



# TALF 101

## ABSTRACT

This white paper briefly explains what the TALF program is and why it was started. It outlines the changes it has undergone since inception, and analyzes the program's impact on the market. It concludes that the TALF program has been successful as ABS issuance has restarted, and ABS and CMBS spreads have narrowed from the peaks of earlier this year. It leaves us with some doubt as to the future of CMBS within TALF and suggests that RMBS may not be added to the program after all.

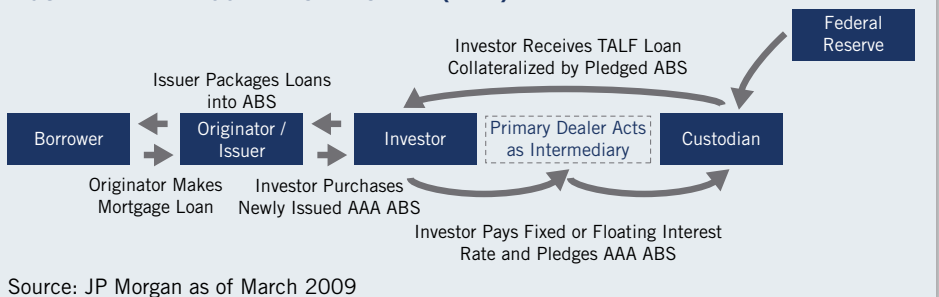
## What is TALF?

The Term Asset-Backed Facility (TALF) is a loan facility provided by the New York Federal Reserve with one, three and five year maturities. The \$200 billion program was started in March 2009 and was set up to finance purchases of newly issued AAA asset-backed securities by private investors. Private asset managers can thus borrow TALF money from the New York Fed at low rates and buy ABS issuance on a levered basis. The ABS securities then become the collateral for the TALF loan (see figure 1).

Newly issued AAA ABS collateralized by the following loan types are eligible for financing under the TALF program: auto loans, credit cards, student loans, small business administration loans, dealer floorplan loans, mortgage servicer advances, equipment leases, auto, fleet and motorcycle leases, and CMBS. CMBS and legacy CMBS were added to the list in May 2009.

There is some speculation in the market that RMBS might be added to this list at some point.

**FIGURE 1: TERM ASSET-BACK FACILITY (TALF)**



Source: JP Morgan as of March 2009

## Why was the TALF Program Started? To Restart the ABS Market

The asset-backed securities (ABS) market has been under strain since the start of the credit crunch in 2007. This strain accelerated in the third quarter of 2008 and the market came to a near-complete halt in October 2008. As a result, spreads on AAA-rated tranches of ABS rose to levels well outside the range of historical experience, reflecting unusually high risk premiums. Since the ABS markets have historically funded a substantial share of credit to consumers and businesses, TALF was designed to increase credit availability and support economic activity by facilitating renewed issuance of consumer and business ABS at more normalized spreads.



## How is the U.S. Treasury Involved?

The U.S. Treasury's Troubled Asset Relief Program (TARP) has purchased \$20 billion of subordinated debt in an SPV created by the New York Fed (see figure 2). The SPV purchases and manages any assets received by the New York Fed in connection with any TALF loans. Residual returns from the SPV will be shared between the New York Fed and the U.S. Treasury.

## Changes to the Program since Inception

Commercial mortgage-backed securities (CMBS) and securities backed by insurance premium finance loans were added to the list of eligible collateral in early May, with the initial subscription date expected to be in late June. A few weeks later, it was announced that starting in July, certain high-quality commercial mortgage-backed securities issued before January 1, 2009 (legacy CMBS) will become eligible collateral.

