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Federal Reserve Bank of New York Releases Updated FAQs on Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility

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Financial Services

On May 4, 2020, the Federal Reserve Bank of New York (the "FRBNY") released an updated series of Frequently Asked Questions ("FAQs") regarding two of the Federal Reserve's liquidity facilities established to provide financial assistance to businesses impacted by the COVID-19 pandemic: the Primary Market Corporate Credit Facility ("PMCCF") and the Secondary Market Corporate Credit Facility ("SMCCF"). The Federal Reserve announced on March 24, 2020 that it would establish the PMCCF to serve as a funding backstop for certain investment-grade U.S. corporate debt issuers, and the SMCCF to purchase eligible corporate bonds and certain exchange-traded funds ("ETFs") in the secondary market. An expansion of each facility, including amended term sheets, was announced on April 9, 2020.

The facilities will take the form of a single special-purpose vehicle ("SPV") established by the FRBNY and capitalized with a $75 billion equity investment from the U.S. Department of the Treasury using funding that was allocated under the CARES Act. The combined size of the PMCCF and SMCCF will be $750 billion.

Although much of the FAQs is a restatement of the April 9 term sheets (*see* PMCCF and SMCCF), key updates from the FAQs are summarized below.

Timing and Implementation

The FAQs indicate that the SMCCF is expected to begin purchasing ETFs in early May. Soon thereafter, the PMCCF is expected to become operational, and the SMCCF will begin purchasing eligible corporate bonds.

To expedite the implementation of the SMCCF, the SMCCF will begin by transacting with Primary Dealers that meet the eligible seller criteria; additional counterparties will be added over time. In addition, the PMCCF will focus on purchasing bonds at issuance at the start of the facility.

To request participation of the PMCCF in a syndicated loan or bond issuance, an eligible issuer will need to approach the PMCCF's investment manager, and demonstrate that there is insufficient demand for the offering. Contact information for such requests will be provided once the PMCCF becomes operational.

Eligible Issuers and Sellers

The PMCCF and SMCCF term sheets indicate that an eligible issuer must:

(i) Be created or organized in the United States, with significant operations in and a majority of employees based in the United States;
(ii) Be rated as investment grade – at least BBB-/Baa3 – by one or more (as applicable) nationally recognized statistical rating organizations ("NRSROs") as of March 22, 2020;
(iii) Not be a an insured depository institution or depository institution holding company;
(iv) Not have received specific support under the CARES Act or subsequent federal legislation; and
(v) Satisfy the conflicts-of-interest requirements of the CARES Act.

The FAQs offer further guidance on most of these eligibility requirements.

<u>"Significant Operations" and "Majority of Employees" in the United States</u>

For purposes of the first eligibility requirement (which also applies to eligible sellers under the SMCCF), the "significant operations" and "majority of employees" tests will be applied on a consolidated basis (*i.e.* at the level of the eligible entity together with its consolidated subsidiaries), without regard to the eligible entity's parents or affiliates. However, if the eligible entity is a subsidiary whose sole purpose is to issue debt, then these tests will be applied at the level of the "primary corporate beneficiary" (*i.e.*, any corporate affiliate of the eligible entity to which 95 percent or more of the proceeds from the syndicated loan or corporate bond purchase are transferred for use in its operations). If there is no primary corporate beneficiary, then 95 percent or more of the proceeds from the syndicated loan or corporate bond purchase must be transferred to corporate affiliates that, in each case, satisfy the "significant operations" and "majority of employees" tests.

The FAQs do not provide a definitive definition of "significant operations in the United States," but note that this criterion would be met by an eligible issuer or eligible seller with greater than 50 percent of its consolidated assets in, annual consolidated net income generated in, annual consolidated net operating revenues generated in, or annual consolidated operating expenses (excluding interest expense and similar expenses) generated in the United States, as reflected in the most recent audited financial statements.

Although the FAQs apply only to the PMCCF and SMCCF, the further detail they provide on the "significant operations" and "majority of employees" tests may be instructive as to how the Federal Reserve is likely to approach the same tests in the context of other facilities the Federal Reserve has created or will create under section 4003(b)(4) of the CARES Act, including the Main Street Lending Program.

<u>Credit Ratings Requirements</u>

For purposes of the second eligibility requirement, only published ratings from the following NRSROs will be accepted: S&P Global Ratings, Moody's Investor Services Inc., and Fitch Ratings, Inc. The Federal Reserve is considering adding other NRSROs to this list in the future. In addition, the FAQs indicate that a new entity may be formed to serve as issuer under the PMCCF; such a new entity may rely on the ratings history of any U.S. affiliate that is guaranteeing the issuance.

The PMCCF and SMCCF term sheets indicate that an issuer that met the ratings requirement as of March 22, 2020, but was subsequently downgraded, may nevertheless participate in the facility if it is rated at least BB-/Ba3 at the time the facility makes a purchase. The FAQs explicitly state that issuers that did *not* meet the rating requirement as of March 22, 2020, but that were subsequently upgraded to investment grade, are not eligible to participate in the facilities.

<u>"Specific Support" under the CARES Act</u>

For purposes of the fourth eligibility requirement, "specific support" is interpreted to mean loans from the U.S. Department of the Treasury under sections 4003(b)(1)–(3) of the CARES Act. "Specific support" does not include tax credits under the CARES Act. In addition, issuers may not participate in both the PMCCF and the Main Street Lending Program.

