Clients&FriendsMemo

COVID-19 Update: Extraordinary Measures in Extraordinary Times: The Federal Reserve Responds to the Coronavirus Pandemic

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The Federal Reserve has established a number of programs to provide targeted support to the corporate credit, asset-backed securities, money market and commercial paper markets in light of the evolving coronavirus disease 2019 (COVID-19) pandemic. In broad strokes, these temporary programs backstop markets through the purchase or financing of highly rated securities. In this memorandum, we review the mandate and key terms of each program.

The programs fit within a broader context of an extraordinary monetary response to the pandemic. Specifically, to date, the Federal Reserve has addressed the market impact of the coronavirus pandemic by:

- Reducing the federal funds rate to a target range of 0% to 0.25%;[1]
- Expanding the outright purchases of Treasury and agency mortgage-backed securities to open-ended amounts and including the purchase of agency CMBS;[2]
- Reducing the primary credit rate at the Discount Window by 150 bps to 0.25% and permitting depository institution to borrow from the Discount Window for periods of up to 90 days, prepayable and renewable on a daily basis;[3]
- Reducing the rate on standing swap lines, increasing the frequency of operations and adding temporary swap arrangements with nine central banks;[4]

1 FOMC Statement, *available here*.

2 Federal Reserve Announces New Measures to Support the Economy, *available here*;
Statement Regarding Agency Commercial Mortgage-Backed Securities Operations, *available here*.

3 Federal Reserve Actions to Support the Flow of Credit to Households and Businesses, *available here*.

4 Coordinated Central Bank Action to Enhance the Provision of U.S. Dollar Liquidity, *available here*;
Establishment of Temporary U.S. Dollar Liquidity Arrangements with Other Central Banks, *available here*;
Coordinated Central Bank Action to Further Enhance the Provision of U.S. Dollar Liquidity, *available here*.

- Restarting the Primary Dealer Credit Facility, allowing primary dealers to finance a wide range of assets for terms of up to 90 days at the same rate as is in effect for depository institutions through the Discount Window;[5] and
- Establishing a temporary repurchase facility to allow central banks and other international monetary authorities to obtain dollar financing against their Treasury securities.[6]

These actions have been complemented by an array of other efforts by the Federal Reserve and other banking agencies to reduce regulatory burdens on lending institutions and remove disincentives to lend.[7] Examples of recent regulatory include the following: (i) an interim final rule to mitigate the regulatory capital effects of the current expected credit loss ("CECL") methodology for loan loss provisioning on financial on banking organizations;[8] (ii) temporarily excluding Treasury security holdings and reserves on deposit at Federal Reserve Banks from the calculation of the supplementary leverage ratio, which is aimed at relieving balance sheet constraints on large banks;[9] (iii) granting financial institutions additional time to remediate non-critical existing supervisory findings;[10] (iv) allowing the early adoption of the "standardized approach for measuring counterparty credit risk" rule (SA-CCR), which addresses how banking organizations are required to measure counterparty credit risk in derivative contracts;[11] and (v) encouraging depository institutions to use intraday credit extended by the Federal Reserve Banks.[12]

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[5] Federal Reserve Board Announces Establishment of a Primary Dealer Credit Facility (PDCF) to Support the Credit Needs of Households and Businesses, *available here*.

[6] Federal Reserve Announces Establishment of a Temporary FIMA Repo Facility to Help Support the Smooth Functioning of Financial Markets, *available here*.

[7] The Federal Reserve maintains a list of supervisory and regulatory actions taken to date in response to the COVID-19 pandemic, *available here*.

[8] The federal banking agencies issued an interim final rule addressing the regulatory capital impact of CECL, *available here*. The rulemaking is in addition to the relief from the accounting standard contained in the CARES Act, which provides that insured depository institutions, bank holding companies and their affiliates are not required to comply with the accounting standard until the termination of the COVID-19 outbreak or December 31, 2020, whichever is sooner. Cadwalader published a Clients & Friends Memo on the inter-agency regulatory capital rule, *available here.*

[9] Federal Reserve Board Announces Temporary Change to Its Supplementary Leverage Ratio Rule to Ease Strains in the Treasury Market Resulting from the Coronavirus and Increase Banking Organizations' Ability To Provide Credit to Households and Businesses, *available here*.

