Financial Institutions

E-ALERT

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Federal Reserve Establishes Term Asset-Backed Securities Loan Facility

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Today, the Federal Reserve announced the creation of a Term Asset-Backed Securities Loan Facility (TALF) that will lend up to $200 billion on a non-recourse basis to holders of certain asset-backed securities (ABS) backed by newly and recently originated consumer and small business loans. The TALF is designed to restore access to credit and economic activity by facilitating the renewed issuance of consumer and small business ABS at normal interest rate spreads.

The following is a summary of the TALF's key terms:

- The Federal Reserve Bank of New York (FRBNY) will make available up to $200 billion in loans under the TALF. The loans will have a one-year term, will be non-recourse to the borrower, and will be fully secured by eligible collateral. Interest on the loans will be payable on a monthly basis, and the loan's term may be lengthened later if appropriate.
- Eligible collateral includes U.S. dollar-denominated cash ABS with a long-term credit rating in the highest investment-grade rating (e.g., AAA) from two or more major nationally recognized statistical rating organizations (NRSROs) and no long-term credit rating of below the highest investment-grade rating category from a major NRSRO. The underlying credit exposures of eligible ABS must be newly or recently originated exposures to U.S.-domiciled obligors and must initially consist of auto loans, student loans, credit card loans, or small business loans guaranteed by the U.S. Small Business Administration.[1] The underlying credit exposures may not include exposures that are cash or synthetic ABS, and substitution of collateral during the term of the loan will not be permitted. Eligible collateral for a particular borrower may not be backed by loans originated by the borrower or by an affiliate of the borrower.
- All U.S. persons that own eligible collateral may participate in the TALF. A U.S. person is a natural person that is a U.S. citizen, a business entity that is 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. Borrowers must access the TALF through a primary dealer that acts as an agent for the borrower and must deliver eligible collateral to a clearing bank.
- The FRBNY will offer a fixed amount of loans under the TALF on a monthly basis. The loans will be awarded to borrowers based on a competitive, sealed bid auction process. Bids must include a desired amount of credit and an interest rate spread over one-year OIS. The FRBNY will set minimum spreads for each auction. The FRBNY also reserves the right to reject or declare ineligible any bid, in whole or in part, in its discretion.

[1] Permissible underlying credit exposures may later be expanded to include commercial mortgage-backed securities, non-Agency residential mortgage-backed securities, or other asset classes.

- The FRBNY will assess a non-recourse loan fee at the inception of each loan transaction. The FRBNY will also establish collateral haircuts for each class of eligible collateral, based on the collateral's price volatility.
- Any remittance of principal or interest on eligible collateral must be immediately used to pay interest due on, or reduce the principal amount of, the TALF loan. TALF loans are not subject to mark-to-market or re-margining requirements.
- Originators of the credit exposures underlying eligible collateral must agree to comply with, or already be subject to, the executive compensation standards applicable to participants in Treasury's Capital Purchase Program.[2]
- The FRBNY will create a special purpose vehicle (SPV) to purchase from the FRBNY and manage any assets received by the FRBNY as a result of TALF loans. To finance the first $20 billion of such purchases (if necessary), the U.S. Treasury's Troubled Asset Relief Program (TARP) will purchase subordinated debt issued by the SPV. If more than $20 billion in assets must be purchased by the SPV, the FRBNY will lend additional funds to finance such additional purchases.
- The TALF will stop making new loans on December 31, 2009, unless the Federal Reserve agrees to extend the facility.

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Attorneys in Covington's Financial Institutions Group have advised many clients on recent financial services and banking developments. The Financial Institutions Group's expertise derives from advising clients on the impact of such developments over the course of the past three decades. Please do not hesitate to contact any member of our Financial Institutions Group, including the undersigned, should you have any questions.

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[2] For a summary of the terms of the executive compensation limitations in the Capital Purchase Program, see our prior e-alert "Executive Compensation Rules for Financial Institutions Participating in the Capital Purchase Program" (October 21, 2008).