COVID-19 NEWS OF INTEREST

Federal Reserve and U.S. Treasury Seek to Bolster Money Market Funds

March 23, 2020

AUTHORS

Justin L. Browder | Benjamin J. Haskin

On March 18, 2020 the U.S. Federal Reserve announced the launch of a Money Market Mutual Fund Liquidity Facility (the "Facility"). Under the terms of the Facility, which commences today, the Federal Reserve Bank of Boston will make loans available to eligible financial institutions secured by high-quality assets purchased by such financial institutions from certain money market mutual funds, including prime funds.[1] Prime money market funds have faced substantial redemptions in recent weeks and are a significant source of credit for corporate borrowers that access the short-term commercial paper market.

The Federal Reserve stated that it designed the Facility to enhance liquidity in commercial paper and other portfolio securities held by money market funds as markets continue to face extreme volatility during the ongoing COVID-19 pandemic. By enhancing liquidity, the Facility is expected to assist funds in meeting demands for redemptions by investors and thereby facilitate credit to the broader economy. Details regarding the Facility were set out in a brief term sheet released by the Federal Reserve, with more details expected in the coming days.[2] The structure and terms of the Facility are substantially similar to the Asset-Backed Commercial Paper Money Market Liquidity Facility that was established in September 2008, except that the new Facility provides for a more extensive list of eligible collateral.

Separately on March 18, the Treasury Department reportedly sought approval from Congress to institute a guarantee program for money market mutual funds similar to the one instituted in 2008. The program would require Congress to lift

[1] *See* Federal Reserve Board broadens program of support for the flow of credit to households and businesses by establishing a Money Market Mutual Fund Liquidity Facility (March 18, 2020), available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200318a.htm

[2] *See* Board of Governors of the Federal Reserve System, Term Sheet, Money Market Mutual Fund Liquidity Facility, available at https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200318a1.pdf.

current limitations on the use of The Exchange Stabilization Fund, a crisis-era backstop fund. On March 19, the Senate introduced a comprehensive economic relief bill that would lift the limitations for purposes of guaranteeing money market funds, but the legislation has not advanced as of this writing.

A summary of the Facility's structure, related regulatory actions, and the reported details of Treasury's proposed guarantee program is set out below.

Summary of the Federal Reserve Facility's Terms

Relief Limited to Certain Money Market Funds. An important limitation under the Facility is that collateral securing loans may be acquired only from a money market fund that identifies itself as a "prime fund," "single-state fund," or "other tax-exempt fund" in Item A.10 of Form MFP,[3] each of which maintains a floating net asset value ("NAV").[4] Prime funds invest in non-government fixed income securities and repurchase agreements while single-state funds and tax-exempt funds generally invest in state and municipal securities exempt from income taxes.[5] In recent weeks, prime funds have faced significant redemptions as investors move to government money market funds, which maintain a stable NAV at a price per share of $1.00 and are not required to impose liquidity fees or suspend redemptions in times of market distress. According to industry reports, investors had redeemed nearly $100 billion from prime funds from March 16 through March 20, and one prime fund in particular was reported to have sold over $1 billion in portfolio securities to an affiliate on March 20 as a means of shoring up liquidity to meet shareholder redemptions.[6]

Eligible Borrowers. All U.S. depository institutions, U.S. bank holding companies (parent companies incorporated in the United States or their U.S. broker-dealer subsidiaries), or U.S. branches and agencies of foreign banks are eligible to borrow under the Facility.

Eligible Collateral. Collateral eligible to be pledged under the Facility is limited to: (i) U.S. Treasuries and Fully Guaranteed Agency Securities; (ii) securities issued by U.S. Government Sponsored Entities ("GSEs"); (iii) asset-backed or unsecured commercial paper that, in each case, is issued by a U.S. issuer, is rated not lower than A1, F1, or P1 by at least two major rating agencies or, if rated by only one major rating agency, is rated within the top rating category by that agency;

3 Board of Governors of the Federal Reserve System, Money Market Mutual Fund Liquidity Facility FAQs, March 21, 2020, available at https://www.federalreserve.gov/monetarypolicy/files/mmlf-faqs.pdf. ("Federal Reserve FAQs").

4 As a result of the Securities and Exchange Commission's 2014 money market fund reforms, a prime fund, single-state fund, or tax-exempt fund that is not exclusively offered to natural person investors must, among other requirements (i) maintain a floating NAV; and (ii) impose liquidity fees in the amount of 1% of the value of shares redeemed (but not more than 2%) if, as of the end of any business day, the fund has less than 10% of its total assets invested in weekly liquid assets, unless the fund's board determines otherwise. See Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31,116 (July 23, 2014), available at https://www.sec.gov/rules/final/2014/33-9616.pdf.