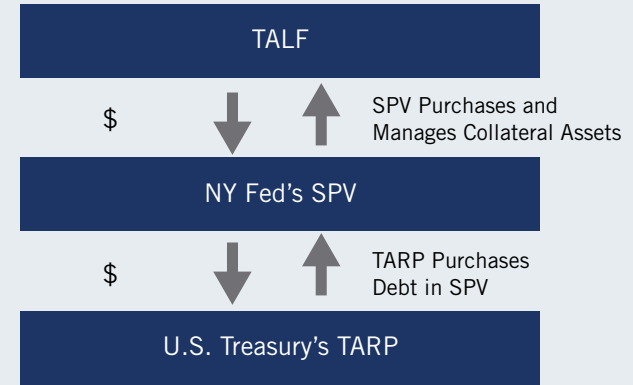
Even though the introduction of CMBS has been welcomed by the market, it has been questioned as to why CMBS was introduced instead of RMBS. Another question has been why legacy CMBS has been allowed when legacy consumer credit ABS has not been introduced.

## How has TALF Impacted the Market Thus Far? ABS Issuance has Restarted

As of June 2nd, \$28 billion of TALF loans have been issued, of which 54% have been allocated to purchase Credit Card ABS, and 29% for auto ABS. According to Morgan Stanley (May 7th, 2009), approximately 70% of total new ABS issuance was due to TALF financing. Credit card deals had TALF financing utilization rates of over 90%, which means that investors in credit card ABS issuance are mainly levered investors. On the other hand, about half of auto loan backed ABS investors were unlevered real money buyers.

It is worth noting that the main intent of the TALF program was to restart ABS issuance. As can be seen in figure 3, before the TALF program started, ABS issuance had fallen to \$1.6 billion from the 1H08 average of \$18.7 billion. March 2009 saw the turnaround with \$10.2 billion being issued with over 80% due to TALF funds. The month of May, in fact, saw all new issuance being backed by TALF, with the average issuance moving up to \$13.5 billion, closer to its long term average. The program seems to be working.

FIGURE 2: TALF & SPECIAL PURPOSE VEHICLE



Source: Babson Capital

TABLE 1: FACILITIES ISSUED (\$ BILLION)

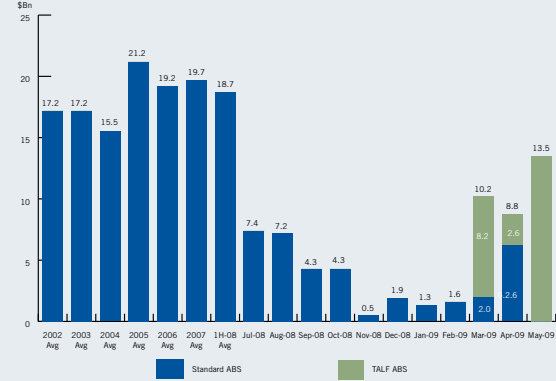
SECTOR	MARCH 17	APRIL 7	MAY 5	JUNE 2	TOTAL	%
Auto	1.90	0.81	2.18	3.31	8.20	29%
Credit Card	2.80	0.90	5.52	6.22	15.44	54%
Student Loan	-	-	2.35	0.23	2.58	9%
Small Business	-	-	0.09	0.08	0.17	1%
Equipment	-	-	0.46	0.59	1.05	4%
Floorplan	-	-	-	-	-	0%
Premium Finance	-	-	-	0.53	0.53	2%
Servicing Advances	-	-	-	0.49	0.49	2%
	<b>4.70</b>	<b>1.71</b>	<b>10.60</b>	<b>11.45</b>	<b>28.46</b>	<b>100%</b>

Source: Federal Reserve Bank of New York



**FIGURE 3: PUTTING ABS ISSUANCE IN CONTEXT**

(ABS backed by credit card, auto, and equipment loans)



