Federal Reserve Launches Term Asset-Backed Securities Loan Facility to Spur Investment in Certain Asset-Backed Securities

With the goal of improving market conditions by addressing the securitization markets, the US Federal Reserve announced the launch of the Term Asset-Backed Securities Loan Facility (TALF) on March 3, 2009. The TALF is designed to make credit available to consumers and small businesses on more favorable terms by facilitating the issuance of certain eligible asset-backed securities (ABS).

The objective of the TALF is to stimulate investor demand for such eligible ABS, and thereby reduce the funding costs of the issuers of loans in such eligible classes. Eligible ABS currently includes newly issued AAA-rated tranches of securitizations backed by auto loans, credit card loans, private and government-guaranteed student loans and loans guaranteed by the Small Business Administration (SBA). The definition of eligible ABS may be expanded over time to include additional ABS, commercial mortgage-backed securities, and collateralized loan and debt obligations.

Under the TALF, the Federal Reserve Bank of New York (FRBNY) has pledged to provide non-recourse financing to owners of eligible ABS in an aggregate amount of up to $200 billion (with additional Treasury financing to make up to $1 trillion available under the program). Once a month, eligible investors can request Federal Reserve loans under the TALF for the purchase of eligible ABS. The first subscription date under the TALF is March 17, 2009, and the first funds will be disbursed on March 25, 2009. The second subscription date is April 7, 2009, with a loan disbursement date of April 14, 2009. Going forward, monthly subscriptions will be scheduled on the first Tuesday of each month. Currently, the TALF is set to cease making loans on December 31, 2009, unless the facility is extended by the Board of Governors.

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the requirements for eligible borrowers and specific interest and haircut terms for TALF loans. We encourage clients who may be interested in this facility to explore it further, and we would be pleased to assist you in doing so.

**Eligibility**

**Eligibility of Borrowers**

TALF funds are accessible to a wide variety of investors. Any US company that owns eligible collateral may borrow from the TALF, provided that the US company maintains an account relationship, and has executed a customer agreement, with a primary dealer.

TALF defines “US company” to include any of the following:

- A business entity or institution that is organized under the laws of the United States or a political subdivision or territory thereof (US-organized) and conducts significant operations or activities in the United States (regardless of whether any such an entity has a parent company that is not US-organized), including any US-organized subsidiary of such an entity;
- A US branch or agency of a foreign bank (other than a foreign central bank) that maintains reserves with a Federal Reserve Bank; or
- An investment fund that is US-organized and managed by an investment manager that has its principal place of business in the United States.

However, “US company” does not include any entity that is controlled by a foreign government or is managed by an investment manager controlled by a foreign government. For these purposes, a foreign government controls a company if, among other things, the foreign government owns, controls or holds with power to vote 25 percent or more of a class of voting securities of the company.

An “investment fund,” for TALF purposes, is any type of pooled investment vehicle, including a hedge fund, private equity fund or mutual fund. An investment fund may invest primarily or exclusively in TALF-eligible ABS or, alternatively, may pursue multiple strategies and invest in diverse asset classes. An eligible investment fund may be newly formed for the purpose of accessing the TALF.

The borrower must also have an account relationship with a primary dealer—a financial institution appearing from time-to-time on the FRBNY’s list of “Primary Government Securities Dealers Reporting to the Government Securities Dealers Statistics Unit of the Federal Reserve Bank of New York”—who will contract with the FRBNY on behalf of the borrower. Dealers are required to apply internal customer identification and due diligence procedures (i.e., their respective “Know Your Customer” programs) to each borrower and represent that each borrower is TALF-eligible.

Executive compensation restrictions that are applicable to institutions receiving government support through other programs will not be applied to TALF borrowers, sponsors or underwriters as a result of their participation in the TALF.

**Eligibility of Collateral**

ABS securities pledged as collateral for TALF loans must be US-dollar denominated cash (i.e., not synthetic) ABS that are cleared through the Depository Trust Company. In addition, eligible ABS must: (1) be backed by permissible underlying credit exposures; (2) receive the requisite highest long-term or short-term investment-grade ratings; (3) not be issued, or have the underlying exposures originated, by the borrower or any borrower affiliate; and (4) comply with origination-date restrictions.
Currently, the underlying credit exposures of eligible ABS must be auto loans, student loans, credit card loans, or small business loans fully guaranteed as to principal and interest by the SBA. The underlying credit exposures must not include exposures that are themselves cash or synthetic ABS. The average life for credit card or auto loan ABS cannot exceed five years. At this time, a minimum of 95 percent of the dollar amount of the underlying credit exposures must be exposures to US-domiciled obligors.

