

Clients & Friends Memo

COVID-19 Update: Federal Reserve Issues New TALF Term Sheet and Responses to Frequently Asked Questions

May 15, 2020

As part of a number of liquidity measures announced in response to the COVID-19 pandemic, the Federal Reserve re-established the Term Asset-Backed Securities Loan Facility (“TALF”)¹ on March 23, 2020.² On April 9, 2020, the Federal Reserve released a term sheet (the “April Term Sheet”) that expanded the range of “eligible collateral” to include certain commercial mortgage-backed securities (“CMBS”) and collateralized loan obligations (“CLOs”) and clarified which businesses would qualify as “eligible borrowers.”³

On May 12, 2020, the Federal Reserve released an updated term sheet (the “May Term Sheet”) for the TALF program.⁴ In addition, the Federal Reserve issued guidance in response to frequently asked questions (“FAQs”).⁵ This memorandum reviews the changes contained in the May Term Sheet and summarizes some of the key take-aways from the FAQs regarding certain aspects of TALF (which, as of the date of this memo, is not yet operational).

Unless otherwise indicated herein, this memorandum does not address the inclusion of CLOs in TALF. For a detailed discussion of the inclusion of CLOs in TALF, please see our May 13, 2020 Clients & Friends Memo, “COVID-19 Update: Federal Reserve Provides Additional Guidance on Inclusion of CLOs in New TALF Term Sheet and Responses to Frequently Asked Questions” (the “CWT TALF CLO Memo”).⁶

Borrower Eligibility

Investment Funds. The FAQs clarify that an investment fund could qualify as an “Eligible Borrower” and, accordingly, participate in TALF. Eligible Borrowers must (a) be created or organized in the

¹ The version of TALF in effect in 2008-2010 is referred to herein as “TALF 1.0”. The current version of TALF is referred to herein as “TALF” or “TALF 2.0”.

² See the Federal Reserve’s term sheet dated March 23, 2020, available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf>

³ Available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a1.pdf>

⁴ Available at <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200512a1.pdf>

⁵ Available at <https://www.newyorkfed.org/markets/term-asset-backed-securities-loan-facility/term-asset-backed-securities-loan-facility-faq>

⁶ Available at <https://www.cadwalader.com/uploads/cfmemos/e57dfa009d44066ae307fcaed9c82a2b.pdf>

United States or under the laws of the United States, (b) have significant operations in and majority of their employees based in the United States, and (c) maintain an account relationship with a primary dealer. As in TALF 1.0, both the investment fund and its investment manager that must be considered for eligibility. To satisfy prong (b) of the Eligible Borrower criteria, investment funds may look through to the investment manager to have “significant operations in and a majority of its employees based in the United States.”⁷ Note that in TALF 1.0, the Federal Reserve used a “principal place of business” criterion for the investment manager.

Note: *Investment funds would not have been able to qualify as Eligible Borrowers due to their inability to satisfy prong (b) of the Eligible Borrower criteria if the Federal Reserve had not clarified that they are permitted to look through to the investment manager.*

Certain features of “investment funds” remain the same as in TALF 1.0:

- Investment funds include (1) any type of pooled investment vehicle that is organized as a business entity or institution, including without limitation a hedge fund, a private equity fund, and a mutual fund, and (2) any type of single-investor vehicle that is organized as a business entity or institution.
- Investment funds can be newly formed and can take the form of limited liability companies or partnerships.⁸
- The investment fund’s strategy need not be limited to investing only in TALF eligible assets; rather, the investment fund may be multi-strategy, investing in a mix of TALF-eligible assets and other assets.

In addition, neither an investment fund nor its investment manager may have any “Material Investors” that are foreign governments⁹, and the investment fund and its investment manager will be obligated, on an ongoing basis, to monitor relevant thresholds for compliance.¹⁰

Adequate Credit Accommodations. Each TALF borrower, including any eligible investment fund, will be required to certify that it is unable to secure adequate credit accommodations from other banking institutions and is not insolvent. This certification may be based on unusual economic conditions in the market or markets that are intended to be addressed by TALF 2.0. The FAQs make it clear that a borrower need not show that no credit is available, but rather, that lending is only available at prices or conditions that are inconsistent with a normal, well-functioning market.

