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US Government Initiatives of 2008 that Bolster Liquidity in the Short-Term Debt Markets

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The unprecedented credit crunch has severely impacted the availability of funding in the short-term debt markets. In an effort to address the illiquidity of the US short-term debt capital markets, the Board of Governors of the Federal Reserve System (the 'Federal Reserve') and the US Department of the Treasury (the 'Treasury Department') have taken innovative and aggressive steps in 2008 to restore confidence in certain short-term debt products and to bolster liquidity in the short-term markets generally.

The AMLF

On 19 September 2008, the Federal Reserve took its first decisive step to bolster liquidity in the US short-term debt markets by establishing the Asset-Backed Commercial Paper ('ABCP') Money Market Mutual Fund Liquidity Facility ('AMLF'). The Federal Reserve established the program to curb the 'run' on money market funds that occurred earlier that week when a number of frantic investors, fearing losses in the fall-out relating to the Lehman Brothers insolvency, withdrew their investments.

In response, the Federal Reserve quickly created the AMLF to enable it to extend loans to eligible borrowers to finance their purchases of high quality ABCP from qualifying money market mutual funds. The AMLF effectively makes the Federal Reserve a 'lender of last resort', enabling funds holding ABCP to meet investor redemption demands and thereby hopefully assuring investors in money market funds that cash would be on hand for redemptions, via the Federal Reserve.

Under the AMLF, eligible borrowers can borrow funds from the Federal Reserve Bank of Boston to fund the purchase of ABCP from qualifying money market mutual funds. The ABCP posted as collateral under the AMLF must be highly rated, be denominated in US dollars, mature within 270 days from the date of issuance and be issued by a US issuer in a program already in existence on 18 September 2008. The borrower must purchase the ABCP from the qualifying money market fund at acquisition cost, not market value.

The tenor of the loans available under the AMLF depends on the type of borrower. The loans generally remain outstanding until the maturity of the financed ABCP, but if the borrower is a depositary institution, the maximum term is 120 days (and the ABCP posted as collateral may not have maturities extending beyond 120 days). A loan may not be prepaid in full or in part prior to the maturity of the loan, except in the event of a bankruptcy or receivership of the borrower, and each loan has a fixed rate of interest through the life of the loan equal to the primary credit rate in effect when made (currently 0.50%).

Borrowers are incentivised to finance ABCP through the AMLF. First, there are no special fees associated with drawing under the AMLF. Secondly, the loans under the AMLF are non-recourse. Thirdly, holdings in ABCP will not be assessed a regulatory capital charge because of the non-recourse nature of the AMLF loans.

As extended on 2 December 2008, the term of the AMLF is scheduled to expire on 30 April 2009, unless further extended by the Federal Reserve.

The Temporary Guarantee Program

On Friday, 19 September 2008, as an additional Federal response to the above-referenced run on money market funds, President George W. Bush authorised the Secretary of the Treasury, Henry M. Paulson, Jr, to utilise USD 50 billion of funds to guarantee the holdings of specified money market funds on a temporary basis. On 29 September 2008, the Treasury Department released the details relating to this temporary guarantee program (the 'Temporary Guarantee Program').

The Temporary Guarantee Program is open to publicly offered money market funds (both retail and institutional) that (i) are registered with the Securities and Exchange Commission (the 'SEC'), (ii) are regulated under Rule 2a-7 ('Rule 2a-7') of the Investment Company Act of 1940, as amended, (iii) have a policy of maintaining a stable net asset value ('NAV') or share price of USD 1.00 per share and (iv) had, as of the close of business on 19 September 2008, an NAV per share

of at least USD 0.995. Eligible funds include both taxable and tax-exempt money market funds.

To participate in the program, the money market fund should have elected to do so by 8 October 2008 and paid to the Treasury Department an up-front, non-refundable premium payment.

The guarantee is triggered if a participating fund's NAV falls below USD 0.995 after 19 September 2008, but on or before the date of termination of the Temporary Guarantee Program, unless promptly cured (the 'Guarantee Trigger Date'). Once triggered, the Treasury Department, through the Exchange Stabilisation Fund, will cover shareholders for the lesser of (i) the number of shares they owned in a participating fund on 19 September 2008, or (ii) the amount of shares they own in the fund as of the Guarantee Trigger Date. If triggered, the fund must liquidate within 30 days after the Guarantee Trigger Date, unless the liquidation period is extended by the Treasury Department. The Temporary Guarantee Program guarantees that shareholders will receive USD 1.00 for each share covered under the Temporary Guarantee Program after liquidation of the fund, subject to the availability of funds under the Temporary Guarantee Program.

Participation is on a fund-by-fund basis, so the performance of a family fund, whether participating or not, will have no effect on the applicability of the guarantee to a particular participating fund. In addition, investors cannot benefit from the Temporary Guarantee Program individually; rather, the fund decides to participate in the Temporary Guarantee Program, executes the requisite documentation and pays the relevant premium.