Source: Morgan Stanley as of May 7, 2009

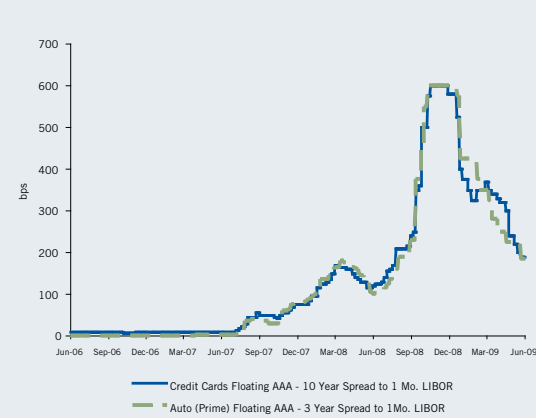
## Spreads Have Narrowed

The TALF program, in restarting ABS issuance, has resulted in narrowing spreads back down though not completely back to normalized levels. The key question then becomes: does the investment opportunity still exist? Is it too late to invest in consumer ABS (autos and credit cards)?

From figures 4 and 5 on consumer credit and CMBS spreads, it seems apparent that the investment opportunity in consumer credit is not as attractive as it was in March. However, spreads have yet to normalize and have some way to go to return to pre-June 2007 levels (see table 2). At the same time, it has to be pointed out that the CMBS market in particular is not as straightforward and has a

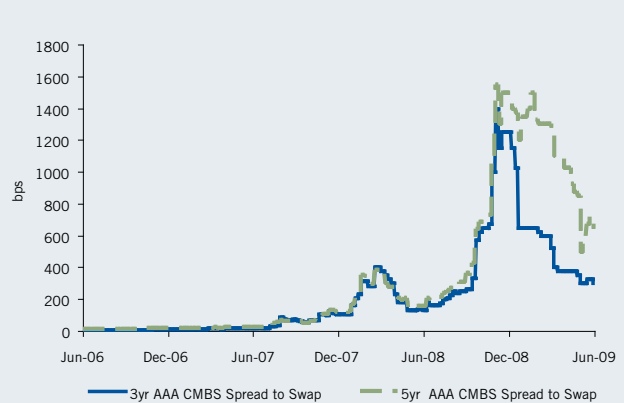
few key obstacles in its way of recovery including recent ratings announcements, application of the bankruptcy code favoring property owners, and worsening CMBS fundamentals including rising vacancies and worsening property prices. As a testament to the market's doubts, no loan requests were submitted through the June 16th CMBS TALF operation.

**FIGURE 4: CONSUMER CREDIT ABS SPREADS**



Source: Morgan Markets as of June 21, 2009

**FIGURE 5: CMBS SPREADS**



Source: Morgan Markets as of June 21, 2009

**TABLE 2: CMBS**

	PRE-JUNE 2007 AVERAGE (BPS)	NOW (BPS)
Credit Cards Floating AAA - 10 Year Spread to 1 Mo. LIBOR	8	190
Auto (Prime) Floating AAA - 3 Year Spread to 1Mo. LIBOR	1	185
10 year AAA CMBS Spread to Swaps	39	715

Source: Morgan Markets as of June 21, 2009

## How about RMBS?

A question that has been often asked since the announcement of the inclusion of CMBS is “why was RMBS not included before CMBS?” Now the question that is being asked is “will RMBS ever be added?” The answer seems to be “probably not.”

According to news reports, a Federal Reserve official has said that the central bank faces challenges in expanding the TALF to RMBS securities due to their “heterogeneous nature” (Bloomberg, May 22nd 2009). At least the



Treasury's PPIP program exists as an option for legacy RMBS securities. Whether the PPIP program takes off or not is a topic for another White Paper.

## **Conclusion**

Since the original intent of the TALF program was to restart new issuance in the consumer ABS market, we can safely say that it has been a successful one. Spreads in the credit card and auto ABS securities have come significantly off their highs of the start of the year. Whether or not the foray into CMBS will be considered successful remains to be seen. Even though CMBS spreads continue to rally thanks to TALF funds, the deteriorating fundamentals including worsening delinquency rates and loss rates, possible rating agency downgrades, and a worsening bankruptcy environment, are causes for concern.

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