

COVID-19: THE FEDERAL RESERVE ANNOUNCES NEW AND EXPANDED LIQUIDITY FACILITIES TO PROVIDE \$2.3 TRILLION IN FUNDING

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U.S. Financial Services Policy Alert

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

On Thursday, April 9, the Federal Reserve Board (“FRB”) [announced](#) the terms sheets of four new liquidity facilities and expanded the scope of the previously announced Term Asset-backed Securities Liquidity (“TALF”), the “Primary Market Corporate Credit (“PMCC”), and the Secondary Market Corporate Credit (“SMCC”) Facilities. Collectively, these facilities will provide up to \$2.3 trillion of liquidity to businesses, states and certain local governments, and nonprofits. The new facilities will operate until September 30, 2020, unless the Department of Treasury and the FRB determine otherwise, which will depend on the nature of the economic recovery.

Notably, the FRB will rely on depository institutions and their holding companies exclusively to provide loans to businesses, as of now. The FRB is also showing an increasing willingness to expand the scope of eligible collateral in an effort to provide liquidity throughout the economy. A brief summary of the key terms of the new facilities and the updated terms of existing facilities follows.

MAIN STREET NEW LOAN FACILITY (“MSNLF”)

The MSNLF ([Term Sheet](#)) is intended to facilitate lending by financial institutions to U.S.-based small- and medium-sized businesses (businesses with up to 10,000 employees or up to \$2.5 billion in 2019 annual revenue). Under this program, a Federal Reserve Bank will issue recourse loans to a special purpose vehicle (“Main Street SPV”) which in turn will purchase 95% of eligible adjustable rate loans at par value from U.S. insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies, which will retain ownership of the remaining 5%. Eligible loans must, among other requirements, be originated on or after April 8, 2020, have four year principal amortization schedule, and provide for interest and amortization of principal deferred for one year. The minimum loan size must be \$1 million and the maximum size must be the lesser of (i) \$25 million, or (ii) an amount that does not exceed four (4) times the borrowers' 2019 EBITDA when added to the borrower's existing outstanding and committed but undrawn debt. Notably, any required collateral has not been determined to-date. For more information about the MSNLF, including on restrictions on proceeds and borrowers' conduct, fees, required certifications, interest rate, and other terms, please see our client alert ([here](#)) and our own term sheet ([here](#)).

MAIN STREET EXPANDED LOAN FACILITY (“MSELF”)

The MSELF ([Term Sheet](#)) is designed to encourage lenders to increase the size of loans originated to the same borrowers eligible under the MSNLF before April 8, 2020 by purchasing the upsized tranches of such loans,

provided the upsized tranches meet much of the same criteria as the loans originated as part of the MSNLF. The Main Street SPV will purchase 95% participation in the upsized tranche of the loan, and the lender will retain a 5% pari passu exposure to the credit risk of the eligible borrower. The maximum loan size must be the lesser of (i) \$150 million, (ii) 30% of the borrower's existing outstanding and committed by undrawn bank debt, or (iii) an amount that is not more than six (6) times the borrower's 2019 EBITDA when added to the borrower's existing outstanding and committed but undrawn debt. The pro rata risk sharing is a notable difference between the MSELF and the MSNLF (and indeed other programs such as TALF). For more information, including restrictions on proceeds and borrowers' conduct, fees, required certifications, and other terms, please see our client alert ([here](#)) and our own term sheet ([here](#)).

Neither facility, at this time, will purchase loans originated or upsized non-bank lenders.

PAYCHECK PROTECTION PROGRAM FACILITY (“PPF”)

Through the PPPF ([Term Sheet](#)), each Federal Reserve Bank will extend non-recourse loans to eligible lenders in its district, taking as collateral loans made by those lenders under the Paycheck Protection Program (“PPP”). The principal of each PPPF loan will be equal to 100% of the principal amount of each underlying PPP loans pledged as collateral. The terms of the PPPF loan, including maturity and acceleration, will be the same as those of the underlying PPP loan. Currently only depository institutions that originate PPP loans are eligible to borrow PPPF loans. (It remains to be seen whether the PPPF will be opened directly or indirectly to other types of lenders, including app-based fintech specialty finance companies that have helped expand the efficacy of PPP lending). To further encourage depository institutions to use the facility, the federal banking regulators issued a joint rule nullifying the effects of PPP loans on the originator's risk-based capital requirements (see [here](#)).

