Alerts & Publications

CARES Act: Direct Loans to Non-Investment Grade Businesses and Federal Reserve Liquidity Facilities

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While much recent attention has been focused on the Paycheck Protection Program and other SBA loan relief for qualifying smaller businesses, more help is on the way. Under both existing authorizations and new authority and appropriations created under the CARES Act, the Federal Reserve and the Treasury are taking actions and creating new programs to provide liquidity to US businesses. For now, available facilities either enhance banks' ability to provide credit or are limited to investment grade businesses, but the Federal Reserve and the Treasury are soon expected to launch programs that directly provide or backstop loans to a broader spectrum of US businesses.

Federal Reserve Creates Credit Facilities to Combine with CARES Act Stimulus

In response to the economic effects of the COVID-19 pandemic, on March 17, 2020, the Federal Reserve announced its establishment of special credit facilities. Beginning on March 23, 2020, the Federal Reserve Bank of New York (FRB-NY) issued guidelines on implementation of several new credit facilities to enhance liquidity in the various bond and credit markets. Although not specifically a result of the massive CARES Act stimulus legislation enacted on March 27, 2020, this action is similarly aimed toward bolstering liquidity in US credit markets. Specifically, the FRB-NY developed four special facilities focused towards US businesses and financial institutions including the Commercial Paper Funding Facility (CPFF), the Primary Dealer Credit Facility (PDCF), the Primary Market Corporate Credit Facility (PMCCF), and the Secondary Market Corporate Credit Facility (SMCCF).

Based on FRB-NY guidance, these facilities have begun, or will begin, issuing loans and purchasing bonds between March 20 and early April. Additionally, Title IV of the CARES Act specifically granted the Secretary of the Treasury authority to make loans to facilities designed to enhance liquidity in these markets in addition to granting the Secretary authority to make direct loans to small businesses. It is likely that some of the funds appropriated to the authority of the Secretary of the Treasury will be used as capital cushion to support the FRB-NY facilities.

This alert provides an overview of the existing FRB-NY credit facilities and discusses the likely next steps the Treasury and the Federal Reserve will take in implementing broader loan programs. This alert does not discuss the programs specific to air carriers and national security businesses under Title IV of the CARES Act.

Federal Reserve Credit Facilities

1. **The Commercial Paper Funding Facility (CPFF):** The CPFF 2020 will be structured as a credit facility to a special purpose vehicle (SPV) to provide a liquidity backstop to US issuers of commercial paper as authorized under section 13(3) of the Federal Reserve Act. Large investment grade businesses with existing commercial paper programs can access this liquidity backstop through the broker-dealer administering its commercial paper program.

Assets of the SPV	Limits per Issuer	Pricing	Termination Date
The SPV will purchase from eligible issuers three-month US dollar-denominatedcommercial paper through the FRB-NY primary dealers. Eligible issuers are US issuers of commercial paper, including US issuers with a foreign parent company. The SPV will only purchase US dollar-denominated commercial paper rated at A-1/P-1/F-1.	The maximum amount of a single issuer's commercial paper the SPV may own at any time will be the greatest amount of US dollar-denominated commercial paper the issuer had outstanding on any day between March 16, 2019 and March 16, 2020. The SPV will not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the SPV) equals or exceeds the issuer's limit.	Pricing will be based on the then-current 3-month overnight index swap (OIS) rate plus 200 basis points. Upon registration, each issuer must pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the SPV may own.	The SPV will cease purchasing commercial paper on March 17, 2021, unless the Board extends the facility.

2. **Primary Dealer Credit Facility (PDCF):** The PDCF was established to expand the availability of credit to primary dealers in order to facilitate lending to businesses and households. The PDCF differs from similar facilities implemented by the FRB-NY in 2008 and 2010. While previous facilities only offered overnight loans, this PDCF allows funding for 90 days, likely to compliment the CPFF's 90-day commercial paper purchases.

Who Can Participate?	Terms and Rate of the Loan	Eligible Collateral	Loan Size	Termination Date
Only primary dealers of the FRB-NY are eligible to participate in the PDCF.	Loans will be made available to primary dealers for a term of up to 90 days. Loans will be made at a rate equal to the primary credit rate ineffect at the FRB-NY offered to depository institutions via the Discount Window.	Collateral eligible for pledge under the PDCF includes all collateral eligible for pledge in open market operations (OMO). Pledged collateral will be valued by the Bank of New York Mellon. Foreign currency-denominated securities are not eligible for pledge under the PDCFat this time.	Loans will be limited to the amount of margin-adjusted eligible collateral pledged by the dealer and assigned to the FRB-NY's account at the clearing bank.	The PDCF will be available for at least six months from the date of establishment (March 17, 2020) or longer if conditions warrant.

