GIBSON DUNN

Federal Reserve Issues New Guidance on Primary Market Corporate Credit Facility, Including Use of Subsidiary Issuers

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The Board of Governors of the Federal Reserve System's ("Federal Reserve") issued revised guidance on May 4, 2020, with respect to the Primary Market Corporate Credit Facility ("PMCCF") and noted that it expects the PMCCF to be operational sometime early this month.[1] The revised guidance clarifies two substantive issues with respect to the application of the PMCCF's issuer requirements.

First, the revised guidance clarifies the extent to which U.S. subsidiaries may participate under the PMCCF in light of the requirement that issuers have "significant operations in and a majority of its employees based in the United States" (the "U.S. Requirements"). Previous guidance on the matter was silent as to whether U.S. subsidiaries would be eligible to participate in the PMCCF and, if eligible, how such entities would be evaluated under the U.S. Requirements (e.g., application of employee and operations on a consolidated basis, whether use of funds would be restricted to U.S. operations, etc.).

Second, the revised guidance clarifies the extent to which the PMCCF restriction that issuers not "have received specific support pursuant to the [Coronavirus Aid, Relief, and Economic Security Act ("CARES Act")] or any subsequent federal legislation" applies to issuers generally. Previous guidance did not provide additional detail as to what constitutes "specific support" under the CARES Act (e.g., support under Title IV programs, tax relief, participation in the Paycheck Protection Program, etc.).

This revised guidance confirms that U.S. subsidiaries can participate in the PMCCF, and provides additional gloss on eligibility requirements under the U.S. Requirements and the "no specific support" under the CARES Act condition. For additional background and information regarding the PMCCF and its requirements, please see our previous alerts, available here and here.

The revised guidance provides several avenues by which a U.S. subsidiary issuer may participate in the PMCCF:

1. *Test 1 (A or B): S. Subsidiary Whose Sole Purpose to Issue Debt.* If the sole purpose of the U.S. subsidiary issuer is to issue corporate debt, eligibility will depend on the contemplated distribution of PMCCF proceeds, based on the satisfaction of one of the two following tests:
    A. If 95 percent or more of the proceeds from the PMCCF are transferred to another corporate affiliate (a "Primary Corporate Beneficiary") for use in its operations, the Primary Corporate Beneficiary, on a consolidated basis with its consolidated subsidiaries, must satisfy the U.S. Requirements.
    B. If there is no Primary Corporate Beneficiary, at least 95 percent of the proceeds of the PMCCF must go to corporate affiliates, each of which, on a consolidated basis with its consolidated subsidiaries, satisfy the U.S.

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Requirements.

2. *Test 2: Other U.S. Subsidiary Issuers.* If the U.S. subsidiary issuer is not a subsidiary whose sole purpose is to issue debt, it may participate in the PMCCF so long as it, on a consolidated basis with its consolidated subsidiaries, satisfies the U.S. Requirements. Use of PMCCF proceeds by issuers satisfying Test #2 does not appear to be restricted to solely U.S. entities or operations and may be directed to non-U.S. operations and non-U.S. affiliates so long as the U.S. subsidiary issuer otherwise satisfies the consolidation test noted above. If the U.S. subsidiary does have a direct or indirect non-U.S. parent or intermediate holding company, please see #4 below. If the U.S. subsidiary's only purpose is to issue debt, the requirements under Test #1(A) or #1(B) must be met.

With respect to the abovementioned tests, we note the following additional takeaways:

1. *Upstream Entities*: Upstream entities and sister affiliates of a U.S. subsidiary issuer will not be considered if the U.S. subsidiary issuer, with its consolidated downstream group, satisfies the U.S. Requirements.
2. *Downstream Entities*: Guidance does not appear to restrict participation in the PMCCF if a downstream consolidated subsidiary of the U.S. subsidiary issuer is not itself a U.S. entity, so long as the consolidated group satisfies the U.S. Requirements.
3. *Creating/Identifying a New U.S. Subsidiary Issuer*: Guidance explicitly provides that corporates may create a new entity or identify an existing entity as an issuer and may rely on the ratings history of any U.S. affiliate that is guaranteeing the issuance. Participating issuers under the PMCCF are subject to a participation threshold that may not exceed 130% of the issuer's maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020. U.S. subsidiary issuers participating in the PMCCF and relying on an affiliate guarantee would be subject to the 130% threshold, calculated with respect to its top-tier parent's issuances on a consolidated basis.[2]
4. *U.S. Subsidiary of a Non-U.S. Parent*: A U.S. subsidiary issuer of a non-U.S. company may participate if it otherwise satisfies the U.S. Requirements, but will be restricted in the use of its PMCCF proceeds. The U.S. subsidiary must covenant that PMCCF proceeds are used only for the benefit of the U.S. subsidiary issuer, its consolidated U.S. subsidiaries, and other affiliates that are U.S. businesses, and not for the benefit of its non-U.S. affiliates.[3]
5. *Significant Operations Requirement*: The revised guidance provides a non-exhaustive list of examples that would satisfy the "significant operations" component of the U.S. Requirements. The U.S. subsidiary issuer would qualify as having "significant operations" in the U.S. if, as reflected in its most recent audited financial statements, it has greater than 50% of its:
    - A. Consolidated assets in the U.S.; or
    - B. Annual consolidated net income generated in the U.S.; or
    - C. Annual consolidated net operating revenues generated in the U.S.; or
    - D. Annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) generated in the U.S.
6. *"Specific Support" Requirement*: Eligibility under the PMCCF also requires issuers not to have "received specific support pursuant to the CARES Act or any subsequent federal legislation." The revised guidance clarifies this restriction by stating that an issuer is not eligible if "it has received a loan, loan guarantee, or other investment from the Treasury Department under section 4003(b)(1)-(3)." In addition, the revised guidance states that an issuer may use tax credits or tax relief in the CARES Act and still participate in the PMCCF.

Conclusion

Revised guidance under the PMCCF provides a path to eligibility for certain U.S. subsidiaries of corporates and manufacturers with substantial overseas operations. It does so without requiring consolidated, parent level calculations. While the guidance helpfully clarifies these structural issues and the substantive requirements thereunder, the guidance does not address the administrative aspects of the PMCCF (e.g., application forms, dates, procedures) other than through a general statement that the PMCCF will purchase eligible assets soon this month. We will continue to monitor developments with respect to the PMCCF, including when additional guidance on the application process for the PMCCF is released.

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[1]   The PMCCF term sheet has not been updated.

[2]   The maximum amount of instruments that may be purchased by the PMCCF and Secondary Market Corporate Credit Facility ("SMCCF") with respect to an issuer may not exceed 1.5% of the combined size of the PMCCF and SMCCF, currently sized at $750 billion. Measurement of the 1.5% threshold will be at the time of purchase of the bond or portion of loan syndication.

[3]   The revised guidance also notes that U.S. branches or agencies of non-U.S. banks may participate as eligible sellers under the SMCCF provided that they otherwise satisfy the U.S. Requirements.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding developments related to the COVID-19 pandemic. For additional information, please contact any member of the firm's Coronavirus (COVID-19) Response Team or its Capital Markets or Financial Institutions practice groups, the Gibson Dunn lawyer with whom you usually work, or the following authors:

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