



## Update 1: Summary of Federal Reserve's Term Asset-Backed Securities Loan Facility

On November 25, 2008, the Federal Reserve Board of Governors (the “**Federal Reserve**”) announced the creation of the Term Asset-Backed Securities Loan Facility (“**TALF**”). After several weeks of consultation with issuers, investors, and dealers in the asset-backed securities (“**ABS**”) markets, the Federal Reserve published revised terms and conditions for, and a question and answer summary related to, TALF on December 19, 2008. This client briefing updates the information provided in our client briefing distributed on November 26, 2008 that summarized the original terms proposed for TALF by the Federal Reserve (the “**Original TALF Client Briefing**”). In particular, this client briefing focuses on the principal changes made, and clarifications provided, by the Federal Reserve to the terms and conditions of TALF in order to address certain of the concerns raised by ABS participants. In addition, at the end of this client briefing, we provide a brief overview of issues that will likely require further clarification as the Federal Reserve begins to implement TALF.

Please note that this client briefing does not attempt to replicate information provided in our Original TALF Client Briefing to the extent such information remains accurate in light of the Federal Reserve's most recent announcement. Thus, this client briefing should be read in conjunction with our Original TALF Client Briefing. In addition, although the Federal Reserve's recent announcement provides significant clarity to the terms and conditions of TALF, we anticipate that the Federal Reserve will continue to refine such terms and conditions over the coming weeks once ABS participants have had an opportunity to respond to the announcement. We intend to continue to issue updated client briefings regarding TALF as such developments occur.

### 1. Key Changes and Clarifications to Terms and Conditions of Term Asset-Backed Securities Loan Facility

#### A. Scope of Facility

The Federal Reserve reiterated in its recent announcement that the Federal Reserve Bank of New York (“**FRBNY**”) has been given the authority under Section 13(3) of the Federal Reserve Act to make up to \$200 billion of non-recourse term loans to eligible borrowers that will be fully secured by eligible automobile, student loan, credit card, and small business loan ABS pledged by such borrowers. The Federal Reserve did, however, make the following changes to the terms and conditions of the TALF facility:

**1. Maturity of TALF Loans.** In response to concerns expressed by ABS investors that the one-year term of loans under TALF as originally proposed would not provide sufficient funding certainty to reignite investor appetite for purchasing ABS, the Federal Reserve has extended the maturity for each TALF loan to three years. The Federal Reserve also clarified that all TALF loans will be pre-payable at the option of the applicable borrower. The ability for ABS investors

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to lock in longer-term funding under TALF (and have the option to pre-pay such financing if credit conditions improve) should increase the incentive for such investors to begin purchasing consumer and small business ABS at lower spreads than currently exist in the ABS markets.

**2. Eligibility of Borrowers.** TALF will be available to all “U.S. companies” that own eligible ABS. A business entity or institution will be considered a “U.S. company” for the purposes of qualifying as an eligible borrower under TALF if it 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 is a U.S. branch or agency of a foreign bank. In the Federal Reserve’s initial TALF proposal, it also permitted natural U.S. persons to participate as borrowers in TALF, but its most recent announcement makes clear that TALF may only be accessed by business entities and institutions.<sup>1</sup>

**3. Eligibility of Collateral.** A borrower must pledge eligible ABS to the FRBNY in order to receive a loan under TALF. In its recent announcement, the Federal Reserve has provided additional clarifications regarding the types of assets that will qualify as “eligible ABS” under TALF:

- a. *Rating Requirement.* The Federal Reserve confirmed that eligible ABS must have a long-term credit rating in the highest investment-grade rating category (*i.e.*, “AAA”) from two or more major, nationally recognized statistical rating organizations (*e.g.*, Standard & Poor’s Ratings Services, Moody’s Investors Service, Inc., or Fitch, Inc.) and cannot have a long-term credit rating of below the highest investment-grade rating category from any such rating agency. However, the Federal Reserve provided an exception to this rating requirement for all U.S. dollar-denominated, small business loan cash ABS that have underlying credit exposures (principal and interest) that are fully guaranteed by the full faith and credit of the U.S. government.
- b. *Type of Underlying Assets.* Eligible ABS must represent a direct interest in an underlying pool of automobile loans, student loans, credit card loans, or small business loans guaranteed by the U.S. Small Business Administration (“**SBA Loans**”). The Federal Reserve provided the following examples of the type of underlying collateral that will qualify as eligible automobile and student loan ABS: (i) retail loans and leases relating to cars, light trucks, and motorcycles and auto dealer floor plan loans and (ii) federally guaranteed student loans (including consolidation loans) and private student loans.<sup>2</sup>
- c. *Domicile of Obligors.* All or “substantially all” of the obligors of the assets collateralizing the ABS must be U.S.-domiciled obligors. Although the Federal Reserve included this obligor requirement in its initial TALF proposal, its most recent announcement permits at least a small portion of the pool of assets collateralizing ABS to have obligors domiciled outside the United States.<sup>3</sup>
- d. *Time of Origination or Issuance.* In its most recent announcement, the Federal Reserve established the following cutoff dates for each type of ABS that will be eligible for TALF funding:

Type of ABS	Effective Date
Automobile Loans	All or “substantially all” of the underlying credit exposures must be originated on or after October 1, 2007.
SBA Loans	All or “substantially all” of the underlying credit exposures must be originated on or after January 1, 2008.

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1. See Section II.B below for a further discussion of issues that still need to be resolved with respect to the eligibility of entities that have both a U.S. and foreign connection.

2. See Section II.A below for a discussion of additional types of eligible collateral that the Federal Reserve may consider.

3. As indicated in Section II.D below, the Federal Reserve has not provided guidance regarding what percentage of a collateral pool would constitute “substantially all” for the purposes of satisfying this eligibility criteria.

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Type of ABS	Effective Date
Student Loans	All or “substantially all” of the underlying credit exposures must have had a first disbursement date on or after May 1, 2007.
Credit Cards	ABS must be issued to refinance existing credit card ABS maturing in 2009 and must be issued in amounts no greater than the amount of the maturing credit card ABS. <sup>4</sup>

- e. *Origination of Underlying Loans.* The loans that collateralize ABS must be originated and securitized by a third party that is unrelated to the borrower. ABS that is backed by loans originated by a borrower that desires to borrow under TALF or an affiliate of such borrower will not be eligible to receive TALF financing. Although this requirement was included in the Federal Reserve’s initial terms and conditions for TALF, the Federal Reserve has clarified in its recent announcement that an “affiliate” of a borrower shall mean “any company that controls, is controlled by, or is under common control with the borrower. For this purpose, a person or company controls a company if it (i) owns, controls or holds securities with power to vote 25 percent or more of a class of voting securities of the company; or (ii) consolidates the company for financial purposes.”

#### B. Pricing and Allocation of TALF Loans

In its initial proposal, the Federal Reserve indicated that FRBNY would offer and price TALF loans pursuant to a monthly competitive auction process. Although the auction process was intended to result in TALF loans with market-based terms, the requirement for potential borrowers to compete for TALF loans in a sealed bid process created a high level of uncertainty among ABS investors regarding whether TALF would provide a reliable, accessible funding alternative for making new ABS investments. In an effort to address this concern, the Federal Reserve has abandoned the competitive auction process in favor of a more simplified monthly application and disbursement process. Borrowers that are interested in borrowing under TALF will be required to submit a borrowing request to FRBNY on a fixed date in each month setting forth a description of the eligible ABS collateral that will secure the TALF loan, the desired loan amount(s), and whether the borrower selects a fixed or floating (with a spread over LIBOR) interest rate format. A borrower may submit multiple loan requests on the fixed date in any given month as long as each loan request is for an amount that equals or exceeds \$10 million. Subject to its sole discretion to reject a borrower’s request (which the Federal Reserve retained from its initial proposal), FRBNY will disburse proceeds of a TALF loan to any borrower upon the receipt by one of FRBNY’s custodian banks of the eligible collateral being pledged by the borrower for such TALF loan. As previously indicated in the Federal Reserve’s initial announcement, FRBNY intends to develop procedures to further scrutinize whether TALF loans should be secured by ABS that has been identified as having a high risk of loss.

