



The Success of the CPFF?

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On October 7, 2008, the Federal Reserve announced the creation of the Commercial Paper Funding Facility (CPFF). The CPFF purchases, through a special-purpose vehicle funded by the Federal Reserve Bank of New York, 91-day unsecured and asset-backed A1/P1-rated commercial paper (CP). The special purpose vehicle purchases the paper at a discount such that, when held to maturity, its rate of return equals a specified spread over the 3-month overnight index swap (OIS) rate on the day of purchase.¹ The CPFF, which first purchased CP on October 27, 2008, and currently is scheduled to cease purchases on October 31, 2009, has been cited by Federal Reserve officials as a hallmark of success for Federal Reserve “credit easing” programs.²

CP is a short-term promissory note issued by a corporation that may be a less costly source of funds than bank loans, despite being intertwined with the issuer’s banking relationships.³ Generally, purchasers of CP look with favor on an issuer’s established banking relationships, because these relationships are a resource to repay the holders if the paper cannot be rolled over. For less-creditworthy issuers, investors might ask that bank-issued letters of credit be attached directly to the paper, such that the bank is obligated to pay the holder at maturity. More recently, asset-backed CP has been sold with attached assets other than bank letters of credit. Most often, the attached assets are themselves financial assets, including auto and consumer loans. The CPFF buys only 91-day maturity CP. In 2008, CP with maturity longer than 81 days comprised only 7 percent of all issuance; the most common maturities, in order of relative share in issuance, are 1 to 4 days, 30 days, and 91 days.

The CP market came under stress in mid-September 2008 when Lehman Brothers failed and, the following day, the Reserve Fund (America’s oldest money market mutual fund) “broke the buck” (that is, the net asset value per share fell in a single day by more than half of 1 percent). Thereafter, some large CP purchasers (including money market mutual funds) scaled back acquisitions, and some large CP issuers encountered difficulty obtaining commercial bank support (in part, due to concerns that the firm would be unable to roll over the paper at maturity). Anecdotal evidence suggested that longer-term paper was difficult to place, even at elevated rates.⁴ Because more than 90 percent of CP is issued by financial firms, including auto and consumer finance companies, credit flowing to

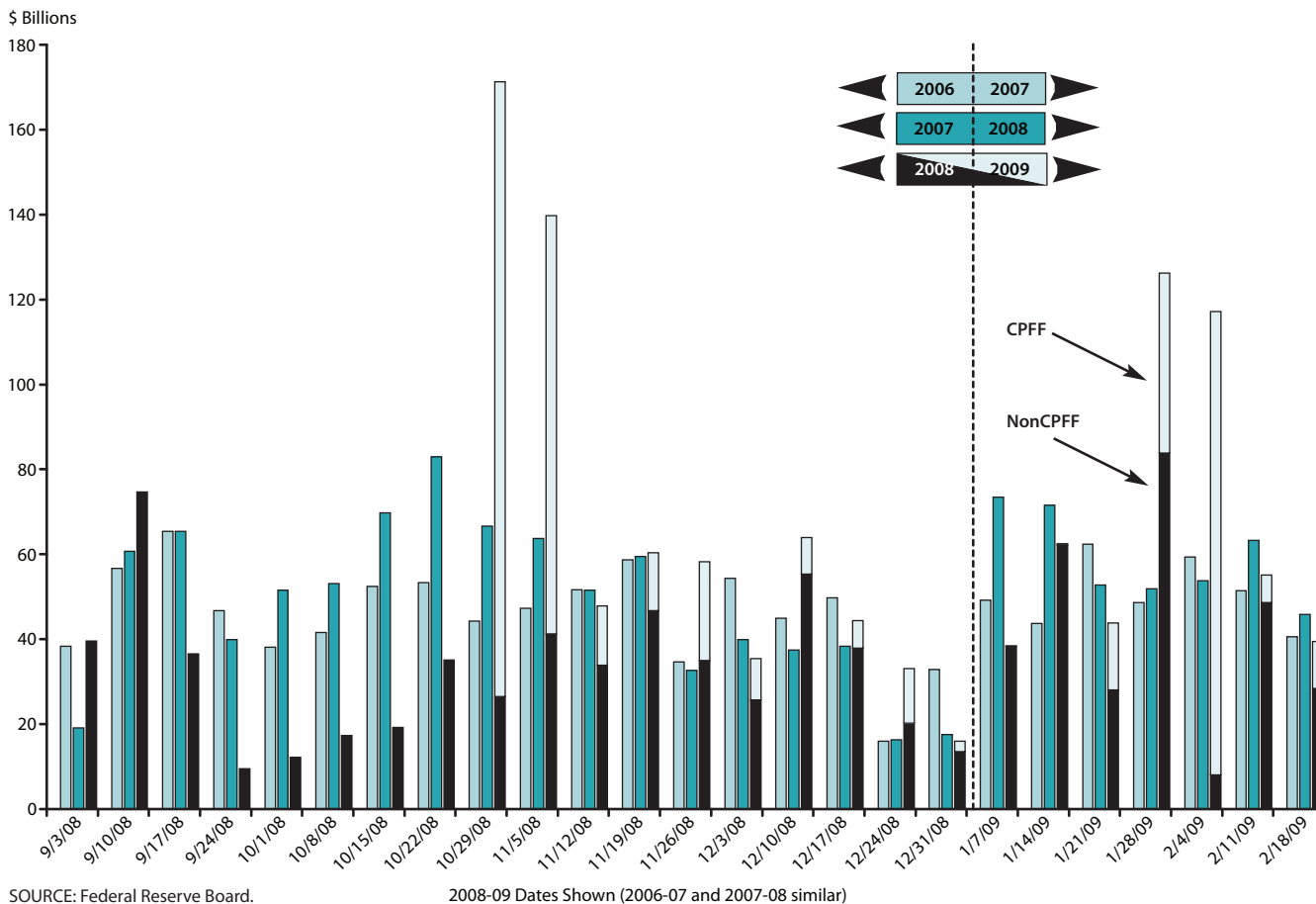
businesses and households is disrupted when these firms experience difficulty selling paper.

