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Client Alert: April 2020 Federal Reserve Action – Term Asset-Backed Securities Loan Facility

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On April 9, 2020, Federal Reserve Chairman Jerome Powell announced new programs of the Federal Reserve 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, or “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 in the April 2020 updated Term Sheet, 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.

As announced on April 9, 2020, the Federal Reserve Bank of New York (the “Reserve Bank”) will commit to lend to a special purpose vehicle (“SPV”) on a recourse basis, and 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. The loans will be nonrecourse to the borrower 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.

ELIGIBLE BORROWERS

Eligible borrowers are all U.S. companies that own eligible collateral and maintain 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 that has significant operations in and a majority of its employees based in the United States.

ELIGIBLE COLLATERAL

The following criteria were stated in the April 9, 2020 program terms:

- Includes U.S. dollar denominated cash (i.e., 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 an eligible NRSRO.

- All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company.
- The issuer of eligible collateral must be a U.S. company.
- With the exception of commercial mortgage-backed securities (“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 meeting the above criteria where the underlying credit exposures are one of the following:
 - Auto loans and leases;
 - Student loans;
 - Credit card receivables (both consumer and corporate);
 - Equipment loans and leases;
 - Floorplan loans;
 - Insurance premium finance loans;
 - Certain small business loans guaranteed by the Small Business Administration;
 - Leveraged loans;
 - Commercial mortgages, subject to further guidance on eligible credit exposures.
 - The April 2020 term sheet states that the Federal Reserve may consider adding other asset classes.
- All or substantially all of the underlying credit exposures must be newly issued, except for legacy CMBS.
- Single-asset single-borrower CMBS and commercial real estate collateralized loan obligations 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. We note that interest on collateralized loan obligations is based on the 30-day average secured overnight financing rate (“SOFR”), which may accelerate the move away from the LIBOR (London Interbank Offered Rate) formula.

HAIRCUT SCHEDULE

The April 2020 lists ABS average life. 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.

¹ This Client Alert is based upon information available on [federalreserve.gov](https://www.federalreserve.gov) as of the morning of April 9, 2020. By its terms, the terms and conditions of the program may be revised at any time by the Board of Governors of the Federal Reserve System by posting an update 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, <https://www.wsj.com/articles/fed-announces-new-facilities-to-support-2-3-trillion-in-lending-11586435450?mo>

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