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Corporate Credit Facility Update: Latest New York Fed Guidance on CCF Programs

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On August 14, 2020, the Federal Reserve Bank of New York (the “New York Fed”) published an updated set of Frequently Asked Questions (“FAQs”) concerning the Primary Market Corporate Credit Facility (the “PMCCF”) and the Secondary Market Corporate Credit Facility (the “SMCCF,” and together with the PMCCF, the “CCFs”) established under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”).

The PMCCF serves as a funding backstop for corporate debt issued by eligible issuers and the SMCCF provides liquidity to the market for outstanding corporate bonds. The combined size of the CCFs will be up to $750 billion. The PMCCF, initially funded with $50 billion of equity from Treasury, will leverage its equity ten times when acquiring bonds or syndicated loans from investment grade issuers, and seven times when acquiring other eligible assets. The SMCCF, initially funded with $25 billion of equity from Treasury, will leverage its equity ten times when acquiring corporate bonds from investment grade issuers and ETFs whose primary investment objective is exposure to investment grade corporate bonds. It will leverage its equity seven times when acquiring corporate bonds from issuers rated at below investment grade, and from three to seven times when acquiring other eligible assets, depending on risk.

The SMCCF began purchasing ETFs on May 12, 2020 and corporate bonds on June 16, 2020. The PMCCF became operational on June 29, 2020. On July 28, 2020, the Federal Reserve Board extended the expiration date of the CCFs, which were scheduled to expire on September 30, 2020. Purchases will be made under the CCFs until December 31, 2020, unless further extended, and the Federal Reserve will continue to fund each facility after such date, until its holdings mature or are sold.

This updated alert describes and analyzes the New York Fed's updated FAQs, the SMCCF term sheet and the PMCCF term sheet. For more information on the CCFs generally, see our client alert here.

Selection of Bonds for Purchase by the SMCCF

Pursuant to the SMCCF, the special purpose vehicle that will purchase corporate debt in the secondary market may purchase (i) individual corporate bonds ("Eligible Individual Corporate Bonds"), (ii) corporate bond portfolios in the form of exchange-traded funds ("Eligible ETFs") and (iii) individual corporate bonds to create a portfolio that tracks a broad, diversified market index of U.S. corporate bonds ("Eligible Broad Market Index Bonds"). The SMCCF began purchasing Eligible ETFs on May 12, 2020 and Eligible Broad Market Index Bonds on June 16, 2020. The SMCCF may in the future purchase Eligible Individual Corporate Bonds using other selection methodologies.

The broad market index, developed specifically for the SMCCF (the "Broad Market Index"), generally tracks the composition of the universe of secondary market bonds that meet the criteria for Eligible Broad Market Index Bonds. To be included in the Broad Market Index, such bonds must be issued by an issuer that (i) is created or organized in the United States or under the laws of the United States; (ii) was rated [1] at least BBB-/Baa3 as of March 22, 2020 by a nationally recognized statistical rating organization, or if subsequently downgraded, is rated at least BB-/Ba3 at the time of index calculation; (iii) is not an insured depository institution, depository institution holding company, or subsidiary of a depository institution holding company, as such terms are defined in the Dodd-Frank Act; and in each case, the bonds must have a remaining maturity of five years or less. The weight of any one issuer's bonds to be represented in the Broad Market Index is limited to the lesser of 10 percent of an issuer's "maximum historical outstanding bonds" and 1.5 percent of the $750 billion combined potential size of the CCFs.[2] The bonds of individual issuers included in the Broad Market Index according to these parameters will inform the sector composition of the index, with each issuer classified into one of 12 sectors.

The Broad Market Index will be recalculated at least every four to five weeks, and a list of bonds that are eligible for purchase will be updated more frequently to add eligible bonds and remove ineligible bonds. Issuers that drop below the minimum rating requirement or that file for bankruptcy protection will be removed from the index. While the New York Fed acknowledges that it will not be possible for the SMCCF's purchases of Eligible Broad Market Index Bonds to exactly replicate the index at all times, its primary focus will be to track the relative weight of each sector in the index as closely as possible, in addition to generally tracking the ratings and maturity profile of the index.

