

Interpretation of the Statutory Accounting Principles Working Group

INT 20-06: Participation in the 2020 TALF Program

INT 20-06 Dates Discussed

Email Vote to Expose May 5, 2020; May 20, 2020

INT 20-06 References

SSAP No. 64—Offsetting and Netting of Liabilities

SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

INT 01-31: Assets Pledged as Collateral

INT 20-06 Issue

1. The Federal Reserve reestablished the Term Asset-Backed Securities Loan Facility (TALF) on March 23, 2020, to support the flow of credit to consumers and businesses. The TALF program will enable the issuance of asset-backed securities (ABS) backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA), and certain other assets.
2. Under the TALF program, the Federal Reserve will lend on a non-recourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans. The Federal Reserve will lend an amount equal to the market value of the ABS less a haircut and will be secured at all times by the ABS. Treasury, using the Exchange Stabilization Fund (ESF), will also make an equity investment in the special purpose vehicle (SPV) established by the Federal Reserve for this facility.
3. The TALF is established by the Federal Reserve under the authority of Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary.
4. Per review of public data available from the prior 2009 TALF program, there were a limited number of insurance reporting entities that were the actual borrower (entity that directly received the loan) under the TALF program. Rather, in most instances, insurance reporting entities were a material investor to the actual borrower. Per the TALF data, a material investor reflects the entity or individual with 10 percent or greater beneficial ownership interest in any class of securities of a borrower. Such ownership interest may be a direct, intermediate or ultimate interest. Due to the different methods of participating in the TALF program, this interpretation focuses on both reporting entity borrowers and reporting entity investors.
5. For reporting entity borrowers (entity that directly received the loan), the accounting issues addressed in this interpretation include:
 - a. How the loan received, and collateral provided shall be reported within the statutory financial statements.
 - b. Whether the pledged assets shall be reported as admitted assets as the collateral pledged to the TALF program is not permitted to be substituted.
6. For reporting entities that are not the direct borrowers, but represent investors to the direct borrower, the accounting issues addressed in this interpretation include:
 - a. How the reporting entity shall report their investment to a TALF borrower.

- b. Whether the reporting entity investor is permitted to pledge assets under the TALF program, and retain admittance, when the reporting entity is not the direct borrower under the TALF program.

7. The April 9, 2020 term sheet for the 2020 TALF program:

<https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a1.pdf>

Term Asset-Backed Securities Loan Facility

Effective April 9, 2020

(The Board of Governors of the Federal Reserve System (“Board”) and Secretary of the Treasury may make adjustments to the terms and conditions described in this term sheet. Any changes will be announced on the Board’s website.)

Facility:

The TALF is a credit facility authorized under section 13(3) of the Federal Reserve Act intended to help meet the credit needs of consumers and businesses by facilitating the issuance of asset-backed securities (“ABS”) and improving the market conditions for ABS more generally.

The TALF will serve as a funding backstop to facilitate the issuance of eligible ABS on or after March 23, 2020. Under the TALF, the Federal Reserve Bank of New York (“Reserve Bank”) will commit to lend to a special purpose vehicle (“SPV”) on a recourse basis. The Department of the Treasury will make an equity investment of \$10 billion in the SPV, as described below.

The TALF SPV initially will make up to \$100 billion of loans available. The loans will have a term of three years; will be nonrecourse to the borrower; and will be fully secured by eligible ABS.

Eligible Borrowers:

All U.S. companies that own eligible collateral and maintain an account relationship with a primary dealer are eligible to borrow under the TALF. For the purpose of this document, a U.S. company is defined as a business that is created or organized in the United States or under the laws of the United States and that has significant operations in and a majority of its employees based in the United States.

