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EMERGENCY LENDING ROUND 2: PRIMARY MARKET CORPORATE CREDIT FACILITY, SECONDARY MARKET CORPORATE CREDIT FACILITY, TERM ASSET-BACKED LENDING FACILITY AND EXPANSION OF OTHER PROGRAMS

To Our Clients and Friends:

Yesterday, in an unprecedented action, the Board of Governors of the Federal Reserve System (Federal Reserve) invoked its emergency lending authority under Section 13(3) of the Federal Reserve Act to create additional programs to stabilize important financial markets. It announced three facilities: the Primary Market Corporate Credit Facility (PMCCF), the Secondary Market Corporate Credit Facility (SMCCF) and the Term Asset-Backed Securities Loan Facility (TALF)

These facilities will provide up to $300 billion in new financing; the Department of the Treasury, using the Exchange Stabilization Fund (ESF), will provide $30 billion in equity to them. The Federal Reserve also expanded two of the Section 13(3) programs it created last week, the Commercial Paper Funding Facility and Money Market Mutual Liquidity Facility. Today's announcements provide only the basic terms of the new programs, with additional detail expected to be made available in the future.

Primary Market Corporate Credit Facility

The PMCCF is open to investment grade companies and will provide bridge financing of four years. Borrowers may elect to defer interest and principal payments during the first six months of the loan, extendable at the Federal Reserve's discretion. If such deferral is chosen, borrowers may not make dividend payments or engage in stock repurchases.

The facility will make use of special purpose vehicle (SPV) in which the Treasury, using the ESF, will make an equity investment. The Federal Reserve Bank of New York (FRBNY) will commit to lend to the SPV on a recourse basis; the SPV will both purchase qualifying bonds directly from eligible issuers and provide loans to eligible issuers.

Eligible corporate bonds and loans must meet each of the following criteria at the time of bond purchase or loan origination:

- They must be issued by an eligible issuer (see below);
- The issuer must be rated at least BBB-/Baa3 by a major nationally recognized statistical rating organization (NRSRO) and, if rated by multiple major NRSROs, rated at least BBB-/Baa3 by two or more NRSROs, in each case subject to review by the Federal Reserve; and

- They must have a maturity of four years or less.

"Eligible issuers" are U.S. companies headquartered in the United States and with material operations in the United States, but they do not include companies that are expected to receive direct financial assistance under pending federal legislation. (Commercial airlines, for example, have been mentioned as potential recipients.)

There are per-issuer limits under the PMCCF that will affect participating issuers' ability to incur additional indebtedness; the maximum amount of outstanding bonds or loans of an eligible issuer that borrows from the Facility may not exceed the applicable percentage of the issuer's maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020:

- 140 percent for eligible assets/eligible issuers with a AAA/Aaa rating from a major NRSRO;
- 130 percent for eligible assets/eligible issuers with a AA/Aa rating from a major NRSRO;
- 120 percent for eligible assets/eligible issuers with a A/A rating from a major NRSRO; or
- 110 percent for eligible assets/eligible issuers with a BBB/Baa rating from a major NRSRO.

The Federal Reserve announced that PMCCF interest rates will be "informed by" market conditions and that a 100 basis point commitment fee will be assessed, but has not yet provided further information regarding rates or calculation of the commitment fee. PMCCF bonds and loans will be callable by an eligible issuer at any time at par. The PMCCF will cease purchasing eligible corporate bonds and extending loans on September 30, 2020, unless the Federal Reserve extends the program.

The terms of the PMCCF are available here.

Secondary Market Corporate Credit Facility

The Federal Reserve also announced the creation of a companion program, the SMCCF, intended to support the secondary market for investment grade corporate debt, including certain corporate debt exchange-traded funds (ETFs). It has a similar structure, an SPV with equity from Treasury and an FRBNY loan secured by the assets of the SPV.

The SPV will purchase eligible individual corporate bonds as well as eligible ETFs in the secondary market. Eligible issuers are the same as in the PMCCF, as are the minimum ratings. Eligible bonds can have a remaining maturity of up to five years. ETFs must be U.S.-listed and intended to provide exposure to a broad section of the investment grade bond market.

