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TALF Update: New Federal Reserve Term Sheet and FAQ

May 15, 2020

On May 12, 2020, the Federal Reserve published an updated Term Sheet and a set of Frequently Asked Questions (“FAQs”) for the Term Asset-Backed Securities Loan Facility ("TALF"). The TALF program, which was first announced on March 23, 2020 and updated on April 9, 2020, will provide a funding backstop for eligible asset-backed securities ("ABS"). The updated Term Sheet and the FAQ provide significant additional details about the terms of the program, including borrower and issuer eligibility, eligible collateral and certain operational details. The Federal Reserve has not yet announced start dates for the TALF program.

This alert discusses key aspects of the updated Term Sheet and the FAQs. For more information on the TALF Program generally, see our previous client alert here. You can view the updated Term Sheet here and the full FAQs here.

Borrower Eligibility

The April 9 Term Sheet required that each of the borrower, the issuer of the ABS and the originator of substantially all of the credit exposures underlying the ABS was required to be a U.S. company. “U.S. company” was defined as an entity organized in the United States and that has significant operations and a majority of its employees based in the United States. The updated Term Sheet and the FAQs provide numerous clarifications about the types of entities that are eligible to participate in the TALF.

The updated Term Sheet defines eligible borrowers to include businesses that (a) are created or organized in the United States or under the laws of the United States, (b) have significant operations in and a majority of their employees based in the United States, and (c) maintain an account relationship with a primary dealer. The updated Term Sheet does not specify that the ABS issuer must be a U.S. company and requires that the originator of the ABS be U.S.-organized, but does not apply the other requirements for a U.S. company to the originator.

U.S. Company. For purposes of borrower eligibility, the FAQs clarify that a U.S. subsidiary or U.S. branch or agency of a foreign bank will be considered to be created or organized in the United States or under the laws of the United States. Such entity must also satisfy the other borrower eligibility requirements. Similarly, the updated Term Sheet clarifies that credit exposures underlying eligible collateral may be originated by a U.S. branch or agency of a foreign bank.

Investment Funds. Neither the previous Term Sheets nor the updated Term Sheet addresses what types of entities can qualify as eligible borrowers. The FAQs, however, make clear that an investment fund may be an eligible borrower if the fund is organized in the United States and the investment manager is created or organized in the United States and has significant operations in and a majority of its employees based in the United States. For purposes of TALF, an "investment fund" includes any type of pooled investment vehicle, such as a hedge fund, private equity fund, or mutual fund, and any type of single-investor vehicle. Eligible investment funds include funds that only invest in TALF-eligible ABS, as well as funds that invest in a mix of TALF-eligible ABS and other assets.

Material Investors. The FAQs define "Material Investor" as a person who owns, directly or indirectly, 10% or more of any outstanding class of securities of an entity. If a U.S. business or investment fund manager has one or more Material Investors that are foreign governments, it will not be eligible to borrow under TALF. The FAQs suggest that a borrower must continually monitor its direct and indirect investors to maintain eligibility as long as the TALF loan is outstanding.

Significant Operations in the United States. The FAQs provide clarity on what it means for a borrower (or investment fund manager) to have significant operations in and a majority of its employees based in the United States. For a borrower that is not an investment fund, operations and employees are measured on a consolidated basis, including consolidated subsidiaries. Parent companies or "sister affiliates" are not included. Accordingly, a U.S. subsidiary with a foreign parent could be an eligible borrower if it otherwise meets the requirements.

For purposes of the TALF program, the FAQs provide a non-exclusive list of examples of what would constitute "significant operations" of a borrower or investment fund manager:

- greater than 50% of its consolidated assets are located in the U.S.;
- greater than 50% of its annual consolidated net income is generated in the U.S.;
- greater than 50% of its annual consolidated net operating revenues are generated in the U.S.; or
- greater than 50% of its annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) are generated in the U.S.

These examples are consistent with those provided in the Federal Reserve's recent FAQs for the Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility programs.

Eligible Collateral

Eligible ABS. The updated Term Sheet and the FAQs provide detail about the requirements for specific types of ABS to qualify as eligible collateral. Those requirements include:

- Eligible ABS generally must be issued on or after March 23, 2020. Commercial mortgage-backed securities ("CMBS") must have been issued prior to March 23, 2020. The updated Term Sheet provides that SBA Pool Certificates and Development Company Participation Certificates must have been issued on or after January 1, 2019.
- Eligible ABS for a particular TALF borrower cannot be backed by loans originated or securitized by the borrower or by an affiliate of the borrower. The FAQs do not provide guidance on how the Federal Reserve will interpret "origination" for this purpose, but it is possible that standards developed for ABS offerings, including definitions applicable to credit risk retention, would apply.
- The FAQs generally prohibit a TALF borrower or its affiliates from also being a borrower on a loan underlying the ABS being provided as collateral for a TALF loan, if those loans to the borrower and its affiliates exceed specified percentages of the eligible ABS asset pool.
- Collateralized loan obligation ("CLOs") must be static. The FAQs provide additional guidance about activities within a static pool that would and would not be permitted under the TALF. For example, loans can be sold to the sponsor for cash at par, plus accrued interest, if the proceeds are used to amortize the CLO, and loans that are in default also may be sold, if the proceeds are used to amortize the CLO.

