



## LSTA Comments on Term Sheet for Term Asset-Backed Securities Loan Facility

### INTRODUCTION

The Loan Syndications and Trading Association<sup>1</sup> ("LSTA") applauds the Federal Reserve's efforts to provide liquidity to U.S. consumers and companies through the inclusion of leveraged loans<sup>2</sup> and CLOs in the Term Asset-Backed Securities Lending Facility ("TALF"). The LSTA also appreciates the opportunity to provide feedback on how the TALF can be refined to most quickly provide financing to companies in need. Our recommendations are informed by the economic considerations specific to CLO transactions. Furthermore, we believe that the CLO market will quickly become a provider of new credit extension to U.S. corporate borrowers if CLOs that are Eligible Collateral for TALF are also attractive to investors in the first-loss and subordinated tranches of CLO securities. Such CLOs must also satisfy NRSRO criteria in order to obtain the requisite ratings for all traditionally rated classes of CLO securities. Our comments below attempt to satisfy both the Federal Reserve's efforts to provide liquidity through CLOs *and* investor and rating agency criteria for new CLOs.

Our letter provides (i) specific recommendations to the definitions of borrower, issuer and credit exposures, (ii) recommended refinements of the definition of "newly issued" assets to facilitate a rapid ramp-up of CLOs (and hence a more rapid deployment of capital to U.S. companies), (iii) historical context on CLO AAA performance and its relevance to haircut schedules, (iv) recommendations on the timeline for TALF loans and (v) other changes that could make the TALF program most effective.

### A. DOMICILE OF ELIGIBLE BORROWERS, ISSUERS OF ELIGIBLE COLLATERAL AND OBLIGORS ON UNDERLYING CREDIT EXPOSURES

The Term Sheet for the Term Asset-Backed Securities Loan Facility ("TALF") provides that each of (i) the eligible borrower under TALF ("Eligible Borrower"), (ii) the issuer of the asset-backed securities ("ABS") that comprise eligible collateral under TALF ("Eligible Collateral") and (iii) the originator of the credit exposures underlying the ABS must be a U.S. company. The Term Sheet defines a U.S. company as a business that is created or organized in the United States or

---

<sup>1</sup> The LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication, and trading of commercial loans. The over 500 members of the LSTA include commercial banks, investment banks, broker-dealers, hedge funds, mutual funds, insurance companies, fund managers, and other institutional lenders, as well as service providers and vendors. The LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, the LSTA has developed standardized practices, procedures, and documentation to enhance market efficiency, transparency, and certainty.

<sup>2</sup> Leveraged loans are simply secured loans to U.S. companies that, if rated by an NRSRO, are rated non-investment grade, or are rated below BBB-/Baa3 by NRSROs. Borrowers in the broadly-syndicated loan market include large, well-known companies (e.g., Cablevision, BJ's Wholesale, Avis, NCR Corporation and YUM! Brands) as well as smaller companies (e.g., Brockway Glass, Aspen Dental and Packers Sanitation Services).

under the laws of the United States that has significant operations in and a majority of its employees based in the United States. As described below, we believe clarification around the domicile of each of these entities is required.

## **Eligible Borrowers**

Eligible Borrowers under TALF should include those persons that were eligible borrowers under the final terms and conditions of the original TALF program implemented in 2010 ("2010 TALF"). Under 2010 TALF, eligible borrowers included, among other persons, a U.S. branch or agency of a non-U.S. bank, a U.S. insured depository institution, a U.S. entity with a non-U.S. parent company and an investment fund that was organized in the U.S. and managed by an investment manager with a principal place of business in the United States. We believe clarifying that a U.S. company includes such persons for purposes of TALF will more accurately reflect the scope and typical organizational structures of investors in the Eligible Collateral who are appropriate Eligible Borrowers. Without such clarification, we believe the number of Eligible Borrowers and the benefits of TALF for the CLO market and the underlying U.S. borrowers would be extremely limited.

