

Legal Update

Federal Reserve Revises New TALF Program Term Sheet

The Federal Reserve issued a revised term sheet¹ on April 9, 2020, for the Term Asset-Backed Securities Loan Facility ("TALF 2020") that was initially announced on March 23, 2020. This Legal Update summarizes the revised terms and conditions applicable to TALF 2020 and updates a Legal Update we previously issued on March 24, 2020².

The revised term sheet includes some significant changes relating to collateral eligibility and pricing and provides more detailed information regarding haircuts for collateral. Of particular importance, asset-backed securities ("ABS") backed by eligible mortgage servicing advance receivables have been removed from the list of eligible collateral, and certain CLOs and CMBS have been added. Pricing has also changed in several ways, including moving away from LIBOR as the benchmark upon which interest will accrue under TALF 2020 in favor of the secured overnight financing rate ("SOFR") for CLOs and the two-year federal funds overnight index swap ("IOS") rate for most other eligible ABS, with some exceptions for certain SBA loans as described below. Pricing spreads have also increased as compared to the original term sheet. The revised term sheet also includes the haircut schedule for each eligible asset class, which is largely consistent with the haircuts provided for under the

original term asset-backed securities loan facility program established in 2008 ("Original TALF").

General. TALF 2020 is intended to facilitate the issuance of ABS and, by improving market conditions for ABS, continued credit availability will be available to US households and businesses. The revised term sheet notes that the Board of Governors of the Federal Reserve System (the "Board") and the Secretary of the Treasury may make adjustments to the terms and conditions described in the term sheet, and any changes will be announced on the Board's website. TALF 2020 is subject to more detailed terms and conditions that have yet to be released.

Under TALF 2020, a special purpose entity ("TALF SPV") will make loans available to borrowers as described in more detail below. Any such loans will have a three-year term, be fully secured by eligible ABS and will be non-recourse to borrowers. To support this facility, the Federal Reserve Bank of New York has committed to lend up to \$100 billion to the TALF SPV on a recourse basis, and the US Department of Treasury will make an equity investment of \$10 billion in the TALF SPV.

Eligible Borrowers. TALF 2020 is limited to US companies that own eligible collateral and maintain an account relationship with a

primary dealer. A list of primary dealers is expected to be included in the yet-to-be-released terms and conditions. The revised term sheet has added a new requirement that an eligible borrower must have significant operations and a majority of its employees based in the United States. On its face, this new requirement could be an issue for investment funds that do not have employees and instead are managed by other entities. We expect further clarification on this point in the terms and conditions.

Eligible Collateral. The revised term sheet includes a number of significant changes with respect to the eligibility of collateral. Most notably, ABS where the underlying credit exposures are leveraged loans, commercial mortgages (solely where the underlying credit exposures are to property located in the United States or one of its territories) and equipment leases are now eligible under TALF 2020. Equipment leases were included in “equipment loans” under Original TALF, but the Federal Reserve clarified the ambiguity in this version of the term sheet. ABS backed by eligible servicing advance receivables are no longer eligible for financing.

Eligible collateral continues to include (1) auto loans and leases, (2) student loans, (3) credit card receivables (both consumer and corporate), (4) equipment loans and leases, (5) floorplan loans, (6) insurance premium finance loans, and (7) certain small business loans that are guaranteed by the Small Business Administration.

Although consumer unsecured loans and other commonly securitized assets were not added as eligible asset classes in the revised term sheet, the revised term sheet notes that the feasibility of adding other asset classes or expanding the scope of existing asset classes will be considered in the future. Also, we must await the issuance of detailed terms and conditions that will further define the eligibility of the underlying securitized assets,

but these terms and conditions are expected to be largely consistent with Original TALF.

ABS eligible for financing under TALF 2020 other than commercial mortgage-backed securities (“CMBS”) must be issued on or after March 23, 2020. CMBS issued on or after March 23, 2020, will not be eligible collateral, so borrowers for CMBS collateral can only finance legacy CMBS. Eligible ABS are required to be US dollar-denominated cash (that is, not synthetic) and cannot bear interest payments that step up or step down to predetermined levels on specific dates.

