermore, we have kept our recommendations in line with the Federal Reserve actions we have seen in both the municipal markets as well as other sectors of the economy that have seen bold and unprecedented interventions.

States and local governments have been and will continue to serve on the frontlines of this national crisis. As you know, an historic cash event, prolonged paralysis in bond markets, and impending budget shocks stemming from the pandemic have all culminated at once, forcing many businesses and nearly every state and local government into a state of damage control. Our primary advocacy with our federal legislators based on current fiscal conditions is for additional direct, unencumbered direct funding to plug budget shortfalls and projected losses in revenues resulting from slowed commerce. Our advocacy extends to support the municipal debt market,

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[1] "Coronavirus Aid, Relief and Economic Security Act." H.R. 748. 116th U.S. Congress. § 4003(b)(4).

where state and local government access to credit and budgets will be further stressed at the most inopportune time, particularly as revenues decline as a result of business closures and rising unemployment. We remain particularly focused on programs to further support access to credit for smaller issuers across the country who represent the vast majority of issuers. Many of these jurisdictions were not included in prior congressional support through CARES, while at the same time smaller issuers, as frontline public service providers, will feel the fiscal impacts of this pandemic deeply.

Above all else, we wish to see the municipal credit markets quickly normalized. To that extent, we wish to serve as a resource for you as you seek to implement new policies and facilities (or to augment facilities already in place), but also offer ourselves as a resource in the future as you seek to ramp down these actions in a sustainable manner to protect the long term health and independence of our markets.

[Existing Action] Creation of the Municipal Liquidity Facility

On April 9, 2020, the Federal Reserve announced the "Municipal Liquidity Facility (MLF)," which will provide direct, short-term lending to eligible state and large local governments. The facility was greatly expanded, on April 27, to include a larger universe of eligible local issuers and multistate entities. The MLF is a critical, historic and necessary first step in supporting larger issuers access to credit for cash flow needs, particularly as they face delayed income tax revenues resulting from the IRS's decision to delay tax filing deadlines and the inevitable drop in revenues caused by the nationwide shutdown. We applaud the Federal Reserve's announcements regarding the MLF and appreciate its immediate positive impacts to issuers accessing credit markets over the past few weeks. We also commend the Federal Reserve's responsiveness and consideration to the issuer community's input as it has built upon and improved various iterations of the facility. However, we see great potential in the extension of the MLF to satisfy more present and intermediate term needs of issuers.

A number of questions regarding specifics of the MLF also remain unanswered. We ask that you respond to and provide further clarity on the specific questions set forth in Appendix A hereto in forthcoming guidance.

[Recommended Action] Extending Credit Term of MLF Paper and Creation of a Purchasing Facility to Buy a Broad Range of Securities from the Secondary Municipal Market

We believe the Federal Reserve can provide the most significant next step in relief for issuers by extending the MLF credit facility to issue longer-term paper and also develop an SPV aimed at supporting issuer access to longer term borrowing in the primary market and providing relief to the secondary market. The municipal bond market has recently improved, but it has done so largely based on expectations that the Federal Reserve will take additional actions to stabilize the market when needed. Issuers' access to credit remains fragile and volatile with many planned new money issues on hold waiting for improved market conditions and business decisions hinging on local market conditions. While the weekly outflows

have lowered from those seen in mid-March, even inflows of $1 to $1.5 B per week would take months to recover during a time when credit from our existing capital markets is most needed. Restoring stability to the municipal bond market through supporting primary market transactions and secondary market purchases when needed would provide significant support for state and local governments and their economies by facilitating continued access to credit to finance infrastructure investments.

Furthermore, uncertainty around the duration of the COVID-19 outbreak and the risk of a "second wave" of infections this fall continue to pose significant risks of a second cash-crunch and selloff in the municipal bond market. At a minimum, having such a facility developed in advance and at the ready to begin purchasing in the event of a second market selloff would provide much needed stability to our fragile markets. We believe such a facility is in line with the congressional intent of Title IV of the CARES Act (P.L. 116-136) and note congressional letters supporting the issue.[2, 3]

[Recommended Action] Easing Rules Around / Treatment of Municipal Securities in and Support for Lending to Small Municipal Issuers

While we believe the two aforementioned recommendations will aid access to credit, particularly for larger issuers, we also believe that targeted easing of capital requirements coupled with minor changes to the U.S. Tax Code would further strengthen access to bank loans and lines of credits for smaller issuers. Smaller regional and community banks have played an invaluable role in meeting small issuer needs through the purchase of bank qualified notes (26 USC 265). Often in smaller communities, the bank relationship between an issuer and the community bank is the primary source of capital. Limitations on the deductibility of carrying costs as well as stressed capital requirements and asset caps placed on banks constrain the abilities of banks to meet the credit needs of small issuers.

