Federal Reserve Broadens Range of Eligible Collateral for TALF

By June Rhee

Original post here.

On April 9, the Federal Reserve (Fed) broadened the range of eligible collateral for the Term Asset-Backed Securities Loan Facility (TALF) to include riskier assets such as legacy commercial mortgage backed securities (CMBS) and collateralized loan obligations (CLOs).

The Fed reintroduced TALF on March 23. It was one of the many programs the Fed used in the 2007-09 Global Financial Crisis to support households, businesses, and the economy. Under the original TALF, the Federal Reserve lent on a non-recourse basis to holders of highly rated asset-backed securities (ABS) backed by newly and recently originated consumer and small business loans.

The 2020 TALF initially only included newly issued non-mortgage asset-backed securities, such as those backed by student loans, small business loans guaranteed by the Small Business Administration, and automobile loans as eligible collateral. However, the expanded 2020 TALF now accepts the triple-A rated tranches of both legacy CMBS and newly issued static CLO as eligible collateral. Single-asset single-borrower CMBS and commercial real estate CLOs are excluded. The other terms and conditions of the new TALF mostly follow the language of the $200 billion TALF that the Fed announced in November 2008 and implemented in March 2009 during the GFC.

Under the 2020 TALF, the Fed, "to help meet the credit needs of consumers and small businesses," will use a special purpose vehicle to make a total of $100 billion in three-year nonrecourse loans to US companies that own eligible collateral. The SPV will be funded by a recourse loan from the Reserve Bank of New York and the Treasury's equity investment. The new TALF is to be open through September 30, unless the Fed and Treasury extend it, and participating borrowers and issuers will be subject to conflict-of-interest requirements under section 4019 of the CARES Act.

The Fed used its authority under Section 13(3) of the Federal Reserve Act to implement the 2020 TALF (see here). Section 13(3) allows the Fed to lend to any "individual, partnership or corporation" when the Federal Reserve Board determines there are "unusual and exigent circumstances," with the Treasury Secretary's approval. The Treasury used the Exchange Stabilization Fund to make a $10 billion equity investment in the 2020 TALF. Further discussion on the Treasury backstop and the 2008 TALF can be found here.

The Fed will haircut collateral based on the riskiness of underlying assets, as in the 2008 TALF. The haircuts range from 5% for short-term Small Business Administration loans to 22% for longer-term leveraged loans.

The Fed also continues to purchase Treasury securities and agency mortgage-backed securities as part of its open market operations. On March 23, the Fed expanded these operations to include the purchase of agency commercial mortgage-backed securities and increased their purchases from a total of $700 billion to an amount "needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy" (see here). Loans will be priced based on the collateral pledged with the appropriate LIBOR swap rate, and haircuts will be applied based on sector, weighted average life, and historical volatility of the ABS (see here).

Click here to read a survey post on market liquidity programs including the TALF and here to read a YPFS case study that discusses the 2008 TALF in detail and provides access to the key documents utilized with that facility.