The collateral eligibility criteria require that all or substantially all of the underlying credit exposures must be newly issued, except for legacy CMBS. Unfortunately, the revised term sheet does not define or provide detail as to what is considered newly issued, so market participants must wait for the detailed terms and conditions to be issued.

Moreover, the underlying securitized assets cannot include exposures that are themselves cash ABS or synthetic ABS, and all or substantially all of the underlying securitized assets must have been originated by a US company. The revised term sheet added the requirement that the issuer of the ABS must also be a US company.

TALF 2020 continues to require the eligible ABS to have a credit rating in the highest long-term or, in the case of non-mortgage backed ABS, the highest short-term investment-grade rating category from at least two eligible nationally recognized statistical rating organizations (“NRSROs”) and to not have a credit rating below the highest investment-grade rating category from an eligible NRSRO.

Restrictions on SASB CMBS and CRE CLOs.

The revised term sheet excludes from eligibility single-asset single borrower CMBS and commercial real estate collateralized loan obligations.

Restrictions on CLO Loan Substitutions. The revised term sheet includes only static CLOs as part of eligible collateral.

Collateral Valuation. The revised term sheet provides the haircuts applicable to different categories of eligible collateral as follows:

Sector	Subsector	ABS Average Life (years) ³						
		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 Vehicle	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%		
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%
Leveraged Loans	Static	20%	20%	20%	20%	20%	21%	22%
Commercial Mortgages	Legacy, Conduit	15%	15%	15%	15%	15%	16%	17%

Pricing. For CLOs, the interest rate for loans under TALF 2020 will be 150 basis points over the 30-day average SOFR.

For SBA Pool Certificates (7(a) loans), the interest rate will be the top of the federal funds target range plus 75 basis points and for SBA Development Company Participation Certificates (504 loan), the interest rate will be 75 basis points over the three-year IOS rate.

For all other eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate for loans under TALF 2020 will be 125 basis points over the two-year IOS rate for securities with a weighted average life less than two years and 125 basis points over the three-year IOS rate for securities with a weighted average life of two years or greater.

The pricing for other eligible ABS will be set forth in the detailed terms and conditions.

Fees. Borrowers will be required to pay the TALF SPV an administrative fee equal to 10 basis points of the loan amount. Such fee will be due and payable on the settlement date for the ABS collateral.

Maturity. Each loan will have a three-year maturity.

Non-Recourse. Loans will be made without recourse to the borrowers provided the requirements of TALF 2020 are met.

Prepayment and Substitution of Collateral. Borrowers may prepay loans in whole or in part at any time. Substitution of collateral during the term of the loan is generally not permitted.

Program Termination. The TALF SPV will not make loans under TALF 2020 after September 30, 2020, unless such date is extended by the Board of Governors of the Federal Reserve and the Department of the Treasury.

Conflicts of Interest. Under the terms of the revised term sheet, eligible borrowers and

issuers of eligible collateral will be subject to the conflicts of interest requirements of section 4019 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) recently enacted by the US Congress, which prohibits certain federal government affiliations. Each TALF 2020 eligible borrower and issuer of eligible collateral will be required to certify that it is eligible to engage in the transaction.

The market is awaiting the Federal Reserve's issuance of the terms and conditions that will further detail the requirements of TALF 2020.

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Endnotes

- ¹ A copy of the Federal Reserve's revised term sheet can be found at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a1.pdf>.
- ² Our previous Legal Update titled "*Federal Reserve Establishes New TALF Program*" can be found at <https://www.mayerbrown.com/en/perspectives-events/publications/2020/03/federal-reserve-establishes-new-talf-program>.
- ³ For auto, credit card, equipment, floorplan and premium finance ABS, the weighted average life must be five years or less. For other new-issue eligible collateral, haircuts will increase by one percentage point for each additional year (or portion thereof) of average life beyond five years. For legacy CMBS with average lives beyond five years, base dollar haircuts will increase by one percentage point of par for each additional year (or portion thereof) of average life beyond five years. No securitization may have an average life beyond ten years.

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