Federal Reserve Liquidity Programs To Support US Economy During COVID-19 Pandemic — Highlights for Funds and BDCs

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In response to the ongoing market turmoil created by the coronavirus/COVID-19 pandemic, the Federal Reserve has established a number of market stability and liquidity programs, many of which may be of interest to funds (both registered investment companies and private funds) and business development companies (BDCs). We continue to monitor these developments and remain committed to helping funds and BDCs navigate this volatile market environment. If a specific topic listed below is of interest to you and you would like to discuss in further detail, please contact any of the below partners or counsel or your usual Skadden contact.

Background

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) became law on March 27, 2020. The economic stimulus package in the CARES Act includes federal funding for business stimulus across three broad categories: (i) grants and direct lending dedicated to specific sectors, such as airlines and national security businesses; (ii) expanded eligibility and payroll support for small businesses through programs administered by the Small Business Administration; and (iii) Department of the Treasury funding for several lending programs administered with the Federal Reserve. More than $450 billion of the allocated funds is directed toward this last category, which is the focus of this summary. The discussion below summarizes six programs recently announced, expanded or expected by the Federal Reserve in response to the COVID-19 pandemic that could be of interest to funds and BDCs.

Implementation

The CARES Act required Treasury to promulgate regulations by April 6, 2020, to implement some of these stimulus initiatives. However, Treasury and Federal Reserve are faced with the daunting task of setting up multiple, complex programs, in a short time, with scrutiny and second-guessing both in real time and in hindsight — all while the agency staff are facing challenging work conditions. Thus, we expect the implementation of these programs will be uneven and iterative, with questions and ambiguities addressed over time rather than in a single set of comprehensive final regulations to be issued in the next week or two.

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Generally Applicable Conditions

The direct lending programs summarized below are generally available only if the recipient is solvent and unable to secure adequate credit from other banking institutions. The Federal Reserve has discretion to make a determination of inadequate credit availability based on generally applicable considerations related primarily to market conditions, rather than on an individual recipient basis.

If a program below derives any portion of its funding from Treasury under the CARES Act, then the recipient generally must be a business that (i) is created or organized in the United States or under the laws of the United States; (ii) has significant operations in the United States; (iii) has a majority of its employees based in the United States; (iv) has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act; and (v) is consistent with certain conflict of interests provisions prohibiting participation by entities in which elected federal officials, the heads of executive branch departments or their family members have a controlling influence.

Money Market Mutual Fund Liquidity Facility (MMLF)

The MMLF (described in further detail here) is designed to benefit money market mutual funds by providing financial institutions (*e.g.*, U.S. banks) with loans secured by eligible collateral purchased by such financial institutions from eligible money market mutual funds. As a result, money market mutual funds may increasingly limit the types of securities they are willing to buy in order to ensure that such securities qualify as eligible collateral for purposes of the MMLF. To the extent that a fund or BDC issues securities that have traditionally been purchased by money market mutual funds, it may be necessary to conform those issuances to the eligible collateral requirements of the MMLF in order to continue to attract money market mutual fund buyers. Below is a brief summary of key terms of the MMLF:

Who is eligible?	How will it work?
- 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 that purchase eligible collateral from eligible money market mutual funds.	- Program will support the market for assets that underlie money market mutual funds. - Federal Reserve will extend credit to eligible banking organizations that is secured by assets purchased by the banking organization from eligible money market mutual funds. - Eligible collateral includes U.S. treasuries, asset-backed commercial paper (ABCP) that has certain short-term ratings, certain municipal variable demand notes, certain bank certificates of deposit and certain other securities that were purchased from eligible money market funds. - An eligible money market fund must be a fund that identifies itself as a Prime, Single State or Other Tax-Exempt money market fund on SEC Form N-MFP. - The rate of the loan will depend on the collateral securing the loan.

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Primary Market Corporate Credit Facility (PMCCF)

The PMCCF (described in further detail here) will extend credit to eligible companies by (i) purchasing qualifying bonds directly from eligible issuers and (ii) making loans to eligible issuers. Eligible funds and BDCs may be able to issue notes to, or borrow directly from, the PMCCF. There also is the possibility, although difficult to predict, that Treasury through implementing regulations could determine to include bond-like instruments structured as preferred stock under this program. This facility could be of particular interest to funds or BDCs seeking to redeem or refinance existing senior securities that have contractual asset coverage, redemption or other terms that are more restrictive than those required by the Investment Company Act of 1940 (the 1940 Act) and less favorable than those available under the PMCCF. Helpful to registered funds and BDCs, Section 18(e) of the 1940 Act (made applicable to BDCs by Section 61 of the 1940 Act) exempts senior securities issued for the purpose of refinancing outstanding senior securities of the same type (*i.e.*, indebtedness or preferred stock) from the provisions of Section 18. Though this provision has rarely been interpreted by the SEC staff, the application of this provision to refinancing of existing senior securities through issuances to the PMCCF may represent an opportunity to maintain existing amounts of leverage in excess of 1940 Act asset coverage requirements while continuing to pay dividends to common stockholders. Below is a brief summary of key terms of the PMCCF:

Who is eligible?	How will it work?
- U.S. companies that (i) are headquartered in the United States, (ii) have "material operations" in the United States, and (iii) are rated investment-grade (at least BBB-/Baa3 by a major 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. - Companies that are expected to receive direct financial assistance under the CARES Act are not eligible. - Eigibility may be expanded in future.	- Program will extend credit to eligible companies by investing in new bonds and/or making loans. - Federal Reserve and Treasury will fund a special purpose vehicle (SPV) that will (i) purchase qualifying bonds directly from eligible issuers and/or (ii) make loans to eligible issuers. - Interest rate to be "informed by market conditions." - Maturity less than four years. - Bonds and loans under program may be called by borrower at par at any time. - Maximum borrowings under program are based on a percentage of the borrower's maximum amount of bonds and loans outstanding on any one day from March 22, 2019, to March 22, 2020; percentage varies from 110-140% based on borrower's rating. - Commitment fee of 100 bps.

