King & Spalding

CRISIS PRACTICE

Coronavirus

FINANCIAL SERVICES

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For more information, contact:

Michael Urschel
+1 212 556 2285
murschel@kslaw.com

Ryan McNaughton
+1 212 556 2244
rmcnaughton@kslaw.com

Matthew Sandiford
+1 404 572 2739
msandiford@kslaw.com

Anthony Mechcatie
+1 212 556 2104
amechcatie@kslaw.com

Kathryn Weiss
+1 212 556 2323
kweiss@kslaw.com

King & Spalding

New York
1185 Avenue of the Americas
New York, New York 10036-4003
Tel: +1 212 556 2100

Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600

Federal Reserve System Implements TALF 2.0 in Response to Coronavirus Disease 2019 (COVID-19) Crisis

On March 23, 2020, the Board of Governors of the Federal Reserve System (the "Board of Governors") announced the implementation of a new Term Asset-Backed Securities Loan Facility ("TALF 2.0") in order to provide liquidity and stability to certain segments of the asset-backed securities market in response to the economic turmoil caused by the spread of the Coronavirus Disease 2019 ("COVID-19"). Below is an outline on the manner in which TALF 2.0 is structured and proposals by the Structured Finance Association (the "SFA") to expand TALF 2.0 to certain additional segments of the asset-backed securities market.

BACKGROUND

On March 23, 2020, the Board of Governors announced the implementation of TALF 2.0 to stimulate certain segments of the asset-backed securities markets. The Federal Reserve Bank of New York (the "FRBNY") has committed to lend funds to a special purpose vehicle ("SPV"), and the U.S. Department of the Treasury ("Treasury") has committed to fund an initial equity investment of $10 billion in the SPV in order for the SPV to extend up to $100 billion of loans secured by eligible asset-backed securities ("ABS") to eligible borrowers on a non-recourse basis pursuant to TALF 2.0. A borrower under TALF 2.0 will only be able to pledge ABS issued on or after March 23, 2020 as eligible collateral meaning on legacy ABS is available for financing pursuant to TALF 2.0. Eligible borrowers under TALF 2.0 include (i) a business entity organized under the laws of the United States or a political subdivision or territory thereof ("U.S.-organized") (including an entity that has a non-U.S. parent) and (ii) a U.S. branch or agency of foreign bank. The TALF 2.0 program is patterned on the Term-Asset-Backed Securities Loan Facility ("TALF 1.0") implemented in the wake of the 2008 financial crisis, and the FRBNY will publish detailed terms and conditions for TALF 2.0 that will be primarily based on the terms and conditions of TALF 1.0.

markets.[1] The Federal Reserve Bank of New York (the "FRBNY") has committed to lend funds to a special purpose vehicle ("SPV"), and the U.S. Department of the Treasury ("Treasury") has committed to fund an initial equity investment of $10 billion in the SPV in order for the SPV to extend up to $100 billion of loans secured by eligible asset-backed securities ("ABS") to eligible borrowers on a non-recourse basis pursuant to TALF 2.0.[2] A borrower under TALF 2.0 will only be able to pledge ABS issued on or after March 23, 2020 as eligible collateral meaning on legacy ABS is available for financing pursuant to TALF 2.0.[3] Eligible borrowers under TALF 2.0 include (i) a business entity organized under the laws of the United States or a political subdivision or territory thereof ("U.S.-organized") (including an entity that has a non-U.S. parent) and (ii) a U.S. branch or agency of foreign bank.[4] The TALF 2.0 program is patterned on the Term-Asset-Backed Securities Loan Facility ("TALF 1.0") implemented in the wake of the 2008 financial crisis, and the FRBNY will publish detailed terms and conditions for TALF 2.0 that will be primarily based on the terms and conditions of TALF 1.0.[5]

