FINANCIAL CRISIS RESPONSE TEAM

Legal News Alert℠

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Update: Term Asset-Backed Securities Loan Facility (TALF)

On November 25, 2008, the Board of Governors of the Federal Reserve System (Federal Reserve Board) announced the creation of the Term Asset-Backed Securities Loan Facility (TALF), a financial relief program designed to free up the asset-backed securities (ABS) market. On December 19, 2008, the Federal Reserve Board released revised terms and conditions of the TALF.

The ABS markets historically have funded a substantial share of consumer credit and small business loans, but the recent credit crisis has brought them to a standstill. The Federal Reserve Board intends the TALF to "increase credit availability and support economic activity by facilitating renewed issuance of consumer and small business ABS."

Overview

Under the TALF, the Federal Reserve Bank of New York (FRBNY) will lend up to $200 billion on a non-recourse basis to holders of certain newly issued, AAA-rated ABS collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the U.S. Small Business Administration (SBA). The U.S. Department of the Treasury — under the Troubled Assets Relief Program of the Emergency Economic Stabilization Act of 2008 — will provide $20 billion of financing to a special purpose vehicle (SPV) established by the FRBNY in connection with the TALF.

The FRBNY will provide non-recourse funding to any eligible borrower owning eligible collateral. On a fixed day each month, borrowers will be able to request one or more three-year TALF loans. Loan proceeds will be disbursed to the borrower, contingent on receipt by the FRBNY's custodian bank of the eligible collateral and a non-recourse loan fee. The amount of the non-recourse loan fee has not been specified.

Eligibility

Eligible borrowers include any U.S. company that owns eligible collateral and maintains an account relationship with a primary dealer. A U.S. company may include a subsidiary of a non-U.S. company, if the subsidiary is organized under the laws of the United States, or a branch or agency of a foreign bank. The Federal Reserve Board will require borrowers to act through primary dealers, which are banks and securities brokerages that trade in U.S. government securities with the Federal Reserve System. The Federal Reserve Board will expect primary dealers to collect, aggregate, and submit loan requests on behalf of their customers and pre-screen the proposed ABS collateral for TALF eligibility.[1]

Eligible collateral includes U.S. dollar-denominated cash (that is, not synthetic) ABS that:

- Have a long-term credit rating in the highest investment-grade rating category (for example, AAA) from two or more major nationally recognized statistical rating organizations (NRSROs)
- Do not have a long-term credit rating below the highest investment-grade rating category from a major NRSRO

Eligible small business ABS also will include U.S. dollar-denominated cash ABS for which all of the underlying credit exposures are fully guaranteed as to principal and interest by the full faith and credit of the U.S. government.

All or substantially all of the credit exposures underlying eligible ABS must be exposures to U.S.-domiciled obligors. The underlying credit exposures of eligible ABS must be auto loans, student loans, credit card loans, or small business loans guaranteed by the SBA.

Eligible ABS and the underlying credit exposures must be new or recent:

- Eligible ABS must be issued on or after January 1, 2009
- All or substantially all of the underlying credit exposures of eligible auto loan ABS must have been originated on or after October 1, 2007
- All or substantially all of the underlying credit exposures of eligible SBA-guaranteed loan ABS must have been originated on or after January 1, 2008
- All or substantially all of the underlying credit exposures of eligible student loan ABS must have had a first disbursement date on or after May 1, 2007

- Eligible credit card ABS must be issued to refinance existing credit card ABS maturing in 2009

Eligible credit card ABS also must be issued in amounts no greater than the amount of the maturing ABS. The minimum loan size under the TALF is $10 million.

Terms

In setting the interest rates on TALF loans, the FRBNY has said it will seek to provide an incentive to purchase eligible ABS at yield spreads between those that would be found in “normal” market conditions and those that have prevailed in the recent illiquid market conditions. Interest rates on TALF loans will be announced in advance of each monthly loan subscription date. Borrowers will be able to choose either a fixed or a floating rate, and floating-rate loans will be based on a spread over LIBOR.

The FRBNY will determine haircuts for each type of eligible ABS based on its view of the riskiness of each type of eligible collateral and the maturity of the eligible collateral pledged to the FRBNY. Haircuts will be announced by the FRBNY in advance of each monthly loan subscription date.

The Federal Reserve Board will periodically review and adjust the TALF interest rates and haircuts for new loans.

Other TALF loan terms are as follows:

- TALF loans will have a three-year maturity, with interest payable monthly
- TALF loans will be prepayable
- Sponsors of the eligible ABS will be subject to the executive compensation requirements of Section 111(b) of the Emergency Economic Stabilization Act of 2008

Consistent with the non-recourse nature of TALF loans, the FRBNY has stated that, if a borrower does not repay, it will enforce its rights in the collateral and sell the collateral to the SPV established by the FRBNY. A borrower will not be permitted to substitute collateral during the term of its loan.

The FRBNY will commence lending under the TALF in February 2009, and will cease lending on December 31, 2009, unless the Federal Reserve Board extends the program.

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[1] For more information concerning the primary dealers, please contact your Foley attorney or the individuals listed at the end of this alert.

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If you have any questions about this alert or would like to discuss the topic further, please contact your Foley attorney or the following individuals:

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