COVID-19: THE FEDERAL RESERVE ESTABLISHES THREE NEW LIQUIDITY FACILITIES AND EXPANDS THE SCOPE OF TWO EXISTING LIQUIDITY FACILITIES

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By: Daniel F. C. Crowley, Anthony R.G. Nolan, Karishma Shah Page, Bruce J. Heiman, William A. Kirk, Dean A. Brazier, Daniel S. Nuñez Cohen

To mitigate the "severe disruptions" to the U.S. economy caused by the COVID-19 crisis, the Federal Reserve Board ("Federal Reserve") is ramping up its efforts to "support…the flow of credit to American families and businesses." To do so, the Federal Reserve announced during the early morning of March 23 that it will establish three new liquidity facilities and expand the scope of eligible securities under the previously established Money Market Mutual Fund Liquidity Facility ("MML Facility") and the Commercial Paper Funding Facility ("CPF Facility"), pursuant to its authority under Section 13(3) of the Federal Reserve Act. Please see our prior alerts about the MML Facility (here) and the CPF Facility as well as the Primary Dealer Credit Facility (here).

SCOPE OF THE THREE NEW LIQUIDITY FACILITIES

The Federal Reserve will establish three new liquidity facilities: the Primary Market Corporate Credit Facility ("PMCC Facility"), the Secondary Market Corporate Credit Facility ("SMCC Facility"), and the Term Asset-Backed Securities Loan Facility ("TAL Facility").

PMCC Facility

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Term Sheet

): The facility will support investment grade bonds of companies headquartered in the United States with material operations in the United States through the provision of secured bridge financing up to four years, provided with an interest rate "informed by market conditions." To do so, the Federal Reserve Bank of New York will extend recourse loans to a special purchase vehicle that will purchase eligible bonds (rated at least BBB-/Baa3 with a maturity of four years or less) directly from issuers in exchange for loans. The eligible bonds will secure the loans. Borrowers may defer interest and principal payments for the first six months of the loan term. Deferments may be extended, per the Federal Reserve Bank of New York's discretion, provided deferment enables the borrower to maintain payroll and the borrower does not engage in stock buybacks or distribute dividends during the deferral period. Eligible entities will not include any otherwise eligible company "expected to receive direct financial assistance" through the Congress's pending COVID-19 Phase III response package. Like the other liquidity facilities, the Department of Treasury will provide $10 billion in equity investment through the Exchange Stabilization Fund ("ESF").

SMCC Facility

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Term Sheet

): The facility will engage in secondary market purchases of investment grade (rated at least BBB-/Baa3) corporate bonds of U.S. companies as well as exchange traded funds that are (1) listed in the United States, and (2) have an investment objective to provide investors a "broad exposure" to U.S. investment grade corporate bonds. The Federal Reserve Bank of New York will provide recourse loans to a special purpose vehicle that will purchase the eligible securities at fair market value. The corporate bonds to be purchased, which will be collateral for the loan, must have a remaining maturity of five years or less. Like the PMCC Facility, issuers must be headquartered in the United States with material operations in the United States and may not receive direct financial assistance from Congress's pending relief package. The Department of Treasury will provide $10 billion in equity investment through the ESF.

TAL Facility

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Term Sheet

): The facility will support AAA-rated asset-backed securities ("ABSs") backed by student loans, automobile loans, credit card loans, equipment loans, floor plan loans, insurance premium finance loans, loans guaranteed by the Small Business Administration ("SBA"), and certain servicing advance receivables ("eligible collateral") issued on or after March 23, 2020. To do so, the Federal Reserve Bank of New York will issue recourse loans to a special purpose vehicle, which, in turn, will extend up to $100 billion in nonrecourse loans with a three-year term to any U.S. company, including a U.S.-based branch or agency of a foreign bank, that owns eligible collateral and has an account relationship with a primary dealer. The loans will be fully secured by the ABSs. "The pledged eligible collateral will be valued and assigned a haircut according to a schedule based on its sector, the weighted average life, and historical volatility of the ABS. This haircut schedule will be roughly in line with the haircut schedule used for the TALF Facility established in 2008." The Department of Treasury will provide $10 billion in equity investment through the ESF.

EXPANDING THE SCOPE OF THE EXISTING LIQUIDITY FACILITIES

In addition to establishing three new liquidity facilities, the Federal Reserve is expanding the scope of the MML Facility and the CPF Facility. Now, the MML Facility will allow eligible borrowers to use municipal variable rate demand notes and bank certificates of deposits as collateral (see updated Term Sheet).

The CPF Facility will be expanded to provide liquidity to municipalities by allowing for high-quality, tax-exempt commercial paper to be held as collateral. Additionally, an issuer whose commercial paper is downgraded to a rating of A2/P2/F2 after March 17 may be eligible for a one-time sale to the facility. The Federal Reserve is also reducing pricing down to the three-month overnight index swap ("OIS") rate plus 100 basis points for A1/P1/F1-rated commercial paper and the OIS rate plus 200 basis points for A2/P2/F2-rated commercial paper (see updated Term Sheet).

FUTURE STEPS

The Federal Reserve also announced that it will establish a "Main Street Business Lending Program to support lending to eligible small-and-medium sized businesses." The lending program will complement existing loan programs offered by the SBA.

For additional insights into these developments, please contact any of the authors.

KEY CONTACTS

DANIEL F. C. CROWLEY
PARTNER

WASHINGTON DC
+1.202.778.9447
DAN.CROWLEY@KLGATES.COM

ANTHONY R.G. NOLAN
PARTNER

NEW YORK
+1.212.536.4843
ANTHONY.NOLAN@KLGATES.COM

KARISHMA SHAH PAGE
PARTNER

WASHINGTON DC
+1.202.778.9128
KARISHMA.PAGE@KLGATES.COM

BRUCE J. HEIMAN
PARTNER

WASHINGTON DC
+1.202.661.3935
BRUCE.HEIMAN@KLGATES.COM

WILLIAM A. KIRK
PARTNER

WASHINGTON DC
+1.202.661.3814
WILLIAM.KIRK@KLGATES.COM