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EMERGENCY LENDING: FEDERAL RESERVE EXPANDS PRIMARY MARKET CORPORATE CREDIT FACILITY, SECONDARY MARKET CORPORATE CREDIT FACILITY AND TERM ASSET-BACKED LENDING FACILITY

To Our Clients and Friends:

Today, the Board of Governors of the Federal Reserve System (Federal Reserve) announced that it was expanding three of the facilities created earlier this spring in reaction to the economic dislocation caused by COVID-19: the Primary Market Corporate Credit Facility (PMCCF), the Secondary Market Corporate Credit Facility (SMCCF) and the Term Asset-Backed Securities Loan Facility (TALF).

The PMCCF and SMCCF will be upsized significantly and will be able to purchase certain non-investment grade securities. Although the size of the TALF remains the same, it will now purchase highly rated asset-backed securities where the underlying instruments are equipment leases, leveraged loans and commercial mortgages. The expansion for commercial mortgage backed securities (CMBS) is for “legacy” CMBS, those issued before March 23, 2020.

Primary Market Corporate Credit Facility

The Federal Reserve issued updated term sheets for the PMCCF and the SMCCF. In an expansion of these facilities, the Department of the Treasury will make a $75 billion equity investment in the facilities’ special-purpose vehicles (SPVs), initially split with $50 billion for the PMCCF and $25 billion for the SMCCF. The Federal Reserve will lend to the SPVs to increase the size of the facilities to a maximum size of $750 billion.

The PMCCF may purchase eligible corporate bonds as the sole investor in a bond issuance, and also portions of syndicated loans or bonds of eligible issuers at issuance. The types of instruments to be purchased are unchanged; they must have a maturity of 4 years or less.

The updated term sheet defines the “eligible issuers” that may make use of the facility. Such issuers are limited to:

- A business that is created or organized in the United States or under the laws of the United States with significant operations in and a majority of its employees based in the United States. (Here, the term sheet repeats the language of the CARES Act without any elaboration.)
- The issuer was rated at least BBB-/Baa3 as of March 22, 2020, by a major nationally recognized statistical rating organization (NRSRO). If rated by multiple major NRSROs, the issuer must have been rated at least BBB-/Baa3 by two or more NRSROs as of March 22, 2020. Issuers that

were rated at least BBB-/Baa3 as of March 22, 2020, but are subsequently downgraded, must be rated at least BB-/Ba3 at the time the Facility makes a purchase. If rated by multiple major NRSROs, such issuers must be rated at least BB-/Ba3 by two or more NRSROs at the time the Facility makes a purchase.

- The issuer is not an insured depository institution or depository institution holding company, as such terms are defined in the Dodd-Frank Act.
- The issuer has not received specific support pursuant to the CARES Act or any subsequent federal legislation.
- The issuer must satisfy the conflicts-of-interest requirements of section 4019 of the CARES Act relating to companies controlled by government personnel.

The updated term sheet revises the per-issuer limits that will apply to the PMCCF. It states that eligible issuers may approach the PMCCF to refinance outstanding debt, from the period of three months ahead of the maturity date of such outstanding debt. In addition, issuers may approach the PMCCF at any time to issue additional debt, provided their rating is reaffirmed at BB-/Ba3 or above with the additional debt by each major NRSRO with a rating of the issuer.

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. Furthermore, the maximum amount of instruments that the PMCCF and the SMCCF combined will purchase with respect to any eligible issuer is 1.5% of the combined potential size of the PMCCF and the SMCCF.

Pricing for the PMCCF will be issuer-specific, informed by market conditions, plus a 100 basis point facility fee. If the loans or bonds are syndicated, the PMCCF will receive the same pricing as other syndicate members, plus a 100 bps facility fee on the PMCCF's share of the syndication.

As in the original term sheet, the PMCCF will cease purchasing eligible corporate bonds and extending loans on September 30, 2020, unless the Federal Reserve extends the program.

The revised terms of the PMCCF are available here.

Secondary Market Corporate Credit Facility

The updated SMCCF term sheet uses the same definition of "eligible issuers" of debt securities as the PMCCF. In a change from the original term sheet, the SMCCF will purchase some ETFs that are U.S.-listed and intended to provide exposure to a broad section of the high-yield corporate bond market, in addition to those intended to provide broad exposure to the investment grade bond market. No change was made with respect to the types of bonds that may be purchased by the SPV – they must have a remaining maturity of 5 years or less.

