ALERTS

New Term Asset-Backed Securities Loan Facility Established by Federal Reserve in Wake of COVID-19

April 2, 2020

On March 23, 2020, as a result of the economic uncertainty caused by the COVID-19 pandemic, the Board of Governors of the Federal Reserve System ("Federal Reserve") authorized a new Term Asset-Backed Securities Loan Facility ("TALF 2020"), among several extensive measures designed to support the flow of credit to consumers and businesses. Like its predecessor established in response to the global financial crisis ("TALF 2008"),[1] TALF 2020 is intended to operate as a funding backstop to facilitate the issuance of eligible asset-backed securities ("ABS") and improving the general market conditions for ABS.[2]

Under TALF 2020, the Federal Reserve will lend to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans. Eligible borrowers consist of all U.S. companies[3] that own eligible collateral and maintain an account relationship with a primary dealer. The Federal Reserve will lend an amount equal to the market value of the ABS less a "haircut" and will be secured at all times by the ABS. All loans made under the TALF 2020 are non-recourse to the borrowers and have a maturity of three years. Additionally, the borrowers will have the option to prepay loans made under the TALF 2020 in whole or in part, but substitution of collateral during the term of the loan is generally not allowed. To support TALF 2020, the Federal Reserve Bank of New York will commit to lend a special purpose vehicle ("SPV") on a recourse basis and the U.S. Department of the Treasury will make an initial equity investment of $10 billion in the SPV using the Exchange Stabilization Fund.

Lenders who considered borrowing from TALF 2008, which was a similar program created to finance consumer and business credit through the issuance of ABS, may wish to consider participating in the TALF 2020. However, lenders considering participation in the TALF 2020 will need to act within the upcoming months, as the SPV will no longer make loans after Sept. 30, 2020, unless the deadline is extended by the Federal Reserve.

Eligible Collateral

The eligible collateral is initially limited to ABS issued on or after March 23, 2020 where the underlying securitized assets are one of the following:[4]

1. Auto loans and leases;
2. Student loans;
3. Credit card receivables (both consumer and corporate);
4. Equipment loans;
5. Floorplan loans;
6. Insurance premium finance loans;
7. Certain small business loans that are guaranteed by the Small Business Administration; or
8. Eligible servicing advance receivables.[5]

Eligible collateral includes U.S. dollar-denominated cash (that is, 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.

ABS that bear interest payments that step up or step down to predetermined levels on specific dates will not be included as eligible collateral. Additionally, the underlying credit exposures of eligible collateral must not include exposures that are themselves cash ABS or synthetic ABS.

All or substantially all of the underlying credit exposures must have been originated by a U.S. company and be newly issued to be considered eligible criteria. The definition of "newly issued" has not been defined by the Federal Reserve, so lenders must wait for the detailed terms and conditions to be provided.

Collateral Valuation

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. The "haircut" will be similar to the "haircut" from the TALF 2008, and will be published by the Federal Reserve at a later date in the detailed terms and conditions.

Pricing and Fees

The interest rate for eligible ABS with underlying credit exposures without a government guarantee will be 100 basis points over the two-year LIBOR swap rate for securities with a weighted average life less than two years, or 100 basis points over the three-year LIBOR swap rate for securities with a weighted average life of two years or greater. The pricing for other eligible ABS will be set forth in the detailed terms and conditions. Additionally, borrowers will be required to pay the SPV an administrative fee equal to 10 basis points of the loan amount on the settlement date for the ABS collateral.

The Federal Reserve will provide more detailed terms and conditions which are predicted to be similar to the terms and conditions for the TALF 2008 at a later date. Schulte Roth & Zabel will continue to provide updates as further developments become known. In the meantime, please contact your SRZ attorney or one of the authors if you have any questions.

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[1] *See* https://www.federalreserve.gov/newsevents/pressreleases/monetary20081125a.htm

[2] *See* https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf

[3] A U.S. company is defined as a U.S. business or entity organized under the laws of the United States or a political subdivision or territory thereof (including such an entity that has a non-U.S. parent company), or a U.S. branch or agency of a foreign bank.

[4] Additional asset classes may be considered in the future.

[5] The detailed terms and conditions to be provided by the Federal Reserve will contain further definitions to the eligibility of the underlying securitized assets and are expected to be similar to the TALF 2008 definitions.

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