

**We will start at 1pm ET. All lines are muted.**

# TALF FUNDS 2020

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- ▶ Focuses on investment company and investment adviser regulatory issues, and related issues affecting the investment management activities of financial institutions
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- ▶ Concentrates his practice in securities law, particularly in representing investment management companies and other clients on matters arising under the Investment Company Act of 1940 and the related Investment Advisers Act of 1940.
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- ▶ Writes and speaks frequently on issues involving investment management, health care and other matters. Mr. Nowak is the author of five books on hedge funds.



# Troutman Sanders and Pepper Hamilton Announce Plans to Combine

Troutman Sanders and Pepper Hamilton LLP have agreed to merge effective July 1, 2020. Troutman Pepper will offer expanded capabilities and practice strengths, with a hallmark focus on client care.



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**sanders**

**Pepper Hamilton LLP**  
Attorneys at Law

# Pepper Hamilton/Troutman Sanders COVID-19 Resources Center

Covid19.pepperlaw.com

Pepper Hamilton and Troutman Sanders have developed a dedicated Resource Center to help guide clients through the global health challenge presented by the novel coronavirus (COVID-19). Find news, recommendations from health professionals, and tools that businesses can use free of charge.

**Pepper Hamilton LLP / Troutman Sanders LLP  
COVID-19 RESOURCE CENTER**

We have assembled a COVID-19 Task Force of Pepper Hamilton and Troutman Sanders attorneys who are available to help companies navigate this evolving public health crisis. They represent diverse practice areas and industries, across multiple geographies. If you have any questions, don't hesitate to contact an attorney on our Response Team, or an attorney with whom you work.

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# Agenda

- ▶ How does the TALF 2020 program work and the lessons learned from the 2008/2009 iteration
- ▶ Who can take advantage of TALF 2020
- ▶ Why investment management professionals and investors should be excited about TALF 2020
- ▶ What should a TALF 2020 Fund look like; what are the applicable mechanics
- ▶ When is the best time to access TALF 2020



# How Does the TALF 2020 Program Work (1/5)

1. TALF is a credit facility of the US Federal Reserve System
2. Administered by the NY Fed
3. Authorized by Section 13(3) of the Federal Reserve Act





# How Does the TALF 2020 Program Work (2/5)

## 3. Discounts for individuals, partnerships, and corporations

- A. In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank: *Provided*, That before discounting any such note, draft, or bill of exchange, the Federal reserve bank shall obtain evidence that such participant in any program or facility with broad-based eligibility is unable to secure adequate credit accommodations from other banking institutions. All such discounts for any participant in any program or facility with broad-based eligibility shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.
- B. i. As soon as is practicable after the date of enactment of this subparagraph, the Board shall establish, by regulation, in consultation with the Secretary of the Treasury, the policies and procedures governing emergency lending under this paragraph. Such policies and procedures shall be designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company, and that the security for emergency loans is sufficient to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion. The policies and procedures established by the Board shall require that a Federal reserve bank assign, consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for a loan executed by a Federal reserve bank under this paragraph in determining whether the loan is secured satisfactorily for purposes of this paragraph.

# How Does the TALF 2020 Program Work (3/5)

ii. The Board shall establish procedures to prohibit borrowing from programs and facilities by borrowers that are insolvent. Such procedures may include a certification from the chief executive officer (or other authorized officer) of the borrower, at the time the borrower initially borrows under the program or facility (with a duty by the borrower to update the certification if the information in the certification materially changes), that the borrower is not insolvent. A borrower shall be considered insolvent for purposes of this subparagraph, if the borrower is in bankruptcy, resolution under title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or any other Federal or State insolvency proceeding.

iii. A program or facility that is structured to remove assets from the balance sheet of a single and specific company, or that is established for the purpose of assisting a single and specific company avoid bankruptcy, resolution under title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or any other Federal or State insolvency proceeding, shall not be considered a program or facility with broad-based eligibility.

iv. The Board may not establish any program or facility under this paragraph without the prior approval of the Secretary of the Treasury.