MUNICIPAL LIQUIDITY FACILITY (“MLF”)

Through the MLF ([Term Sheet](#)), a Federal Reserve Bank will provide recourse loans to an SPV (the “Muni SPV”) to purchase eligible notes from states, the District of Columbia, cities with more than 1 million residents, and counties with more than 2 million residents and entities that are authorized to issue eligible notes on their behalf at the time of issuance, securing the loans with the notes. The Federal Reserve's term sheet suggests that the population determinations will be based on U.S. Census Bureau data as of July 1, 2018, but future clarification on this point may be necessary. Regardless of how population is determined for eligibility purposes, only one issuer per State, city and county will be eligible to issue notes under this facility. For each eligible issuer, the Muni SPV may only purchase 20% of the general revenue from the issuer's own sources and utility revenue (in aggregate) for fiscal year 2017, unless the FRB gives permission for excess purchases to support political subdivisions that may not sell their own notes to the Muni SPV.

Eligible notes are tax anticipation notes, tax and revenue anticipation notes, bond anticipation notes, and similar short-term instruments with maturities of 2 years or less. The proceeds of the notes must be used to (i) manage reduced cash flow from extended income tax filing deadlines, (ii) fund potential reductions of tax and other revenues, (iii) fund increased expenditures related to or resulting from the COVID-19 pandemic, (iv) pay required principal and interest payments on outstanding obligations, or (v) purchase notes of political subdivisions or assist those subdivisions financially for these same reasons.

EXPANDED COLLATERAL FOR THE TALF

The FRB also announced an expansion of the types of asset-backed securities and their underlying collateral that may be offered as collateral for non-recourse loans under the TALF program ([updated Term Sheet](#)). Now, the TALF will accept triple-A rated tranches of both certain newly issued static collateralized loan obligations (“CLO”) (including CLOs comprised of leveraged loans) and certain commercial mortgage-backed securities (“CMBS”) that were issued before March 23, 2020 and are backed by mortgages on real property in the U.S. or its territories. The updated term sheet now expressly excludes single-asset single-borrower CMBS, and commercial real estate CLOs from the definition of eligible collateral.

The updated TALF term sheet also imposes new criteria for TALF-eligible asset-backed securities. Now, the underlying credit exposures must be all or substantially all originated by companies organized in the U.S. or under U.S. law with significant operations in the U.S. and with a majority of their employees in the U.S., and the issuer of the asset-backed securities must meet this criteria as well. This requirement aligns the TALF with the requirements imposed on the Main Street Facilities pursuant to the CARES Act and also addresses an ambiguity created by the inclusion of CLOs, which often have offshore issuers.

EXPANDED SCOPE AND REQUIREMENTS OF THE PMCC

As of April 8, the PMCC ([updated Term Sheet](#)) will accept corporate credit at lower ratings than previously, under certain circumstances, but will only purchase bonds from U.S. businesses. The facility will now also purchase up to 25% of a syndicated loan or bond if purchased at issuance, provided the loan or bond is issued by an eligible issuer and has a maturity of 4 years or less. Such loans and bonds will be purchased at the same price as other syndicate members plus a 100 basis points fee on the SPV's share of the syndication. For corporate bonds, the facility will negotiate the purchase price on a case-by-case basis and include a 100 basis point fee. Now, issuers rated at least BB-1/Ba3 at the time of the proposed purchase may participate, provided they were rated at least BBB-/Baa3 as of March 22, 2020.

Eligible issuers, however, now must be businesses created or organized in the U.S. or under the laws of the U.S., have significant operations in the U.S., and have a majority of their employees in the U.S. They may not be insured depository institutions or depository institution holding companies. This requirement aligns the facility with the scope of the Main Street facilities.

EXPANDED SCOPE AND REQUIREMENTS OF THE SMCC

The FRB has imposed similar new requirements on the SMCC ([updated Term Sheet](#)) to align with the PMCC. For an exchange traded fund (“ETF”) to be eligible for purchase by the SPV, the preponderance of ETF holdings must be of ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds, and the remainder must be in ETFs whose primary investment objective is exposure to U.S. high-yield corporate bonds. Eligible issuers now must be businesses created or organized in the U.S. or under the laws of the U.S., have significant operations in the U.S., and have a majority of their employees in the U.S. They may not be insured depository institutions or depository institution holding companies.

The issuer's rating must still be BBB-/Baa3 as of March 22, 2020, but if the issuer was rated at the level as of March 22, 2020 and was subsequently downgraded, it must be rated at least BB-1/Ba3 at the time of the proposed purchase in order to remain eligible.

Over the next two or three weeks, additional details are expected including procedures for accessing these facilities. For additional insights into these developments, please contact any of the authors.

For information about the Primary Market Corporate Credit, the Secondary Market Corporate Credit, and the Term Asset-Backed Securities Loan Facilities, please see [here](#).

For information about the Money Market Mutual Fund Liquidity Facility, please see [here](#) and [here](#).

For information about the Commercial Paper Funding and Primary Dealer Credit Facilities, please see [here](#), [here](#) and [here](#).

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

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