TALF 2.0

Shoring up the New Issue ABS Market

A Review of the Federal Reserve's Term ABS Loan Facility

By Fouad Onbargi, Head of Asset Finance, EA Markets

Despite record issuance in the IG corporate market, Asset-Backed Security (ABS) issuance has slowed to a virtual standstill since COVID-19 hit America's shores. New issue spreads have gapped out to levels not seen since the Great Recession - making it uneconomic for auto, credit card, student loan and other consumer lenders to issue bonds. Corporate lenders and leasing companies have not been spared, they also see the market demanding credit spreads far in excess of what they can reasonably charge their customers. According to the Securities Industry and Financial Markets Association (SIFMA), the outstanding balance of ABS at the end of 2019 amounted to $1.8 trillion [i]. That's a lot of credit in the system and keeping this economic oxygen supply open will be key to ensuring the US consumer and corporate borrower survives the pandemic's economic impact.

Enter Uncle Sam…on March 23rd, 2020 the Federal Reserve announced the re-implementation of the Term Asset Backed Securities Loan Facility (TALF), which we are calling TALF 2.0. To get investors into the market, the Fed will offer non-recourse financing on new issue "triple-A" rated ABS. By funding anywhere from 83% to 95% of a senior bond's par value (amount advanced will be a function of underlying ABS asset class and bond tenor) at LIBOR swap rates plus 1.25%, the Fed is betting that hedge funds and other money managers typically uninterested in the ABS market will step-in. A new issue bond with a credit spread of 2.75% financed with TALF debt equal to 92% of the par balance could yield 20% - not a bad risk-reward proposition. For America's corporate ABS issuers, the 2.75% credit spread was unfathomably high a few months ago. Today, it is a low enough spread to keep the spigots open.

Overview of the Term ABS Loan Facility (TALF)

TALF is a credit facility offered by the Federal Reserve Bank of New York (FRBNY) to shore up liquidity in the asset securitization market.

During the 2009 financial crisis, "TALF 1.0" offered an aggregate $200 billion to investors in "AAA" rated ABS. Per the Structured Finance Association, the original TALF "supported the origination of nearly 3 million auto loans, more than 1 million student loans, nearly 900,000 loans to small businesses, 150,000 other business loans, millions of credit card loans. The program did not incur a single dollar of loss and ultimately earned $1.2 billion in interest income for the U.S. taxpayer." [ii]

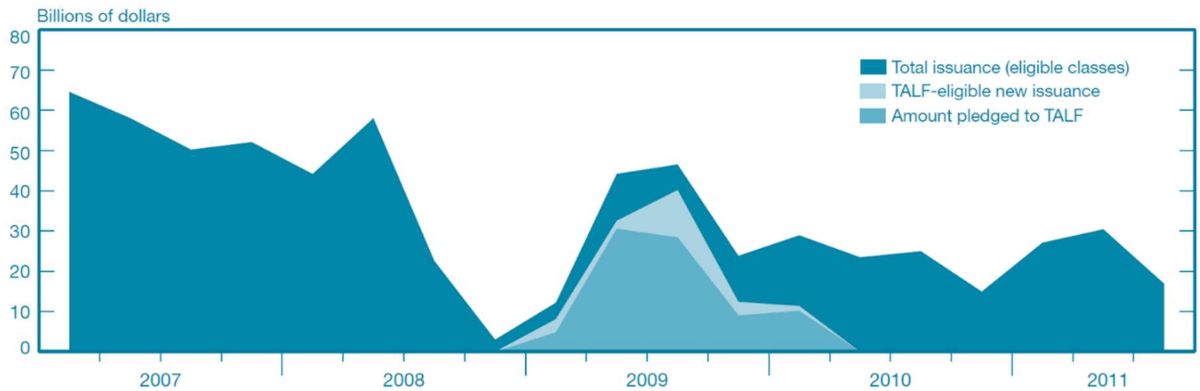
The chart on the next page shows just how effective the original TALF program was. As new issuance came to a standstill, TALF loans ensured a ready source of investors to take up volume. Over time, as new issue spreads reverted to normal, the need for TALF ended.

TALF 2.0 was announced on March 23rd, 2020 as part of a broader stimulus package aimed at curbing the market effects of the COVID-19 pandemic. To support this facility, the FRBNY will create a special purpose vehicle (SPV) to fund up to $100 billion against eligible ABS.

To be eligible for Fed financing, the underlying security has to be issued by a US sponsor, denominated in USD and rated "in the highest ratings category" by at least two rating agencies. While today that means "triple-A", the SFA has asked the Fed to allow for single-A senior bonds to be eligible. That

120 West 45th Street, 24th Floor, New York, NY 10036 | 646.470.6587 | info@eamarkets.com

Asset Backed Security Issuance, 2007-11
Total Issuance in TALF-Eligible Classes and Breakdown of TALF Issuance
Source: Federal Reserve Bank of New York Economic Policy Review, November 2012 issue



would allow “top of the capital stack” securities rated IG but not “triple A” to qualify, subject to additional haircuts. SFA is working to ensure many issuers who can’t achieve “triple-A” due to novelty of asset class, corporate linkage or obligor concentrations still have access to this liquidity injection. Depending on the depth and breadth of this economic recession, the Fed may want to include all rated tranches of ABS in the program.

Eligible asset classes under TALF 2.0 include most categories included in the original TALF (auto loans and leases, student loans, credit cards, equipment loans and leases, etc.). Recently, the Fed expanded the program to CLOs and CMBS but interestingly not servicer advances. If anyone needs liquidity in today’s ABS markets, it is those mortgage servicers fronting for the beleaguered American mortgagor.

Many of those servicers do not have access to cheap deposits and need the ABS markets as an outlet. The SFA is also seeking to expand eligible asset classes to include unsecured consumer loans (i.e. FinTech), transportation, containers, railcars, perhaps aviation (and shipping), solar (PACE, loans and leases, PPAs), wireless receivables, and even wholecompany securitization all in an effort to keep liquidity flowing to consumers and corporates impacted by COVID 19.

Corporate issuers should explore whether ABS as leveraged through TALF 2.0 should be included in their funding strategies. Prospective investors who have not historically purchased ABS should consider whether buying with leverage is a suitable means of participating in this important segment of the capital markets.

Having seen the success of TALF 1.0 in the last financial crisis, the ABS market can enact the best practices of the past. TALF 2.0 should ensure consumer and corporate credit continues to flow during these turbulent times.

i “Fixed Income Chart - SIFMA.” *Securities Industry and Financial Markets Association*, www.sifma.org/resources/research/fixed-income-chart/.
ii “TALF Resurrected.” *Structured Finance Association*, https://structuredfinance.org/resource-details/talf-resurrected/.

Fouad Onbargi is Managing Director and head of the asset finance practice at EA Markets. He leads the firm’s expanding securitization business. He has helped raise over $50 billion of financing for leading companies across asset classes including transportation, IP, alternative energy and specialty finance. Prior to EA, Fouad led ABS banking teams at both JP Morgan and Barclays Capital. He began his career as a corporate attorney advising on leveraged and project finance at White & Case and securitization at Sidley. **fouad.onbargi@eamarkets.com**