Client Alert

May 2020

New York Fed Releases Frequently Asked Questions on the Term Asset-Backed Securities Loan Facility (TALF)

On May 12, 2020, the Federal Reserve Bank of New York (New York Fed) released an initial set of Frequently Asked Questions (FAQs) to address certain questions about the Term Asset-Backed Securities Loan Facility (TALF) established by the Federal Reserve Board. In addition, the New York Fed updated the TALF term sheet.

The TALF was established to increase credit availability and support economic activity by facilitating renewed issuance of asset-backed securities (ABS), thereby increasing the availability of credit to households and businesses.

Under the TALF, the New York Fed will lend to a special purpose vehicle (TALF SPV) which will provide funding to eligible borrowers owning eligible collateral. Funding to eligible borrowers will be in an amount equal to the market value of the ABS less a haircut and will be secured by the ABS. The Treasury will make a 10 percent equity investment in the TALF SPV. The TALF SPV initially will make up to $100 billion of loans available. The TALF loans will have a term of three years and borrowers will be able to request one or more loans on fixed days each month. The TALF loans will be nonrecourse to the borrower except for breaches of representations, warranties and covenants. The New York Fed will publish a Master Loan and Security Agreement (MLSA) which will provide detailed terms of the TALF loans.

While the FAQs provide some clarity on questions regarding eligibility criteria for borrowers and issuers, there remain several questions to be clarified, we hope, in the final documentation for the TALF program. We highlight below a few items of note, some of which reflect differences from the TALF program that was established in the wake of the financial crisis of 2008.

Eligible Borrower

A US business that owns eligible collateral may borrow from the TALF if it is:

a) Created or organized in the United States or under the laws of the United States:

- a US subsidiary or US branch or agency of a foreign bank could be eligible;
- an investment fund (including a newly created investment fund) that is created or organized in the United States and managed by an investment manager that is created or organized in the United States and has significant operations in and a majority of its employees based in the United States is eligible;
- a US business or investment fund with any Material Investor that is a foreign government is not eligible (a Material Investor is a person who directly or indirectly owns 10 percent or more of any outstanding class of securities of an entity);

b) Has significant operations in and a majority of its employees based in the United States:

- The FAQs provide a nonexhaustive list of examples of "significant operations in the United States": 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. The determination is made with respect to the borrower and its consolidated subsidiaries (or with respect to the investment manager, if the borrower is an investment fund) and the Fed will not consider any parent company or sister affiliate under this test; and

c) Maintains an account relationship with a TALF Agent.

The FAQs make clear that investment funds include any pooled investment vehicle organized as a business entity or institution, including but not limited to, hedge funds, private equity funds and mutual funds, as well as any single-investor vehicle that is organized as a business entity or institution.

Each borrower is required to make a continuous representation that such borrower is an eligible borrower that meets the eligibility requirements above at all times during the life of the TALF loan. The borrower has to monitor its direct and indirect investors and if any investor reaches the Material Investor threshold, the borrower must alert its TALF Agent for due diligence review. The FAQs are silent on the consequence of such review.

Each borrower will be required to certify that:

a) It is unable to secure adequate credit accommodations from other banking institutions:

- This certification may be based on unusual economic conditions in the market intended to be addressed by the TALF. According to the FAQs, a lack of adequate credit does not mean that no credit is available. Lending may be available, but at prices or on conditions that are inconsistent with a normal, well-functioning market. It remains to be seen whether this certification requirement will be second-guessed to the same degree as occurred with respect to the "necessity certification" requirement under the Paycheck Protection Program.

b) It is not insolvent; and

c) It is eligible to receive a TALF loan in light of the conflicts of interest prohibition set forth in Section 4019 of the CARES Act (making entities in which the president, the vice president, certain cabinet members or a member of Congress, or their family members hold an equity interest of 20 percent or more ineligible to participate).

On a monthly basis, the Fed will publicly disclose information regarding the TALF, including the identity of each borrower and other participant in the TALF, each Material Investor of a borrower, the amount borrowed by each borrower, the interest rate paid by each borrower, the types and amounts of ABS collateral pledged by each borrower, and overall costs, revenues and other fees for the facility.

The impact of this public disclosure requirement on an institution relying on TALF financing may depend on the nature of the institution and its particular circumstances.

Eligible Collateral

Eligible collateral generally includes US dollar-denominated cash (not synthetic) ABS that (a) 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 rating agencies, (b) do not have a credit rating below the highest investment-grade rating category from an eligible rating agency and (c) are collateralized by eligible underlying assets (as further described below).

S&P Global Ratings, Moody's Investors Service Inc. and Fitch Ratings, Inc. are eligible rating agencies. The Fed may consider additional rating agencies. If an ABS is downgraded by a rating agency, it does not affect an existing TALF loan secured by such ABS and the borrower is not required to post any additional margin, but the ABS may not be used as collateral for any new TALF loans.

