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Testimony before the Congressional Oversight Commission

“Hearing to Examine the Main Street Lending Program”

August 7, 2020

Members of the Commission, my name is Lauren Anderson and I am a Senior Vice President and Associate General Counsel at the Bank Policy Institute (BPI). I thank you for the opportunity to be a witness at today’s hearing regarding the Main Street Lending Program (MSLP). BPI is a nonpartisan public policy, research and advocacy group, representing the nation’s leading banks. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ nearly 2 million Americans, make 72% of all loans and nearly half of the nation’s small business loans and serve as an engine for financial innovation and economic growth. BPI strongly supports the efforts to date by Congress, the Treasury and the Federal Reserve to tackle the COVID crisis and provide much needed relief to households and businesses.

On March 23, 2020, the Federal Reserve announced that it would be establishing a Main Street Business Lending Program;<sup>1</sup> and, as part of Title IV of the CARES Act, Congress shortly thereafter provided \$454 billion to be used to support loan and loan guarantees provided by Federal Reserve lending facilities, including the MSLP. On April 9, 2020, the Federal Reserve announced the first iteration of the term sheets for the MSLP and indicated that it would be able to purchase up to \$600 billion in loans supported by \$75 billion in equity provided by Treasury through the Exchange Stabilization Fund (ESF).<sup>2</sup> Last week, the Federal Reserve announced that it would be extending the scheduled expiration of its emergency lending programs, including the MSLP, from September 30 through the end of the year.<sup>3</sup> BPI, working with commercial lending experts from its member banks, has been actively engaged in commenting on the MSLP since these initial term sheets were published in early April and through subsequent iterations, including the newly added facilities related to nonprofit organizations.

At the outset, it is worth noting how unique the MSLP is in relation to emergency lending programs established during the pandemic--and even in relation to emergency programs established during the financial crisis in 2008 and 2009. This program is not a loan forgiveness or grant program like the Paycheck Protection Program, and it is not a market liquidity program for debt of investment grade borrowers. The MSLP requires credit underwriting decisions on a heterogeneous set of individual non-bank borrowers, which is challenging and not something the Federal Reserve has done before. With the expansion of the MSLP to nonprofit organizations, which themselves are very different across different sectors, the Federal Reserve ventured even further into uncharted territory. Given the complexity of the task and the need to complete it as soon as possible, it was entirely sensible for the Federal Reserve

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<sup>1</sup> See “Federal Reserve announces extensive new measures to support the economy,” (March 23, 2020); available at <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm>

<sup>2</sup> See “Federal Reserve takes additional actions to provide up to \$2.3 trillion in loans to support the economy,” (April 9, 2020); available at <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm>

<sup>3</sup> See “Federal Reserve Board announces an extension through December 31 of its lending facilities that were scheduled to expire on or around September 30,” (July 28, 2020); available at <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200728a.htm>

to leverage the expertise of banks in making lending decisions and to seek comment from lenders to establish the terms of the program.

The focus of BPI's comments to date has largely been on ensuring the terms of the program are consistent with market practices, so the program can quickly achieve the broadest participation possible, and ensuring prudent risk management to safeguard taxpayer funds. We commend the Federal Reserve for seeking public comment on the terms of the program and engaging in an iterative process to try to improve the end result. For example, we welcomed the adjustments to the original term sheets with regard to the definition of EBITDA, the move from SOFR to LIBOR and the more recent adjustments to lengthen loan tenure from 4 to 5 years and allow for co-borrowers.

We are very pleased that the program began accepting lender registration in June<sup>4</sup> and officially became operational for business lending and to purchase participations in eligible loans on July 6.<sup>5</sup> Since then, lenders continue to register and loans, albeit a small amount, are being made. According to testimony from Federal Reserve Chairman Powell in front of the House Financial Services Committee at the end of June, over 300 lenders had begun the process of registering<sup>6</sup>. A number of BPI member banks have registered; and 11 BPI members have indicated that they will be accepting applications from new customers.<sup>7</sup> As of July 29, the Federal Reserve had purchased \$82 million in participations of Main Street Loans.<sup>8</sup>

