

Chapman Client Alert

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Current Issues Relevant to Our Clients

Term Asset-Backed Loan Facility 2020

On March 23, 2020, the Board of Governors of the Federal Reserve System (Federal Reserve) announced the establishment of the Term Asset-Backed Securities Loan Facility (TALF 2020) to support the flow of credit to consumers and businesses. Although it did not provide many details about TALF 2020, the Federal Reserve did state that TALF 2020 is primarily based on the terms and conditions of the Term Asset-Backed Securities Loan Facility used during the 2007-09 financial crisis (TALF 2009). The Federal Reserve provided a brief Term Sheet for TALF 2020¹ and promised to provide more detailed terms and conditions at a later date. The following questions and answers describe the major features of TALF 2020 as we know them at the current time.

What is TALF 2020?

TALF 2020 is a Federal Reserve credit facility authorized under Section 13(3) of the Federal Reserve Act. As noted above, it is intended to help meet the credit needs of consumers and small businesses by facilitating the issuance of asset-backed securities (ABS) and improving the market conditions for ABS more generally. TALF 2020 will serve as a funding backstop to facilitate the issuance of eligible ABS on or after March 23, 2020. Under the program, the Federal Reserve Bank of New York (FRBNY) will commit to lend to a special purpose vehicle on a recourse basis. The U.S. Treasury Department will utilize the Exchange Stabilization Fund to make an initial \$10 billion equity investment in that special purpose vehicle.

Initially, TALF 2020 will make available up to \$100 billion in loans. These loans will have a term of three (3) years and will be fully secured by the related eligible ABS. They also will be made on a non-recourse basis to the borrower, so long as all of the program's requirements are met. New credit extensions will **not** be made after September 30, 2020, unless that date is extended by the Federal Reserve.

What is the History of the TALF Program?

During the 2007-09 financial crisis, the Federal Reserve utilized TALF 2009 for the same broad purposes, and under the same general terms and conditions, as TALF 2020.

The Federal Reserve announced TALF 2009 on November 25, 2008 and began lending operations in March 2009. Lending

under TALF 2009 was authorized through March 2010 for most loans collateralized by eligible collateral (and June 2010 for loans collateralized by newly issued commercial mortgage-backed securities).

Under TALF 2009, the FRBNY provided non-recourse funding to eligible borrowers owning eligible collateral. On a specified date each month, borrowers were able to request one or more three-year loans from the program. Loan proceeds were disbursed to the borrower, contingent on receipt by the FRBNY's custodian bank of the eligible collateral, an administrative fee, and, if applicable, margin. If the borrower did not repay the loan, the FRBNY enforced its rights in the collateral and sold the collateral to a special purpose vehicle established specifically for the purpose of managing those assets. In the event of a loss, the U.S. Treasury Department provided credit protection to TALF 2009. In connection with TALF 2009 lending, the FRBNY published standard loan documentation for borrowers to use, copies of which are still available at www.newyorkfed.org.

Who Can Borrow under TALF 2020?

All U.S. companies that own eligible collateral (as discussed below) and maintain an account relationship with a primary dealer are eligible to borrow under the new TALF program. The Federal Reserve defines "U.S. company" as a U.S. business entity organized under the laws of the United States (including any of its political subdivisions or territories). The definition also includes a U.S. business entity that has a non-U.S. parent company and a U.S. branch or agency of a foreign bank.

What Collateral is Eligible to Be Pledged under TALF 2020?

The eligible collateral under TALF 2020 is very similar to the eligible collateral under TALF 2009. Specifically, it must:

- be U.S. dollar-denominated ABS;
- not be a synthetic ABS;
- satisfy certain ratings requirements (see below);
- be issued on or after the date of establishment of the program (for TALF 2020, March 23, 2020); and
- not bear interest payments that step up or step down to predetermined levels on specific dates.

In addition, there are requirements for the credit exposures underlying the ABS, including that:

- “all or substantially all” of the credit exposures must have been originated by a U.S. company and must be “newly issued”;
- the credit exposures cannot include exposures that are themselves cash ABS or synthetic ABS; and
- the credit exposures must be in one of the following eight (8) asset classes:
 - (i) auto loans and leases,
 - (ii) student loans
 - (iii) consumer and corporate credit card receivables,
 - (iv) equipment loans,
 - (v) floorplan loans,
 - (vi) insurance premium finance loans,
 - (vii) certain small business loans that are guaranteed by the Small Business Administration, or
 - (viii) eligible servicing advance receivables.²

The Federal Reserve noted that “[t]he feasibility of adding other asset classes to the facility will be considered in the future” and that the detailed terms and conditions will further define the eligible underlying credit exposures for purposes of TALF 2020.