UPDATE: The SMCCF will not sell its holdings of corporate bonds in order to track the Broad Market Index. However, the SMCCF may occasionally sell bonds to resolve trading or settlement issues in connection with transactions into which it has entered.

Pace of Purchases by the SMCCF

The pace at which the SMCCF purchases bonds or ETFs is based on a percentage of average daily volumes in the respective markets. The percentage to be purchased each day depends upon several measures of corporate bond market functioning including transaction costs, bid-ask spreads, volatility and dealer inventories. Similar ETF-specific measures, such as premium or discount to net asset value and creation/redemption volumes, will be considered for ETF purchases. The FAQs provide that if such measures indicate improvement in market functioning to levels that reflect pre-COVID dislocation, purchases under the SMCCF are expected to slow or pause, with the ability to accelerate once again in the event of market deterioration.

Information Handling

UPDATE: In order to foster transparency and fair access to information about its activities, the SMCCF publishes the components of the Broad Market Index it intends to track and then announces on a monthly basis which specific bonds and ETFs it has actually purchased. Accordingly, the SMCCF expects that Eligible Sellers will not use or share non-public information that they receive while acting as an eligible seller for any purpose other than executing and completing the transaction with SMCCF and their risk management and internal control requirements.

Issuer and Seller Eligibility

Significant Operations in the United States. To qualify for the CCFs, issuers under the PMCCF, issuers of Eligible Individual Corporate Bonds under the SMCCF and eligible sellers under the SMCCF (together "Eligible Entities") must be organized in the United States or under the laws of the United States with significant operations in and a majority of their employees based in the United States.

For purposes of the CCFs, the FAQs provide a non-exclusive list of examples of what would constitute "significant operations in the United States" of a prospective issuer or seller:

- greater than 50% of its consolidated assets located in the U.S.;
- greater than 50% of its annual consolidated net income generated in the U.S.;
- greater than 50% of its annual consolidated net operating revenues generated in the U.S.; or
- greater than 50% of its annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service), each as reflected in its most recent audited financial statements, generated in the U.S.

Measuring Operations and Employees. The FAQs address the question of whether operations and employees of parent entities and affiliates should be counted for purposes of establishing issuer and seller eligibility. If the Eligible Entity is not a subsidiary whose sole purpose is to issue debt, operations and employees are measured at the Eligible Entity level without consideration of any parent companies or affiliated entities. However, if the Eligible Entity is a subsidiary whose sole purpose is to issue debt, and 95% or more of the proceeds of the syndicated loan or corporate bond issuance are transferred to a corporate affiliate of such subsidiary, that corporate affiliate must also have significant operations in and a majority of its employees based in the United States.

Additional Considerations. The FAQs clarify that the following entities are eligible to participate in one or both of the CCFs, subject to satisfaction of the other eligibility requirements:

- a U.S. company that is a subsidiary of a foreign company may be an eligible issuer under the PMCCF or an issuer of Eligible Individual Corporate Bonds under the SMCCF if created or organized in the U.S., with significant operations in and a majority of its employees based in the U.S. Specifically with respect to the PMCCF, such an entity must not use proceeds derived from participation in the program for the benefit of its foreign affiliates;

- a U.S. subsidiary or U.S. branch of a foreign bank may be an eligible seller under the SMCCF if created or organized in the U.S. or under U.S. law;
- a newly-formed entity may be an eligible issuer to the PMCCF, relying on the ratings history of a U.S. affiliate that is guaranteeing the issuance;
- a non-profit organization may be an eligible issuer under either program; and
- a business development company ("BDC") may be an eligible issuer under the PMCCF if: (i) the manager of the BDC is 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 U.S., and makes all applicable certifications, (ii) the BDC's portfolio companies, in the aggregate, have significant operations in and a majority of their employees based in the U.S., and (iii) the BDC has procedures in place to ensure that proceeds derived from participation in the program are not distributed to an insolvent portfolio company.

