Simpson Thacher

Memorandum

Federal Reserve Expands Term Asset-Backed Securities Loan Facility

April 10, 2020

On April 9, 2020, the Federal Reserve announced the expansion of the Term Asset-Backed Securities Loan Facility ("TALF") as part of a series of new actions providing up to $2.3 trillion in loans to support the economy.[1] The TALF is a credit facility authorized under section 13(3) of the Federal Reserve Act intended to help meet the credit needs of consumers and small businesses by facilitating the issuance of asset-backed securities ("ABS") and improving the market conditions for ABS more generally. The Federal Reserve broadened the range of assets that are eligible collateral for the TALF. TALF-eligible collateral will now include the triple-A rated tranches of certain types of outstanding commercial mortgage-backed securities ("CMBS") and newly issued collateralized leveraged loan obligations ("CLOs"). However, TALF-eligible collateral does not include single-asset borrower CMBS or commercial real estate CLOs. In addition, the Federal Reserve removed residential mortgage servicing advances from the list of eligible collateral. The TALF will serve as a funding backstop to facilitate the issuance of eligible ABS (other than CMBS) on or after March 23, 2020; for CMBS, only legacy securities issued before that date will be eligible.

As discussed in our previous memorandum available here, under the TALF the Federal Reserve will initially commit to lend up to $100 billion to a special purpose vehicle ("SPV") on a recourse basis. The Treasury Department will make an equity investment of $10 billion in the SPV in connection with the TALF.

TALF Updated Key Terms

The Federal Reserve Board released the following updated terms of the TALF and indicated that more detailed program terms and conditions and an operational calendar will be subsequently published, which will be primarily based off of the terms and conditions used for the TALF program established in 2008.[2]

- **Eligible Borrowers**: All U.S. companies that own eligible collateral and maintain an account relationship with a primary dealer are eligible to borrow under the TALF.[3] A U.S. company is defined as a business that

[1] The $2.3 trillion loan program consists of a $350 billion expansion of the Small Business Administration's Paycheck Protection Program ("PPP") through term financing backed by PPP loans to small businesses, expanding the size and scope of the Primary and Secondary Market Corporate Credit Facilities and the TALF by $750 billion and $100 billion, respectively, and the establishment of the Main Street Business Lending Facilities that makes $600 billion in new financing available to eligible small- and medium-sized businesses and the Municipal Liquidity Facility that will offer up to $500 billion in lending to states and municipalities. Comments (limited to 1,500 characters) regarding the announced $2.3 trillion loan programs can be submitted to the Federal Reserve by April 16, 2020 via the Federal Reserve's feedback form available here.

[2] Our memorandum summarizing the TALF program established in 2008 is available here.

[3] A list of primary dealers is available here.

is organized in the United States and has significant operations in and a majority of its employees based in the United States. U.S. companies which are owned by foreign parents are not restricted from participating in the TALF.

- **Eligible Collateral**: Eligible collateral includes U.S. dollar denominated cash (that is, not synthetic) ABS that 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 do not have a credit rating below the highest investment-grade rating category from any eligible NRSRO. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company, and the issuer of the ABS must be a U.S. company. With the exception of CMBS, eligible ABS must be issued on or after March 23, 2020. CMBS issued on or after March 23, 2020, will not be eligible. For CMBS, the underlying credit exposures must be to real property located in the United States or one of its territories.

  Eligible collateral must be ABS where the underlying credit exposures are one of the following:

  1. Auto loans and leases;[4]
  2. Student loans;[5]
  3. Credit card receivables (both consumer and corporate);
  4. Equipment loans and leases;[6]
  5. Floorplan loans;[7]
  6. Insurance premium finance loans;[8]
  7. Certain small business loans that are guaranteed by the Small Business Administration;

[4] Under the 2008 TALF program, eligible auto-related receivables included retail loans and leases relating to cars, light trucks, motorcycles and other recreational vehicles; commercial and government fleet leases; and commercial loans secured by vehicles and the related fleet leases of such vehicles to rental car companies.

[5] Under the 2008 TALF program, eligible student loan receivables included federally guaranteed student loans (including consolidation loans) and private student loans.

[6] Under the 2008 TALF program, eligible equipment-related receivables included agricultural, construction, or manufacturing equipment; trucks other than light trucks; smaller ticket items such as communications, office, and medical equipment, computers, copiers and security systems; and equipment types (other than aircraft) that have collateralized equipment ABS in the past.

[7] Under the 2008 TALF program, eligible receivables for floorplan ABS included revolving lines of credit used to finance dealer inventories of cars, light trucks, motorcycles, recreational vehicles, trailers, boats and sports vehicles; agricultural, construction, or manufacturing equipment; manufactured housing; large appliances; and electronic equipment.

[8] Under the 2008 TALF program, eligible premium finance receivables included loans used to finance premiums for property and casualty insurance but did not include deferred payment obligations acquired from insurance companies.