3. **The Primary Market Corporate Credit Facility (PMCCF):** The PMCCF was established to support credit to large employers for new bond and loan issuance to allow investment grade companies access to credit so that they are better able to maintain business operations and capacity. BlackRock has been engaged as the investment manager for this facility.

Eligible Assets	Eligible Issuers	Interest Rate	Termination Date
The Facility will purchase eligible corporate bonds directly from eligible issuers and will make eligible 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 by the Facility: - Issued by an eligible issuer; - Issuer is rated at least BBB- /Baa3; - Have a maturity of four years or less.	Eligible issuers are US 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 the CARES Act.**	The Facility will purchase bonds and make loans that have interest rates informed by market conditions.	The Facility will cease purchasing eligible corporate bonds or extending loans on September 30, 2020, unless the Facility is extended.

4. **Secondary Market Corporate Credit Facility (SMCCF):** The SMCCF will purchase corporate bonds in the secondary market issued by investment grade US companies and US-listed exchange-traded funds to provide broad exposure to the market for US investment grade corporate bonds. This facility is intended to provide market liquidity and does not directly provide liquidity to businesses.

Eligible Assets	Eligible Issuers	Termination Date
The Facility may purchase corporate bonds that meet each of the following criteria at the time of purchase by the Facility: - Issued by an eligible issuer; - Rated at least BBB-/Baa3; - Have a remaining maturity of five years or less. The Facility also may purchase **US-listed Exchange Traded Funds (ETFs)** whose investment objective is to provide broad exposure to the market for US investment grade corporate bonds.	Eligible issuers for direct purchases of individual corporate bonds on the secondary market are US businesses with material operations in the United States. **Eligible issuers do not include companies that are expected to receive direct financial assistance under the CARES Act.**	The Facility will cease purchasing eligible corporate bonds and eligible ETFs September 30, 2020, unless the Facility is extended.

CARES Act Direct Loans

Within the provision of up to $500 billion for the Secretary of the Treasury to support the purchase of equities and securities to enhance credit liquidity, Section 4003(b)(4) of Title IV of the CARES Act also authorizes the Secretary of the Treasury to make direct loans to businesses, with an emphasis on supporting "mid-sized businesses," meaning those with between 500 and 10,000 employees. These loans do not require borrowers to be investment grade. Under a parallel provision of the CARES Act, these appropriation can also backstop a Federal Reserve lending program for "mid-sized businesses." Under 4003(b)(4), the CARES Act grants extensive discretion to the Secretary of the Treasury in determining the amounts, rates, creditworthiness, and required collateral for loans issued under 4003(b)(4).Rates for mid-sized businesses under the Federal Reserve lending program may not be greater than 2% annualized.

(b)(4) Loan Eligibility

While we await more information from the Treasury on this program, the CARES Act did lay out baseline eligibility requirements and restrictions for businesses to be able to participate. To qualify for a 4003(b)(4) loan, a business must be organized in the United States and have significant operations and the majority of its employees based in the United States. The term “employee” is defined by reference to 29 U.S.C. § 152 and would include full-time and part-time employees but not independent contractors.

To be eligible for the Federal Reserve loan program, a borrower must also certify on a good-faith basis to the following:

- The uncertainty of current economic conditions makes necessary the loan request to support ongoing operations;
- The funds will be used to retain at least 90% of its workforce until Sept. 30, 2020;
- The recipient intends to restore at least 90% of its workforce that existed as of Feb. 1, 2020, including restoring compensation and benefits, within four months after the end of the public health emergency;
- The recipient is organized and domiciled in the US with significant operations and a majority of employees in the US;
- The recipient is not in bankruptcy proceedings.

For all 4003(b)(4) loans, a borrower is restricted from: 1) paying dividends on common stock or conducting a stock buyback while the loan is outstanding; 2) outsourcing or offshoring jobs for the term of the loan and two years after; 3) abrogating existing collective bargaining agreements for the term of the loan and two years after; and (4) taking a non-neutral stance if employees attempt to unionize.

Finally, all 4003(b)(4) loans are subject to Section 13(3) of the Federal Reserve Act, which provides that loans provided must be backed by collateral and be credit-worthy.

Many important details have not yet been released, including whether proceeds can be utilized to refinance other debt and other use of proceeds restrictions, how determinations of credit-worthiness under Section 13(3) of the Federal Reserve Act will be made, and how loans can be applied for and with whom.

Financial Agents for Implementation

To assist the Treasury Secretary in implementing this program, the CARES Act authorizes the Secretary to designate financial institutions to perform all reasonable duties the Secretary determines necessary to respond to the coronavirus. Given that the Treasury and the Federal Reserve are likely ill-equipped to negotiate the terms of possibly thousands of loans, it is expected that the Treasury will backstop assets of certain large financial institutions and rely on those institutions to issue loans under the program. We will continue to follow the development of the direct loan programs and provide additional details as they become available.

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