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Term Asset-Backed Securities Loan Facility Launches: Key Details

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On March 3, 2009, the U.S. Treasury and Federal Reserve Board ("Fed") announced the launch of the Term Asset-Backed Securities Loan Facility ("TALF"), which is intended to increase the availability of credit to consumers and small businesses by unfreezing related securitization markets. The March 3 announcement modified previously announced terms with the goal of broadening TALF's scope and its appeal to investors. Under the first phase of TALF, the Federal Reserve Bank of New York ("FRBNY") has committed to lend up to $200 billion to "Eligible Borrowers," and it is expected that commitment could increase to up to $1 trillion. The FRBNY will fund the first of the TALF borrowings in March 2009, and the program will run through December 2009, unless further extended by the Fed. Today, the FRBNY released updated guidance and documents related to TALF, including to the "Frequently Asked Questions," and we expect the FRBNY to issue further updates from time to time. Participants should consult the FRBNY's website at http://www.newyorkfed.org/markets/talf.html for current information on the program.

Eligible Borrowers

To increase the potential scope of the program, TALF defines "Eligible Borrowers" broadly to include generally (i) U.S. based companies, (ii) U.S. branches or agencies of foreign banks that maintain reserves with a Federal Reserve Bank and (iii) U.S. based investment funds that are managed by a U.S. based investment manager (including funds set up for the purpose of investing in assets with TALF funding). A significant restriction is the exclusion of U.S. operations of foreign banks that are foreign-government controlled (even if only temporarily as a result of stabilization measures). TALF also prohibits entities that originated the underlying credit exposures and their affiliates from borrowing under TALF to finance purchases of Eligible Collateral backed by such credit exposures.

Overview of Terms

Under TALF, the FRBNY will make loans ("Loans") to Eligible Borrowers to fund purchases of "Eligible Collateral," which is restricted to certain AAA-rated asset backed securities ("ABS").[1] At least ninety-five percent of the credit exposures underlying the Eligible Collateral must be incurred by U.S.-domiciled obligors, and that underlying credit is initially limited to auto loans, credit card loans, student loans and SBA-guaranteed small business loans. The Fed has indicated that it may expand the list of eligible underlying credit exposures to include commercial mortgages, non-Agency residential mortgages and other asset classes, but the timing of any such expansion is uncertain. At least eighty-five percent of the underlying credit exposures must have been recently originated, with different time periods for different classes of collateral, and the underlying credit exposures may not include exposures that are themselves cash or synthetic ABS. For an ABS issue to be eligible for TALF funding, the sponsor must certify in the offering document that it is eligible and must retain an accounting firm to attest that the underlying credit exposures meet the TALF eligibility criteria. The sponsor also must execute an undertaking to the FRBNY to indemnify the FRBNY from any losses that it may incur if such certifications are untrue.

Loans will be made at a "haircut" to the value of the Eligible Collateral in accordance with guidelines published by the Fed (initially 5% to 16% depending on the Eligible Collateral) and will bear interest at what the Fed believes are market favorable rates.[2] The purchase price of the Eligible Collateral may be up to 110% of par.

Because the Loans will be made on a non-recourse basis, an Eligible Borrower's maximum loss will be limited to the amount of the initial haircut, and the government will bear the risk of a decline in the value of the Eligible Collateral beyond that amount. Unlike traditional lending facilities, Eligible Borrowers will not be required to post additional collateral in the event that the value of the Eligible Collateral declines during the term of the Loan. However, all of the Loans will have a three-year term, while in many cases the Eligible Collateral will have a significantly longer term, leaving Eligible Borrowers with the choice of selling the Eligible Collateral in three years or attempting to refinance the Loan at that time. Borrowers may also surrender their collateral in payment of their Loan (and forfeit their haircut amount) at any time before the Loan matures. Substitutions of collateral will not be permitted.

[1] The ABS must be rated "AAA" or the equivalent by at least two of Moody's, S&P and Fitch and cannot be rated less than that by any of the three. The AAA rating cannot be achieved through the use of a third-party guarantee. Some commentators have noted that restricting Eligible Collateral to AAA-rated securities may hamper the overall effectiveness of TALF because the market for subordinated tranches of new securitizations may continue to remain frozen, which could reduce the number of issuances backed by TALF.

[2] Depending on the type of Eligible Collateral, interest rates will be 50 or 100 bp over 1-month LIBOR, 75 bp over the federal funds target rate, or 50 or 100 bp over the 3-year LIBOR swap rate.

Procedures to Apply for Loans

Each Eligible Borrower must be a customer of a primary dealer that is participating in TALF and must execute a customer agreement with the primary dealer prior to applying for any Loan. The FRBNY will allocate Loans on monthly subscription dates. In order to receive a Loan, an Eligible Borrower must submit a Loan request to its primary dealer before a subscription date specifying the amount of the Loan requested,[3] the interest rate format (fixed or floating), and the offering documents and CUSIPs of the Eligible Collateral. The primary dealers will convey this information to the FRBNY on each subscription date. The initial subscription date is March 17, 2009 and the first Loan settlement date is March 25, 2009. Thereafter, the subscription date will be the first Tuesday of every month. On the Loan settlement date, the Eligible Borrower must pay the haircut amount plus an administrative fee of 5 basis points of the Loan amount to the FRBNY's settlement account. TALF allows participants to fund purchases of Eligible Collateral that is issued on the same day as a Loan settlement date.

Legal Issues of Note

Executive Compensation

Amending previous announcements, the Fed has announced that TALF participants (including Eligible Borrowers, sponsors and underwriters), solely by virtue of their participation in TALF, will not be subject to the executive compensation restrictions that are imposed on participants in the Troubled Asset Relief Program. Compensation restrictions on TALF participants arising under other TARP programs will continue to apply.

Exemption from Section 11(d)(1) of the Securities Exchange Act of 1934 ("Act")

Section 11(d)(1) of the Act prohibits a dealer from directly or indirectly extending or arranging for the extension of credit to customers to purchase securities in an issuance in which such dealer participated as a member of the selling syndicate or group within 30 days prior to the issuance. To prevent this restriction from limiting the number of TALF issuances, the SEC has granted a limited exemption for primary dealers participating in TALF who have been a member of a selling syndicate or group with respect to the applicable TALF issuance. The prohibition against a primary dealer's direct extension of credit with respect to TALF issuances remains in full force. Each primary dealer must submit a conflicts of interest remediation plan to the FRBNY in the event that it or one of its related persons intends to arrange a Loan, act as underwriter for the related Eligible Collateral and borrow through TALF.

[3] The minimum amount for a Loan request is $10 million; there is no maximum amount.

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