⁷ The meaning of “significant operations in the United States” includes a borrower (or an investment manager in the case of investment funds) with greater than 50% of its consolidated assets in, annual consolidated net income generated in, annual consolidated net operating revenues generated in, or annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) generated in the United States as reflected in its most recent audited financial statements.

⁸ The full definition of eligible business entities or institutions includes entities organized as limited liability companies, partnerships, banks, corporations, and business or other non-personal trusts.

⁹ Neither the May Term Sheet nor the FAQs provide a definition of “foreign government.”

¹⁰ A “Material Investor” is a person who owns, directly or indirectly, 10% or more of any outstanding class of securities of an entity; i.e., the investment fund or the investment manager.

What is not clear is whether TALF borrowers will have an affirmative obligation to try to find alternative financing or whether it will be sufficient to argue that none would be available.

Collateral Eligibility

The May Term Sheet and the FAQs also provide additional clarification around the characteristics of the asset classes (and their related underlying exposures) that are eligible to be collateral under a TALF loan.¹¹ Although no new asset classes were added to TALF 2.0 in the May Term Sheet¹², there are a few notable changes for existing asset classes. This section provides an overview of certain selected eligibility requirements that have changed from those described in the April Term Sheet or from similar eligibility requirements in TALF 1.0. Selected requirements for CMBS and student loan ABS are described in subsections below.

Note: *Notwithstanding industry lobbying, the list of eligible ABS still does not include residential mortgage-backed ABS, servicing advance receivables, new issue CMBS, single-asset single borrower ("SASB") CMBS or commercial real estate collateralized loan obligations ("CRE CLOs").*

Connection of Underlying Exposures to the U.S. The requirement in the April Term Sheet that all or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company has been replaced in the May Term Sheet with requirements that:

- All or substantially all of the credit exposures underlying the eligible ABS must:
 - for newly issued ABS (except for CLOs) be originated by U.S.-organized entities (including U.S. branches or agencies of foreign banks),
 - for CLOs, have a lead or a co-lead arranger that is a U.S.-organized entity (including a U.S. branch or agency of a foreign bank), and
 - for all ABS (including CLOs and CMBS), be to U.S.-domiciled obligors or with respect to real property located in the United States or one of its territories.
- With respect to each of the requirements in the bullets above, the FAQs clarify that "all or substantially all" means that 95% or more of the dollar amount of the assets or loans must have the characteristics described above.

Domicile of Issuer. The requirement in the April Term Sheet that the issuer of eligible collateral must be a U.S. company has been removed.

Note: *Most ABS issuers would not have satisfied the proposed definition of U.S. company in the April Term Sheet. This change will also allow CLOs to continue to use offshore issuers so long as their collateral*

¹¹ The only change to the list of underlying exposures that may back eligible ABS (that is, compared with the April Term Sheet) is a clarification that the only type of eligible "Insurance premium loans" are "Premium finance loans for property and casualty insurance." This change is consistent with the FAQs from TALF 1.0.

¹² The FAQs indicate that the set of permissible underlying assets of eligible ABS may be expanded later to other asset classes.

managers meet certain requirements, as described in the CWT TALF CLO Memo.

Newly-Issued Requirements. Other than CMBS, SBA Pool Certificates or Development Company Participation Certificates, eligible ABS must be issued on or after March 23, 2020. CMBS must be issued prior to March 23, 2020, and SBA Pool Certificates or Development Company Participation Certificates must be issued on or after January 1, 2019.

In order for an ABS to constitute eligible collateral, all or substantially all of the underlying credit exposures must be newly-issued or originated, except for CMBS. The FAQs clarify the requirements around timing of origination and issuance with respect to each type of underlying exposure, as set forth in the following table:

Asset Type	Requirement
Auto loan ABS (non-revolving trust)	All or substantially all of the underlying assets must have been originated on or after January 1, 2019
Auto loan ABS (existing revolving (or master) trust)	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing auto ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing auto ABS
Auto loan ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
Credit card ABS (existing revolving (or master trust)	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing auto ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing auto ABS
Credit card ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
Student loan ABS	All or substantially all of the underlying assets must have had a first disbursement date on or after January 1, 2019
SBA Pool Certificates and Development Company Participation Certificates	No specific origination restriction for underlying loans or debentures as long as the SBA Pool Certificates and Development Company Participation Certificates were issued on or after January 1, 2019