Business Administration, and (8) eligible servicing advance receivables.[6] These ABS assets types are generally consistent with the eligible collateral under TALF 1.0 with the exception of commercial mortgage-backed securities that are currently excluded under TALF 2.0.[7] The FRBNY has indicated that it will consider the feasibility of additional segments of the asset-backed securities as eligible collateral uner TALF 2.0 in the future.[8] Eligible ABS must be U.S. dollar-denominated cash ABS (i.e., not synthetic credit exposures) that are rated in the highest long-term or short-term rating category from at least two eligible nationally-recognized statistical rating organizations ("NRSROs") and are not rated below the highest rating category from an eligible NRSRO.[9] The credit exposures underlying eligible ABS must be all or substantially all newly issued. Similar to TALF 1.0, eligible collateral pledged under TALF 2.0 will be subject to an initial haircut based on its sector, weighted average life ("WAL"), and historical volatility, and the FRBNY expects the haircuts to be "roughly in line" with TALF 1.0.[10]

Loans extended under TALF 2.0 will have a three year maturity.[11] For eligible ABS that do not benefit from an underlying government guarantee, interest on a TALF 2.0 loan will be 100 basis points over the 2-year LIBOR swap rate for ABS with a WAL less than two years or 100 basis points over the 3-year LIBOR swap rate for ABS with a WAL two years or greater.[12] Pricing on a TALF 1.0 loan was determined according to a matrix by asset class, WAL, and the interest rate on the eligible ABS pledged as collateral.[13] A TALF 2.0 loan will be pre-payable in whole or in part by a borrower, but a borrower will not be generally allowed to substitute collateral [14] Loans under the TALF 2.0 program will be extended until September 30, 2020 unless the Board of Governors extends the TALF 2.0 program.[15]

SFA'S RECOMMENDATIONS

The SFA issued a letter on March 22, 2020[16] to the Board of Governors and Treasury recommending the implementation of a program like TALF 1.0 program and providing specific suggestions on alterations to make to TALF 1.0 to best address the current economic crisis. Although the TALF 2.0 term sheet issued by the Federal Reserve System on March 23, 2020 sets forth terms virtually identical to those initially included in TALF 1.0, the SFA expects to continue to propose changes to TALF 2.0 to make it more effective in promoting liquidity and stability in a wider range of ABS. Below is a discussion of some of the key features recommended by the SFA.

Inclusion of Legacy ABS. The SFA notes that in addition to offering loans backed by new issue and recently-issued ABS, the TALF program should also make loans against legacy ABS (both those currently trading in the secondary market and those retained by issuers). The SFA notes that the inclusion of legacy ABS is particularly important, because maintaining liquidity in the market will encourage investors to purchase newly issued ABS.

Inclusion of Broader Array of ABS. The SFA recommends including many classes of ABS not included in TALF 1.0. These include:

- **Private Label RMBS**: The SFA notes that many of the underwriting concerns that existed after the 2008 financial crisis are not currently relevant, largely due to regulations enacted in response to that crisis In particular, "non-qualified" mortgage borrowers receive these private label mortgages, and providing liquidity for such bonds would help continue provide assistance to those struggling borrowers
- **Unsecured Consumer Loans**: These loans have become prominent since 2008, and therefore, were likely not considered as TALF 1.0 collateral. The SFA notes that the partial economic shutdown in response to the COVID-19 pandemic tends to have a disproportionate impact on the same lower-wage individuals who obtain unsecured consumer loans, many of whom would not be well-served by bank lenders, and therefore it is important to keep this market active during our current downturn.
- **Mortgage Servicing Rights and Credit Risk Transfer ABS:** The SFA explains that mortgage servicing rights ABS and credit risk transfer securities have become popular products following the 2008 crisis. Making them TALF 2.0-eligible collateral would allow servicers to better provide assistance to their customers and allay panic in the mortgage markets.
- **Additional Asset Classes**: Although they may require more consideration, the SFA also recommends, given the current crisis and need for immediately liquidity, that the following types of ABS be TALF 2.0-eligible: transportation-related ABS (containers, rail cars, aircraft and shipping assets), whole-business securitizations, unguaranteed small business loans, renewable energy (solar loans), insurance premium finance agreement, consumer refinance loans, re-performing and seasoned performing mortgages, triple-net leases and timeshares.