## **Issuers of Eligible Collateral**

ABS are typically issued by special purpose vehicles ("SPVs"). SPVs would not satisfy the definition of U.S. company set forth in the Term Sheet, so the Term Sheet should be amended to reflect that an SPV is an eligible issuer of ABS. In addition, in CLO transactions the issuer of the CLO securities is typically an SPV organized in the Cayman Islands, with a co-issuer organized in the United States (commonly organized in Delaware). Unless TALF is expanded to include an SPV organized under non-U.S. law to be an eligible issuer of ABS, the benefits of TALF for the CLO market are likely to be limited. We believe a Cayman Islands SPV should be an eligible issuer of Eligible Collateral comprised of leveraged loans so long as the co-issuer of such CLO securities is an entity organized in the U.S., and the manager or servicer engaged by the issuer to manage or service the underlying exposures is a U.S. entity that is a registered investment adviser, registered with the Securities and Exchange Commission (including any relying adviser to such U.S. entity), with significant operations in, and a majority of its employees (or the related filing adviser's employees, if applicable) based in, the United States.<sup>3</sup> This would be analogous to the Commercial Paper Funding Facility established by the Federal Reserve, which also permits commercial paper issued by a foreign issuer so long as the co-issuer is a U.S. entity that satisfies all the other program terms and conditions.

---

<sup>3</sup> ABS issued in a CLO transaction is typically issued by a Cayman Islands SPV, and co-issued by a Delaware limited liability company. The issuer of ABS in a CLO transaction engages a registered investment adviser (or a relying adviser) to manage or service the portfolio. This is true even in static CLO transactions, as the investment adviser determines whether any credit risk, defaulted or equity securities received in a default should be sold, and acts on behalf of the issuer in reviewing amendments to the underlying credit exposures. In addition, the trustee for CLO transactions, who retains custody of the underlying credit exposures and cash received and makes payments and distributions to the holders of the CLO securities, is also a U.S. entity. The NRSROs that rate CLO securities require that trustees maintain certain ratings and the ability to act as depository for cash in the United States. Moreover, CLO documentation is typically governed by New York law, and thus the rights of the secured parties are enforceable under New York law. In the aggregate, most of the participants in, and activities of, a CLO transaction are based in the United States.

## **Obligors on Underlying Credit Exposures**

CLOs, unlike other ABS, do not have an originator or depositor. Instead, the underlying credit exposures for CLOs (i.e., leveraged loans) are primarily acquired in the primary and secondary markets from third parties. Therefore, we believe the requirement that the originator of the underlying exposures must be a U.S. company needs to be clarified with respect to CLO transactions to require that the obligor or issuer of the underlying credit exposure must be Domiciled<sup>4</sup> in the United States. This clarification would fulfill the underlying purpose of TALF to increase liquidity for U.S. corporate borrowers, and still reflect the strict requirements and terminology deployed by NRSROs in rating CLO transactions.

## **B. UNDERLYING CREDIT EXPOSURES**

### **Newly Issued Underlying Credit Exposures**

Under TALF, all or substantially all of the underlying credit exposures must be newly issued, but no framework has yet been provided for what constitutes "newly issued." The terms and conditions for 2010 TALF indicate that the Federal Reserve has previously been willing to consider a "look-back" period for what constitutes "newly issued." We would request

---

<sup>4</sup> "Domicile" is a term of art in CLO documentation, and any changes to the term are subject to published NRSRO criteria. The term Domicile is typically defined as set forth below, and certain other conditions in the CLO documentation specify where the obligor of an underlying exposure may be Domiciled. In order for a CLO to qualify as Eligible Collateral, we would expect the CLO documentation to specify that the obligors of all or substantially all of the underlying exposures are Domiciled in the United States. As noted in the definition below, this would include circumstances where the issuer or obligor of the underlying exposure was organized outside the United States so long as either a substantial portion of its operations are located or derived in the United States, or if its payment obligations are guaranteed by a person organized in the United States.

"Domicile" or "Domiciled": With respect to any issuer of, or Obligor with respect to, a Collateral Obligation:

- (a) except as provided in clause (b) or clause (c) below, its country of organization;
- (b) if it is organized in a Tax Jurisdiction, each of such jurisdiction and the country in which, in the Collateral Manager's good faith estimate, a substantial portion of its operations are located or from which a substantial portion of its revenue is derived, in each case directly or through subsidiaries (which shall be any jurisdiction and country known at the time of designation by the Collateral Manager to be the source of the majority of revenues, if any, of such issuer or Obligor); or
- (c) if its payment obligations in respect of such Collateral Obligation are guaranteed by a Person that is organized in the United States, then the United States; *provided* that, such guarantee satisfies the Domicile Guarantee Criteria.

