Chapman and Cutler LLP

Chapman Client Alert

April 3, 2020 Current Issues Relevant to Our Clients

Federal Reserve Posts FAQ and Borrowing Documents for Money Market Liquidity Facility

The Federal Reserve has established a webpage https://www.federalreserve.gov/monetarypolicy/mmlf.htm that provides links to a FAQ and other documents for the Money Market Fund Liquidity Facility (MMLF) described in our March 20, 2020 Client Alert *Federal Reserve Announces Money Market Fund Liquidity Facility* (Original Client Alert), as updated by our March 24, 2020, Client Alert *Federal Reserve Amends Money Market Fund Liquidity Facility to Include Additional Collateral* (Updated Client Alert).[1]

The FAQ is available at this link https://www.federalreserve.gov/monetarypolicy/files/mmlf-faqs.pdf and is also attached as Attachment I.

Consistent with the 2008 AMLF program mentioned in our Original Client Alert, question and answer C.3 on page 6 of the attached FAQ explains that commercial paper must be purchased from a money market fund (MMF) at "amortized cost."[2] As with the AMLF program, this ensures the MMF receives "par"[3] for the commercial paper it sells under the facility. This emphasizes the question we raised in our Original Client Alert whether the MMLF will be useful for commercial paper owned by MMFs purchased between roughly March 4 and March 13, since such paper typically sold at a price to yield less than the 1.25% interest rate for loans under the MMLF.[4]

Other documents posted on the Federal Reserve webpage for the MMLF program include documents that must be completed by the MMF from which a bank, broker-dealer or other eligible borrower under the MMLF purchases the relevant collateral. Among other things, this includes a form of certificate attached as Attachment II, which requires the MMLF to certify it "is unable to secure adequate credit accommodations from other banking institutions." The form, however, also states: "Lack of adequate credit does not mean that no credit is available. Lending may be available, but at prices or on conditions that are inconsistent with a normal, well-functioning market."

For More Information

If you would like further information concerning the matters discussed in this Client Alert, please contact the Chapman attorney with whom you regularly work.

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1 The Federal Reserve Bank of Boston maintains a separate webpage https://www.bostonfed.org/news-and-events/news/2020/03/key-information-moneymarket-mutual-fund-liquidity-facility.aspx describing the facility that links to the Federal Reserve webpage with the FAQ and other program documents.

2 As we noted in our Updated Client Alert, this requirement was not contained in the term sheet attached as Attachment I to the Updated Client Alert.

3 The MMF's "amortized" cost or book value for the commercial paper.

4 As explained in our Original Client Alert, "At 1% above the primary credit rate, loans to finance purchases of private commercial paper will currently bear interest at 1.25%... In general, following the FOMC's March 3, 2020, 50 bps reduction in the target federal funds rate

commercial paper rates were below 1.25%" until "commercial paper rates spiked above 1.25% on March 16." This was generally true for both financial and nonfinancial commercial paper. The Federal Reserve's April 2, 2020, H.15 release https://www.federalreserve.gov/releases/h15/, which updates each business day at 4:15 pm, shows 2 month nonfinancial commercial paper sold at 1.13% on March 30 and at 1.09% on April 1, but other maturities for nonfinancial CP and all reported prices for other dates from March 26 through April 1 (and all reported prices for financial CP) were above a 1.25% yield.

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Money Market Mutual Fund Liquidity Facility FAQs

The following is intended to address questions about the Money Market Mutual Fund Liquidity Facility (MMLF or Facility). The Federal Reserve may periodically update these FAQs and, therefore, please check this website for new FAQs or revisions to a previously issued FAQ.

Effective March 21, 2020. Amended March 27, 2020

A. Purpose and Design

A1. How will this program support money market mutual funds (MMMFs)?

In the days prior to the initiation of the program, some MMMFs experienced significant demands for redemptions by investors. Under ordinary circumstances, they would have been able to meet those demands by selling assets. Recently, however, many money markets have become extremely illiquid due to uncertainty related to the coronavirus outbreak.

