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TALF Offers Potential Investment Opportunities to Qualified Borrowers

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TALF - the **Term Asset-Backed Securities Loan Facility** recently announced by the Federal government offers *nonrecourse* financing from the Federal Reserve Bank of New York (FRBNY) to qualified borrowers to finance the purchase of qualifying asset-backed securities.

The Federal Reserve Board has initiated the TALF program pursuant to its authority under the Federal Reserve Act. The intent of the program is to restart the asset-backed securities industry and thereby the flow of credit to primarily consumers and small businesses as loans to these borrowers will be eligible for the program.

Executive Summary. The TALF will enable eligible entities to borrow money from the FRBNY on a nonrecourse basis. The loans from the FRBNY will be collateralized by AAA-rated newly issued asset-backed securities purchased and then pledged by those borrowers. The eligible asset-backed securities will themselves be backed by eligible recently originated consumer and small business loans and leases.

In greater detail the program is as follows:

- Entities that hold eligible assets, initially recently originated auto loans and leases, credit card receivables, student loans, and SBA-guaranteed small business loans, will pool those loans and issue asset-backed securities backed by discrete pools of those assets.
- The securities issued will need to be structured so that at least one class of the issued securities is rated AAA by at least two nationally recognized statistical rating organizations. The AAA rating cannot be based upon third-party insurance; it must be based upon the structure of the securities offering and the strength of the underlying TALF eligible loans.
- That AAA-rated securities will be eligible collateral for a TALF loan. Generally, the asset-backed securities ("ABS") must be issued after January 1, 2009, to be eligible for the TALF.
- To be eligible, auto loan and credit card ABS must have an average life of not more than five years.
- Eligible purchasers of the eligible ABS will be permitted to borrow from the FRBNY, on a nonrecourse basis, a substantial part of the purchase price of the eligible ABS.
- Loan amounts must be at least \$10 million. The loan-to-value ratio will be set based upon a discount (referred to as a "haircut" in the announcement of the program) related to the underlying loans backing the ABS.
- The amount of the "haircut" will range from a low of 5% for one-year expected life credit card ABS backed by "prime" obligations to a high of 14% for five-year expected life auto lease ABS backed by "prime leases." The full grid of haircuts is attached as Schedule 1.
- Upon taking a loan from the FRBNY, the borrower will pledge the eligible ABS to the FRBNY and will deliver the eligible ABS to the custodian appointed by the FRBNY.
- Principal payments on the pledged ABS must be used to pay down the loan obtained from the FRBNY based upon the loan-to-value ratio. In other words, if the haircut is 10% with a

90% loan-to-value ratio, 90 cents of each dollar received as principal is used to pay down the loan and 10% can be paid to the owner of the pledged ABS.

- The loans will have a maturity of three years. The interest rate for most loans will be either a fixed rate to be set at 100 basis points over the three-year Libor swap rate or a floating rate to be set at 100 basis points over the one-month Libor rate for most loans. Loans for student loan backed ABS and SBA loan-backed ABS will be at lower rates. The borrower may select either a fixed or floating rate.
- There are no fixed limits on the number of loans a borrower can receive each month. The minimum loan amount is \$10 million. The facility has been allocated \$200 billion at this time.
- An eligible borrower is virtually any United States entity that has business operations in the United States and that owns ABS that is eligible to be pledged under the TALF. While the US-formed subsidiary of a foreign company can be an eligible borrower, the borrower may not be controlled, directly or indirectly, by a foreign sovereign.
- Subscriptions for the first funding will be due March 17, 2009, and fund on March 25, 2009. The respective dates for the second funding will be April 7, 2009, and April 14, 2009.

Conclusion. A borrower who receives a TALF loan will acquire ABS with an investment risk no greater than the haircut applicable to the loan in question. The FRBNY will have recourse only to the pledged ABS. It will have no recourse to the borrower. The borrower's only risk is the price it pays to acquire the eligible ABS in excess of the loan proceeds received by the borrower from the TALF. As the ABS must be rated AAA, it will of necessity be heavily over-collateralized to achieve that rating. Hence, utilizing the TALF will enable eligible borrowers to make a potentially good interest arbitrage with little risk. Historically, including the present market, virtually all credit card- and auto loan-backed ABS have performed according to expectations with owners of AAA-rated securities receiving payments on their investments as expected.

The following link is to the FAQs posted by the FRB on its web site regarding the TALF:

http://www.newyorkfed.org/markets/talf_faq.html

Schedule 1

Sector	Subsector	ABS Expected Life (years)						
		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	Floorplan	12%	13%	14%	15%	16%		
Auto	RV/motorcycle	7%	8%	9%	10%	11%		
Credit Card	Prime	5%	5%	6%	7%	8%		
Credit Card	Subprime	6%	7%	8%	9%	10%		
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Student Loan	Gov't guaranteed	5%	5%	5%	5%	5%	6%	6%
Small Business	SBA loans	5%	5%	5%	5%	5%	6%	6%

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