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Financial Institutions Regulation Group

Client Alert

Federal Reserve Expands Credit Facilities to Aid Economy During COVID-19 Crisis

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On April 9, 2020, the Board of Governors of the Federal Reserve System (the “Federal Reserve”) released guidelines on seven leveraged credit facilities pursuant to Section 13(3) of the Federal Reserve Act that have the potential to provide nearly $2.3 trillion in loans to US households, businesses, cities, and states. All the credit facilities are currently scheduled to terminate on September 30, 2020, although the termination date can be extended by the Federal Reserve or the Treasury.

The facilities are a combination of those that have previously been announced by the Federal Reserve, but that have been modified in certain respects, and facilities for which the Federal Reserve is unveiling details for the first time. All, however, have been expanded in scope, including through additional equity infusions by the Treasury that allow the Federal Reserve to leverage the facilities to a greater scale.

Taken together with previous actions by the Federal Reserve, the set of new and modified facilities represent a robust attempt to stabilize otherwise illiquid credit markets, to preserve employment, and to protect corporate borrowers that would otherwise face overwhelming liquidity challenges due to the COVID-19 pandemic and resulting economic slowdown.

Primary Market Corporate Credit Facility (“PMCCF”). The PMCCF is intended to serve as a funding backstop for corporate debt. Under the PMCCF, the Federal Reserve Bank of New York (“FRBNY”) will commit to lend to a special purpose vehicle (“SPV”) on a recourse basis, and the SPV will (i) purchase qualifying bonds as the sole investor and (ii) purchase up to 25% portions of syndicated loans or bonds at issuance.[1] Eligible syndicated loans and eligible bonds are those issued by an eligible issuer with a final maturity of four years or less. An eligible issuer (i) is a business organized in the US or under the laws of the US with a significant portion of its operations and employees based in the US, (ii) is rated at least BBB-/Baa3 as of March 22, 2020 by a major nationally recognized statistical rating organization (“NRSRO”) or by two or more NRSROs if rated by multiple major NRSROs as of March 22, 2020 (if an otherwise eligible issuer’s rating is downgraded after March 22, 2020, the requirement is lowered to at

[1] Under the initial iteration of the PMCCF announced by the Federal Reserve before the passage of the CARES Act, the facility would have had the ability to make direct loans to eligible borrowers, rather than purchase portions of syndicated loans. However, businesses that receive direct loans from Federal Reserve programs or facilities funded by Section 4003 of the CARES Act are required to agree to a range of stipulations, including restrictions on stock buybacks, payment of dividends, and compensation. As the PMCCF no longer contemplates direct loans, these restrictions are not required for borrowers that take advantage of the facility.

least BB-/Ba3), (iii) is not an insured depository institution or depository institution holding company under the Dodd-Frank Act, (iv) is not a recipient of specific support pursuant to the CARES Act or any subsequent legislation, and (v) satisfies the conflict-of-interests requirements under section 4019 of the CARES Act. The Treasury will make a $75 billion equity investment in the SPV (which will include $50 billion allocated toward the PMCCF and $25 billion toward the SMCCF, discussed below) which will be leveraged at 10 to 1 when acquiring corporate bonds or syndicated loans from investment grade issuers, and at 7 to 1 when acquiring any other type of eligible asset. Issuers may use the PMCCF to refinance outstanding debt beginning at three months ahead of maturity and to draw additional debt so long as the issuers meet minimum rating requirements. No eligible issuer may have outstanding bonds or loans in excess of 130 percent of the issuer's maximum outstanding bonds or loans on any day between March 22, 2019 and March 22, 2020.

Secondary Market Corporate Credit Facility ("SMCCF"). Under the SMCCF, the FRBNY will lend to an SPV that will purchase secondary market corporate debt issued by eligible issuers. The SPV will purchase eligible individual corporate bonds as well as corporate bonds in the form of shares in ETFs. The initial allocation of equity from the Treasury to the SMCCF is $25 billion. The SMCCF may purchase corporate bonds that meet the following specifications: (i) issued by an eligible issuer, (ii) will mature in five years or less, and (iii) were sold to the SMCCF by an eligible seller. Eligible issuers under the SMCCF must meet the same requirements as eligible issuers under the PMCCF. Eligible sellers are businesses organized in the US or under the laws of the US with a significant portion of their operations and employees based in the US. The facility may leverage the Treasury at 10 to 1 when acquiring corporate bonds from issuers that are investment grade and may leverage its own equity at 7 to 1 when acquiring below investment grade corporate bonds. The SMCCF and PMCCF may purchase a maximum of 1.5% of the combined potential size of both facilities combined from any eligible issuer. The maximum amount in bonds the SMCCF may purchase from any issuer is 10% of the issuer's maximum bonds outstanding on any given day between March 22, 2019 and March 22, 2020. The maximum combined size of the SMCCF and PMCCF will be $750 billion.

