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Federal Reserve Announces New Term Asset-Backed Securities Loan Facility (TALF) in Response to COVID-19

The new Term Asset-Backed Securities Loan Facility will support consumer and business access to credit through securitization.

On March 23, 2020, in response to the financial uncertainty created by the COVID-19 pandemic, the US Federal Reserve announced the implementation of several new measures to support the stability of the economy and to promote a swift recovery once the pandemic abates.

One of the facilities included in the Federal Reserve announcement is the Term Asset-Backed Securities Loan Facility (TALF), established by the Federal Reserve under the authority of Section 13(3) of the Federal Reserve Act, with the approval of the Treasury Secretary. It is intended to support the flow of credit to consumers and businesses by enabling the issuance of asset-backed securities (ABS) backed by certain types of eligible collateral, including student loans, auto loans and leases, credit card receivables, small business loans guaranteed by the Small Business Administration (SBA), equipment loans, and certain other assets.

Under the TALF, the Federal Reserve will lend on a non-recourse basis to holders of certain AAA-rated ABS issued on or after March 23 and backed by newly and recently originated consumer and small business loans. The Federal Reserve will lend an amount equal to the market value of the ABS less a haircut and will be secured at all times by the ABS. The program may be extended in scope and asset classes in the future.

The newly announced TALF is modeled after a similar TALF program (2008 TALF) created by the Federal Reserve in response to the 2008 financial crisis to address funding and liquidity problems in the securitization markets. Under the 2008 TALF program, the Federal Reserve extended term loans collateralized by certain high-quality ABS and commercial mortgage-backed securities (CMBS). The 2008 TALF began operation in March 2009 and was closed for new loan extensions on June 30, 2010, with the final 2008 TALF loan repaid in October 2014. Over the life of the program, all 2008 TALF loans were repaid in full and no 2008 TALF collateral was surrendered. The 2008 TALF is largely seen as making a significant contribution to restoring liquidity to the market during the height of the 2008 financial crisis and helping to prevent the shutdown of lending to consumers and small businesses.

Program Summary

Initial Scope

- The TALF initially will make up to US$100 billion of loans available. Loans will be made by the Federal Reserve Bank of New York, will be non-recourse to the borrower, and will be fully secured by eligible ABS.
- As currently proposed, the program will not issue new credit extensions after September 30, 2020, although this date may be extended by the Board of Governors of the Federal Reserve System.

Eligible Collateral

- US-dollar-denominated cash ABS issued on or after March 23, 2020, with a credit rating in the highest long-term or the highest short-term investment-grade rating category from at least two eligible nationally recognized statistical rating organizations (NRSROs) and which do not have a credit rating below the highest investment-grade rating category from an eligible NRSRO.
- All or substantially all of the credit exposure underlying eligible ABS must have been originated by a US company (note the definition of "company" uses the broader term of "entities," as further described below).
- Collateral will generally not be permitted to be substituted during the term of the loan.
- The underlying credit exposures must be one of the following:
  - Auto loans and leases
  - Student loans
  - Consumer and corporate credit card receivables
  - Equipment loans
  - Floorplan loans
  - Insurance premium finance loans
  - Certain small business loans guaranteed by the SBA
  - Eligible servicing advance receivables
- Additional asset classes may be added in the future, and certain industry groups continue to work with regulators to have additional sectors, including AAA CMBS and residential mortgage-backed securities, considered eligible for the TALF program.

Eligible Borrowers[1]

- Must be a US business entity organized under the laws of the United States or a political subdivision or territory thereof. US business entities may include an entity that has a non-US parent company or is a US branch or agency of a foreign bank.

- Eligible borrowers must maintain an account relationship with a primary dealer.

Collateral Value and Applicable Haircuts

- Eligible collateral will be assigned a value and an applicable haircut set forth in a schedule to be provided; such values and haircuts will be based on the sector, weighted average life, and historical volatility of the ABS. The Federal Reserve has noted that the schedule will be roughly in line with the schedule used for the 2008 TALF, which provided that the average life of the security was based on assumptions regarding the prepayment of the applicable ABS, based on standardized prepayment assumptions by asset class.

Pricing and Fees

- The TALF loan rate will be set as a spread over the life of the program, with the spread varying by asset class and loan term. For ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 100 basis points over the two-year LIBOR swap rate for securities with a weighted average life less than two years, or 100 basis points over the three-year LIBOR swap rate for securities with a weighted average life of two years or greater.

- Pricing will be updated to account for the expected LIBOR transition.

- Further details regarding the pricing terms and conditions will be forthcoming.

- A 10 basis point administrative fee will be assessed against the applicable loan amount.

Loan Term

- Three years.

Prepayments

- Loans will be pre-payable in whole or in part at the option of the borrower.

Footnote

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1 While additional details regarding the TALF will be forthcoming, note that the Term Asset-Backed Securities Loan Facility: Frequently Asked Questions published by the Federal Reserve Bank of New York and effective on October 5, 2009, clarified under the 2008 TALF that any "U.S. company that owns eligible collateral may borrow from the TALF provided the company maintains an account relationship with a TALF Agent. An entity is a U.S. company if it is (1) a business entity or institution that is organized under the laws of the United States or a political subdivision or territory thereof (U.S.-organized) and conducts significant operations or activities in the United States, including any U.S.-organized subsidiary of such an entity; (2) a U.S. branch or agency of a foreign bank (other than a foreign central bank) that maintains reserves with a Federal Reserve Bank; (3) a U.S. insured depository institution; or (4) an investment fund that is U.S.-organized and managed by an investment manager that has its principal place of business in the United States. An entity that satisfies any one of the requirements above is a U.S. company regardless of whether it is controlled by, or managed by, a company that is not U.S.-organized. Notwithstanding the foregoing, a U.S. company excludes any entity, other than those described in clauses (2) and (3) above, that is controlled by a foreign government or is managed by an investment manager, other than those described in clauses (2) and (3) above, that is controlled by a foreign government."

Additional Programs

Other programs announced on March 23, 2020, in addition to the TALF program include:

- The Federal Open Market Committee will agree to purchase Treasury securities and agency mortgage-backed securities to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy.
- New programs, that, taken together, will provide up to US$300 billion in new financing to support the flow of credit to employers, consumers, and businesses.
- Creation of two facilities to support credit to large employers: the Primary Market Corporate Credit Facility for new bond and loan issuance, and the Secondary Market Corporate Credit Facility to provide liquidity for outstanding corporate bonds.
- Expansion of the Money Market Mutual Fund Liquidity Facility to include a wider range of securities (including municipal variable rate demand notes and bank certificates of deposit).
- Modification of the Commercial Paper Funding Facility to reduce pricing of the facility and to expand the facility to include high-quality, tax-exempt commercial paper as eligible securities.
- A soon-to-be-announced Main Street Business Lending Program to support lending to eligible small-and-medium sized businesses.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

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