Underlying Credit Exposures. The updated Term Sheet provides further details about credit exposures underlying eligible ABS. To be eligible ABS, all or substantially all of the underlying credit exposures must be originated by U.S.-organized entities satisfying the following requirements:

1. For newly issued ABS, except for CLOs, the originator must be a U.S.-organized entity, which includes U.S. branches or agencies of foreign banks;

2. CLOs must have a lead or a co-lead arranger that is a U.S.-organized entity, which includes a U.S. branch or agency of a foreign bank; and

3. For all ABS (including CLOs and CMBS), the obligors must be U.S. domiciled or with respect to real property located in the United States or one of its territories.

The FAQs clarify that "all or substantially all" in this context means 95% or more of the dollar amount of the underlying assets in the ABS, CMBS, or CLOs.

Origination Date Restrictions. The updated Term Sheet also provides that all or substantially all of the eligible ABS's underlying credit exposures must be newly issued, except for CMBS. The FAQs clarify the meaning of "newly issued" by specifying various origination date restrictions, which vary by asset class. Eligible ABS that are backed by a fixed pool of assets must be originated on or after January 1, 2019. ABS backed by dynamic pools of receivables (*i.e.,* credit card receivables, floor-plan receivables, premium receivables and some auto ABS) are not subject to origination date restrictions, unless the ABS are issued by a master trust that was established on or after March 23, 2020. In the case of a master trust established on or after March 23, 2020, all or substantially all of the assets underlying eligible ABS must have been originated on or after January 1, 2020. CMBS is not subject to an origination date restriction.

Master Trusts. The FAQs specify that eligible ABS issued by an existing master trust (established before March 23, 2020) must be issued to refinance existing ABS maturing prior to the TALF Termination Date (September 30, 2020) and must be issued in amounts no greater than the amount of the maturing ABS. This refinancing limitation applies at the sponsor level rather than the individual master trust level. In addition, eligible ABS issued to refinance ABS that mature prior to the TALF Termination Date may be issued up to three months in advance of maturity or in bulk on any date after maturity.

While the updated Term Sheet did not change the asset classes that can qualify as eligible ABS, the FAQs provide very detailed guidance about specific characteristics of the eligible underlying credit exposures within each asset class. For example, the FAQs prescribe portfolio concentration limits for certain types of loans for CLOs and specify that credit card receivables may include both consumer and corporate credit card receivables.

Update on Pricing of Certain TALF Loans

The April 9 Term Sheet provided pricing information for CLOs, SBA Pool Certificates, SBA Development Company Participation Certificates and all other eligible ABS with underlying credit exposures that do not have a government guarantee. The updated Term Sheet provides that the pricing for eligible ABS that was not addressed in the April 9 Term Sheet will be the same as the pricing previously provided for "other eligible ABS" with underlying credit exposures that do not have a government guarantee, specifically:

- For securities with a weighted average life of less than two years, 125 basis points over the 2-year overnight index swap (OIS)
- For securities with a weighted average life of two years or greater, 125 basis points over the 3-year OIS rate.

The updated Term Sheet made no other changes to the interest rates or haircut schedules. However, the FAQs provide additional guidance on the calculation of haircuts and average life.

Representations and Certifications

The representations required to be made by a TALF borrower will be included in a Master Loan and Security Agreement ("MLSA"), which will be published by the Federal Reserve and will require a continuous representation that such borrower is an eligible borrower. Thus, the TALF borrower must have a mechanism in place to continuously monitor compliance throughout the life of the TALF loan. The FAQs do not address the consequences if a TALF borrower ceases to meet the eligibility requirements.

The FAQs confirm that a TALF borrower will be required to certify that it is unable to secure adequate credit accommodations from other banking institutions, consistent with Section 13(3) of the Federal Reserve Act. The Federal Reserve will require evidence of such inability, but it has not yet specified the type or manner of such evidence. The FAQs clarify that lack of adequate credit does not mean that no credit is available. Rather, lending may be available, but at prices or on conditions that are inconsistent with a normal, well-functioning market. The borrower's certification may be based on unusual economic conditions in the markets intended to be addressed by the TALF program. The borrower must also certify as to solvency and the conflicts of interest requirements under section 4019 of the CARES Act.

Other Terms and Clarifications

Credit Ratings. The FAQs provide that the eligible rating agencies are currently S&P Global Ratings, Moody's Investors Service Inc. and Fitch Ratings, Inc. Additionally, eligible ABS cannot be on review or watch for downgrade, with limited exceptions for certain CMBS. Downgrade of an ABS does not affect a TALF loan after the loan is made.

Public Disclosure. The Federal Reserve will publicly disclose the following information about the TALF program on a monthly basis: information identifying each borrower and other participants, information identifying each Material Investor of a borrower, the amount borrowed by each borrower, the interest rate paid by each borrower and the type and amount of ABS collateral pledged by each borrower. Overall costs, revenues, and other fees for the facility will also be disclosed.

What's Next?

The New York Federal Reserve will publish a MLSA that will provide further details on the terms of the TALF loans. The FAQs also identify a number of areas where additional information and documentation will be forthcoming, including borrower certifications, requirements for collateral review, documentation requirements for newly issued ABS (*e.g.*, issuer certifications, auditor assurances, and SBA documentation) and procedures for loan subscriptions and closing. It remains unclear when the TALF will become operational.

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