



Insight

Timeline: The Federal Reserve Responds to the Threat of Coronavirus

THOMAS WADE | MARCH 18, 2020

Executive Summary

- On Sunday, March 15, the Federal Reserve embarked on a large-scale program employing emergency powers in order to stabilize a tumultuous economy under pressure from the novel coronavirus COVID-19.
- Chief among these emergency actions are cutting interest rates effectively to zero and a \$700 billion round of quantitative easing.
- Despite these actions, stock prices on Monday took their steepest dive since 1987's Black Monday, and it remains to be seen whether enough liquidity has been injected into the market to prevent the financial system from widespread failures.

Most Recent Activity

April 6 – Fed Implements CARES Act Community Bank Capital Ratio

The Coronavirus Aid, Relief, and Economic Security (CARES) Act [contains several provisions](#) decreasing the regulatory burden on banks with a view to freeing up capital that can then be made available to businesses. One of these provisions requires the federal banking regulators to lower the leverage ratio (the most basic capital requirement) of community banks to 8 percent. On April 6 the Fed announced two interim rules implementing this directive but noted that this would be a temporary measure, with the community bank leverage ratio returning to 9 percent by 2022.

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Context

As financial markets reel in response to the unique threat posed by COVID-19, Chairman of the Federal Reserve Jerome Powell noted in a surprise [press briefing](#) on Sunday, March 15, “The effects of the [coronavirus](#) will weigh on economic activity in the near term and pose risks to the economic outlook.” The Federal Reserve (the Fed) took the opportunity to embark on a slew of emergency actions, most notably slashing its key interest rate to 0 percent and launching an ambitious round of quantitative easing (QE). Presented below is a summary of actions taken this week by the Fed in an attempt to shore up the economy.

Glossary and timeline of Fed emergency lending facilities

<i>Date</i>	<i>Facility</i>	<i>Acronym</i>
March 17	Commercial Paper Funding Facility	CPFF
	Primary Dealer Credit Facility	PDCF
March 18	Money Market Mutual Fund Liquidity Facility	MMLF
March 23	Primary Market Corporate Credit Facility	PMCCF
	Secondary Market Corporate Credit Facility	CMCCF
	Term Asset-Backed Securities Loan Facility	TALF
TBA	Main Street Business Lending Program	

The Fed’s Response

March 15 – The Fed Funds Rate Cut to Zero

The federal fund rate, used as a benchmark for short-term lending and the rate to which most consumer rates are pegged, serves as a stand-in for interest rates for the American economy. Despite considerable pressure, the Fed has been reluctant to lower the federal fund rate over [the past two years](#), eventually lowering the rate from 2.25 percent to 2 percent in August 2019, with further minor cuts in September and October. Despite dropping the rate 50 basis points on March 3, this was evidently not enough, and on Sunday, March 16, the Fed took the dramatic step to lower the federal fund rate to [0 percent](#).

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March 15 – Quantitative Easing

In addition to cutting the federal funds rate to zero, the Fed also announced a new round of QE, [a controversial tool](#) for boosting the economy last employed in any significant way as a result of the 2007 – 2008 financial crisis. Quantitative easing, also known as large scale asset purchases, typically involves a central bank itself purchasing government bonds or other long-term securities in order to restore confidence and, crucially, add liquidity back into the market. The Fed announced that it would commence the QE program with an immediate \$80 billion buy (\$40 billion on Monday, \$40 billion on Tuesday) but would purchase “at least” \$700 billion in assets over the coming months with no limit.

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March 15 – Encouraging Use of the Discount Window

One of the Fed’s many roles in the economy is to act as lender of last resort. It does this by providing banks with what is called the “discount window,” which banks can use as an emergency source of funding. Historically banks have been loath to use this facility, as it has previously signaled to the market that a bank is in extreme distress. Banks are, however, pushing back on this stigma with the Financial Services Forum, an advocacy forum representing U.S. banking giants, putting out a [press release](#) indicating that all its members would be using this facility. The Fed announced that it would encourage use of the discount window by lowering the primary credit rate 150 basis points, designed to encourage a more “active” use of the window.

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March 15 – Flexibility in Bank Capital Requirements

Modern banks are subject to a wide range of capital requirements, from total loss absorbing capacity (TLAC) to a variety of buffers, including countercyclical and buffers based on international size and prominence (for more information on capital bank requirements, see [here](#)). These buffers are intended to act as emergency reserves that a bank can dip into in times of stress. The Fed announced on Sunday that it would support banks using these funds, which normally are not considered accessible, to lend to households and businesses impacted by coronavirus, provided that lending occur in a safe and sound manner. For smaller lenders, the Fed also reduced reserve requirements to zero.

