Fed Announces $2.3 Trillion of Additional Support to the Economy

The Federal Reserve continues to throw more money in to the U.S. financial system to support the sputtering economy. Today, the U.S. central bank said it would provide up to $2.3 trillion in loans for American households and businesses, as well as local governments besieged by the coronavirus outbreak. Federal Reserve Chairman Jerome Powell said the Fed's role was to "provide as much relief and stability as we can during this period of constrained economic activity, and our actions today will help ensure that the eventual recovery is as vigorous as possible."

The Federal Reserve's role is guided by its mandate from Congress to promote maximum employment and stable prices, along with its responsibilities to promote the stability of the financial system. In support of these goals, the Federal Reserve is using its full range of authorities to provide powerful support for the flow of credit in the economy.

The actions the Federal Reserve is taking today to support employers of all sizes and communities across the country will be:

Paycheck Protection Program Liquidity Facility

Bolster the effectiveness of the Small Business Administration's Paycheck Protection Program (PPP) by supplying liquidity to participating financial institutions through term financing backed by PPP loans to small businesses. The PPP initiative provides loans to small businesses so that they can meet payroll obligations and other necessary overhead for up to eight weeks. The loans may be forgiven if the small businesses meet certain criteria such as retaining or rehiring workers. The Paycheck Protection Program Liquidity Facility (PPPLF) will extend credit to eligible financial institutions that originate PPP loans, taking the loans as collateral at face value. Extensions of credit under the PPPLF will be at a rate of 35 bps. The maturity date of an extension of credit under the PPPLF will equal the maturity date of the PPP loan pledged to secure the extension of credit. Importantly, PPP loans will be assigned a weight of zero percent under the risk-based capital rules. Federal Banking Regulators also issued an interim final rule that will allow financial institutions to neutralize the effect of PPP loans financed under the PPPLF on regulatory capital ratios. This relief applies to both risk-based and leverage capital ratios, including the Community Bank Leverage Ratio. The capital relief is effective immediately.

Takeaway for financial institutions: These efforts by the Fed and Federal Banking Regulators should speed up the flow of funds to small businesses and assuage fears from financial institutions concerning potential liquidity pressure and capital constraints in connection with extending financing under the PPP.

Municipal Liquidity Facility

Help state and local governments manage cash flow stresses caused by the coronavirus pandemic by establishing a Municipal Liquidity Facility that will provide debt liquidity to eligible states, cities, and counties in the amount of $500 billion. The facility will purchase eligible notes from states and larger city and county issuers, and the notes will have maturity dates of 24 months from issuance or less. The Fed allows for wide latitude in how issuers disperse the proceeds from securities purchased by the facility, but the intention is to lessen the impacts of disruptions from income tax deferrals, reductions in tax revenues or increases in expenses, and to also allow for the timely payment of debt obligations of the issuer.

Takeaway for financial institutions: While the Federal Reserve is injecting the necessary liquidity to ease the short-term burdens on issuers due to the COVID-19 pandemic, the impacts will likely be mostly felt on the front end of the municipal curve. The facility should improve bond liquidity across the entire sector, pushing overall municipal bond yields down to some degree, but the effect of limiting the facility's purchases to short-term debt securities should serve as an anchor on the front end of the curve. Financial institutions, which typically invest on the longer end of the municipal curve, will likely still find similar value where they have found it in the past: in notes with maturity dates of 10-15 years (or longer).

Main Street Lending Program

Support the borrowing needs of small to mid-sized businesses as originally announced by the Fed in a March 23rd press release. The intent is for it to complement the SBA's efforts for businesses that might otherwise be ineligible or cap-out on borrowings under the Paycheck Protection Program (PPP). The program will operate under two facilities, The Main Street New Loan Facility (MSNLF) and the Main Street Expanded Loan Facility (MSELF). They chose to operate these very similar programs under two separate facilities. Below is a brief overview of the program and we encourage you to look at the actual term sheets for further detail.

Treasury will make a $75 billion equity investment in a Special Purpose Vehicle (SPV) enabling up to $600 billion in new borrowings. Eligible businesses may have up to 10,000 employees or $2.5 billion in 2019 revenue. Previous or subsequent participation in PPP does not exclude one from this program. The minimum loan size under this program is $1 million and lenders will retain a 5% interest in loans made and the SPV will purchase the remaining 95%. Risk sharing between lender and the SPV will be on a pari passu basis. Loan proceeds, in general, must be new borrowings and may not be used to pay down, refinance, or reduce other commitments of the borrower. Loan terms are a 4-year maturity, amortization of P&I deferred for one year, interest rate of SOFR + 250-400 bps, and prepayments allowed with no penalties. Borrowers will face restrictions on stock buybacks, dividends, and executive compensation as noted in section 4003(c)(3)(A)(ii) of the CARES Act.

Takeaway for financial institutions: This program provides further liquidity so lenders can provide financing for larger commercial customers who may have either been excluded or capped out on borrowings under the SBA's Paycheck Protection Program (PPP). Unlike the PPP, there is an element of risk here for the lender as they retain 5% of the loans. However, the interest rate on the loans are much higher as the interest rate will be SOFR (currently 0.01%) + 250-400 bps.

Primary & Secondary Market Corporate Credit Facilities / Term Asset-Backed Securities Loan Facility

Increase the flow of credit to households and businesses through capital markets, by expanding the size and scope of the Primary and Secondary Market Corporate Credit Facilities (PMCCF and SMCCF) as well as the Term Asset-Backed Securities Loan Facility (TALF). To qualify for eligibility through the PMCCF or SMCCF, the issuer must have been rated investment grade (BBB-/Baa3 or better) by a major nationally recognized rating organization as of March 22, 2020. Issuers that are subsequently downgraded after that deadline but maintain a BB-/Ba3 rating will also qualify. TALF-eligible collateral will now include the triple-A rated tranches of both outstanding commercial mortgage-backed securities and newly issued collateralized loan obligations. TALF will continue to support the issuance of asset-backed securities that fund a wide range of lending, including student loans, auto loans, and credit card loans. These three programs will now support up to $850 billion in credit backed by $85 billion in credit protection provided by the Treasury.

Takeaway for financial institutions: Investment grade spreads have widened dramatically during the COVID-19 outbreak, leading to considerable dislocation in the corporate sector. The Fed's Primary and Secondary Market Corporate Credit Facilities (PMCCF and SMCCF), which are buying investment-grade bonds directly from issuers and in the market, should ease the flow of credit in the capital markets and therefore return corporate spreads closer to historical norms. The addition of the "fallen angel" clause should further reduce recent volatility in the corporate sector due to heightened credit downgrades amid the COVID-19 pandemic. The liquidity facility through the TALF will allow the continued securitization of collateral such as auto and student loans, credit card receivables, and equipment loans and leases. This program should further bolster liquidity and reduce spreads in the sector.

These programs are certain to be a fluid situation and we will provide periodic updates as necessary. In the meantime, if you have any questions, comments, or would like to discuss further, please don't hesitate to reach out to your account representative or the strategies department.

Links to Individual Term Sheets

TALF: Term Asset-Backed Securities Loan Facility (PDF)

PMCCF: Primary Market Corporate Credit Facility (PDF)

SMCCF: Secondary Market Corporate Credit Facility (PDF)

MLF: Municipal Liquidity Facility (PDF)

PPPLF: Paycheck Protection Program Lending Facility (PDF)

Main Street Lending Program

MSNLF: Main Street New Loan Facility (PDF)

MSELF: Main Street Expanded Loan Facility (PDF)

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