REGULATORY ALERT:

AN ANALYSIS OF THE FEDERAL RESERVE'S NEW AND EXPANDED PROGRAMS TO SUPPORT THE US ECONOMY

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EXECUTIVE SUMMARY

On April 9, 2020, the Board of Governors of the Federal Reserve (Federal Reserve) announced an array of new and expanded programs designed to ease the economic dislocation caused by the COVID-19 pandemic. Together, these programs will provide up to $2.3 trillion in funding to support the flow of credit to US businesses of all sizes, individual households, and state and local governments. Although these programs in many ways mirror those established by the Federal Reserve after the 2008 financial crisis, there are some significant expansions and differences as well.

The support programs include:

- a new "Main Street" lending program that will provide up to $600 billion in loans to small- and medium-sized businesses;
- expanded corporate credit programs that will provide up to $750 billion to purchase corporate debt on the primary and secondary markets, including, in a significant departure for the Federal Reserve, debt that is rated below investment grade;
- a groundbreaking new program that will provide up to $500 billion in lending to state and local governments;
- up to $100 billion in loans for borrowers who pledge certain highly rated asset-backed securities (ABS), which will support consumer and other types of lending; and
- a new lending facility that will provide up to $350 billion in financing to banks to help them meet the overwhelming demand by small businesses for the Paycheck Protection Loans created by the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act).

As extraordinary as the single day commitment of $2.3 trillion may seem, the programs announced last week may only be the opening salvo. As we reported in our prior alert, the CARES Act made up to $454 billion available to the US Department of the Treasury (Treasury) to support the Federal Reserve's Section 13(3) emergency lending facilities. The programs announced last week and discussed in this alert will be supported by $165 billion of the $454 billion allocated, leaving Treasury and the Federal Reserve with nearly two-thirds of the originally allocated funds as "dry powder" available for future use. Treasury's commitment of CARES Act funds comes with several levels of government oversight, reporting requirements, and other conditions described in this alert. The implementation and oversight of these Federal Reserve programs will likely become a key feature of the economic environment in the United States for the foreseeable future.

In terms of mechanics, the Federal Reserve will run most of these new programs through special purpose vehicles (SPVs) that will each be seeded by an initial equity investment from Treasury. Treasury's investment stands in a "first loss" position. To the extent that the programs withstand losses, they will initially be borne by Treasury, up until its investment in a particular SPV is exhausted. Although the Federal Reserve's models likely predict that any losses would be well below Treasury's investments, if losses do exceed those amounts, either Treasury will need to put additional funds into the SPV or future losses will be absorbed by the Federal Reserve.

The Federal Reserve funds the loans or other investments contemplated by the program well above and beyond Treasury's commitment. Some programs are receiving a higher multiple of Treasury's investment from the Federal Reserve than others—presumably based on the Federal Reserve's assessment of the risk of loss associated with the program. For example, for some of the state and local government lending, the Federal Reserve will commit more than 14 times Treasury's initial equity investment—allowing a higher bang for its buck based on its lower risk assessment. Others, like the Federal Reserve's funding for certain corporate bond exchange-traded funds, may see as low as a three to one investment, signaling a higher assessment of risk of loss. The amount of leverage that the Federal Reserve will apply to each of the programs is detailed below.

This alert summarizes the key terms of the new programs, including for those businesses and other entities who might seek relief under its provisions, along with the most important eligibility requirements, restrictions and conditions for each program. For most of the programs, we note that the Federal Reserve has only provided term sheets, some of which are still open to comment, and the programs may very well change as more details, updates and further guidance are posted. What follows below is a summary of the currently available information. We encourage you to follow up with any questions or concerns. Jenner & Block offers a wide array of resources and lawyers with experience necessary to help our clients navigate the implications of these important new programs, led by our COVID-19 Response Team. This team, described more fully below, includes lawyers who played key, leading roles in the country's response to the last economic crisis and who have been recognized nationally for their insight in this one. It includes government veterans whose senior positions meant that they were intimately involved in the design of many of the government's most recent bailout programs, oversaw the loan application and distribution processes that were a key part of them, and ran and responded to the investigations that followed. It also includes transactional lawyers who are already engaged with the government for clients seeking to avail themselves of aspects of the programs discussed below.

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The new and expanded Federal Reserve programs include several under the CARES Act:

Main Street Lending Program. The Main Street lending program will provide up to $600 billion in lending to small- and medium-sized businesses, seeded with $75 billion of the $454 billion allocated to Treasury discussed above. The Main Street program will offer loans ranging from $1 million to $150 million with a four-year maturity, at an initial interest rate of approximately 2.5% to 4%. They will have no prepayment penalty and not require any loan payments for a full year. Businesses with less than 10,000 employees and/or up to $2.5 billion in 2019 annual revenues are eligible to apply. Loans made through this program will include limits on stock buybacks, dividends and executive compensation. The Treasury Secretary has indicated that Treasury hopes to have this program "up and running as soon as we can." The Federal Reserve has not, however, provided a timeline or forms for application, and has opened a period of comment until April 16, 2020, meaning the program may not be operational until May.

Primary and Secondary Market Corporate Credit Facilities. The Primary and Secondary Market Corporate Credit Facilities will purchase up to $750 billion in new and already issued corporate bonds in an attempt to help large US businesses access credit and increase liquidity in the corporate debt markets. The Primary Market Corporate Credit Facility (Primary Market CCF) will purchase newly issued corporate bonds and syndicated loans. The Secondary Market Corporate Credit Facility (Secondary Market CCF), the smaller of the two, will focus on the secondary market, purchasing corporate bonds that have previously been issued as well as corporate bond exchange-traded funds. BlackRock Financial Market Advisory (BlackRock) will manage these facilities for the Federal Reserve. Treasury will commit $75 billion in equity to these programs, $55 billion of which comes from the CARES Act, and $20 billion of which was committed from pre-existing funds. There are no CARES Act restrictions on stock buybacks, dividends, and executive compensation for this program. The Federal Reserve has not yet published a timeline for program launch or further details on how to participate.

Municipal Liquidity Facility. In addition to the direct assistance provided to local municipalities under the CARES Act, the Municipal Liquidity Facility will provide up to $500 billion in short-term loans to all 50 states and heavily populated cities and counties facing financial distress due to COVID-19. To put this level of support into perspective, the amount of all municipal securities issued in 2019, according to several estimates, was approximately $422 billion. Recipients may use the proceeds of the notes to address the impact of lower tax revenue or increases in expenses due to COVID-19, to manage the cash-flow impact of income-tax payment deferrals, and to pay interest and principal on outstanding bonds. They may also use the funds to provide financial support to their political subdivisions and instrumentalities which, in turn, may use the funds for the purposes described above. Although the program term sheet indicates that participants can only borrow amounts up to 20% of their general revenue and utility revenue in 2017, they can exceed that cap if they use the funds to support smaller municipalities that do not meet the size requirements necessary to directly participate in the program. Treasury will commit $35 billion in equity to this program, all of which comes from the CARES Act.

Participants in these programs should be aware that they may be subject to various forms of reporting and government oversight. Unless further guidance from the Federal Reserve indicates otherwise, participants in these programs should assume that their participation will become public, and that they could become the subject of congressional and executive branch oversight and investigation, including through the new oversight bodies established by the CARES Act, like the Office of the Special Inspector General for Pandemic Recovery (SIGPR), Congressional Oversight Commission and Pandemic Response Accountability Committee.

