Corporate Dash for Cash

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**Brazilian Finance Meeting: Firms and Liquidity after COVID**

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Borrowers are drawing down heavily on bank lines of credit anticipating that market sources of funding may dry up or get costlier, especially short-term commercial paper, creating stress on bank balance-sheets and liquidity conditions and contagion that could aggravate if stress worsens (https://www.bloomberg.com/news/articles/2020-03-12/dash-for-cash-is-on-as-corporate-titans-draw-down-credit-lines):

"Companies are maxing out unused credit lines for extra liquidity. U.S. banks had a total of $2.5 trillion of credit commitments to companies that weren’t used at the end of 2019, with two-thirds of provided by JPMorgan, BofA, Citi & Wells Fargo.”
Why draw down credit lines?

“Freeze” in segments of commercial paper, bank loan and bond markets, ...
1-Month AA Asset-Backed Commercial Paper (% per annum)
1-Month AA Nonfinancial Commercial Paper (% per annum)
1-Month A2/P2/F2 Nonfinancial Commercial Paper (% per annum)

Source: Federal Reserve Board/Haver Analytics
Borrowing costs have soared as the market has whipsawed

Yields on US corporate debt, by rating class (%)
How does credit line drawdown compare to past recessions?

<table>
<thead>
<tr>
<th>Credit Grade</th>
<th>Undrawn CL (2008)</th>
<th>Expected Drawdown Rate</th>
<th>Expected Drawdowns</th>
<th>Actual Drawdowns</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
<td>March (Drawdowns)</td>
<td>March (Drawdown Rate)</td>
</tr>
<tr>
<td>AAA-A</td>
<td>322,183</td>
<td>17.00%</td>
<td>54,771</td>
<td>25,872</td>
</tr>
<tr>
<td>BBB</td>
<td>449,817</td>
<td>23.80%</td>
<td>107,056</td>
<td>136,766</td>
</tr>
<tr>
<td>Non-IG</td>
<td>309,163</td>
<td>28.50%</td>
<td>88,111</td>
<td>102,256</td>
</tr>
<tr>
<td>Not Rated</td>
<td>162,725</td>
<td>39.20%</td>
<td>63,788</td>
<td>33,034</td>
</tr>
<tr>
<td>Total</td>
<td>1,243,888</td>
<td></td>
<td>313,726</td>
<td>297,928</td>
</tr>
</tbody>
</table>
How has the “dash for cash” played out?

The short-term drawdown risk far more intense than past stress scenarios...
Scramble for cash across board; Fed stabilization; Fallen angel risk for BBB firms
"Cash is King": Preference of firms for cash over bank lines of credit

Cash increase was mainly financed with new debt; Q4 2019 -> Q1 2020: D/A +7%
Unprecedented drawdown rate on bank credit lines since early March

Fed announced corporate bond buying program
Drawdowns were clustered within a few weeks

<table>
<thead>
<tr>
<th></th>
<th>AAA-A</th>
<th>BBB</th>
<th>NonIG</th>
<th>Unrated</th>
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</thead>
<tbody>
<tr>
<td>March</td>
<td></td>
<td>150</td>
<td></td>
<td></td>
</tr>
<tr>
<td>April</td>
<td></td>
<td></td>
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</table>

Riskier firms still relied on bank credit lines
“Run” on credit lines at the beginning of the crisis

Daily Drawdowns (% Credit Line Limit)

- **AAA-A**
- **BBB**
- **NR**
- **NonIG**
Riskier firms rely on credit line drawdowns
IG-rated firms benefited most from Fed interventions

“Cliff” risk of becoming a “fallen angel”
Riskier firms could only issue bonds at substantially higher yield.

“Cliff” risk of becoming a “fallen angel”
Cliff-risk: BBB-rated firms perform similar to non-IG rated firms

Dash-for-cash particularly among riskier BBB-rated firms.
Firms increase cash-asset ratios and decrease undrawn credit in Q1 2020

\[
\text{Liquidity} = \frac{\text{Unused credit lines} + \text{cash and short term investments} - \text{short term debt}}{\text{Total assets}}
\]
Firms with ex-ante liquidity have been rewarded
Where are we going from here?

“Dash-for-cash” has reversed; bond issuances and repayment of credit lines; ”Run on *liquidity*” (new credit lines, amendments of credit lines,...)
Amendments (April - May 2020)

- Financial Covenant Flexibility: 59.8%
- Pricing Change: 40.9%
- Payment restrictions: 24.4%
- Tenor Extension: 22.0%
- Minimum Liquidity Cov.: 18.1%
- Libor floor added: 13.4%
- New facility: 11.8%
- Change borrowing base: 7.1%

Based on firms’ 8k filings (127 filings)
Implications for Banks / Lending

The Great – sustained – Crash; Episodic Pricing of Liquidity Risk; Solvency Risks; Implications for Stress Tests
Bank balance-sheet liquidity risk & bank stock prices

\[
\text{Liquidity Risk} = \frac{\text{Unused commitments} + \text{Wholesale Funding}}{\text{Liquidity Total Assets}}
\]
Tightening of lending standards

Government guarantee programs
Lower (!!) rejection rates: The creation of Zombie firms?
Conclusion

• Early March 2020: Aggregate demand for cash (‘‘dash-for-cash’’)

• Leverage of riskier firms increases -> worsening of debt overhang
  • High-quality firms raise bonds to repay credit lines

• Role of banks as liquidity provider puts pressure on bank equity and might affect bank lending going forward

• Role of government support:
  • Likely increase balance-sheet leverage -> worsening of debt overhang
  • Might prevent efficient liquidation of firms -> zombie lending
  • Implications for growth and financial stability?