Ratings. To be eligible for purchase of its bonds or loans by the PMCCF, the issuer also must have been rated at least BBB-/Baa3 as of March 22, 2020 by a nationally recognized statistical rating organization. An issuer that was rated at least BBB-/Baa3 as of March 22, 2020, but was subsequently downgraded, must be rated at least BB-/Ba3 as of the date on which the PMCCF makes a purchase. If rated by multiple major NRSROs, such an issuer must be rated at least BB-/Ba3 by two or more NRSROs as of the date on which the Facility makes a purchase. Unless the eligible issuer is borrowing under the PMCCF solely for the purpose of refinancing debt maturing within three months, its ratings must be reaffirmed at BB-/Ba3 or above by each major NRSRO that has rated the eligible issuer, and the reaffirmed rating must account for the additional debt (the "additional debt ratings reaffirmation requirement").

UPDATE: The updated FAQs clarify that when the PMCCF is participating in transactions alongside other investors, the total amount of the transaction relative to debt maturing within three months is considered. For example, in a syndicated bond issuance of $1 billion in which the PMCCF purchases 25% ($250 million), the additional debt ratings reaffirmation requirement would apply if the amount of debt maturing within three months were less than $1 billion. Similarly, if the stated use of proceeds for a transaction includes uses in addition to refinancing, such as general corporate purposes, then the additional debt ratings reaffirmation requirement would apply.

Specific Support Condition. The PMCCF and SMCCF term sheets specify that issuers under the PMCCF and issuers of Eligible Individual Corporate Bonds under the SMCCF must not have received specific support pursuant to the CARES Act. The FAQs clarify that "specific support" refers only to a loan, loan guarantee, or other investment from the Treasury Department under Section 4003(b)(1)-(3) of the CARES Act. The FAQs further clarify that an issuer may not participate in both the PMCCF and the Main Street Lending Facilities. However, eligible issuers may utilize tax credits or tax relief in the CARES Act and still participate in the CCFs.

Notably, the eligibility requirements for issuers of Eligible Broad Market Index Bonds are similar, but not identical, to those for Eligible Individual Corporate Bonds. Issuers of Eligible Broad Market Index Bonds must be incorporated and domiciled in the United States, but they are not required to have significant operations in the United States or to meet the specific support condition.

Seller Eligibility. The SMCCF began by transacting with Primary Dealers, or affiliates thereof, that meet the eligible seller criteria.

UPDATE: On September 9, 2020, the New York Fed announced the first wave of additional firms selected to be eligible sellers under the SMCCF. The selected firms represent a diverse range of market participants, including minority, women and veteran-owned business entities ("MWVs").

Underwriter Eligibility and Fees (PMCCF)

The updated FAQs specify that issuers must use two or more underwriters to facilitate purchases by the PMCCF. At least one of the underwriters in the transaction, including the underwriter acting as billing and delivering agent, must have "significant experience" with transactions that are comparable to the PMCCF in size and complexity. "Significant experience" is defined as underwriting a minimum of 100 transactions and $10 billion in investment-grade corporate bonds, excluding self-led transactions, in the capacity of active bookrunner between March 22, 2019 and March 22, 2020. Issuers are strongly encouraged to use MWVs as underwriters, and the FAQs note that when a MWV does not meet the "significant experience" criteria, it may still participate in the transaction as an additional underwriter. The amount paid for underwriting services will be determined entirely between the issuer and the underwriter.

Compliance and Certifications

The FAQs describe most, but not all, of the compliance and certification requirements for entities interested in participating in the CCFs. Issuers of Eligible Broad Market Index Bonds will not be required to provide certifications under Section 13(3) of the Federal Reserve Act for purposes of the SMCCF. Issuers of Eligible Individual Corporate Bonds may be required to provide certifications, the criteria for which will be provided before the SMCCF begins Eligible Individual Corporate Bond purchases. PMCCF issuers must certify that they are both solvent and unable to secure adequate alternative credit accommodations, consistent with Section 13(3). The FAQs clarify that a lack of “adequate credit” does not mean that no credit is available.

