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## TALF 2020: Summary of MLSA and Revised Frequently Asked Questions

On May 20, 2020, the Federal Reserve Bank of New York (the Fed) released the Master Loan and Security Agreement (MLSA) and further revised the Frequently Asked Questions (FAQs) in connection with the 2020 Term Asset-Backed Securities Loan Facility (TALF) program. The Fed also announced that the first subscription date for loans backed by eligible asset-backed securities (ABS) would be June 17, 2020, and the first loan closing date would be June 25, 2020.

Below is a high-level summary of the new information to come out of the MLSA and updated FAQs. For information regarding the current Term Sheet and earlier reports on the 2020 TALF program, please see our previous alerts [here](#) and [here](#). Capitalized terms not otherwise defined in this Alert have the same meaning as in the MLSA.

### Loan Subscriptions, Conditions and Closing

The Fed announced it would provide two loan subscription dates per month that will be open to all eligible asset classes. On each TALF loan subscription date, the TALF Agent will submit a loan request on behalf of an eligible borrower and on each settlement date, the TALF Agent will deliver (a) the Eligible ABS Collateral, (ii) the administrative fee, and (iii) the applicable margin to the TALF special purpose vehicle's (SPV) settlement account at the TALF custodian.

There will not be a limit on how many loans an eligible borrower may request, and borrowers may request loans through multiple TALF Agents.

#### A. Delivery Requirements.

**Section 3.2** of the MLSA sets forth the document delivery requirements in connection with each loan subscription date. TALF Agents, on behalf of eligible borrowers, must submit the following along with each loan request: the preliminary and/or final prospectus, offering memorandum or other offering materials with respect to the Collateral for the requested loans. Further,

- For Expected ABS Collateral issued on or after March 23, 2020 and before May 22, 2020:

No later than 3:00 p.m. on June 30, 2020, TALF Agents must deliver:

(1) Either:

- (a) AUP Report (TALF) and, if available AUP Report (Industry) with respect thereto in the case of CLO Collateral; or

(b) Auditor Attestation with respect thereto in the case of all such Expected ABS Collateral other than CLO Collateral; and

(2) an Indemnity Undertaking.

- For Expected ABS Collateral issued on or after May 22, 2020:

No later than 5:00 p.m. on the related Business Day the related Form ABS-15G was filed, TALF Agents must deliver:

(1) Either:

(a) AUP Report (TALF) and, if available, AUP Report (Industry) with respect thereto in the case of CLO Collateral, or

(b) Auditor Attestation with respect thereto in the case of all such Expected ABS Collateral other than CLO Collateral; and

(2) an Indemnity Undertaking.

#### B. Certain Loan Conditions.

**Section 3.7** of the MLSA sets forth the conditions for the TALF loans. Material updates include:

- **Section 3.7(b):** The minimum principal amount of each loan under the 2020 TALF program is \$5,000,000.
- **Section 3.7(e):** For two-year OIS Loans: the Eligible Collateral must:
  - Not consist of CLO Collateral, Development Company Certificates or SBA Pool Certificates, and
  - Have an average life of less than two years.
- **Section 3.7(f):** For three-year OIS Loans: the Eligible Collateral must:
  - Not consist of CLO Collateral or SBA Pool Certificates,
  - Consist of Development Company Participation Certificates or have an average life of two years or greater.
- **Section 3.7(g):** For 30-day SOFR Loans: the Eligible Collateral must consist solely of CLO Collateral
- **Section 3.8(h):** For Floating Rate Fed Funds Loans: the Eligible Collateral must consist solely of SBA Pool Certificates.

#### C. Credit Hedging.

**Section 10.1** of the MLSA provides the representation and warranties to be made in connection with the TALF loans. One important update in the 2020 TALF MLSA is included in **Section 10.1(e)(vii)(6)**, which prohibits credit hedging in relation to the Collateral prior to and after the applicable loan closing date. Borrowers must be sure to unwind any related hedging transaction in connection with pledging Collateral to the TALF lender.

#### **1940 Act Legal Considerations for Investment Funds**

With the specific details of TALF being released by the Fed, the program, as expected, will be substantially similar to the previous TALF program that was conducted in 2009 (TALF 2009). It should be noted that one major change to the

MLSA was the removal of the term “investment fund” throughout the document, as such investment funds wishing to participate in the program will have to rely, at least for the current time, on the guidance provided in the FAQs.<sup>1</sup>

It can be expected that registered investment companies wishing to participate in TALF should consider the following Investment Company Act of 1940, as amended (the 1940 Act) considerations. In connection with TALF 2009, some fund groups sought no-action relief from the SEC in relation to Section 17 and Section 18 issues.<sup>2</sup> It should be noted that the below should not be considered an exhaustive list of 1940 Act issues for consideration:

A. Section 17 of the 1940 Act.

TALF 2009 raised concerns for funds under Rule 17f-1 under the 1940 Act due to the primary dealers holding fund assets outside of the requirements of Rule 17f-1. The sections relevant to primary dealers referred to in the MLSA as “TALF Agents,” have not materially changed in the current TALF. Similar to TALF 2009, TALF will depend upon primary dealers that have been selected by the Fed. Additionally, the primary dealer will have limited access to fund assets and will hold the assets for a period of time between when the fund sends over the assets and when the assets are deposited by the primary dealer with the TALF custodian.