The set of permissible underlying credit exposures may be expanded over time, and regulators currently anticipate that ABS backed by rental, commercial and governmental vehicle fleet leases, and ABS backed by small ticket equipment, heavy equipment, and agricultural equipment loans and leases will be eligible for the April funding of the TALF. Other types of securities under review include private-label residential mortgage-backed securities, commercial mortgage-backed securities, collateralized loan and debt obligations, and other ABS not included in the initial rollout such as ABS backed by non-auto floorplan loans and ABS backed by mortgage-servicer advances.

Eligible collateral must be rated in the highest long-term or short-term investment-grade ratings category by at least two major nationally recognized statistical rating organizations (NRSROs), and cannot have a credit rating below the highest investment-grade category from any major NRSRO. The major NRSROs for purposes of determining TALF eligibility are Fitch Ratings, Moody's Investors Service and Standard & Poor's. Required ratings must be achieved without the benefit of third-party credit enhancement. In addition, ABS that are rated in the highest investment-grade category but are on review or watch for downgrade are not TALF-eligible. If an ABS that was eligible for TALF financing is downgraded by an NRSRO, the downgrade does not affect existing TALF loans secured by that ABS. However, the ABS may not be used as collateral for any new TALF loans until it regains its eligibility.

Additionally, eligible collateral for a particular borrower must not be backed by loans originated or securitized by the borrower or its affiliate. This means that a company cannot originate loans, securitize them, and acquire the AAA-rated tranche of the securitization with a loan under the TALF and thereby finance its own loans using the TALF. For purposes of determining eligible collateral, an entity is an affiliate of the borrower if it controls, is controlled by, or is under common control with the borrower. A person or company controls a company if, among other things, it: (i) owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company; or (ii) consolidates the company for financial reporting purposes.

**TALF Loans**

**Structure of Loans**

Credit extensions under the TALF will take the form of non-recourse loans secured entirely by pledged eligible collateral. TALF loans will have a three-year term, with interest payable monthly. The loans will not be subject to mark-to-market or re-margining requirements.

**Allocation of Loans**

The minimum amount for a TALF loan is $10 million, and there is no maximum. On each monthly subscription date (defined below), borrowers will have the ability to request an unlimited number of loans under the TALF and will have the option to elect a fixed or a floating rate on each loan taken. While borrowers are allowed to pledge any combination of ABS as collateral for a single loan, a fixed rate ABS must be
pledged against a fixed rate loan and a floating rate ABS must be pledged against a floating rate loan. The FRBNY reserves the right to reject any request for a loan, in whole or in part, in its sole discretion.

For each loan requested, the borrower must simply indicate the eligible ABS collateral to be pledged, the desired amount of the loan, and the corresponding rate format (fixed or floating). Once a borrower has submitted a TALF loan request through its primary dealer, the request may only be adjusted if the borrower is allocated less than the expected amount of a new ABS issue. The original request may not be adjusted in order to obtain a larger amount of TALF loans than initially requested.

The FRBNY will disburse the loan proceeds to the borrower once its custodian bank receives the eligible ABS collateral, the administrative fee (described below) and the haircut amount (described below).

### Pricing of Loans

The Federal Reserve will periodically review and, if appropriate, adjust TALF interest rate spreads and haircuts for new loans, consistent with the policy objectives of the TALF.

### Interest Rates

The interest rate spread assessed on each TALF loan will depend upon the characteristics of the pledged ABS collateral. Interest rates will be set by the FRBNY on the subscription date and will be designed to provide borrowers with an incentive to purchase newly issued eligible ABS at yield spreads higher than in more normal market conditions, but lower than in the prevailing tumultuous market conditions. The following table summarizes the interest rates based upon the underlying ABS:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Subsector</th>
<th>Fixed</th>
<th>Floating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auto</td>
<td></td>
<td>3-year LIBOR swap rate + 100 bps</td>
<td>1-month LIBOR + 100 bps</td>
</tr>
<tr>
<td>Credit Card</td>
<td></td>
<td>3-year LIBOR swap rate + 100 bps</td>
<td>1-month LIBOR + 100 bps</td>
</tr>
<tr>
<td>Student Loan Private</td>
<td></td>
<td>N/A</td>
<td>1-month LIBOR + 100 bps</td>
</tr>
<tr>
<td>Student Loan Gov't Guaranteed</td>
<td></td>
<td>N/A</td>
<td>1-month LIBOR + 50 bps</td>
</tr>
<tr>
<td>Small Business SBA loans 7(a)</td>
<td></td>
<td>N/A</td>
<td>Fed Funds Target + 75 bps</td>
</tr>
<tr>
<td>Small Business SBA loans 504</td>
<td></td>
<td>3-year LIBOR swap rate + 50 bps</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Haircut Rates
The amount of a TALF loan will correspond to the value of the pledged ABS minus a haircut. Initial collateral haircuts are as follows:

If the market value of the collateral ABS is below par, the TALF loan will be equal to the market value of the ABS minus the haircut amount. Alternatively, if the market value of the pledged ABS exceeds par, the FRBNY will lend an amount equal to the market value (subject to a cap of 110 percent of par value) minus the haircut amount, and the borrower will be required to periodically prepay a portion of the loan. The prepayments will be calculated to adjust for the expected reversion of market value toward par value as the ABS matures.

Fees
The FRBNY will assess an administrative fee equal to five basis points of the TALF loan amount which the borrower must pay on each loan's settlement date.

Repayment of Loans
Interest payments on TALF loans are due on a monthly basis. If the net interest on the pledged ABS is insufficient to cover the interest payment on the loan, the borrower will be granted a 30-day grace period. If the loan remains delinquent at the end of the grace period, the FRBNY will enforce its rights to the underlying ABS collateral.

TALF loans are pre-payable at any time, in full or in part, at the option of the borrower. If the borrower makes a partial prepayment, collateral securing
its loan will be released on a pro-rata basis, taking into consideration minimum ABS denominations. There are no penalties associated with prepayment of a TALF loan.

The borrower is not allowed to substitute collateral during the term of the TALF loan unless it is discovered that the collateral has failed any of the eligible collateral criteria in effect at the time the loan was made. In that case, the borrower is required either to replace the collateral with eligible collateral or to repay the loan.

If any principal of the eligible collateral is disbursed to the borrower, it must be used immediately to reduce the principal amount of the TALF loan in proportion to the original loan-to-value ratio. As an example, if the original loan-to-value ratio was 90 percent, then 90 percent of any remittance of principal on the ABS must immediately be repaid to the FRBNY. If, on the other hand, the collateral ABS incurs a principal loss, the borrower is still responsible for all interest and principal payments on the TALF loan. If the borrower fails to make these payments, the FRBNY will enforce its rights to the collateral and the borrower will forfeit its haircut amount.

The borrower may elect not to repay its TALF loan by instead surrendering the collateral to the FRBNY. All of the ABS that secure an individual loan must be surrendered. This is done through the primary dealer by delivering a Collateral Surrender and Acceptance Notice with respect to the TALF loan to the FRBNY. If the borrower does not deliver the Notice by the maturity date of the loan, the FRBNY may exercise recourse rights and force the borrower to repay its loan. If a TALF loan is not repaid, the FRBNY will enforce its rights to the collateral and sell it to a Special Purpose Vehicle (SPV) established specifically for the purpose of managing such assets.

In a situation where the collateral ABS matures after the three-year TALF loan matures, the borrower has three options. The borrower may: (1) repay the loan and have the collateral released by the FRBNY; (2) sell the collateral and instruct the FRBNY to deliver the ABS to the counterparty upon payment; or (3) surrender the collateral to the FRBNY in lieu of repaying the outstanding principal or interest on the TALF loan as outlined above. If the borrower elects the second option, it must make up any shortfall that exists between the sale amount and the principal and accrued interest amount on the TALF loan. On the other hand, any excess sale proceeds will be remitted to the borrower if applicable.

During the three-year term of the TALF loan, the borrower may sell the underlying collateral supporting the loan and assign all of its obligations with respect to the loan to another eligible borrower with the prior consent of the FRBNY. The FRBNY will assess the eligibility of the assignee as a borrower at the time of the transfer and confirm that the assignee has executed all of the requisite documentation for the facility. However, no assignments will be consented to after the termination date for making new loans, which is currently December 31, 2009.

**Acquiring a Loan Under the TALF**

On a fixed day each month (the "subscription date"), borrowers will be able to request one or more three-year TALF loans. Although each borrower must identify the collateral that it intends to pledge as security for each loan at the subscription stage, this collateral does not need to be furnished until settlement. The loan proceeds will be disbursed to the borrowers on settlement dates that will occur shortly following each subscription date, provided the custodian for the FRBNY has received the applicable collateral.
Accessing the TALF: Up to and Including the Subscription Date

Customer Agreement with Primary Dealer
In order to be eligible to obtain TALF loans, a borrower must be a customer of a primary dealer and must have executed a customer agreement with such primary dealer. The customer agreement must authorize the primary dealer to, among other things, execute a Master Loan and Security Agreement (MLSA) with the FRBNY as agent for the borrower, grant a security interest in the borrower's ABS collateral on behalf of the borrower and act as agent for the borrower in connection with the applicable TALF loans.