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March 15 – Coordinated International Action to Lower Pricing on U.S. Dollar Liquidity Swap Arrangements

The Fed, in coordination with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank, announced a coordinated effort to lower pricing on standing U.S. dollar liquidity swap arrangements by 25 basis points, and to offer U.S. dollars with an 84-day maturity in addition to the usual weekly maturity. Both of these actions are designed to improve global liquidity of the U.S. dollar.

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March 17 – Creation of a Commercial Paper Funding Facility (CPFF)

Corporate, or commercial, paper is an unsecured, short-term financial instrument critical to business funding. On March 17, the Fed announced the creation of a new facility with the authority to buy corporate paper from issuers who might otherwise have difficulty selling the paper on the market, at a [cost](#) of the three-month overnight index swap rate plus 200 basis points. Treasury Secretary Steven Mnuchin noted in a [press briefing](#) that the cost of this facility could be as high as \$1 trillion but that he did not expect it to rise so high. The Treasury will provide \$10 billion of credit protection to the Fed for the CPFF from the Treasury's Exchange Stabilization Fund.

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March 17 – Creation of a Primary Dealer Credit Facility (PDCF)

In a related move, the Fed also announced that it would re-establish a facility offering collateralized loans to large broker-dealers. The Fed will accept a wide range of permissible capital, including corporate paper, in an attempt to encourage these investors to participate in the corporate paper market, and the market more generally.

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March 18 – Creation of a Money Market Mutual Fund Liquidity Facility (MMLF)

Similarly, the Fed also announced that it would establish a facility offering collateralized loans to large banks who buy assets from money market mutual funds. A money market mutual fund is a form of mutual fund that invests only in highly liquid instruments and as a result offers high liquidity with a low level of risk. Again, the Fed will accept a wide range of permissible capital, including corporate paper, in an attempt to encourage these investors to participate in the money market mutual fund market, and the market more generally.

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March 19 – U.S. Dollar Liquidity Swap Arrangements Extended to More International Central Banks

Currency swap arrangements, previously extended and modified with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank, expanded to include arrangements with 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).

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March 20 – Frequency of U.S. Dollar Liquidity Swap Operations Updated To Daily

The Fed, in coordination with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank, announced a coordinated effort to improve the liquidity of U.S. dollar swaps by increasing the frequency of 7-day maturity operations from weekly to daily.

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March 20 – MMLF Will Now Accept Municipal Debt

The Money Market Mutual Fund Liquidity Facility (MMLF), in co-ordination with the Federal Reserve Bank of Boston, expanded the list of acceptable collateral required for a loan to include high-quality municipal debt.

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March 23 – Fed Announces Extensive New Measures To Support The Economy

In its most sweeping and dramatic intervention in the economy to date, the Fed announced a series of measures employing a wide range of the monetary policy authorities available to it, all with the aim to “support smooth market functioning”. The Fed:

- Expanded its quantitative easing program (see March 15) to include purchases of commercial mortgage-backed securities in its mortgage-backed security purchases.
- Established three new emergency lending facilities, a Primary Market Corporate Credit Facility (PMCCF) and a Secondary Market Corporate Credit Facility (SMCCF) to support credit to large employers, and a revival of the Term Asset-Backed Securities Loan Facility (TALF) to provide liquidity for outstanding corporate bonds. These three programs will support up to \$300 billion in new financing options for firms, backed by the Treasury

Department's Exchange Stabilization Fund (ESF) which will provide \$30 billion in equity to these facilities.

– Expands the powers of two existing programs, the CPFF and PDCF (see March 17 and 18). The MMLF, which already accepted a broad range of collateral including corporate paper, will now cover a wider range of securities including municipal variable rate demand notes (VRDNs) and bank certificates of deposit. Similarly, the list of acceptable corporate paper that the CPFF would consider acceptable will now include high-quality, tax-exempt commercial paper as eligible securities. The Fed will also lower the price to use the CPFF facility.

– In addition, the Fed noted that it expects to announce shortly a fourth new program, to be called the Main Street Business Lending Program, designed to support small and medium-sized businesses. This program will support the work of the Small Business Administration (SBA).

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March 23 – Technical Changes to Total Loss Absorbing Capacity (TLAC)

Having already demonstrated on March 15 that the Fed, to encourage greater lending, would employ flexibility in allowing banks to use otherwise impermissible capital reserves, the Fed announced a technical rule change that amends the implementation of a rule impacting banks' requirements to maintain total loss absorbing capacity (TLAC). The interim final rule, imposing restrictions on TLAC, will be phased in gradually to avoid cutting into the capital available to banks too significantly.

