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ClientAdvisory

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Federal Reserve and Treasury Provide TALF Pricing, Haircuts and Other Further Revised Terms

On February 10, 2009, the Treasury Department announced a new Financial Stability Plan, which, among other things, expands the Term Asset-Backed Securities Loan Facility (TALF) into a new Consumer and Business Lending Initiative (CBLI). The TALF, as expanded by the Financial Stability Plan, will be a lending facility of up to $1 trillion collateralized by all assets currently covered by the TALF with the significant addition of securities backed by commercial mortgage loans (CMBS). The Treasury released a revised fact sheet describing the Financial Stability Plan[1], but the many specifics regarding the CBLI are not yet available, including details about the eligibility of particular types and vintages of CMBS collateral.

The Federal Reserve Board had also announced further revised terms for the TALF on February 6, 2009. The TALF was originally announced on November 25, 2008, and initially revised on December 19, 2008, and is intended to help consumers and small businesses obtain credit by promoting the issuance of asset-backed securities (ABS) backed by student loans, auto loans, credit card receivables, certain small business loans, and, as of February 10, 2009, as mentioned above, securities backed by commercial mortgage loans. The facility eventually may be expanded to include securities backed by non-agency residential mortgage loans, assets collateralized by corporate debt or other assets, but at this time such assets are not covered. The first TALF loans are expected to be disbursed before the end of February. The new terms and conditions include loan interest rates, collateral haircuts and additional specifications regarding eligible ABS collateral and other matters. In addition to a revised term sheet[2], the Federal Reserve Board released a revised frequently-asked-questions document detailing the changes[3].

Highlights of New TALF Terms

The following are certain highlights of the newest changes and clarifications to the TALF:

- TALF expanded through the Financial Stability Plan to be an up to $1 trillion facility collateralized by all assets currently covered by TALF and also securities backed by commercial mortgage loans.
- Eligible collateral will not include ABS that rely on third party guarantees for ratings or that have been placed on review or watch for downgrade by a nationally recognized statistical rating organization (NRSRO).
- Eligible collateral will include only ABS that are cleared through the Depository Trust Company.
- Eligible auto loan ABS and credit card ABS must have an expected life of no more than five years.

1 See http://www.financialstability.gov.

2 See http://www.newyorkfed.org/markets/talf_terms.html

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

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- A U.S.-organized operating subsidiary of a foreign entity is an eligible TALF borrower if the U.S. subsidiary conducts significant operations or activities in the United States, unless the U.S. subsidiary is directly or indirectly controlled by a foreign government.
- An investment fund that is organized in the United States and managed by an investment manager that has its principal place of business in the United States is an eligible TALF borrower, unless the investment fund is controlled by a foreign government or is managed by an investment manager controlled by a foreign government.
- The interest rates on fixed rate TALF loans will be three-year LIBOR swap rate plus 100 bp and the interest rate on floating rate TALF loans will be one-month LIBOR plus 100 bp, with a 5 bp administrative fee on all TALF loans.
- An initial haircut schedule for each asset type has been added (see table on page 3).
- The Federal Reserve Bank of New York (FRBNY) will publish a Master Loan and Security Agreement (MLSA) which will provide further details on the terms that will apply to borrowings under the TALF. Each TALF loan will be non-recourse except for breaches of representations, warranties and covenants, as further specified in the MLSA. Some of the mechanics of subscribing to and settling a new TALF loan are described in the revised frequently-asked-questions document.
- The issuer and sponsor must ensure that the information included in a prospectus or other offering document of an ABS they represent as eligible collateral under the TALF includes a signed certification (the form of which will be available on the FRBNY's TALF website) indicating that (a) the ABS is TALF eligible, (b) an accounting firm retained by the sponsor has provided a certification, in a form acceptable to the FRBNY, that the ABS is TALF eligible, (c) the sponsor (or the relevant entity as specified in forthcoming TALF certification documents) has agreed to comply with the executive compensation requirements of the TALF and (d) the issuer and sponsor have executed an undertaking to the FRBNY indemnifying it from any losses it may suffer if such certifications are untrue.
- The initial TALF subscription date is expected to be announced in February and will occur approximately two weeks after an announcement of the terms for the initial subscription. The initial loan settlement date will occur approximately two weeks after the initial subscription date.
- A borrower may assign all of its obligations with respect to a TALF loan to another eligible borrower with the prior consent of the FRBNY.

