

Economic Stabilization Advisory Group | March 6, 2009

TALF Update: New Guidance Available, Program to Launch this Month

On March 3, 2009, the Board of Governors of the U.S. Federal Reserve System (the “Federal Reserve”) and the U.S. Treasury Department announced the details of the Term Asset-Backed Securities Loan Facility (“TALF”).¹ The general terms of the program had been announced in mid-February.² TALF aims to jump-start the stalled securitization markets by providing non-recourse loans to hedge funds and other purchasers of certain AAA-rated asset-backed securities (“ABS”) backed by newly and recently originated automobile loans, credit card loans, student loans, and SBA-guaranteed small business loans, thereby reopening lending to consumers for automobiles, education and credit cards and to small businesses. The program will initially offer \$200 billion in loans, possibly expanding to \$1 trillion. The first loans are expected to be made on March 25, 2009 with a maturity date of March 26, 2012.

New Developments

Key revisions to TALF since its February 10, 2009 announcement include:¹

- Lifting the originally proposed requirement that some participants agree to comply with executive compensation rules;²
- Allowing an unlimited number of loans per eligible borrower per month (minimum loan size is \$10 million);
- Reducing the interest rates and collateral haircuts for loans secured by asset-backed securities guaranteed by the Small Business Administration or backed by government-guaranteed student loans;
- Acceptance of collateral priced over par with graduated prepayment of premium amount;
- Switching from maturity to average life calculations; and
- Clarification that offset/hedging prohibitions do not apply to portfolio-wide (non-specific) hedging.³

¹ The TALF revised terms and conditions are available at http://www.newyorkfed.org/markets/talf_terms.html and the TALF revised FAQ's are available at <http://www.federalreserve.gov/newsevents/press/monetary/monetary20090303a2.pdf>.

It is expected that each of these websites will continue to be updated.

² The relevant rules were those under the Emergency Economic Stabilization Act of 2008, which are further described in the following Shearman & Sterling publication: “Executive Compensation Under the Emergency Economic Stabilization Act of 2008: A First Take on the Guidance,” available at http://www.shearman.com/eceb_102108/.

Market Reaction

- As the media has suggested, a broad swath of market intermediaries, such as banks and brokers,

³ For information on the February 10, 2009 announcement, please see the following Shearman & Sterling publication: “Government Financing Initiatives for Private Investors: Update on the U.S. Treasury’s Financial Stability Plan and the Expansion of TALF,” available at http://www.shearman.com/esag_021709/.

as well as potential investors, such as hedge funds and private equity funds, appear to be excited about participating. Our contacts bear this out. We see an accelerating volume of TALF-focused client inquiries;

- We also see significant interest from market participants in developing properly structured vehicles that will not only allow institutions to mitigate losses from troubled assets, but also enhance returns; and
- Finally, clients are interested in whether the government will offer further support, whether in the form of credit enhancements and tax incentives. There is also a large measure of disappointment that mortgage-related assets are not yet covered, although that may change, and – at least among issuers that would like to package existing assets – disappointment that the eligible ABS itself, and most of the loans underlying the eligible ABS, must be recently issued.

The Role of the Primary Dealers

Any interested borrower or issuer must submit a subscription through one of the primary dealers recognized by the Federal Reserve Bank of New York (“FRBNY”).⁴ There is no opportunity to transact directly with the FRBNY; all transactions are through the primary dealers.

The Securities and Exchange Commission has granted a limited exemption from Section 11(d)(1) of the Securities Exchange Act of 1934 for primary dealers arranging TALF financing from the FRBNY on new issues of non-exempted securities where such dealers may have been within the preceding 30 days a “member of a selling syndicate or group” in respect of the distribution of the new issue. This exemption is limited to the arranging

prohibitions of Section 11(d)(1), and does not relieve primary dealers from any applicable limitations on direct extensions of credit by them.⁵

A primary dealer will not be permitted to acquire from a borrower collateral that it underwrites at a price designed to reduce or eliminate any loss that such borrower would realize on sale or enter into any other agreement or consummate any other transaction intended to have the same effect. As a result, primary dealers will not be permitted to enter into any transaction that is designed to hedge against losses specific to securities purchased with TALF financing. Under the FRBNY’s revised guidance, this prohibition would not extend to hedges on a borrower’s broader portfolio, which may include securities purchased with TALF financing.