In addition, the SMCCF will purchase only from "eligible sellers": a business that is created or organized in the United States or under the laws of the United States with significant U.S. operations and a majority of U.S.-based employees. Such "eligible sellers" must also satisfy the conflicts-of-interest requirements of section 4019 of the CARES Act.

The revised terms of the SMCCF are available here.

Term Asset-Backed Lending Facility

Like the PMCCF and the SMCCF, the revised TALF term sheet restricts participation in the facility to businesses "created or organized in the United States or under the laws of the United States and that ha[ve] significant operations in and a majority of its employees based in the United States" (U.S. Companies). The TALF remains sized at $100 billion and continues to offer three-year loans to eligible borrowers on a non-recourse basis to holders of certain AAA-rated asset-backed securities (ABS). From the revised term sheet, it appears that the TALF currently does not make use of CARES Act funds.

Significantly, the revised term sheet expands the types of credit exposures underlying the ABS to include equipment leases, leveraged loans and commercial mortgages, and eliminates "servicing advance receivables." The result is an expanded definition of "eligible collateral" for the TALF loans:

> U.S. dollar denominated cash (that is, not synthetic) ABS that have a credit rating in the highest long-term or, in the case of non-mortgage backed ABS, the highest short-term investment-grade rating category from at least two eligible NRSRO and do not have a credit rating below the highest investment-grade rating category from an eligible NRSRO. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. Company, and the issuer of eligible collateral must be a U.S. Company. With the exception of commercial mortgage-backed securities (CMBS), eligible ABS must be issued on or after March 23, 2020. CMBS issued on or after March 23, 2020, will not be eligible. For CMBS, the underlying credit exposures must be to real property located in the United States or one of its territories.

In addition, the revised TALF term sheet states that single-asset single-borrower (SASB) CMBS and commercial real estate collateralized loan obligations will not be eligible collateral, and that only static CLOs will be eligible collateral. The TALF includes a collateral haircut schedule, reproduced as Appendix 1, that the Federal Reserve states is consistent with the haircut scheduled used for the TALF established in 2008.

In term of pricing, loans secured by CLOs will bear an interest rate of 150 basis points over the 30-day average secured overnight financing rate (SOFR). Loans secured by SBA Pool Certificates will bear an interest rate of the top of the federal funds target range plus 75 basis points. For loans backed by SBA Development Company Participation Certificates, the interest rate will be 75 basis points over the 3-year fed funds overnight index swap (OIS) rate.

For loans secured by all other eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 125 basis points over the 2-year OIS rate for securities with a weighted average life less than two years, or 125 basis points over the 3-year OIS rate for securities with a weighted average life of two years or greater.

The revised terms of the TALF are available here.

APPENDIX 1

Haircut Schedule:

		ABS Average Life (years)*						
Sector	**Subsector**	**0-<1**	**1-<2**	**2-<3**	**3-<4**	**4-<5**	**5-<6**	**6-<7**
Auto	Prime retail lease	10%	11%	12%	13%	14%		
Auto	Prime retail loan	6%	7%	8%	9%	10%		
Auto	Subprime retail loan	9%	10%	11%	12%	13%		
Auto	Motorcycle/ other recreational vehicles	7%	8%	9%	10%	11%		
Auto	Commercial and government fleets	9%	10%	11%	12%	13%		
Auto	Rental fleets	12%	13%	14%	15%	16%		
Credit Card	Prime	5%	5%	6%	7%	8%		
Credit Card	Subprime	6%	7%	8%	9%	10%		
Equipment	Loans and Leases	5%	6%	7%	8%	9%		
Floorplan	Auto	12%	13%	14%	15%	16%		
Floorplan	Non-Auto	11%	12%	13%	14%	15%		
Premium Finance	Property and casualty	5%	6%	7%	8%	9%		
Small Business	SBA Loans	5%	5%	5%	5%	5%	6%	6%
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Leveraged Loans	Static	20%	20%	20%	20%	20%	21%	22%

Commercial Mortgages	Legacy, Conduit	15%	15%	15%	15%	15%	16%	17%

* For auto, credit card, equipment, floorplan, and premium finance ABS, the weighted average life must be five years or less. For other new-issue eligible collateral, haircuts will increase by one percentage point for each additional year (or portion thereof) of average life beyond five years. For legacy CMBS with average lives beyond five years, base dollar haircuts will increase by one percentage point of par for each additional year (or portion thereof) of average life beyond five years. No securitization may have an average life beyond ten years.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the issues discussed in this video. For further information, please contact the Gibson Dunn lawyer with whom you usually work or any of the following members of the Paris office by phone (+33 1 56 43 13 00) or by email:

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