

# Federal Reserve Supports Corporate Bond Markets

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Original post [here](#).

On March 23, the Federal Reserve [introduced two new facilities](#) to support credit to large US companies. One will purchase newly issued bonds and loans on the primary market and the other will purchase outstanding corporate bonds and exchange-traded funds (ETFs) on the secondary market. The Fed used its emergency authority under section 13(3) of the Federal Reserve Act to create these programs.

Under both facilities, the Federal Reserve Bank of New York will lend to a special purpose vehicle (SPV) on a recourse basis. These loans will be secured by all assets of the SPV. The US Treasury, using the Exchange Stabilization Fund (ESF), will provide \$20 billion in equity—\$10 billion for each SPV.

Under the Primary Market Corporate Credit Facility, the SPV will transact directly with US-based companies with material operations in the US. The SPV will purchase investment-grade (BBB-/Baa3 or higher) corporate bonds with maximum maturities of four years. It will also grant loans at interest rates informed by market conditions. The Fed designed the facility to help companies “maintain business operations and capacity” during the coronavirus disruption.

The Fed set limits on each issuer’s total borrowing while it participates in the program, including its borrowing from the SPV. The limits are based on the issuer’s credit rating. An AAA/Aaa1-rated issuer’s total outstanding bonds and loans may not exceed 140% of its maximum outstanding bonds and loans on any day during the 12-month period ending March 22, 2020. For BBB-/Baa3-rated companies, the limit is 110%.

Borrowing companies may defer interest and principal payments for the first six months of their loans, which may be extendable at the Fed’s discretion. The commitment fee will be set at 100 bps. Bonds and loans will be callable at any time at par. (See the [term sheet](#)).

Under the Secondary Market Corporate Credit Facility, a separate SPV will purchase investment grade (BBB- or higher) corporate bonds with maximum maturities of five years. As with the primary market facility, issuers must be US-based and have material operations in the US. Companies that receive direct financial assistance under the new federal CARES Act will not be eligible.

The SPV can also purchase US-listed exchange-traded funds (ETFs) whose investment objective is to provide broad exposure to the market for US investment-grade corporate bonds. The SPV will purchase corporate bonds at “fair market value” and up to a maximum of 10% of the issuer’s maximum bonds outstanding. It will purchase ETFs up to a maximum of 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.” (See the [term sheet](#)).