# How Does the TALF 2020 Program Work (4/5)

C. The Board shall provide to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives--

- not later than 7 days after the Board authorizes any loan or other financial assistance under this paragraph, a report that includes--
  - the justification for the exercise of authority to provide such assistance;
  - the identity of the recipients of such assistance;
  - the date and amount of the assistance, and form in which the assistance was provided; and
  - the material terms of the assistance, including--
    - (aa) duration;
    - (bb) collateral pledged and the value thereof;
    - (cc) all interest, fees, and other revenue or items of value to be received in exchange for the assistance;
    - (dd) any requirements imposed on the recipient with respect to employee compensation, distribution of dividends, or any other corporate decision in exchange for the assistance; and
    - (ee) the expected costs to the taxpayers of such assistance; and
- once every 30 days, with respect to any outstanding loan or other financial assistance under this paragraph, written updates on--
  - the value of collateral;
  - the amount of interest, fees, and other revenue or items of value received in exchange for the assistance; and
  - the expected or final cost to the taxpayers of such assistance.

# How Does the TALF 2020 Program Work (5/5)

D. The information required to be submitted to Congress under subparagraph (C) related to--

- the identity of the participants in an emergency lending program or facility commenced under this paragraph;
- the amounts borrowed by each participant in any such program or facility;
- identifying details concerning the assets or collateral held by, under, or in connection with such a program or facility,

shall be kept confidential, upon the written request of the Chairman of the Board, in which case such information shall be made available only to the Chairpersons or Ranking Members of the Committees described in subparagraph (C).

E. If an entity to which a Federal reserve bank has provided a loan under this paragraph becomes a covered financial company, as defined in section 201 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, at any time while such loan is outstanding, and the Federal reserve bank incurs a realized net loss on the loan, then the Federal reserve bank shall have a claim equal to the amount of the net realized loss against the covered entity, with the same priority as an obligation to the Secretary of the Treasury under section 210(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[12 USC 343. As added by act of July 21, 1932 (47 Stat. 715); and amended by acts of Aug. 23, 1935 (49 Stat. 714); Dec. 19, 1991 (105 Stat. 2386); and July 21, 2010 (124 Stat. 2113). As enacted by Public Law 111-203 (124. Stat. 2115), "any reference in any provision of Federal law to the third undesignated paragraph of section 13 of the Federal Reserve Act [FRA] (12 USC 343) shall be deemed to be a reference to section 13(3) of the FRA."]

# TALF Terms

1. Borrow up to 90% -- of eligible assets purchases -- from the Fed
2. Non Recourse
3. Highest quality of assets
4. Three year term to TALF loans



# Who Can Take Advantage of TALF

- ▶ Any “US Company”: that owns “eligible collateral” and that maintains an account relationship with a “primary dealer”

Primary Dealers	
Amherst Pierpont Securities LLC	HSBC Securities (USA) Inc.
Bank of Nova Scotia New York Agency	Jefferies LLC
BMO Capital Markets Corp.	J.P. Morgan Securities LLC
BNP Paribas Securities Corp.	Mizuho Securities USA LLC
Barclays Capital Inc.	Morgan Stanley & Co. LLC
BofA Securities, Inc.	NatWest Markets Securities Inc.
Cantor Fitzgerald & Co.	Nomura Securities International, Inc.
Citigroup Global Markets Inc.	RBC Capital Markets, LLC
Credit Suisse AG, New York Branch	Societe Generale, New York Branch
Daiwa Capital Markets America Inc.	TD Securities (USA) LLC
Deutsche Bank Securities Inc.	UBS Securities LLC.
Goldman Sachs & Co. LLC	Wells Fargo Securities, LLC

# US Company Defined

- ▶ “ a business that is created or organized in the United States or under the laws of the United States that has significant operations in and a majority of its employee based in the United States”
- ▶ As of April 9, 2020 Release. Note: differs from the March 23, 2020 definition



# Eligible Collateral Defined (1/2)

- ▶ US Dollar Denominated
- ▶ Cash ABS (i.e. not synthetic)
- ▶ Credit Rating in the highest long-term or in the case of non-mortgage backed ABS, the highest short-term investment grade rating from two (2) NRSROs
- ▶ All credit exposure of the ABS must have been originated by a US Company, and the issuer of the ABS must be a US Company
- ▶ **With one exception, all ABS must be issued on or after 3/23/2020**

# Eligible Collateral Defined (2/2)

- ▶ CMBS must be *legacy* CMBS
  - Issued before 03/23/2020
  - For CMBS, the underlying credit exposures must be to real property located in the US or one of its territories
- ▶ Eligible collateral does not include ABS that bears interest payments that step up or step down to predetermined levels on specified dates
- ▶ Underlying credit may not include exposures that are themselves cash ABS or synthetic ABS (i.e., no CDO's)

