CLIFFORD CHANCE

CORONAVIRUS UPDATE: U.S. FEDERAL RESERVE BROADENS 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**") established and funded a special purpose vehicle ("**SPV**") to buy eligible ABS issued on or after March 23, 2020.

On April 9, 2020, the Board of Governors took additional action to expand the new TALF program. Notably, the program was expanded to broaden the range of assets that are eligible collateral for TALF. TALF-eligible collateral will now include the triple-A rated tranches of both outstanding commercial mortgage-backed securities and newly issued collateralized loan obligations. The program as expanded is described below.

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 during the Global Financial Crisis. However, the purpose of this TALF is different from the 2008 TALF and is generally focused to facilitate lending to consumers and businesses. This different objective manifests itself in some important differences between this TALF and the 2008 TALF as described herein.[1]

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.

[1] The FRBNY did release numerous documents and forms that specified more specifically the terms of the 2008 TALF. While not applicable to this TALF, we understand that the FRBNY will refer to the 2008 TALF documentation in specifying specific terms for this TALF. The documentation for the 2008 TALF may be found here for reference purposes only. https://www.newyorkfed.org/markets/talf_docs.html

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 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, managed-CLOs, SASB and CRE CLOs (as defined below).

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

A number of questions remain open with respect to the new TALF program. For instance:

- it remains unclear whether aircraft loans will be considered "equipment loans" and therefore eligible collateral (as described below), or whether they will be excluded as they were in the 2008 TALF.
- although CLOs are now eligible collateral, they are required to be "static" and issued by a U.S. company, In addition, like other ABS, CLOs must be comprised of credit exposures that are "newly issued," which may create practical difficulties in originating new CLOs because they generally source their credit exposures in the open market. CLOs are subject to different pricing and haircuts (apparently less attractive) than other ABS.
- unlike the other categories of eligible collateral, CMBS is required to be "legacy," which means issued before March 23, 2020.
- there is some uncertainty whether a fund and/or newly-formed entity can be an eligible borrower under 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 that is created or organized in the United States or under the laws of the United States and that has significant operations in and a majority of its employees based in the United States. It is unclear whether a fund or similar entity can meet this requirement.

Eligible Collateral

Eligible collateral includes U.S. dollar denominated cash (not synthetic) ABS that have a credit rating in the highest long-term or, in the case of non-mortgage backed ABS, 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, and the issuer of eligible collateral must be a U.S. company. For CMBS, the underlying credit exposures must be to real property located in the United States or one of its territories.

With the exception of CMBS, 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 and leases;
- Floorplan loans;
- Insurance premium finance loans;
- Certain small business loans that are guaranteed by the Small Business Administration;
- Leveraged loans; or
- Commercial mortgages.

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.

Eligible collateral also will not consist of single-asset single-borrower ("**SASB**") CMBS, commercial real estate collateralized loan obligations ("**CRE CLOs**") or consist of actively managed CLOs.

With respect to CMBS collateral, no new-issue CMBS can be pledged as any CMBS must have been issued prior to March 23, 2020. With respect to CLO collateral, only static CLOs will be accepted. Collateral will be accepted if the average life of the securitization is beyond ten years.

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

Collateral Valuation

The haircut schedule is consistent with the haircut schedule used for the 2008 TALF and is set forth in Appendix A.

Pricing

For CLOs, the interest rate will be 150 basis points over the 30-day average secured overnight financing rate (“**SOFR**”). For SBA Pool Certificates, the interest rate will be the top of the federal funds target range plus 75 basis points. For SBA Development Company Participation

Certificates, the interest rate will be 75 basis points over the 3-year fed funds overnight index swap ("**OIS**") rate. For all other eligible ABS with underlying credit exposures that do not have a government guarantee, 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. 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 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 and the Department of the Treasury.

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.

Appendix A

Haircut Schedule

		ABS Average Life (years)*						
Sector	**Subsector**	**0-<1**	**1-<2**	**2-<3**	**3-<4**	**4-<5**	**5-<6**	**6-<7**
Auto	Prime retail lease	10%	11%	12%	13%	14%		
Auto	Prime retail loan	6%	7%	8%	9%	10%		
Auto	Subprime retail loan	9%	10%	11%	12%	13%		
Auto	Motorcycle/ other recreational vehicles	7%	8%	9%	10%	11%		
Auto	Commercial and government fleets	9%	10%	11%	12%	13%		
Auto	Rental fleets	12%	13%	14%	15%	16%		
Credit Card	Prime	5%	5%	6%	7%	8%		
Credit Card	Subprime	6%	7%	8%	9%	10%		
Equipment	Loans and Leases	5%	6%	7%	8%	9%		
Floorplan	Auto	12%	13%	14%	15%	16%		
Floorplan	Non-Auto	11%	12%	13%	14%	15%		
Premium Finance	Property and casualty	5%	6%	7%	8%	9%		
Small Business	SBA Loans	5%	5%	5%	5%	5%	6%	6%
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Leveraged Loans	Static	20%	20%	20%	20%	20%	21%	22%
Commercial Mortgages	Legacy, Conduit	15%	15%	15%	15%	15%	16%	17%

* For auto, credit card, equipment, floorplan, and premium finance ABS, the weighted average life must be five years or less. For other new-issue eligible collateral, haircuts will increase by one percentage point for each additional year (or portion thereof) of average life beyond five years. For legacy CMBS with average lives beyond five years, base dollar haircuts will increase by one percentage point of par for each additional year (or portion thereof) of average life beyond five years. No securitization may have an average life beyond ten years.

CONTACTS

Lee Askenazi
Partner

T +1 212 878 8230
E lee.askenazi
@cliffordchance.com

Jeff Berman
Partner

T +1 212 878 3460
E jeffrey.berman
@cliffordchance.com

Jim Cotins
Partner

T +1 212 878 4944
E james.cotins
@cliffordchance.com

David Felsenthal
Partner

T +1 212 878 4922
E matthew.lyons
@cliffordchance.com

Robert Hagan
Partner

T +1 202 912 5161
E robert.hagan
@cliffordchance.com

Matthew Lyons
Partner

T +1 212 878 4922
E matthew.lyons
@cliffordchance.com

Gareth Old
Partner

T +1 212 878 8539
E gareth.old
@cliffordchance.com

Robert Villani
Partner

T +1 212 878 8214
E robert.villani
@cliffordchance.com

Alistair Dunlop
Counsel

T +1 212 878 3259
E alistair.dunlop
@cliffordchance.com

Greg Kahn
Counsel

T +1 212 878 3297
E greg.kahn
@cliffordchance.com

Leah Willmore
Counsel

T +1 202 912 5198
E leah.willmore
@cliffordchance.com

Rebecca O'Brien
Associate

T +1 212 878 8263
E rebecca.obrien
@cliffordchance.com