Available credit at prices or on conditions that are not consistent with a “normal” market could support the required certification.

On May 5, 2020, the New York Fed posted a seller certification packet for the SMCCF on its website, which includes form seller certifications as to solvency, the U.S. business requirement and the conflicts of interest requirements under Section 4019. The packet also includes a verification pursuant to which the seller will agree to maintain records containing the bases for such certifications, to be provided to the New York Fed upon request. The seller certification packet is available here.

On June 29, 2020, the New York Fed posted two issuer certification packets for the PMCCF on its website. The *Advance Issuer Certification Packet* contains documents that an issuer must complete and submit before entering into a transaction with the PMCCF, including form issuer certifications as to the U.S. business requirement and the conflicts of interest requirements under Section 4019. This packet also includes a verification form pursuant to which the issuer must agree to maintain records containing the bases for such certifications, to be provided to the New York Fed upon request. Issuers are strongly encouraged to complete these certifications well in advance of expected issuance under the PMCCF.

The *Trade Date Issuer Certification Packet* contains additional certifications that an issuer must complete on the trade date and submit directly to the investment manager. This packet includes certifications as to solvency and lack of adequate credit accommodations, the prohibition on specific support under the CARES Act, and the issuer's obligation to pay the facility fee. The Advance and Trade Date Issuer Certification packets are available here.

Issuers participating in the PMCCF must also deliver written confirmations about their compliance with certain eligibility requirements. Such confirmations include information regarding the issuer's outstanding indebtedness, lack of participation in the Main Street Lending Programs, that it is not a depository institution or depository institution holding company (or a subsidiary thereof), and, in certain circumstances, the use of PMCCF proceeds. The issuer must also acknowledge that if its certifications contain a known material misrepresentation, the bonds may be subject to mandatory repurchase on demand.

Additional Issuer Forms (PMCCF)

On June 29, 2020, in addition to the issuer certification packets, the New York Fed published the following forms specific to the PMCCF:

- *CCF Letter Agreement* - Issuer must agree to repurchase the bonds sold to the PMCCF upon demand, at the 100% of the outstanding principal amount plus accrued interest, in the event the issuer has made any knowing material misrepresentation or there is a material breach of the use of proceeds provisions under the PMCCF program.
- *Co-Investor Issuer Authorization Form* - Information related to the transaction and issuer eligibility, including related confirmations to be made by the issuer, as described above.
- *Co-Investor Underwriter Authorization Form* - Information related to the transaction and issuer eligibility from the underwriter or initial purchaser serving as the Billing & Delivery Agent.
- *Sole Investor Issuer Authorization Form* - Information related to the transaction and issuer eligibility, including related confirmations to be made by the issuer, as described above.
- *Sole Investor Underwriter Authorization Form* - Information related to the transaction and issuer eligibility from the underwriter or initial purchaser serving as

the Billing & Delivery Agent.

- *PMCCF Sole Investor Standard Terms (Company)* - Minimum covenants and other terms applicable to transactions where the PMCCF is the sole investor.
- *PMCCF Sole Investor Standard Terms (Guarantor)* - Minimum covenants and other terms applicable to transactions where the PMCCF is the sole investor.

All forms are available on the PMCCF website here.

Asset Eligibility

The FAQs clarify certain asset eligibility requirements:

- the CCFs will not purchase non-U.S. denominated corporate bond issues;
- the CCFs do not expect to purchase corporate bonds that are widely considered to be subordinated to other corporate bonds of the issuer;
- the CCFs will not purchase bonds issued by U.S. branches, agencies or subsidiaries of non-U.S. banking organizations;
- the CCFs will not purchase bonds of issuers that are majority-owned or controlled by a foreign government;
- where the PMCCF is the sole participant in an offering, it will only purchase fixed-rate bonds;
- where the PMCCF is approached to participate in a syndication of floating-rate debt, it will expect any debt priced by reference to LIBOR to include adequate fallback language;
- the SMCCF will purchase a range of bonds, including floating-rate debt that is priced off LIBOR;
- ETFs purchased by the SMCCF may include underlying bonds with maturities of greater than five years, or that would otherwise be ineligible for purchase by the SMCCF;
- the SMCCF generally will not purchase ETFs that are trading at a premium above the lower of the following, relative to the prior end-of-day net asset value (NAV): (i) 1% or (ii) the 1-standard deviation level of the ETF’s premium to end-of-day NAV over the prior 52 weeks, on a rolling basis; and
- the CCFs may purchase privately placed corporate bonds issued pursuant to Rule 144A.

Offering Requirements (PMCCF)

The FAQs indicate the PMCCF will purchase bonds from eligible issuers only through offerings registered under the Securities Act of 1933 or conducted under Rule 144A. For Rule 144A offerings, the PMCCF must receive an offering circular with customary disclosures, such as a description of the issuer, terms and conditions of the bonds, and risk factors. In all offerings, the underwriters or initial purchasers must perform customary due diligence and receive customary closing documents, including auditor comfort letters, Rule 10b-5 letters, and legal opinions.

To request PMCCF participation in a transaction where the PMCCF is the sole investor, the underwriters or initial purchasers are expected to contact the investment manager approximately two weeks prior to pricing. For a transaction involving other investors, it is expected that the initial contact would occur as soon as the underwriters expect to bring the bond issuance to the PMCCF for consideration, but should not be later than 1:00 p.m. ET on pricing day.

Standard Terms for PMCCF Bonds (Sole Investor)

The update FAQs outline the general terms and conditions for bonds to be sold under the PMCCF where the facility will be the sole investor. The indenture or supplemental indenture for such bonds should have terms consistent with market convention and the issuer’s most recent prior debt issuance. In addition, the indenture must include certain standard terms provided by the New York Fed, which are designed to promote consistency within the PMCCF and minimize individual negotiation. The FAQs note that the standard terms may be updated from time to time. Issuers must include the most recent version as of the date the bonds are issued to the PMCCF, and the PMCCF may decline to participate in the transaction if the indenture does not include all of the then-current standard terms. Notably, if the issuer’s most recent prior debt issuance includes more investor-favorable terms than the PMCCF standard terms, those terms also must be included in the indenture or supplemental indenture.

PMCCF Pricing

Pricing for eligible corporate bonds where the PMCCF is the sole investor will be issuer-specific, informed by market conditions, plus a 100 bps facility fee. Pricing also will be subject to minimum and maximum spreads over yields on comparable maturity U.S. Treasury securities, and such spread caps and floors will vary based on an eligible issuer’s credit rating as of the date on which the PMCCF makes a purchase. All pricing determinations for sole investor transactions will be made by the PMCCF and are not subject to negotiation. For syndicated loans and bonds, 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.

Other Terms and Clarifications

Public Disclosure

The New York Fed will disclose information regarding the CCFs during the duration of the programs, including participants, transaction sizes, costs, revenues and other fees.

Investment Manager

Initially, BlackRock Financial Markets Advisory will serve as the investment manager for the CCFs, acting at the sole direction of the New York Fed on behalf of the facilities pursuant to investment guidelines provided by the New York Fed. Once the urgent need to commence the programs has passed, the role of investment manager will be subject to a competitive process.

Program Limitations

Issuers may participate in both the PMCCF and the SMCCF at the same time, assuming per-issuer limits are satisfied without exceeding the total debt allowed under the facilities. If the SMCCF purchases a particular issuer’s corporate bonds prior to the issuer selling to the PMCCF, it will reduce the issuer’s capacity available under the PMCCF.

There is no minimum issuance amount when the PMCCF purchases eligible corporate bonds as the sole investor. However, eligible issuers are not expected to use the PMCCF to borrow small amounts or small percentages of the total deal where multiple investors are involved.