Equipment receivables ABS	All or substantially all of the underlying assets must have been originated on or after January 1, 2019
Floorplan ABS (existing revolving (or master) trust)	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing floorplan ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing ABS
Floorplan ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
Premium finance ABS (existing revolving (or master) trust)	No specific origination restriction for underlying assets, although eligible ABS must be issued to refinance existing premium finance ABS maturing prior to September 30, 2020, and may not be in amounts greater than the amount of the maturing ABS
Premium finance ABS (master trust established on or after March 23, 2020)	All or substantially all of the underlying assets must have been originated on or after January 1, 2020
CLOs	All or substantially all of the leveraged loans underlying CLOs must have been originated (or been refinanced) on or after January 1, 2019
CMBS	No specific origination restriction for underlying mortgage loans, although CMBS must be issued before March 23, 2020

Additionally, the FAQs clarify that the requirement that “all or substantially all” of the underlying exposures be “newly issued” means 95% or more of the principal balance of the underlying assets in the eligible ABS. By contrast, in TALF 1.0, the threshold was 85%.

Rating Agencies. At this time, the Federal Reserve has designated only S&P Global Ratings, Moody’s Investors Service Inc., and Fitch Ratings, Inc. as eligible NRSROs to rate eligible ABS in TALF 2.0. The Federal Reserve explicitly noted in the FAQs that it may consider including other NRSROs. Under TALF 1.0, other rating agencies were permitted, but only with respect to certain asset classes.

LIBOR. Floating rate ABS that references LIBOR will be eligible collateral for TALF loans. However, the Federal Reserve expects that any ABS benchmarked to LIBOR will include adequate

fallback language, such as that recommended by the Alternative Reference Rates Committee (“ARRC”) or substantially similar fallback language. For additional information on LIBOR and leveraged loans underlying eligible CLOs, please see our CWT TALF CLO Memo.

Acquisition of Eligible ABS. If eligible ABS is not issued on the same day that an investor borrows a TALF loan, the eligible ABS must have been acquired in arms-length secondary market transactions within 30 days prior to the relevant TALF loan subscription date.¹³

Optional Redemption. The FAQs clarify that newly issued eligible ABS may not include a redemption option that is exercisable prior to three years after the disbursement date of any TALF loan secured by the pledge of such ABS, other than pursuant to a “customary clean-up call” (a definition of which is included in the FAQs). Additionally, newly issued ABS may not permit a redemption option at any time when such ABS is owned by the New York Fed or by the TALF SPV.

Note: *Under TALF 1.0, TALF borrowers had the option of surrendering eligible collateral in lieu of repayment of the TALF loan. While the TALF 2.0 term sheets and FAQs are silent on collateral surrender, if it remains an option, eligible newly issued ABS may need to have a prohibition on exercise of redemption options (other than clean-up calls) for longer than three years. Additionally, under TALF 1.0, the FAQs indicated that the Federal Reserve might permit certain newly issued ABS with optional redemption features on a case-by-case basis. The TALF 2.0 FAQs do not contemplate such flexibility.*

Weighted Average Life and Prepayment Assumptions. Under the May Term Sheet and the FAQs, the weighted average life of auto, credit card, equipment, floorplan, and premium finance ABS must be five years or less. The average life for SBA Pool Certificates and private student loan ABS cannot be greater than seven years. No securitization may have an average life beyond ten years.

The FAQs provide guidance for determining the average life of eligible ABS with methodologies consistent with TALF 1.0. For amortizing ABS, average life is defined as the weighted average life to maturity based on the prepayment assumptions and market conventions listed in the FAQs. While most of the prepayment assumptions used for calculating the weighted average lives of eligible ABS are consistent with the prepayment assumptions used in TALF 1.0, the FAQs do include changes to three prepayment assumptions. Specifically:

- For Prime Auto Lease ABS, average life is determined by the weighted average life to maturity based on the prepayment assumption of 100% of the prepayment curve (as opposed to 75% in TALF 1.0);
- For SBA 504 loan ABS, average life is determined by the weighted average life to maturity based on the prepayment assumption of 7% Conditional Prepayment Rate (“CPR”)¹⁴ (as opposed to 5% in TALF 1.0); and

¹³ While not explicitly stated, eligible ABS acquired by a TALF borrower in the primary market should also be eligible collateral for a TALF loan, if they satisfy all other eligibility criteria.

