Latham & Watkins Structured Finance Practice

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Federal Reserve Expands Scope of New Term Asset-Backed Securities Loan Facility (TALF): Update

Certain commercial mortgaged-backed securities and collateralized loan obligations are now eligible.

On April 9, 2020, the Federal Reserve announced it is taking additional actions to support further credit flow to households and business by, among other actions, broadening the range of assets that are considered eligible collateral under the previously announced TALF program (see Latham's March 30 *Client Alert* on the TALF). Under the revised terms (see the Federal Reserve Term Sheet), the TALF program will provide additional liquidity for certain commercial mortgaged-backed securities (CMBS) and collateralized loan obligations (CLOs).

The updated list of eligible underlying credit exposures includes the following:

- Auto loans and leases
- Student loans
- Consumer and corporate credit card receivables
- Equipment loans and leases
- Floorplan loans
- Insurance premium finance loans
- Certain small business loans guaranteed by the SBA
- Leveraged loans
- Commercial mortgages

CMBS issued on or after March 23, 2020, will not be eligible. The CMBS underlying credit exposures must be to real property located in the United States or one of its territories. Single-asset single-borrower CMBS and commercial real estate CLOs (CRE CLOs) will not be eligible collateral. With respect to non-CRE CLOs, the CLO securities must be issued on or after March 23, 2020, all or substantially all of the

CLO's underlying leveraged loans must be newly issued credit exposures, and only static pool CLOs are currently considered eligible.

Pricing on the TALF facility for CLOs will be based off the 30-day average secured overnight financing rate (SOFR) (pricing set at SOFR+150 basis points).[1]

While the April 9 announcement broadens the scope of the TALF program, the impact this will have, on the CLO market in particular, remains to be seen given the current limitations (including limiting eligibility to newly originated credit exposures, restricting eligibility to static pool CLOs, and TALF loan pricing based on SOFR).[2]

In addition to the expansion of what constitutes eligible collateral for the program, other updates include:

- The inclusion of pricing terms for SBA Pool Certificates and SBA Development Company Participation Certificates
- An update to the proposed pricing terms for ABS with underlying credit exposures that do not have a government guarantee (increasing the interest rate from 100 basis points over two- or three-year LIBOR swap rate to 125 basis points over two- or three-year fed funds overnight index swap rate)
- The inclusion of the proposed collateral valuation haircut schedule (which, as previously anticipated, is intended to be consistent with the haircut schedule used for the TALF established in 2008)[3]

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Endnotes

[1] Although the original Federal Reserve announcement on March 23, 2020, did not include CLOs and CMBS as eligible collateral, that announcement based pricing off LIBOR and noted that LIBOR replacement provisions would be included. The new announcement includes updated pricing based off SOFR and the fed funds overnight index swap rate.

[2] Eligibility is limited to AAA-rated securities (*i.e.,* 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.

[3] The most recently distributed term sheet also includes a definition of Eligible Borrowers that states that, for purposes of the term sheet, "a U.S. company is defined as a business that is created or organized in the United States or under the laws of the United States and that has significant operations in and a majority of its employees based in the United States." This definition appears to omit the language in the Eligible Borrower definition included in the March 23, 2020, announcement that also included a US branch or agency of a foreign bank or an entity that has a non-US parent company.