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Secondary Market Corporate Credit Facility (SMCCF)

The SMCCF (described in further detail here) will provide enhanced liquidity for corporate bonds of eligible issuers in the secondary market by purchasing such bonds directly from holders. Funds and BDCs who hold or purchase eligible assets may be able to sell those assets directly to the SMCCF. Unlike the other programs discussed herein, foreign entities may be able to participate in this program if they hold eligible assets. Below is a brief summary of key terms of the SMCCF:

Who is eligible?	How will it work?
- U.S. businesses that have (i) "material operations" in the United States and (ii) investment-grade corporate bonds (at least BBB-/Baa3 by a major 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. - Companies that are expected to receive direct financial assistance under the CARES Act are not eligible.	- Program will support credit markets by providing liquidity for outstanding corporate bonds of eligible companies. - Federal Reserve and Treasury will fund a SPV that will (i) purchase qualifying bonds in the secondary market of eligible companies and/or (ii) purchase U.S.-listed exchange traded funds (ETFs) whose investment objective is broad exposure to U.S. investment-grade bonds. (It is not clear, however, if such purchases will be of securities issued by ETFs or of their underlying assets). - Maximum amount of bonds of a particular eligible company that will be purchased under this program is capped at 10% of the company's maximum amount of bonds outstanding on any day from March 22, 2019, through March 22, 2020. The facility will "not purchase more than 20% of the assets" of any particular ETF as of March 22, 2020. - The facility will purchase eligible corporate bonds at fair market value in the secondary market. The facility will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value (NAV) of the underlying portfolio.

Term Asset-Backed Securities Loan Facility (TALF)

The TALF (described in further detail here) will provide liquidity for asset-backed securities (ABS) by making three-year, non-recourse loans to eligible borrowers secured by eligible ABS. Eligible borrowers who are funds or BDCs, may want to consider ensuring that their future portfolio security purchases of ABS qualify for purchase under this program so as to ensure an ability to raise liquidity from the program in the future. Below is a brief summary of key terms of the TALF:

Who is eligible?	How will it work?
- Borrowers that (i) are 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, (ii) own eligible collateral, and (iii) maintain an account relationship with a primary dealer.	- Program will help meet the credit needs of consumers and small businesses by facilitating the issuance of asset-backed securities and improving the market for asset backed securities (ABS) more generally. - Federal Reserve and Treasury will fund a SPV that will make three-year loans to eligible borrowers that are non-recourse and fully secured by eligible consumer and business ABS. - Eligible collateral must be USD-denominated cash ABS that (i) 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 no rating below the highest investment grade rating category from an eligible NRSRO; and (ii) all or substantially all of the underlying credit exposure (a) was originated by a U.S. company, (b) was issued on or after March 23, 2020, and (c) is limited to ABS backed by auto loans and leases, student loans, credit card receivables (both consumer and corporate), equipment loans, floorplan loans, insurance premium finance loans, certain small business loans that are guaranteed by the Small Business Administration or eligible servicing advance receivables.

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Commercial Paper Funding Facility (CPFF)

The CPFF (described in further detail here) will provide liquidity to eligible issuers who issue short-term commercial paper. Funds or BDCs who have issued asset-backed commercial paper in the past year may be able to issue short-term commercial paper directly to the CPFF. Below is a brief summary of key terms of the CPFF:

Who is eligible?	How will it work?
- U.S. issuers of commercial paper (including municipal issuers and U.S. issuers with a foreign parent company) that (i) meet certain ratings requirements and (ii) have issued asset backed commercial paper to institutions other than the sponsoring institution for any consecutive period of three-months or longer between March 16, 2019, and March 16, 2020.	- Program will support issuance of short-term commercial paper by supporting purchases of eligible commercial paper. - Primary dealers will purchase from eligible issuers three-month USD-denominated commercial paper. - The amount of commercial paper of a particular issuer that may be purchased under this program depends in part on the issuer's rating. - Pricing for commercial paper that is rated A1/P1/F1 will be based on the then-current three-month overnight index swap rate plus 110 basis points (or in the case of downgraded issuers who still qualify, 200 basis points). - Issuers are required to pay a facility fee equal to 10 bps of the maximum amount of commercial paper such issuers can sell to the SPV.

Primary Dealer Credit Facility (PDCF)

The PDCF (described in further detail here) will enhance market liquidity by extending loans to certain primary dealers secured by eligible collateral, including investment grade debt, municipal bonds and a range of equity securities. As a result, funds and BDCs may want to consider ensuring that future portfolio security purchases include assets that would qualify as eligible collateral under this program so that they can help meet future liquidity needs by selling those assets to primary dealers. Below is a brief summary of key terms of the PDCF:

Who is eligible?	How will it work?
- Primary dealers of the Federal Reserve Bank of New York that have eligible collateral.	- Program will help primary dealers support smooth market functioning by providing primary dealers with short-term loans. - Federal Reserve will offer overnight and term funding with maturities up to 90 days to primary dealers with eligible collateral. - Eligible collateral includes collateral eligible for pledge in open market operations, investment grade corporate debt securities, international agency securities, commercial paper, municipal securities and certain other securities. - Loans will be made at a rate equal to the primary credit rate in effect at the Federal Reserve Bank of New York offered to depository institutions via the Discount Window.