[10] Federal Reserve Statement on Supervisory Activities, *available here*.

[11] Agencies Announce Two Actions to Support Lending to Households and Businesses, *available here*.

[12] Federal Reserve Actions to Support the Flow of Credit to Households and Businesses, *available here*.

PRIMARY MARKET CORPORATE CREDIT FACILITY

What is it? The Primary Market Corporate Credit Facility ("PMCCF") is the first of the Federal Reserve's two-part support for corporate debt markets. The PMCCF supports corporate issuers by purchasing newly issued corporate bonds or extending loans based on specified eligibility criteria.

Who can participate? The PMCCF may purchase the new issue bonds of or make loans to U.S. companies headquartered in the United States and with material operations in the United States. Eligible issuers do not include companies that are expected to receive direct financial assistance under federal legislation that was pending at the time the program was announced.

What assets are eligible? To be eligible, the obligor must be an eligible issuer and rated at least BBB-/Baa3 by a major nationally recognized statistical rating organization ("NRSRO") and rated at least BBB-/Baa3 by two or more NRSROs if rated by multiple major NRSROs. Eligible assets are required to have a remaining maturity of four years or less.

What are the other key terms? The maximum availability to an issuer under the PMCCF is the product of a multiplier based on the issuer rating and the issuer's maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020. The facility will charge a 100 basis points commitment fee. The borrower may elect to defer the first six months of interest provided that a borrower that makes this election does not pay dividends or make stock buybacks during the period of the interest deferral. Bonds purchased and loans originated under the facility may be callable at par at any time. The PMCCF is administered by the Federal Reserve Bank of New York ("New York Fed"), and the New York Fed has retained BlackRock Financial Markets Advisory as a third-party vendor to serve as the investment manager for the facility.[13]

How long will the program continue? Unless extended by the Federal Reserve, the PMCCF will cease purchasing eligible corporate bonds or extending loans on September 30, 2020. The facility will remain funded until its underlying assets mature.

Where can I find out more? The term sheet published by the Federal Reserve summarizing the program can be found here. The New York Fed has also provided contact information for inquiries related to the program here.

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13 Federal Reserve Bank of New York Primary Market Corporate Credit Facility, *available here*.

SECONDARY MARKET CORPORATE CREDIT FACILITY

What is it? The Secondary Market Corporate Credit Facility ("SMCCF") is the second part of the Federal Reserve's support for corporate debt markets. The SMCCF specifically addresses the functioning of the secondary market by purchasing outstanding corporate bonds issued by investment grade U.S. companies. The facility mandate further recognizes the significance of exchange traded funds ("ETFs") and the SMCCF may purchase broad market U.S. investment grade corporate bonds ETFs.

Who can participate? The SMCCF may purchase bonds of U.S. companies headquartered in the United States and with material operations in the United States. Eligible issuers do not include companies that are expected to receive direct financial assistance under federal legislation that was pending at the time the program was announced.

What assets are eligible? To be eligible for purchase by the SMCCF, bonds must be issued by an eligible issuer rated at least BBB-/Baa3 by a major NRSRO and rated at least BBB-/Baa3 by two or more NRSROs if rated by multiple major NRSROs. Eligible assets are required to have a remaining maturity of five years or less. The SMCCF may also purchase interests in U.S.-listed ETFs that have the objective of providing broad exposure to the market for U.S. investment grade corporate bonds.

What are the other key terms? The maximum amount of bonds that the Facility will purchase from any eligible issuer will be capped at 10 percent of the issuer's maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020. Specific to ETFs, the facility will not purchase more than 20 percent of the assets of any particular ETF measured as of March 22, 2020. The SMCCF is administered by the New York Fed, and BlackRock Financial Markets Advisory has been selected as a third-party vendor to serve as the investment manager for the facility.[14]

How long will the program continue? Unless extended by the Federal Reserve, the SMCCF will cease purchasing eligible corporate bonds on September 30, 2020. The facility will remain funded until its underlying assets mature.

Where can I find out more? The term sheet published by the Federal Reserve summarizing the program can be found here. The New York Fed has also provided contact information for inquiries related to the program here.