Summary of Revised Program

Under the TALF, the FRBNY in conjunction with the Treasury will lend up to $1 trillion (as noted, expanded by the Financial Stability Plan from the original $200 billion amount specified in the FRBNY's term sheet) on a non-recourse basis to holders of certain "eligible collateral" (as defined below). On a fixed day each month, borrowers will be able to request one or more non-recourse three-year TALF loans in a principal amount of a minimum of $10 million. The principal amount of each TALF loan will be equal to the market value of the eligible collateral pledged minus a haircut established for each class of eligible collateral and based on the price volatility for that class of collateral. Borrowers will be able to request either fixed rate or floating rate loans. Interest rates on TALF loans will be a per annum rate equal to the three-year LIBOR swap rate plus 100 bp for fixed rate loans, and the one-month LIBOR plus 100 bp for floating rate loans, and there will be a 5 bp administrative fee on all TALF loans. TALF loans will be prepayable by the borrower, but substitution of collateral will not be permitted. Interest will be payable monthly. Any principal remitted on the eligible collateral will be used immediately to reduce the principal of the TALF loan in proportion to the loan's original LTV ratio. TALF loans will not be subject to mark-to-market or re-margining requirements.

The Federal Reserve Bank of New York (FRBNY) will publish a Master Loan and Security Agreement (MLSA) which will provide further details on the terms that will apply to borrowings under the TALF. Some of the mechanics of subscribing to and settling a new TALF loan are described in the revised frequently-asked-questions document. The FRBNY is expected to begin making loans in before the end of February and will stop making new loans on December 31, 2009, unless the Federal Reserve Board agrees to extend the facility.

Haircuts

The FRBNY's preliminary collateral haircut chart is as follows:

		ABS Expected Life (years)						
Sector	**Subsector**	**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%		
Bank Card	Prime	5%	5%	6%	7%	8%		
Bank Card	Subprime	6%	7%	8%	9%	10%		
Retail Card	Prime	6%	7%	8%	9%	10%		
Retail Card	Subprime	7%	8%	9%	10%	11%		
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Student Loan	Gov't guaranteed	5%	5%	5%	6%	7%	8%	9%
Small Business	SBA loans	5%	5%	5%	5%	6%	7%	8%

For ABS with expected lives beyond seven years, haircuts will increase by one percentage point for each additional year of expected life beyond seven years. The Federal Reserve Board will periodically review and may at its option adjust the TALF interest rate spread and haircuts for new loans. The new terms do not yet address specifics regarding CMBS eligible collateral.

Eligible Collateral

TALF loans may only be secured by "eligible collateral", which are ABS that are:

- public or privately placed U.S. dollar-denominated cash (not synthetic) ABS with a long-term credit rating of AAA or its equivalent from two or more NRSROs and which do not have a long-term rating below AAA or its equivalent from any NRSRO;
- cleared through the Depository Trust Company;
- not reliant on third party guarantees for ratings and that have not been placed on review or watch for downgrade by any NRSRO;
- originated on or after January 1, 2009, and can be either credit card or auto dealer floorplan ABS with an expected life of no more than five years that is issued to refinance existing credit card or auto dealer floorplan ABS, as applicable, maturing in 2009 in amounts no greater than the amount of maturing ABS, or backed by:
  - retail loans or leases relating to cars, light trucks, motorcycles or RVs (except auto dealer floorplan loans) in each case, with respect to a principal amount equal to at least 85% of the principal amount of the ABS, that were originated on or after October 1, 2007 (commercial, government and rental fleet leases of cars, trucks and light trucks will not be eligible);
  - federally guaranteed student loans (including consolidation loans) or private student loans, in each case, with respect to a principal amount equal to at least 85% of the principal amount of the ABS, with a first disbursement date on or after May 1, 2007; or
  - small business loans guaranteed by the U.S. Small Business Administration originated on or after January 1, 2008[4]; or
  - commercial mortgage loans (no specifics yet with respect to dates of origination or other requirements);

[4] Notwithstanding the rules for other eligible ABS, SBA Pool Certificates or Development Company Participation Certificates must have been issued on or after January 1, 2008, regardless of the dates of the underlying loans or debentures.

- backed by underlying credit exposures, with respect to a principal amount equal to at least 95% of the principal amount of the ABS, that were made to U.S. domiciled obligors;
- not backed by underlying credit exposures that include exposures that are themselves cash or synthetic ABS (i.e., no resecuritizations or CDOs); and
- for any particular borrower, not backed by loans originated or securitized by that borrower or any of its affiliates.