The chart displays weekly issuance of 91-day CP (A1/P1 and A2/P2) between September 2008 and February 2009—and, for comparison, aligned weeks in 2006-07 and 2007-08. Issuance decreased sharply during September 2008, but increased steadily during October. During its first two weeks (October 29 and November 5, 2008), the CPFF purchased the overwhelming majority of all newly issued 91-day CP; yet, non-CPFF issuance remained comparable to that of surrounding weeks. In subsequent weeks, the CPFF purchased little CP.⁵ Purchases jumped again in the weeks of January 28 and February 4, 2009, when previously purchased issues of 91-day paper matured. Thereafter, the CPFF again became a small force in the market. Year-to-year comparisons show a surprising result: Weekly issuance of 91-day CP during 2008-09 differed little from comparable weeks in 2006-07 and 2007-08. Undoubtedly, the paper market was under strain during 2008-09, and anecdotal reports suggest that longer-maturity paper became difficult to place. Yet, aggregate issuance changed little.

“The CPFF is regarded as a hallmark of success among credit-easing policies.”

At face value, the data suggest a small role for the CPFF. But that may be too simple. First, it is clear that the CPFF assisted year-end financing. Second, funding A1/P1 CP through the CPFF is relatively expensive, at 200 basis points above the OIS rate; anecdotal reports suggest that larger A2/P2 issuers increasingly are able to place 30-day CP at a total cost of 250 to 300 basis points. Third, the CPFF announcement followed the creation of two support programs for money market mutual funds, which are important buyers of CP: the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility on September 19 and the Treasury’s Temporary Guarantee Program for Money Market Mutual Funds on September 29. Both likely took some wind from the sails of the CPFF. Finally, during February 2009, some previous CPFF customers are reputed to have obtained financing through the FDIC’s Temporary Liquidity Guarantee Program introduced on October 14, 2008.⁶

Commercial Paper Issuance (A1/P1 and A2/P2)
 (weekly data, aligned weeks, September 2008–February 2009 and previous years)



In short: Was the CPFF a success in stabilizing the CP market, or was the CPFF an unneeded government intervention? It does seem likely that the existence of the CPFF, even if not used, backstopped the market, particularly with respect to the risk that firms might not be able to roll over maturing paper elsewhere. The plethora of overlapping Federal Reserve, Treasury, and FDIC programs makes judgment difficult. In any case, the CPFF deserves high marks for providing funding over year-end. It is less clear that the CPFF revived the paper market, with its share of new issuance being modest except for its first two weeks. ■

¹ The provisions are more complex than summarized here. For example, unsecured paper is discounted at a 100-basis-point spread over the OIS rate (often, in market transactions, the OIS rate is the effective federal funds rate) plus a 100-basis-point surcharge. For details, see the Federal Reserve Bank of New York website on the CPFF: www.newyorkfed.org/markets/cpff.html.

² Bernanke, Ben S. “The Crisis and the Policy Response.” The Stamp Lecture, London School of Economics, London, England, January 13, 2009; and “Federal

Reserve Programs to Strengthen Credit Markets and the Economy,” Testimony before the Committee on Financial Services, U.S. House of Representatives, Washington, DC, February 10, 2009.

³ For background, see Stigum, Marcia. *The Money Market*. Homewood, IL: Dow-Jones Irwin, 1990; Hahn, Thomas K. “Commercial Paper” in Timothy Q. Cook and Robert K. Laroche, eds., *Instruments of the Money Market*. 7th edition. Richmond, VA: Federal Reserve Bank of Richmond, 1993, pp. 105-27. Kavanagh, Barbara; Boemio, Thomas R. and Edwards, Gerald A. Jr. “Asset-Backed Commercial Paper Programs.” *Federal Reserve Bulletin*, February 1992, pp. 107-16; and Post, Mitchell A. “The Evolution of the U.S. Commercial Paper Market Since 1980.” *Federal Reserve Bulletin*, December 1992, pp. 879-91.

⁴ Covitz, Dan and Downing, Chris. “Liquidity or Credit Risk? The Determinants of Very Short-Term Corporate Yield Spreads.” *Journal of Finance*, October 2007, 62(5), pp. 2303-28.

⁵ The data, published by the Federal Reserve Board and supplied by the Depository Trust & Clearing Corporation, cover almost all activity in the paper market. Covitz and Downing (2007) further describe these data.

⁶ A timeline of actions by various agencies is available at <http://timeline.stlouifed.org>.

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Views expressed do not necessarily reflect official positions of the Federal Reserve System.