Eligible Borrowers

An eligible borrower is any U.S. company that owns eligible collateral and maintains an account relationship with a primary dealer. Under TALF, a U.S. company has been preliminarily defined as:

- A business entity organized under the laws of the U.S. (or a political subdivision or territory thereof) (“U.S.-organized”) that conducts significant operations or activities in the United States (including entities whose parent companies are not U.S.-organized), including any U.S.-organized subsidiary of such an entity;
- 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
- An investment fund (preliminarily defined as any type of pooled investment vehicle, including a hedge

⁴ A list of primary dealers is available online at http://www.newyorkfed.org/markets/pridealers_current.html.

⁵ See the SEC’s letter to the FRBNY on this matter: <http://www.sec.gov/divisions/marketreg/mr-noaction/2009/frbny021709.pdf>.

fund or private equity fund, or any vehicle that primarily invests in eligible collateral and borrows from TALF) that is U.S.-organized and managed by an investment manager that has its principal place of business in the United States. U.S.-organized and US-managed subsidiaries of non-U.S. funds are eligible borrowers.

Any entity controlled by a foreign government or managed by an investment manager controlled by a foreign government will not be an eligible borrower. A foreign government is considered to control a company if, among other things, it owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company. So far unsuccessfully, the Institute of International Bankers (“IIB”) has urged the FRBNY to reconsider its exclusion of the U.S. operations of internationally headquartered banks that are controlled by their home country governments from participation in TALF. The IIB believes such banks should be permitted to participate in TALF, especially foreign banking organizations that have only recently come under the control of their home country government as a result of the financial assistance and capital support provided to them in connection with recent coordinated efforts to stabilize the global financial system.⁶

The FRBNY has published a Master Loan and Security Agreement (“MSLA”), which provides additional details on all of the terms that will apply to borrowings under TALF.⁷ Borrowers are made parties to the MSLA by the relevant primary dealer acting on their behalf. While the MSLA can be amended in the FRBNY’s sole discretion, so that it should be monitored by borrowers before each new borrowing, no amendment will affect the rights or obligations of a borrower or primary dealer

in respect of a loan outstanding prior to the effectiveness of the amendment.

Sponsor Requirements

In addition to any information required by applicable laws, the issuer and sponsor must ensure that the prospectus or other offering document of an ABS they represent as eligible collateral under TALF include a signed certification indicating, among other items, that:

- The ABS is TALF eligible;
- An accounting firm retained by the sponsor has provided an accountant’s report, in a form acceptable to the FRBNY, that the ABS is TALF eligible;⁸ and
- The sponsor (or, if the sponsor is a special purpose vehicle, the sponsor’s direct or indirect ultimate parent) has executed and delivered an undertaking to the FRBNY indemnifying it from any losses it may suffer if such certifications are untrue. The indemnity undertaking must be delivered to the FRBNY no later than four days prior to the TALF loan settlement date using a specified form.⁹

The “issuer” for purposes of this issuer certification requirement, in both public and private offerings of TALF eligible ABS, will be the legal entity that issues the ABS.

Again, while the earlier iteration of TALF would have subjected issuers to executive compensation rules, that requirement has been lifted.

⁶ The letter from the Institute of International Bankers is available at <http://www.iib.org/associations/6316/files/20090224FinalTALFLetter.pdf>

⁷ The TALF MSLA is available at http://www.newyorkfed.org/markets/TALF_MSLA.pdf.

⁸ The auditor attestation form is available online at <http://www.newyorkfed.org/markets/TALFAuditorAttestationForm.pdf>.

⁹ The form certification and indemnity undertaking is available online at http://www.newyorkfed.org/markets/Form_Certification_TALF_Eligibility.pdf.