Pursuant to Section 13(3) of the Federal Reserve Act, and with prior approval of the Secretary of the Treasury, the Board of Governors of the Federal Reserve System (Board) authorized the Federal Reserve Bank of Boston (FRBB) to establish the MMLF. In addition, the Secretary of the Treasury, using the Exchange Stabilization Fund, will provide $10 billion of credit protection to FRBB. The MMLF will assist MMMFs in meeting demands for redemptions by households and other investors, enhancing overall market functioning and the provision of credit to households, businesses and municipalities.

A2. How does the program work?

Under the MMLF, the FRBB will provide a nonrecourse advance to an eligible borrower to purchase certain types of assets from an eligible MMMF. The MMMF must be a fund that identifies itself as a Prime, Single State, or Other Tax Exempt money market fund under item A.10 of Securities and Exchange Commission Form N-MFP. The assets are pledged to the FRBB as collateral (eligible collateral). *See* FAQ C1 for further details on eligible collateral under the program.

A3. When will the program begin?

The program opened on March 23, 2020.

A4. How long is this program in effect?

This program was established to respond to uncertainty related to the coronavirus and is authorized through September 30, 2020. No new credit extensions will be made after September 30, 2020, unless the MMLF is extended by the Board. Terms of the program may be adjusted before that time as market conditions warrant.

A5. How will the Federal Reserve administer this program?

It will be administered by the FRBB, which is authorized to make loans under this facility to eligible borrowers in any of the twelve Federal Reserve districts.

A6. Where can I find updates regarding the terms of the program and any operating documents?

The terms of the program are available on the Board's website, and will be updated to reflect modifications. Program documents can be found at https://www.federalreserve.gov/monetarypolicy/mmlf.htm

B. Borrower Information

B1. Who is eligible to participate in this program?

Eligible borrowers include 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. Eligible borrowers must provide the FRBB with necessary certifications, which include a certification that both the borrower and the MMMF from which the collateral is purchased are not insolvent.

B2. Is it necessary to have a master account with the Federal Reserve Bank of Boston or any Federal Reserve Bank to borrow under this facility?

No. If an eligible borrower has an account with any Federal Reserve Bank, the loan will settle through the existing account. Non-accountholders may borrow through a correspondent.

B3. What borrowing documents are needed to obtain a loan under this facility?

The documents will be posted at [www.frbdiscountwindow.org]. A Borrower that does not currently have OC-10 documentation on file with their local Reserve Bank must complete Authorizing Resolutions for Borrowers adopted by the Borrower's board of directors and signed by a certifying official. An official authorized under that resolution must sign the FRBB's Letter of Agreement governing the program. Prior to receiving an advance, a borrower must provide certain written certifications, including a certification that it and the MMMF are not insolvent (*See* section 201(d)(5)(iii) of the Board's Regulation A). Certifications must be made by the chief executive officer or other authorized person. A borrower must notify FRBB immediately if any information in the certifications changes.

A scanned copy of properly executed documents must be delivered via e-mail to MMLF@bos.frb.org, prior to any extension of credit under the MMLF. The original executed documents should then be delivered or mailed to the address specified in the documents.

B4. Can the eligible borrower pledge commercial paper bought from proprietary funds under this facility?

Yes. For example, if eligible borrower "XYZ" manages a qualified MMMF, "Blue Ribbon Fund," XYZ may fund the purchase of CP from Blue Ribbon Fund under this Facility, so long as the transaction does not otherwise violate banking laws, securities laws or any other laws.

B5. Can the borrower buy from a qualified fund ABCP that was issued by an ABCP program for which the borrower serves as the sponsor and pledge that paper under this Facility?

Yes. A qualified borrower may pledge ABCP from one of its own programs. For example, if qualified borrower "XYZ" sponsors ABCP "Blue Ribbon Funding Trust IV," which is held by a qualified MMMF, XYZ may fund the purchase of ABCP from the fund and pledge it to secure a loan under this Facility.

