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INSIGHT

Capital Markets, COVID-19, and Federal Government Emergency Facilities

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The spread of COVID-19 induced heavy capital markets selloffs and rebounds in 2020. The crisis-induced stress conditions have been broadly felt in all corners of capital markets—stocks, bonds, investment funds, and other segments have all experienced heightened volatility. In response, the Federal Reserve (Fed), sometimes with support from the Treasury Department, has established several emergency facilities to provide support for key capital markets segments (**Table 1**). As of the publication of this Insight, some markets affected by the announced emergency support appear to have rebounded to a certain extent. **Figure 1** illustrates market conditions at the time of selected Fed announcements. The changes in market activities do not suggest direct causal relationships with Fed announcements. Changes in the course of the pandemic, other economic factors, and other government responses, such as the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136), likely also had significant effects. Capital markets conditions are discussed in more detail in CRS Report R46424, *Capital Markets Volatility and COVID-19: Background and Policy Responses*, by Eva Su.

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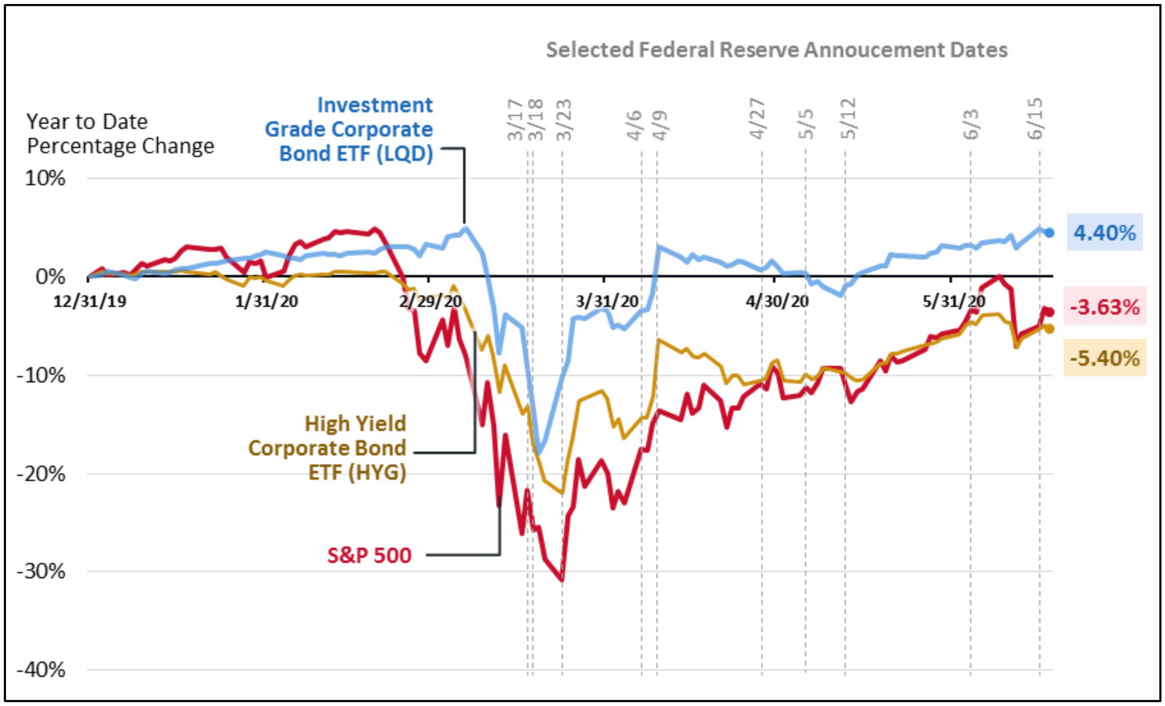
Table 1. Selected Capital Markets Segments Supported by Federal Reserve Funding, Credit, Liquidity, and Loan Facilities

