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Securitization, Financial Services Regulatory & Enforcement Update
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The Rubber Hits the Road for the Term Asset-Backed Securities Loan Facility

This Client Update summarizes the terms and conditions currently applicable to the Term Asset-Backed Securities Loan Facility (TALF), as updated through May 19, 2009. Mayer Brown represented the issuers in a number of the early TALF-eligible transactions involving various asset classes and represented primary dealers in negotiating customer agreements relating to TALF. We also successfully advocated for the addition of residential mortgage servicing advances as an eligible underlying asset category.

Overview

TALF was initially designed to restart primary issuance in the ABS markets, which have played a critical role in funding consumer and business finance in recent years but were "virtually shuttered"[1] in late 2008 and early 2009. It is hoped that reopening these markets as a source of funding and liquidity for lenders will increase the availability of credit to consumers and businesses and, in turn, stimulate the broader economy. On May 19, 2009, the Federal Reserve Board expanded TALF's mission by announcing that, starting in July, some high-quality commercial mortgage-backed securities issued before January 1, 2009 (legacy CMBS) will become eligible TALF collateral.[2] The extension of TALF to finance legacy CMBS is intended to promote price discovery and liquidity for legacy CMBS, which the Federal Reserve Board hopes in turn will also facilitate the issuance of newly issued CMBS.[3] The May 19 announcement follows up on a March 23, 2009 announcement that the Federal Reserve would evaluate extending the list of eligible TALF collateral to include some legacy CMBS and non-agency residential mortgage-backed securities (RMBS).[4] Details as to any expansion of TALF to legacy RMBS have not yet been announced.

Under TALF, the Federal Reserve Bank of New York (FRBNY) is encouraging investment in eligible high quality ABS by offering up to $200 billion in secured, non-recourse loans to finance these investments on terms that are meant to be attractive to investors. Initially, all TALF loans had a maturity of three years, but FRBNY has indicated it will permit five-year maturities beginning in June 2009 for TALF loans collateralized by CMBS, student loan ABS and ABS backed by loans guaranteed by the Small Business Administration (SBA). Initially, the aggregate amount of five-year loans is limited to $100 billion, but the Federal Reserve Board has indicated that it will continue to evaluate that limit. Some of the interest on collateral financed with a five-year loan may be required to be diverted toward an accelerated repayment of the loan, especially in the fourth and fifth years.

Up to $20 billion of funds under the Troubled Asset Relief Program (TARP) will be available to absorb losses that FRBNY might otherwise incur with respect to ABS that are pledged as collateral for TALF loans. As part of the Financial Stability Plan announced by President Obama, the US

Department of the Treasury (Treasury) agreed to allocate an additional $80 billion of funds to TALF, which could enable FRBNY to lend up to $1 trillion.

The Contractual Framework

FRBNY has entered into a Master Loan and Security Agreement (MLSA)[5] that will govern all of the loans made under TALF. Also party to that agreement are The Bank of New York Mellon (BNY Mellon), which will act as FRBNY's administrator and custodian for the ABS pledged to secure TALF loans, and some or all of the Federal Reserve's 16 primary dealers. Each primary dealer wishing to participate in TALF becomes a party to the MLSA by executing and delivering a letter of agreement in the form attached to the MLSA. Although TALF loans are non-recourse as to credit and market value risk on the pledged ABS, borrowers (and the primary dealers acting as their agents) are required to make representations about the eligibility of the collateral and the borrower, as well as some other matters, and are responsible to FRBNY if those representations are inaccurate (subject to a reasonable care defense in some circumstances). Primary dealers that also acted as underwriters on the pledged ABS are required to represent as to the accuracy and completeness of the offering materials.

FRBNY has also issued conflict-of-interest guidance[6] and a borrower eligibility and due diligence policy[7] for primary dealers. These documents are intended to provide specific guidance to primary dealers participating in TALF. Similarly, FRBNY's FAQ relating to TALF provides guidance on the limited steps that primary dealers are expected to take to show reasonable care as to the eligibility of the collateral.

Investors that wish to obtain TALF loans enter into a Customer Agreement with a primary dealer. FRBNY did not dictate the form of the Customer Agreement, but the MLSA specifies minimum contents, including that the customer must authorize the primary dealer to act as the customer's agent in taking various actions under the MLSA. The primary dealer community cooperated, through the Securities Industry and Financial Markets Association (SIFMA), in producing a form Customer Agreement to be used by participating primary dealers, but the form is subject to negotiation at the discretion of each primary dealer that uses it.

