FEDERAL RESERVE'S TALF LENDING PROGRAM GETS UNDER WAY AND GETS EXPANDED TWICE

Following a modest, yet successful, launch in March, the Federal Reserve Bank of New York's (FRBNY) highly anticipated US$1 trillion Term Asset-Backed Securities Lending Facility, or TALF, has been expanded twice in the past few weeks as the Obama administration continues to deploy new tools to spur consumer and small business lending and unlock the frozen credit markets.

As a component of the Consumer and Business Lending Initiative of the Obama administration's Financial Stability Plan, on March 3, 2009, the US Department of the Treasury (Treasury) and the Federal Reserve Board announced the commencement of TALF, and the first TALF loans were funded by the FRBNY on March 25, 2009. Under TALF, the FRBNY will make up to US$1 trillion of low-interest loans on a non-recourse basis to holders of certain AAA-rated asset-backed securities (ABS) backed by newly and recently originated consumer or small business loans. The loans will have a term of three years and will be fully secured by the financed ABS. In addition, Treasury has stated that it will provide up to US$100 billion of credit protection to the FRBNY in connection with TALF using funds of the Troubled Asset Relief Program (TARP) of the Emergency Economic Stabilization Act of 2008 (EESA). The FRBNY states that the goal of TALF is "to increase credit availability and support economic activity by facilitating renewed issuance of consumer and small business ABS at more normal interest rate spreads."

The FRBNY will make loans under TALF on a monthly basis. It will announce monthly TALF loan subscription and settlement dates. It is expected that subscriptions for funding will be accepted on the first Tuesday of every month, and funding of approved loans will occur one week later. TALF will hold monthly fundings at least through December 2009 and possibly longer if extended by the FRBNY. The second subscription is scheduled for April 7, 2009, with the funds disbursed on April 14, 2009. The minimum size of each loan will be US$10 million. There is no maximum TALF loan amount, and there is no limit on the number of loans that an eligible borrower may request at each monthly subscription.

ELIGIBILITY

Participation in TALF is open to all business entities and investment funds that are organized in the US and conduct significant operations or activities in the US, as well as US branches or agencies of a foreign bank that maintains reserves with a

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Market Volatility and the Changing Regulatory Landscape

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Federal Reserve Bank. However, a US-organized investment fund must also be managed by an investment manager that has its principal place of business in the US in order to be eligible to participate. Any entity (other than (i) a US branch or agency of a foreign bank (other than a foreign central bank) that maintain reserves with the Federal Reserve or (ii) a US FDIC-insured depository institution) that is controlled by a foreign government or is managed by an investment manager (other than these two types of entities) that is controlled by a foreign government is not an eligible TALF borrower.

A borrower must use a primary dealer to participate in TALF. The primary dealer will act as agent for the borrower in all aspects of the program. Among other things, the primary dealer will collect loan request information from the borrower; submit loan requests to the FRBNY; and collect from the borrower administrative fees, haircut amounts, and collateral and deliver such to the FRBNY's custodian. The primary dealer will also receive and transmit payments from the borrower to the custodian and loan disbursements from the FRBNY to the borrower. A borrower must enter into a Customer Agreement with a primary dealer and may use more than one primary dealer to submit TALF loan requests to the FRBNY.

A borrower must own eligible collateral that can serve as security for the non-recourse loan in order to obtain a loan under TALF. Generally, eligible collateral for TALF includes US dollar-denominated cash ABS that has a long-term or short-term credit rating in the highest investment-grade rating category (i.e., AAA) from two or more major nationally recognized statistical rating organizations (NRSROs). The ABS cannot have a credit rating below the highest investment-grade rating category from any major NRSRO. Eligible collateral will not include ABS that has obtained necessary credit ratings based on the benefit of a third-party guarantee. Each ABS issuer must hire an external auditor to certify that all information conveyed to the rating agencies about the ABS is correct, and that the ABS meets the TALF eligibility requirements. Other than certain US Small Business Administration (SBA) ABS, eligible ABS must have been issued on or after January 1, 2009.

For the initial round of TALF loans in March 2009, the only collateral eligible for the program included auto loans, student loans, credit card loans, and small business loans guaranteed by the SBA. However, the Federal Reserve announced on March 19, 2009 that eligibility was being expanded to include four additional categories of ABS starting with the April TALF funding. The four additional categories of eligible ABS are ABS backed by mortgage servicing advances, loans, or leases relating to business equipment, vehicle fleet leases, and floorplan loans.

Also, as announced on February 10, 2009 as part of the Financial Stability Plan, Treasury plans to increase its level of credit protection for TALF from the originally-announced amount of US$20 billion to US$100 billion, allowing the FRBNY to eventually increase the amount of loans available under TALF from an original amount of US$200 billion to US$1 trillion. Treasury also indicated that TALF will be expanded as part of the Financial Stability Plan to include commercial mortgage backed securities. The Financial Stability Plan is described in the Arnold and Porter LLP client advisory available at http://www.arnoldporter.com/resources/documents/CA_TreasuryAnnouncesFinancialStabilityPlan_021309.pdf.

On March 23, 2009 Treasury—in conjunction with the Federal Reserve—announced as part of the Legacy Securities Program component of the Public-Private Investment Program (PPIP) under the Financial Stability Plan that TALF will be expanded to include certain non-agency residential mortgage-backed securities or commercial mortgage-backed securities originally issued prior to 2009. Details of the PPIP and its related expansion of TALF are still being finalized, and it is not yet known when these types of legacy mortgage-backed securities will be eligible collateral for TALF loans.