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March 24 – Fed Delays Implementation Of Foreign Banking Organization (FBO) Maximum Daily Overdraft Rule

In another move designed to ease operating restrictions on depository institutions, but in this case foreign banking organizations (FBO), the Fed announced a six-month delay to an incoming new rule. This intraday capital rule is designed to cap the maximum daily overdraft available to FBOs in their accounts at the Fed. By delaying implementation the Fed hopes that both it and FBOs can instead focus on 'heightened priorities'.

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March 24 – Fed Scales Back Non-Critical Oversight

Perhaps in recognition that the Fed only has so many resources, March 24 also saw the Fed announce that it would scale back non-critical oversight of the financial institutions it regulates, with the impact most felt at smaller firms. The Fed will pivot from examinations as usual to "monitoring and outreach to help financial institutions of all sizes understand the challenges and risks of the current environment." Crucially, however, banks that are required to submit capital adequacy plans will still be required to do so by April 6, although at this stage most of the largest U.S. financial institutions would be nearing completion of work required for this anyway.

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March 26 – Fed Provides Reporting Relief For Small Financial Institutions

Recognizing that businesses are suffering staffing and other disruptions at this time, the Fed announced that it would not take action against any firm with less than \$5 billion in total assets that submit financial statements after filing deadlines. This provides only 30 day's grace, however, and the Fed recommends that firms likely to be in this position contact their Reserve Bank in advance.

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March 26 – New York Fed To Buy Commercial Mortgage-Backed Securities

The New York Federal Reserve announced that it would begin purchasing securities backed by commercial mortgages for the first time. The New York Fed announced the immediate purchase of \$1 billion fixed-rate Fannie Mae Delegated Underwriting and Servicing pools, with a 10-year loan term, with a further \$3 billion to be purchased the following week. The New York Fed noted that the securities in question would primarily be backed by multifamily housing blocks, such as apartment buildings, but that this effort may be expanded to cover other commercial mortgages.

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March 30 – Fed and Banking Regulators Ease Impact of Rulemakings on Banks

The Fed, in coordination with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC), announced two new actions designed to promote bank lending, in one case hastening the implementation of a new rulemaking, and in the other delaying. For the first, banks may now adopt early a new methodology for measuring counterparty risk. The rule, known as the “standardized approach for measuring counterparty credit risk” (SA-CCR), better reflects safety and soundness improvements in the derivatives market. For the second, the agencies have released an interim final rule concerning the calculation of “current expected credit loss” (CECL), an upcoming rule that would significantly and adversely impact how banks calculate their losses. This interim final rule would allow for the implementation of this new standard over an additional two years to the three-year postponement period already in place.

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March 31 – Fed Postpones Bank Control Framework

In January 2020 the Fed finalized a new framework by which it determines what constitutes “control,” or ownership, within a bank organizational hierarchy. If a corporate entity has control over a bank, it is subject to additional and enhanced scrutiny. The effective date of this new framework has been postponed six months from the original date of April 1 to September 30 2020.

[Press release](#)

March 31 – Fed Establishes New Temporary Repo Facility

The Fed established a new temporary facility (FIMA Repo Facility) allowing foreign banks to exchange Treasury securities – temporarily – for U.S. dollars via repurchase agreements. This significantly increases the

availability of the U.S. dollar in that this provides a source that does not rely on the outright sale of securities. The new facility will commence April 6 and be available for six months.

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April 1 – Fed Loosens Bank Capital Requirement

The supplementary leverage ratio (SLR) is a secondary capital ratio that applies only to banks holding more than \$250 million in consolidated assets. Like all capital ratios, the SLR requires bank holding companies to hold additional and sufficient capital against a time of need. On April 1st the Fed announced that it would loosen the requirements of the SLR on the banks to which it applies. Like many of the Fed's actions, the intent here is to free up capital so that lenders can continue to provide the economy with credit, with the Fed noting that any other use of these additional funds (including in returns to shareholders) is prohibited.

[Press release](#)

April 6 – Fed Implements CARES Act Community Bank Capital Ratio

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Conclusions

“We’re going to go in strong,” said Fed Chairman Jerome Powell in his [press briefing](#) Sunday evening, and “we will restore market functioning.” Despite Sunday’s emergency announcement and the Fed’s implementation of crisis-era monetary policy, however, all major stock indices were down after trading on Monday, with the Dow Jones seeing a [13 percent fall](#) – the most severe decline since 1987’s Black Monday. Both the Dow and the S&P 500 closed at their weakest in three years.

Clearly it is too soon to see the actual economic impacts of the Fed’s emergency measures, but short-term investor confidence is not the most important measure of success for the Fed at this juncture. Instead the Fed will have to be judged on whether these measures, and the measures to come, have ensured the market possesses the necessary liquidity to allow business to continue with something resembling normalcy.