Eligible Borrowers

TALF loans may be obtained by any U.S. companies that own eligible collateral and that have an account relationship with a primary dealer. An entity is a "U.S. company" for purposes of the TALF if it is (i) a business entity or institution that is organized under the laws of the United States or a political subdivision or territory thereof (U.S.-organized) and conducts significant operations or activities in the United States (regardless of whether any such entity has a parent company that is not U.S.-organized), including any U.S.-organized subsidiary of such an entity; (ii) a U.S. branch or agency of a foreign bank (other than a foreign central bank) that maintains reserves with a Federal Reserve Bank; or (iii) an investment fund that is U.S.-organized and managed by an investment manager that has its principal place of business in the United States. Notwithstanding the foregoing, a U.S. company excludes any entity that is controlled by a foreign government or is managed by an investment manager controlled by a foreign government. An "investment fund" is any type of pooled investment vehicle, including a hedge fund, a private equity fund and a mutual fund, or any vehicle that primarily invests in eligible collateral and borrows from the TALF. Newly formed investment funds may borrow from the TALF as long as their collateral meets the collateral eligibility requirements.

Disclosure and Certification Requirements

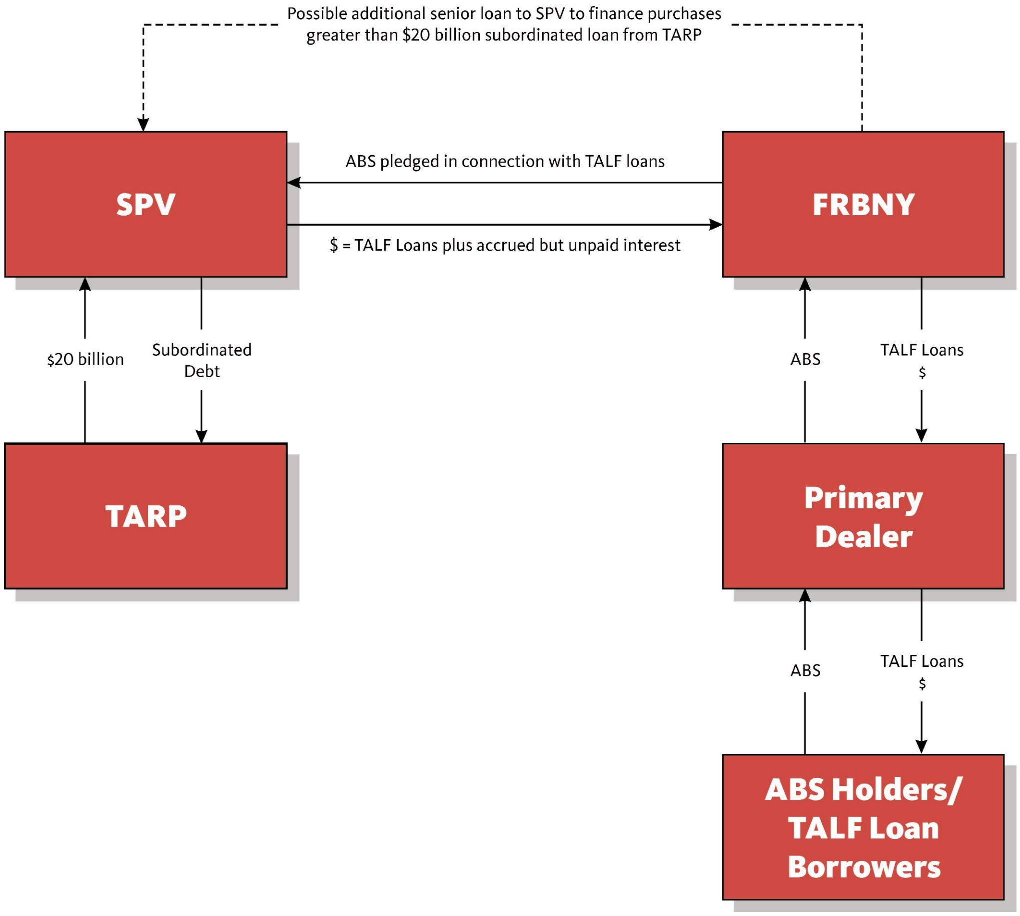
An accounting firm retained by the sponsor will be required to provide a certification, in a form acceptable to the FRBNY[5], indicating that the ABS is TALF eligible. The accounting firm must be a nationally recognized certified public accounting firm that is registered with the Public Company Accounting Oversight Board.

