Corporate Credit and the CARES Act and Federal Lending Programs

As of April 23, 2020

Miriam Legrand
VP, Corporate Credit Research

Over the past few weeks the government and the Fed have announced key programs that have helped to stabilize the credit markets. Below we outline the ones we believe are most critical to the high-grade markets:

PROGRAM	EFFECTIVE	DETAILS	IMPACT TO CORPORATE CREDIT
Commercial Paper Funding Facility ($10 B facility)	March 23rd	Announced March 17th. An SPV, financed by the Fed, will purchase unsecured and asset backed A1/P1 (as of March 17, 2020) commercial paper from eligible companies. Treasury will provide $10 B of credit protection from the Exchange Stabilization Fund.	Increased confidence in short term lending markets to reduce prime funds outflows.
Primary Corporate Credit Facility ($500 B capacity)	April 9th	Announced March 23rd. The PMCCF will now be able to purchase corporate bonds of maturity up to 4 years both as the sole investor in a bond issuance or as part of the syndication process, similar to the ECB. The Fed eased the terms of eligibility for issuers in the announcement to include those rated at least BBB-/Baa3 as of March 22 and later downgraded to a rating of at least BB-/Ba3 at the time of the Fed's purchase. Issuers must be US businesses, cannot be banks, and cannot be recipients of other specific support under the CARES Act.	Supports investment grade issuers and those that were investment grade but fell into high yield at 3/22/20 and provides them an additional source of capital. This should support the broader high yield market and absorb the inflow of investment grade "fallen angel" bonds.
Secondary Corporate Credit Facility ($250 B capacity)	April 9th	Announced March 23rd. The SMCCF will purchase both individual corporate bonds with a remaining maturity of up to 5 years and corporate bond ETFs. The issuer eligibility criteria for individual issuers are the same as those for the PMCCF. Most ETF holdings will provide exposure to investment grade bonds, but some will also provide exposure to high yield bonds.	Supports investment grade bonds and funds as well as some high yield funds.
CARES Act	March 27th	Announced on March 25th, the wide encompassing act will provide: ▪ Recovery rebates ▪ Unemployment compensation ▪ Support for air carriers and businesses critical to national security.	Should support financial institutions as it weakens the impact of the pandemic on asset quality. Provides direct loans and grants to airlines and other large companies critical to national security. Many of these companies are issuers in the investment grade and high yield markets.

Source: Federalreserve.gov/monetarypolicy/policytools, www.congress.gov and Fiera Research, as of April 9, 2020.

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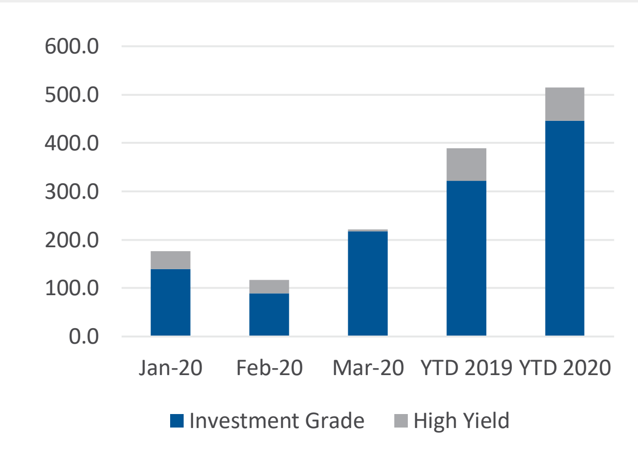
Key implications across the corporate credit market

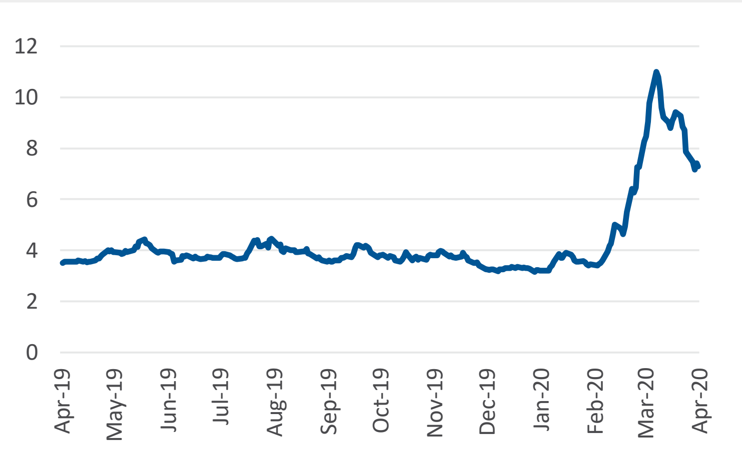
The backdrop for credit became more constructive post the announcements of these programs. We have seen record issuance for corporates given a more favorable backdrop and have seen a compression in high yield spreads.

Issuance



Source: SIFMA, as of 4/7/20

US Corporate High Yield Average OAS Bid Price



Source: Bloomberg Barclays, as of 4/17/20

The Federal Reserve released an FAQ for its bond buying program. Here are some of the points the FED addressed:

- The FED will require statements of eligibility from program participants
- Under the programs the ratings criteria refer to ratings by Moody's, S&P and Fitch
- Eligible issuers may use the primary corporate credit facility to refinance existing debt
- Eligible issuers must pay a facility fee of 100bps each time they access the facility
- Investment grade senior secured bonds issued by non-investment grade issuers will not be eligible under the Primary Corporate Credit Facility
- The Secondary Market Corporate Credit Facility will only purchase US dollar bonds of eligible issuers

But some questions remain outstanding:

- When is the start date of the program?
- Which part of the front end of the yield curve will the Fed look to buy?
- The Fed has asked BlackRock to serve as the initial investment manager facilitating the program. How other managers will be determined still unclear.

The level of participation from investment grade companies is not clear as the primary corporate credit facility requires a 1% upfront fee. In addition, companies may be wary of having the US government as a creditor given concerns about potential limitations. We continue to see lower quality investment grade issuers tap the market prior to the programs beginning so does that imply they will be less inclined to participate? We will not know until the program begins but we continue to watch.

Click here to access the Fed's FAQ.

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