# Eligible Collateral

- ▶ Must be ABS where the underlying credit exposures are one of the following:
  1. Auto loans and leases
  2. Student loans
  3. Credit card receivables (both consumer and corporate)
  4. Equipment loans and leases
  5. Floorplan loans
  6. Insurance premium finance loans
  7. Certain small business loans that are guaranteed by the Small Business Administration
  8. Leveraged loans
  9. Commercial mortgages

# What's the excitement about?

- ▶ Non-recourse borrowing
- ▶ Haircuts (discounts) of 5% to 20%
  - Depending on sector (i.e., credit card, student loan, SBA, etc.) and ABS average life (see next slide)
- ▶ Loan fees – 10 bps servicing fee
- ▶ Low pricing – (see second next slide)

# Haircut Schedule

Sector	Subsector	ABS Average 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	Motorcycle/ other recreational vehicles	7%	8%	9%	10%	11%		
Auto	Commercial and government fleets	9%	10%	11%	12%	13%		
Auto	Rental fleets	12%	13%	14%	15%	16%		
Credit Card	Prime	5%	5%	6%	7%	8%		
Credit Card	Subprime	6%	7%	8%	9%	10%		
Equipment	Loans and Leases	5%	6%	7%	8%	9%		
Floorplan	Auto	12%	13%	14%	15%	16%		
Floorplan	Non-Auto	11%	12%	13%	14%	15%		
Premium Finance	Property and casualty	5%	6%	7%	8%	9%		
Small Business	SBA Loans	5%	5%	5%	5%	5%	6%	6%
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Leveraged Loans	Static	20%	20%	20%	20%	20%	21%	22%
Commercial Mortgages	Legacy, Conduit	15%	15%	15%	15%	15%	16%	17%

\* For auto, credit card, equipment, floorplan, and premium finance ABS, the weighted average life must be five years or less. For other new-issue eligible collateral, haircuts will increase by one percentage point for each additional year (or portion thereof) of average life beyond five years. For legacy CMBS with average lives beyond five years, base dollar haircuts will increase by one percentage point of par for each additional year (or portion thereof) of average life beyond five years. No securitization may have an average life beyond ten years.

# Pricing

- For CLOs, the interest rate will be 150 basis points over the 30-day average secured overnight financing rate (“SOFR”). For SBA Pool Certificates (7(a) loans), the interest rate will be the top of the federal funds target range plus 75 basis points.
- For SBA Development Company Participation Certificates (504 loans), the interest rate will be 75 basis points over the 3-year fed funds overnight index swap (“OIS”) rate.
- For all other eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 125 basis points over the 2-year OIS rate for securities with a weighted average life less than two years, or 125 basis points over the 3-year OIS rate for securities with weighted average life of two years or greater. The pricing for other eligible ABS will be set forth in the detailed terms and conditions.

# Example

## ▶ Assume

- \$60mm in new CC ABS with < 3yr WAM
- Fund puts up \$6mm
- FED lends \$54mm (9x ~ maybe more)
- Fund pays 125bps + 25bps = 1.5% + 10pbs fee = 1.6% cost of loan
- CC ABS Senior tranche pays 5%
- As a simplifying assumption only, assume no pay downs = interest only
  - \$60mm x 5% = \$3mm gross
  - \$54mm x 1.6% = \$0.864mm FED cost
  - \$2.136mm / \$6mm equity = 36% return!



# 2020 TALF Fund Considerations

- ▶ Constraints and design considerations
  - Open or closed end? Iterative series?
    - TALF window scheduled to close on September 30, 2020 – could be extended, but see §13(3) *supra*
  - Valuation issues?
  - Management fee -- on just NAV OR NAV plus outstanding TALF debt
  - Performance fee? consider designing as a fee (as opposed to an allocation) since no real opportunity for capital gains due to loan rate environment and periodic principal payments of underlying assets

# Likely Target Investors?

- ▶ ERISA and Endowments?
  - UBTI issues
  - Use of off-shore corporate blocker
- ▶ HNW individuals and state and local governments – perfect, especially if performance fee has a hurdle rate
- ▶ Key to launch is establishing the primary dealer relationship



# Best Time

- ▶ Now to opening of window
  - Build fund and establish relationships
- ▶ Once economy opens and consumers start to spend
  - Be the first in line to buy the ABS while spreads are wide
  - Adds to that “5%” return assumption in example
- ▶ Look for new asset classes being added by the FED
  - possibilities: **P2Ps, MCAs, other Alt. Finance-generated paper?**

