Federal Reserve Establishes 'TALF 2.0'

Coronavirus/COVID-19 Update

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In Response to COVID-19, Federal Reserve Establishes 'TALF 2.0'

On March 23, 2020, as part of its response to support the flow of credit to consumers and businesses in the face of the COVID-19 pandemic, the Board of Governors of the Federal Reserve System (Federal Reserve) announced the establishment of the Term Asset-Backed Securities Loan Facility (TALF) and released a preliminary summary of its terms. The TALF will make government financing available to private investors to purchase asset-backed securities (ABS). The program is intended to create a source of funding for consumer and business loans by providing liquidity for the new issuance market for ABS.

The TALF initially will make up to $100 billion of loans available to eligible borrowers. The loans will have a term of three years and are required to be fully secured by eligible ABS. While more detailed terms and conditions will be provided at a later date, the Federal Reserve has said that the terms and conditions, including the haircuts in collateral valuation, will be primarily based off the terms and conditions used for the original TALF program established in connection with the financial crisis in 2008.

The term sheet for the TALF is available at:

https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf.

Under the TALF, the Federal Reserve will lend on a nonrecourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans. The Federal Reserve will lend an amount equal to the market value of the ABS less a haircut and will be secured at all times by the ABS. The U.S. Department of the Treasury (Treasury), using the Exchange Stabilization Fund (ESF), also will make a $10 billion equity investment in the special purpose vehicle (SPV) established by the Federal Reserve for this facility. The TALF — along with the Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuance and the Secondary Market Corporate Credit Facility (SMCCF), which provides liquidity for outstanding corporate bonds), both of which were announced on the same day — was established by the Federal Reserve under the authority of Section 13(3) of the Federal Reserve Act, with approval of the Treasury secretary.

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Under the TALF, a U.S. company organized and existing under the laws of the United States, including entities with non-U.S. parent companies, or a U.S. branch of a foreign bank (Eligible Borrowers), can obtain a loan secured by eligible ABS, which is limited to ABS backed by:

- auto loans and leases;
- student loans;
- credit card receivables (both consumer and corporate);
- equipment loans;
- floorplan loans;
- insurance premium finance loans;
- certain small business loans that are guaranteed by the Small Business Administration; or
- eligible servicing advance receivables.

Eligible ABS include U.S. dollar-denominated cash (as opposed to synthetic) ABS that have a credit rating in the highest long-term or 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 other eligible NRSRO.

All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company and the eligible ABS must be issued on or after March 23, 2020. All or substantially all of the underlying credit exposures must be newly issued.

The pledged eligible collateral will be valued and assigned a haircut according to a schedule based on its sector, the weighted average life and the historical volatility of the ABS. For eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be: (i) 100 basis points over the two-year London Inter-bank Offered Rate (LIBOR) swap rate for securities with a weighted average life less than two years, or (ii) 100 basis points over the three-year LIBOR swap rate for securities with a weighted average life of two years or greater. In addition, the SPV will assess an administrative fee equal to 10 basis points of the loan amount on the settlement date for the eligible collateral.

Each loan provided under the TALF will have a maturity of three years and will be made without recourse to the borrower, provided the requirements of the TALF are met. Loans made under the TALF will be prepayable 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.

No new credit extensions will be made after September 30, 2020, unless the TALF is extended by the Federal Reserve. It is expected that the initial terms will be based off of the terms and conditions used for the 2008 TALF.

Given the need for speed and decisiveness in light of the severe economic challenges posed by the COVID-19 pandemic, the Federal Reserve largely stuck to the terms and conditions used for the 2008 TALF program in its initial announcement of the new TALF. Going forward, the Federal Reserve may modify and amend the program in light of the evolving financial situation and the changes in the securitization industry over the past decade.

Among the modifications that could be considered for implementation are the expansion of eligible collateral to:

- include not only newly-issued ABS but also legacy ABS, which would be consistent with the later-inclusion of legacy commercial mortgage-backed securities (CMBS) in the original TALF program
  - the addition of legacy ABS would promote liquidity and price discovery for such ABS
- add new asset classes
  - subsequent to the original TALF program, new asset classes have emerged that support the financial needs of consumers and businesses, including, but not limited to:
    - unsecured consumer loan ABS;
    - transportation-related ABS, including those collateralized by containers, rail cars, aircrafts and shipping assets;
    - whole business securitizations;
    - wireless device payment plan securitizations; and
    - solar loans and property assessed clean energy (PACE) ABS
  - in addition, private label residential mortgage-backed securities (RMBS) could be added to the definition of eligible collateral
- expand the credit ratings criteria to allow for investment grade tranches that are rated by one of any NRSROs instead of the highest long-term or short-term investment grade rating from at least two NRSROs.

The TALF program is still being developed, and the Federal Reserve continues to clarify and publish additional program details. We will continue to provide updates as more TALF guidance is made available.