Previous No-Action Letters (NALs) provided guidance on this issue in relation to TALF 2009. In the NALs, the SEC determined that this arrangement was permissible as it did not raise the safekeeping concerns underlying the rule or Section 17(f) generally. That said, funds are expected to review each TALF Agent and determine which would best suit the needs of the fund.

Under TALF 2009, one fund complex received no-action relief under Sections 17(a) and 17(d) of the 1940 Act and Rule 17d-1 thereunder to permit registered funds to participate by investing in one or more affiliated private funds that would

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participate in TALF (i.e., in order to reach the minimum borrowing limit of \$10 million). The relief was limited to that fund complex. TALF 2020 lowered the minimum borrowing limit to \$5 million, which should provide some relief for funds that want to participate. It is unclear whether the SEC staff would entertain similar industry-wide relief under the current program.

#### B. Section 18 of the 1940 Act.

Section 18 of the 1940 Act restricts the ability of registered closed-end and open-end funds to issue or sell any class of "senior security." The issues that a fund or client may face if participating in TALF include:

(1) Section 18(a)(1) of the 1940 Act prohibits any registered closed-end fund from issuing any class of senior security or selling any senior security of which it is the issuer, that represents an indebtedness, unless (among other things) immediately after such issuance or sale the fund will have asset coverage of at least 300%.

(2) Section 18(c) of the 1940 Act, with certain exceptions, prohibits any registered closed-end fund from issuing any senior security representing indebtedness if immediately thereafter such fund would have outstanding more than one class of senior security representing indebtedness.

(3) Section 18(f)(1) of the 1940 Act prohibits any registered open-end fund from issuing any class of senior security or selling any class of senior security of which it is the issuer, except that the fund may borrow from any bank, provided that immediately after any such borrowing there is asset coverage of at least 300% for all of the borrowings of the fund.

It should be noted that in 2009, each of these concerns was resolved by the NALs which allowed funds to treat the TALF loan in a similar manner to reverse repurchase agreements as outlined by SEC Release 10666.<sup>3</sup> Certain processes must be followed in connection with the SEC Release.

#### C. Liquidity Risk Management and Rule 22e-4.

Rule 22e-4 (the Liquidity Rule) prohibits an open-end fund from acquiring any illiquid investment if, immediately after the acquisition, the fund would have invested more than 15% of its net assets in illiquid investments.

An illiquid asset is any asset that may not be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value at which the fund carries the asset on its books. Although closed-end funds are not subject to this limitation, some closed-end funds have a non-fundamental investment policy to limit its investments in illiquid securities to 15% of its total assets.

While this remains at issue for TALF, it should be noted that back in 2009, the SEC stated that they were not in a position to provide no-action relief on any potential liquidity issues under the 1940 Act.

#### Other Areas of Note for Investment Funds

The updated FAQs and MLSA did not provide clarification to all issues surrounding an investment fund's participation in TALF. Primarily, the FAQs and MLSA do not address whether additional disclosure of the investment fund's participation in TALF will be required in the investment fund's offering documents or registration statements. Additionally, the Fed will publicly disclose who is participating in TALF, and to the extent that is an area of concern for individual investment funds, it should be discussed prior to participating in the program.

As previously mentioned, the MLSA also requires additional representations and warranties for eligible borrowers, which includes investment funds participating in the program. Newly added **Section 10.1(e)(v)** requires that at the time any loan is made to such eligible borrower that it has disclosed to its TALF Agent each "Material Investor" in, and "Control Person" of, such eligible borrower. Thereafter the eligible borrower must notify its TALF Agent of any change to its Material Investors.<sup>4</sup> This will require investment funds to monitor the ownership of its securities, and the revised FAQs and MLSA do not address the consequences, if any, of changes to an investment funds Material Investors;

although if the Material Investor is a foreign government, the borrower will no longer be considered eligible.

Additionally, the revised FAQs and MLSA do not specifically address whether a fund would be able to participate indirectly in TALF via an offshore vehicle, *e.g.*, through a Cayman Islands subsidiary or master fund.

We will continue to monitor for additional guidance from the Fed and keep you informed of any subsequent changes to the TALF term sheet, FAQs and MLSA.

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<sup>1</sup> For more information about the requirements for investment funds to participate in the program *see*, *TALF 2020: Summary of Frequently Asked Questions and Revised Term Sheet*, May 15, 2020, Stradley Ronon, available at: <https://www.stradley.com/insights/publications/2020/05/client-alert-talf-may-15-2020>.

<sup>2</sup> *See e.g.*, SEC No-Action Letter, Franklin Templeton Investments “Investment Company Act of 1940 – Sections 18(a)(1), 18(c) and 18(f)(1)” (June 19, 2009), available at: <https://www.sec.gov/divisions/investment/noaction/2009/franklintempleton061909.htm>.

<sup>3</sup> SEC Release No. 10666, Apr. 18, 1979, available at <https://www.sec.gov/divisions/investment/imseniorsecurities/ic-10666.pdf>.

<sup>4</sup> For the purpose of the MLSA, “Control Person” and “Material Investor” are defined as:

**Control Person** means any Person with Control over the Borrower’s general business and also includes, with respect to a Borrower’s participation in TALF, any Person that has the direct or indirect power to direct or manage, or cause the direction or management of, Borrower’s participation in TALF.

**Material Investor** means a Person who owns, directly or indirectly, an interest in any class of securities of a Borrower that is greater than or equal to a 10% interest in such outstanding class of securities.