The Term Asset-Backed Securities Loan Facility: Opportunities for American Businesses

September 2020

Sarah Hammer

On March 23, 2020, faced with a liquidity crisis caused by the coronavirus (COVID-19) global pandemic, the Federal Reserve established the Term Asset-Backed Securities Loan Facility (TALF), to support the flow of credit to consumers and small businesses. The stated purpose of TALF is to enable the issuance of asset-backed securities backed by student loans, auto loans, credit card loans, small business loans, and certain other assets, as well as to improve market conditions for asset-backed securities (ABS) generally. The 2020 TALF was modeled after the TALF program that was announced in 2008 and in effect from 2009 to 2010, which addressed stresses in the ABS markets due to the Great Financial Crisis.

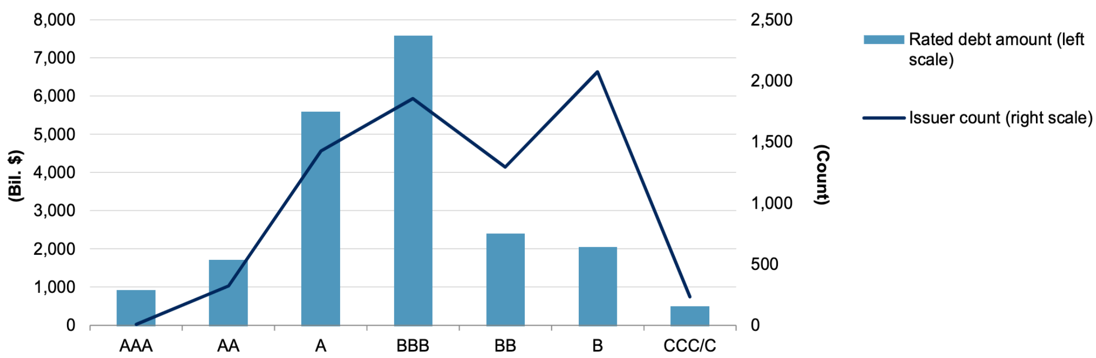
Under the 2020 TALF, the Federal Reserve Bank of New York lends to a special purpose vehicle (SPV) on a non-recourse basis, which in turn provides funding secured by eligible collateral to eligible borrowers. To initiate TALF, the U.S. Department of Treasury made an equity investment of $10 billion in the SPV. TALF lending is then conducted on a non-recourse basis to holders of AAA-rated ABS backed by newly- and recently- originated consumer and small business loans. The loans have a term of three years, are non-recourse to the borrower, and are fully secured by eligible collateral.

After many months of planning, the first subscription date for TALF was set for June 17, 2020. Originally, the lending facility was scheduled to expire on or around September 30, 2020. However, in the face of prolonged economic stresses due to the coronavirus, the Federal Reserve later announced extension of TALF until December 31, 2020. The extension is intended to facilitate planning by facility participants and provide certainty that the facilities will continue to be available to help the economy recover from the COVID-19 pandemic.

As mentioned, a key objective for TALF is to increase the flow of credit to consumers and small businesses, and improve market conditions for ABS generally. Unfortunately, TALF has not met this objective. In fact, the program has fallen far short of this goal. Utilization of TALF has been very minor: The Federal Reserve Board of Governor’s Periodic Report of September 7 revealed that, as of August 31, only $2.6 billion of the $100 billion in TALF had been tapped.

A primary reason for such poor utilization is the eligibility requirements for collateral under TALF. Like TALF in 2008, TALF 2020 requires all collateral to be not just investment grade, but AAA-rated. However, this requirement runs contrary to the stated purpose of TALF, because AAA-rated assets do not actually need the liquidity afforded by the program. Indeed, it is the less creditworthy companies that represent the majority of economic activity in the U.S.

Distribution Of Global Corporate Debt By Rating Category



Note: Issue amount includes bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings from financial and nonfinancial issuers. Issuer count is based on the total number of issuer credit ratings. Data as of April 1, 2020. Sources: S&P Global Ratings Research.

Rather than limiting the type of eligible collateral to AAA-rated ABS, TALF should be expanded to include all investment grade assets. This change would greatly increase the types and amount of eligible collateral, which in turn would result in broader support for asset prices and better functioning capital markets. Importantly, this change would also be consistent with the Federal Reserve's Secondary Market Corporate Credit Facility (SMCCF), which supports market liquidity by purchasing investment grade corporate bonds as well as US-listed exchange traded funds that provide exposure to U.S. corporate bonds. The activities of the SMCCF pertain to all investment grade corporate bonds, not just AAA-rated debt.

It is understandable that one of the objectives of the Federal Reserve Board is to mitigate risk to the Federal Reserve and prevent losses. However, the purpose of TALF is to support the flow of credit to consumers and small businesses. If the program is not utilized, it cannot achieve its objective. It is not too late for the Federal Reserve to make adjustments to TALF: Although ABS credit spreads have moved back toward pre-COVID levels, many uncertainties remain, including high unemployment and continued challenges in reopening the economy. Amending TALF to broaden eligibility requirements for collateral would significantly improve market functioning and provide important ongoing support to the credit markets.