"Domicile Guarantee Criteria": The following criteria: (i) the guarantee is one of payment and not of collection; (ii) the guarantee provides that the guarantor agrees to pay the guaranteed obligations on the date due and waives demand, notice and marshalling of assets; (iii) the guarantee provides that the guarantor's right to terminate or amend the guarantee is appropriately restricted; (iv) the guarantee is unconditional, irrespective of value, genuineness, validity, or enforceability of the guaranteed obligations; (v) the guarantee provides that the guarantor waives any other circumstance or condition that would normally release a guarantor from its obligations; (vi) the guarantor also waives the right of set-off and counterclaim; and (vii) the guarantee provides that it reinstates if any guaranteed payment made by the primary Obligor is recaptured as a result of the primary Obligor's bankruptcy or insolvency.

clarifications around this requirement for underlying credit exposures in CLO transactions, including some form of look-back and explicit substantiation on what "substantially all" means, as we believe it will be necessary to include loans previously issued in order to satisfy NRSRO and investor concerns about portfolio diversity.<sup>5</sup> In addition, such inclusion will speed the formation of adequate subordinated capital required to underpin Eligible Collateral under TALF. Specifically:

- Include as "newly issued" all leveraged loans issued in 2020 (or since the date specified under the TALF generally, if such date is before 2020).
- Include as "newly issued" all leveraged loans to which an ABS issuer acquires exposure pursuant to existing warehouse, credit or lending facilities, whether such leveraged loans are acquired in the primary or secondary market or as part of a balance sheet transaction, so long as such warehouse, credit or lending facilities were in place on or prior to April 9, 2020.<sup>6</sup>
- Include as "newly issued" any leveraged loans subject to a material modification or an upsize, or the term-out of a revolving facility, in each case that is documented in an amendment or a new credit agreement or evidenced by a new CUSIP or other loan identifier, including, but not limited to, refinancings, re-pricings, resets and other material modifications (including maturity amendments).
- Clarify that "substantially all" with respect to "newly issued" means 75% of the portfolio of leveraged loans, by par amount.<sup>7</sup>

## Static CLOs

While we understand and generally agree with the Treasury's decision to prohibit loan substitution for CLOs that are included as Eligible Collateral, we would request clarification around the meaning of "static." Specifically, we believe it is in the best interests of investors in CLO

---

<sup>5</sup> A typical CLO transaction will include underlying credit exposures of anywhere from 150 to 300 different obligors. In order to achieve the highest rating from an NRSRO, CLO transactions are required to diversify across industries (e.g., no more than 10% of the portfolio may be concentrated in one industry) and obligors (e.g., no more than 1.5% to 2% of the portfolio may be comprised of credit exposures issued by a single obligor). In order for a CLO transaction to satisfy the NRSRO criteria on diversification required to achieve the highest rating, it would take a number of months to acquire a sufficiently diverse portfolio comprised of only newly issued loans. For example, in times of normal liquidity, a typical CLO will warehouse and season assets for at least three to six months, and a significant amount of the assets acquired after the CLO transaction prices will be acquired in the secondary market to ensure that the CLO has sufficient underlying exposures that satisfy NRSRO criteria and investor requirements by the time the CLO securities are issued. In times of limited liquidity, ramping a diverse portfolio will take even longer, particularly as arranger banks who provide lending facilities to allow CLOs to "warehouse" assets are already at or near capacity on their existing warehouse lines.

<sup>6</sup> In order for lending banks to have capacity to warehouse assets for CLOs with leveraged loans originated after April 2020 – the intent of TALF – the existing backlog of warehouse facilities will need to be cleared or banks may not be able to obtain the credit approvals necessary to open new lines of financing.