For these reasons we encourage Bank Regulators, including the Federal Reserve, to examine ways in which changes to asset caps and other rules could improve the capacity of regional and community banks to serve the credit needs of their local communities during these challenging times. With a general decline in economic activity leading to a decline in traditional retail lending, we believe these changes would have a double positive impact. Access to affordable lines of credits to state and local governments could be further enhanced by creating an SPV to lend to banks at the Federal Fund Rate, provided that they exclusively use such proceeds to make loans to or purchase securities from small municipal issuers.

We also encourage Congress to modernize provisions around the deductibility of carrying costs associated with municipal securities to further incentivize banks to engage in the municipal markets. Specifically, we support the inclusion of the "Municipal Bond Market Support Act of

[2] "Letter from Congressman Steve Stivers, Dutch Ruppersberger et. al. Calling for Support for the Secondary Municipal Bond Market." May 1, 2020. See attached.
[3] "Letter from Senator Robert Menendez, Thom Tillis et. Al. Encouraging the Treasury and the Federal Reserve to Take Further Action to Stabilize the Municipal Bond Market." May 14, 2020. See attached.

2019” (H.R. 3967), which would greatly expand the number of small issuers eligible to issue “bank qualified debt” and provide an additional purchaser in our markets to further diversify sources of credit to state and local governments.

Conclusion

Without timely and strong federal government efforts to support the municipal bond market and compensate for delayed revenues, our state and local governments will be forced to take actions that will exacerbate economic contraction and offset the vital stimulus that Congress, the Federal Reserve, and the Administration have worked to provide. We urge you to consider using your authority provided in Title IV of the CARES Act and existing powers under Section 13 of the Federal Reserve Act to develop and refine facilities like those outlined above in order to counter the unprecedented impacts of current market uncertainty.

Please consider our organizations, staff and memberships as resources available to assist when and how you need during this process. We have asked Brian Egan (brian@statetreasurers.org | 202-630-1880) and Emily Brock (ebrock@gfoa.org | 540-589-0441) in our respective offices to address any additional questions you may have. Finally, we thank you for your attention and continued action to stabilize our economy.

Sincerely,

- Colleen Davis, NAST Rep, Treasurer, State of Delaware
- Kenton Tsoodle, GFOA Rep, Assistant City Manager, City of Oklahoma City
- Janet Aylor, NAST Rep, Director of Debt Management, Virginia Department of Treasury
- Dan Huge, GFOA Rep, Public Finance Director, Indiana Finance Authority
- Katherine Kardell, GFOA Rep, Senior Debt Administrator, Hennepin County, Minnesota
- Jessica Lamendola, GFOA Rep, Director of Administrative and Financial Services, City of Topeka, Kansas
- James MacDonald, NAST Rep, First Deputy Treasurer, Commonwealth of Massachusetts
- Sarah Sanders, NAST Rep, Assistant Treasurer for Debt Management, State of Connecticut
- Cindy Harris, GFOA Rep, Chief Financial Officer, Iowa Finance Authority
- Tim Schaefer, NAST Rep, Deputy Treasurer, State of California
- Ben Watkins, GFOA Rep, Director of Division of Bond Finance, State of Florida
- David Erdman, NAST and GFOA Rep, Capital Finance Director, State of Wisconsin

CC: Members of the Federal Reserve Board of Governors
Federal Reserve Bank of New York
Members of the House Committee on Ways and Means
Members of the Senate Committee on Finance

Appendix A

Questions and requests for clarifications and amendments to the Municipal Liquidity Facility (MLF).

- Expansion of Universe of Eligible Issuers: We applaud the Federal Reserve's decision to update the MLF term sheet to more than triple the number of eligible issuers. We also recognize the updated facility still only provides direct lending to less than one percent of the total issuers of municipal bonds. Will the Federal Reserve further expand the universe of eligible issuers to include more smaller communities who are less prepared and have fewer resources and capability of managing the negative economic and fiscal impacts of the COVID-19 crisis and ensuing economic slowdown?