On 24 November 2008, the Treasury Department extended the term of the Temporary Guarantee Program to 30 April 2009, and it is authorised to make further extensions up to 18 September 2009. During the extension period, the Temporary Guarantee Program will continue to provide coverage to shareholders in participating money market funds up to amounts they held in such funds as of the close of business on 19 September 2008. However, only money market funds already participating in the Temporary Guarantee Program can benefit from the extension of the Temporary Guarantee Program, provided such funds satisfy certain extension requirements (e.g., that the net asset value of the electing fund is higher than a specified threshold as of the date of extension and that the board of the fund agrees that participation in the program on an extended basis is in the best interests of the funds' shareholders). Funds participating in the extension of the Temporary Guarantee Program were required to elect to do so and pay an additional premium payment to the Treasury Department by 5 December 2008.

According to the Treasury Department, the Temporary Guarantee Program covers over USD 3 trillion of assets.

The CPFF

Although the market reacted positively to the AMLF and the Temporary Guarantee Program, the liquidity strain continued unabated. In response, on 7 October 2008, the Federal Reserve took another decisive step by establishing the Commercial Paper Funding Facility ('CPFF'). Under the CPFF, the Federal Reserve, through the Federal Reserve Bank of New York ('FRBNY'), provides a credit facility to a special purpose vehicle ('SPV') that uses the funds obtained from the FRBNY to purchase from eligible issuers three-month, highly rated US dollar-denominated commercial paper that is neither interest-bearing nor extendible. The SPV purchases the commercial paper at a discount (with ABCP financed at a higher discount than unsecured commercial paper).

The issuer must be a US issuer, but the Federal Reserve has indicated that commercial paper issued by a US issuer with a foreign parent (including many ABCP issuers), and US branches of non-US banks, is acceptable. Municipal issuers are currently unable to access the CPFF.

The maximum amount of commercial paper that an issuer can finance under the CPFF is the greatest amount of US dollar-denominated commercial paper that the issuer had outstanding on *any* day between 1 January 2008 and 31 August 2008. The SPV will not purchase any additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the SPV) exceeds or equals the issuer's maximum limit.

Participating issuers must register for the program and pay a one-time facility fee based on the maximum amount of the participating issuer's commercial paper that the SPV may own under the CPFF.

The CPFF is available through 30 April 2009, unless extended by the Federal Reserve.

The MMIFF

The Federal Reserve created the Money Market Investor Funding Facility ('MMIFF') on 22 October 2008. It is the first substantial private sector initiative to help alleviate the ongoing global liquidity crisis. Working closely with the Federal Reserve, J. P. Morgan structured and designed the MMIFF. Orrick, Herrington & Sutcliffe LLP acted as counsel to J. P. Morgan throughout the process.

Under the MMIFF, the Federal Reserve, through the FRBNY, provides senior secured funding to a series of private sector special purpose vehicles ('PSPVs') to enable them to purchase at amortised cost US dollar-denominated certificates of deposit, bank notes and commercial paper, each with a remaining maturity of 90 days or less (collectively, 'Eligible Assets'), from eligible sellers. Eligible Assets owned by each PSPV must

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have been issued by one of 10 highly rated financial institutions, as identified in the PSPV's operational documents, and a PSPV cannot purchase an Eligible Asset issued by a qualifying financial institution if the aggregate Eligible Assets of that institution constitute more than 15% of the total Eligible Assets held by the PSPV at the time of purchase of such Eligible Asset.

On 7 January 2008, the Federal Reserve expanded the MMIFF so that, along with US money market funds regulated under Rule 2a-7, funds managed or owned by a US bank, insurance company, pension fund, trust company or SEC-registered investment advisor or a US state or local government are eligible to access the MMIFF for liquidity purposes. To qualify, these funds must (i) maintain a dollar-weighted average portfolio maturity of 90 days or less; (ii) hold their assets until maturity under 'usual' circumstances; and (iii) hold only assets that, at the time of purchase, are rated by a nationally recognised statistical rating organisation in one of the top three long-term investment-grade rating categories (i.e., 'A' or above) or have an equivalent credit level. In addition, US dollar-denominated cash collateral reinvestment funds, accounts or portfolios associated with securities lending transactions that are managed or owned by a US bank, insurance company, pension fund, trust company, or SEC-registered investment advisor are also now eligible to access the MMIFF. An investor's participation in the MMIFF is subject to approval by the FRBNY and may be conditioned on satisfaction of certain other debt and/or deposit rating criteria.

Each PSPV finances its purchase of an Eligible Asset from an eligible seller by: (i) selling to the eligible seller ABCP in an amount equal to 10% of the Eligible Asset's purchase price and (ii) borrowing the remaining 90% of the purchase price from the FRBNY. The PSPV's ABCP must satisfy certain ratings thresholds and mature on the maturity date of the related Eligible Asset.

Under the MMIFF, each PSPV may purchase Eligible Assets until 30 April 2009, unless such date is extended by the Federal Reserve.

Conclusion

Clearly, the ability of corporations, banks and other financial institutions to access short-term funding in the debt capital markets is a cornerstone of the health and efficiency of the global economies. Although we have some way to go before the US short-term debt capital markets are fully functional again, these US government initiatives point the markets in the right direction and provide helpful financing options until the short-term markets recover.

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International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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