Bond Dealers of America

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Submitted Electronically

The Honorable Steven Mnuchin
Secretary of the Treasury
Main Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable Jerome Powell
Chair of the Board of Governors
The Federal Reserve
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Secretary Mnuchin and Chairman Powell,

As you know the President on Friday signed into law the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136, the "Act"). Section 4003 of the Act provides authorization for the Treasury Department "to make loans and loan guarantees to, and other investments in, programs or facilities established by the Board of Governors of the Federal Reserve System for the purpose of providing liquidity to the financial system that supports lending to eligible businesses, States, or municipalities." We write today with our initial views on this new program as it relates to the municipal securities market. BDA is the only DC-based group exclusively representing the interests of securities dealers and banks focused on the US fixed income markets.

The municipal securities market is a vital national asset because it is the means by which states and localities raise capital to finance infrastructure. The market has suffered significantly over the last several weeks, with the cancellation or postponement of new issuance, price volatility of historic proportions, and a significant deterioration of liquidity. BDA supports Section 4003 of the Act and the new authority it provides Treasury and the Fed to support the municipal market during the stress brought about by the coronavirus crisis. As you begin to work through the details, please consider the following points.

Issuers should be the focus of the Treasury and the Fed. Municipal issuance volume in March was much lower than anticipated due to issuers being forced to strategically make the decision to postpone or cancel a number of new issue transactions. Although the new issue market continues to recover, it is not nearly as healthy as it should be. We recommend that Treasury and the Fed concentrate the majority of your municipal market resources on “purchasing obligations or other interests directly from issuers” as permitted by the Act. This is especially true for issuers expected to be particularly hard hit by the crisis such as those dependent on travel-related taxes or fees. One area of focus the Fed should consider is to establish a standby, short-term lending facility for states and localities experiencing cash flow timing shortfalls.

The secondary market remains volatile and under stress. For the last three weeks or so the municipal market has experienced unprecedented stress. Liquidity has at times all but disappeared. Bid-ask spreads have widened significantly. Price volatility has been at historic levels. Some dealers have reported that their municipal inventories are “full” and they are unable to take more bonds onto their balance sheets. The market is not functioning as it needs to for the benefit of issuers and investors. For these reasons we encourage targeted, short term Fed intervention in the secondary municipal market to provide additional support. We urge the Fed to monitor market conditions closely and to intervene as needed to address periods of unusual stress.

The municipal market is fundamentally sound, but will experience pressure in coming months. The municipal securities market generally remains a safe asset class with long-term default rates at or near zero. We expect, however, that credit conditions among some municipal issuers will deteriorate as the economic slowdown continues. When the uncertainty associated with the virus has passed, we fully anticipate the municipal market will return to its safe, steady normality. In the meantime, however, the Fed should consider funding programs targeted at state and local issuers who find themselves under fiscal pressure as a result of the virus crisis. In general, to maintain a healthy municipal market and not create an artificial dependency, we urge Treasury and the Fed to plan on ending its municipal market support program as soon as practical.

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As you and your teams work through the details of your municipal market support program, please consider our comments. We would be happy to provide any additional information.

Sincerely,

Mike Nicholas
Chief Executive Officer
Bond Dealers of America