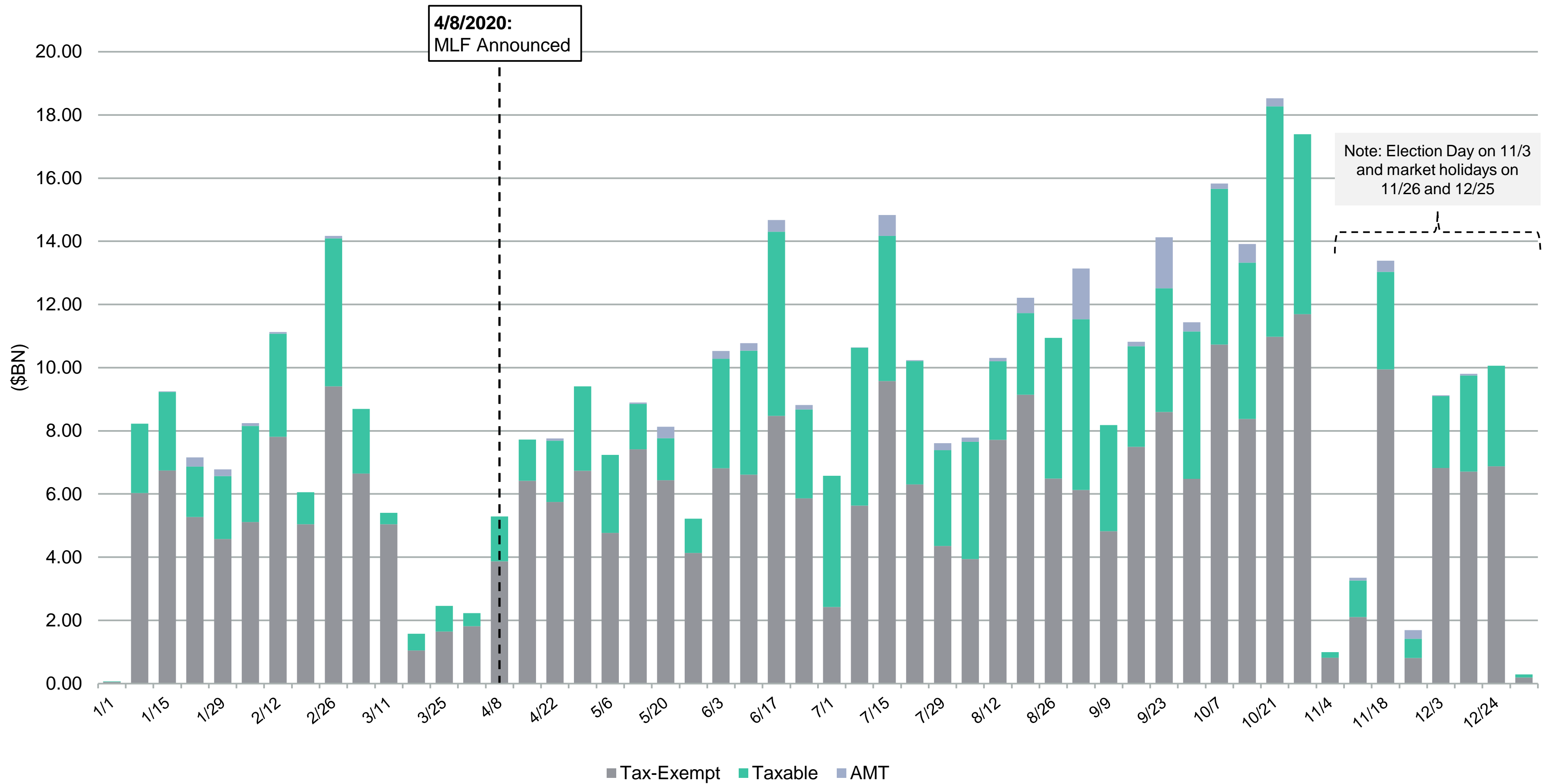
- Credit Risk Sharing of "Downstream" Lending: In keeping with our shared goal of ensuring access to credit for the largest number of issuers possible, would the Federal Reserve share at least a portion of the credit risk of eligible issuers lending to ineligible political subdivisions, municipalities, authorities or other governmental entities?

- Pricing and Taxability: Given that the Federal Reserve would have no federal tax liability for interest earned on MLF securities, we fail to understand why separate pricing matrices for taxable and tax-exempt securities are necessary or helpful. The overwhelming needs of eligible issuers are cash flow borrowings, which are largely prohibited from tax-exempt issuance. Therefore, we anticipate issuers would need, or at least strongly prefer, to issue taxable securities through the MLF and not be penalized with increased borrowing costs but also get the benefit of eliminating IRS compliance expense. We recommend that the MLF consider all securities taxable and priced at a fair rate similar to the matrix developed for tax-exempt securities.

- Certification Requirements: Under the current rules, an issuer must provide a "certification that it is unable to secure adequate credit accommodations from other banking institutions" as well as provide "evidence that participants in the MLF are unable to secure adequate credit accommodations from other banking institutions." We find the current penalty pricing model to make such a certification and demonstration redundant. No issuer would select the MLF as an option if other credit accommodations were available. For this reason, we request that the Federal Reserve reconsider and remove this added burden on issuers.

Municipal Bond Issuance – Weekly Reporting

January – December 2020



Source: Morgan Stanley