Issuers that wish to make their ABS eligible as TALF collateral will be required to:

- Include a Certification as to TALF Eligibility[8] in the applicable prospectus or similar offering document;
- Deliver an Indemnity Undertaking to FRBNY covering any losses that FRBNY may incur as a result of the certification being false; and
- Cause a nationally recognized independent accounting firm that is registered with the Public Company Accounting Oversight Board to deliver to FRBNY an auditor attestation in a prescribed form[9] covering certain collateral eligibility requirements.

However, these deliveries are not required (or may be made on different forms) if the subject collateral consists of SBA Pool Certificates or Development Company Participation Certificates.

In our experience, beyond these TALF-specific documents, underwriting agreements and closing deliveries for TALF-eligible ABS are being adjusted in some ways to reflect and react to TALF requirements.

Eligible Collateral

In order to meet the program's goal of increasing the availability of credit to US consumers and businesses, ABS that are to be funded under TALF must meet various eligibility requirements relating to the characteristics of the underlying receivables, including their date of origination. Other eligibility criteria are meant to limit the credit risk taken by FRBNY and the Treasury through TALF. In summary, to be eligible as TALF collateral, ABS must:

- Be US dollar-denominated cash (that is, not synthetic) ABS with credit ratings in the highest long-term or short-term investment-grade rating category from:
  - » In the case of ABS other than CMBS or small-business loan ABS addressed below, two or more of Fitch, Moody's and S&P, and no lower credit ratings from any of those entities; and
  - » In the case of CMBS, two or more of DBRS, Fitch, Moody's, Realpoint and S&P, and no lower credit ratings from any of those entities.
  - » In either case, the credit ratings must not be based on a third-party guarantee and must not have been placed on review or watch for downgrade.
  - » In the case of small-business loan ABS that are, or for which all of the underlying credit exposures are, fully guaranteed as to principal and interest by the full faith and credit of the US government, there is no rating requirement.
- Be backed by auto "loans,"[10] student loans,[11] credit card loans,[12] equipment "loans,"[13] floorplan loans,[14] residential mortgage servicing advances,[15] small business loans fully guaranteed as to principal and interest by the SBA, commercial mortgage loans, or insurance premium finance loans, which in each case meet the following additional requirements:
  - » 95 percent or more (by dollar amount) must be (1) originated by U.S.-organized entities or institutions or U.S. branches or agencies of foreign banks and (2) have obligors domiciled in the United States,[16] except that for commercial mortgage loans there is no requirement as to obligor domicile. Instead, for new issue CMBS, all of the subject properties must be located in the United States. For legacy CMBS, 95 percent or more of the subject properties (by related loan principal balance) must be located in the United States.
  - » For auto loan ABS issued by a non-revolving trust, and for all equipment ABS, at least 85 percent of the underlying loans or leases (by dollar amount) must have been originated on or after October 1, 2007.
  - » For residential mortgage servicing advance ABS, at least 85 percent of the underlying servicing advances must have been originated on or after January 1, 2007.
  - » For student loan ABS, at least 85 percent of the underlying loans (by dollar amount) must have had a first disbursement date on or after May 1, 2007.
  - » SBA Pool Certificates and Development Company Participation Certificates must have been issued on or after January 1, 2008, regardless of the dates of the underlying loans or debentures. The SBA-guaranteed credit exposures underlying all other eligible small business ABS must have been originated on or after January 1, 2008.
  - » Eligible premium finance loans will include loans used to finance premiums for property and casualty insurance but will not include deferred payment obligations acquired from insurance companies. The issuer of the ABS must acquire ownership of each premium

finance loan in its entirety (as opposed to merely a participation or beneficial interest). The securitization must include a back-up servicer obligated to service the loans upon the resignation or termination of the initial servicer.

- » For CMBS, the terms include detailed requirements as to:
  - –Issuer type (must not be an agency or instrumentality of the United States or a government-sponsored enterprise);
  - – Payment terms (must entitle holders to payments of both principal and interest, so IOs and POs are not eligible; nor are subordinated securities);
  - – Underlying assets (must be fully-funded, first priority, fixed-rate whole mortgage loan (or certain senior interests in such loans) that are (1) current in payment at the time of securitization and (2) secured by a mortgage or similar instrument on a fee or leasehold interest in one or more income-generating commercial properties located in the United State. Also, in the case of new issue CMBS, the underlying loans must have been originated on or after July 1, 2008 and recently underwritten or re-underwritten on a specified basis;
  - – In the case of new issue CMBS, terms of the governing pooling and servicing agreements (including priority of distributions, control over servicing, representations as to improvements and use of post-securitization appraisals); and
  - – Supplemental terms as to diversity of the underlying collateral pools, the role of a collateral monitor to be employed by FRBNY, discretion of FRBNY to reject any particular CMBS as TALF collateral and other matters. FRBNY has also established a process to permit issuers to reserve prospective funding of TALF loans collateralized by new issue CMBS, for a monthly reservation fee. FRBNY is also working on other requirements that will apply to legacy CMBS, including a possible limit on volume of TALF loans collateralized by legacy CMBS and methods to validate market values.