A borrower may request loans through multiple primary dealers. If a borrower requests loans through multiple primary dealers, it must deliver the collateral for each loan through the respective primary dealer, unless the collateral is a new issuance delivered by the applicable underwriter/other syndicate desk.

Borrowing Request
Prior to each subscription date, each primary dealer will collect from prospective eligible borrowers the amount of each borrower's loan request(s), the interest rate format corresponding to the type of collateral pledged (i.e., fixed or floating), the CUSIPs of the ABS the borrower expects to deliver and pledge to the FRBNY, and the prospectuses or offering documents of such ABS expected to be pledged. At this stage, if any of the CUSIP numbers correspond to a new issuance, then the prospectus or offering documents submitted with respect to such ABS may be preliminary. However, final versions of these documents must be provided to the FRBNY's custodian no later than four days prior to the TALF loan settlement date (see below).

On the subscription date, the dealer will forward the information collected from the borrower to the FRBNY's custodian for review. The dealer will also submit to the FRBNY the aggregate amount of all loans requested by all of its eligible borrower customers by rate type and asset class. Borrowers do not need to own the identified eligible collateral as of the subscription date.

Accessing the TALF: Between Subscription and Settlement

Notice of Allocation Shortfall; Final Prospectus or Offering Documents
No less than four days prior to the settlement date, the borrower must inform the FRBNY and its custodian, through its primary dealer, if the borrower expects to pledge newly issued ABS as collateral but is allocated less than expected of the new ABS issue. This permits margin and administrative fees to be adjusted to reflect the reduced volume of collateral pledged.

Additionally, if the borrowing proposal submitted at subscription relied on preliminary prospectuses or offering documents, final versions of these documents must be delivered to the FRBNY's custodian by the primary dealer no later than four days prior to the settlement date. The borrower should therefore ensure that the final form of the documents are in the dealer's possession.

Notice of Loan Amount
No less than two business days prior to the loan settlement date, the FRBNY's custodian will send a confirmation to the primary dealer listing each borrower's loan amount and the ABS it expects to be delivered on the loan settlement date. The confirmation also will set forth the amount of the administrative fee and haircut to be collected by the primary dealer and paid on the loan settlement date.

Settlement
On the loan settlement date, the primary dealer will deliver the administrative fee, the appropriate haircut amount
and the ABS collateral to the FRBNY's custodian against payment of the loan proceeds. As such, the borrower will be required to deliver the administrative fee, the haircut amount and, unless the applicable ABS is being issued on the loan settlement date, the pledged collateral to the primary dealer prior to the settlement date.

If the borrower (through its agent, the dealer) fails to furnish collateral identified in the custodian's confirmation, no penalty will be assessed. However, with respect to any portion of the expected ABS collateral which is not received as of the settlement date, a commensurate percentage of the loan will be cancelled and the corresponding administrative fee will not be returned.

Endnotes

1 Prepayment amount (in dollars) is determined by the following formula:

\[
\text{Par} \times (1-h) \times \left( \frac{\min (\text{Price}, 1.10 \times \text{Par})}{\text{Par}} - 1 \right) / (b \times \text{WAL})
\]

Par = the par value of the bond.

h = the haircut from the table on page 5 corresponding to the expected life and asset class of the bond.

Price = the price of the bond.

WAL = the weighted average life of the bond measured in years and calculated at the prepayment assumption used to compute expected life. If the WAL is not available, half of the weighted average life to maturity (WALM) may be used as an approximation.

b = 12, 4 or 2 for securities with a remittance frequency of monthly, quarterly or semi-annually, respectively.
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Practice Areas

**Asset Management**  
Vicki E. Marmorstein  
+1.213.891.8340  
Angelo Lombardo  
+1.213.891.7832

**Financial Regulation**  
Brian W. Smith  
+1.202.637.2288  
Gregory S. Feder  
+1.202.637.1082

**Securities Disclosure**  
John J. Huber  
+1.202.637.2242

**Structured Finance**  
Kevin T. Fingeret  
+1.212.906.1237

**Derivatives**  
Carlos Alvarez  
+1.212.906.1269  
Guy Dempsey  
+1.212.906.1891

**Insolvency**  
David S. Heller  
+1.212.906.1243

**Litigation**  
Peter K. Rosen  
+1.213.891.8778

**Executive Compensation**  
James D.C. Barrall  
+1.213.891.8342  
David T. Della Rocca  
+1.202.637.1050

**Secured Lending**  
Larry Safran  
+1.212.906.1711

**Global Offices**

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