<sup>7</sup> As noted above, even if a significant amount of the portfolio of leveraged loans is comprised of newly issued loans, after pricing of the CLO transaction it will be necessary to acquire loans in the secondary market to finish the ramp-up process in a timely manner before the CLO transaction closes.

transactions, and the TALF itself, for CLO managers to have the ability to sell credit risk assets<sup>8</sup> and defaulted assets, as such latitude would allow for both the faster amortization of the AAA-rated CLO securities that constitute Eligible Collateral under TALF and the management of credit risk that may be detrimental to the performance of CLOs and, ultimately, the TALF. In addition, in certain circumstances, the CLO will need the ability to sell equity or other securities it receives in a workout; there can be negative tax and other regulatory implications for CLOs holding such assets. Finally, we believe it does not impair the static nature of the transaction, and does in fact support the intent of TALF in creating liquidity for U.S. borrowers, to permit the CLO to vote on amendments to the underlying credit exposures, including amendments to extend the stated maturity of underlying credit exposures.

## C. PAYMENT TERMS AND HAIRCUT ON ELIGIBLE COLLATERAL

### Payment Frequency under TALF

Although the Term Sheet is silent on when payments are required to be made under TALF, we have noted that the terms and conditions of 2010 TALF required payments to be made under the facility on a monthly basis. Under CLO transactions, unlike other ABS, all payments are made quarterly.<sup>9</sup> We believe a mismatch in timing between payments on the CLO securities and payments made under TALF will discourage investors in CLO AAA-rated securities from utilizing TALF, as they would need to manage that mismatch, and such solutions may add an additional layer of complexity and expense. We would request that the payment tenor for CLOs under TALF be quarterly, not monthly.

### Haircut on Eligible Collateral

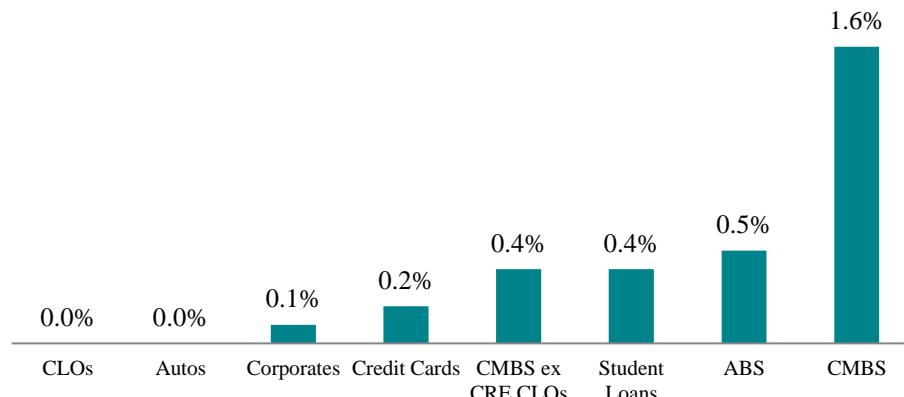
The TALF Term Sheet includes a haircut schedule for all asset classes, ranging from 5% on Prime credit cards, equipment leases, property and casualty, and SBA loans to 15% for commercial mortgages and 20% for leveraged loans in CLOs. Assuming that haircuts are intended to reflect the risk inherent in the AAA tranches of the applicable asset classes, haircutting CLO AAAs at 20% is out of line with historical and projected performance. No CLO AAA has ever defaulted and, consequently, the 10-year AAA impairment rate on CLOs is at the low end of all asset classes (Figure 1). It is difficult to reconcile this performance with by far the largest haircut. Therefore, we believe the haircut for ABS secured by leveraged loans should be reduced to a level commensurate with the level of risk of such ABS assets.

---

<sup>8</sup> Under CLO documentation, a credit risk asset is typically defined as an asset that has a risk of declining in credit quality or price, as determined by the manager or servicer of the CLO transaction. This determination may, but is typically not required to, be based on certain objective factors, including but not limited to a decrease in the price or market value of such loan, a downgrade of the rating on such loan, an increase in the spread over the reference rate paid with respect to such loan or the issuer or obligor of such loan showing worse financial results since the published financial reports first produced after the loan was acquired by the ABS issuer.

<sup>9</sup> Payments on CLO securities are made quarterly, largely because leveraged loans have historically paid quarterly. We do not believe the CLO market would be willing to change to monthly pay for a variety of reasons, including the mismatch in payment between liabilities and assets, and the additional expense and reporting required to make payments more frequently than quarterly.

