McDermott Will & Emery

The Federal Reserve Bank of New York Announces Eligibility of CMBS and Insurance Premium Finance Loans for TALF's June 2009 Subscription

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On May 1, 2009, the Federal Reserve Bank of New York (FRBNY) announced that commercial mortgage-backed securities (CMBS) and insurance premium finance asset-backed securities (ABS) will become eligible for the Term Asset-Backed Securities Loan Facility (TALF) in June 2009. This announcement relates only to newly issued CMBS (issued on or after January 2009), not legacy CMBS that may be covered by a later FRBNY announcement in conjunction with the Legacy Securities Public-Private Investment Funds Program.

In addition, the FRBNY has also recently issued the following TALF-related documents and guidance:

- A revised form of TALF Master Loan and Security Agreement (May 4, 2009)
- A revised "Frequently Asked Questions," pertaining to the expansion of the TALF eligible asset classes (May 1, 2009)
- "(CMBS): Frequently Asked Questions" and "(CMBS): Terms and Conditions" (May 1, 2009)
- An overview for prospective investors on access to TALF entitled "How Investors Access the Term Asset-Backed Securities Loan Facility" (April 28, 2009)

For a more detailed description of the TALF program generally, including TALF processes and procedures, please read McDermott Will & Emery's previous *White Papers*, "The Federal Reserve Board and Treasury Launch the Term Asset-Backed Securities Loan Facility (TALF)" and "Expansion of the Term Asset-Backed Securities Loan Facility (TALF) and Update on the First TALF Funding," which can be accessed at http://www.mwe.com/info/news/wp0309a.htm, and http://www.mwe.com/info/news/wp0309d.htm, respectively.

Expansion of Asset Classes of Eligible Collateral

Effective with the June 2009 TALF operation, the FRBNY has expanded the list of asset classes that are eligible to collateralize TALF financings to include loans relating to commercial mortgages and premium finance loans. Before this announcement, the TALF eligible asset classes were limited to student loans, auto loans, credit card loans, loans guaranteed by the U.S. Small Business Administration (SBA), loans or leases relating to business equipment, mortgage servicing advances loans, leases of vehicle fleets and floorplan loans.

Qualifying CMBS

The FRBNY announced that eligible collateral for a CMBS TALF loan will include U.S. dollar-denominated, cash (not synthetic) commercial mortgage-backed pass-through securities that are issued on or after January 1, 2009, as to which, as of its date of issuance, all of the following conditions are satisfied:

- *Assets:* The underlying collateral securing the CMBS must have the following characteristics: (i) fixed rate loans originated on or after July 1, 2008, that are fully-funded, first-priority, non-interest only, and are current in payment at the time of securitization; (ii) the security for each mortgage must be a fee or leasehold interest, whose subject property is located in the United States; and (iii) the loans must be underwritten or re-underwritten using then-current in-place, stabilized and recurring net operating income and then-current property appraisals. Each of these characteristics are more fully described below under "CMBS Qualifying Assets."
- *Current Ratings:* As of the applicable TALF loan closing date, the CMBS must have a credit rating in the highest long-term investment-grade rating category from the required number of TALF CMBS-eligible rating agencies and must not have a credit rating below the highest investment-grade rating category from any other TALF CMBS-eligible rating agency. Eligible collateral will not include a CMBS that obtains such credit ratings based on the benefit of a third-party guarantee or a CMBS that a TALF CMBS-eligible rating agency has placed on review or watch for downgrade. The FRBNY is currently engaged in a review process of the rating methodologies of all rating agencies that have expressed an interest in rating TALF-financed CMBS. Prior to the June subscription date, the FRBNY will release a list of TALF CMBS-eligible rating agencies and the required number of TALF CMBS-eligible rating agencies from which TALF-eligible CMBS must obtain a rating.

Non-CMBS ABS TALF must have a credit rating in the highest long-term investment-grade rating category from at least two major nationally recognized statistical rating organizations (NRSROs) and must not have a credit rating below the highest investment-grade rating category from any other major NRSRO.

- *Payment Terms:* The CMBS must (i) entitle its holders to payments of principal and interest (cannot be an interest-only or principal-only security), (ii) bear interest at a pass-through rate that is fixed or based on the weighted average of the underlying fixed mortgage rates, and (iii) not be junior to other securities with claims on the same pool of loans.

- *Issuer:* The issuer of the CMBS must not be an agency or instrumentality of the United States or a government-sponsored enterprise.

- *Settlement:* Each CMBS must be cleared through the Depository Trust Company.