For the current eligible forms of collateral, the following standards apply:

Auto Loan ABS

- Includes retail loans, and leases relating to cars, light trucks, recreational vehicles, or motorcycles

- Commercial, government, and rental fleet leases of cars, trucks, and light trucks are also eligible
- All or substantially all of the credit exposures must have been originated on or after October 1, 2007
- Auto ABS issued by a revolving trust must be issued to refinance existing auto ABS maturing in 2009
- May also be issued out of an existing or newly established master trust in which all or substantially all of the underlying exposures were originated on or after January 1, 2009
- Must have an average life of no more than five years

Student Loan ABS

- Includes federally guaranteed student loans (including consolidation loans) and private loans
- All or substantially all of the credit exposures must have a first disbursement date on or after May 1, 2007

SBA Loan ABS, SBA Pool Certificates, and Development Company Participation Certificates

- Includes loans, debentures, or pools originated under the SBA's 7(a) and 504 programs, provided they are fully guaranteed as to principal and interest by the US government
- Must have been issued on or after January 1, 2008

Credit Card ABS

- Includes consumer and corporate credit card receivables
- Must be issued to refinance existing credit card ABS maturing in 2009
- Issuance amount can be no greater than the amount of the maturing ABS
- Must have an average life of no more than five years

Equipment Loan ABS

- Includes retail loans and leases relating to business equipment
- All or substantially all of the credit exposures must have been originated on or after October 1, 2007
- Must have an average life of no more than five years

Floorplan ABS

- Includes revolving lines of credit to finance dealer inventories
- Must be issued to refinance existing floorplan ABS maturing in 2009
- May also be issued out of an existing or newly established master trust in which all or substantially all of the underlying exposures were originated on or after January 1, 2009
- Must have an average life of no more than five years
- Issuance amount can be no greater than the amount of the maturing ABS

Servicing Advance ABS

- Includes receivables created by principal, interest, tax and insurance, and corporate advances made by Fannie Mae- or Freddie Mac-approved residential mortgage servicers under pooling and servicing agreements
- All or substantially all of the servicing advances must have been originated on or after October 1, 2007
- Must have an average life of no more than five years

The underlying credit exposures for the collateral may not include exposures that are themselves cash or synthetic ABS. Executive compensation restrictions will *not* apply to participants in the TALF program.

TRANSACTION STRUCTURE, PRICING, AND ALLOCATION

Under TALF, the FRBNY will make non-recourse loans secured by eligible collateral. The loans will have a three-year term, with interest payable monthly. The term of TALF loans may be lengthened at a later date. TALF loans will not be subject to mark-to-market or remargining requirements.

The FRBNY will establish collateral haircuts for each class of eligible collateral based on an assessment of the riskiness of the ABS. For example, the haircut on a TALF loan secured by prime credit card ABS with an average life of less than one year is 5%, which means that for every US$100 of such ABS to be financed, the borrower must pledge to the FRBNY

US$100 in eligible ABS collateral and provide US$5 in cash as the haircut amount in order to borrow US$95. Haircut amounts for currently eligible categories of collateral range from 5% to 16%. Any remittance of a collateral's principal must be immediately used to pay down the TALF loan principal at a proportion equal to the loan-to-value ratio set through the original TALF haircut.

Interest rates on TALF loans can be fixed or variable, depending on the type of collateral. The fixed rate will be set at 100 basis points over the three-year LIBOR swap rate. The variable interest rate will be 100 basis points over the one-month LIBOR. The basis point spread for both fixed and variable rate TALF loans backed by government guaranteed collateral will be only 50 basis points. The FRBNY will periodically review and, if appropriate, adjust TALF interest rate spreads and haircuts for new loans, consistent with the policy objectives of TALF. The FRBNY will also charge a five basis point administrative fee at the settlement date of each loan transaction.

In the case of default or surrender of collateral by a borrower, the FRBNY will sell the collateral ABS to a newly-created special purpose vehicle (SPV). The SPV will purchase the assets at a price equal to the TALF loan amount plus accrued but unpaid interest. Treasury will finance the SPV with TARP funds.

The FRBNY has published a Master Loan and Securities Agreement, which provides further details on the terms that will apply to borrowings under the TALF. The Master Loan and Security Agreement and other TALF program documents can be found on the FRBNY's TALF website at http://www.newyorkfed.org/markets/talf.html.

MARCH TALF RESULTS

After a series of last-minute tweaks and changes by the FRBNY to address concerns of potential borrowers and primary dealers, the first round of TALF loans were disbursed by the FRBNY on March 25, 2009. The FRBNY approved and funded US$4.7 billion of TALF loans in this first installment. Of that amount, US$1.9 billion represented loans secured by auto loan ABS, and US$2.8 billion of loans were for credit card ABS. There were no TALF loans for student loan or small business ABS in March. The loan volume for the March TALF installment appears to have been less than was expected. However, the FRBNY described it as a "good start for a program that we will continue to build on in the future." Some potential borrowers may have been reluctant to participate in the March TALF installment due to uncertainty as to the level of government oversight to which participants would be subjected and concern about the possibility that Congress could direct retroactive changes to the terms of program.

Arnold & Porter attorneys can assist companies and financial institutions in working through the details of TALF and determining whether they are eligible to take part in the TALF program. If you have any questions, please contact your Arnold & Porter attorney, or:

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