Selected Capital Markets Segments	Examples of Related Federal Reserve Facilities	Market Reactions Following the Announcements
Corporate Bonds	The Fed announced in March the purchase of higher credit quality investment-grade bonds for the first time through the Primary Market Corporate Credit Facility (**PMCCF**) and Secondary Market Corporate Credit Facility (**SMCCF**). The programs were extended to fallen angels in April by including companies that lost investment-grade credit ratings after March 22, 2020. The Fed updated **SMCCF** on June 15, 2020, to spell out the plan to purchase bonds using an internally developed broad, diversified market index.	At the first announcement of **PMCCF** and **SMCCF**'s creation, the bond market rebounded, but high-yield bonds, which did not receive the announced support, stabilized less. Following the announcement of the expansion, prices for high-yield bonds rose substantially, possibly signaling the restoration of the market to some extent. Both investment-grade and high-yield bond markets reportedly reacted positively after the Fed disclosed more details on its index-based buying strategy.
Asset-Backed Securities (ABS)—Collateralized Loan Obligations (CLOs)	The Fed established the Term Asset-Backed Securities Loan Facility (**TALF**) on March 23, 2020, to support ABS flow of credit to consumers and businesses. It expanded **TALF** to provide funding for CLO investors (and indirectly leveraged loans) in April. Certain senior tranche AAA-rated static CLOs could qualify for **TALF**. Static CLOs are CLOs that do not include a period of reinvestment of collateral proceeds. The eligible CLOs must have been newly issued, on or after March 23, 2020. The Fed expanded **TALF** again on May 12, 2020, to include CLOs backed by eligible leveraged loans from earlier periods, including loans originated on or after January 1, 2019.	While higher-rated CLOs rebounded to a large extent, the lower-tranche CLOs, which are designed to absorb losses for the collateral pools, did not recover at the same level.
Municipal Bonds	The Fed included certain municipal bonds with short maturities in some of its early liquidity facilities—the Money Market Mutual Fund Liquidity Facility (**MMLF**) and the Commercial Paper Funding Facility (**CPFF**). The Fed expanded its support of state and local governments on April 9 by announcing a program devoted specifically to municipal debt, purchasing certain longer-term bonds issued by states, cities, and counties—the Municipal Liquidity Facility (**MLF**).	Following the Fed announcements, certain municipal bonds' pricing pressure appears to have been reduced. Some broad measures of the market—for example, the 10-year municipal bond yields—declined substantially from the March selloff levels.
Money Market Mutual Funds (MMF)	The Fed created the **MMLF** based on a facility it had deployed during the 2007-2009 financial crisis. MMF assets that could serve as eligible collaterals include U.S. Treasuries, government-sponsored enterprise debt, high quality asset-backed and unsecured commercial paper, certain certificates of deposit, and certain municipal debt.	After the announcement on March 18, 2020, certain MMFs (prime and municipal) that were previously facing redemption pressure saw waves of inflows. The conditions for MMFs and the related underlying short-term credit markets have eased since the announcement.
Exchange-Traded Funds (ETF)	For bond ETFs, on March 23, 2020, the Fed established the **SMCCF** that can buy certain ETFs providing broad exposure to investment-grade bonds. It expanded the program on April 9, 2020, to include certain high-yield bond ETFs as well.	Before any actual purchases took place, the ETF market showed signs of stabilization. Bond ETFs experienced strong inflows immediately following the announcement, and some ETFs reportedly ceased trading at discounts to their net asset value.

Source: CRS based on Federal Reserve disclosures.

Notes: The table provides general examples. It is not inclusive of all related emergency lending actions and market events. The market reactions capture changes in market activities; they do not suggest direct causal relationships. Market conditions often changed before any actual purchases took place (e.g., TALF, SMCCF, PMCCF, and MLF). See **Figure 1** for changes in market conditions following the related emergency lending announcements. For more details on individual programs, see Federal Reserve Board, *Funding, Credit, Liquidity, and Loan Facilities*, at https://www.federalreserve.gov/funding-credit-liquidity-and-loan-facilities.htm; and CRS Insight IN11327, *Federal Reserve: Emergency Lending in Response to COVID-19*, by Marc Labonte.

Figure 1. Changing Market Conditions and Selected Federal Reserve Announcement Dates



Source: CRS based on S&P Capital IQ data.

Capital Markets and COVID-19 Product Series

CRS Report R46424, *Capital Markets Volatility and COVID-19: Background and Policy Responses*, by Eva Su.

CRS Insight IN11421, *Leveraged Loans and Collateralized Loan Obligations (CLOs): Recent Developments and Policy Actions*, by Eva Su.

CRS Insight IN11309, *COVID-19 and Stock Market Stress*, by Eva Su.

CRS Insight IN11275, *COVID-19 and Corporate Debt Market Stress*, by Eva Su.

CRS Insight IN11339, *Securities and Exchange Commission (SEC) Actions to Mitigate the Impact of COVID-19*, by Gary Shorter.

CRS In Focus IF11320, *Money Market Mutual Funds: A Financial Stability Case Study*, by Eva Su.

Federal Reserve Emergency Facilities and COVID-19 Product Series

CRS Report R46411, *The Federal Reserve's Response to COVID-19: Policy Issues*, by Marc Labonte.

CRS Report R44185, *Federal Reserve: Emergency Lending*, by Marc Labonte.

CRS Insight IN11327, *Federal Reserve: Emergency Lending in Response to COVID-19*, by Marc Labonte.

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