CMBS Qualifying Assets

The FRBNY announced that collateral underlying eligible TALF-financed CMBS must satisfy the following conditions:

- *Asset Types:* Each CMBS must evidence an interest in a trust fund consisting of fully-funded, first-priority mortgage loans that are current in payment at the time of securitization, and not other CMBS, other securities or interest rate swap or cap instruments or other hedging instruments. Additionally, the FRBNY release stated that a participation or other ownership interest in such a loan will be considered a mortgage loan and not a CMBS or other security if, following a loan default, the ownership interest is senior to or *pari passu* with all other interests in the same loan in right of payment of principal and interest. All mortgage loans must be fixed-rate loans. No mortgage loan may provide for interest-only payments during any part of its remaining term.

- *Property Types:* The security for each mortgage loan must include a mortgage or similar instrument on a fee or leasehold interest in one or more income-generating commercial properties. The subject property must be located in the United States or one of its territories.

- *Origination Dates:* All mortgage loans must have been originated on or after July 1, 2008.

- *In-Place Underwriting:* All mortgage loans must have been underwritten or re-underwritten recently prior to the issuance of the CMBS, generally on the basis of then-current in-place, stabilized and recurring net operating income and then-current property appraisals of the month.

CMBS Pooling and Servicing Agreements

The pooling and servicing agreement and other agreements governing the issuance of the CMBS and the servicing of its assets must contain provisions to the following effect:

- If the class of the CMBS is one of two or more time-tranched classes of the same distribution priority, distributions of principal must be made on a *pro rata* basis to all such classes once the credit support is reduced to zero as a result of both actual realized losses and "appraisal reduction amounts."

- Control over the servicing of the assets, whether through approval, consultation or servicer appointment rights, must not be held by investors in a subordinate class of CMBS once the principal balance of that class is reduced to less than 25 percent of its initial principal balance as a result of both actual realized losses and "appraisal reduction amounts."

- A post-securitization property appraisal may not be recognized for any purpose under such agreements if the appraisal was obtained at the demand or request of any person other than the servicer for the related mortgage loan or the trustee.

- The mortgage loan seller must represent that, upon the origination of each mortgage loan, the improvements at each related property were in material compliance with applicable law.

The FRBNY has not previously imposed requirements for the agreements governing non-CMBS ABS TALF asset classes.

CMBS Loan Terms and Conditions

The FRBNY announced that the general terms and conditions of the TALF program will apply to CMBS TALF loans, except as modified by the following:

- Collateral pools are expected to be diversified with respect to loan size, geography, property type, borrower sponsorship and other characteristics; *provided, however,* the FRBNY will consider CMBS backed by nondiversified collateral on a case-by-case basis.

- The FRBNY will hire a collateral monitor and will reserve the right, until the issuance of the CMBS, to exclude specific loans from each pool. In addition, the FRBNY will retain the right to reject any CMBS as TALF loan collateral based upon its risk assessment.

- The agreements must provide for reporting that is sufficient to enable the FRBNY to monitor and evaluate its position as the secured lender.

- The average life of a CMBS will be the remainder of the original weighted average life determined by its issuer employing "industry-standard assumptions." The FRBNY did not provide details as to what is or will be considered "industry-standard assumptions."

- Any principal payment on the CMBS must be used immediately to reduce the principal amount of the TALF loan in proportion to the TALF advance rate.

- A TALF borrower must agree not to exercise or refrain from exercising any voting, consent or waiver rights under a CMBS without the consent of the FRBNY.

- The interest rates and collateral haircuts for the CMBS TALF loans are set forth below under "Collateral Haircuts and Interest Rates Announced by the FRBNY on May 1, 2009."

Subscription Process for CMBS

Although the FRBNY did announce that the initial CMBS subscription date will be in late June, the FRBNY did not release a specific date for the funding. The subscription and settlement cycle for CMBS will occur in the latter part of each month, which is contrary to the loan cycle for non-CMBS ABS TALF asset classes (including the newly added premium finance ABS), which remains at the beginning of each month.

Topics Being Considered by the FRBNY

The FRBNY is in the process of developing the form of issuer/sponsor certification and auditor certification for CMBS TALF loans. Additionally, the FRBNY is considering developing a process to permit interested issuers to reserve prospective funding of TALF loans collateralized by newly issued CMBS. If the FRBNY grants a reservation to an issuer, such recipient would pay a monthly reservation fee equal to a fraction of the amount reserved for every month that the reservation is outstanding until the CMBS is issued.

