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Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Money Market Mutual Fund Liquidity Facility

Federal Reserve System: Board of Governors

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Overview

On March 18, 2020, the Board of Governors of the Federal Reserve System (the Board), by the unanimous vote of its five members and with the approval of the Secretary of the Treasury, approved under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343(3)) the establishment of the Money Market Mutual Fund Liquidity Facility (MMLF) and authorized the Federal Reserve Bank of Boston (the Reserve Bank) to lend under that program.[1] The MMLF will provide funding to U.S. depository institutions and bank holding companies to finance their purchases of certain types of assets from money market mutual funds (MMMFs) under certain conditions. The program is intended to assist MMMFs that hold such paper in meeting demands for redemptions by investors and to foster liquidity in the markets for the assets held by MMMFs, including the market for municipal securities.

Background on the MMLF

Recent events have significantly and adversely impacted global financial markets. The spread of the Coronavirus Disease 2019 (COVID-19) has halted economic activity in many countries, including the United States. In particular, sudden disruptions in financial markets have put increasing liquidity pressure on MMMFs. Given these pressures, MMMFs have been faced with redemption requests from clients with immediate cash needs. The MMMFs may need to sell a significant number of assets to meet these redemption requests, which could further increase market pressures.

In these circumstances, the Board determined that unusual and exigent circumstances existed and approved the establishment of the MMLF to help restore liquidity to help MMMFs meet demands for redemption and to avoid the forced liquidation of commercial paper, municipal bonds, and other short-term obligations into already strained financial markets. These measures are also intended to help restore stability in the markets for assets held by MMMFs. The

[1] Subsequently, the Board, by the unanimous vote of its five members and with the approval of the Secretary of the Treasury, announced expansions of the MMLF, which are reflected in this report.

Department of the Treasury, using the Exchange Stabilization Fund, has committed to provide $10 billion as credit protection to the Reserve Bank.

MMMFs are common investment tools for families, businesses, and a range of companies. In order to prevent the disruptions in the money markets from destabilizing the financial system, the Board has authorized the Reserve Bank to establish the MMLF, which would extend non-recourse loans to eligible financial institutions to purchase certain assets from MMMFs, which would be pledged as collateral for the loan. The MMLF will assist MMMFs in meeting demands for redemptions by households and other investors, enhancing overall market functioning and credit provision to the broader economy. MMMFs are registered with the Securities and Exchange Commission and are limited to holding securities with maturities of less than 397 days that the fund's board of directors determines present minimal credit risk.[2] These funds are major purchasers and holders of high-quality short-term debt instruments, including highly rated commercial paper and municipal bonds.

Structure and Basic Terms

Eligible borrowers may borrow funds from the MMLF in order to fund the purchase of eligible U.S. government debt, municipal securities, and commercial paper from an MMMF under certain conditions. Lending under the MMLF commenced on March 23, 2020.

The following provides an overview of the terms and conditions that govern the MMLF. The MMLF program will extend loans to eligible borrowers to purchase, and pledge as collateral, a broader range of assets, but its structure is very similar to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, or AMLF, that operated from late 2008 to early 2010. The Board and Reserve Bank continue to monitor the affected financial markets and to consult with market participants and, accordingly, the terms and conditions governing the facility may be modified in the future as appropriate. The terms and conditions of the MMLF are available to the public on the Board's website. The discussion below summarizes these terms and conditions.

Borrower Eligibility. U.S. depository institutions, bank holding companies (parent companies incorporated in the United States or their U.S. broker-dealer affiliates), and U.S. branches and agencies of foreign banks are eligible to borrow under this facility. To participate, eligible borrowers must comply with

[2] 17 CFR 270. 2a-7(a).

the terms and conditions set forth by the Reserve Bank.

Advances. Each advance shall be in an amount that is equal to the value of the collateral purchased from an MMMF and pledged to the Reserve Bank. The collateral valuation will either be amortized cost or fair value. For asset-backed and unsecured commercial paper, the valuation will be amortized cost. The maturity date of an advance will equal the maturity date of the eligible collateral pledged to secure the advance made under this MMLF, except in no case will the maturity date of an advance exceed 12 months. MMLF advances are made without recourse, provided the terms and conditions of the program are met.

Collateral Eligibility and Valuation. Advances under the MMLF are secured by a pledge of eligible collateral. Eligible collateral includes U.S. government debt or highly rated commercial paper, securities issued by government-sponsored entities; and highly rated municipal securities.

Rate and Fees. The rates charged on advances made under the MMLF are based on the collateral securing the advance. For example, advances made under the facility that are secured by U.S. Treasury securities and fully guaranteed agencies or securities issued by U.S. government-sponsored entities will be made at a rate equal to the primary credit rate in effect at the Reserve Bank that is offered to depository institutions at the time the advance is made. There are no special fees associated with the facility.

Termination Date. No new MMLF credit extensions will be made after September 30, 2020, unless the facility is extended by the Board.

Requirements Imposed on Recipients. The MMLF will not impose any new requirements on U.S. depository institutions and bank holding companies with respect to employee compensation, distribution of dividends, or any other corporate decision in exchange for the assistance.

Expected Costs. As MMLF credit is non-recourse to the borrower, the Federal Reserve, and not the borrower, bears the risk of loss on the collateral. To mitigate this risk, the program is limited to collateral that is generally considered high quality. In addition, for eligible asset-backed commercial paper collateral, the commercial paper is supported by the assets backing the paper. The rates charged on advances under the program are based on the type of collateral, with advances secured by U.S. Treasury securities receiving the lowest rate. The Reserve Bank does not expect the costs of administering the program to be significant. As a result, the Board does not expect at this time that advances under the MMLF will result in any losses to the Federal Reserve or the taxpayer.