Floating-rate ABS that references LIBOR will be eligible, though the Federal Reserve generally expects the inclusion of fallback language (such as that recommended by the Alternative Reference Rates Committee).

ABS positions held to satisfy risk retention obligations will not be eligible collateral for TALF loans.

ABS that bear interest payments that step up or step down to predetermined levels on specific dates will not be eligible. Zero coupon ABS will also not be eligible.

ABS that are collateralized by loans originated or securitized by the TALF borrower or by an affiliate of the TALF borrower will not be eligible collateral for such TALF borrower.

A borrower may not pledge a newly issued ABS with a redemption option exercisable prior to three years after the disbursement date of any TALF loan secured by the pledge of such ABS, other than pursuant to a customary clean-up call. Additionally, a newly issued ABS shall not permit redemption options any time when such ABS is owned by the New York Fed or by the TALF SPV.

Eligible Underlying Assets

For an ABS to be eligible TALF collateral, the underlying credit exposures must be one of the following:

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) Premium finance loans for property and casualty insurance;
7) Certain small business loans that are guaranteed by the Small Business Administration;
8) Leveraged loans; or
9) Commercial mortgages.

The Fed may expand this list to include other asset classes, although it appears unlikely that ABS that is not in the highest long-term or short-term ratings category will be included.

Substantially all of the credit exposures underlying the eligible ABS must (a) for newly issued ABS (except CLOs), be originated by US-organized entities (which includes US branches or agencies of foreign banks); (b) for CLOs, have a lead or a co-lead arranger that is a US-organized entity (which includes a US branch or agency of a foreign bank); and (c) for all ABS, be to US-domiciled obligors or with respect to real property located in the United States or one of its territories. With certain exceptions (relating primarily to refinancings and master trusts), substantially all the underlying credit exposures must have been originated on or after January 1, 2019.

Information regarding interest rates, fees and the haircut schedule for the TALF program can be found here.

Certain Asset Specific Eligible Collateral Restrictions

We highlight below certain restrictions regarding specific asset classes identified in the FAQs.

- *CLOs*
  - Eligible CLOs must be static (i.e., they must not permit reinvestment of collateral proceeds), although a reinvestment period that begins at least three years after the disbursement date of any TALF loan secured by such CLO securities is permissible. An eligible CLO also must include certain concentration tests and an overcollateralization trigger specified in the FAQs. Proceeds from sales of underlying loans that have defaulted must be used to amortize the CLO.
  - CLOs backed by commercial real estate will not be eligible.
- *CMBS*
  - In order to be eligible, CMBS must not have been junior (with respect to subordination for credit support) to other securities with claims on the same pool of loans.
  - SASB CMBS (CMBS backed by a single asset or obligations to a single borrower) will not be eligible. Interest-only and principal-only CMBS will also not be eligible.
  - No CMBS issued on or after March 23, 2020 are eligible.

Permissible Age and Average Life of Eligible ABS

Eligible ABS must be issued on or after March 23, 2020 (with the exception of CMBS and SBA Pool Certificates or Development Company Participation Certificates). CMBS issued on or after March 23, 2020 will not be eligible (only legacy CMBS issued prior to March 23, 2020 will be eligible).

The average life for credit card, auto, equipment, floorplan and premium finance ABS cannot be greater than five years. The average life for SBA Pool Certificates and private student loan ABS cannot be greater than seven years. The average life for Development Company Participation Certificates, CMBS and CLOs cannot be greater than ten years.

Timing

The starting date of the TALF is uncertain. No new TALF loans will be made after September 30, 2020, unless this date is extended by the Fed and the Treasury Department.

*   *   *

Hunton Andrews Kurth LLP is a longstanding market leader in structured finance and securitization. For more than 35 years, we have represented clients in connection with mortgage-backed and asset-backed securities offerings and other structured financing matters. Our practice is at the forefront of the development of securitization and structured finance techniques, having represented our respective clients in many groundbreaking transactions. We represented eligible issuers and borrowers during the original iteration of TALF in the wake of the 2008 financial crisis and are experienced in guiding prospective participants and structuring transactions to ensure compliance with TALF. Please do not hesitate to contact any of the attorneys below if you have questions regarding TALF. Eric Mogel and Sunyi Snow contributed to the publication of this article.

Contacts

Rudene Mercer Haynes
rhaynes@HuntonAK.com

John J. Dedyo
jdedyo@HuntonAK.com

Thomas Y. Hiner
thiner@HuntonAK.com

Mike Nedzbala
mnedzbala@HuntonAK.com

Eric Mogel
emogel@HuntonAK.com

Sunyi Snow
sunyisnow@HuntonAK.com