Insurance Premium Finance ABS

To be TALF eligible, premium finance loans can include loans used to finance premiums for property and casualty insurance but cannot include deferred payment obligations acquired from insurance companies. The issuer of the premium finance loan ABS must acquire ownership of each premium finance loan in its entirety (as opposed to merely a participation or beneficial interest). The premium finance loan securitization must include a back-up servicer obligated to service the loans upon the resignation or termination of the initial servicer. The average life for premium finance ABS cannot be greater than five years. Premium finance ABS issued by a revolving (or master) trust must be issued to refinance existing premium finance ABS maturing in 2009 and must be issued in amounts no greater than the amount of the maturing ABS. Eligible premium finance ABS may also be issued out of an existing or newly established master trust in which all or substantially all of the underlying exposures were originated on or after January 1, 2009.

Five-Year Maturity for Certain TALF Loans

Starting in June 2009, TALF borrowers will have the option of electing loans with either three-year or five-year maturities for the following TALF asset classes, CMBS, student loans, SBA Pool Certificates and SBA Development Company Participation Certificates.

For a five-year TALF loan, the excess of ABS or CMBS interest distributions over the TALF loan interest payable to the FRBNY will be remitted to the TALF borrower only until such excess equals:

- For years one to three of the loan, 25 percent per annum of the haircut amount
- For year four of the loan, 10 percent of the haircut amount
- For year five of the loan, 5 percent of the haircut amount.

The remainder of such excess will be applied to the TALF loan principal amount. Therefore, the FRBNY has in effect increased the haircut for the applicable ABS or CMBS by requiring the TALF borrower to apply excess interest payments to pay down the TALF loan principal amount that would otherwise be paid directly to the TALF borrower.

Collateral Haircuts and Interest Rates Announced by the FRBNY on May 1, 2009

The FRBNY announced that the collateral haircuts for CMBS and premium finance ABS will be as follows:

		ABS EXPECTED LIFE (YEARS)						
Sector	**Subsector**	**0-1**	**>1-2**	**>2-3**	**>3-4**	**>4-5**	**>5-6**	**>6-7**
Premium Finance	Property and casualty	5%	6%	7%	8%	9%		
CMBS	Commercial mortgages	15%	15%	15%	15%	15%	16%	17%

For CMBS with average lives beyond five years, haircuts will increase by one percentage point for each additional year of average life beyond five years; *provided, however,* no CMBS may have an average life beyond 10 years. Therefore, the maximum allowable haircut for CMBS with an average life of 10 years will be 20 percent.

The FRBNY announced that the interest rates for the new five-year TALF loans will be as follows:

Sector	Subsector	Fixed Rate ABS	Floating Rate ABS
CMBS	Commercial mortgages	5-year LIBOR swap rate + 100 BPS	N/A
Small Business	SBA Pool Certificates	N/A	Fed Funds Target + 75 BPS
Small Business	SBA Development Company Participation Certificates	5-year LIBOR swap rate + 100 BPS	N/A
Student Loan	Private	N/A	1-month LIBOR + 100 BPS
Student Loan	Government Guaranteed	N/A	1-month LIBOR + 50 BPS

The FRBNY announced that the interest rates for the new three-year TALF loans will be as follows:

		FIXED RATE ABS (WEIGHTED AVERAGE LIFE IN YEARS)			
Sector	Subsector	<1	1 to <2	≥2	Floating Rate ABS
CMBS	Commercial mortgages	N/A	N/A	3-year LIBOR swap rate + 100 BPS	N/A
Premium Finance	Property and casualty	1-year LIBOR swap rate + 100 BPS	2-year LIBOR swap rate + 100 BPS	3-year LIBOR swap rate + 100 BPS	1-month LIBOR + 100 BPS

For the updated form of the TALF Master Loan and Security Agreement, released by the FRBNY on May 4, 2009, please visit http://www.newyorkfed.org/markets/MLSA.pdf.

To read the revised "Frequently Asked Questions" released by the FRBNY on May 1, 2009, please visit http://www.newyorkfed.org/markets/talf_faq.html.

For the "(CMBS): Terms and Conditions" released by the FRBNY on May 1, 2009, please visit http://www.newyorkfed.org/markets/talf_cmbs_terms.html.

To read the "(CMBS): Frequently Asked Questions" released by the FRBNY on May 1, 2009, please visit http://www.newyorkfed.org/markets/talf_cmbs_faq.html.

For the announcement "How Investors Access the Term Asset-Backed Securities Loan Facility (TALF)" released by the FRBNY on April 28, 2009, please visit http://www.newyorkfed.org/markets/talf_guide.html.

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