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Federal Reserve TALF Program, Announced April 9, 2020 and Updated May 12, 2020[1]

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On April 9, 2020, Federal Reserve Chairman Jerome Powell announced new Federal Reserve programs to "provide as much relief and stability as we can during this period of constrained economic activity, and our actions today will help ensure that the eventual recovery is as vigorous as possible."[2]

One of the new programs – the Term Asset-Backed Securities Loan Facility ("TALF") is intended to facilitate the issuance of asset-backed securities ("ABS") and improve the ABS market conditions. Although the 2020 TALF is similar to the one used for the 2008 crisis, as announced on March 23, 2020 and as further refined on May 12, 2020, the Federal Reserve now allows classes of debt that were excluded from the 2008 TALF, i.e., certain AAA-rated ABS backed by newly and recently originated consumer and small business loans.

No date has yet been set for when the TALF will become operational.

The Federal Reserve Bank of New York (the "Reserve Bank") will commit to lend to a special purpose vehicle ("SPV") on a recourse basis. Using funds appropriated under the CARES Act, the U.S. Department of Treasury will make an equity investment of $10 billion in the SPV. This SPV will make up to $100 billion of loans available with a term of three (3) years.

LOAN TERMS

According to the May 12 FAQ, the Reserve Bank will publish a Master Loan and Security Agreement ("MLSA"). On fixed days each month, borrowers may request one or more three-year TALF loans under the terms of the MLSA. According to the Term Sheet, the loans will be nonrecourse to the borrower (except for breaches of representations, warranties, and covenants, as further specified in the MLSA) and will be fully secured by eligible ABS. Although pre-payment will be permitted in whole or in part, the substitution of collateral will not be permitted. The SPV will assess an administrative fee equal to 10 basis points of the loan amount.

As noted in the FAQ: a TALF borrower will be required to certify that it is unable to secure adequate credit accommodations from other banking institutions and that it is not insolvent. More information will be forthcoming about the borrower certifications. Nevertheless, another FAQ explains that the Reserve Bank must obtain evidence that participants in the TALF are unable to secure from other banking institutions adequate credit accommodations, i.e., at prices or on conditions that are inconsistent with a normal, well-functioning market. After the chaos and uncertainty of administering the certification in the Paycheck Protection ("PPP"), and given the short life of the TALF, this requirement would seem to present a significant deterrence to using the TALF. Not only would an erroneous certification lead to recourse debt, but certifications under other programs, may result in hefty penalties under the False Claims Act. At least under the PPP, the certification dealt with facts unique to the borrower. Here, the Reserve Bank would be well aware of market conditions.

ELIGIBLE BORROWERS

Eligible borrowers "include"[3] businesses that are U.S. companies owning eligible collateral and maintaining an account relationship with a primary dealer. For this program, a U.S. company is a business created or organized in the United States or under the laws of the United States, and which has significant operations in, and a majority of its employees based in the United States.

The FAQ's example of an entity with "significant operations in the United States" is a borrower (or an investment manager, in the case of investment funds) with greater than 50 percent of its consolidated assets in, annual consolidated net income generated in, annual consolidated net operating revenues generated in, or annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) generated in the United States, as reflected in its most recent audited financial statements.

According to the FAQ, a U.S. business with any material investor that is a foreign government is not eligible to borrow under the TALF.

In the MLSA, a borrower will make a continuous representation of its eligibility.

ELIGIBLE COLLATERAL

- Includes U.S. dollar denominated cash (i.e., not synthetic) ABS that have a credit rating in the highest long-term or, if no long-term rating is available, 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 an eligible NRSRO.
- The issuer of eligible collateral must be a U.S. company.
- With the exception of commercial mortgage-backed securities ("CMBS"), SBA Pool Certificates, and Development Company Participation Certificates, eligible ABS must be issued on or after March 23, 2020. CBMS issued on or after March 23, 2020 will not be eligible. SBA Pool Certificates or Development Company Participation Certificates must be issued on or after January 1, 2019.
- To be eligible collateral, all or substantially all of the underlying credit exposures must be newly issued, except for CMBS.
- All or substantially all of the credit exposures underlying the eligible ABS must (1) for newly issued ABS, except for collateralized loan obligations (CLOs), be originated by U.S.-organized entities (including U.S. branches or agencies of foreign banks), (2) for CLOs, have a lead or a co-lead arranger that is a U.S.-organized entity (including a U.S. branch or agency of a foreign bank), and (3) for all ABS (including CLOs and CMBS), be to U.S.-domiciled obligors or with respect to real property located in the United States or one of its territories.
- Eligible collateral must be ABS meeting the above criteria where the underlying credit exposures are one of the following, with additional requirements set forth in the FAQs:
  - Auto loans and leases;
  - Student loans;
  - Credit card receivables (both consumer and corporate);
  - Equipment loans and leases;
  - Floorplan loans (per FAQ, subject to affiliation rules);
  - Premium finance loans for property and casualty insurance;
  - Certain small business loans guaranteed by the Small Business Administration;
  - Leveraged loans; and
  - Commercial mortgage loans (per FAQ, subject to affiliation rules).
- Eligible collateral will not include ABS that bear interest payments adjusting on predetermined dates, or that include exposures that are cash ABS or synthetic ABS.
- Single-asset single-borrower CMBS and commercial real estate CLOs do not constitute eligible collateral.
- The conflict-of-interest rules, primarily applicable to governmental officials and members of Congress, are made applicable to the 2020 TALF.

PRICING

Interest will be assessed according to the nature of the facility. For example, interest on CLOs is 150 basis points over the 30-day average secured overnight financing rate ("SOFR"), which may accelerate the move away from the London Interbank Offered Rate ("LIBOR") formula. SBA Development Company Participation Certificates (504 Loans) will bear interest at 75 basis points over the three-year fed funds overnight index swap rate.

HAIRCUT SCHEDULE

The May 12 Term Sheet replaces the ABS average life schedule. For auto, credit card, equipment, floorplan, and premium finance ABS, the weighted average life must be five (5) years or less. Additional haircuts for longer average life are applicable. No securitization may have an average life beyond ten (10) years.

Access the May 12 Term Sheet and FAQ.

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[1] This Client Alert is based upon information available on federalreserve.gov as of April 9, 2020 and updated on May 12, 2020. The Board of Governors of the Federal Reserve System may adjust the terms by posting an announcement on its website.
[2] Wall Street Journal, "*Fed Expands Corporate-Debt Backstops, Unveils New Programs to Aid States, Cities and Small Business*," *April 9, 2020*.
[3] The word "include" was added in the March 12, 2020 Term Sheet without clarification. The FAQ omits this word.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our Shumaker COVID-19 Client Resource & Return-to-Work Guide at shumaker.com. To receive the latest news and updates regarding COVID-19 straight to your inbox, sign up here.