Eligible Collateral

Eligible collateral includes U.S. dollar-denominated cash ABS that have a long-term credit rating in the highest investment-grade rating category from two or more major nationally recognized statistical rating organizations (“NRSRO”) and do not have a long-term credit rating below the highest investment-grade rating category from a major NRSRO.

The set of permissible underlying credit exposures of ABS includes only the following assets (although it may be expanded over time to include commercial mortgage-backed securities, private-label residential mortgage-backed securities, or other ABS):

- Automobile loans (including retail loans and leases relating to cars, light trucks, recreational vehicles, or motorcycles, and will include automobile dealer floorplan loans; however, commercial, government and rental fleet leases of cars, trucks and light trucks will not be eligible);
- Student loans (including federally guaranteed student loans, consolidation and private loans);
- Credit card loans (including consumer and corporate credit card receivables); and
- Small SBA loans (including 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 full faith and credit of the U.S. government and meet all other TALF eligibility requirements).

The collateral must meet the following date of issuance and related criteria:

- ABS other than SBA Pool Certificates and Development Company Participation Certificates must have been issued on or after January 1, 2009; and

- SBA Pool Certificates and Development Company Participation Certificates must have been issued on or after January 1, 2008, regardless of the dates of the underlying loans or debentures.

The collateral must meet the following asset-class specific criteria:

- Automobile loan ABS (other than automobile dealer floorplan ABS) must be backed by automobile loans at least 85% of which, by dollar amount, were originated on or after October 1, 2007;
- Student loan ABS must be backed by student loans at least 85% of which, by dollar amount, have a disbursement date on or after May 1, 2007;
- Small business loan ABS (other than SBA Pool Certificates and Development Company Participation Certificates) must be backed by small business loans fully guaranteed as to principal and interest by the SBA and originated on or after January 1, 2008; and
- Credit card ABS and automobile dealer floorplan ABS must be issued to refinance existing credit card and automobile dealer floorplan ABS, respectively, maturing in 2009 and must be issued in amounts no greater than the amount of the maturing ABS; and
- Automobile loan ABS and credit card ABS must have an average life of no more than five years.

With respect to all asset classes:

- The ABS must be backed by exposures at least 95% of which, by dollar amount, are to U.S.-domiciled obligors; and
- The ABS may not be backed by ABS (i.e., no resecuritization) or by loans originated or securitized by the TALF borrower or its affiliates.

Eligible collateral for a particular borrower must not be backed by loans originated by the borrower or by an affiliate of the borrower.

Operational Mechanics: How TALF Is Funded and the Timing of TALF Subscriptions

Operationally, the FRBNY will (i) provide borrowers with non-recourse loans (“TALF loans”) to purchase eligible ABS, (ii) accept the ABS as pledged collateral to guarantee repayment under TALF loans, and (iii) in case of default by the borrower under a TALF loan, enforce its rights in the collateral by selling it to a newly created special purpose vehicle. The FRBNY will enter into a forward purchase agreement with the SPV under which the SPV will commit, for a fee, to purchase all ABS securing a TALF loan that has been defaulted by a borrower. Treasury’s Troubled Asset Relief Program (“TARP”) will purchase subordinated debt issued by the SPV to finance the first \$20 billion of asset purchases. If more than \$20 billion in assets are purchased by the SPV, the FRBNY will lend additional funds to the SPV to finance such additional purchases.

The Federal Reserve and the Treasury expect issuers and investors in the private sector to begin to arrange and market new securitizations of recently generated loans and subscriptions. Subscriptions for certain ABS under TALF will be accepted on March 17, 2009. On the subscription date, each primary dealer will submit this information to the FRBNY’s custodial agent for review and will also submit to the FRBNY the aggregate loans request amount for all its customers by rate type and asset class.

The FRBNY will announce the monthly TALF loan subscription and settlement dates. On each subscription date, borrowers will be able to request one or more floating-rate and one or more fixed-rate TALF loans by indicating for each loan the eligible ABS collateral they expect to pledge, the desired loan amount, and the desired interest rate format (fixed or floating). Loan proceeds will be disbursed to the borrower, contingent on receipt by the FRBNY’s custodian bank of the eligible ABS

collateral. In addition, the value of the collateral pledged to the FRBNY to secure TALF loans will be reported on the Federal Reserve’s website.