[14] Federal Reserve Bank of New York Secondary Market Corporate Credit Facility, *available here*.

MONEY MARKET MUTUAL FUND LIQUIDITY FACILITY

What is it? The Money Market Mutual Fund Liquidity Facility ("MMLF") makes funding available to bank entities to purchase high quality assets from money market funds as these funds meet demands for redemptions. The program was initially announced on March 18, 2020 and subsequently expanded on March 23, 2020 to include a wider range of securities.

Who can participate? Funding through the MMLF is available to all U.S. depository institutions, U.S. bank holding companies (parent companies incorporated in the United States or their U.S. broker-dealer subsidiaries), or U.S. branches and agencies of foreign banks. Assets must be purchased from a fund that identifies itself as a Prime, Single State, or Other Tax Exempt money market fund under item A.10 of Securities and Exchange Commission Form N-MFP.

What assets are eligible? The MMLF permits five categories of eligible assets: (1) U.S. Treasuries and fully guaranteed agency securities; (2) securities issued by U.S. Government Sponsored Entities; (3) Asset-backed commercial paper, unsecured commercial paper, or a negotiable certificate of deposit that is issued by a U.S. issuer (4) U.S. municipal short-term debt; and (5) Variable rate demand note that has a demand feature that allows holders to tender the note at their option within 12 months. Additional ratings and maturity eligibility criteria apply depending on the asset class.

What are the other key terms? Advances made under the Facility that are secured by U.S. Treasuries and Fully Guaranteed Agencies or Securities issued by U.S. Government Sponsored Entities will set at the primary credit (Discount Window) rate in effect at the at the time the advance is made. Advances secured by U.S. municipal short-term debt, including variable rate demand notes, will be made at a rate equal to the primary credit rate in effect at the time the advance is made plus 25 bps. Receivables from certain repurchase agreements and other asset classes may be considered for inclusion in the future. In terms of bank regulatory capital, assets purchased under the MMLF may be excluded from assets for purposes of calculating risk-based capital or leverage.[15]

How long will the program continue? Unless extended by the Federal Reserve, the MMLF will stop making new credit extensions on September 30, 2020. The facility will remain funded until its underlying assets mature.

Where can I find out more? The term sheet published by the Federal Reserve summarizing the program can be found here. Documentation, terms and program contact information may be found here.

[15] Regulatory Capital Rule: Money Market Mutual Fund Liquidity Facility, *available here*.

COMMERCIAL PAPER FUNDING FACILITY

What is it? The Commercial Paper Funding Facility ("CPFF") supports the issuance of term commercial paper by eligible issuers by purchasing eligible commercial paper through primary dealers.

Who can participate? Eligible issuers are U.S. issuers of commercial paper, including U.S. issuers with a foreign parent company.

What assets are eligible? U.S. dollar-denominated commercial paper (including asset-backed commercial paper) that is rated at least A1/P1/F1 by a major NRSRO or, if rated by multiple major NRSROs, is rated at least A1/P1/F1 by two or more major NRSROs. (The CPFF also permitted one-time purchases of commercial paper from issuers that met the eligibility criteria as of March 17 and were rated at least A-2/P-2/F-2 as of the purchase date.)

What are the other key terms? The maximum amount of a single issuer's commercial paper the facility may own at any time will be the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between March 16, 2019 and March 16, 2020. In addition, the CPFF will not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the CPFF) equals or exceeds the issuer's limit.

Together, the above two limits make the facility inaccessible to any commercial paper issuer that has outstandings in excess of the maximum under the 12-month lookback to March 16, 2020. The limits are in play, for example for issuers that have grown outstandings since March 16, 2020, and may additionally limit the ability of issuers to access the facility as existing customers draw on unutilized commitments that predate the current market crisis.[16]

Pricing will be based on the then-current three-month overnight index swap rate plus 200 basis points. At the time of its registration to use the CPFF, each issuer must pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the CPFF may own.

How long will the program continue? Unless extended by the Federal Reserve, the CPFF will stop purchasing commercial paper on March 17, 2021. The facility will remain funded until its underlying assets mature.

Where can I find out more? The term sheet published by the Federal Reserve summarizing the program can be found here. Additional information and program contracts may be found here.

