Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Commercial Paper Funding Facility

Overview

On March 17, 2020, the Board of Governors of the Federal Reserve System (Board), by the unanimous vote of its five members and with the approval of the Secretary of the Treasury, approved under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343(3)) the establishment of the Commercial Paper Funding Facility (CPFF) by the Federal Reserve Bank of New York (the Reserve Bank).[1] The purpose of the CPFF is to provide liquidity to short-term funding markets. The CPFF would provide a liquidity backstop to U.S. issuers of commercial paper and certain municipal bonds by purchasing three-month unsecured and asset-backed commercial paper directly from eligible issuers.

Background and Details on the CPFF

Commercial paper is an important source of short-term funding for large financial and nonfinancial businesses. In particular, the asset-backed commercial paper (ABCP) market is an important source of funding for smaller businesses that do not have direct access to capital markets. Businesses can finance their receivables by selling them to an ABCP program. Municipalities also rely on markets to raise funds to support transportation, housing, and health care. The markets for commercial paper and municipal debt have been under considerable strain recently as businesses, municipalities, and households face greater uncertainty in light of the coronavirus outbreak. In particular, money market mutual funds and other investors have become increasingly reluctant to purchase commercial paper, especially at longer-dated maturities. As a result, interest rates on longer-term commercial paper have increased very significantly, and many firms are reportedly unable to issue commercial paper with terms longer than a week.

In light of the foregoing, the Board determined that unusual and exigent circumstances existed and approved the establishment of the CPFF. By

[1] Subsequently, the Board, by the unanimous vote of its five members and with the approval of the Secretary of the Treasury, announced expansions of the CPFF, which are reflected in this report.

eliminating much of the risk that eligible issuers will not be able to repay investors by rolling over their maturing commercial paper obligations, this facility should encourage investors to once again engage in term lending in these markets. An improved commercial paper market will enhance the ability of businesses to maintain employment and investment and municipalities to continue to provide services.

The Board, with the approval of the Secretary of the Treasury, established the CPFF. The Department of the Treasury will provide a $10 billion equity investment in a special purpose vehicle (SPV) for the CPFF from the Exchange Stabilization Fund. The Federal Reserve will then provide financing to the SPV.

Structure and Basic Terms. Under the CPFF, the Reserve Bank will provide a loan to the SPV authorized under section 13(3) of the Federal Reserve Act on a recourse basis. The SPV will purchase certain types of assets from eligible issuers, subject to limitations based on the amount of the issuer's outstanding debt prior to the start of the program.

The Board expects that the SPV and the CPFF will be operational within a few weeks. Because the CPFF is not yet operational, the specific identity of recipients of its assistance is not yet known, and no assistance has yet been provided. The following provides an overview of the terms and conditions that are expected to govern the CPFF at this time. The terms and conditions are available on the Board's website.

Assets Eligible to Be Purchased by the SPV. The SPV will purchase directly from eligible issuers three-month U.S. dollar-denominated commercial paper at a spread over the three-month overnight index swap (OIS) rate plus 110 basis points. In addition, at the time of its registration to use the CPFF, each issuer must pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the SPV may own.

Commercial paper (including ABCP) purchased by the SPV generally must be rated at least A-1/P-1/F-1 by a major Nationally Recognized Statistical Rating Organization (NRSRO) and, if rated by multiple major NRSROs, must be rated at least A-1/P-1/F-1 by two or more major NRSROs. The SPV will only purchase commercial paper issued by U.S. issuers (including U.S. issuers with a foreign parent).

Security for Advances. All advances to the SPV will be made with full recourse to the SPV and will be secured by all the assets of the SPV. As noted above, all issuers will pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the SPV may own. All fees will be retained by the SPV to provide an additional cushion against losses.

Limits per Issuer. To help ensure that the facility is available to meet the needs of a wide range of eligible issuers, the amount of commercial paper that a single eligible issuer may sell to the SPV is subject to a cap. Specifically, the maximum amount of a single issuer's commercial paper the SPV may own at any time will be the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between March 16, 2019, and March 16, 2020. The SPV will not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the SPV) equals or exceeds the issuer's limit.

The size of the commercial paper market is approximately $1.1 trillion. The size of the facility will depend on the amount and extent to which eligible issuers participate in the program and subject to limitations based on the issuer's outstanding debt prior to the start of the program.

Termination Date. The SPV will cease purchasing commercial paper on March 17, 2021, unless the Board agrees to extend the facility. The Federal Reserve will continue to fund the SPV after such date until the SPV's underlying assets mature.

Requirements Imposed on Recipients. The CPFF will not impose any new requirements on issuers with respect to employee compensation, distribution of dividends, or any other corporate decision in exchange for the assistance.

Expected Costs. The SPV will hold assets that are considered high-quality, and the SPV will charge issuers a facility fee of 10 basis points. As discussed above, the Reserve Bank will have recourse to all of the assets in the SPV, including earnings and fees accumulated in the course of the SPV's operation. In light of the assets held by the SPV and fees charged eligible issuers, the Board does not expect at this time that advances under the CPFF will result in any losses to the Federal Reserve or the taxpayer.