B6. If a broker-dealer is participating in the Primary Dealer Credit Facility, can the authorizing resolution filed by the broker-dealer in conjunction with that program satisfy the resolution requirements for the MMLF?

No. A separate authorizing resolution is required.

B7. How will borrowers be notified of loan amounts and terms?

The FRBB will send via email a report of loan amounts and terms on the day following the borrowing to the individuals designated by the borrower on the Letter of Agreement.

B8. Are there other account-related steps that need to be taken prior to borrowing?

Yes. Each borrowing entity needs to establish a new Federal Reserve issued customer identification number or "pseudo ABA" at least 24 hours in advance of requesting a loan. Please send any related inquiries or requests for pseudo ABAs to MMLF@bos.frb.org.

B9. Can the borrower buy from a qualified fund CP or NCDs that were issued by the borrower and pledge that paper under this Facility?

Yes.

B10. Can the borrower buy from a qualified fund Variable Rate Demand Notes (VRDNs) that are liquidity or credit enhanced by the borrower and pledge that paper under this Facility?

Yes.

B11. How does the Borrower repay principal and interest of the loans under the MMLF?

On the morning of the maturity date, the FRBB will debit the Reserve Bank account associated with the pseudo ABA of the Borrower for the loan amount and associated accrued interest.

B12. How will MMLF loans appear on the Account Management Information (AMI®) statements?

MMLF loans are issued to the borrower's newly created Federal Reserve issued customer identification numbers or "pseudo ABAs." This is done in order to segregate these loans from other types of FRBB advances. The FRBB has defined these pseudo ABAs to settle all of the transactions associated with these loans to the borrowing institution's master account, or to their designated correspondent's master account. The loan activity will appear on the master account's Statement of Account in the respondent detail section. These entries may also be viewed real-time in the AMI® application by drilling down on Account Balance, requesting the Single Respondent account view, and choosing the applicable pseudo ABA.

C. Collateral Requirements

C1. Which forms of collateral are eligible?

At this time, the collateral that is eligible for pledge under the Facility must be one of the following types:

1. U.S. Treasuries & Fully Guaranteed Agencies;
2. Securities issued by U.S. Government Sponsored Entities;
3. Asset-backed commercial paper (ABCP), unsecured commercial paper, or a negotiable certificate of deposit (NCD) that is issued by a U.S. issuer, and that has a short-term rating at the time purchased from the Fund or pledged to the Reserve Bank in the top rating category (e.g., not lower than A1, F1, or P1, as applicable) from at least two major nationally recognized statistical rating organizations (NRSRO) or, if rated by only one major NRSRO, is rated within the top rating category by that NRSRO;
4. U.S. municipal short-term debt (excluding variable rate demand notes) that:
    a. Has a maturity that does not exceed 12 months; and
    b. At the time purchased from the Fund or pledged to the Reserve Bank:
        i. Is rated in the top short-term rating category (e.g., rated SP1, MIG1, or F1, as applicable) by at least two major NRSROs or if rated by only one major NRSRO, is rated within the top rating category by that NRSRO; or
        ii. If not rated in a short-term rating category, is rated in one of the top two long-term rating categories (e.g., AA or equivalent or above) by at least two major NRSROs or if rated by only one major NRSRO, is rated within the top two rating categories by that NRSRO.
5. Variable rate demand note (VRDN) that:
    a. Has a demand feature that allows holders to tender the note at their option within 12 months; and
    b. At the time purchased from the Fund or pledged to the Reserve Bank:
        i. Is rated in the top short-term rating category (e.g., rated SP1, VMIG1, or F1, as applicable) by at least two major NRSROs or if rated by only one major NRSRO, is rated within the top rating category by that NRSRO; or
        ii. If not rated in a short-term rating category, is rated in one of the top two long-term rating categories (e.g., AA or equivalent or above) by at least two major NRSROs or if rated by only one major NRSRO, is rated within the top two rating categories by that NRSRO.

Please see the responses to questions below (e.g., C7) for additional limitations and clarifications on collateral eligibility and pledging of collateral.

