Federal Reserve Expands Support to Corporate Bond Markets

By Manuel Leon Hoyos

Original post here.

On April 9, the Federal Reserve (Fed) updated and expanded the corporate bond-buying programs originally announced on March 23 to support credit to riskier corporations.

The Fed used its authority under Section 13(3) of the Federal Reserve Act to implement the Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit Facility (SMCCF) (see here). For both facilities, the Federal Reserve Bank of New York lends to a special purpose vehicle (SPV) on a recourse basis. These loans are secured by all assets of the SPV. The Treasury, using the Exchange Stabilization Fund (ESF), increased the amount of equity it will provide from $20 billion to $75 billion—$50 billion for the PMCCF's SPV and $25 billion for the SMCCF's SPV. The combined size of both facilities can now be up to $750 billion; the Fed has not provided any allocation between the two programs. Further discussion on the Treasury backstop can be found here.

Under both facilities, companies that receive direct financial assistance under the new CARES Act or other subsequent federal legislation are not eligible. Eligible institutions must satisfy the conflict-of-interest requirements of section 4019 of the CARES Act. Both facilities are to be open through September 30 unless the Fed and Treasury extend it.

Under the PMCCF, the SPV transacts directly with US-based companies with material operations in the US. The SPV purchases investment-grade corporate bonds with maximum maturities of four years. The latest revision includes purchases of portions of syndicated loans or bonds at issuance.

The Fed set limits on each issuer's total borrowing under the PMCCF. The limits are based on the issuer's credit rating. Initially, for an AAA/Aaa1-rated issuer, the total outstanding bonds and loans were not to exceed 140% of its maximum outstanding bonds and loans on any day during the 12-month period ending March 22, 2020. The latest revision, however, reduces this limit to 130%. Additionally, the maximum amount of instruments that both the PMCCF and the SMCCF combined can purchase from an eligible issuer is limited to 1.5% of the combined potential size of both facilities.

Under the SMCCF, the SPV has purchased investment grade corporate bonds with maximum maturities of five years at a fair market value up to 10% of the issuer's bonds outstanding. As with the PMCCF, issuers must be US-based and have material operations in the US. The SPV also has purchased US-listed exchange-traded funds (ETFs) whose investment objective is to provide broad exposure to the market for US investment-grade corporate bonds. The latest revision adds ETFs whose primary investment objective is exposure to US high-yield corporate bonds. Purchases of ETFs are limited to 20% of an ETF's assets. Amidst price dislocation in the ETF market, rather than purchase at fair market value, the Fed says in its term sheet: "The Facility will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio."