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# CORONAVIRUS: U.S. FEDERAL RESERVE ESTABLISHES NEW TERM ASSET-BACKED SECURITIES LOAN FACILITY

On March 23, 2020, the Board of Governors of the Federal Reserve System launched six new programs in response to the distressed economic conditions caused by the COVID-19 pandemic, including a new Term Asset-Backed Securities Loan Facility ("**TALF**") to facilitate the issuance of asset-backed securities ("**ABS**"). Under the TALF, the Federal Reserve Bank of New York ("**FRBNY**") will establish and fund a special purpose vehicle ("**SPV**") to buy eligible ABS issued on or after March 23, 2020.

The new TALF program is modeled on a similar credit facility established in 2008 (the "**2008 TALF**") to ensure the proper functioning of critical ABS markets.

Clifford Chance is developing structures to facilitate broad access to the program; please contact any of the individuals named below or your normal Clifford Chance contact for further information.

## KEY FEATURES OF THE TALF

The TALF is a credit facility authorized under section 13(3) of the Federal Reserve Act to help meet the credit needs of consumers and small businesses by facilitating the issuance of ABS and improving the market conditions for ABS more generally. Under the TALF, the FRBNY will commit to lend to an SPV on a recourse basis and the Department of the Treasury will make an equity investment of $10 billion in the SPV. The TALF SPV initially will make up to $100 billion of loans available. The loans will have a term of three years, subject to prepayment, and will be fully secured by eligible ABS, without recourse to the borrower. Notably, as currently proposed, the TALF does not include RMBS, CMBS and CLOs.

The Federal Reserve Board released a term sheet (available here) containing the following description of the terms of the TALF.

## Borrower Eligibility

All U.S. companies that own eligible collateral and maintain an account relationship with a primary dealer (a list of primary dealers is available here) are eligible to borrow under the TALF. A U.S. company is defined as a U.S. business entity organized under the laws of the United States or a political subdivision or territory thereof (including an entity that has a non-U.S. parent company), or a U.S. branch or agency of a foreign bank.

## Eligible Collateral

Eligible collateral includes U.S. dollar denominated cash (not 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 an eligible NRSRO. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company.

Eligible ABS must be issued on or after March 23, 2020. Eligible collateral must be ABS 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;
- Floorplan loans;
- Insurance premium finance loans;
- Certain small business loans that are guaranteed by the Small Business Administration; or
- Eligible servicing advance receivables (the definition of which is expected to be broadly consistent with that used in the 2008 TALF).

As described below, at this time, eligible collateral will not include ABS backed by corporate loans (such as CLOs) and commercial real estate (such as CMBS or CRE CLOs). Eligible collateral will not include ABS that bear interest payments that step up or step down to predetermined levels on specific dates. In addition, the underlying credit exposures of eligible collateral must not include exposures that are themselves cash ABS or synthetic ABS.

To be eligible collateral, all or substantially all of the underlying credit exposures must be newly issued. The Federal Reserve noted that the feasibility of adding other asset classes to the facility will be considered in the future.

### Collateral Valuation

The term sheet notes that the pledged eligible collateral will be valued and assigned a haircut according to a schedule based on its sector, the weighted average life, and historical volatility of the ABS. This haircut schedule will be published in the detailed terms and conditions and will be roughly in line with the haircut schedule used for the 2008 TALF.

### Pricing

For eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 100 basis points over the 2-year LIBOR swap rate for securities with a weighted average life less than two years, or 100 basis points over the 3-year LIBOR swap rate for securities with a weighted average life of two years or greater. In the term sheet, the Federal Reserve notes that, if necessary, the pricing structure will be updated to account for the expected industry transition away from LIBOR. The pricing for other eligible ABS will be set forth in the detailed terms and conditions.

### Fees

The SPV will assess an administrative fee equal to 10 basis points of the loan amount on the settlement date for collateral.

### Maturity

Each loan provided under this facility will have a maturity of three years.

### Investment by the Department of the Treasury

The Department of the Treasury, using the Exchange Stabilization Fund, will make an initial equity investment of $10 billion in the SPV.

### Recourse

Loans made under the TALF are made without recourse to the borrower, provided the requirements of the TALF are met.

### Prepayment

Loans made under the TALF will be pre-payable 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.

### Program Termination

No new credit extensions will be made after September 30, 2020, unless the TALF is extended by the Board of Governors of the Federal Reserve System.

## Program Limits – limited support for CLOs, RMBS and CMBS

As noted above, the TALF is limited to ABS backed by specified asset classes. Notably, those asset classes do not include corporate loans (such as CLOs), commercial real estate (such as CMBS or CRE CLOs) or residential mortgage loans (such as RMBS).

Senior AAA rated tranches of CLOs and CMBS may be funded through the Fed's Primary Dealer Credit Facility, as described here.

Under the initiatives announced today, agency RMBS and CMBS (i.e. programs established by Government Sponsored Entities such as Fannie Mae and Freddie Mac) will be supported by the Federal Open Market Committee (FOMC)'s purchase of Treasury securities and agency mortgage-backed securities in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy. The FOMC had previously announced it would purchase at least $500 billion of Treasury securities and at least $200 billion of mortgage-backed securities. In addition, the FOMC will include purchases of agency commercial mortgage-backed securities in its agency mortgage-backed security purchases. The FRBNY has issued an announcement to initiate those purchases immediately. There are no targeted programs to support private label RMBS and CMBS at this time, although there have been calls from industry, including from the Structured Finance Association, for other collateral to be permitted, such as certain private label residential mortgage, unsecured personal loans, and commercial mortgage assets.

## Further information

The Federal Reserve indicated that more detailed terms and conditions will be provided at a later date, primarily based on the terms and conditions used for the 2008 TALF. In the press release, the Federal Reserve also noted that it reserves the right to review and make adjustments to the terms and conditions – including size of program, pricing, loan maturity, collateral haircuts, and asset and borrower eligibility requirements – consistent with the policy objectives of the TALF.

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