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The newly announced programs also include several that fall outside the direct mandate of the CARES Act, but nonetheless invoke the Federal Reserve's emergency lending authority to support the liquidity of various markets critical to the economy. There is also the possibility that, if these programs are expanded, they may draw on CARES Act funding. These are:

Term Asset-Backed Securities Loan Facility (TALF). The Federal Reserve first launched the TALF program in response to the 2008 financial crisis. On March 23, 2020, the Federal Reserve rebooted the program for the 2020 crisis, announcing that it will provide up to $100 billion in non-recourse loans to borrowers who pledge certain types of highly rated ABS secured by pools of assets, such as consumer and business loans. Because the loans are non-recourse, the borrower can always stop paying the loan and surrender the securities to the Federal Reserve. The stated goal of the program is to ensure the free flow of credit for households and small businesses by fueling demand for ABS as a financing mechanism. The intended design is that by creating steady demand for eligible ABS, demand for the loans underlying them will also increase, freeing up lenders to profitably replace those loans with cash they can use for additional lending.

Most recently, on April 9, 2020, the Federal Reserve broadened the range of assets considered eligible collateral to include riskier assets, such as certain commercial mortgage-backed securities (CMBS) and collateralized loan obligations (CLOs). The TALF program will be backed by a $10 billion equity investment from Treasury, which was provided before the CARES Act was enacted.

Paycheck Protection Program Lending Facility (PPPLF). As described in our prior alert, the Paycheck Protection Program (PPP), launched on April 3, 2020, provides small businesses with potentially forgivable loans to pay ongoing business expenses, such as payroll, rent and utilities. The initial demand for PPP loans was both immediate and overwhelming, and banks have been slow to meet that demand. The PPPLF was launched to provide cheap financing to banks to help them originate more PPP loans and keep up with demand. Based on the current size of the PPP, the PPPLF will allow banks making PPP loans to obtain *up to* $350 billion in non-recourse loans directly from the regional Federal Reserve banks using only PPP loans, taken at face value, as collateral. All depository institutions that originate PPP loans are eligible to borrow from this facility, and although other types of PPP lenders are not currently eligible, the Federal Reserve plans to expand the program to other lenders originating PPP loans in the near future.

This facility is not backed by Treasury funds because the PPP loans funded through this facility are already 100% guaranteed from loss by the Small Business Administration (SBA) under Title I of the CARES Act. On the same day that the PPPLF was announced, the federal banking regulatory agencies issued an interim rule that will ensure that participating in the PPPLF will not negatively impact the banks' regulatory capital requirements. The program is now open.

Commercial Paper Funding Facility (CPFF). The Federal Reserve re-established the CPFF, also first used in response to the 2008 financial crisis, on March 23, 2020. The purpose of this program is to increase liquidity in the commercial paper market because of stresses in the private market brought on by the crisis. The CPFF will purchase eligible three-month unsecured commercial paper and asset-backed commercial paper (ABCP) through the FRBNY's primary dealers. The CPFF will be managed by Pacific Investment Management Company, with State Street Bank serving as custodian and administrator. Before the enactment of the CARES Act, Treasury provided $10 billion in equity to support this program and, at this time, the Federal Reserve has placed no limit on the amount of financing it will provide. There are, however, limits on how much commercial paper each issuer can sell to the facility, based on its credit rating and prior outstanding amount of commercial paper. Companies may apply for financing under this program starting on April 14, 2020. Unless extended by the Federal Reserve and Treasury, the CPFF will cease purchasing assets on March 17, 2021.

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As noted above, Jenner & Block is well positioned to help our clients manage the challenging issues related to the current crisis, from applications for funds, to managing workforce concerns, to the Congressional oversight and government investigations that inevitably come along with any such financial assistance. Our COVID-19 Response Team includes alumni from various government agencies and other lawyers involved in the fallout from the 2008 financial crisis whose experience can prove invaluable in times like these. The team include includes:

- Neil Barofsky, the former Presidentially-appointed first Special Inspector General of the $700 billion Troubled Asset Relief Program (SIGTARP). In his role as SIGTARP, Mr. Barofsky established and supervised the audit division that oversaw the financial assistance provided to corporations after the 2008 financial crisis, and provided real time advice and oversight as Treasury developed and implemented many of the TARP programs. He also created and oversaw its law enforcement division, which conducted criminal and civil investigations related to the bailouts, and helped provide transparency through his testimony dozens of times to Congress;

- Firm Chair Tom Perrelli, who draws on his experience as Associate Attorney General, the third-ranking official at the US Department of Justice, where, among other things, he led the government's investigation and eventual $25 billion settlement into the mortgage servicing abuses that arose out of the crisis, and served as the lead Department of Justice representative involved in the American Recovery and Reinvestment Act in 2009;

- Partner Erin Schrantz, who represented global clients who came under Congressional and Justice Department scrutiny related to their receipt of TARP funds;
- Partner Damon Smith, who served as liaison to the Financial Crisis Inquiry Commission during his five years at the US Department of Housing and Urban Development, where he served as acting general counsel; and
- Lawyers who advised Partner Anton Valukas, in his role as the court-appointed Examiner in the Lehman Brothers Holdings bankruptcy, an event many commentators point to as the precipitating event triggering the 2008 financial crisis.

Additional materials prepared by the COVID-19 Response Team are available on Jenner & Block's COVID-19 Resource Center. For more information on the CARES Act, please reach out to CARESAct@jenner.com or your primary Jenner & Block contact.

I. CARES ACT PROGRAMS

A. Main Street Program

On April 9, 2020, the Federal Reserve announced the creation of two new complementary facilities to support lending to small- and medium-sized US businesses: the Main Street New Loan Facility (New Loan Facility) and the Main Street Expanded Loan Facility (Expanded Loan Facility) (together, the Main Street Program). The Main Street Program will provide up to $600 billion in lending from US banks to a broad range of US businesses, seeded with $75 billion of the $454 billion allocated in the CARES Act to backstop Federal Reserve programs.

Although the CARES Act provided discretion to Treasury to waive restrictions placed on borrowers, the new guidance makes clear that, to receive loans under this program, borrowers must agree to the restrictions set forth in the CARES Act for direct loans facilitated through a Federal Reserve facility, including limits on buybacks, dividends and executive compensation. In addition, borrowers will be subject to the reporting requirements and government oversight provisions of the CARES Act.

The Treasury Secretary has indicated that Treasury hopes to have the program "up and running as soon as we can."[1] But the Federal Reserve has not yet provided a timeline or forms for application, and has opened a period of comment until April 16, 2020, meaning the program may not be operational until May.

The Structure of the Main Street Program

The Main Street Program does not involve direct lending by the Federal Reserve to eligible businesses. Instead, the Federal Reserve will encourage banks to make loans to eligible borrowers and then purchase 95% of each of those loans. To do so, the Federal Reserve will lend to a special purpose vehicle (SPV), a legal entity that will be seeded by a $75 billion equity investment from Treasury. The SPV, in turn, will spend up to $600 billion in funds provided by the Federal Reserve to make the loan purchases. The Main Street Program will require the banks to retain 5% of each loan in order to make sure they maintain some "skin in the game." In other words, lenders will still be on the hook for a portion of the losses if the borrower subsequently defaults, thereby incentivizing them to properly underwrite the loan.

The Main Street Program will be broken into two components. Under the New Loan Facility, the SPV will purchase 95% of qualifying new loans issued on or after April 8, 2020. Under the Expanded Loan Facility, the SPV will purchase 95% of an additional portion of pre-existing loans (*i.e.*, an additional tranche). Thus, under the latter part of the program, which offers higher lending caps and lower fees than the New Loan Facility, borrowers can increase the size of their existing loans rather than starting from scratch.