***Expanded Credit Ratings Criteria*.** The SFA recommends that the ratings criteria be expanded such that the highest-rated tranche in any securitization if such tranche is rated at-least investment grade, noting that many ABS classes would be functionally excluded from TALF 2.0 if the requirement for two NRSROs remains. Similarly the SFA has advised that allowing securities to only be rated by one NRSRO rather than two and allowing any NRSRO to rate the ABS rather than those on an enumerated list of three, would provide greater relief.

***Operational Improvements*.** The SFA also writes that, given the urgent need for liquidity in ABS markets, improving the operational start time for TALF 2.0 and removing barriers to eligibility for sponsors could be helpful. In particular, the SFA recommends removing the requirement for the ABS sponsor to deliver an attestation opinion from a nationally recognized independent accounting firm and streamlining the documentation process with non-negotiable, standard loan documents.

***Additional Flexibility*.** The SFA's final recommendation is to make the financing terms of TALF 2.0 as flexible as possible, given the need for immediate market liquidity. In particular, the SFA highlights allowing more flexible haircuts and extending the maturity of TALF 2.0 loans.

ADDITIONAL LIQUIDITY OPTIONS FOR ESOTERIC ABS

In addition to TALF 2.0, the Board of Governors on March 23, 2020, also announced the Primary Market Corporate Credit Facility ("PMCCF") and the Secondary Market Corporate Credit Facility ("SMCCF") pursuant to which the FRBNY will lend money on a recourse basis to two SPVs that will purchase corporate bonds directly from eligible issuers in the case of the PMCCF and on the secondary market in the case of the SMCCF. [17] While the PMCCF contains a requirement that eligible issuers be rated at least BBB-/Baa3 by a major NRSRO,[18] the SMCCF requires only that the corporate bonds themselves be rated at least BBB-/Baa3 by a major NRSRO.[19] Given the requirement for an issuer (as opposed to security) rating, changes will need to be made for the PMCCF to be used for most esoteric securitizations in its current form, including whole-business securitizations, but the SMCCF could be an option to create additional liquidity in the secondary market for certain esoteric ABS in its current form. We are working with certain market participants to explore the possibility of issuer-level ratings to potentially avail esoteric securitizations the benefits of the PMCCF and also are seeking clarification of the maturity date restrictions in the PMCCF and SMCCF, as noted below.

To date, the Board of Governors has released limited information about the PMCCF and SMCCF, but certain limitations may need to be addressed for securitization bonds in respect of maturities eligible for the programs. For example, eligible bonds must have a maturity date within five years for the SMCCF and four years for the PMCCF.[20] While many esoteric securitizations have anticipated repayment dates within that range, the legal final maturity date is typically 30 years from the closing date. Therefore, the ability to include esoteric ABS in this program will depend on whether the FRBNY interprets an anticipated repayment date as maturity.

CONCLUDING REMARKS

King & Spalding will continue to monitor the implementation of TALF 2.0, PMCCF, SMCCF and any other relevant programs as more details become available, and will advise clients as to its impact on current and future ABS transactions and the broader ABS market.

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[1] Federal Reserve Announces Extensive New Measures to Support the Economy, www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm.
[2] Term Asset-Backed Securities Loan Facility, www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf.
[3] *Id.*
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] Term Asset-Backed Securities Loan Facility: Terms and Conditions, www.newyorkfed.org/talf_terms.html.
[8] Term Asset-Backed Securities Loan Facility, www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf.
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] Term Asset-Backed Securities Loan Facility: Terms and Conditions, www.newyorkfed.org/talf_terms.html.
[14] Term Asset-Backed Securities Loan Facility, www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf.
[15] *Id.*

[16] Solutions to Power the Advancement and Revitalization of Consumer Credit (“SPARCC”), https://structuredfinance.org/wp-content/uploads/2020/03/106711__113068379v7_SFA-SPARCC-comment-letter_SFALetterhead.pdf

[17] Federal Reserve Announces Extensive New Measures to Support the Economy, www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm.

[18] Primary Market Corporate Credit Facility, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b1.pdf

[19] Secondary Market Corporate Credit Facility, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b2.pdf

[20] *Id*.