

Clients & Friends Memo

COVID-19 Update: Updated FAQs and MLSA Released by the Federal Reserve Provides Additional Details on Eligible ABS, Eligible Borrowers and Financing Terms under TALF

May 27, 2020

On Wednesday, May 20, 2020, the Federal Reserve announced the first loan subscription date for the Term Asset-Backed Securities Loan Facility (“TALF”) and published the Master Loan and Security Agreement (the “MLSA”) and an expanded set of Frequently Asked Questions, providing further details on the terms and conditions that will apply to borrowings under TALF.¹ On Tuesday, May 26, 2020, the Federal Reserve released another updated set of Frequently Asked Questions with additional clarifications applicable to TALF² and an updated form of issuer and sponsor certification.³ The Updated FAQs follow the release on May 12, 2020 by the Federal Reserve of its initial set of Frequently Asked Questions for the TALF program (the “Initial FAQs”).⁴

TALF's first subscription date for loans backed by eligible asset-backed securities (“Eligible ABS”) will be June 17, 2020, and the first loan closing date will be June 25, 2020.

For a discussion of the Initial FAQs, see our Clients & Friends Memo dated May 15, 2020 titled “*COVID-19 Update: Federal Reserve Issues New TALF Term Sheet and Responses to Frequently Asked Questions*”⁵ and our Clients & Friends Memo dated May 13, 2020 titled “*COVID-19*

¹ <https://www.newyorkfed.org/newsevents/news/markets/2020/20200520>

² The cumulative updates contained in the Frequently Asked Questions relating to TALF released on May 20, 2020 and the Frequently Asked Questions relating to TALF released on May 26, 2020 <https://www.newyorkfed.org/markets/term-asset-backed-securities-loan-facility/term-asset-backed-securities-loan-facility-faq> are collectively referred to herein as the “Updated FAQs”.

³ <https://www.newyorkfed.org/medialibrary/media/markets/talfdocs/talf-issuer-sponsor-certification.pdf>

⁴ <https://www.newyorkfed.org/newsevents/news/markets/2020/20200512>

⁵ <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-reserve-issues-new-talf-term-sheet-and-responses-to-frequently-asked-questions>

*Update: Federal Reserve Provides Additional Guidance on Inclusion of CLOs in New TALF Term Sheet and Responses to Frequently Asked Questions.*⁶

The additional details and clarifications provided by the Updated FAQs generally relate to: (i) collateral eligibility, (ii) borrower eligibility, (iii) financing terms, (iv) borrowing procedures, and (v) the role, responsibilities and protections of TALF Agents. This memorandum summarizes certain of the additional details and clarifications relating to collateral eligibility, borrower eligibility and financing terms described in the Updated FAQs.

Eligible ABS

Additional details and/or clarifications relating to Eligible ABS:

- *Eligible NRSROs*. The list of eligible NRSROs under TALF has been expanded to include DBRS, Inc. and Kroll Bond Rating Agency. However an Eligible ABS must also have a qualifying rating from one of Fitch Ratings, Inc., Moody's Investors Service, Inc. or S&P Global Ratings.
- *Unsolicited Ratings*. Unsolicited ratings will not be considered in determining whether collateral constitutes Eligible ABS.
- *SBA ABS*. The expanded description of small business ABS ("SBA ABS") that may be pledged as collateral for a TALF loan clarifies that the SBA ABS (rather than the underlying assets as provided in the Initial FAQs) must be fully guaranteed by the full faith and credit of the U.S. government and that the underlying assets consist of loans made pursuant to (i) section 7(a) of the Small Business Act and (ii) the Certified Development Company/504 loan program of the U.S. Small Business Administration.
- *Junior Triple-A ABS Are Not Eligible ABS*. ABS tranches that are junior to any other class of securities backed by the same pool of assets are not Eligible ABS under TALF.

Note: This restriction raises the question of whether, as a technical matter, triple-A CLO notes (commonly designated as Class A Notes or Class A-1 Notes) that would otherwise qualify as Eligible ABS would be ineligible if the CLO issuer also issued "Class X Notes" that amortize during the term of the TALF loan, even though there is no express subordination.