<u>Certification Requirements</u>

Eligible issuers will be required to certify compliance with the above-described eligibility requirements. A similar certification will be required from eligible sellers under the SMCCF. In addition, issuers under the PMCCF will be required to certify that they are unable to secure adequate credit from other sources, and that they are not insolvent, as required under section 13(3) of the Federal Reserve Act and its implementing regulations. Eligible issuers under the SMCCF will not be required to provide certifications under section 13(3) of the Federal Reserve Act. More details about the certification process will be published at a later time.

Foreign Company-Related Issuers and Sellers

The FAQs provide that a U.S. subsidiary of a foreign company may be an eligible issuer (assuming the U.S. subsidiary meets the eligibility criteria). However, in the case of the PMCCF, a U.S. subsidiary of a foreign company must use the proceeds derived from participation in the PMCCF only for the benefit of such U.S. subsidiary and its consolidated U.S. subsidiaries and other U.S. affiliates, and not for the benefit of foreign affiliates.

U.S. branches and agencies of foreign banks will be considered to be created or organized in the United States for purposes of the eligible seller criteria under the SMCCF.

Finally, the SMCCF will not purchase non-U.S. dollar denominated corporate bond issues of eligible issuers.

Eligible Assets

The PMCCF will purchase eligible corporate bonds as the sole investor in a bond issuance, or will purchase up to 25 percent of a syndicated bond issuance or loan syndication. In each case, the bonds or loans must be issued by an eligible issuer and have a maturity of four years or less. The FAQs indicate that, where the PMCCF is purchasing bonds as sole investor, only fixed-rate bonds will be purchased. In the case where the PMCCF is participating in a syndicated issuance, fixed-rate debt is preferred, but floating-rate debt may be purchased if it is priced off LIBOR to include adequate fallback language

The SMCCF will purchase a range of bonds, including floating-rate debt priced off LIBOR. ETFs are also eligible for purchase, but the preponderance of the SMCCF's ETF holdings will be of ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds, and the remainder will be ETFs whose primary investment objective is exposure to U.S.

high-yield corporate bonds. In some cases, ETF holdings may include underlying bonds that have a remaining maturity longer than five years, or bonds that would otherwise be ineligible for purchase by the SMCCF.

Maturing loans from a period of three months ahead of the maturity date may be refinanced and replaced with corporate bonds issued under the PMCCF.

Both the PMCCF and the SMCCF may purchase privately placed corporate bonds pursuant to SEC Rule 144A.

Pricing

Where the PMCCF purchases bonds as sole investor, pricing will be issuer-specific and informed by market conditions. Where the PMCCF purchases syndicated loans or bonds, the facility will receive the same price as other syndicate members.

The SMCCF will purchase eligible corporate debt at market prices. Where the SMCCF purchases ETFs, the SMCCF will not purchase shares of an ETF that are trading at a premium above the lower of the following limits relative to the prior end-of-day official net asset value ("NAV"): (i) 1 percent, or (ii) the one-standard deviation level of the ETF's premiums to end-of-day NAV observed over the prior 52 weeks, on a rolling basis.

Per-Issuer Limits

Under the PMCCF, the maximum amount of outstanding bonds or loans of an eligible issuer that borrows from the facility 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. For this purpose, outstanding bonds and loans will include current and non-current portions of corporate bonds and loans, including drawn portions of term loans, drawn portions of long-term revolving facilities (with a maturity greater than one year), and long-term bonds (whether U.S. dollar denominated or otherwise), but will not include any operating leases, non-recourse debt, commercial paper, and other short-term liabilities.

Under the SMCCF, the maximum amount of bonds and loans that the facility will purchase is capped at 10 percent of the issuer's maximum bonds outstanding on any day over the same period. In addition, the maximum amount of instruments that may be purchased from any eligible issuer by the PMCCF and SMCCF combined is capped at 1.5 percent of the combined size of the two facilities.

The FAQs indicate that these per-issuer limits will be calculated at the consolidated top-tier parent level. For avoidance of doubt, the FAQs make explicit that an eligible issuer may participate in the PMCCF at the same time as its bonds are being purchased by the SMCCF, subject to the per-issuer limits.

The underlying bonds in ETFs purchased by the SMCCF will not count toward the per-issuer limits.

Finally, the FAQs note that there is no minimum required issuance amount where the PMCCF acts as sole investor, and there is no minimum amount where the PMCCF participates in syndicated transactions.

Public Reporting

The FAQs state that the Federal Reserve will publicly disclose information regarding the facilities, including "information regarding participants, transaction amounts, costs, revenues and other fees." Balance sheet items related to the SPV will be reported weekly, and the Federal Reserve will disclose to Congress the required information under the Federal Reserve Act, the CARES Act, and other statutes.

Miscellaneous Issues

The Federal Reserve is considering ways to include minority-, women-, and veteran-owned businesses ("MWV-owned businesses"), including by (i) expanding the pool of entities who may be eligible sellers under the SMCCF, and (ii) including more MWV-owned businesses as short-term vendors to the SPV.

The FAQs indicate that a non-profit organization may be an eligible issuer provided it meets the eligibility criteria.

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