The Main Street Program will continue purchasing loans until the earlier of it expending $600 billion or September 30, 2020, unless it is expanded or extended by the Federal Reserve and Treasury.

[1] Victoria Guida, *Mnuchin Hopes to Unveil 'Main Street' Lending Facility This Week*, Politico (Apr. 8, 2020), https://www.politico.com/news/2020/04/08/mnuchin-hopes-to-unveil-main-street-lending-facility-this-week-174858.

Terms of the Loans

The Federal Reserve has set general terms for the loans issued or expanded under the Main Street Program. They will be four-year adjustable rate loans, with all payments on both interest and principal deferred for one year, and borrowers will be allowed to prepay without penalty. The adjustable interest rate on the loans will be calculated using the Secured Overnight Financing Rate (SOFR) and then adding between 2.5 to 4 percentage points. SOFR currently stands at approximately 0.1 percent.

The minimum amount for each loan is $1 million, and the maximum will vary depending on whether it is a new or expanded loan:

- For new loans, the maximum loan size is the lesser of (i) $25 million or (ii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed four times the borrower's 2019 earnings before interest, taxes, depreciation and amortization (EBITDA). For example, if a borrower's outstanding and committed debt is $30 million and its 2019 EBITDA was $10 million, the maximum loan size would be $10 million ((4 x $10 million) - $30 million).

- For expanded loans, the maximum loan size for the expanded portion is the lesser of (i) $150 million, (ii) 30% of the borrower's existing outstanding and committed but undrawn debt, or (iii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed six times the borrower's EBITDA. For example, if a borrower's outstanding and committed debt is $200 million and its 2019 EBITDA was $50 million, the maximum loan size is $60 million (30% of $200 million debt) because that number is less than the $150 million indicated under (i) and the $100 million calculated under (iii) ((6 x $50 million) – $200 million).

The SPV and the lender will share risk on all loans *pari passu*, meaning they will have equal payment rights (*e.g.*, if a borrower made a $1 million payment, the SPV would receive $950,000 and the lender would receive $50,000). Moreover, any collateral securing a loan under the Expanded Loan Facility will secure the loan on a pro rata basis between the SPV and lender.

Borrowers must pay the lender either an origination or upsizing fee of 1% of the principal amount of the new or expanded loan. In addition, the New Loan Facility requires lenders to pay the SPV a facility fee of 1% of the principal amount of the SPV's loan participation, which the lender may pass on to the borrower.

Separately, under either program, the Federal Reserve will pay an annual fee of 0.25% of the principal amount of the Federal Reserve's stake in the loan in return for the lenders' servicing of the loan.

Borrowers

Eligible borrowers are businesses with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues. Unlike the SBA loans issued in connection with the PPP, the Main Street Program does *not* state that in calculating these caps a business must include the employees of its affiliates, although as noted above, the terms are not complete and the programs are still open for comment. Borrowers also must have been created or organized in the United States, or under the laws of the

United States, and have "significant operations"[2] in and a majority of their employees based in the United States. Finally, borrowers must not have participated in the Primary Market CCF (described below), and may participate in only one of the two Main Street facilities (New Loan Facility or Expanded Loan Facility), not both. There is no restriction, however, preventing smaller businesses who participated in the PPP from participating in the Main Street Program.

To receive loans under the Main Street Program, borrowers will have to agree to a series of restrictions related to each loan (discussed below). The CARES Act gave the Federal Reserve broad discretion to establish a Main Street program, but did include provisions that must apply to direct loan programs under the CARES Act unless the Treasury Secretary waives them. These provisions include rules restricting buybacks, dividends, and executive compensation, all of which are included in the Main Street Program. However, the Federal Reserve did not include several other restrictions that the CARES Act suggested could apply to a model lending program for "mid-sized businesses," including firmer restrictions on maintaining and restoring payroll, and against outsourcing jobs, among others.

Main Street borrowers must attest that they will abide by the following restrictions:

1. Exigent Circumstances/Reasonable Efforts to Maintain Payroll. A borrower must attest that it requires financing due to the exigent circumstances presented by COVID-19, and that it will make "reasonable efforts" to maintain payroll and employees during the term of the loan. The term sheets for the Main Street Program do not provide clarification of what "reasonable efforts" means, but we would expect further elucidation on this term after the comment period ends.

2. No Buybacks or Dividends. From the time the borrower receives the loan until one year after the loan is fully repaid, a borrower may not purchase its own stock or the stock of its parent company, except to the extent required under a contractual obligation predating the enactment of the CARES Act, or pay dividends or make other capital distributions of the borrower's common stock.

3. Executive Compensation. From the time the borrower receives the loan until one year after the loan is fully repaid, the borrower may not increase total compensation for any officer or employee whose total compensation exceeded $425,000 in 2019. The borrower may pay any officer or employee who earned more than $3 million in 2019 no more than $3 million plus 50% of the excess over $3 million that they earned in 2019.

4. No Golden Parachutes. For the same period, for the same set of officers and employees whose 2019 compensation exceeded $425,000, a borrower may not provide severance pay or other benefits upon termination of employment that exceed twice the maximum total compensation received by the officer or employee in 2019.

5. No Excessive Debts. A borrower must attest that the amount of the loan it is receiving, when added to its existing outstanding and committed debt, does not exceed four times its EBITDA (for new loans) or six times its EBITDA (for expanded loans).

[2] The Federal Reserve does not define "significant operations."

6. No Refinancing, Cancellation or Reduction. A borrower must commit that the proceeds of the loan will not be used to repay or refinance any pre-existing loans or lines of credit, and a borrower must further commit to refrain from repaying other debt of equal or lower priority, with the exception of mandatory principal payments, unless the borrower repays the Main Street Program loan in full. In addition, a borrower must certify that it will not cancel or reduce any outstanding lines of credit to the lender or any other lender. These restrictions are presumably aimed at prioritizing repayment to the Federal Reserve over other lenders, and to incentivize the borrower to use the funds to maintain its payroll and not simply refinance its already outstanding debts at more favorable terms.

7. Conflicts of Interest. A borrower must certify that neither the President, the Vice President, a head of an executive department, member of Congress, or the spouse, child, or son- or daughter-in-law of any of the foregoing holds an interest in the company of 20% or greater.

Lenders

Only certain financial institutions can participate as lenders—specifically, US-insured depository institutions, US bank holding companies, and US savings and loan holding companies. Unlike the PPP, non-bank lenders are not eligible.

Like borrowers, lenders will also be subject to certain restrictions. Specifically, lenders must represent that for each loan they sell to the facility, (1) they will not cancel or reduce any existing lines of credit outstanding to the borrower, and (2) the proceeds of the loan will not be used to repay or refinance pre-existing loans or lines of credit made by the lender to the borrower. These provisions were presumably included to prevent lenders from merely shifting to the Federal Reserve their credit risk exposure to the borrower. Lenders must also represent that they have no conflicts of interest (as discussed above for borrowers).

B. Corporate Bond and Syndicated Loan Market Support

In its April 9, 2020, release, the Federal Reserve also expanded on several previously established facilities, including two initially announced on March 23, 2020, which are designed to help large US businesses access the credit markets by supporting newly and previously issued corporate debt. The first, the Primary Market CCF, will set up an SPV to purchase corporate bonds and syndicated loans at the time of issuance. The second, the Secondary Market CCF, will be managed out of the same SPV and will purchase corporate bonds that have previously been issued on the secondary market, as well as corporate bond exchange-traded funds.

