



Term Asset-backed securities Loan Facility (TALF): Can Wall Street Help Main Street?

On November 25, 2008, the U.S. Department of the Treasury (Treasury) and the Federal Reserve Board (Federal Reserve) announced the creation of the Term Asset-backed securities Loan Facility, or TALF. The TALF was created to improve lending to consumers and small businesses by providing liquidity to securities backed by consumer and small business loans. Borrowers under the program can finance the purchase of qualifying asset-backed securities through acquisition of a loan from the Federal Reserve Bank of New York (New York Fed). The initial subscription period for loans was March 17-19, 2009, with the initial settlement date scheduled for March 25, 2009.

TALF is modeled after other programs launched by the Federal Reserve to facilitate resumption of more normalized extensions of credit and economic activity. Please see our coverage of these coordinated efforts and the current financial crisis at [Financial Crisis Legal Updates and News](#).

Background

In the third quarter of 2008, securitization funding for consumer and small business loans became unavailable. The TALF is designed to resume normalized originations of consumer and small business loans by providing low-risk funding for asset-backed securities (ABS) investors, restarting the securitization markets for these products. The Federal Reserve initially authorized the New York Fed to make up to \$200 billion of non-recourse loans to eligible borrowers secured by eligible ABS. The ABS will be pledged as collateral for the loans, and held by the New York Fed's custodian. If a borrower fails to repay its loan, the ABS will be transferred to a special purpose vehicle (SPV) to be established by the New York Fed. Using funds available to it under the Troubled Assets Relief Program authorized by the Emergency Economic Stabilization Act of 2008, Treasury will purchase subordinated debt issued by the SPV; the subordinated debt will absorb the first losses at the SPV. Treasury's initial commitment to the TALF was for \$20 billion. Any residual income from the SPV will be shared by the New York Fed and Treasury, after repayment of each of their loans.

On February 10, 2009, in coordination with the release of the Treasury's plan for the next phase of the Troubled Assets Relief Program (TARP), the Federal Reserve announced its willingness to increase its TALF commitment from \$200 billion to as much as \$1 trillion. Treasury's commitment would increase proportionally to up to \$100 billion. Treasury also announced expanding the program beyond the asset classes originally designated (credit cards, auto receivables, student loans and small business loans) to include commercial mortgage-related ABS and the Federal Reserve announced consideration of further expansion to include private label residential mortgage-related ABS and assets collateralized by corporate debt.

On March 3, 2009, the Federal Reserve announced its intention to expand the TALF to include auto ABS backed by rental commercial and government vehicle fleet leases and ABS backed by small ticket equipment, heavy

equipment and agricultural equipment loans and leases. Those additional asset classes could be included as early as the April 2009 funding of TALF loans. As an update to its earlier announcement, the Federal Reserve indicated that it, along with Treasury, was analyzing the appropriate terms and conditions for including commercial mortgage-backed securities in the program. Additionally, several other asset classes were identified as under consideration for inclusion, such as: private label mortgage-backed securities, collateralized loan and debt obligations, ABS backed by non-auto floorplan loans and ABS backed by mortgage servicing advances.

On March 19, 2009, the Federal Reserve announced terms and conditions for the inclusion of the previously announced new assets classes in the April 2009 funding: ABS backed by mortgage servicing advances, ABS backed by loans or leases relating to business equipment, ABS backed by leases of vehicle fleets, and ABS backed by floorplan loans.

TALF Overview

Eligible borrowers will be able to finance their purchase of eligible collateral through loans from the New York Fed. The New York Fed publishes information about the program through its TALF website at www.newyorkfed.org/markets/talf.html. Materials provided by the New York Fed include regularly updated Terms and Conditions, Frequently Asked Questions, Operations updates and Documents and Forms. Participation in the program may be effected exclusively through a primary dealer. Primary dealers are required to enter into a master loan and security agreement with the New York Fed and the TALF custodian. Borrowers will be required to execute a customer agreement with their primary dealer, authorizing the primary dealer to take all required action under the program.

Eligibility

The TALF has eligibility requirements for borrowers, for the ABS pledged as collateral for the loans, for the assets underlying the ABS and for the sponsors of the ABS. Primary dealers will also have program specific roles and responsibilities, specified in detail in the master loan and security agreement to be entered into between the primary dealer, on behalf of its borrower clients and the New York Fed.