Under the Federal Reserve’s current proposal, FRBNY will announce fixed and floating interest rates, as well as the discount (or “haircut”), that will be applicable to TALF loans in advance of each monthly loan request date. FRBNY will set monthly interest rates for TALF loans at a level necessary to provide borrowers with an incentive to purchase eligible ABS at yield spreads higher than spreads that would typically be required under more “normal” market conditions, but lower than the spreads that exist in the current illiquid ABS markets. In addition, FRBNY will establish a discount for the collateral underlying TALF loans based on the perceived riskiness and maturity of such collateral. The elimination of the auction pricing mechanic will give FRBNY additional flexibility to adjust interest rates and discounts in response to improving or deteriorating market conditions. It remains to be seen, however, whether such additional flexibility will come at a price for the U.S. taxpayers since it introduces the possibility that (i) interest rates for TALF loans could be artificially set below market-based

4. Unlike automobile loan, SBA, and student loan ABS, the pool of collateral underlying credit card ABS constantly revolves as obligors incur new debt under, and repay, their credit lines. As a result, the pools of collateral underlying credit card ABS will consist of existing and newly originated receivables. Refinancings of credit card ABS typically fund newly originated receivables in the pool. Since the Federal Reserve intends for TALF to provide liquidity and lower cost funding for new consumer loans and receivables, the Federal Reserve has chosen to establish a cutoff date for credit card ABS tied to the issuance date of ABS refinancings.

interest rates and/or (ii) discounts applied to the collateral underlying eligible ABS could be fixed at levels smaller than the discount rate that the market would otherwise impose on collateral with similar risk characteristics.<sup>5</sup>

As previously indicated by the Federal Reserve, each borrower that requests to receive a loan from TALF must use a primary dealer as its agent to access TALF. Any such primary dealer will simply be acting on behalf of a borrower in an agency capacity and will not have any liability with respect to TALF loans. The Federal Reserve clarified that the role of such primary dealers will be to collect, aggregate and submit loan requests on behalf of borrowers (similar to the actions such dealers would take at a Treasury auction) and to pre-screen collateral for proposed TALF loans to ensure such collateral satisfies the eligibility criteria established by the Federal Reserve.

In addition to the change in the process of pricing TALF loans, the Federal Reserve announced that FRBNY will assess a non-recourse loan fee on each borrower at the time each TALF loan is made. The Federal Reserve has not provided guidance regarding the amount (or range of amounts) of the loan fee that will be charged to borrowers.

### C. Use of Collateral Proceeds Under TALF

In the original TALF proposal, the Federal Reserve required all principal and interest collected on eligible collateral pledged to FRBNY to be immediately allocated to pay interest due on, or reduce the principal amount of, the related TALF loan. While the Federal Reserve retained the requirement for a borrower to utilize all principal collections on eligible collateral to pay the principal balance of the TALF loan secured by such collateral, the Federal Reserve curiously removed any requirement to allocate interest proceeds from eligible collateral to the payment of accrued interest on the related TALF loan. By eliminating the use of interest proceeds restriction from TALF, a borrower may continue to use such interest proceeds to, among other things, pay for operating expenses and/or make periodic distributions to its investors during the term of the TALF loan. The elimination of this restriction should not significantly increase the structural risk of TALF loans because FRBNY will continue to have the ability to enforce its lien on all of the collateral underlying a TALF loan in the event that a borrower misses an interest payment on such TALF loan.

### D. Reporting of TALF Activity

In its recent announcement, the Federal Reserve stated that it will report lending activity under TALF in its H.4.1 weekly statistical release entitled “Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks.” In addition, the Federal Reserve will provide a weekly explanatory note identifying when new TALF activity is being reported in any such release.