C2. How is "U.S. Issuer" defined for purposes of collateral eligibility?

A U.S. issuer is an entity organized under the laws of the United States or a political subdivision or territory thereof, or is a U.S. branch of a foreign bank.

C3. At what price must the banking organization purchase the eligible collateral from the Money Market Mutual Fund?

To be eligible collateral, it must be purchased at a price consistent with the collateral valuation. The collateral valuation will either be the seller's amortized cost or the fair value. For ABCP, unsecured commercial paper, NCDs, U.S. municipal short-term debt, and VRDNs, the valuation will be the seller's amortized cost.

C4. The Letter of Agreement requires a borrower to represent and warrant that certain collateral types (e.g., commercial paper, negotiable CDs, VRDNs) pledged to the Reserve Bank under the MMLF were purchased at amortized cost. Does that mean that assets that a borrower purchased or will purchase at fair market value pursuant to an exemption from Section 23A of the Federal Reserve Act and the Board's Regulation W issued by the Federal Reserve would be ineligible for pledge under the facility?

No, the assets are eligible for pledge as collateral. For the purposes of the Letter of Agreement only, unless and until otherwise notified by the Reserve Bank in its sole discretion, eligible collateral purchased by a borrower at fair market value pursuant to and in compliance with an exemption from Section 23A of the Federal Reserve Act and the Board's Regulation W issued by the Federal Reserve shall be treated as having been purchased at amortized cost. The borrower must otherwise comply with all the terms and conditions in the Letter of Agreement, including other requirements on eligible collateral.

C5. Are floating rate instruments deemed to be acceptable collateral?

Yes. Floating rate instruments that qualify as eligible collateral may be posted to the MMLF as collateral under the same fixed-rate terms and purchase price as other loans. Accordingly, interest rate risk will be borne by the borrower.

C6. Under the program, can an eligible borrower borrow against collateral that it had owned prior to creation of the program?

No. It can only borrow against eligible collateral purchased from a MMMF on or after March 18, 2020.

C7. When must an eligible borrower pledge collateral? Is it necessary for the eligible borrower to pledge and borrow against the eligible collateral on the same day that it purchases such collateral from a MMMF?

Type of collateral	Purchased	Must be Pledged
U.S. Treasuries & Fully Guaranteed Agencies	On or after March 18, 2020, and before close of business on March 23, 2020	Expeditiously*
U.S. Treasuries & Fully Guaranteed Agencies	After March 23, 2020	Concurrently
Securities Issued by U.S. Government Sponsored Entities	On or after March 18, 2020, and before close of business on March 23, 2020	Expeditiously*
Securities Issued by U.S. Government Sponsored Entities	After March 23, 2020	Concurrently
ABCP and unsecured commercial paper	On or after March 18, 2020, and before close of business on March 23, 2020	Expeditiously*
ABCP and unsecured commercial paper	After March 23, 2020	Concurrently
Short-term municipal bonds	On or after March 20, 2020, and before close of business on March 23, 2020	Expeditiously*
Short-term municipal bonds	After March 23, 2020	Concurrently
VRDNs**	On or after March 23, 2020, and before close of business on March 25, 2020	Expeditiously, starting on March 25, 2020.*
VRDNs**	After March 25, 2020	Concurrently
NCDs**	On or after March 23, 2020, and before close of business on March 25, 2020	Expeditiously, starting on March 25, 2020.*
NCDs**	After March 25, 2020	Concurrently

*Collateral pledged by close of business on March 25, 2020, will be considered to have been pledged expeditiously.

**FRBB will not accept VRDNs and NCDs before March 25, 2020.

C8. Can CP with an extendable maturity be pledged to the MMLF?

No. If the CP has an extendable feature such that the CP maturity date can be extended under certain conditions, the CP is not eligible to be pledged to the MMLF.

C9. What are the instructions for pledging collateral?

