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Client Alert
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Federal Reserve releases an expanded set of Frequently Asked Questions regarding the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility

On May 4, 2020, the Federal Reserve released an expanded set of Frequently Asked Questions (**FAQs**) regarding the Primary Market Corporate Credit Facility (**PMCCF**) and the Secondary Market Corporate Credit Facility (**SMCCF**).[1]

The FAQs indicate that the SMCCF is expected to begin purchasing eligible ETFs in early May. Soon thereafter, the PMCCF is expected to become operational and the SMCCF is expected to begin purchasing eligible corporate bonds. The FAQs indicate that, to start, the PMCCF will focus on purchasing bonds at issuance.

Each of these facilities will operate through a special purpose vehicle (**SPV**) to be established by the Federal Reserve.

The FAQs now include details that had not been included in the term sheets for the PMCCF and the SMCCF published on April 9, 2020.[2] The following is a list of certain new information contained in the FAQs:

1. *US nexus of Eligible Issuers and Eligible Sellers.* The term sheets state that, in order to take advantage of the facilities, whether as an Eligible Issuer under the PMCCF and the SMCCF, or as an Eligible Seller under the SMCCF, a company must be (i) a business that is created or organized in the US or under the laws of the US and (ii) with significant operations in and a majority of its employees based in the US.

   The FAQs provide clarification on what it means for a business to have significant operations in and a majority of its employees based in the

[1] FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility. A prior version of the FAQs had been published on April 17, 2020.
[2] See PMCCF Term Sheet and SMCCF Term Sheet.

US. The FAQs provide two answers, one for an entity that is a subsidiary whose sole purpose is to issue debt (a **Finance Subsidiary**), and the other for all other entities.

If the business is not a Finance Subsidiary, the entity, on a consolidated basis (i.e., together with its consolidated subsidiaries), must have significant operations in and a majority of its employees based in the US. Under this test, in evaluating the entity, the Federal Reserve would not consider any parent company or sister affiliate.

If the entity is a Finance Subsidiary, any corporate affiliate of the entity to which 95% or more of the proceeds from the syndicated loan or corporate bond purchase are transferred for use in its operations (defined in the FAQs as the **primary corporate beneficiary**) must have significant operations in and a majority of its employees based in the US on a consolidated basis. If there is no primary corporate beneficiary, the Federal Reserve requires that corporate affiliates that, in each case, have significant operations in and a majority of their employees based in the US on a consolidated basis must receive, in the aggregate, 95% or more of the proceeds from the syndicated loan or corporate bond purchase.

2. *Significant operations in the US.* The FAQs provide an example of circumstances where a business would be deemed to have “significant operations” in the US, but do not provide a definitive statement of what the phrase means. Here is the example provided:

   An Eligible Issuer or Eligible Seller with greater than 50% of its consolidated assets in, annual consolidated net income generated in, annual consolidated net operating revenues generated in, or annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) generated in the US as reflected in its most recent audited financial statements.

3. *US subsidiaries of non-US parents.* As noted above, in order to be an Eligible Issuer or an Eligible Seller under the PMCCF and the SMCCF, a business must be created or organized under the laws of the US. There have been questions as to whether US subsidiaries of non-US parent entities may obtain financing under these programs.

   The FAQs state that an Eligible Issuer may be a subsidiary of a non-US company, provided that (i) the Eligible Issuer is itself created or organized in the US or under the laws of the US and (ii) the Eligible Issuer on a consolidated basis has significant operations in and a majority of its employees based in the US. Under the PMCCF, an Eligible Issuer that is a subsidiary of a foreign company must use the proceeds derived from participation in the PMCCF only for the benefit of the Eligible Issuer, its consolidated US subsidiaries and other affiliates of the Eligible Issuer that are US businesses, and not for the benefit of its foreign affiliates.

The FAQs do not address generally whether a US subsidiary of a non-US parent may be an Eligible Seller under the SMCCF, although they do state that a US subsidiary or US branch or agency of a foreign bank would be considered to be created or organized in the US or under the laws of the US and would satisfy this requirement, so long as it satisfied all of the other criteria specified in the SMCCF term sheet to qualify as an Eligible Seller thereunder.