Notably, one of the more significant changes in the previously announced programs is that the April 9, 2020, term sheets for these facilities now permit the purchase of lower-rated debt of so-called “fallen angels”—*i.e.*, companies that were investment-grade rated as of March 22, 2020, but were subsequently downgraded to a non-investment grade, or “junk bond” rating—so long as the rating does not dip below BB-/ Ba3 at the time of purchase. The program is also permitted to invest in Exchange Traded Funds (“ETFs”) that are primarily exposed in non-investment grade high-yield debt.

BlackRock Financial Market Advisory (“BlackRock”) will manage the SPV for the Federal Reserve. Treasury will commit $75 billion in equity to the SPV for the two facilities, an increase from its initial $20 billion commitment on March 23, 2020. At launch, $50 billion will be allocated for the Primary Market CCF and $25 billion for the Secondary Market CCF. The Federal Reserve will lend to the SPV up to set amounts, as discussed below, increasing the potential size of the facilities to a potential maximum of up to $750 billion. Like many of the other facilities discussed in this alert, both facilities will cease purchasing assets by September 30, 2020, unless extended by the Federal Reserve and Treasury.

1. Primary Market Corporate Credit Facility

Eligible Assets

The Primary Market CCF may purchase corporate debt in the following ways:

1. As the Sole Investor in Corporate Bond Issuance. The Primary Market CCF may purchase corporate bonds as the sole investor in a bond issuance. These bonds must have a maturity of four years or less.

2. As a Participant in Syndicated Loan or Corporate Bond Issuance. The Primary Market CCF may also purchase a portion of a syndicated loan or corporate bond at the time of issuance. Again, these bonds or loans must have a maturity of four years or less. If the Primary Market CFF selects this option, it may not purchase more than 25% of each eligible loan or bond.

Eligible Issuers and Borrowers

The Primary Market CCF may purchase corporate debt only from businesses that meet the following requirements:

- US Business. The business must be a US business with significant operations in and a majority of its employees based in the United States.

- Ratings Requirements. The business that is issuing the debt (the issuer) must be rated as investment grade (at least BBB-/Baa3) as of March 22, 2020, by a major nationally recognized statistical rating organization (NRSRO).[3] If rated by multiple major NRSROs, the issuer must have been rated investment grade by two or more NRSROs as of March 22, 2020. If the issuer was subsequently downgraded to non-investment grade status, it still must be rated at least BB-/Ba3 at the time the Primary Market CCF makes a purchase. If rated by multiple major NRSROs, the issuer must be rated at least BB-/Ba3 by two or more NRSROs at the time the Primary Market CCF makes a purchase. In all cases, the Federal Reserve has indicated that it will not necessarily rely solely on the ratings issued by NRSROs; instead, the ratings are subject to further review by the Federal Reserve.

[3] In order for a debt security like a corporate bond to be sold to a wide group of investors, it generally receives a rating from a NRSRO like Moody's Investor Services, Standard & Poor's, and Fitch Ratings. NRSROs also rate syndicated loans. A NRSRO is not part of the federal government, but instead is a company that analyzes the security to determine the risk that investors owning the security may suffer a loss. Investors frequently consider credit ratings when making investment decisions.

- Other Support. The business cannot have otherwise received specific support pursuant to the CARES Act or any subsequent federal legislation.

- Conflicts of Interest. The business cannot be owned directly or indirectly by the President, senior executive branch officials, members of Congress, and certain of their immediate family members.

- Banks Not Permitted to Participate. The business cannot be an insured depository institution or depository institution holding company, as these terms are defined in the Dodd-Frank Act.

Limits

Businesses may approach the Primary Market CCF at any time prior to its expiration date to facilitate the issuance of new debt, provided that it meets the credit ratings discussed above and will not be downgraded below BB-/Ba3 as a result of the issuance of the new debt.

Issuers can also refinance outstanding debt at maturity through the Primary Market CCF. Issuers are permitted to apply to do so during the three-month period before the maturity date of the outstanding debt.

The maximum amount of outstanding bonds or loans of a business that borrows from the Primary Market CCF may not exceed 130% of the business's total outstanding bonds and loans on any single day between March 22, 2019, and March 22, 2020. In other words, the business must certify that the amount it seeks to sell to the facility does not exceed 130% of its high-water mark for outstanding bonds and loans over the year preceding March 22, 2020.

The maximum amount of assets that the Primary Market CCF and the Secondary Market CCF combined may purchase with respect to any single eligible business is also limited to 1.5% of the combined potential size of the Primary Market CCF and the Secondary Market CCF (as discussed below). For example, assuming a maximum potential cap on these facilities at $750 billion (as discussed in more detail below), the maximum exposure these facilities would be able to have to a single company would be $11.25 billion.

The Primary Market CCF will lever-up the $50 billion in equity provided by Treasury to invest between $350 billion and $500 billion in corporate debt. The facility may leverage Treasury's equity investment at 10 to one when acquiring investment-grade corporate debt, meaning that $1 of equity will support the acquisition of $10 in investment-grade debt. When acquiring non-investment grade corporate debt, however, the facility may leverage its equity at only seven to one, meaning that $1 of equity will support $7 of investment in non-investment grade debt. If the facility purchases only non-investment-grade debt as part of the Primary Market CCF, it could therefore acquire up to only $350 billion of corporate debt.

Pricing

For bonds where the Primary Market CCF is the sole investor, pricing will be issuer-specific, informed by market conditions, plus a 1% facility fee. If the Primary Market CCF is funding a syndicated loan or buying a part of a bond issuance, the Primary Market CCF must receive the same pricing as the other participants, plus a 1% facility fee on the Primary Market CCF's share of the loan or bond.

2. Secondary Market Corporate Credit Facility

Unlike the Primary Market CCF, which will work directly with companies to purchase corporate debt at the time of issuance, the Secondary Market CCF will purchase on the secondary market corporate debt and shares in ETFs that hold such debt. As noted above, BlackRock will manage the Secondary Market CCF. The terms of BlackRock's mandate specify that BlackRock will work with the Federal Reserve Bank of New York (FRBNY) to develop specific and auditable guidelines for the implementation of the Secondary Market CCF, including selection criteria, portfolio construction and diversification rules, trading strategies, and execution protocols.[4]

At this time, the following guidelines have been agreed upon:

1. Individual Corporate Bonds. The Secondary Market CCF may purchase corporate bonds on the secondary market with a remaining maturity of five years or less. The Secondary Market CCF may only purchase individual corporate bonds for businesses that meet the issuer eligibility requirements described above for the Primary Market CCF. In other words, if the issuer eligibility requirements would have prohibited the Primary Market CCF from purchasing an individual corporate bond at the time of issuance, then the Secondary Market CCF cannot buy that bond on the secondary market. The Secondary Market CCF will purchase eligible bonds only at fair market value. There are also caps on the amount of corporate bonds that the Secondary Market CCF may purchase on the secondary market for a particular issuer, which is set at the lesser of (1) 10% of the maximum aggregate amount outstanding under the issuer's bonds on any day between March 22, 2019, and March 22, 2020, and (2) 1.5% of the combined maximum potential size of the Primary Market CCF and the Secondary Market CCF, as discussed above.

2. Exchange-Traded Funds. The Secondary Market CCF may purchase shares in US-listed ETFs whose investment objective is to "provide broad exposure to the market for US corporate bonds." The term sheet for the program specifies that the "preponderance" of ETF holdings will be of ETFs whose primary stated investment objective is exposure to US investment-grade corporate bonds, and the remainder will be in ETFs whose primary investment objective is exposure to non-investment grade US corporate bonds, also commonly referred to as "high-yield" or "junk." The Secondary Market CCF may not hold more than 20% of a particular ETF's outstanding shares. The Secondary Market CCF will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio.

