INSIGHT
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Term Asset-Backed Securities Loan Facility (TALF)

The program to ease the liquidity crisis caused by the Covid-19 Pandemic

Term Asset-Backed Securities Loan Facility (TALF)

On March 23rd, 2020, the Federal Reserve established the Term Asset-Backed Securities Loan Facility (TALF) program to ease the liquidity crisis caused by the COVID-19 global pandemic. The Federal Reserve will participate by lending loans to banks using Asset Backed Securities (ABS) as collateral.

The program was initiated during the 2008 recession to address the liquidity crisis. Its previous success has provided the confidence for the Federal Reserve to re-launch it again during the current COVID-19 pandemic. As part of the current Coronavirus Aid, Relief, and Economic Security (CARES) Act the Federal Reserve has established many programs including the Term Asset-Backed Securities Loan Facility (TALF) such as Primary Market Corporate Credit Facility, Secondary Market Corporate Credit Facility and Main Street Business Lending Program to restore consumer confidence in the credit market.

Overview of the TALF program

The 2008 crisis had resulted in a huge liquidity gap, the Federal Reserve along with the US Treasury launched the program on March 03, 2009, under section 13(3) of the Federal Reserve Act to boost consumer credit in the economy. The program had lent loans up to USD 200 billion and the US Treasury provided USD 20 billion credit protection under this program.

The Federal Reserve plays a crucial role in supporting US households and businesses with multiple programs to reduce disruptions caused by the pandemic. It is important to note that the flow of credit will support businesses in getting the jumpstart required to progress towards the road of recovery. Currently, as part of the COVID-19 pandemic, the program will provide nonrecourse debt up to USD 100 billion for three years. The collateral (ABS) can comprise student loans, corporate credit card loans, consumer credit card loans, auto and equipment finance, floorplan loans, loans on property and casualty premiums, commercial mortgages, leveraged loans and finally the loans guaranteed by the Small Business Administration (SBA). These collaterals are valued at market value after the haircut determined by the Federal Reserve Bank of New York (FRDNY). The below mentioned is the haircut schedule for all the eligible collaterals.

	ABS Average Life (years)*						
Sector- Subsector	0<1 Year	1<2 Years	2<3 Years	3<4 Years	4<5 Years	5<6 Years	6<7 Years
Auto-Prime Retail Lease	10%	11%	12%	13%	14%		
Auto-Prime Retail Lease	06%	07%	08%	09%	10%		
Auto-Subprime Retail Loan	09%	10%	11%	12%	13%		
Auto-Motorcycle or Other Recreation Vehicle	07%	08%	09%	10%	11%		
Auto-Commercial and Government Fleet	09%	10%	11%	12%	13%		
Auto-Rental Fleet	12%	13%	14%	15%	16%		
Credit Card-Prime	05%	05%	06%	07%	08%		
Credit Card-Subprime	06%	07%	08%	09%	10%		
Equipment-Loans and Leases	05%	06%	07%	08%	09%		
Floor Plan -Auto	12%	13%	14%	15%	16%		
Floor Plan-Non-Auto	11%	12%	13%	14%	15%		
Premium Finance-Property and Casuality	05%	06%	07%	08%	09%		
Small Business-SBA loans	05%	05%	05%	05%	05%	06%	06%
Student Loan-Private	08%	09%	10%	11%	12%	13%	14%
Leverage Loans-static	20%	20%	20%	20%	20%	21%	22%
Commercial Mortgages-Legacy, Conduit	15%	15%	15%	15%	15%	16%	17%

All the collaterals are United States Dollar denominated and the synthetic ABS are excluded as per the program. Also, the collateral should be rated with investment-grade by at least two Nationally recognized statistical rating organizations. The below mentioned is the pricing term based on the collateral used to secure the loan:

Collateral	Pricing
Collateralized Loan Obligation (CLO's)	30-day average Secured Overnight Financing Rate (SOFR) + 150 basis points
SBA pool certified	Federal Funds Target Rate + 75 basis points
SBA development company participation certificates	3 years fed fund overnight index swap (OIS) rate + 75 basis points
Other eligible collaterals with a weighted average life less than two years	2 year OIS rate + 125 basis points
Other eligible collaterals with weighted average life more than two years	3 year OIS rate + 125 basis points

