Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Term Asset-Backed Securities Loan Facility

Overview

On November 24, 2008, the Board of Governors of the Federal Reserve System (Board), by the unanimous vote of its five members, approved under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343) the establishment of the Term Asset-Backed Securities Loan Facility (TALF). The TALF is intended to assist the financial markets in accommodating the credit needs of consumers and small businesses by facilitating the issuance of asset-backed securities (ABS) and improving the market conditions for ABS more generally.

Background and Details on the TALF

Background. New issuance of ABS declined precipitously in the third quarter of 2008 and came to a halt in October 2008. At the same time, interest rate spreads on AAA-rated tranches of ABS soared to levels well outside the range of historical experience, reflecting unusually high risk premiums. The ABS markets historically have funded a substantial share of consumer credit and of small business loans guaranteed by the Small Business Administration (SBA). Continued disruption of these markets could significantly limit the availability of credit to households and small businesses and thereby contribute to further weakening of U.S. economic activity. These disruptions, when combined with the ongoing stresses in other parts of the credit markets, present significant risks to financial stability and economic conditions in the United States.

In light of the foregoing, the Board determined that unusual and exigent circumstances existed that warranted approval of the TALF. The TALF is designed to support the issuance of ABS collateralized by student loans, auto loans, credit card loans, and SBA-guaranteed small business loans at more normal interest rate spreads. In so doing, the TALF should increase credit availability for consumers and small businesses and support economic activity.

Structure and Basic Terms. The following provides an overview of the terms and conditions that are expected to govern the TALF at this time. The Board and the Federal Reserve Bank of New York (Reserve Bank) continue to monitor the ABS markets and to consult with market participants and, accordingly, the terms and conditions governing the facility may be modified in the future. The Board expects that the TALF will be operational in February 2009.

The Reserve Bank will make up to $200 billion of loans under the TALF. TALF loans will have a one-year term (with interest payable monthly), will be fully secured by the market value of high-quality ABS (subject to a collateral haircut), and will be non-recourse to the borrower. The term of TALF loans may be lengthened later if appropriate. Substitution of collateral during the term of the loan will not be allowed. TALF loans will not be subject to ongoing mark-to-market or re-margining requirements.

The U.S. Treasury Department – under the Troubled Assets Relief Program (TARP) of the Emergency Economic Stabilization Act of 2008 – will provide $20 billion of credit protection to the Reserve Bank in connection with the TALF, as described below.

Eligible Collateral. Eligible collateral will include U.S. dollar-denominated ABS that have a long-term credit rating in the highest investment-grade rating category (for example, AAA) from two or more major nationally recognized statistical rating organizations (NRSROs) and do not have a long-term credit rating of below the highest investment-grade rating category from a major NRSRO.

All or substantially all of the credit exposures underlying eligible ABS must be newly or recently originated exposures to U.S.-domiciled obligors. The underlying credit exposures of eligible ABS initially must be auto loans, student loans, credit card loans, or SBA-guaranteed small business loans. The underlying credit exposures must not include exposures that are themselves ABS.

Originators of the credit exposures underlying eligible ABS (or, in the case of SBA-guaranteed loans, the ABS sponsor) must agree to comply with, or already be subject to, the executive compensation requirements in section 111(b) of the Emergency Economic Stabilization Act of 2008.

This eligible collateral framework is designed to best stimulate new consumer and small business lending while minimizing risk to the Federal Reserve and the U.S. Treasury Department.

Collateral Haircuts. Collateral haircuts will be established by the Reserve Bank for each class of eligible collateral. Haircuts will be determined based on the price volatility of each class of eligible collateral.

Eligible Borrowers. All U.S. persons that own eligible collateral may participate in the TALF. A U.S. person is a natural person that is a U.S. citizen, a company that is organized under the laws of the United States or a political subdivision or territory thereof (including such an entity that has a non-U.S. parent company), or a U.S. branch or agency of a foreign bank.

Maximum Size of the TALF. The Board has authorized the Reserve Bank to make up to $200 billion in loans under the TALF.

Pricing and Allocation of Federal Reserve Lending. The Reserve Bank will offer a fixed amount of loans under the TALF on a monthly basis. TALF loans will be awarded to borrowers each month based on a competitive, sealed bid auction process. Each bid must include a desired amount of credit and an interest rate spread over the one-year overnight index swap (OIS) rate. The Reserve Bank will set minimum spreads for each auction.

The Reserve Bank will reserve the right to reject or declare ineligible any bid, in whole or in part, at its discretion. In this regard, the Reserve Bank will develop and implement procedures to identify for further scrutiny potentially high-risk ABS that a borrower proposes to pledge under the TALF.

The Reserve Bank will assess a non-recourse loan fee at the inception of each loan transaction.

Role of the U.S. Treasury Department. The Reserve Bank will create a special purpose vehicle (SPV) to purchase and manage any assets acquired by the Reserve Bank in connection with default on any TALF loans. The Reserve Bank will enter into a forward purchase agreement with the SPV under which the SPV will commit, for a fee, to purchase – at a price equal to the TALF loan amount plus accrued but unpaid interest – all assets securing a TALF loan that are acquired by the Reserve Bank. The U.S. Treasury Department's TARP will purchase up to $20 billion of subordinated debt issued by the SPV. The Reserve Bank will lend additional funds to the SPV as necessary to finance additional asset purchases, up to a maximum amount of $180 billion. The Reserve Bank's loan to the SPV will be senior to the TARP subordinated debt, with recourse to the SPV, and secured by all the assets of the SPV. All cash flows from SPV assets will be used first to repay principal and interest on the Reserve Bank senior loan until the loan is repaid in full. Next, cash flows from assets will be used to repay principal and interest on the TARP subordinated debt until the debt is repaid in full. Residual returns from the SPV will be shared between the Reserve Bank and the U.S. Treasury Department. The interest rates on the U.S. Treasury Department's subordinated debt in the SPV and any Federal Reserve loan to the SPV have not yet been determined.

Executive Compensation Requirements. Originators of the credit exposures underlying eligible ABS (or, in the case of SBA-guaranteed loans, the ABS sponsor) must agree to comply with, or already be subject to, executive compensation standards consistent with the U.S. Treasury Department's TARP guidelines applicable to its Capital Purchase Program.

Security for Federal Reserve Loans. The Reserve Bank loans under the TALF will be fully collateralized at inception by eligible ABS. As noted above, these ABS will be high-credit-quality debt instruments that are externally rated in the highest rating category by multiple NRSROs. In addition, as noted above, the Reserve Bank will employ substantial haircuts and screens to ensure that the Federal Reserve and the taxpayer are protected from a decline in the value of the ABS collateral during the term of a loan. Moreover, as noted above, the U.S. Treasury Department's TARP has agreed to absorb at least the first ten percent of any losses incurred by the Federal Reserve in connection with the program.

Termination Date. The Reserve Bank will cease making new loans under the TALF on December 31, 2009, unless the Board agrees to extend the facility. TALF loans that are outstanding on the facility termination date will remain outstanding until maturity.

Expected Costs. In light of the high-credit-quality ABS collateral that will secure Reserve Bank lending under the TALF, the collateral haircuts and screens that will be employed by the Reserve Bank in connection with TALF lending, and the $20 billion program-wide credit protection provided by the U.S. Treasury Department to support TALF lending, the Board does not expect at this time that extensions of credit under the TALF will result in any losses to the Federal Reserve or the taxpayer.