The Secondary Market CCF may only purchase securities from "eligible sellers," who are defined in the term sheet as US businesses with significant US operations and a majority of US-based employees. The selling institution also must satisfy the conflicts-of-interest requirements of Section 4019 of the CARES Act.

The Secondary Market CCF will lever-up the $25 billion in equity provided by Treasury. The facility will leverage equity at 10 to one when acquiring investment-grade corporate bonds and ETFs whose primary investment objective is exposure to US investment-grade corporate bonds. If the facility purchases only these instruments, it could acquire up to $250 billion of them. The facility will leverage

[4] The initial understanding of BlackRock and the FRNBY posted on the FRBNY's website describes certain aspects of BlackRock's mandate; however, the full terms of BlackRock's engagement are pending completion of an Investment Management Agreement for the facility.

equity at seven to one when acquiring non-investment grade corporate bonds, meaning that $1 of equity will support $7 of investment in non-investment grade corporate bonds, or up to $175 billion. The facility will leverage equity at a range between three to one and seven to one when acquiring any other type of eligible asset. The Federal Reserve will presumably provide more guidance on this provision in the future.

C. Municipal Liquidity Facility

The CARES Act directed the Federal Reserve to seek to implement a program to provide liquidity to states and municipalities.[5] In response, the Federal Reserve announced the Municipal Liquidity Facility (the Municipal Facility), an unprecedented program that will provide up to $500 billion in up to two-year loans to states and municipalities that are experiencing financial distress as a result of COVID-19. To put this level of support into perspective, the amount of all municipal securities issued in 2019, according to several estimates, was approximately $422 billion.[6]

This program will bring the Federal Reserve into uncharted waters as it has never before provided such direct support to states and municipalities.[7] To counter the 2008 financial crisis, the Federal Reserve purchased debt issued by a variety of borrowers, but did not purchase municipal debt.

The program has not yet launched, but the Federal Reserve published a term sheet on April 9, 2020, seeking public comment.[8] Thus, the terms of the program may be adjusted by the Federal Reserve and the Treasury Secretary before it is formally launched.

Basis for the Program

State and local governments are experiencing a two-pronged shortage of funds as a consequence of COVID-19. They are facing increased spending burdens due to pandemic healthcare and related public-services costs, and a material reduction in revenue because tax payments and other revenue based on economic activity have fallen sharply. In addition, states and municipalities have delayed tax filing and payment deadlines. Receiving tax payments several months after they are usually paid contributes to the risk that local governments will not have the cash on hand to meet their obligations as they come due, because unlike the federal government, states and municipalities do not have nearly unlimited demand for their debt, cannot print money to pay their obligations, and as a general matter, are required to pass, and adhere to, a balanced budget each year.

Overview of the Program

In essence, the Municipal Facility will provide bridge loans with maturities as long as two years to states and certain municipalities to address the immediate and short-term financial impact of COVID-

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[5] Section 4003(c)(3)(E) of the CARES Act.
[6] *An Opportunity for Muni Investors: Forward-Delivery Bonds*, Wells Fargo Asset Magmt., 3 (2020), https://www.wellsfargoassetmanagement.com/assets/public/pdf/insights/investing/an-opportunity-for-muni-investors-forward-delivery-bond.pdf; *2019's Municipal Bond Market Eclipsed the $400B Mark*, Yahoo! Fin. (2020), https://finance.yahoo.com/news/2019s-municipal-bond-market-eclipsed-130000007.html; *see also* https://www.nuveen.com/en-us/thinking/municipal-bond-investing/municipal-market-recap-and-outlook.
[7] Nick Timiraos, *Fed Expands Corporate-Debt Backstops, Unveils New Programs to Aid States, Cities and Small Businesses*, Wall St. J. (Apr. 9, 2020), https://www.wsj.com/articles/fed-announces-new-facilities-to-support-2-3-trillion-in-lending-11586435450.
[8] Although the Federal Reserve's press release does not specify a comment deadline date specific to the Municipal Facility, it specified a deadline of April 16 for the Main Street Program, and the comment page allows for comments on the Municipal Facility.

19. The Municipal Facility will finance an SPV that will purchase up to $500 billion of notes issued by states and certain local governments.

The Municipal Facility will purchase notes issued by (collectively, the State and Qualifying Municipalities):

- States and Washington, D.C. (but not territories, such as Puerto Rico);
- Cities with more than 1 million residents; and
- Counties with more than 2 million residents.

States and Qualifying Municipalities will have a great deal of flexibility in how they spend the proceeds of the notes issued. The funds may be used:

- To manage the cash-flow impact of income-tax deferrals resulting from an extension of the income-tax filing deadline;
- To address the impact of lower tax revenue or increases in expenses due to COVID-19; and
- To pay interest and principal on outstanding bonds.

In addition, States and Qualifying Municipalities may use the proceeds to purchase municipal bonds or otherwise provide financial support to its political subdivisions and instrumentalities that, in turn, may use the funds for the purposes described above. For example, Massachusetts provides 49% of the funding for Boston's transit system, which is operated by the Massachusetts Bay Transportation Authority (the MBTA).[9] Massachusetts could either use proceeds from the Municipal Facility to directly fund the MBTA, or to purchase new debt issued by the MBTA.

The maximum amount that any State or Qualifying Municipality can borrow under the Municipal Facility is equal to 20% of its general revenue and utility revenue in FY2017. However, a state may request an exemption to exceed this limit to purchase notes from, or otherwise assist, political subdivisions and instrumentalities that are not eligible borrowers because they do not meet the population thresholds described above. This allows states, especially those experiencing significant financial constraints due to COVID-19, to obtain additional liquidity to fund municipalities and counties that will not be receiving direct assistance under this program.

Although the Federal Reserve will be buying only newly issued debt, the Municipal Facility can fairly be viewed as providing a back-stop for both new and already issued municipal bonds over the next two years because proceeds from the new facility can be used to pay interest and principal on those obligations. The secondary municipal bond market (*i.e.*, trading in bonds that have already been issued) has experienced significant selling pressure in response to the effects of COVID-19 on state and local governments' finances, leading to a market-wide liquidity shortfall and significant volatility.[10]

[9] Emily Badger, *Transit Has Been Battered by Coronavirus. What's Ahead May Be Worse*, N.Y. Times (Apr. 9, 2020), https://www.nytimes.com/2020/04/09/upshot/transit-battered-by-coronavirus.html.

[10] Heather Gillers & Gunjan Banerji, *How the Muni Market Became the Epicenter of the Liquidity Crisis*, Wall St. J. (Apr. 2, 2020), https://www.wsj.com/articles/how-the-muni-market-became-the-epicenter-of-the-liquidity-crisis-11585823404.

As States and Qualifying Municipalities can use the proceeds of the newly issued notes to make payments on their preexisting debt, the Municipal Facility provides the municipal bond market with an additional level of assurance that these borrowers will have sufficient liquidity to satisfy their obligations during the next two years.

The Municipal Facility allows the Federal Reserve to buy the types of notes that are used by municipalities to generate liquidity in periods when they are waiting for tax revenue or the proceeds of a bond issuance. These bridge financing instruments are commonly called tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), and bond anticipation notes (BANs).[11] The notes that the SPV will purchase can be structured as TANs, TRANs, BANs, or what the Federal Reserve has described as "similar short-term notes." The details of how a note's interest rate will be determined have not yet been announced, but the Federal Reserve has provided general guidance that the rate will be based on the applicable issuer's credit rating at the time of the note purchase. The SPV will charge an origination fee of 0.10%, which the State or Qualified Municipality can pay out of the proceeds of the note purchase. States and Qualifying Municipalities can repay borrowings at any time without any prepayment penalty.