4. *Level of corporate structure at which tests applied.* The term sheets for the PMCCF and the SMCCF impose certain limitations on an issuer. These limits include (i) a cap under the PMCCF on the maximum amount of outstanding bonds or loans of an Eligible Issuer of 130% of the issuer’s maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020, (ii) a purchase limit of 1.5% of maximum combined size of the PMCCF and the SMCCF and (iii) a cap on the maximum amount of bonds of an issuer that may be purchased under the SMCCF of 10% of the issuer’s maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020.

   The FAQs make clear that per-entity limits are calculated at the consolidated top-tier parent level and not at the issuer level (unless the issuer is the top-tier parent).

5. *Issuer debt limit under the PMCCF*. For purposes of calculating an issuer’s maximum outstanding bonds and loans under the PMCCF, the FAQs state that this includes current and non-current portions of corporate bonds and loans, including drawn term loans, drawn portions of long-term (maturity greater than one year) revolving facilities and long-term bonds (whether US-dollar-denominated or otherwise). Operating leases, non-recourse debt, commercial paper and other short-term liabilities are not included. Information on debt should be consistent with the issuer’s audited financial reports maintained during the March 22, 2019 to March 22, 2020 period, including the value of non-US-dollar-denominated debt. Issuers that are public companies may not use a higher amount of outstanding bonds and loans than is reflected in public filings.

   For the purposes of calculating maximum bonds and loans outstanding, the value of any non-US-dollar-denominated debt should be consistent with the issuer's financial statements for periods ending between March 22, 2019, and March 22, 2020.

6. *PMCCF facility fee*. The FAQs state that the 100 basis point facility fee under the PMCCF will be applied to each issuance to, or borrowing from, the PMCCF.

7. *New entities as issuers under the PMCCF.* The FAQs make clear that a company may identify or form a new entity to serve as an issuer to the PMCCF. The FAQs state that such a new entity generally may rely on the ratings history of any US affiliate that is guaranteeing the issuance and would be limited in its issuances by the 130% cap calculated based on the historical issuances of its consolidated top-tier parent.

8. *Non-profit organizations as Eligible Issuers.* The FAQs make clear that a non-profit organization that meets the eligibility criteria will be considered an Eligible Issuer under each of the PMCCF and the SMCCF.

9. *Ability of Eligible Issuers to use the PMCCF to refinance existing bonds or issue new bonds.* The FAQs state that Eligible Issuers may approach the PMCCF to refinance existing bonds and issue new bonds, subject to certain conditions and limitations. An Eligible Issuer may refinance outstanding debt up to three months ahead of the maturity date of such outstanding debt. Eligible Issuers also may approach the PMCCF at any time to issue additional debt, provided that the Eligible Issuer's rating is reaffirmed at BB-/Ba3 or above by each major NRSRO[3] that has rated the Eligible Issuer and the Eligible Issuer's reaffirmed rating accounts for the additional debt.

10. *How to request the participation of the SPV in syndicated loan or bond issuances under the PMCCF.* The FAQs indicate that, when the SPV purchases portions of syndicated bond or loan issuances of Eligible Issuers under the PMCCF, the SPV's participation is expected to be alongside that of other participants, at the same terms and price, with an additional 100 basis point facility fee.

    The FAQs indicate that, after a transaction is announced and shown to prospective purchasers, if there is insufficient demand and the issuer desires to approach the SPV for participation to complete the transaction, the issuer and all leads on the syndication may approach the SPV through the investment manager and request participation by

[3] Nationally recognized statistical rating organization. The FAQs indicate that, currently, there are three NRSROs that the Federal Reserve is referring to in connection with the facilities: S&P Global Ratings, Moody's Investors Service Inc. and Fitch Ratings, Inc. The Federal Reserve said it is considering including other NRSROs under the two facilities.

the SPV in up to 25% of the offering. Issuers will be required to certify compliance with all eligibility criteria and provide additional data on the proposed transaction, including, but not limited to, tenor, seniority, offering format, transaction size, initial price talk and expected final yield. The SPV will apply the 100 bps facility fee on the amount of its participation.

