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The Federal Reserve Returns to Emergency Lending: Creates Commercial Paper Funding Facility and Primary Dealer Credit Facility

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Yesterday, in response to the COVID-19 crisis, the Federal Reserve Board invoked its emergency lending authority under Section 13(3) of the Federal Reserve Act to shore up liquidity in important financial markets. It announced two facilities, the Commercial Paper Funding Facility (CPFF), and the Primary Dealer Credit Facility (PDCF). Similar facilities were used in the 2008 Financial Crisis to stem seizing in the financial markets.

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Commercial Paper Funding Facility

The CPFF will fund purchases of highly rated, U.S. dollar denominated, three-month, unsecured or asset-backed commercial paper (ABCP) issued by U.S. issuers, including U.S. issuers with a foreign parent company. It will thus act as a liquidity backstop to “Tier 1” commercial paper issuers, given the Federal Reserve’s recognition that the commercial paper markets directly finance a wide range of economic activity.

The facility will operate through an SPV, which will purchase the commercial paper from Federal Reserve primary dealers, using financing from the Federal Reserve Bank of New York (FRBNY).

The SPV will purchase commercial paper rated at least A-1/P-1/F1, and the maximum amount of a single issuer’s commercial paper that the SPV may own at any time will be the greatest amount of 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 this limit. In addition, the SPV will make one-time purchases of commercial paper (up to the amount outstanding on March 17, 2020) from issuers that met these ratings criteria as of March 17, 2020 but had been downgraded to A-2/P-2/F-2 as of the purchase date. These purchases will be subject to separate pricing. The Federal Reserve stated that it “reserve[d] the right to review and make adjustments to the terms and conditions” of the CPFF, including its eligibility requirements.

Pricing will be based on the 3-month overnight index swap (OIS) rate plus 200 basis points, and issuers will be required to pay a one-time facility fee of 10 basis points of the maximum amount of its commercial paper the SPV may own. Purchases are scheduled to cease on March 17, 2021.

Significantly, the Treasury Department will provide $10 billion of credit protection to the Federal Reserve system in connection with the CPFF from the Treasury's Exchange Stabilization Fund (ESF).

A brief description of the CPFF provided by the Federal Reserve is available here. More detailed terms and conditions of the CPFF are expected to be published later.

Primary Dealer Credit Facility

In addition, the Federal Reserve announced the creation of the PDCF. Under this facility, the FRBNY will offer overnight and term funding with maturities up to 90 days to primary dealers (generally broker-dealers that act as dealers in U.S. government securities); the funding will be available on March 20, 2020. The PDCF will be in place for at least six months and may be extended as conditions warrant.

PDCF credit may be collateralized by a broad range of securities. Commercial mortgage-backed securities (CMBS), collateralized loan obligations (CLOs), and collateralized debt obligations (CDOs) are acceptable collateral only if AAA rated. Corporate debt, municipal securities, and commercial paper is acceptable if rated investment grade (BBB- securities and above), including both A1/P1 and A2/P2 commercial paper. Equity securities are also eligible collateral, except for exchange traded funds (ETFs), unit investment trusts, mutual funds, rights and warrants.

The interest rate charged will be the FRBNY's primary credit rate, or discount rate. The PDCF thus makes the equivalent of discount window funding available to broker-dealers, entities that in normal times are not eligible for such funding as the discount window is limited to banking institutions. By providing this emergency liquidity to broker-dealers, it will aid them in maintaining liquidity in the markets for the securities that may be pledged as collateral.

A brief description of the PDCF provided by the Federal Reserve is available here. More detailed terms and conditions of the PDCF are expected to be published later.

Conclusion

In the Financial Crisis, the Federal Reserve made use of both a CPFF and PDCF. The CPFF's size peaked in early 2009 at approximately $350 billion, and the PDCF aided broker-dealers substantially when they were having difficulty financing through normal means. It is reasonable to assume additional facilities will be created as necessary. The rapid creation of the facilities demonstrates the Federal Reserve's commitment to act as appropriate in its lender of last resort function, consistent with the constraints placed on its Section 13(3) powers by the Dodd-Frank Act.

Importantly, both the CPFF and PDCF are programs of broad-based eligibility. "Broad-based eligibility" is one of the principal constraints that the Dodd-Frank Act placed on the Federal Reserve's Section 13(3) powers, which previously permitted loans to any corporation or partnership. *See Arthur S. Long, Revised Section 13(3) of the Federal Reserve Act*. Although it is commendable that the Federal Reserve has so rapidly made use of its Section 13(3) powers, now is the time to look closely at all of the numerous Dodd-Frank requirements for Section 13(3) lending and determine whether they are appropriate given current events.

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 CPFF and the PDCF. 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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