## II. Open Issues

Although the Federal Reserve provided significant clarification to TALF in its recent announcement, issues remain that will need to be resolved in connection with the implementation of TALF. The following is a brief summary of some of the open issues that we have identified:

### A. Scope of Eligible Collateral

The Federal Reserve continues to limit the scope of TALF to ABS that satisfies the long-term “AAA” credit rating requirement. As currently constructed, TALF will be accessible as a funding source for only a small portion of the consumer and small business loan ABS market. Our expectations are that the Federal Reserve will revisit whether the scope of TALF should be expanded to finance lower-rated ABS if the initial rollout of TALF proves to be successful.

In addition, real estate trade groups have recently requested that the Federal Reserve include commercial mortgage-backed securities (“**CMBS**”) as an additional category of collateral eligible for TALF funding. Conditions in the CMBS markets have deteriorated significantly over the past few months, reducing the willingness of financial institutions to extend new facilities

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5. Given the current low volume of new issuance of consumer and small business ABS, it is possible that the level of interest rates and discounts established by FRBNY on a monthly basis will be considered the “market-based” rate and discount, at least until origination volume and liquidity improve in the ABS markets.

to, or refinance existing credit facilities for, commercial real estate developers. The real estate trade groups have requested an extension of TALF (or the implementation of a new program based on the TALF model) to the CMBS market with the hope of increasing liquidity and reducing spreads in the secondary CMBS market, and thus improving the availability of credit for commercial real estate developers. Although the Federal Reserve has not formally responded to the request made by the real estate trade groups, the Federal Reserve repeated its assertion in its recent announcement that it may expand the scope of ABS that are eligible for financing under TALF to include CMBS, non-GSE residential mortgage-backed securities, and other asset classes if the initial implementation of TALF has a positive impact on the liquidity and pricing of the consumer and small business loan securitization markets.

#### B. Eligibility of U.S.-Based Investors Organized or Investing Outside the United States

As indicated above, the Federal Reserve intends to limit access to TALF to borrowers that qualify as “U.S. companies.” The Federal Reserve has stated that a U.S. branch or agency of a foreign bank will qualify as a “U.S. company”, but the Federal Reserve is still considering whether to make TALF available to “U.S.-based” ABS investors that are organized outside the United States or invest through vehicles located outside of the United States.

#### C. Size of Discounts

The Federal Reserve has not yet provided guidance regarding the size of discounts that they will apply to the different types of collateral eligible for TALF funding. Since the Federal Reserve will have the ability to adjust discounts on a monthly basis, it is possible that the Federal Reserve will not release proposed discounts levels until the implementation of TALF, but given the significant impact that the sizing of the discounts will have on investor demand for funding under TALF, the Federal Reserve may choose to issue additional guidance in the coming weeks regarding the projected range of discounts for each type of eligible collateral.

#### D. Meaning of “Substantially All”

The Federal Reserve has injected a new concept of “substantially all” in its recent collateral eligibility criteria. The concept appears in both the origination and issuance cutoff dates established for automobile, student, and SBA loan ABS, and the requirement for obligors of each type of eligible collateral to be domiciled in the United States. The inclusion of the “substantially all” language should provide additional flexibility for investors to obtain TALF funding for ABS backed by collateral pools that would not otherwise satisfy an all or nothing bright line test of such eligibility criteria, but it is not currently clear what portion of an underlying collateral pool will be considered an acceptable exception to the cutoff date and obligor domicile requirements. We expect the Federal Reserve will make such determinations on a case-by-case basis and could expand or contract the scope of this exception as market conditions change.

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The Global Financial Markets Spotlight Group of Winston & Strawn advises financial organizations and investors in banks on financing and funding issues and has been advising clients on matters under the Emergency Economic Stabilization Act of 2008 and all programs that have been established to restore market stability. Please contact one of the following attorneys below or on the following page for more information:

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