**Figure 1: AAA 10-year Impairment Rates on Securitizations (1993-2016)**



Source: Wells Fargo, Moody's Investor Service

## D. TENOR AND TIMING OF TALF; MISCELLANEOUS

### Tenor and Timing of TALF

As noted above, it can take anywhere from three to six months (or longer) to acquire a portfolio of leveraged loans that satisfy NRSRO and investor criteria, particularly on diversification, for a CLO transaction.<sup>10</sup> Therefore, unless the termination end-date of TALF is extended through the end of 2020, we believe the indirect extension of credit to U.S. companies through TALF and CLOs would be extremely limited. In addition, although the Term Sheet is silent on this point, we have noted that 2010 TALF prohibited most redemption features. Optional redemption at the direction of the most subordinated class of CLO securities which has a residual interest in the transaction ("CLO equity") is a traditional feature in CLO transactions, and we believe TALF would not be utilized by the CLO market if optional redemption features were prohibited because it would make marketing and selling the CLO equity difficult if not impossible.<sup>11</sup> In accordance with NRSRO criteria and typical CLO market practice, such redemption could not be effected unless the rated CLO securities, including for the avoidance of doubt, CLO securities constituting Eligible Collateral under TALF, would be repaid at an amount equal to the sum of their face (or par) amount plus accrued and unpaid interest.

<sup>10</sup> This three to six month period is commonly referred to as the warehousing period, and occurs prior to the issuance of the CLO securities. During this period, the acquisition of leveraged loans is financed pursuant to a warehouse, credit or other lending facility. Because the ABS is only issued at the end of this period, the CLO market will not be able to take advantage of TALF financing until a certain threshold of leveraged loans is warehoused. However, such warehouse facilities are extended to borrowers based on the confidence that CLO ABS will be able to be issued, which is why it is important for TALF to be available through the end of 2020 to encourage the issuance of new loans to U.S. corporate borrowers.

<sup>11</sup> In a typical CLO transaction, CLO equity has the option to direct the redemption of the rated CLO securities on any date one or two years after the closing date of the CLO transaction (or prior to the end of such non-call period following the occurrence of certain tax events). However, in order to effect such a redemption, the CLO must have sufficient proceeds to repay the CLO securities at par plus any accrued and unpaid interest.

## **Other Concerns**

The Term Sheet requires that the ABS constituting Eligible Collateral receive ratings in the highest rating category from two NRSROs. We would request that the terms and conditions specify (1) that such rating requirement is satisfied on the date on which Eligible Collateral is first pledged to the TALF (and remains deemed satisfied if any such rating on the Eligible Collateral is later withdrawn or downgraded) and (2) which, among the various NRSROs regulated by the Securities and Exchange Commission, are specifically qualified to provide ratings for CLO transactions.<sup>12</sup> In addition, we believe that obtaining ratings from two NRSROs places an undue burden on the CLO, as static CLOs typically only obtain ratings from one NRSRO. The additional expense may make marketing and selling first-loss and subordinated tranches of CLO securities, particularly the CLO equity, difficult as those tranches of CLO securities would bear the expense of an additional rating for little substantive benefit.

Under 2010 TALF, certain certifications were required from both the issuer of the ABS and the sponsor of the ABS. Unlike other ABS, CLO transactions do not include a party comparable to a "sponsor." Therefore, we believe that any certifications and/or indemnities required under TALF in respect of a CLO should be provided by the issuer of the CLO as is customary under normal market conditions.

## **CONCLUSION**

In conclusion, we applaud the Federal Reserve's TALF proposals that, with some clarifications, could facilitate the provision of significant liquidity to thousands of corporate borrowers (and their millions of employees) that rely on CLOs to provide the ultimate funding for their loans. We thank you for your consideration of our comments and concerns and stand ready to provide any additional information you believe might be useful. Please feel free to contact me at (212) 880-3002 if you have any questions regarding this letter.

Sincerely,



Lee M. Shaiman  
Executive Director

---

<sup>12</sup> CLOs typically are rated by Moody's, Standard & Poor's and Fitch.