FinReg
Davis Polk Insights on Financial Regulation

Fed Creates Secondary Market Corporate Credit Facility to Provide Liquidity to Corporate Bonds

By John Banes, Luigi L. De Ghenghi, Randall D. Guynn, Margaret E. Tahyar, Andrew Samuel & Ledina Gocaj on March 26, 2020

POSTED IN CORONAVIRUS (COVID-19), FEDERAL RESERVE

The Federal Reserve **announced** on March 23, 2020 further action in response to the coronavirus crisis: the creation of the **Secondary Market Corporate Credit Facility (SMCCF)**, along with establishment of the **Primary Market Corporate Credit Facility (PMCCF)** and the **Term Asset-Backed Securities Loan Facility (TALF)**. We discuss the PMCCF and TALF in separate blog posts (link to **PMCCF post**; link to **TALF post**). This announcement follows that of the creation of the **Money Market Mutual Fund Liquidity Facility (MMLF)**, the **Commercial Paper Funding Facility** and the **Primary Dealer Credit Facility**. All of these facilities are covered in our **two-page overview** of the Federal Reserve's actions to date, which includes hyperlinks to the primary materials on the Federal Reserve's website.

The SMCCF and PMCCF both aim to support credit to large companies. The SMCCF does so by supporting the liquidity of existing corporate bonds, while the PMCCF aims to support new bond and loan issuances.

The SMCCF will take the form of a special purpose vehicle (**SPV**) that will purchase individual corporate bonds as well as corporate bond portfolios in the secondary market. The Federal Reserve Bank of New York (**FRBNY**) will lend to the SPV on a recourse basis and the FRBNY's loans will be secured by the entirety of the assets of the SPV. The U.S. Department of the Treasury will make a $10 billion equity investment in the SPV using the Exchange Stabilization Fund.

Key features of the SMCCF are described below. Additional details can be found in the **SMCCF term sheet**.

- The SMCCF will purchase individual corporate bonds from eligible issuers that meet the following asset and issuer eligibility criteria.
  - **Eligible individual corporate bonds** under the SMCCF must be:
    - issued by an eligible issuer (defined below);
    - rated BBB-/Baa3 or more by a major nationally recognized statistical rating organization (NRSRO), subject to review by the Federal Reserve;[1] and
    - have a remaining maturity of five years or less.
  - **Eligible issuers** under the SMCCF are all U.S. businesses with material operations in the United States.
    - Companies that are expected to receive direct financial assistance under pending federal legislation are excluded from participation in the SMCCF. A draft of the CARES Act fiscal stimulus package (which, as of the time of this writing, remains subject to Congressional negotiations) provided financial assistance to companies affected by the coronavirus pandemic. Davis Polk's rush summary of the CARES Act's economic stabilization and small business assistance provisions will be available on our **Coronavirus Updates Blog**.
  - The SMCCF will purchase eligible corporate bonds at **fair market value** in the secondary market.
- The SMCCF will also purchase **corporate bond portfolios**, which are limited to **exchange traded funds (ETFs)** whose investment objective is to provide broad exposure to the market for U.S. investment grade corporate bonds.
  - The SMCCF can purchase up to 10% of an issuer's maximum bonds outstanding at any time between March 22, 2019 and March 22, 2020.
  - The SMCCF can purchase up to 20% of the assets of any one ETF as of March 22, 2020.
  - The SMCCF will not purchase shares of ETFs at a price that materially exceeds the estimated net asset value of the ETF's underlying portfolio.

- **Procedural considerations**:
  - The SMCCF will continue asset purchases until September 30, 2020. The Federal Reserve may choose to extend the SMCCF after that time.
  - The FRBNY will continue to fund the SMCCF after its termination until the holdings of the SMCCF mature or are sold.

---

[1] Corporate bonds that are rated by two or more NRSROs must be rated BBB-/Baa3 or more by at least two NRSROs.