¹⁴ CPR represents the proportion of the principal of a pool of loans that is assumed to be paid off prematurely in each period.

- For amortizing eligible student loan ABS, average life is determined by the weighted average life to maturity based on the prepayment assumption of 8% CPR (as opposed to 4% in TALF 1.0).

The FAQs note that prepayment assumptions may be updated periodically for future TALF subscriptions and may be adjusted on a deal-specific basis.

Student Loan ABS. The May Term Sheet and FAQs have set forth certain requirements for student loan ABS that are different from the eligibility requirements for student loan ABS under TALF 1.0. Notably:

- All or substantially all of the assets underlying eligible student loan ABS must have had a first disbursement date on or after January 1, 2019.¹⁵
- Private student loans, and private student loans that are for the purpose of refinancing existing private student loans or loans guaranteed by the federal government, if the refinanced loan disbursement date is on or after January 1, 2019, are eligible collateral.
- The average life for private student loan ABS cannot be greater than seven years.
- For amortizing eligible student loan ABS, the average life is determined by the weighted average life to maturity based on the prepayment assumption of 8% CPR. See "*Collateral Eligibility—Weighted Average Life and Prepayment Assumptions*" above.

CMBS. The May Term Sheet and the FAQs address eligibility requirements for CMBS, as described below.

Eligible Collateral Remains Limited to Pooled Legacy CMBS. The May Term Sheet did not expand (as industry participants had hoped) the scope of CMBS that qualifies as eligible collateral or extend eligibility to CRE CLOs. Eligible CMBS collateral remains limited to CMBS that:

- was issued on or before March 23, 2020;
- is not backed by only a single asset or obligations of only a single borrower (i.e., is not a SASB CMBS);
- has credit exposure that is "all or substantially all" with respect to U.S. domiciled obligors or real property located in the United States or one of its territories; and
- has an average life no greater than 10 years.

Additional Clarity on CMBS Eligibility. The FAQs did identify additional requisite characteristics specific to eligible CMBS. To qualify as eligible collateral under the TALF program, CMBS must:

¹⁵ See "*Collateral Eligibility—Newly-Issued Requirements*" above.

- entitle its holder to payments of principal and interest (i.e., interest-only and principal-only CMBS do not qualify);
- bear interest at a fixed pass-through rate or a rate based upon the weighted average of underlying fixed-rate mortgage loans (i.e., floating rate CMBS do not qualify);
- not be junior to other securities with claims to the same pool of mortgage loans; and
- evidence an interest in a trust fund consisting of fully-funded mortgage loans the security for which must be evidenced by a mortgage or similar instrument on a fee or leasehold interest in one or more income-generating commercial properties.

Prohibition on Eligibility of Borrower-Affiliated CMBS. Consistent with the provisions of TALF 1.0, the FAQs also make clear that otherwise eligible CMBS will nonetheless be ineligible collateral for TALF loans as to a particular borrower where the borrower (or an “affiliate”¹⁶) is the borrower under a mortgage loan or mortgage loans that constitute more than 5% of the aggregate principal balance of the pool of mortgage loans in the related trust fund on the subscription date.

Terms of TALF Loans

Loan Size and Haircuts

Market Value and Loan Size. Under the FAQs, for all ABS other than SBA ABS, the market value must be no greater than par. For such assets, the New York Fed will lend to each borrower an amount equal to the market value of the pledged collateral, minus a haircut. For SBA ABS with a market value above par, the New York Fed will lend an amount equal to the market value, subject to a cap of 105% of par value, minus a haircut, and the borrower will periodically prepay a portion of the loan. The prepayments will be calculated to adjust for the expected reversion of market value toward par value as such ABS mature.

Haircuts. The haircuts for eligible ABS used to determine TALF loan size are consistent with the haircut levels set forth in TALF 1.0, other than for CLOs, which were not eligible collateral in TALF 1.0.

Interest Rates. The May Term Sheet made only small changes to the interest rates applicable to TALF loans. The TALF loan rate is determined by the type of collateral securing the loan. The rates for TALF loans are as follows:

- For CLOs, the interest rate will be 150 basis points over the 30-day average Secured Overnight Financing (“SOFR”) rate (30-day average SOFR);
- For SBA Pool Certificates (7(a) loans), the interest rate will be the top of the federal funds target range plus 75 basis points;

¹⁶ The term “affiliate” will have the meaning set forth in the Master Loan and Security Agreement (the “MLSA”). The TALF 2.0 MLSA has not yet been released.