To pledge collateral, the following steps must be completed by 3:30 p.m. on the day the collateral is pledged:

(i) Approved for pledging. The FRBB has directed the Borrower to transfer the securities to the FRBB's Pledgee 600 account at DTC under the pseudo ABA number assigned to the Borrower by FRBB pursuant to the MMLF; and

(ii) Transfer. Borrower transfers the securities as directed by the FRBB and the transfer shows as "made" at DTC at the official close of DTC on the day of transfer.

C10. Are Tender Option Bonds deemed to be acceptable collateral?

No.

C11. Are NCDs and CP issued *directly* by a foreign entity acceptable collateral?

No. However, NCDs and CP issued by the U.S. branch of a foreign bank are acceptable, subject to MMLF terms and conditions.

C12. What is the specific collateral information required to be provided when requesting a loan and how will I know if I qualify?

There is a standard Excel spreadsheet titled "MMLF Liquidity Facility Request Form." A borrower will file a consolidated spreadsheet showing all collateral being pledged. All fields should be completed and the spreadsheet e-mailed to MMLF@bos.frb.org no later than 12:00 p.m. Eastern Time of the day a loan will be requested.

C13. Can a borrower pledge collateral for which it provides liquidity support and/or credit enhancement?

Yes.

D. Other Terms

D1. At what rate will loans under this facility be extended?

Loans made under the Facility that are secured by U.S. Treasuries and Fully Guaranteed Agencies or Securities issued by U.S. Government Sponsored Entities will be made at a rate equal to the primary credit rate in effect at the FRBB that is offered to depository institutions at the time the loan is made. Loans made under the Facility that are secured by U.S. municipal short-term debt and VRDNs will be made at a rate equal to the primary credit rate in effect at the FRBB that is offered to depository institutions *plus* 25 basis points. All other loans will be made at a rate equal to the primary credit rate in effect at the FRBB that is offered to depository institutions at the time the loan is made, *plus* 100 basis points. That rate will be fixed for the term of the loan. There are no special fees associated with the Facility.

D2. What will be the maturity of the loans?

The maturity date of an advance will be the earlier of: (i) the maturity date of the eligible collateral pledged to secure the advance, and (ii) twelve months from the date of the advance. The maturity date of the eligible collateral is the earlier of the original stated maturity or any prepayment, in whole or in part, of the collateral (whether by acceleration, call, demand or otherwise, including at the option of the borrower or the issuer or any other party). Because the maturity on the advance will not exceed 12 months, for any eligible collateral with a longer maturity the borrower will need to repay the loan and either sell the collateral, request repayment of the security (e.g., VRDNs), or retain it on the borrower's balance sheet without nonrecourse treatment and capital relief.

D3. Can I exercise a demand feature on a pledged VRDN?

Yes, per the Letter of Agreement, the exercise of the demand feature would lead to an effective maturity of the collateral and thus repayment of the loan would be required.

D4. What if the issuer prepays the collateral?

If the issuer prepays on the underlying security, in whole or in part, the borrower is expected to repay the associated loan, in whole or in part, that corresponds to the collateral.

E. Accounting and Regulatory Implications

E1. How should the eligible borrower account for the facility?

Consistent with GAAP, the Federal Reserve would expect borrowers to report purchased eligible collateral as an investment security (i.e., held-to-maturity or available-for-sale) on their balance sheets. These assets would be reflected at the time of purchase at the amortized cost or fair value, as applicable. The nonrecourse nature of the transaction would impact the valuation of the liability to the Federal Reserve. After reflecting any appropriate discounts on the assets and associated liabilities, organizations are not expected to report any material net gains or losses (if any) at the time of purchase. Any discounts generally would be accreted over time into income and expense. The Federal Reserve staff, in connection with providing the above guidance, has consulted with staff of the SEC's Office of the Chief Accountant.

E2. What capital charge will be assessed against a banking organization that received these loans from the Federal Reserve?

On March 19, 2020, the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation issued an interim final rule to allow banking organizations to neutralize the effects of purchasing assets through the program on risk-based and leveraged capital ratios. *See* https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200319a1.pdf.

