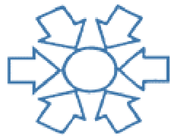

FedFin Client Report

Thursday, April 9, 2020

Fed Opens the Floodgates

Client Report: **COVID10**

Executive Summary

As signalled earlier this week by Secretary Mnuchin, the Fed opened its windows still wider early this morning, launching facilities it says will add as much as $2.3 trillion of liquidity for what it describes as "Main Street" businesses, state and local governments, and a PPP secondary market. It has also significantly revised its corporate-loan and TALF facilities. This report describes each facility in detail, noting changes to the Fed's initial design (see *Client Report* **COVID6**) and the sharp increase in Treasury backstops reflecting the $454 billion allocated for this in the CARES Act (See FSM Report **RESCUE72**). Doubtless reflecting the PPP's troubled launch, the Fed notes in its Main Street program that it may be altered over time, seeking comment on how to do so until April 16. The Fed will also monitor the new municipal facility, although it does not seek comment on how to do so. Facilities under the 13(3) aegis remain focused only on solvent counterparties, with Chairman Powell stressing today that the Fed's mandate here is limited; as we have noted, this constraint and the need for Treasury approval make it at best challenging for the Fed to support mortgage servicers, although Mr. Powell today signalled that the Fed is carefully watching this sector.

Analysis

Main Street Facilities

Under its 13(3) authority, the Fed via an SPV will buy loans up to four years totaling $600 billion to firms with revenues up to $2.5 billion and up to 10,000 employees. This employment total differs from the facility as originally envisioned in that even the smallest firms may apply and those receiving PPP loans are not barred from doing so. However, it is likely that the bulk of this facility will be quickly taken up by large firms best able to navigate its complex processes.

New eligibility requirements include payroll-maintenance commitments, along with compliance with compensation, stock-repurchase, and dividend restrictions as required by the CARES Act for direct Fed loans. P&I payments are deferred for one year, with banks allowed to count existing loans as well as to originate loans for the facility. Eligible lenders are U.S. IDIs, BHCs, and SLHCs. Risk retention is a new feature, with banks required to hold a five percent piece of all loans sent on to the Fed.

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Municipal Liquidity Facility

This 13(3) facility will purchase up to $500 billion of short-term notes directly from states (D.C. included), counties with more than two million residents, and cities with more than one million residents. Eligible states may use proceeds for smaller counties and cities. These will be recourse loans, with the Fed also protected by a $35 billion Treasury backstop. Eligible notes include tax-anticipation and similar short-term issues with maturities no later than 24 months. Only one issuer per state, county, or city is eligible (with certain exceptions) and the Fed reserves the right to review documentation and other criteria. Pricing has yet to be determined, but there is ten basis point origination fee payable from facility proceeds if desired.

PPP Lending Facility

This is also a 13(3) window, in which all of the Reserve Banks will take PPP loans as collateral for term loans for which all IDIs making PPP loans are eligible; however, eligibility will be broadened at some point also to nonbank PPP lenders. Fed loan maturity equals that of the PPP loan and is accelerated if the PPP loan goes into default and the loan is sold to the SBA. Facility loans will also be accelerated to reflect forgiveness, with all Fed loans made at a 35 bps rate without any additional fees or recourse to the borrower. PPP collateral will be judged at loan face value. As presaged by the FDIC, PPPLF loans will bear a zero risk weight and an exemption from the leverage ratio was granted by an IFR on Thursday.

TALF

TALF-eligible collateral now includes AAA-rated tranches of outstanding commercial MBS and new CLOs. TALF will remain fixed at $100 billion, remaining open to a wide range of ABS. Treasury's backstop is $10 billion.

Corporate Debt

The primary and secondary market corporate-debt facilities have been increased via a $75 billion Treasury backstop to handle as much as $750 billion. Most of the primary facility's earlier requirements remain (i.e., penalty pricing, better than BBB ratings, U.S. domicile). Entities may not be insured depositories, but BHCs now are apparently eligible along with any other entity owning an IDI. Revisions also allow access by "fallen angels" as long as ratings have only recently slipped from BBB and are still higher than BB.

The secondary facility will buy bond portfolios, now including those housed in ETFs that are U.S. and broadly-based vehicles focusing on investment-grade obligations. This facility will have a 10:1 leverage ratio compared to Treasury's dedicated $10 billion backstop.

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