The limited number of loans made thus far under the MSLP can best be understood by recognizing its place in a larger commercial credit ecosystem. First, many smaller businesses that received PPP loans, and eventually grants, did not require MSLP loans in addition. BPI member banks for instance helped provide over 1.6 million PPP loans totaling over \$188 billion to help small businesses meet payroll needs.<sup>9</sup> Second, the largest businesses retain access to capital markets, which remain extremely active with the support of numerous Federal Reserve programs. Investment grade and corporate debt has been issued at record levels, with U.S. companies raising over \$1 trillion year to date. Third, and perhaps most significantly, as the severity of the health crisis became evident in the first quarter, both small and large businesses prudently accessed credit from their banks to ensure liquidity. Between February 12, 2020 and April 1, bank loans increased approximately \$700 billion, in large part because banks were funding draws on lines of credit as large and small businesses sought to stockpile

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<sup>4</sup> See "Federal Reserve's Main Street Lending Program opens for lender registration," (June 15, 2020); available at <https://www.bostonfed.org/news-and-events/press-releases/2020/federal-reserves-main-street-lending-program-opens-for-lender-registration.aspx>

<sup>5</sup> See "Boston Fed announces Main Street Lending Program is fully operational," (July 6, 2020); available at <https://www.bostonfed.org/news-and-events/press-releases/2020/boston-fed-announces-main-street-lending-program-is-fully-operational.aspx>

<sup>6</sup> See Testimony of Chairman Jay Powell before the House Financial Services Committee "Oversight of the Treasury Department's and Federal Reserve's Pandemic Response," (June 30, 2020); available at <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=406688>

<sup>7</sup> Information retrieved on August 4, 2020 from <https://www.bostonfed.org/supervision-and-regulation/supervision/special-facilities/main-street-lending-program/information-for-borrowers.aspx#map>

<sup>8</sup> Information retrieved on August 4, 2020 from <https://www.federalreserve.gov/releases/h41/current/h41.htm>

<sup>9</sup> See "Paycheck Protection Program (PPP) Report," (July 31, 2020); available at <https://home.treasury.gov/system/files/136/SBA-Paycheck-Protection-Program-Loan-Report-Round2.pdf>

cash.<sup>10</sup> Thus, a lack of demand for MSLP loans likely indicates that most businesses are finding credit through other market channels.

Given the fact that the MSLP requires borrowers to not only meet certain eligibility criteria, but also to satisfy bank underwriting standards, it is not surprising that creditworthy borrowers are finding solutions through normal market channels: borrowers generally prefer to avoid the stigma of government assistance if private sector funding is available, and lenders have incentives to continue serving creditworthy borrowers. Where the MSLP may be more useful is where a bank is balance sheet constrained and cannot lend the full amount needed by a creditworthy borrower. In this instance, an MSLP loan may be attractive to both a borrower and a lender as the MSLP SPV will buy 95% of the loan through the participation structure. However, as demonstrated by the Federal Reserve's recent stress test in which nearly all banks were projected to remain well capitalized even in a severe further downturn, banks currently have plenty of capital to support their lending. In this regard, we believe the MSLP may be of greater utility if the economic downturn worsens and banks come under greater pressure.

If, however, Congress desires to provide further relief to small and midsize businesses experiencing acute stress due to the pandemic, including less creditworthy borrowers who would not currently pass bank underwriting standards, the design of the program would need to be modified. MSLP loans originated as "non-pass" credits would be classified by bank examiners and treated as workouts; non-pass credits would also likely trigger examiner criticism, higher capital charges, and other regulatory constraints. Furthermore, the additional leverage created by an MSLP loan might cause a downgrade of an existing bank credit. So, even a 5 percent participation in an MSLP loan to a borrower that is anything but creditworthy carries significant disincentives for a bank to participate. To avoid this outcome, the government would need to provide downside credit risk protection that would allow the MSLP loan, and existing credit, to be considered lower risk.

I thank you again for the opportunity to be a witness for the Commission and I look forward to answering your questions.

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<sup>10</sup> Recent regulatory reports and banks' earnings reports indicate that many of the recent draws on credit lines have been repaid.