F. Other

F1. Where should questions regarding the facility be directed?

Effective immediately, inquires can be emailed to MMLF@bos.frb.org. Eligible borrowers interested in the MMLF should call the FRBB at 800-322-0580 starting at 8:00 am Eastern Time on Monday, March 23, 2020. Eligible borrowers should direct supervisory policy questions (e.g., regulatory capital, accounting, section 23A of the Federal Reserve Act) to Arthur W. Lindo, Deputy Director, (202) 452-2695, Anna Lee Hewko, Associate Director, (202) 530-6260, and Molly Mahar, Associate Director, (202) 973-7360, Division of Supervision and Regulation, or Asad Kudiya, Senior Counsel, (202) 475-6358, and Mary Watkins, Senior Attorney, (202) 452-3722, Legal Division.

Certification Instructions: Borrower's registration must contain a certification regarding solvency and lack of available credit, as discussed below. Certification must be made in writing by an authorized person or officer.

1. Not insolvent. Borrower must certify that it and the Fund from which it is purchasing assets are not insolvent (i.e., not in bankruptcy or resolution, generally able to make payments during the previous 90 days). See section 13(3) of the Federal Reserve Act and section 201(d)(5)(iii) of the Board's Regulation A.

2. Lack of adequate credit. Borrower must certify that it is unable to secure adequate credit accommodations from other banking institutions. This certification may be based on economic conditions in the market or markets intended to be addressed by the MMLF facility. The Board of Governors of the Federal Reserve System authorized the establishment of the MMLF in response to significant demands for redemptions by investors of MMMFs that posed significant risk to the financial system. In the days prior to the initiation of the program, some MMMFs experienced significant demands for redemptions by investors. Under ordinary circumstances, they would have been able to meet those demands by selling assets. Recently, however, many money markets have become extremely illiquid due to uncertainty related to the coronavirus outbreak. Borrower also may consider economic or market conditions as compared to usual economic or market conditions, including the availability and price of credit. Lack of adequate credit does not mean that no credit is available. Lending may be available, but at prices or on conditions that are inconsistent with a normal, well-functioning market.

Sample Certification:

MMLF CEO or Other Authorized Officer Certification

I, the undersigned Chief Executive Officer or other authorized officer of the eligible borrower named below ("Borrower"), hereby attest that, as of the date hereof, and shall be deemed to attest that, as of the date of any borrowing made under the Money Market Mutual Fund Liquidity Facility (the "MMLF" or the "Facility") authorized by the Board of Governors of the Federal Reserve System ("Board") on March 18, 2020, as such authorization may be amended from time to time, under sections 13(3) of the Federal Reserve Act, (1) Borrower is unable to secure adequate credit accommodations from other banking institutions, and (2) Borrower and any fund from which Borrower purchases assets is not insolvent.

For the purposes of this certification, a borrower or fund is insolvent if it is in bankruptcy, resolution under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), or any other Federal or State insolvency proceeding (as defined in paragraph B(ii) of Section 13(3) of the Federal Reserve Act), or fails to generally pay undisputed debts as they become due during the 90 days preceding the date of borrowing under MMLF.

I further attest that, if any of the information in this certification changes, Borrower will immediately notify the Federal Reserve Bank of Boston.

I acknowledge that, if this certification includes a knowing material misrepresentation, all emergency credit extended to the borrower immediately becomes due and payable, and the Federal Reserve will promptly refer the matter to appropriate law enforcement authorities for action under applicable criminal and civil law.

On behalf of the Borrower, I further acknowledge and agree that the Federal Reserve Board is required to comply with any disclosure requirements under applicable law including without limitation the Federal Reserve Act and the Dodd-Frank Act with respect to the MMLF, which may include without limitation the identity of the borrowers, the date and amount of the assistance and form in which assistance was provided and other material terms of the assistance. On behalf of the Borrower, I consent to such disclosure.

Borrower:

By: ______________________

Name: ____________________

Title: _____________________

Date: _____________________