8. Leveraged loans; or

9. Commercial mortgages.[9]

Eligible collateral will not include ABS that bear interest payments that step up or step down to predetermined levels on specific dates. In addition, the underlying credit exposures of eligible collateral must not include exposures that are themselves cash ABS or synthetic ABS.

To be eligible collateral, all or substantially all of the underlying credit exposures must be newly issued, except for legacy CMBS.

The feasibility of adding other asset classes to the TALF or expanding the scope of existing asset classes will be considered in the future.

- **Conflicts of interest:** Eligible borrowers and issuers of eligible collateral will be subject to the conflict-of-interest restrictions of the CARES Act, which would generally prohibit any entity from receiving TALF loans if the entity is at least 20% owned by the U.S. President or Vice President, senior administration officials, a member of Congress or certain of their family members.
- **Collateral Restrictions:**
  - Single-asset single-borrower CMBS, and all commercial real estate CLOs, will not be eligible collateral.
  - Only static CLOs will be eligible collateral.
- **Collateral Valuation**: The haircut schedule is included in the Appendix to this memorandum, and is consistent with the haircut scheduled used for the TALF program established in 2008.
- **Pricing**: For CLOs, the interest rate will be 150 basis points over the 30-day average secured overnight financing rate ("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. For SBA Development Company Participation Certificates (504 loans), the interest rate will be 75 basis points over the 3-year fed funds overnight index swap ("OIS") rate.
- For all other eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 125 basis points over the 2-year OIS rate for securities with a weighted average life less than two years, or 125 basis points over the 3-year OIS 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**: The SPV will assess an administrative fee equal to 10 basis points of the loan amount on the settlement date for collateral.
- **Maturity**: Each loan provided under the TALF will have a maturity of three years.

[9] The Federal Reserve will issue detailed terms and conditions will further define the eligible underlying credit exposures for purposes of the TALF. The definitions are expected to be broadly consistent with the defined terms used for purposes of the TALF established in 2008.

- **Non-Recourse**: Loans made under the TALF are made without recourse to the borrower, provided the requirements of the TALF are met.
- **Prepayment**: Loans made under the TALF will be pre-payable in whole or in part at the option of the borrower, but substitution of collateral during the term of the loan generally will not be allowed.
- **Program Termination**: No new credit extensions will be made after September 30, 2020, unless the TALF is extended by the Federal Reserve and the Treasury Department.

The Federal Reserve reserved the right to review and make adjustments to these terms and conditions–including size of program, pricing, loan maturity, collateral haircuts, and asset and borrower eligibility requirements–consistent with the policy objectives of the TALF.

Appendix

		ABS Average 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%		
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%

*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.

We offer a dedicated team of advisors to help businesses weigh available options and seek assistance under one or more of the liquidity and support programs established under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). Whether in the form of direct funding from Treasury, loans or other credit support from a Federal Reserve lending facility or participation in Small Business Administration loan programs, our team has the expertise to help navigate the complex political and legal challenges associated with obtaining government financial assistance and the experience to help access the programs if a decision is made to do so.

Led by Lee Meyerson, who guided the Firm's financial crisis team that advised Treasury in developing, structuring and documenting its $250 billion TARP program for purchasing equity in U.S. financial institutions and related programs, and Keith Noreika, who recently served with Treasury Secretary Mnuchin as acting Comptroller of the Currency, a role in which he also acted as a director of the FDIC and member of the Financial Stability Oversight Council, the cross-disciplinary team also includes financing and governance lawyers, as well as former Treasury and Federal Reserve counsel.

See our Accessing Emergency Government Support Programs webpage for further information.

CONTACTS

Lee A. Meyerson
+1-212-455-3675
lmeyerson@stblaw.com

Keith A. Noreika
+1-202-636-5864
keith.noreika@stblaw.com

NEW YORK CITY

J. Alden Millard
+1-212-455-2871
jmillard@stblaw.com

Arthur D. Robinson
+1-212-455-7086
arobinson@stblaw.com

Patrick J. Ryan
+1-212-455-3463
pryan@stblaw.com

William B. Sheehan
+1-212-455-3355
wsheehan@stblaw.com

Ismael Duran
+1-212-455-3425
iduran@stblaw.com

Spencer A. Sloan
+1-212-455-7821
spencer.sloan@stblaw.com

WASHINGTON, D.C.

Joshua Ford Bonnie
+1-202-636-5804
jbonnie@stblaw.com

Christopher Brown
+1-202-636-5513
cbrown@stblaw.com

Adam J. Cohen
+1-202-636-5578
adam.j.cohen@stblaw.com

Jonathan H. Pacheco
+1-202-636-5565
jonathan.pacheco@stblaw.com

PALO ALTO

Michael Vernace
+1-650-251-5182
mvernace@stblaw.com