The PMCCF may purchase no more than 25% of any syndicated bond offering or loan. The FAQs clarify that the 25% participation limit is applied on an individual tranche basis, and not on a total transaction basis, assuming all eligibility criteria are met.

UPDATE: The maximum amount of debt that an eligible issuer may have outstanding after borrowing from the PMCCF may not exceed 130% of such issuer's maximum outstanding bonds and loans on any date between March 22, 2019 and March 22, 2020. The updated FAQs clarify that the total amount of a syndicated bond offering or loan, not just the eligible issuer's participation amount, will count toward the 130% issuer cap.

UPDATE: The updated FAQs clarify that the full amount of debt issued in a transaction involving the PMCCF counts against the 130% issuer cap. However, outstanding debt with a maturity of three months or less that the eligible issuer will refinance using the proceeds of the PMCCF transaction will not count against the 130% issuer cap. Outstanding debt with a remaining maturity of more than three months being refinanced with proceeds from the PMCCF transaction will fully count against the 130% issuer cap until maturity, alongside the new debt incurred in the transaction. The FAQs provide the following examples to illustrate how the 130% issuer cap is calculated:

> Suppose issuer ABC's maximum outstanding bonds and loans on any day between March 22, 2019, and March 22, 2020 (the "historical maximum") was **$2.0 billion**. The 130% issuer cap would be **$2.6 billion** (i.e., 130% of the historical maximum of $2.0 billion).
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> Issuer proposes to issue additional debt with no refinancing. Outstanding debt on transaction date is lower than the 130% issuer cap.
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> - Outstanding debt on transaction date, without giving effect to the transaction: $1.5 billion
> - Outstanding debt maturing within three months that ABC intends to refinance: $0
> - Maximum total borrowing permitted from the PMCCF for additional debt: $1.1 billion
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> Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion).

Issuer proposes to refinance existing debt with no additional borrowing. Outstanding debt on transaction date is higher than the 130% issuer cap.

- Outstanding debt on transaction date, without giving effect to the transaction: $2.61 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $2.0 billion
- Maximum total borrowing permitted from the PMCCF: $0

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion). In this scenario, outstanding debt of $2.61 billion on transaction date exceeds the 130% issuer cap. No borrowing (additional debt or refinancing) is permitted under the PMCCF.

Issuer proposes to refinance existing debt with no additional borrowing. Outstanding debt on transaction date is at or lower than the 130% issuer cap.

- Outstanding debt on transaction date, without giving effect to the transaction: $2.6 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $2.0 billion
- Maximum total borrowing permitted from the PMCCF: $2.0 billion

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion). In this scenario, outstanding debt of $2.6 billion on transaction date does not exceed the 130% issuer cap. The amount being refinanced that matures within three months temporarily does not count towards the cap once the new debt has been issued.

The updated FAQs also explain that debt that is maturing within three months and is being refinanced does not count towards the 130% issuer cap during the period before it is repaid and the new indebtedness is outstanding.

What’s Next?

As noted in the FAQs, we expect the New York Fed to issue further guidance on the SMCCF requirements and processes for issuer certification related to Eligible Individual Corporate Bond purchases. We will continue to monitor the New York Fed and Treasury Department announcements for additional information and guidance.

You can view the full FAQs here, the updated SMCCF term sheet here and the updated PMCCF term sheet here.

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[1] If the bonds are issued by a wholly-owned subsidiary of an eligible issuer, the rating of the subsidiary will determine the bond's eligibility. If the subsidiary is not independently rated, the ratings of the parent company and the bond jointly determine the bond's eligibility.

[2] It is unclear from the FAQs whether the former limitation should be read literally, such that the cap will be calculated according to the issuer's maximum outstanding bonds at any point in its operating history or whether, instead, the single-issuer cap that applies to all bonds purchased in the CCFs of 10 percent of an issuer's maximum bonds outstanding "on any day between March 22, 2019 and March 22, 2020" will be applied. We believe a reasonable reading would be to apply the same one-year window for weighting in the Broad Market Index that is applied to the single-issuer cap.

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