Municipal Liquidity Facility ("MLF"). To support the flow of credit to municipal bond issuers, the MLF facilitates direct lending to states, the District of Columbia, cities with more than 1 million residents, and counties with more than 2 million residents. The geographically appropriate Federal Reserve Bank will commit to lend on a non-recourse basis to an SPV which will be able to purchase up to $500 billion of eligible notes. Notes eligible for purchase include tax anticipation notes, tax and revenue anticipation notes, bond anticipation notes, and other similar short-term notes issued by eligible government issuers. Eligible notes must mature no later than 24 months from the date of issuance. Eligible issuers may use the proceeds of eligible notes purchased by the SPV to address a number of permitted purposes, including to help manage the cash flow impact of income tax deferrals, reductions of tax and other revenues, increases in expenses related the COVID-19 pandemic, and payment of principal and interest on obligations of the relevant government entity.

Term Asset-Backed Securities Loan Facility ("TALF"). The TALF 2020 facility is modeled on the TALF used by the Federal Reserve in the last financial crisis in 2008 and 2009. It is intended to meet the credit needs of consumers and businesses through the purchase of asset-backed securities. TALF will operate through an SPV that will initially make $100 billion in financing available to US companies that own eligible collateral. Eligible collateral includes US dollar denominated cash asset-backed securities that meet the TALF's credit rating requirements and were issued on or after March 23, 2020. All or substantially all of the credit exposures underlying the asset-backed securities must have originated with a US company and have a US company as its issuer (each an "eligible issuer"). Commercial mortgage-backed securities may also take advantage of the TALF program, if real property located in the US is the basis of their underlying credit exposure and they were issued prior to March 23, 2020. TALF loans will be available on a non-recourse basis and will have a final maturity of three years.

For more information regarding the TALF 2020 facility, see TALF Expanded to Include AAA Tranches of Static CLOs.

Paycheck Protection Program Lending Facility ("PPP"). The PPP lending facility provides loans to depository institutions that originate PPP loans so they have additional funds to make PPP loans to small businesses. The new liquidity facility will be provided on a non-recourse basis, with only PPP loans

guaranteed by the Small Business Administration ("SBA") as collateral. PPP loans to SBA PPP lenders will mature on the same date as the PPP loan pledged to secure each extension of credit. The maturity date of PPP loans to SBA lenders may be accelerated if the underlying PPP loans go into default and the eligible borrower sells the PPP Loan to the SBA to realize on the SBA guarantee or if any loan forgiveness reimbursement is received by the eligible borrower from the SBA. Borrowers who receive PPP loans may also potentially receive loans under the Main Street New Loan Facility and the Main Street Expanded Loan Facility described below.

Main Street New Loan Facility ("MSNLF"). The MSNLF will facilitate lending to small- and medium-sized businesses. In conjunction with the Main Street Expanded Loan Facility, a Federal Reserve Bank will commit to lend to a common SPV on a recourse basis. The SPV will purchase 95% of participations in eligible loans from eligible lenders which include US insured depository institutions, US banks holding companies, and US saving and loan holding companies. Eligible lenders will retain 5% of the upsized tranche. Eligible borrowers under the MSNLF are US businesses with up to 10,000 employees or up to $2.5 billion in annual revenue in 2019. Eligible loans made under this facility must be unsecured and originate on or after April 8, 2020 and have a 4 year maximum final maturity, a minimum loan size of $1 million, and permit prepayment without penalty among other requirements. Each eligible loan will also be subject to attestations and certain other required certifications. An example of one such attestation is that eligible lenders "must attest that the proceeds of the [loan] will not be used to repay or refinance pre-existing loans or lines of credit made by the [lender] to the [borrower]." Borrowers that choose to participate in the MSNLF cannot participate in the Main Street Expanded Loan Facility (described below) or the PMCCF. The MSNLF is meant to complement the PPP which generally provides financing for small businesses with 500 or fewer employees.

Main Street Expanded Loan Facility ("MSELF"). The MSELF and the MSNLF are largely similar. The MSNLF will also facilitate lending to small- and medium-sized businesses through an SPV that will purchase 95% participations in the upsized tranche of eligible loans from US insured depository institutions, US banks holding companies, and US saving and loan holding companies. As with the MSNLF, eligible borrowers under the MSNLF are US businesses with up to 10,000 employees or up to $2.5 billion in annual revenue in 2019. Eligible loans under the MSELF are term loans made by eligible lenders that originated before April 8, 2020 with an upsized tranche that meets the same requirements as MSNLF eligible loans except that the maximum loan size for MSELF loans is the lesser of (i) $150 million, (ii) 30% of the borrower's existing outstanding and committed but undrawn bank debt, or (iii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed six times the borrower's 2019 EBITDA. Borrowers that choose to participate in the MSELF cannot participate in the MSNLF or the PMCCF.

As these initiatives and rules continue to evolve, we remain available to provide guidance on the applicability of the Federal Reserve's programs to markets and to particular transactions or institutions.

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