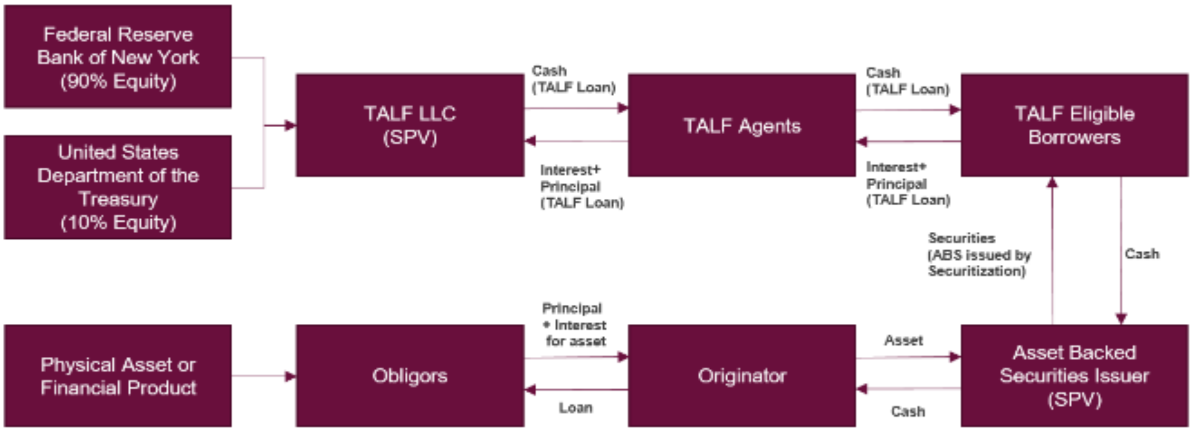
One of the interesting challenges as part of this program is that if a borrower uses a Collateralized Loan Obligation (CLO) as their collateral they have to pay the regulators at SOFR rate. The financial institutions are currently in the process of transitioning into the new SOFR rate and as part of the new changes, Sia Partners is assisting various clients through the unique and complex transition across multiple solutions and activities.

How is the Federal Reserve helping the consumer credit market?

The US Treasury and Federal Reserve Bank of New York established a TALF LLC as an SPV to disburse loans to borrowers who can use the eligible ABS as collateral. It comes as no surprise that the SPV was established to have the claim on the collateral in the event of credit default on any loans disbursed under the program. Furthermore, the Bank of New York Mellon is the administrator and custodian for the program.

that is finally sold to investors (TALF borrowers) to generate liquidity on the credit lent. To ensure that the ABS has better liquidity it is usually rated with the credit rating agencies before selling. Thus the information on the type of credit that originator has lent and credit ratings that the ABS received serves as an eligibility requirement for the program.

The Federal Reserve is focusing on market participants who have credit exposure to the entire consumer credit market. Additionally, it is ensuring that support is not provided for riskier ABS that are created. The credit is only lent to investment-grade ABS and valued post haircut thus protecting the US taxpayers' money. Besides, the US treasury would receive a 10% profit from the program for their equity investment through credit protection for the program. Regulators also understand that the credit exposures are traditionally moved from the originators/ banks to the investors of the securitized products. Currently, in the light of



To understand further as part of the program the borrower can obtain the funds from the TALF agents who are authorized to disburse the funds according to the terms laid out in the program's Master Loan and Security Agreement (MSLA) signed with TALF LLC. The TALF agents can be acting on behalf of its customer or itself and will be acting as just the agent of the borrower in the transactions. They are liable for the regulatory reporting and tax withholding of the loans under the program.

Additionally, to understand the type of collateral, we need to understand where was the credit exposure initially created. As depicted in the below diagram the process begins when the obligor obtains credit from the originator to buy a financial product or physical asset. As part of the securitization process, the originator creates an SPV that pools this debt along with similar debts into a financial product

COVID-19 higher unemployment rate is resulting in deferred payment in the consumer credit market. The regulators are supporting the market participants who hold these exposures by providing loans under this program so that deferred payment would not lead to any liquidity crisis. Finally, This will ensure that the consumer credit market doesn't fall during the financial stress caused by the pandemic.

The current financial crisis largely focused on the liquidity rather than the credit quality and it is still unclear about the impact level caused by the pandemic. The steps taken by the Fed have raised confidence in the consumer credit market and will ensure constant support by actively monitoring the situation.

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