Treasury, using funds appropriated to the Exchange Stabilization Fund under section 4027 of the CARES Act, will make an initial $35 billion equity investment in the SPV. Unless the Federal Reserve and Treasury extend the term of the Municipal Facility, the SPV will stop purchasing notes on September 30, 2020.

D. Oversight and Transparency

Participants in any of the programs that draw on CARES Act funding—*i.e.*, the Main Street Program, the Primary and Secondary Market Corporate Credit Facilities, and the Municipal Lending Facility—should be aware that participating in these programs may subject them to various forms of reporting and oversight set forth in the CARES Act. Unless further guidance from the Federal Reserve indicates otherwise, participants in these programs should assume that their participation will become public, and that they could become the subject of congressional and executive branch oversight and investigation. The CARES Act sets forth the following mechanisms for oversight and transparency (as detailed further in our prior alert):

- The Office of the Special Inspector General for Pandemic Recovery (SIGPR). The CARES Act creates an office of a Special Inspector General responsible for auditing and investigating the loans, loan guarantees and investments made to businesses by the Treasury Secretary under the Act. The SIGPR has law enforcement authority and may subpoena documents related to its oversight of Title IV funds distributed under the Act. The Act does not expressly state that the SIGPR's authority reaches participants in Federal Reserve facilities like the Main Street Program. However, under the similarly worded Emergency Economic Stabilization Act of 2008 ("EESA"), the Special Inspector General applied oversight over similar Federal Reserve facilities that were seeded with Treasury equity investments.

[11] Term Sheet at 1; James Chen, *Revenue Anticipation Note (RAN)*, Investopedia (Apr. 8, 2019), https://www.investopedia.com/terms/r/ran.asp; James Chen, *Bond Anticipation Note (BAN)*, Investopedia (Apr. 4, 2019), https://www.investopedia.com/terms/b/bondanticipationnote.asp; James Chen, *Tax Anticipation Note (TAN)*, Investopedia (Apr. 8, 2019), https://www.investopedia.com/terms/t/tan.asp.

- Federal Reserve Reporting. The CARES Act requires the Federal Reserve to report to Congress, pursuant to Section 13(3), regarding the assistance it provides under programs supported by the CARES Act. Specifically, the Federal Reserve must report the following information to Congress within seven days of providing financial assistance: Its justification for providing the assistance, the identity of the recipients, and the date, amount, form, and material terms of the assistance. Section 13(3) also requires the Federal Reserve to report to Congress monthly on its outstanding loans, including the value of collateral, amount of interest and fees received in return, and the expected cost to taxpayers. The CARES Act further requires the Federal Reserve to publish these reports on its website soon after providing them to Congress. Although in certain circumstances the Federal Reserve can generally seek to keep the identities of program participants secret, until further guidance is issued that states otherwise, borrowers and lenders alike should assume that this information will be disclosed under this provision.

- Congressional Oversight. Title IV of the CARES Act also creates a five-member commission responsible for oversight of the loan relief under Title IV. Similar to an oversight panel created in connection with the 2008 economic crisis, the congressional oversight commission is likely to hold robust hearings and issue commentary on the effectiveness of the Federal Reserve programs created pursuant to the CARES Act and on loan recipients. The Speaker of the House also recently announced the formation of a select committee to oversee the use of the funding for all of Congress'\ COVID-19-related legislation. Other Senate and House committees may also exercise oversight pursuant to their traditional powers.

- Pandemic Response Accountability Committee. Finally, the CARES Act creates a new Pandemic Response Accountability Committee (PRAC) to oversee the entire governmental response to COVID-19, including all funds distributed pursuant to that response. The PRAC consists of at least nine Inspectors General and will have full-time staff devoted to overseeing, auditing, and investigating any fraud, waste, abuse, or mismanagement within the government's response.

II. ADDITIONAL FEDERAL RESERVE PROGRAMS

The Federal Reserve has also expanded and initiated additional programs aimed at supporting the economy.

A. Term Asset-Backed Securities Loan Facility (TALF)

TALF provides loans to borrowers who pledge certain types of highly rated asset-backed securities (ABS). ABS are types of bonds that are secured by pools of assets like mortgage loans, business loans, or consumer loans, and whose payments to investors come from the principal and interest payments that borrowers make on those underlying loans. To create ABS, ABS issuers purchase the underlying loans either directly from lenders or on the secondary market.

Under the TALF, the Federal Reserve will commit to lend to a SPV. The TALF will make up to $100 billion of loans available, seeded by a $10 billion Treasury equity investment in the SPV that predated the CARES Act. A borrower can pledge eligible ABS as collateral for a three-year loan from the SPV on a non-recourse basis (which means that the borrower can always stop paying the loan and surrender the securities to the SPV). The stated goal of the program is to ensure the free flowing of credit for households and small businesses during the financial crisis by spurring demand for ABS as a financing mechanism. It will do this by creating steady demand for eligible ABS, which in turn will create demand for the loans that underlie them. Such demand will mean that lenders can profitably sell those loans to the issuer of the ABS for cash that lenders can then use to make more loans.

The TALF Reboot

The Federal Reserve first created the TALF in 2008 in response to the 2008 financial crisis. The 2008 TALF, which was backed by funds from the Troubled Asset Relief Program, provided $71.1 billion in loans which, according to the Federal Reserve, supported the making of three million automobile loans, one million student loans, 900,000 loans to small businesses, 150,000 other business loans, and millions of credit card loans. As the 2008 crisis subsided, the program was gradually wound down, with the last loan paid in full in 2014.

On March 23, 2020, the Federal Reserve re-established the TALF. The 2020 TALF will make up to $100 billion of loans available. The terms of the TALF that the Federal Reserve announced on March 23 were similar to the program from 2008, but included a narrower range of eligible collateral compared to its predecessor, and a simplified interest rate structure.

On April 9, 2020, however, the Federal Reserve announced changes to the TALF. Importantly, it broadened the range of assets considered eligible collateral to include riskier assets, such as certain CMBS and CLOs.

Eligible Borrowers

Only US companies may participate in the TALF as a borrower. That means the business must be created or organized in the US or under US law, with significant operations in and a majority of its employees based in the United States

Borrowers must also maintain an account relationship with a primary dealer (*i.e.* a bank or securities broker-dealer that trades in U-S Government securities with the FRBNY for the purpose of carrying out open-market operations).

Eligible Collateral

To obtain a TALF loan, the collateral securing the loan must be ABS and must have the highest-possible credit rating (AAA). In addition, the assets underlying the ABS must be one of the following:

- Automobile loans and leases;
- Student loans;
- Credit card receivables (both consumer and corporate);
- Equipment loans and leases;
- Floorplan loans;
- Insurance premium finance loans;
- Certain small business loans guaranteed by the SBA;
- Leveraged loans; or

- Commercial real estate mortgages.

With the exception of CMBS, eligible ABS must be issued on or after March 23, 2020. CMBS, however, are eligible only if they were issued prior to March 23, 2020.

All or substantially all of the loans underlying the ABS must have been originated by a US company, and the issuer of the ABS must be a US company. For CMBS, the underlying mortgages must be for properties located in the US or a US territory.

The TALF term sheet contains additional restrictions on the types of eligible collateral, including limitations on the types of eligible CLOs and CMBS, as indicated in the footnote below.[12] The Federal Reserve has indicated that it may add other types of eligible collateral in the future.