- Not be backed by any underlying credit exposures that are themselves cash or synthetic ABS. While this requirement initially created some interpretive issues for credit card structures that use multiple trusts (as well as auto lease titling trust structures), a supplemental FAQ has confirmed that the structures commonly used for these asset types do not violate this eligibility requirement.
- In the case of credit card ABS, floorplan ABS or premium finance ABS issued by a revolving (or master) trust, be issued to refinance such existing ABS that mature in 2009 (meaning they cannot be issued in amounts greater than the amount of the maturing ABS). FRBNY has published some interpretive FAQs relating to this calculation. Eligible floorplan or premium finance ABS may also be issued out of an existing or newly established master trust in which all or substantially all of the underlying exposures were originated on or after January 1, 2009.
- Be issued on or after January 1, 2009 (except for SBA Pool Certificates or Development Company Participation Certificates and legacy CMBS) in a public offering or private placement and cleared through DTC.
- In the case of auto loan, credit card, equipment, residential mortgage servicing advance and premium finance ABS, have an average life of no more than five years. CMBS must have an average life of no more than ten years.

In addition, eligible collateral for a particular borrower must not be backed by loans originated or securitized by the borrower or its affiliate (with an exception for loans underlying SBA Pool Certificates and Development Company Participation Certificates, if the borrower does not have knowledge that the underlying loans were originated by the borrower or its affiliate), nor may it consist of ABS issued by the borrower or its affiliate. "Affiliate" is broadly defined to include any company that controls, is controlled by, or is under common control with the borrower. Control exists if, among other things, the company has the power to vote 25 percent or more of any class of voting securities of the company, or consolidates the company for financial reporting purposes.

Eligible Borrowers

The following entity types are eligible to borrow under TALF (if they comply with the other terms and conditions):

- Business entities that are organized under the laws of the United States or one of its political subdivisions or territories, and that conduct significant operations or activities in the United States;
- A US insured depository institution;
- US branches or agencies of foreign banks (other than foreign central banks) that maintain reserves with a Federal Reserve Bank; and
- Investment funds[17] that are US-organized and are managed by an investment manager with a principal place of business in the United States.

An entity that satisfies any one of the requirements above can be an eligible borrower regardless of whether it is controlled or managed by a company that is not US-organized. However, business entities (other than banks) and investment funds that are controlled by a foreign government or are managed by an investment manager (other than a bank) that is controlled by a foreign government are ineligible.

Haircuts and Pricing

The haircuts applicable to different categories of TALF collateral (other than CMBS) are currently as follows:

		ABS EXPECTED LIFE (YEARS)						
Sector	**Subsector**	**0-1**	**>1-2**	**>2-3**	**>3-4**	**>4-5**	**>5-6**	**>6-7**
Auto	Prime retail lease	10%	11%	12%	13%	14%		
Auto	Prime retail loan	6%	7%	8%	9%	10%		
Auto	Subprime retail loan	9%	10%	11%	12%	13%		
Auto	Motorcycle/other recreational vehicles	7%	8%	9%	10%	11%		
Auto	Commercial and government fleets	9%	10%	11%	12%	13%		
Auto	Rental fleets	12%	13%	14%	15%	16%		
Credit Card	Prime	5%	5%	6%	7%	8%		

		ABS EXPECTED LIFE (YEARS)						
Sector	**Subsector**	**0-1**	**>1-2**	**>2-3**	**>3-4**	**>4-5**	**>5-6**	**>6-7**
Credit Card	Subprime	6%	7%	8%	9%	10%		
Equipment	Loans and Leases	5%	6%	7%	8%	9%		
Floorplan	Auto	12%	13%	14%	15%	16%		
Floorplan	Non-Auto	11%	12%	13%	14%	15%		
Premium Finance	Property and casualty	5%	6%	7%	8%	9%		
Small Business	SBA Loans	5%	5%	5%	5%	5%	6%	6%
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Student Loan	Government guaranteed	5%	5%	5%	5%	5%	6%	6%
Servicing Advances	Residential mortgages	12%	13%	14%	15%	16%		
For ABS benefiting from a substantial government guarantee with average lives beyond five years, haircuts will increase by one percentage point for every two additional years of average life beyond five years. For all other ABS with average lives beyond five years, haircuts will increase by one percentage point for each additional year of average life beyond five years.								