⁶ <https://www.cadwalader.com/resources/clients-friends-memos/covid-19-update-federal-reserve-provides-additional-guidance-on-inclusion-of-clos-in-new-talf-term-sheet-and-responses-to-frequently-asked-questions>

- Issuer Disclosure and Documentation.
 - Eligible ABS issued on or after March 23, 2020 and before May 22, 2020 are excluded from the requirement (described in the Initial FAQs) that the offering document for such Eligible ABS disclose whether the deal is prime or subprime.
 - Issuers of Eligible ABS will be required to submit the final credit rating letters from each eligible NRSRO no later than 10:00 a.m. (New York time) on the applicable TALF loan settlement date.
 - Sponsors or issuers of ABS proposed as Eligible ABS must provide to the Federal Reserve Bank of New York (the “FRBNY”) all data on the ABS or its underlying exposures that the issuer has provided to any NRSRO no later than 5:00 p.m. (New York time) three weeks in advance of the applicable TALF subscription date.
 - Sponsors or issuers of ABS proposed as Eligible ABS must also provide a written waiver or consent to any such NRSRO, permitting such NRSRO to share its view of the credit quality of the ABS and its underlying exposures with the FRBNY.
 - Sponsors and issuers of Eligible ABS (other than SBA ABS) are required to ensure that the information included in the offering document contains a certification that, among other things, (i) the ABS is “eligible collateral” and (ii) the sponsor (or, if the sponsor is a special purpose vehicle, the sponsor’s direct or indirect ultimate parent) has executed and delivered an indemnity in favor of the TALF SPV and the FRBNY indemnifying each of them from any losses they may suffer if such certifications are untrue.

Note: The “sponsor” for purposes of the issuer and sponsor certification and the sponsor indemnity undertaking, in both public and private offerings for Eligible ABS, will be the legal entity that is the sponsor of the ABS issuance. The sponsor is the entity that organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity. For CLOs, the collateral manager will be the “sponsor” for these purposes even if the collateral manager is not the “sponsor” for purposes of the risk retention rules.⁷ If the sponsor is a special purpose vehicle, the sponsor’s direct or indirect ultimate parent must execute the certification and indemnity undertaking.

⁷ The United States federal interagency credit risk retention requirements of Section 15G of the Exchange Act, as added by Section 941 of the Dodd-Frank Act, and promulgated at 17 C.F.R. Part 246, became effective with respect to CLOs on December 24, 2016. Subsequently, the U.S. Court of Appeals for the District of Columbia Circuit ruled, in *The Loan Syndications & Trading Ass’n v. SEC*, No. 17-5004 (D.C. Cir. Feb. 9, 2018), that managers of “open-market CLOs” are not securitizers under Section 941 of the Dodd-Frank Act and, consequently, are not subject to the credit risk retention requirements in respect of the CLOs they manage.

- As a condition to the disbursement of a TALF loan secured by newly-issued ABS, an accounting firm retained by the issuer must provide to the FRBNY: (i) an auditor attestation regarding the issuer and sponsor's certification that the ABS is TALF eligible ("Auditor Attestation") or (ii) in the case of CLOs, an agreed upon procedures report with respect to factual matters related to various TALF eligibility criteria for the leveraged loans underlying such CLO ("AUP Report (TALF)"). If available, the accounting firm must also provide the FRBNY a copy of the report on agreed upon procedures that it delivers to the sponsor and the underwriter or initial purchaser, including any updates to such report, in connection with CLOs ("AUP Report (Industry)").⁸
- Timing Considerations. While the Updated FAQs address some timing issues relating to Eligible ABS, some ambiguity remains with respect to Eligible ABS issued on dates *prior* to the disbursement of the related TALF loan proceeds.
- Eligible ABS expressly includes:
 - (i) ABS purchased by the borrower on the same day as the extension of the related TALF loan (*i.e.*, primary transactions that coincide with a TALF loan disbursement date); and
 - (ii) ABS issued within the 30-day period immediately preceding the applicable TALF subscription date if such ABS has been acquired in an arm's length secondary market transaction (*i.e.*, secondary transactions that occurred not more than 30 days prior to the applicable TALF subscription date).

Note: It remains unclear whether ABS purchased by a proposed TALF borrower in a primary transaction not more than 30 days prior to the applicable TALF subscription date would qualify as Eligible ABS.

Eligible Borrowers

Additional details and/or clarifications relating to eligible borrowers under TALF:

- Borrower Certification. A TALF borrower may rely on "ABS spreads that are elevated relative to normal market conditions" to make the required certification that it is unable to secure adequate credit accommodations from other banking institutions.
- Regulatory Capital Treatment. The regulatory capital requirements for securities financed by a TALF loan are the same as those for securities that are not financed by a TALF loan.

