Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Secondary Market Corporate Credit Facility

Overview

On March 22, 2020, the Board of Governors of the Federal Reserve System (the Board), by the unanimous vote of its five members and with the approval of the Secretary of the Treasury, authorized the Federal Reserve Bank of New York (Reserve Bank) to establish and operate the Secondary Market Corporate Credit Facility (SMCCF) under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343(3)). Under the SMCCF, the Reserve Bank will lend to a special purpose vehicle (SPV), which will purchase in the secondary market (i) investment grade corporate bonds issued by U.S. companies and (ii) U.S.-listed exchange-traded funds (ETFs) whose investment objective is to provide broad exposure to the market for U.S. investment grade corporate bonds. The SMCCF is intended to facilitate the provision of credit to a wide range of U.S. companies.

Background on the SMCCF

Recent events have significantly and adversely impacted global financial markets. The spread of the coronavirus disease 2019 (COVID-19) has halted economic activity in many countries, including the United States. The disruption has impacted many different sectors of the financial system. In general, the availability of credit has contracted for issuers of debt, while, at the same time, the disruptions to economic activity have heightened the needs for companies to obtain financing in order to pay off maturing debt and sustain themselves until economic conditions normalize. These disruptions have extended to even highly rated companies, who have seen a significant drop-off in demand for new debt issuance.

In these circumstances, the Board determined that unusual and exigent circumstances existed and approved the establishment of the SMCCF to help facilitate access to credit so that companies are better able to maintain business operations and capacity during the period of dislocations related to the pandemic. The Department of the Treasury, using the Exchange Stabilization Fund, will make an initial $10 billion equity investment in the SPV.

Structure and Basic Terms

Under the SMCCF, the Reserve Bank will lend, on a recourse basis, to an SPV that will purchase in the secondary market corporate debt issued by eligible issuers. The SPV will purchase eligible individual corporate bonds and shares of eligible ETFs in the secondary market. The Reserve Bank will be secured by all of the assets of the SPV. The SMCCF is not yet operational.

The term sheet for the SMCCF is available to the public on the Board's website, and the more detailed terms and conditions will be available when finalized. The discussion below summarizes these terms and conditions. The Board and Reserve Bank continue to monitor the affected financial markets and to consult with market participants and, accordingly, the terms and conditions governing the SMCCF may be modified in the future as appropriate.

Eligible Individual Corporate Bonds. The SMCCF may purchase corporate bonds that meet each of the following criteria at the time of purchase: (i) issued by an eligible issuer; (ii) rated at least BBB-/Baa3 by a major nationally recognized statistical rating organization (NRSRO) and, if rated by multiple major NRSROs, rated at least BBB-/Baa3 by two or more NRSROs, in each case subject to review by the Federal Reserve; and (iii) have a remaining maturity of five years or less.

Eligible Issuers for Individual Corporate Bonds. Eligible issuers for direct purchases of individual corporate bonds on the secondary market are U.S. businesses with material operations in the United States. Eligible issuers do not include companies that are expected to receive direct financial assistance under pending federal legislation.

Eligible ETFs. The SMCCF also may purchase U.S.-listed ETFs whose investment objective is to provide broad exposure to the market for U.S. investment grade corporate bonds.

Limits per Issuer or ETF. The maximum amount of bonds that the SMCCF will purchase from any eligible issuer will be capped at 10 percent of the issuer's maximum bonds outstanding on any day between March 22, 2019, and March 22, 2020. The SMCCF will not purchase more than 20 percent of the assets of any particular ETF as of March 22, 2020.

Pricing. The SMCCF will purchase eligible corporate bonds at fair market value in the secondary market. It will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio.

Termination Date. The SMCCF will cease purchasing eligible corporate bonds and eligible ETFs no later than September 30, 2020, unless it is extended by the Board. The Reserve Bank will continue to fund the SMCCF after such date until its holdings either mature or are sold.

Requirements Imposed on Recipients. The SMCCF will not impose any new requirements with respect to employee compensation, distribution of dividends, or any other corporate decision.

Expected Costs to Taxpayers. The Federal Reserve and the Department of the Treasury, through its equity investment, will bear the risk of loss on the bonds and ETFs purchased by the SMCCF. To mitigate this risk, the program is limited to bonds that are rated at least BBB-/Baa3 by a major NRSRO and, if rated by multiple major NRSROs, rated at least BBB-/Baa3 by two or more NRSROs, in each case subject to review by the Federal Reserve. The SMCCF will purchase only ETFs whose investment objective is to provide broad exposure to the market for U.S. investment grade corporate bonds. In addition, the SMCCF will purchase eligible bonds at their fair market value and will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio. The SMCCF will receive payments from eligible issuers and through its ETF holdings. As a result, the Board does not expect at this time that the SMCCF will result in losses in excess of the Department of the Treasury's equity investment. Accordingly, the SMCCF is not expected to result in losses to the Federal Reserve or the taxpayer.