CMBS may have an average life of up to ten years. The haircut for CMBS with an average life up to (and including) five years will be 15 percent. For CMBS with average lives beyond five years, haircuts will increase by one percentage point for each additional year of average life beyond five years.

TALF loans are not subject to mark-to-market or re-margining requirements, are pre-payable in whole or in part at the option of the borrower, and do not permit substitution of collateral. The pledged ABS is held by BNY Mellon, as FRBNY's custodian, and principal payments received are applied to the TALF loan consistent with the original haircut. A borrower may elect to surrender collateral to FRBNY in lieu of repaying outstanding principal or interest by delivering a Collateral Surrender and Acceptance Notice.

The interest rate on TALF loans depends on the nature of the underlying receivables and maturity of the loan. Applicable rates are published by FRBNY in connection with the other terms for each round of subscriptions.

FRBNY also charges an administrative fee of 5 bps of the initial loan amount at settlement.

Endnotes

1 Joint Press Release by the Department of the Treasury and the Federal Reserve Board, March 3, 2009, available at http://www.federalreserve.gov/newsevents/press/monetary/20090303a.htm.

2 The terms and conditions for asset classes other than legacy CMBS under TALF are set out at http://www.newyorkfed.org/markets/talf_terms.html and supplemented with responses to "frequently asked questions" at http://www.newyorkfed.org/markets/talf_faq.html. There are separate terms and conditions and FAQ for legacy CMBS at http://www.newyorkfed.org/markets/talf_cmbs_terms.html and http://www.newyorkfed.org/markets/talf_cmbs_faq.html, respectively.

3 Federal Reserve Board press release at http://www.federalreserve.gov/newsevents/press/monetary/20090519b.htm.

4 This announcement was made in conjunction with the announcement of the Public-Private Partnership Investment Program, which is addressed in our Client Update, "Treasury Department Releases Details on Public-Private Partnership Investment Program," available at http://www.mayerbrown.com/publications/article.asp?id=6402&nid=6, and our White Paper, "US Department Of The Treasury Public-Private Investment Program: Opportunities, Issues and Considerations for Fund Sponsors and Investors," available at http://www.mayerbrown.com/publications/article.asp?id=6469&nid=6.

5 Available at http://www.newyorkfed.org/markets/MLSA.pdf.

6 Available at http://www.newyorkfed.org/markets/TALF_Conflict_of_Interest.pdf.

7 Available at http://www.newyorkfed.org/markets/TALF_FRBNY_Due_Diligence_Policy.pdf.

8 The form of certification and related indemnity undertaking are available at http://www.newyorkfed.org/markets. FRBNY has indicated that additional guidance as to the issuer certification required with respect to CMBS will be forthcoming.

9 Available at http://www.newyorkfed.org/markets/TALFAuditorAttestationForm.pdf. FRBNY has indicated that additional guidance as to the attestation required with respect to CMBS and servicing advance receivables will be forthcoming.

10 For this purpose, "auto loans" includes retail loans and leases relating to cars, light trucks, recreational vehicles or motorcycles, as well as commercial, government and rental fleet leases.

11 Eligible student loans include federally guaranteed student loans (including consolidation loans) and private student loans.

12 Receivables under both consumer and commercial cards are eligible. The releases to date do not appear to address charge cards, as distinct from credit cards.

13 For this purpose, "equipment loans" includes retail loans and leases relating to business equipment.

14 Floorplan loans generally arise under revolving lines of credit to finance dealer inventories. A broad category of underlying inventory is permitted, including autos and any other type of inventory that has collateralized securitized floorplan loans in the past.

15 These advances can cover principal and interest, tax and insurance and corporate advances. They must be made by residential mortgage servicers approved by Fannie Mae or Freddie Mac under securitization servicing agreements that (a) grant the servicer first priority in any insurance or liquidation proceeds from a loan, (b) if those proceeds are insufficient, grant the servicer a first priority to general collections of the related securitization, (c) give the servicer the right to assign, transfer or pledge its rights to be reimbursed and (d) provide that all advances are reimbursed on a "first-in first-out" basis.

16 In this context, the TALF terms, conditions and FAQ generally include territories of the United States along with the United States proper.

17 This term includes (1) any type of pooled investment vehicle that is organized as a business entity or institution, including a hedge fund, a private equity fund and a mutual fund, and (2) any type of single-investor vehicle that is organized as a business entity or institution.

For more information about TALF, TARP or any other matter raised in this Update, please contact the Mayer Brown lawyer with whom you regularly communicate, or any member of our Securitization or Financial Service Regulatory & Enforcement practices. Please visit http://www.mayerbrown.com/securitization/overview/index.asp; and http://www.mayerbrown.com/financialservicesregulatoryandenforcement/overview/index.asp.

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0509