Simpson Thacher

Memorandum

Federal Reserve Reestablishes Primary Dealer Credit Facility From the 2008 Financial Crisis

March 18, 2020

On March 17, 2020, the Federal Reserve Board announced the establishment of a Primary Dealer Credit Facility (“PDCF”) to allow primary dealers—broker-dealers that serve as trading counterparties for the Federal Reserve's open market operations—access to short-term loans beginning on March 20, 2020. Because primary dealers play a key role in providing liquidity in the U.S. Treasuries market, the PDCF is designed to allow primary dealers to support smooth market functioning and increase the availability of credit to businesses and households. The PDCF will offer overnight and term funding with maturities up to 90 days and will function similarly to the way the Federal Reserve’s discount window provides a backup source of funding to depository institutions. Credit extended to primary dealers under this facility may be collateralized by a broad range of investment grade debt securities, including commercial paper and municipal bonds, and a broad range of equity securities. There is no aggregate limit on funding under this program.

The PDCF was established pursuant to section 13(3) of the Federal Reserve Act, which provides the Federal Reserve with emergency lending authority to companies other than depository institutions through broad-based programs and facilities that relieve liquidity pressures in financial markets. The Federal Reserve Board previously implemented a similar primary dealer credit facility in March 2008 to support primary dealers during the Financial Crisis.

The PDCF follows other recent actions by the Federal Reserve Board to support the U.S. economy, including lowering interest rates and bank reserve requirements, encouraging discount window borrowing, enhancing the provision of liquidity via the standing U.S. dollar liquidity swap line arrangements with other major central banks, as well as the recent establishment of a commercial paper credit facility.

PDCF Key Terms

The Federal Reserve Board released the following high-level description of the terms of the PDCF and indicated that more detailed program terms and conditions and an operational calendar will be subsequently published.

- Borrower Eligibility: Only primary dealers of the Federal Reserve Bank of New York (“FRBNY”) are eligible to participate in the PDCF. Currently, 24 large financial institutions are primary dealers of the FRBNY.
- Eligible Collateral: Collateral eligible to be pledged under the PDCF includes all collateral eligible to be pledged in open market operations and Treasury strips, investment grade corporate debt securities,

international agency securities, commercial paper, municipal securities, mortgage-backed securities and asset-backed securities, and equity securities (except as described below).

To be eligible to be pledged, certain types of securities (including commercial mortgage-backed securities, collateralized loan obligations and collateralized debt obligations) must be AAA-rated. Other types of securities specified above will be eligible collateral if rated investment grade (*i.e.*, BBB- and above for securities such as equity and corporate debt securities and A1/P1 and A2/P2 for commercial paper).

Certain types of collateral will not be eligible to be pledged under the PDCF, including exchange traded funds, unit investment trusts, mutual funds, rights and warrants, foreign currency-denominated securities and collateral that is not priced by the clearing bank. The Federal Reserve Board may permit additional collateral at a later date.

- Term: Loans will be made available to primary dealers for a term of up to 90 days.
- Rate: Loans made under the PDCF will be made at a rate equal to the primary credit rate in effect at the FRBNY offered to depository institutions via the Discount Window.
- Prepayment: Borrowers may prepay loans at any time.
- Time of Day: During Fedwire hours.
- Custody Rules and Arrangement: Primary dealers will communicate their demand for funding to their clearing bank. The clearing bank will verify that a sufficient amount of eligible collateral has been pledged by each primary dealer participating in the PDCF and notify the FRBNY.

  Once the FRBNY receives notice that a sufficient amount of margin-adjusted eligible collateral has been assigned to the FRBNY's account, the FRBNY will transfer the amount of the loan to the clearing bank for credit to the primary dealer.
- Collateral Valuation: The pledged collateral will be valued by Bank of New York Mellon according to a schedule designed to be similar to the margin schedule for lending by the Discount Window, to the extent possible.
- Loan Size: Loans will be limited to the amount of margin-adjusted eligible collateral pledged by the dealer and assigned to the FRBNY's account at the clearing bank.
- Recourse: Loans made under the PDCF are made with recourse beyond the pledged collateral to the primary dealer entity.
- Program Termination: The PDCF will remain available to primary dealers for at least six months, or longer if conditions warrant.

For more information regarding these final rules, please contact any member of the Firm's Financial Institutions Group, including those listed below.

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