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Federal Reserve Clarifies Terms of the TALF Program to Support the Securitization Market

April 16, 2020

On April 9, 2020, the Federal Reserve released an updated term sheet for the Term Asset-Backed Securities Loan Facility ("TALF"). The TALF program, which was first announced on March 23, 2020, will provide a funding backstop for eligible asset-backed securities ("ABS") issued on or after March 23, 2020.[1] The updated term sheet expands the asset classes that qualify as eligible collateral to include certain commercial mortgage-backed securities ("CMBS"), as well as newly issued static collateralized loan obligations ("CLOs"). The updated TALF program was announced along with a number of other programs under Title IV of the CARES Act, which collectively will provide up to $2.3 trillion to support the U.S. economy. For information concerning other programs, see here and here.

TALF will operate through a special purpose vehicle ("SPV") created by the Federal Reserve Bank of New York ("Reserve Bank"). The SPV initially will make up to $100 billion of TALF loans to eligible borrowers, which will be funded through a commitment by the Reserve Bank and an equity investment of $10 billion by the Department of the Treasury. No new loans will be made after September 30, 2020.

As of the date of this client alert, TALF is not yet active. The updated term sheet published by the Federal Reserve on April 9 contemplates that more detailed terms and conditions will be provided at a later date, primarily based on the terms and conditions used for a similar TALF program established in response to the 2008 financial crisis ("2008 TALF"). The Federal Reserve has invited comments and questions on the TALF but has not set a specific deadline for submitting public comment on the TALF term sheet.

The following summarizes key terms of TALF as set forth in the updated term sheet.

Borrower and Collateral Eligibility

- An eligible borrower must be a U.S. company that owns eligible collateral. "U.S. company" is defined as a business that is organized in the United States and has

significant operations, and a majority of its employees, based in the United States. The 2008 TALF provided a more detailed list of the types of entities that would be considered a "U.S. company" for purposes of borrower eligibility, including certain investment funds. It is unclear whether all of those entities would qualify under the current TALF. Additionally, the updated term sheet omits a provision from the 2008 TALF that expressly permitted a company that is organized under U.S. law but managed or controlled by a foreign entity to be an eligible borrower.

- Eligible collateral must be ABS that (i) have the highest investment grade credit rating from at least two eligible nationally recognized statistical rating organizations and (ii) do not have a credit rating below the highest investment grade rating category.
- In order to be eligible collateral, ABS must be issued by a U.S. company, and all or substantially all of the credit exposures underlying the ABS must have been originated by a U.S. company. Eligible ABS must be issued on or after March 23, 2020 (except for CMBS, which must be issued prior to March 23, 2020). Except for legacy CMBS, all or substantially all of the underlying credit exposures must be newly issued. The underlying credit exposures for CMBS must be to real property located in the United States or one of its
- The updated term sheet identifies a total of nine eligible asset classes, including auto loans, student loans, credit card receivables, certain small business loans guaranteed by the SBA, commercial mortgages and static CLOs. The eligible asset classes included in the current TALF term sheet are broadly consistent with those included in the final terms and conditions of the 2008 TALF.
- The following will not be eligible collateral:
  - Single-asset single-borrower CMBS and commercial real estate CLOs.
  - CLOs that are not static CLOs (*e.*, substitution of collateral is not allowed).
  - ABS that bear interest payments that step up or step down to predetermined levels on specific dates.
  - ABS that include underlying credit exposures that are cash ABS or synthetic ABS.

Loan Terms

- Generally, the Reserve Bank will lend to each eligible borrower an amount equal to the market value of the pledged collateral minus a discount, or "haircut." Haircut amounts for each asset class are identified in the TALF term sheet and range from 5%-22% depending on the type of ABS and the average life. The haircut schedule generally is consistent with the haircut schedule used for the 2008 TALF.

- The loans will have a term of three years, will be nonrecourse to the borrower and will be fully secured by eligible ABS.
- Interest rates will vary, depending on the nature of the eligible collateral:
    - CLOs: 150 basis points over the 30-day average secured overnight financing rate ("SOFR");
    - SBA Pool Certificates (7(a) loans): the top of the federal funds target range plus 75 basis points;
    - SBA Development Company Participation Certificates (504 loans): 75 basis points over the 3-year fed funds overnight index swap ("OIS") rate;
    - All other eligible ABS with underlying credit exposures that do not have a government guarantee:
        - For securities with a weighted average life of less than two years, 125 basis points over the 2-year OIS rate.
        - For securities with a weighted average life of two years or greater, 125 basis points over the 3-year OIS rate.
    - The pricing for other eligible ABS will be determined at a later date and set forth in the detailed terms and conditions.
- There is an administrative fee equal to 10 basis points of the loan amount.

Lessons from the 2008 TALF

The TALF term sheet makes clear that the Federal Reserve intends to provide more detailed terms and conditions modeled after the 2008 TALF. Terms and conditions developed in connection with the 2008 TALF provided considerably more detail about borrower eligibility, the underlying credit exposures for eligible asset classes, a risk assessment process for proposed collateral, transaction structure and pricing. We anticipate similar details about the current TALF to be provided by the Federal Reserve in the coming days or weeks.

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Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. We will continue to evaluate the CARES Act, related regulations and any subsequent legislation to provide our clients guidance in real time. Please visit our Coronavirus Resource Center for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.

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[1] The term sheet published on April 9, 2020 updated the initial term sheet that was published when the program was announced on March 23, 2020.

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