[16] The SFA has submitted comments on the challenges associated with the size limits to the New York Fed.

PRIMARY DEALER CREDIT FACILITY

What is it? Rather than targeting a particular market, the Primary Dealer Credit Facility ("PDCF") supports the overall functioning of primary dealers by making repurchase financing available on a broad range of investment grade debt securities, including commercial paper and municipal bonds, and a broad range of equity securities.

Who can participate? The PDCF is available only to primary dealers of the New York Fed.

What assets are eligible? The collateral eligible for pledge under the PDCF includes all collateral that is eligible to be pledged in open market operations (Treasury securities, agency mortgage backed securities and agency CMBS), investment grade corporate debt securities, AAA-rated CMBS and CLOs, international agency securities, commercial paper, municipal securities, mortgage-backed securities, and asset-backed securities and certain equity securities. Foreign currency-denominated securities and collateral that is not priced by the clearing bank are not be eligible for pledge under the PDCF.

What are the other key terms? The PDCF provides same-day-settlement funding for terms of up to 90 days. Loans are priced at the primary credit rate available from the Discount Window regardless of term. Pledged collateral is valued by the Bank of New York Mellon in line with the margin schedule for lending by the Discount Window.

How long will the program continue? While no definite date has been set for duration of the program, PDCF will remain available to primary dealers for at least six months.

Where can I find out more? The term sheet published by the Federal Reserve summarizing the program can be found here. Additional information and program contracts may be found here and answers to frequently asked questions here.

TERM ASSET-BACKED SECURITIES LOAN FACILITY

What is it? The Term Asset-Backed Securities Loan Fund ("TALF") provides non-recourse term funding to holders of certain AAA-rated newly and recently originated asset backed securities ("ABS") backed by specified categories of consumer and small business loan collateral.

Who can participate? Three criteria apply: To participate, an entity must (1) be a U.S. company (2) own eligible collateral and (3) maintain an account relationship with a primary dealer. A U.S. company is defined as a U.S. business entity organized under the laws of the United States or a political subdivision or territory thereof (including such an entity that has a non-U.S. parent company), or a U.S. branch or agency of a foreign bank.

What assets are eligible? Eligibility criteria address the issuer, the collateral and the securities. To be eligible, the ABS must be issued on or after March 23, 2020. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company. Underlying credit exposure must be auto loans and leases, student loans, credit cards receivables, equipment loans, floorplan loans, insurance premium finance loans, small business loans guaranteed by the SBA or eligible servicing advance receivables. The securities must be denominated in dollars and carry credit rating in the highest long-term or the highest short-term investment-grade rating category from at least two eligible NRSROs and not have a credit rating below the highest investment-grade rating category from an eligible NRSRO. ABS that includes cash or synthetic ABS in the underlying collateral are ineligible as are ABS that bear interest payments that step up or step down to predetermined levels on specific dates.

What are the other key terms? Advance rates will be determined based on the sector, weighted average life and historical volatility of the ABS. While the haircut schedule and other terms are expected to be broadly consistent with the terms of the TALF program from 2008,[17] finalized terms have not been published as of this writing. For eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 100 basis points over the two-year swap rate for securities with a weighted average life less than two years, or 100 basis points over the three-year swap rate for securities with a weighted average life of two years or greater. The pricing for other eligible ABS may be further detailed in the future. Among the asset classes not included in the program are CMBS, agency CMBS, CLOs, and personal loan securitizations, although the Federal Reserve has left open the possibility of considering additional asset classes for future inclusion.

How long will the program continue? The TALF will make up to $100 billion of loans available. Unless the TALF is extended by the Federal Reserve, no new credit extensions will be made after September 30, 2020. The facility will remain funded until its underlying assets mature.

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[17] The Structured Finance Association has published a helpful comparison of the TALF 2008 and TALF 2020 programs: *available here*.

Where can I find out more? The term sheet published by the Federal Reserve summarizing the program can be found here.

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The Federal Reserve's response to the coronavirus marks a new chapter in the central bank's approach to market intervention. Application has so far targeted specific capital markets but illustrate how the Federal Reserve can act to further expand its support if called upon. Market participants have a defined window within which to evaluate and participate in these programs. Please feel free to contact the following Cadwalader contacts with questions.

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