CARES Act Impacts Municipal Securities Market

By Andrew C. Maher / Apr 03, 2020

In response to the recent global social and economic turbulence wrought by the COVID-19 pandemic, President Trump signed into law on March 27, 2020, the $2 trillion Coronavirus Aid, Relief, and Economic Security Act (“CARES”), that includes the Coronavirus Economic Stabilization Act of 2020 (“Act”).

The Act, among other things, authorizes the Board of Governors of the Federal Reserve System (“Federal Reserve” or “Fed”) to establish mechanisms by which it may provide significant liquidity support to the market for municipal securities, which has, as a result of the COVID-19 pandemic, struggled as investors have fled capital markets. These Federal Reserve mechanisms are intended to support lending to State and local governments by, among other things, purchasing debt obligations issued by such governmental entities in either primary offerings or on the secondary market.

Under the terms of the Act, the Secretary is authorized to allocate $454 billion to make loans and loan guarantees to, and other investments in, programs or facilities established by the Federal Reserve to provide liquidity to financial systems that support lending to eligible businesses, States, or municipalities by (i) purchasing obligations or other interests directly from issuers, (ii) purchasing obligations or other interests in secondary markets or otherwise, or (iii) making loans, including loans or other advances secured by collateral." To accomplish these purposes, the Federal Reserve has authorized the establishment or expansion of six facilities: the Commercial Paper Funding Facility, the Money Market Mutual Fund Liquidity Facility, the Primary Market Corporate Credit Facility, the Secondary Market Corporate Credit Facility, the Term Asset-Backed Securities Loan Facility, and the Main Street Business Lending Program, through which these allocated funds will be deployed in the municipal securities market.

Additionally, the Act requires that any liquidity facilities authorized to be established or expanded by the Federal Reserve to comply with the “loan collateralization, taxpayer protection, and borrower solvency” requirements under Section 13(3) of the Federal Reserve Act.

Section 13(3) of the Federal Reserve Act authorizes the Federal Reserve “in unusual and exigent circumstances,” to discount notes and similar loan instruments of solvent borrowers “unable to secure adequate credit accommodations from other banking institutions.” It is unclear how this provision will impact action by the Fed in its efforts to support the municipal securities market. Of the significant unknowns concerning the implementation of the Act, we do not know whether the Fed will favor the purchase of securities in the primary or secondary market, which kind of municipal securities will be favored, and where along the yield curve the Fed will be active.

What is known is that the announcement that the Federal Reserve would be active in the municipal market brought some much-needed relief to the market which, since the middle of March, had seized almost completely, as many deals had to be pulled for want of buyers. The prospect of the Federal Reserve helping to make a market for municipal securities, even if its parameters are not yet known, should help buy time for the broader municipal securities market to heal and, it is hoped, re-establish more normal operations sooner rather than later.

The authority to make new loans, loan guarantees and investments under the Act terminates on December 31, 2020, but transactions still outstanding after that date “may be modified, restructured, or otherwise amended.”

Nobody knows what the long-term impact of the COVID-19 pandemic will have on the broader economy, particularly the long-term impact on State and local governments. Until that picture comes into better focus, the Federal Reserve has been given significant authorization to help stabilize the municipal securities market. Such stabilization may allow, at least in the short-term, State and local governments to seek capital through the issuance of municipal securities until regular operation returns.