Borrower Eligibility

An eligible borrower must be:

- One of the following U.S. entities:
 - A business entity or borrower organized under the laws of the United States, or any of its political subdivisions or territories, that conducts significant operations or activities in the United States, including any of its U.S. organized subsidiaries;
 - A U.S. branch or agency of a foreign bank (other than a foreign central bank) that maintains reserves with a Federal Reserve Bank; or
 - An investment fund, including any pooled investment vehicle such as a hedge fund, private equity fund, mutual fund or any vehicle that invests primarily in eligible collateral and borrows from the TALF, that is organized under the laws of the United States or any of its political subdivisions or territories and that is managed by an investment manager that has its principal place of business in the United States. The investment fund may be formed to participate in the TALF;

Any of these may include a U.S. subsidiary of a foreign entity, provided the U.S. entity conducts significant operations or activities in the United States and the subsidiary (and, in the case of an investment fund that is a subsidiary of a non-U.S. entity, that fund's investment manager) is not controlled directly or indirectly by a foreign government. A foreign government "controls" an entity if it can vote 25 percent or more of a class of voting securities of the entity.

- An entity not affiliated with the sponsor of the ABS or the entity that originated the underlying assets; and
- A customer of a primary dealer that has authorized the primary dealer to execute the TALF master loan agreement on the borrower's behalf.

ABS Eligibility

To be eligible, ABS must be backed by eligible underlying assets, described below, and must be:

- U.S. dollar-denominated;
- Cash ABS (not synthetic);
- Rated in the highest long-term or short-term ratings category by at least two major NRSROs (Moody's, Standard & Poor's or Fitch), and not have a credit rating below that category from a major NRSRO; the rating can't be based on an insurance policy and in place of a rating, the small business backed ABS may be guaranteed by the full faith and credit of the U.S. government;¹
- Cleared through the Depository Trust Company;
- Issued on or after January 1, 2009, other than SBA Pool Certificates or Development Company Participation Certificates which must be issued on or after January 1, 2008; and
- If backed by credit cards or auto dealer floorplan loans, issued to refinance existing similarly-backed ABS maturing in 2009 (such refinancing may be done up to three months prior to maturity, or for any prior maturity in 2009) and the aggregate TALF-pledged ABS may not exceed aggregate ABS maturing in 2009.

Eligible ABS may be issued on the settlement date for a TALF loan.

ABS Underlying Asset Eligibility

TALF-eligible ABS must:

- Be backed by auto loans or leases (auto includes cars, light trucks, motorcycles and recreational vehicles),² dealer floorplan receivables, student loans that are either government-guaranteed or private, credit card loans or small business loans guaranteed by the Small Business Administration;³
- Have at least 95% of the underlying assets, by dollar amount, from U.S. domiciled obligors; and
- Have at least 85% of the underlying assets, by dollar amount, meeting the following origination criteria:
 - Auto loan and auto leases must have been originated on or after October 1, 2007;
 - Student loans must have had a first disbursement date on or after May 1, 2007; and
 - SBA loans (other than those backing SBA Pool Certificates or Development Company Participation Certificates) must have been originated on or after January 1, 2008.

As discussed, expansion of the eligible asset classes is under consideration by the Federal Reserve.

¹ ABS backed by loans, debentures or pools under the SBA's 7(a) and 504 programs will be eligible without an independent credit rating provided all of the underlying assets, or the ABS themselves, are fully guaranteed as to principal and interest by the full faith and credit of the U.S. government.

² Commercial, governmental and rental fleet leases of cars, trucks and light trucks will not be eligible.

³ Small Business Administration loans include loans, debentures, or pools originated under the Small Business Administration's 7(a) and 504 programs, provided they are fully guaranteed as to principal and interest by the full faith and credit of the U.S. government and meet the other TALF eligibility requirements.

Sponsor Eligibility

The TALF imposes requirements on the sponsors of eligible ABS, utilizing the SEC's Regulation AB definition for sponsor: an entity organizing and initiating an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.

The sponsor must certify in the offering document for the ABS that:

- The ABS is TALF eligible;⁴
- A nationally recognized certified public accounting firm registered with the Public Company Accounting Oversight Board and retained by the sponsor has provided,⁵ or will provide by the issuance date, an attestation that the ABS is TALF eligible;⁶
- The issuer and the sponsor have executed and delivered an undertaking to the New York Fed indemnifying it from any losses it may suffer if the TALF certifications are untrue; and
- With respect to credit card and auto dealer floorplan backed ABS, that the aggregate issuance pledged as collateral under the TALF does not exceed expected 2009 maturities.

The extensive participation of ABS sponsors in the process for acquiring a TALF loan will require primary dealers, borrowers and sponsors to work closely together to issue TALF-eligible loans. In addition, sponsors of credit card and dealer floorplan ABS will be required to monitor the ABS pledged as collateral. Although the New York Fed's FAQs indicate that previously issued ABS may be pledged, a prospective borrower would need to work closely with the sponsor to amend or otherwise supplement the offering document in a manner acceptable by the New York Fed to satisfy these sponsor certification requirements.

Loan Structure, Fees and Pricing

Loans will be available on a monthly basis to eligible borrowers.