- For Development Company Participation Certificates (504 loans), the interest rate will be 75 basis points over the 3-year fed funds overnight index swap (“OIS”) rate; and
- For all other eligible ABS, the interest rate will be 125 basis points over the 2-year OIS rate for securities with a weighted average life less than two years, or 125 basis points over the 3-year OIS rate for securities with a weighted average life of two years or greater.

Interest rates will be set one day prior to the applicable loan subscription date.

Interest on TALF loans financing ABS (other than CLOs) will be payable monthly; interest on TALF loans financing CLOs will be payable quarterly.

Fees. On each loan settlement date, the borrower must pay to the TALF SPV’s settlement account an administrative fee equal to 10 basis points of the loan amount, which will cover the fees associated with the facility. Unlike TALF 1.0, the FAQ does not contemplate a higher fee payable for TALF loans collateralized by CMBS.

Additional Information Expected From the Federal Reserve

The FAQs acknowledge that open questions remain regarding the operation of TALF 2.0. The FAQs expressly provide that further information will be forthcoming on a variety of relevant topics, including borrower certifications, collateral review, issuer certifications, auditor assurances, SBA documentation and loan subscription and closing mechanics. Also, many terms of the program, including the definition of “affiliate”, are expected to be provided in the MLSA for TALF 2.0, which has not yet been released.

Additional Resources

Cadwalader “[TALF 2.0: Overview and Opportunities](#)” webinar, April 30, 2020

Cadwalader Clients & Friends Memo, “[COVID-19 Update: Federal Reserve Launches TALF \(Again\)](#),” March 23, 2020

Cadwalader Clients & Friends Memo, “[COVID-19 Update: Federal Reserve Provides Additional Guidance on Inclusion of CLOs in New TALF Term Sheet and Responses to Frequently Asked Questions](#),” May 13, 2020

* * *

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Cheryl Barnes	+1 202 862 2340	cheryl.barnes@cwt.com
Joseph Beach	+1 704 348 5171	joseph.beach@cwt.com
Aaron Benjamin	+1 704 348 5384	aaron.benjamin@cwt.com
David Burkholder	+1 704 348 5309	david.burkholder@cwt.com
Scott Cammarn	+1 704 348 5363	scott.cammarn@cwt.com
Sophie Cuthbertson	+1 202 862 2341	sophie.cuthbertson@cwt.com
Michael Gambro	+1 212 504 6825	michael.gambro@cwt.com
Chris Gavin	+1 212 504 6760	chris.gavin@cwt.com
David Gingold	+1 212 504 6386	david.gingold@cwt.com
Anna Glick	+1 212 504 6309	anna.glick@cwt.com
Stuart Goldstein	+1 704 348 5258	stuart.goldstein@cwt.com
Kahn Hobbs	+1 704 348 5376	kahn.hobbs@cwt.com
Gregg Jubin	+1 202 862 2485	gregg.jubin@cwt.com
Robert Kim	+1 212 504 6258	robert.kim@cwt.com
Henry LaBrun	+1 704 348 5149	henry.labrun@cwt.com
Ivan Loncar	+1 212 504 6339	ivan.loncar@cwt.com
Dorothy Mehta	+1 212 504 6846	dorothy.mehta@cwt.com
Jed Miller	+1 212 504 6821	jed.miller@cwt.com

Peter Morreale	+1 202 862 2258	peter.morreale@cwt.com
Lisa Pauquette	+1 212 504 6298	lisa.pauquette@cwt.com
Frank Polverino	+1 212 504 6820	frank.polverino@cwt.com
Gregory Prindle	+1 212 504 6984	gregory.prindle@cwt.com
Jeffrey Rotblat	+1 212 504 6401	jeffrey.rotblat@cwt.com
Ira Schacter	+1 212 504 6035	ira.schacter@cwt.com
Nathan Spanheimer	+1 704 348 5195	nathan.spanheimer@cwt.com
Neil Weidner	+1 212 504 6065	neil.weidner@cwt.com
Joseph Gambino	+1 212 504 6028	joseph.gambino@cwt.com
Peter Williams	+1 212 504 6573	peter.williams@cwt.com