Loan Terms

The amount of each TALF loan is equal to the value of the ABS used as collateral, minus a standardized haircut based on the type of ABS offered. The Federal Reserve includes haircuts to incentivize borrowers under non-recourse loans to conduct sufficient due diligence when issuing or purchasing ABS to pledge as collateral for TALF loans, because it represents the amount of risk the borrower will continue to maintain if the ABS suffers losses. For example, if the pledged ABS declines in value, the borrower will suffer those losses first, up to the amount of the haircut. Once the losses exceed the haircut, the borrower can then surrender the collateral to the SPV and have no further obligations on the loan, leaving those additional losses with the SPV. Haircuts are often referred to as forcing the borrower to maintain “skin in the game,” and a simplified example is provided in the footnote below.[13]

The Federal Reserve set the haircut rates consistent with the values it set during the 2008 TALF. The haircuts vary based on the characteristics of the underlying loans, such as underlying credit exposure, average life, and historical volatility. ABS that the Federal Reserve views as riskier, such as CMBS and CLOs, receive a larger haircut. For example, certain CMBS may require a 17% haircut, and certain CLOs max out at 22%. Other types of ABS are viewed as less risky and have substantially lower haircuts, such as 5% for certain short-term equipment leases. The TALF term sheet contains the full haircut schedule.

The program will assess an administrative fee equal to 0.10% of the loan amount. Loans made under the TALF will be pre-payable in whole or in part at the option of the borrower without penalty. No new credit extensions will be made after September 30, 2020, in the absence of an extension by the Federal Reserve and Treasury. The Federal Reserve reserves the right to adjust the program’s terms

[12] Among other terms, eligible collateral must be US dollar denominated cash (rather than synthetic); the collateral cannot include credit exposures that are themselves ABS; and the collateral must not be ABS with interest payments that step up or step down to predetermined levels on specific dates. CLOs must be static, meaning that the underlying loans cannot be swapped out for other loans. In addition, single-asset single-borrower CMBS and commercial real estate CLOs are not eligible collateral.

[13] Take, as a simplified example, a TALF borrower that pledges a CLO and borrows against its face value of $100. Assuming a 20% haircut, the borrower pledges the security as collateral and gets a loan for $80. If the value of the CLO drops to $75, the borrower may decide to surrender the collateral to the SPV rather than to continug paying the loan balance. The borrower would then no longer have any obligation on the loan, but would have lost $20 (the $100 face value of the security minus the $80 loan it received). The SPV will have effectively purchased the security for $80 that is now trading for $75, but if it holds onto the security, it may rebound in value and the SPV would benefit from any interest and principal payments that the security continues to generate.

and conditions, including the "size of [the] program, pricing, loan maturity, collateral haircuts, and asset and borrower eligibility requirements."

As noted above, the loan is non-recourse to the borrower, meaning that if the borrower chooses not to repay the loan, the borrower will have to surrender the ABS used as collateral, but will not be on the hook for the remaining balance of the loan, so long as the other requirements of the TALF are met.

The interest rate for each loan depends on the type of underlying credit exposure and is tied to certain benchmarks, such as the 30-day average secured overnight financing rate (currently approximately 0.12%), the top of the federal funds target range (currently 0.25%), or the 3-year Federal Funds Overnight Index Swap (OIS) rate. The following table summarizes what the Federal Reserve set forth in the TALF term sheet:

Underlying Credit Exposure	Interest Rate
CLOs	1.50% over the 30-day average secured overnight financing rate
SBA Pool Certificates (Section 7(a) loans)	0.75% over the top of the federal funds target range
SBA Development Company Participation Certificates (504 loans)	0.75% over the 3-year federal funds OIS rate
Other eligible ABS with underlying credit exposures without a government guarantee	1.25% over the 2-year OIS rate for securities with a weighted average life less than two years, or 1.25% over the 3-year OIS rate for securities with a weighted average life of two or more years
Other eligible ABS	To be set forth in detailed terms and conditions

Notwithstanding the TALF's non-CARES Act funding, the Federal Reserve will require that eligible borrowers and issuers of eligible collateral be subject to the conflicts of interest requirements of Section 4019 of the CARES Act. As discussed in detail earlier, this provision prohibits businesses directly or indirectly owned by the President, senior executive branch officials, members of Congress, and certain of their immediate family members, from receiving relief.

B. Paycheck Protection Program Lending Facility

The CARES Act's chief small business lending program, the Paycheck Protection Program (PPP), was launched on April 3, 2020.[14] It offers small businesses fully forgivable loans to pay for ongoing business expenses like payroll, rent, and utilities. Demand for PPP loans was immediate and overwhelming. Lending institutions, however, have been slow to meet this demand. Even with last-minute changes to the program that were designed to make it more attractive to lenders, which we described in detail in a previous alert, some lenders have expressed concern with keeping up with

[14] For a comprehensive look at Title I of the CARES Act, which established the PPP, see our prior alert.

demand, and others have either limited the number of applications that they will take or indicated they would sit out of the program altogether unless further changes were made.[15]

In apparent response to those concerns, the Federal Reserve announced the PPP Lending Facility (PPPLF), which is now open. The PPPLF allows banks making PPP loans to borrow directly from the regional Federal Reserve banks on a non-recourse basis using only those PPP loans, taken at face value, as collateral. Because this facility enables borrowing directly from Federal Reserve banks, rather than through an SPV like the other facilities discussed in this alert, it is not seeded with Treasury funds. Such seeding is unnecessary because the loans funded through this facility—PPP loans—are already 100% guaranteed from loss by the SBA under Title I of the CARES Act.

As noted above, because the PPPLF loans are non-recourse, the bank is free to surrender the collateral (the PPP loan it initiated) at any time and have no further payment due. By providing the banks with cash at favorable terms, the facility will enable banks to take the proceeds of the loans and use them to originate more PPP loans. It will also give banks relief from certain capital requirements that were threatening their ability to meet the seemingly unquenchable demand by small businesses for PPP loans, as discussed below.[16] The PPPLF will continue to make loans until September 30, 2020, unless extended by the Federal Reserve and Treasury.

Eligibility

All depository institutions (*e.g.*, banks and credit unions) that originate PPP loans are eligible to borrow from this facility. Other types of PPP lenders are not currently eligible, but the Federal Reserve plans to expand the program to "other lenders that originate PPP loans in the near future." This will presumably include fintech and other nonbank lenders as these non-traditional lenders ramp up their ability to comply with heightened requirements and other conditions to become participating lenders.[17] Indeed, the PPPLF will be vital for these non-bank lenders who, unlike many banks, traditionally sell the loans they initiate and do not keep loans on their books. The PPPLF will assure these lenders that if they participate in the PPP, they will be able to quickly replenish their cash coffers to make more loans.

Terms

Eligible PPP lenders may seek a loan from the PPPLF equal to the principal amount of the PPP loans that they pledge as collateral. PPPLF loans bear interest at a rate of 0.35% and have no fees. They are also made without recourse, which as noted above, means that a borrower is not liable and its assets (other than the PPP loans pledged as collateral) cannot be reached in the event of default as long as the borrower has not breached the terms of the lending facility loan agreement by, for example, misrepresenting its eligibility for a loan.