What Are the Ratings Requirements for the Eligible Collateral Securing the TALF 2020 Loans?

The ABS securing TALF 2020 loans must have a credit rating in the highest long-term or highest short-term investment grade rating category from at least two (2) eligible nationally recognized rating agencies (NRSROs). In addition, the ABS must not have a credit rating below the highest investment grade rating category from an eligible NRSRO. The current term sheet does not specify which NRSROs are “eligible”.

How Much Collateral Must Be Pledged and Maintained to Secure a TALF 2020 Loan?

Under the term sheet, eligible collateral that is pledged for a TALF 2020 loan will be valued and assigned a haircut according to a schedule based on its asset type, its weighted average life, and historical volatility of the ABS. This schedule will be published in the forthcoming detailed terms and conditions, and the Federal Reserve noted that it will be “roughly in line” with the haircut schedule used for TALF 2009. The term sheet did not include any other information about collateral requirements.

What is the Term of a TALF 2020 Loan and Can It Be Repaid?

Each TALF 2020 loan will have a three (3) year term. A TALF 2020 loan will be prepayable, in whole or in part, at the borrower’s option. We note, though, that substitution of collateral during the term of the TALF 2020 loan generally will not be allowed.

What is the Pricing for a TALF 2020 Loan?

The interest rate for TALF 2020 loans collateralized by eligible ABS whose underlying credit exposures do not have a government guarantee is:

- 100 basis points over the two-year LIBOR swap rate, for securities with a weighted average life less than two (2) years
- 100 basis points over the three-year LIBOR swap rate, for securities with a weighted average life of two (2) years or greater³

The pricing for TALF 2020 loans collateralized by all other eligible ABS will be set forth in the detailed terms and conditions.

The borrower will also owe an administrative fee equal to 10 basis points of the amount of each TALF 2020 loan it receives.

What Are the Procedures for Obtaining a TALF 2020 Loan?

The Federal Reserve provided little detail about the procedures for obtaining loans under TALF 2020, but did promise the issuance of more detailed terms and conditions. Generally, TALF 2020 is expected to have similar procedures to TALF 2009.

In TALF 2009, loan requests were accepted on a specified day each month, and monthly loan closings occurred approximately a week later for all loans in compliance with program requirements.

In TALF 2009, loans were made by the FRBNY to eligible borrowers only through primary dealers (subject to qualifying customer agreements between borrowers and dealers). Primary dealers were responsible for collecting loan requests, documentation and fees from borrowers, performing due diligence on borrowers and collateral, administering the pledge of collateral, and distributing funds to borrowers. Standardized forms of loan documents were required and the accountants for the sponsors of the pledged asset-backed securities were required to attest to the eligibility of the collateral.

What is the Status of the TALF 2020 Program and the Possibility of Expanding Its Coverage?

As mentioned above, in its TALF 2020 announcement, the Federal Reserve stated that TALF 2020 would be “primarily

based off the terms and conditions” used for TALF 2009, but reserved the right to modify TALF 2020 in a manner “consistent with the policy objectives of the TALF.”

Market participants and industry groups have applauded the announcement of TALF 2020, but have advised the Federal Reserve that certain features of TALF 2009 will not adequately address the unique economic and life disruptions caused by the COVID-19 pandemic or give effect to the significant changes that have occurred in the credit market since the 2008 financial crisis. Most importantly, market participants and industry groups have strongly recommended to the Federal Reserve certain more flexible features for TALF 2020, including (i) expanding the types of ABS that are eligible collateral,⁴ (ii) modifying the ratings requirements to reflect the highest ratings of the expanded asset types and to allow for one rating from an expanded group of NRSROs, and (iii) allowing for both new and existing ABS to be pledged as collateral.

We will be monitoring the Federal Reserve’s response to this advocacy and will advise you as to changes made to the TALF 2020 program.

For More Information

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

1 See, <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf>.

2 ABS backed by servicing advances were not eligible for TALF 2009. Commercial mortgage-backed securities were included as eligible collateral to TALF 2009.

3 The term sheet does not address the availability of LIBOR over the term of a TALF 2020 loan.

4 Additional types of eligible collateral include the following: private label residential mortgage-backed securities; ABS backed by unsecured consumer loans, mortgage servicing rights or handsets; transportation-related asset backed securities, such as rail car and aircraft; credit risk transfer assets.

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