Loan Structure

The New York Fed will make TALF loans to eligible borrowers on a non-recourse basis. The loans will be secured by delivery to the New York Fed custodian of the borrower's eligible ABS. Principal cash flows from the ABS must be used to repay the proportionate principal amount of the loan; a loan with an advance rate of 90% will require 90% of principal cash flows to be used to pay down principal of the loan. If there is a default on the loan, the New York Fed's only recourse will be to take possession of the ABS from the custodian. Upon any such default, the ABS will be transferred to the SPV.

TALF loans will have a three-year maturity, with interest payable monthly. Loans may be prepaid at any time, in whole or in part, subject to ABS minimum denomination requirements, without penalty. Loans may be transferred with the consent of the New York Fed.

Interest will be either fixed or floating, at the election of the borrower. Each month a borrower may subscribe for one fixed rate loan and one floating rate loan, each of which may be backed by multiple ABS. The minimum loan

⁴ The form of certification and indemnity is available at www.newyorkfed.org/marktes/Form_Certification_TALF_Eligibility.pdf. For SBA Pool Certificates and Development Company Participation Certificates, an issuer certification or indemnity is not required. However, pool assemblers must deliver to the New York Fed an undertaking in connection with SBA Pool Certificates which can be found at www.newyorkfed.org/markets/TALF_Undertaking_SBA_ABS.pdf. Development Company Participation Certificates do not require a certification or indemnity.

⁵ An example of an acceptable form of accounting firm certification is available at www.newyorkfed.org/markets/TALFAuditorAttestationForm.pdf.

⁶ An auditor's attestation will not be required for SBA Pool Certificates and Development Company Participation Certificates.

size is \$10 million dollars, and there is no maximum subscription size. Two days prior to the settlement date, the New York Fed custodian will confirm allocations to borrowers.

Loan Pricing

Loans will be available to borrowers on a monthly basis, with subscription and settlement dates to be announced on the New York Fed’s TALF website under “TALF Operations.” Haircuts and interest rates described below are also subject to periodic review and changes, to be published on the TALF website.

Interest Rates: Interest on the TALF loans will accrue at a rate of 1-Month LIBOR plus 100 bps for floating rate loans, and 3-yr LIBOR swap rate plus 100 bps for fixed rate loans. The interest rate will be set prior to settlement date, and will be provided when the custodian confirms allocations to borrowers. Interest payments will be satisfied initially from ABS cash flows and borrowers will have a 30-day grace period for the payment of any unpaid interest.

Haircuts: Each loan amount will be subject to a haircut based on the credit characteristics of the underlying assets. Although subject to periodic review by the New York Fed, haircuts are expected to be initially as set forth in the following chart. For ABS with expected lives beyond seven years, haircuts will increase by one percentage point for each additional year of expected life.

Sector	Subsector	ABS Expected Life (years)						
		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	6%	7%	8%	9%	10%		
Auto	Subprime retail	9%	10%	11%	12%	13%		
Auto	Floorplan	12%	13%	14%	15%	16%		
Auto	RV/ motorcycle	7%	8%	9%	10%	11%		
Bank Card	Prime	5%	5%	6%	7%	8%		
Bank Card	Subprime	6%	7%	8%	9%	10%		
Retail Card	Prime	6%	7%	8%	9%	10%		
Retail Card	Subprime	7%	8%	9%	10%	11%		
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Student Loan	Gov’t Gttee	5%	5%	5%	6%	7%	8%	9%
Small Business	SBA Loans	5%	5%	5%	5%	6%	7%	8%

Administrative Fee: An administrative fee of 5 bps will be assessed on the settlement date for all subscriptions that have been confirmed by the New York Fed's custodian two business days prior to settlement. If a borrower subscribes for a TALF loan, but fails to deliver the collateral to the custodian on settlement date, the borrower will be assessed the 5 bps administrative fee.

Conclusion

In advance of the initial subscription date, the Federal Reserve modified the original March 17, 2009 date to an open subscription period from March 17 through March 19, 2009. This change highlighted the challenges of launching the program; TALF presents new roles for market participants in a risk adverse and cautious environment. Primary dealers are being asked to assume a new role in an industry that has experienced significant upheaval and criticism. Traditional purchasers of ABS have vacated the market, and new entrants evaluating the TALF need to understand the ABS market as well as the risks/benefits and liabilities associated with participation in the TALF program itself. Auditors are being directed to provide new attestations as to eligibility. Issuers and sponsors are assuming unique liability and entering into indemnity undertakings with a new counterparty. New roles and relationships are being assessed as quickly as possible by both traditional and potential new market participants in an effort to restart securitization and encourage extensions of credit to consumers and small businesses. Notwithstanding the challenges posed, initial indications for the program's success are promising.

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