Also, in addition to information required by applicable laws, the issuer and sponsor must ensure that the information included in a prospectus or other offering document of an ABS they represent as eligible collateral under the TALF includes a signed certification (the form of which will be available on the FRBNY's TALF website) indicating that (a) the ABS is TALF eligible, (b) an accounting firm retained by the sponsor has provided a certification, in a form acceptable to the FRBNY, that the ABS is TALF eligible, (c) the sponsor (or the relevant entity as specified in forthcoming TALF certification documents) has agreed to comply with the executive compensation requirements of the TALF and (d) the issuer and sponsor have executed an undertaking to the FRBNY indemnifying it from any losses it may suffer if such certifications are untrue.

Treasury Department Credit Enhancement of TALF Loans Through TARP-Funded SPV

The U.S. Treasury Department, under the Troubled Asset Relief Program (TARP) of the Emergency Economic Stabilization Act of 2008, will provide up to $100 billion (as noted, expanded by the Financial Stability Plan from the original $20 billion amount specified in the FRBNY's term sheet) of credit protection to the FRBNY in connection with the TALF. As depicted in the flow chart below, the FRBNY will create a special purpose vehicle (SPV) to purchase and manage assets received by the FRBNY in connection with any TALF loans. Pursuant to a forward purchase agreement with the FRBNY, the SPV will commit to purchase all assets securing a TALF loan that are received by the FRBNY at a price equal to the TALF loan amount plus accrued but unpaid interest. The TARP will purchase subordinated debt issued by the SPV to finance the first $100 billion of asset purchases. If more than $100 billion in assets are purchased by the SPV, the FRBNY will lend additional funds to the SPV to finance such additional purchases. The TARP's investment in the SPV will provide $100 billion of credit enhancement for any potential losses on the TALF loans because the FRBNY's loan to the SPV will be secured by all assets of the SPV and will be senior to the TARP subordinated loan. All cash flows from SPV assets will be used first to repay principal and interest on the FRBNY loan until the loan is repaid in full. Next, cash flows from assets will be used to repay principal and interest on the TARP loan until the loan is repaid in full. Residual returns from the SPV will be shared between the FRBNY and the U.S. Treasury.

5 An example of an acceptable form can be obtained by emailing the FRBNY at talf.compliance@ny.fb.org.



Executive Compensation

Originators of the credit exposures underlying eligible ABS (or, in the case of SBA-guaranteed loans, the ABS sponsor) must have agreed to comply with the executive compensation requirements in section 111(b) of the Emergency Economic Stabilization Act of 2008. The standards specified under EESA apply to the originator's "senior executive officers" (i.e., the chief executive officer, chief financial officer and the next three most highly compensated executive officers) and generally include: (i) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (ii) requiring repayment or "clawback" provisions for any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (iii) prohibiting the originator from making any "golden parachute" payment to a senior executive officer; and (iv) disallowing tax deductions for compensation paid to each senior executive officer in excess of $500,000 per year. These requirements may require modification or waivers of existing contracts and severance arrangements. The chief executive officer (CEO) or other authorized representative of the sponsor or other applicable entity must complete the executive compensation certification form which will be available on the FRBNY's website and submit it to the FRBNY before the sponsor or entity's ABS can be offered as eligible collateral. In order to remain compliant with the executive compensation requirements, an annual certification of compliance process will require the signature of the company's CEO or authorized representative as well as the company's auditor. If a sponsor or applicable entity fails to certify its compliance annually, its securities will not be accepted as eligible collateral on subsequent TALF subscription dates.

Katten's TARP Task Force

Katten Muchin Rosenman LLP's multidisciplinary TARP Task Force advises clients on the U.S. Treasury's Troubled Asset Relief Program created under the Emergency Economic Stabilization Act of 2008. Katten's TARP Task Force can advise clients on obtaining TALF loans, determining how the executive compensation rules apply to them, and structuring their compensation arrangements appropriately. Katten's TARP Task Force also can advise clients with respect to all aspects of other TARP-related programs such as (i) the Capital Purchase Program, whereby the U.S. Treasury is purchasing preferred shares in certain publicly traded and privately held financial institutions, (ii) the new Capital Assistance Program providing additional capital in the form of purchase of convertible securities to financial institutions which have been subject to a stress-test, (iii) the new $500 billion to $1 trillion Public-Private Investment Fund in which the government will finance purchases of legacy assets by private sector institutions, and (iv) the new $50 billion plan to prevent avoidable foreclosures.

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