

Treasury Backstop for Fed Lending under CARES Act: Lessons from 2008 TALF

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Original post [here](#).

[Section 4003\(b\) of the CARES Act](#) appropriates \$454 billion for the Treasury to backstop Federal Reserve (Fed) lending programs aimed at supporting credit flows to businesses, states, or municipalities in the midst of the coronavirus pandemic.

The week before the CARES Act was signed into law, the Treasury had already used [\\$50 billion in total](#) from the [Exchange Stabilization Fund \(ESF\)](#) to backstop five Fed emergency lending programs, including the [reintroduced Term Asset-Backed Securities Loan Facility \(TALF\)](#). In 2008 during the Global Financial Crisis (GFC) the Treasury backstopped the [first TALF](#) using funds appropriated by Congress in the [Emergency Economic Stabilization Act of 2008 \(EESA\)](#).

The Fed has yet to determine the nature of any emergency lending programs (see [here](#) for discussion on the Fed's section 13(3) power) it will launch under this authority, but Fed Chairman Jerome Powell [said](#) on March 26 that the Fed's emergency lending powers are dependent on this Treasury backstop: "[Effectively, \\$1 of loss-absorption is worth \\$10 worth of loans.](#)" The Treasury backstop certainly [extended the Fed's lending power](#) during GFC but what were the Treasury and Fed's expectations in actually using this backstop? These expectations certainly influenced the design of 2008 TALF and a recent report to Congress includes the Fed's expectation in the 2020 TALF.

Pre-CARES Act Treasury Backstop in 2020 TALF

On March 23, the Fed and the Treasury reintroduced [TALF](#) to support credit flows to households and businesses in the midst of economic distress caused by the coronavirus pandemic. Similar to the 2008 TALF, a special purpose vehicle (SPV) will make a total of \$100 billion three-year nonrecourse loans to US companies that own eligible ABS. The SPV is funded by a recourse loan from the Federal Reserve Bank of New York (FRBNY) and an initial \$10 billion equity investment by the Treasury. The Fed relies on [Section 13\(3\) of the Federal Reserve Act \(FRA\)](#) and the Treasury uses the Exchange Stabilization Fund to backstop the 2020 TALF.

On March 29, [the Fed's report to Congress pursuant to Section 13\(3\)](#) revealed the Fed's expectation in using the Treasury backstop. The Fed "does not expect at this time that the TALF will result in losses in excess of the Department of the Treasury's equity investment". Therefore, it seems the Fed is interpreting the Treasury's backstop as available to use. Similar language is included in the report to Congress for the [Primary Market Corporate Credit Facility](#), [and the Secondary Market Corporate Credit Facility](#).

Treasury Backstop in 2008 TALF

The [Emergency Economic Stabilization Act of 2008](#), which Congress passed in the midst of the GFC, established the [Troubled Assets Relief Program \(TARP\)](#) to help stabilize the US financial system and restore credit flows to households and businesses. It enabled the Treasury "[to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system.](#)" Initially, Congress authorized

\$700 billion for TARP. It reduced TARP's size to \$475 billion in 2010 in the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#).

Structure of Treasury Backstop in 2008 TALF

The [2008 TALF](#) was a joint program between the Treasury and the Fed aimed at restarting the asset-backed securities (ABS) markets, which had come to a near complete halt in the fall of 2008 after the bankruptcy of the Lehman Brothers investment bank. The Fed, under [Section 13\(3\) of the FRA](#), and the Treasury, using TARP funds, initially committed \$200 billion. Later on February 10, 2009, this commitment was expanded up to a potential \$1 trillion. The FRBNY made non-recourse loans to investors to purchase eligible ABS and the Treasury provided credit support for these loans.

Initially the staff at the Fed settled on [two possible models](#) for the Treasury backstop. The Board staff preferred market participants forming funds that would invest in ABS to which the Fed would provide leverage, the Treasury would provide mezzanine financing, and private investors would provide equity. A similar model without the leverage from the Fed was adopted by the Treasury as the [Public-Private Investment Program \(PPIP\)](#) during the GFC. The FRBNY staff favored a model under which the Fed would lend to private investors holding ABS, with the Treasury providing the Fed credit protection for those loans. This model became TALF. An important advantage of this model was that it would naturally sunset when credit risk spreads normalized and alternative financing became more attractive than TALF loans. (see [here](#))

The FRBNY created a special purpose vehicle (SPV, TALF LLC) to manage assets posted as collateral for the loans. The SPV was initially funded by a \$100 million drawing on the Treasury's \$20 billion commitment to purchase subordinated debt issued by the SPV. \$16 million of this initial funding was set aside for administrative funding. If the SPV needed further funding beyond \$20 billion committed by the Treasury, the FRBNY would lend up to \$180 billion. The FRBNY's loan to the SPV was senior to the Treasury's subordinated debt, with recourse to the SPV, and secured by all the assets of the SPV.

Loan repayments and proceeds from asset sales were distributed in the following order under the [credit agreement](#) among the SPV, the FRBNY and the Treasury:

1. pay general TALF program administrative expenses,
2. repay the \$16 million Treasury loan made to the SPV to cover administrative expenses,
3. repay outstanding principal on any FRBNY senior loans,
4. fund the cash collateral account,
5. repay outstanding principal on any Treasury loans,
6. repay FRBNY loan interest,
7. repay Treasury loan interest, and
8. repay any other obligations that may arise that have not been specified by the agencies.

Any residual returns were shared by the Treasury (90%) and the FRBNY (10%).

Expectations on Actual Usage of Backstop and Features of 2008 TALF

Unlike the 2020 TALF, testimonies by Treasury and Fed officials seem to suggest that neither the Treasury nor the Fed expected that the Fed would need to resort to the backstop. William R. Nelson, then Deputy Director of the Division of Monetary Affairs in the Board testified that [“\[a\]lthough the Treasury provided credit protection for the Federal Reserve, the risk controls built into the TALF..., were designed to keep the risk for the US government as a whole very low”](#).

For further discussion on the risk controls built into 2008 TALF reflecting the Treasury and Fed’s expectation, see the [YPFS case on the 2008 TALF](#).