The maximum amount of bonds that the SMCCF will purchase of any eligible issuer will be capped at 10 percent of the issuer's maximum aggregate amount of bonds outstanding on any day between March 22, 2019 and March 22, 2020. The SMCCF will not purchase more than 20 percent of the assets of any particular ETF as of March 22, 2020. Bonds will be purchased at fair market value in the secondary market; the SMCCF will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio. The facility has the same term as the PMCCF.

The terms of the SMCCF are available here.

Term Asset-Backed Lending Facility

Under the TALF, the Federal Reserve will lend on a non-recourse basis to holders of certain AAA-rated asset-backed securities (ABS) backed by newly and recently originated consumer and small business loans. The Federal Reserve will lend an amount equal to the market value of the ABS less a haircut and will be secured at all times by the ABS.

The TALF SPV will originally make $100 billion in loans available. The loans will have a term of three years; will be nonrecourse to the borrower; and will be fully secured by eligible ABS.

Eligible borrowers under the TALF are all "U.S. companies" that own eligible collateral and maintain an account relationship with a primary dealer. A "U.S. company" is 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 non-U.S. bank.

Eligible collateral includes U.S. dollar denominated cash (that is, not synthetic) ABS that have a credit rating in the highest long-term or the highest short-term investment-grade rating category from at least two eligible NRSROs and do not have a credit rating below the highest investment-grade rating category from an eligible NRSRO. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company, and eligible ABS must be issued on or after March 23, 2020. The credit exposures underlying the ABS must be one of the following:

1. Auto loans and leases;
2. Student loans;
3. Credit card receivables (both consumer and corporate);
4. Equipment loans;
5. Floorplan loans;
6. Insurance premium finance loans;
7. Certain small business loans that are guaranteed by the Small Business Administration; or
8. Eligible servicing advance receivables.

Eligible collateral will not include ABS that bear interest payments that step up or step down to predetermined levels on specific dates. In addition, the underlying credit exposures of eligible collateral must not include exposures that are themselves cash ABS or synthetic ABS.

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 published in the TALF's detailed terms and conditions and will be roughly in line with the haircut schedule used for the TALF Facility established in 2008.

In terms of interest rates, for eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 100 basis points over the 2-year LIBOR swap rate for securities with a weighted average life less than two years, or 100 basis points over the 3-year LIBOR swap rate for securities with a weighted average life of two years or greater. The pricing for other eligible ABS will be set forth in the Facility's detailed terms and conditions. The SPV will assess an administrative fee equal to 10 basis points of the loan amount on the settlement date for collateral.

Loans made under the TALF are made without recourse to the borrower, and will be pre-payable in whole or in part at the option of the borrower, but substitution of collateral during the term of the loan generally will not be allowed. No new credit extensions will be made after September 30, 2020, unless the TALF is extended by Federal Reserve.

The terms of the TALF are available here.

Expansion of Previously Created Programs

In addition to creating the three new programs, the Federal Reserve expanded its Money Market Mutual Fund Liquidity Facility (MMLF) to include a wider range of securities that could be used as collateral, including certain municipal variable rate demand notes (VRDNs) and bank certificates of deposit. The Federal Reserve also expanded its Commercial Paper Funding Facility (CPFF) to include high-quality, tax-exempt commercial paper (*e.g.*, issued by states and municipalities) as eligible securities and reduced the facility's pricing.

Conclusion

With the creation of the PMCCF and SMCCF, and expansion of existing programs, the Federal Reserve has, in a matter of days, moved beyond its use of Section 13(3) authority in the Financial Crisis. It would be surprising, at this point, if the Federal Reserve stops there. We will continue to monitor its actions as America's Central Bank to stabilize financial markets in these unprecedented and all too interesting times.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding developments related to the COVID-19 outbreak. For additional information, please contact any member of the firm's ***Coronavirus (COVID-19) Response Team****.*

Gibson Dunn's ***Capital Markets*** *and* ***Financial Institutions*** *practice groups also are available to answer questions about the PMCCF, SMCCF, and the TALF. Please contact any member of the Gibson Dunn team, the Gibson Dunn lawyer with whom you usually work, or the authors:*

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