⁸ The Auditor Attestation or AUP Report (TALF), as applicable, and, if available, the AUP Report (Industry) must be submitted to the FRBNY no later than 5:00 p.m. (New York time) on the same day the issuer furnishes such reports on Form ABS-15G.

- *CARES Act Restrictions.* The compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the Coronavirus Aid Relief and Economic Security Act do not apply to TALF.
- *CMBS and CLO Borrowers.* The aggregate of any mortgage loans (in the case of CMBS) or leveraged loans (in the case of CLOs) made to a TALF borrower and any of its affiliates (rather than just the TALF borrower's affiliates, as described in the Initial FAQs) may not constitute more than a minimum percentage⁹ of the underlying collateral pool securing the Eligible ABS pledged by such TALF borrower.

Financing Terms

Additional details and/or clarifications relating to TALF loan terms:

- *Term.* Each TALF loan will have a three year maturity.
- *Prepayment.* A TALF borrower may prepay a TALF loan in full or in part (subject to the terms and procedures set forth in the MLSA, including the restrictions on permitted repayment dates) by delivering a prepayment notice to the FRBNY. There are no prepayment penalties.
- *Loan Amounts.* The loan amount for an Eligible ABS issued on or after March 23, 2020 and purchased no more than 30 days before the proposed subscription date will be equal to: (i) the base value¹⁰ minus (ii) the base dollar haircut.¹¹ If the base value is less than the base dollar haircut, the ABS is not eligible collateral for TALF.
- *Substitution of Eligible ABS.* TALF borrowers are not permitted to substitute Eligible ABS under a TALF loan.
- *Assignment of TALF Loans.* A TALF borrower may assign all of its obligations with respect to a TALF loan to another eligible TALF borrower in accordance with the terms and procedures set forth in the MLSA, including that the related ABS constitutes Eligible ABS as of the date of the assumption, and with the prior consent of the FRBNY by delivering an Assignment and Assumption.
- *Payment at Maturity.* At the maturity of a TALF loan, the TALF borrower may: (i) repay the TALF loan with same day funds, at which time the TALF SPV will deliver the collateral free of payment; (ii) arrange for the sale of the collateral and instruct the TALF SPV to deliver the pledged ABS to

⁹ Four percent of the aggregate principal balance of mortgage loans in the portfolio, in the case of CMBS, and five percent of the aggregate principal balance of leveraged loans in the portfolio, in the case of CLOs.

¹⁰ "Base value is equal to the least of: (i) the dollar purchase price on the applicable trade date, (ii) the market value as of the subscription date, and (iii) a value based on the [FRBNY's] review, *provided, however*, that, other than SBA ABS, the base value may not be greater than par.

¹¹ Base dollar haircut varies with the asset class and average life of the ABS. *See* CWT Clients & Friends Memo, *supra* note 5.

the counterparty versus payment in an amount sufficient for the repayment of the TALF loan; or (iii) deliver a Collateral Surrender and Acceptance Notice and surrender the collateral to the TALF SPV by the TALF loan maturity date, in lieu of repaying the outstanding principal or interest on a TALF loan.

- *Principal Losses on Eligible ABS.* If a TALF-financed ABS incurs a principal loss during the term of the related TALF loan, the TALF borrower is responsible for all interest and principal payments on such TALF loan. If the TALF borrower does not make such payments, the FRBNY will enforce its rights over the collateral and the borrower will forfeit its haircut amount.
- *Interest Shortfall; Grace Period.* A TALF borrower has a grace period of 30 days to pay any interest shortfall on a TALF loan if the interest received on the pledged ABS is not sufficient to cover the interest payment on the TALF loan. After the grace period, if the loan remains delinquent, the FRBNY will enforce its rights over the related TALF loan collateral. Where the interest shortfall relates solely to a timing difference between the interest payments on the pledged ABS and the interest payments on the TALF loan (and the pledged ABS continue to pay in accordance with their terms), that timing differential is not considered a delinquency.

Additional Resources

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

* * *

Please feel free to contact any of the following attorneys if you have any questions about this memorandum.

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

Danielle Katz	+1 202 862 2393	danielle.katz@cwt.com
Adam Risell	+1 202 862 2388	adam.risell@cwt.com
Peter Williams	+1 212 504 6573	peter.williams@cwt.com