

Federal Reserve Announces \$750 Billion in Credit Facilities for Corporate Debt Market

On April 9, the Federal Reserve Board announced updated terms for two facilities to support corporate debt markets. The Primary Market Corporate Credit Facility (“PMCCF”) will serve as a funding backstop for corporate debt issued by eligible issuers. The PMCCF will (i) purchase qualifying bonds directly from issuers; and (ii) purchase portions of syndicated loans or bond offerings. The Secondary Market Corporate Credit Facility (“SMCCF”) will purchase in the secondary market corporate debt issued by eligible issuers, including eligible corporate bond portfolios in the form of exchange-traded funds (“ETFs”). The most significant change in the updated terms is that eligible issuers now included investment grade issuers and issuers recently downgraded from investment grade.

PMCCF

PMCCF may purchase eligible corporate bonds directly from issuers. Eligible corporate bonds for a direct purchase must be: (i) issued by an eligible issuer; and (ii) have a maturity of 4 years or less. PMCCF also may purchase portions of syndicated loans or bond offerings of eligible issuers. Eligible syndicated loans and bond offerings must be: (i) issued by an eligible issuer; and (ii) have a maturity of 4 years or less. PMCCF may purchase no more than 25 percent of any loan syndication or bond offering.

Eligible issuers are United States organizations with significant operations in and a majority of its employees based in the United States. They must have been rated at least BBB-/Baa3 as of March 22, 2020. Issuers downgraded after that date, must be rated at least BB-/Ba3 at the time of purchase. Eligible issuers may not be an insured depository institution or have received specific support pursuant to the CARES Act or any subsequent federal legislation. Eligible issuers must satisfy the conflicts-of-interest requirements of the CARES Act, but not the compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under the CARES Act.

Issuers may contact PMCCF to refinance outstanding debt from the period of three

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months ahead of the maturity date of such outstanding debt. Issuers may additionally contact PMCCF at any time to issue additional debt, provided their rating is reaffirmed at BB-/Ba3 or above, after taking account of the additional debt, by each major NRSRO with a rating of the issuer. The maximum amount of outstanding bonds or loans of an eligible issuer that borrows from PMCCF may not exceed 130 percent of the issuer's maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020.

Pricing on direct purchases of bonds as the sole investor will be based on issuer-specific considerations, market conditions, plus a 100 bps facility fee. On eligible syndicated loans and bond offerings, PMCCF will receive the same pricing as other syndicate members or offering participants, plus a 100 bps facility fee on PMCCF's share of any loan syndication.

SMCCF

SMCCF may purchase corporate bonds that, at the time of purchase: (i) were issued by an eligible issuer; (ii) have a remaining maturity of 5 years or less; and (iii) were sold to SMCCF by an eligible seller. SMCCF also may purchase U.S.-listed ETFs whose investment objective is to provide broad exposure to the market for U.S. corporate bonds. The preponderance of ETF holdings will be of ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds, and the remainder will be in ETFs whose primary investment objective is exposure to U.S. high-yield corporate bonds. The requirements for eligible issuers under SMCCF are the same as under PMCCF. Eligible sellers, such as broker-dealers, must be organized under US law and have a majority of employees in the United States.

SMCCF will purchase eligible corporate bonds at fair market value in the secondary market. It will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio. SMCCF will not purchase for any eligible issuer more than 10 percent of the issuer's maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020. It will not purchase shares of a particular ETF if after such purchase the Facility would hold more than 20 percent of that ETF's outstanding shares.

Special Purpose Vehicle (SPV)

PMCCF and SMCCF will operate through a SPV funded through lending provided by the Federal Reserve Bank of New York on a recourse basis and \$75 billion of equity provided by Treasury. PMCCF will initially be funded with \$50 billion of equity and will leverage the Treasury equity at 10 to 1 when acquiring corporate bonds or syndicated loans from issuers that are investment grade at the time of purchase. It will leverage its equity at 7 to 1 when acquiring any other type of eligible asset. SMCCF will initially be funded with \$25 billion of equity and will leverage this equity at 10 to 1 when acquiring corporate bonds from issuers that are investment grade at the time of purchase and when acquiring ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds. It will leverage its equity at 7 to 1 when acquiring

corporate bonds from issuers that are rated below investment grade at the time of purchase and in a range between 3 to 1 and 7 to 1, depending on risk, when acquiring any other type of eligible asset.

Conclusions

The Federal Reserve actions significantly boost its involvement in corporate debt markets. They increase the Fed's ability to provide direct liquidity to investment grade issuers and to certain issuers who have recently been downgraded below investment grade during the COVID-19 crisis. The help to the latter firms, combined with the ability to purchase ETFs whose primary investment objective is exposure to U.S. high-yield corporate bonds, will provide support for high-yield markets. The new terms for the facilities provide flexibility for an issuer to seek one-off support from the facilities or support in the form of the facilities participating in bond offerings and loan syndications. It remains to be seen how the facilities balance the mix between participation in new offerings and support for secondary markets, although the allocation of Treasury equity is tilted 2:1 in favor of new offerings.