Updated FAQs on Fed's Corporate Credit Facilities

The Devil Is in the Details

We view the updated FAQs on the two corporate credit facilities as an incremental negative for credit. While the SMCCF will start buying ETFs soon, the more stringent certification requirements to access the PMCCF will likely severely limit its use.

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The Fed provided updated details on the two corporate credit facilities this morning. While we believe the two programs are positive for investment grade credit, we view the new details as an incremental negative, as they will limit the facilities' efficacy. The SMCCF will begin purchasing ETFs soon, but the self-certification process appears still to be under development, suggesting a likely further delay before the two credit facilities can start buying corporate bonds. More important, the certification requirement to access PMCCF, which is twice the size of the secondary facility (based on initial size), is much more stringent and will likely keep most issuers from accessing it unless they face substantial distress. Below, we discuss some of the key updates provided today (for more details on the facilities, see Fed Provides Strong Support for BBBs and Fallen Angels, Disappoints for Rest of High Yield and Loans):

1. **Timing**: the SMCCF is expected to begin purchasing eligible ETFs in "early May," with the PMCCF and corporate bond buying under the SMCCF expected to begin "soon after." It appears that the certification process, which requires issuers to certify that they meet five conditions[1] to have their bonds eligible even for the secondary facility, remains under development and has not been fully finalized. Specifically, the FAQs state that the "requirements and processes for certification are under development and will be provided in the near future." Once they are finalized, it will likely take companies some time to revert to the Fed with their certifications, suggesting further delays before the two facilities can start buying corporate debt.

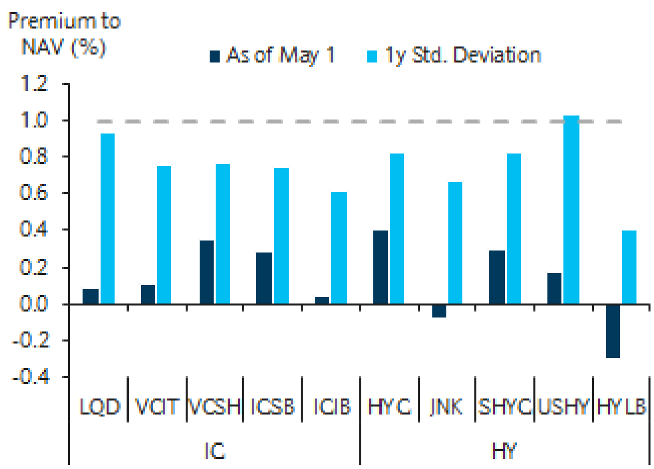
2. With the initial focus on ETFs, there have been additional details on what securities the Fed will target. In terms of the universe, it is the same as before: primarily investment grade ETFs, with the remainder in high yield ETFs. Importantly, the SMCCF will purchase only ETFs that are trading with a premium below the lower of 1% and rolling one-year standard deviation of the prior 52-week premiums.

   Figure 1 shows the current premium, as well as the past one-year standard deviation level for the largest five investment grade and high yield ETFs. Currently, all the ETFs are trading at a premium below 1% as well as one standard deviation, suggesting that they should be eligible for the SMCCF. However, as a contrast, we also show levels as of April 8, when premiums were elevated. On that day, none of the top five ETFs would have met the criteria.

[1] Including being a US business and ratings requirements

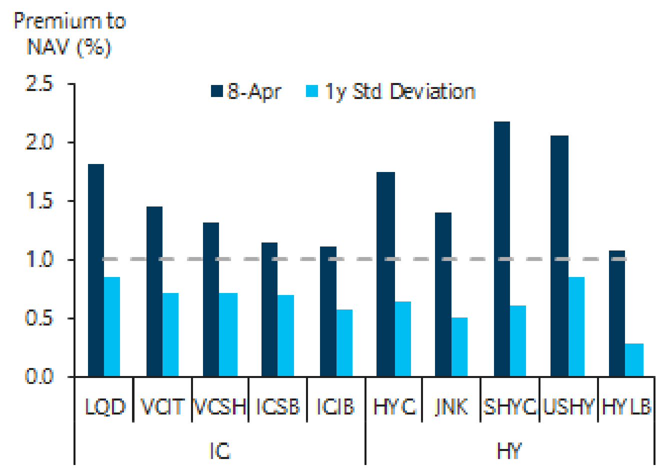
Importantly, for almost all of the securities, the one-year standard deviation level is less than 1%, and while that could change over time (as the criterion is for a rolling calculation), it is likely to be the binding constraint.

FIGURE 1. **The Premium to NAV for Select Corporate Bond ETFs iIs Well below 1% Currently ...**



Source: Bloomberg, Barclays Research

FIGURE 2. **...But That Has Not Always Been the Case**



Source: Bloomberg, Barclays Research

3. **Additional certification under PMCCF:** We believe one of the more significant updates is an issuer must also certify that it is "unable to secure adequate credit accommodations from other banking institutions and the capital markets and that it is not insolvent" to access the PMCCF. That is a fairly strong statement, which many investment grade issuers may be be unwilling to make, in our opinion. The FAQs clarify that lack of adequate credit does not necessarily mean that credit is not available but rather is available "at prices or on conditions that are inconsistent with a normal, well-functioning market."

While that may reduce some of the stigma of accessing the PMCCF, the bar to access the facility has clearly been raised: the funding environment will have to worsen significantly (ie, spreads will have to be meaningfully wider) for issuers to access the facility given this certification requirement. The PMCCF is obviously meant as a backstop facility, but this requirement means that it is more remote than we and perhaps market participants anticipated. While the PMCCF should still limit extreme tail risk, we believe the more stringent certification requirements mean that the level of spread widening before issuers access it much more acute that previously expected. All else equal, we think this is a negative for valuations in the lower-rated segments of the investment grade market.

4. **Eligible issuers - What it means to have significant operations in the US:** The term sheets state that an eligible business must have significant operations in and a majority of its employees based in the US, but did not define thresholds for significant operations. The Fed provided a list of examples (not exhaustive) that would meet the significant operations requirement, including greater than 50% of consolidated assets in or annual consolidated net income, revenue, or operating costs generated in the US. The Fed also clarified that a US subsidiary of a foreign parent could be an eligible issuer and that it will not consider any parent or sister affiliates in calculating eligibility.

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