The FRBNY will hold monthly subscriptions on the first Tuesday of every month through December 31, 2009. An eligible borrower may request an unlimited number of loans at each monthly subscription.

Key upcoming dates under TALF are:

Date	Announcement/Event
March 3, 2009	Launch of TALF. Publication of the details for the first funding
March 3-17, 2009	Marketing first funding to investors
March 17, 2009	Subscriptions for first funding recorded
March 25, 2009	First TALF funds disbursed
Date	Announcement/Event
March 24, 2009	Announcement of details of second funding
March 24-April 7, 2009	Marketing second funding to investors
April 7, 2009	Subscriptions for second funding recorded
April 14, 2009	Additional TALF funds disbursed

Loan Terms

Credit extensions under TALF will be in the form of non-recourse loans secured by eligible collateral. TALF loans:

- Will have a three-year term, with interest payable monthly;
- Will not be subject to mark-to-market or re-margining requirements;
- Will be pre-payable in whole or in part at the option of the borrower, but substitution of collateral during the term of the loan generally will not be allowed; and
- Must use any remittance of principal on eligible collateral immediately to reduce the principal amount of TALF loan in proportion to the loan’s original loan-to-value ratio (e.g., if the original loan-

to-value ratio was 90 percent, 90 percent of any remittance of principal must immediately be repaid to the FRBNY).

If a borrower requests TALF loans through multiple primary dealers, it must deliver the collateral for each loan through the respective primary dealer, unless the collateral is a new issuance delivered by the underwriter or other syndicate desk.

The minimum size for each TALF loan will be \$10 million.

Loan Pricing

The interest rate on TALF loans secured by:

- ABS backed by Federally guaranteed student loans will be 50 basis points over 1-month Libor;
- SBA Pool Certificates (which must have been issued on or after January 1, 2008) will be the Federal funds target rate plus 75 basis points;
- SBA Development Company Participation Certificates (which must have been issued on or after January 1, 2008) will be 50 basis points over the 3-year Libor swap rate;
- Other eligible fixed-rate ABS, the interest rate will be 100 basis points over the 3-year Libor swap rate; or
- Other eligible floating-rate ABS, the interest rate will be 100 basis points over 1-month Libor.

The FRBNY will assess an administrative fee equal to 5 basis points of the loan amount on the settlement date of each loan transaction.

For ABS benefiting from a government guarantee with average lives beyond five years, haircuts will increase by one percentage point for every two additional years of average life beyond five years. For all other ABS with average lives beyond five years, haircuts will increase by

one percentage point for each additional year of average life beyond five years.

For ABS with bullet maturities, which includes credit cards and automobile dealer floor plans, average life is determined by the expected principal payment date. For amortizing ABS, which includes automobile retail loans and leases, student loans and SBA loans, average life is defined as the weighted average life to maturity based on the prepayment assumptions and market conventions.

(Additional pricing information is set out in the tables on the following page.)

Looking Ahead

The Federal Reserve and the Treasury will continue to analyze the appropriate terms and conditions for accepting commercial mortgage-backed securities and will continue to evaluate a number of other types of AAA-rated newly issued ABS for possible acceptance under the expanded program.

Summary of the Structure and Price

Sector	Subsector	Fixed	Floating
Auto		3-year LIBOR swap rate + 100 bps	1-month LIBOR + 100 bps
Credit Card		3-year LIBOR swap rate + 100 bps	1-month LIBOR + 100 bps
Student Loan	Private	NA	1-month LIBOR + 100 bps
Student Loan	Gov't guaranteed	NA	1-month LIBOR + 50 bps
Small Business	SBA loans 7(a)	NA	Fed Funds Target + 75 bps
Small Business	SBA loans 504	3-year LIBOR swap rate + 50 bps	NA

For collateral priced at a premium to par the borrower will make an additional principal payment calculated to adjust for the expected reversion of market value toward par value as the ABS matures.

Haircuts

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

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this memorandum, you may contact your regular Shearman & Sterling contact person or any of the following:

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