[15] Alexandra Hutzler, *The New Small Business Loan Program Got Off to a Rocky Start—Here Are the Big Problems Companies and Banks are Facing*, Newsweek (April 9, 2020), https://www.newsweek.com/ new-small-business-loan-program-off-rocky-start-biggest-problems-facing-banks-businesses-1496930.
[16] Kate Davidson & Nick Timiraos, *Feds Preparing to Finance New Small-Business Payroll Loans*, Wall St. J. (April 6, 2020), https://www.wsj.com/articles/fed-preparing-to-purchase-new-small-business-payroll-loans-11586194588.
[17] Section 1102(a)(1)(F)(iii) of the CARES Act permits additional lenders to participate in the PPP. The interim final rule implementing the PPP sets out the terms and conditions applicable to "additional lenders." *See* US Small Bus. Admin., Interim Final Rule: Business Loan Program Temporary Changes; Paycheck Protection Program (Apr. 2, 2020), https://www.sba.gov/sites/default/files/2020-04/PPP--IFRN%2020 FINAL_0.pdf.

Credit extended to PPP lenders under this facility will have the same maturity as the underlying PPP loans pledged as collateral. The date the money is due can be accelerated in two scenarios: (1) the loan goes into default and the SBA purchases the loan pursuant to its guarantee; and (2) when the participating bank receives any loan forgiveness reimbursement from the SBA, but the acceleration is limited to the extent of the reimbursement received. The borrowing bank must repay the amounts accelerated when these events occur.

Regulatory Capital Treatment

On the same day that the PPPLF was announced, the federal banking regulatory agencies issued an interim rule[18] that will ensure that participating in the PPPLF will not negatively impact the banks' regulatory capital requirements.

C. Commercial Paper

In addition to the several new programs announced on April 9, 2020, the Federal Reserve used its Section 13(3) authority on March 17, 2020, to resurrect the Commercial Paper Funding Facility (CPFF).[19] The CPFF was first established in 2008, allowing businesses to sell commercial paper to the Federal Reserve as the private market dried up amidst the broader financial crisis. The current crisis once again puts pressure on the market for commercial paper, pushing the Federal Reserve to inject billions of dollars of liquidity to lower interest rates and help businesses fund short-term operations.

The CPFF will operate through a SPV managed by Pacific Investment Management Company ("PIMCO"), with State Street Bank and Trust Company serving as custodian and administrator. The CPFF will purchase eligible three-month unsecured commercial paper and asset-backed commercial paper (ABCP) through the FRBNY's primary dealers. Before the enactment of the CARES Act, Treasury provided $10 billion from the Exchange Stabilization Fund as an equity investment that can be used to cover initial losses, meaning none of the additional conditions described in Title IV.A of the CARES Act apply to businesses receiving relief through the CPFF. At this time, the Federal Reserve has placed no limit on the amount of financing it will provide through this facility.

Eligibility

At its establishment, the CPFF was reserved for US dollar-denominated commercial paper from issuers that held the top credit rating of A-1/P-1/F-1.[20] In its April 9, 2020 release, the Federal Reserve expanded the facility to allow issuers rated A-1/P-1/F-1 on March 17, 2020, but that were subsequently downgraded to A-2/P-2/F-2. Issuers that maintain the top rating will be permitted to roll over their commercial paper with the CPFF so long as they otherwise meet the eligibility requirements, while those who were downgraded may only engage in a one-time sale to the facility. However, issuers rated A-2/P-2/F-2 may receive expanded access to the facility in the future, as the Federal Reserve comes

[18] Regulatory Capital Rule: Paycheck Protection Program Lending Facility and Paycheck Protection Program Loans, 85 F.R. 20,387 (April 13, 2020) (to be codified at 12 C.F.R. pts. 3, 217, 324).
[19] Commercial paper is short-term unsecured debt issued by companies to assist them in managing day-to-day liquidity needs.
[20] If an issuer is rated by multiple major rating agencies, it must receive the required rating by at least two major rating agencies. Currently the CPFF accepts ratings from Moody's Investor Service Inc., S&P Global Ratings, and Fitch Ratings, Inc.

under pressure to broaden the CPFF's eligibility requirements, including from the Federal Energy Regulatory Commission and some members of Congress.[21]

Participants in the facility must be US issuers,[22] which includes, for purposes of the CPFF, businesses organized under the laws of the United States (including businesses with a foreign parent) and municipalities. If an issuer intends to sell ABCP to the CPFF, the issuer must not have gone more than three consecutive months without issuing ABCP during the year ending March 16, 2020.

Limits

Though there is no stated maximum size to the CPFF, there are limits on how much commercial paper each issuer can sell to the facility. For issuers that have maintained their credit rating at A-1/P-1/F-1, the cap will ensure that a participant can have no more US dollar-denominated commercial paper outstanding than it did on any day in the year ending March 16, 2020 (the "Limit"). For example, if an issuer hit a high-water mark of $2 billion of outstanding commercial paper during that period, and currently has $1 billion outstanding, it could sell no more than an additional $1 billion in commercial paper to the CPFF. For issuers that were downgraded to no lower than A-2/P-2/F-2 subsequent to March 17, 2020, the Limit is the amount of their outstanding US dollar-denominated commercial paper on the day before the date they were downgraded.

Pricing

The CPFF will buy commercial paper at a discount to its face value by calculating an imputed interest rate. Issuers rated A-1/P-1/F-1 will be priced at the then-current three-month OIS rate (a standard measure of borrowing costs in money markets) plus 1.10%. Issuers downgraded to A-2/P-2/F-2 after March 17, 2020, will be priced at the then-current three-month OIS rate plus 2.0%. The effective OIS rate for each business day will be posted on the FRBNY's website by 8:00 am Eastern Time.[23]

Application

The CPFF will officially launch on April 14, 2020. Participants will need to complete a set of registration materials, which includes financial information about the participant and other documents, at least two business days in advance of when they intend to sell assets to the CPFF. Participants are required to pay an entry fee to the facility equal to 0.1% of their Limit, as defined above.

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[21] Letter from Federal Energy Regulatory Commission and National Association of Regulatory Utility to The Honorable Jerome Powell (Apr. 7, 2020), https://www.ferc.gov/media/news-releases/2020/2020-2/Letter-to-Fed-Reserve.pdf; Letter from Representative Frank D. Lucas, et al. to The Honorable Jerome Powell (Apr. 2, 2020), https://lucas.house.gov/press-release/lucas-urges-federal-reserve-extend-commercial-paper-funding-facility-cp-issuers.

[22] For issuers of corporate unsecured commercial paper, the "issuer" is defined as the legal entity issuing commercial paper. For issuers of asset-backed commercial paper, the "issuer" is defined as the special-purpose entity issuing commercial paper. For issuers of municipal commercial paper, the "issuer" is defined as the municipal entity issuing the commercial paper for each commercial paper ticker or CUSIP associated with its commercial paper programs.

[23] Investment Management Agreement at 3 (Apr. 6, 2020), https://www.newyorkfed.org/medialibrary/media/markets/CPFF_Investment_Management_Agreement.pdf.

Termination

The CPFF will cease purchasing assets on March 17, 2021, unless extended by the Federal Reserve and Treasury.

D. Oversight

These programs will be subject to oversight under the Federal Reserve's Section 13(3) authority. Specifically, under Section 13(3), the Federal Reserve will make the same reports as detailed above concerning CARES Act programs. However, unlike the CARES Act reporting to Congress, which will be published publicly, Section 13(3) on its own does not require public posting of the information reported, and also permits the Federal Reserve to seek confidential treatment of reported information and thereby limit disclosure to only the chairs of relevant congressional committees. However, as above, given the emphasis on transparency in the government's COVID-19 response, and the Federal Reserve's note in its CPFF FAQs that it may disclose this information, participants in these programs should assume there will be disclosure.

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