

Client Alert

A report
for clients
and friends
of the Firm

October 2008

Commercial Paper Funding Facility

The Federal Reserve announced today a new initiative to avert a crippling liquidity crisis for U.S. businesses that rely on the commercial paper market to fund short-term liquidity. The Federal Reserve is establishing a special fund to lend money directly to eligible businesses/issuers. Eligible issuers are U.S. issuers, including U.S. issuers with a foreign parent.

The new “Commercial Paper Funding Facility” will be a special purpose vehicle (“SPV”), funded by both the Federal Reserve and the Treasury Department, that will purchase highly rated three-month commercial paper (i.e., debt instruments) issued by eligible corporations. The commercial paper must be rated at least A1/P1/F1 by a major nationally-recognized statistical rating organization (or “NRSRO”) and not rated below A1/P1/F1 by any major NRSRO. The eligible commercial paper will include both asset-backed commercial paper (“ABCP”) and non asset-backed commercial paper. If the paper is non asset-backed, the Federal Reserve will require other security to its satisfaction; specifically, such security may be provided in one of the following ways:

- (i) the issuer pays the SPV an up-front fee based on the commercial paper initially sold to the SPV and a further fee based on subsequent commercial paper sales above that initial amount; or
- (ii) the issuer obtains an indorsement or guarantee of the issuer’s obligations on the commercial paper sold to the SPV that is satisfactory to the Federal Reserve; or
- (iii) the issuer provides security or collateral arrangements that are satisfactory to the Federal Reserve.

In an effort to provide additional flexibility, the Federal Reserve also has indicated that it will consult with market participants about other methods for issuers of non asset-backed commercial paper to provide satisfactory security to the Federal Reserve.

The intended vagueness of the language setting forth the security requirements suggest that the specific requirements have been left to evolve over time, as market participants – and the markets more generally – react to the terms of the facility.

This new facility will provide immediate liquidity support to eligible businesses that otherwise may be frozen out of the commercial paper market. The stated policy goal is “to help provide liquidity to term funding markets,” specifically by “eliminating much of the risk that eligible issuers will not be able to repay investors by rolling over their maturing commercial paper obligations.” The Federal Reserve’s intended policy outcome is to encourage investors to engage once again in term lending in the U.S. commercial paper market.

The terms of the facility assume a more normalized lending environment. For instance, interest on the 3-month U.S. dollar-denominated commercial paper will be determined by a spread over the 3-month overnight index swap (OIS) rate. The “Federal Reserve will consult with market participants regarding appropriate spreads that are consistent with the facility serving as a funding backstop under more normal market conditions (for example, 100 basis points).”

The facility should provide increased confidence in the U.S. commercial paper market. However, it is not intended to increase the volume above pre-existing levels. The maximum amount of commercial paper that a single business/issuer may sell to the SPV will be the average amount of commercial paper the issuer had outstanding as of August 2008, less any amount of the issuer’s outstanding commercial paper held by investors other than the SPV.

The Treasury will make a special deposit at the Federal Reserve Bank of New York to support this facility. This U.S. government intervention in the U.S. commercial paper market is without precedent, but is consistent with the government's effort to support the continued functioning of the U.S. credit markets.

The SPV will stop purchasing commercial paper on April 30, 2009, unless the Federal Reserve elects to extend the facility. However, the Federal Reserve will continue to fund the SPV beyond that date until the SPV's assets mature.

Proskauer's Finance group continues to work with its clients to resolve the numerous challenges and legal issues arising during these difficult economic times. Our team is available to answer any questions you may have regarding this client alert or your commercial paper facilities.

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