The FAQs state that the SPV will not have a minimum amount or percentage of the total deal. The FAQs also say that Eligible Issuers are not expected to use the PMCCF to borrow very small amounts or small percentages of the total deal, although doing so is not prohibited by the terms of the facility.

11. *Representations and certifications by companies participating in the PMCCF and the SMCCF.* The FAQs state that:

    a. Eligible Issuers are not required to provide certifications under section 13(3) of the Federal Reserve Act for purposes of the SMCCF.
    b. For purposes of section 13(3) of the Federal Reserve Act, under the PMCCF, an Eligible Issuer will be required to provide a written certification that it is unable to secure adequate credit accommodations from other banking institutions and the capital markets and that it is not insolvent.
    c. The Federal Reserve must obtain evidence that participants in the PMCCF are unable to secure adequate credit accommodations from other banking institutions and the capital markets. In certifying whether an issuer is unable to secure adequate credit accommodations from other banking institutions or the capital markets, the issuer may consider economic or market conditions in the market intended to be addressed by the PMCCF as compared to normal conditions, including the availability and price of credit. The FAQs state that "[l]ack of adequate credit does not mean that no credit is available. Credit may be available, but at prices or on conditions that are inconsistent with a normal, well-functioning market."
    d. Before participating in the PMCCF and SMCCF, issuers will be required to certify compliance with CARES Act requirements, including the US business requirement and the conflicts of interest requirement under section 4019 of the CARES Act.

12. *Currency denominations.* The FAQs state that the PMCCF and the SMCCF will not purchase debt denominated in any currency other than US dollars.

13. *Floating and fixed rate debt purchases.* The FAQs state that

   a. If the PMCCF is the sole participant in an offering, it will only purchase fixed-rate bonds.
   b. The PMCCF generally will only purchase fixed-rate debt when participating in a syndicated issuance.
   c. To the extent that the PMCCF is approached to participate in a syndication of floating-rate debt, it generally will expect any debt priced off LIBOR to include adequate fallback language.
   d. The SMCCF intends to purchase a range of bonds, including floating-rate debt that is priced off LIBOR.

14. *ETFs.* The FAQs clarify certain points about ETFs with respect to the SMCCF:

   a. The FAQs state that "in some cases" the holdings of ETFs the shares of which are purchased under the SMCCF may include underlying bonds that have a remaining maturity longer than five years at the time of purchase, or include underlying bonds that would otherwise be ineligible for purchase by the SMCCF
   b. The underlying holdings of ETFs will not be counted towards the issuer limits
   c. The SMCCF will generally not purchase shares of an ETF that are trading at a premium above the lower of the following limits relative to the prior end-of-day official net asset value (**NAV**): (a) 1%, or (b) the 1-standard deviation level of the ETF's premiums to end-of-day NAV observed over the prior 52 weeks.

15. *Investment manager.* The Federal Reserve previously announced that BlackRock has been appointed as investment manager for the PMCCF and the SMCCF. The FAQs now indicate that such appointment is only on an interim basis and that, once the exigent need to commence operations of the facilities has passed, the investment manager role will be subject to a competitive bidding process.

    The FAQs state that the investment manager will act as a fiduciary to the SPV in performing investment management services and will be required to follow the Federal Reserve's investment guidelines. The investment management agreement will be made public before launch of the facilities.

16. *Minority-, women- and veteran-owned business entities.* The Federal Reserve indicated that it is committed to the fair inclusion and utilization of minority-, women- and veteran-owned (**MWV**) business entities as it responds to the economic effects of the COVID-19 pandemic. The SMCCF will consider expanding the pool of entities it

will transact with as Eligible Sellers to include a wider range of entities, including MWV-owned business entities. In addition, MWV-owned business entities may participate as underwriters in the PMCCF, and the FAQs state that more information will be provided on that process in the future. Finally, as short-term vendor relationships are revisited in the coming months, the Federal Reserve stated that it will look to include a broader set of firms, including MWV-owned business entities, in the various roles supporting the PMCCF and the SMCCF.

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