5 17 C.F.R. § 270.2a-7(a).

6 Paul Kiernan, Andrew Ackerman and Dave Michaels, *Why the Fed Had to Backstop Money-Market Funds, Again*, WALL ST. J. (March 21, 2020), available at https://www.wsj.com/articles/why-its-so-difficult-to-stop-the-spread-of-the-coronavirus-11584871200?mod=cxrecs_join#cxrecs_s.

(iv) certain U.S. municipal short-term debt; and (v) receivables from certain repurchase agreements. Borrowers are eligible to pledge collateral acquired from affiliated money market funds so long as the transaction is otherwise permitted under applicable law.[7]

Interest and Recourse. Under the Facility, advances secured by U.S. Treasuries and Fully Guaranteed Agency Securities or securities issued by GSEs will be subject to a rate equal to the primary credit rate in effect at the time the advance is made. Advances secured by other collateral will be subject to a rate equal to the primary rate plus 100 basis points. All advances will be made on a non-recourse basis, and the Federal Reserve was careful to note in the term sheet that “borrowers under the [Facility] will bear no credit risk.”

Maturity and Term. The maturity date of an advance will be equal to the earlier of: (i) 12 months from the date of the advance; or (ii) the maturity date of the collateral pledged to secure the advance. The Facility itself will be in place until September 30, 2020, unless extended by the Federal Reserve.

Credit Protection. The Treasury Department, under the Exchange Stabilization Fund, will provide $10 billion in credit protection to the Federal Reserve Bank of Boston. The Exchange Stabilization Fund was established in 2008 to provide guarantees to money market funds.

Corresponding Regulatory Relief

Following the announcement of the Facility, the OCC and FDIC issued interim final rules that act to neutralize the impact of a banking institution’s participation in the Facility for purposes of regulatory capital requirements, including risk-based capital and leverage requirements.[8] Under the agencies’ capital rules, risk-based and leverage capital requirements are expressed as a ratio of regulatory capital to assets. Participation in the Facility will result in a banking institution acquiring and holding assets on its balance sheet. As a result, a banking institution that participates in the Facility could potentially be subject to increased capital requirements. Because of the non-recourse nature of the Federal Reserve’s extension of credit to a banking institution that participates in the Facility, such institution will not be exposed to credit or market risk from the assets purchased and pledged to the Federal Reserve. Accordingly, the agencies determined to adopt the interim final rules to permit a banking institution to exclude the effects of purchasing assets through the Facility from the institution’s regulatory capital.

7 Federal Reserve FAQs.

8 *See* Regulatory Capital Rule: Money Market Mutual Fund Liquidity Facility 12 C.F.R. Part 3 Docket No. OCC-2020-0011; RIN 1557-AE83, available at https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200319a1.pdf.

Related Efforts by Treasury to Guarantee Money Market Funds

News reports on March 18 indicated that the Treasury Department has also sought permission from Congress for authority to develop a new guarantee program for money market mutual funds by tapping into the Exchange Stabilization Fund.[9] Any such authority would require Congress to lift limitations that expressly prohibit the Treasury Department from using the Fund for the establishment of any future guarantee programs for the U.S. money market mutual fund industry.[10] These limitations were instituted in the wake of political objections to crisis-era bailouts. On March 19, the U.S. Senate introduced a comprehensive economic relief bill that would lift the limitations until the termination of the state of emergency that was declared by President Trump on March 13, 2020.[11] The legislation has not advanced as of this writing.

Willkie has multidisciplinary teams working with clients to address coronavirus-related matters, including, for example, contractual analysis, litigation, restructuring, financing, employee benefits, SEC and other corporate-related matters. Please click here to access our publications addressing issues raised by the coronavirus. For advice regarding the coronavirus, please do not hesitate to reach out to your primary Willkie contacts.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

Justin L. Browder
202 303 1264
jbrowder@willkie.com

Benjamin J. Haskin
202 303 1124
bhaskin@willkie.com

9 *See, e.g.*, Kate Davidson and Dave Michaels, *Treasury Department Asks Congress to Let It Backstop Money Markets*, WALL ST. J. (March 18, 2020), available at https://www.wsj.com/articles/treasury-department-asking-congress-for-permission-to-backstop-money-markets-11584546598; Saleh Mohsin, Josh Wingrove et al., *Treasury Proposed to Guarantee Money Funds in Stimulus*, BLOOMBERG, March 18, 2020, available at https://www.bloomberg.com/news/articles/2020-03-18/treasury-proposes-to-guarantee-money-market-funds-in-stimulus.

10 12 U.S.C. § 5236.

11 CARES Act, S. 3548 – 116th Congress, § 5001 (2020).

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Palo Alto, San Francisco, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.