Eligible Collateral:

Eligible collateral includes U.S. dollar denominated cash (that is, not synthetic) ABS that have a credit rating in the highest long-term or, in the case of non-mortgage backed ABS, the highest short-term investment-grade rating category from at least two eligible nationally recognized statistical rating organizations (“NRSROs”) and do not have a credit rating below the highest investment-grade rating category from an eligible NRSRO. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a U.S. company, and the issuer of eligible collateral must be a U.S. company. With the exception of commercial mortgage-backed securities (“CMBS”), eligible ABS must be issued on or after March 23, 2020. CMBS issued on or after March 23, 2020, will not be eligible. For CMBS, the underlying credit exposures must be to real property located in the United States or one of its territories. Eligible collateral must be ABS where the underlying credit exposures are one of the following:

- 1) Auto loans and leases;
- 2) Student loans;
- 3) Credit card receivables (both consumer and corporate);
- 4) Equipment loans and leases;
- 5) Floorplan loans;
- 6) Insurance premium finance loans;
- 7) Certain small business loans that are guaranteed by the Small Business Administration;
- 8) Leveraged loans; or
- 9) Commercial mortgages.

Eligible collateral will not include ABS that bear interest payments that step up or step down to predetermined levels on specific dates. In addition, the underlying credit exposures of eligible collateral must not include exposures that are themselves cash ABS or synthetic ABS.

To be eligible collateral, all or substantially all of the underlying credit exposures must be newly issued, except for legacy CMBS.

The feasibility of adding other asset classes to the facility or expanding the scope of existing asset classes will be considered in the future.

Conflicts of interest: Eligible borrowers and issuers of eligible collateral will be subject to the conflicts of interest requirements of section 4019 of the CARES Act.

Restriction on single-asset single-borrower (“SASB”) CMBS and commercial real estate collateralized loan obligations (“CRE CLOs”): SASB CMBS and CRE CLOs will not be eligible collateral.

Restrictions on CLO loan substitution: Only static CLOs will be eligible collateral.

Collateral Valuation: Haircut schedule is below. The haircut schedule is consistent with the haircut scheduled used for the TALF established in 2008.

Pricing: For CLOs, the interest rate will be 150 basis points over the 30-day average secured overnight financing rate (“SOFR”). For SBA Pool Certificates (7(a) loans), the interest rate will be the top of the federal funds target range plus 75 basis points. For SBA Development Company Participation Certificates (504 loans), the interest rate will be 75 basis points over the 3-year fed funds overnight index swap (“OIS”) rate. For all other eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 125 basis points over the 2-year OIS rate for securities with a weighted average life less than two years, or 125 basis points over the 3-year OIS rate for securities with a weighted average life of two years or greater. The pricing for other eligible ABS will be set forth in the detailed terms and conditions. Fees: The SPV will assess an administrative fee equal to 10 basis points of the loan amount on the settlement date for collateral.

Maturity: Each loan provided under this facility will have a maturity of three years.

Investment by the Department of the Treasury: The Department of the Treasury, using the Exchange Stabilization Fund, will make an equity investment of \$10 billion in the SPV.

Non-Recourse: Loans made under the TALF are made without recourse to the borrower, provided the requirements of the TALF are met.

Prepayment: Loans made under the TALF will be pre-payable in whole or in part at the option of the borrower, **but substitution of collateral during the term of the loan generally will not be allowed.**

Program Termination: No new credit extensions will be made after September 30, 2020, unless the TALF is extended by the Board of Governors of the Federal Reserve System and the Department of the Treasury.

Other Terms and Conditions: More detailed terms and conditions will be provided at a later date, primarily based off of the terms and conditions used for the 2008 TALF. In addition, the Federal Reserve reserves the right to review and make adjustments to these terms and conditions – including size of program, pricing, loan maturity, collateral haircuts, and asset and borrower eligibility requirements – consistent with the policy objectives of the TALF.

INT 20-06 Discussion

For Reporting Entity Borrowers - Insurance Reporting Entity Received the Loan

8. Reporting entity borrowers shall report the cash received under the TALF program with a corresponding liability. The liability shall be captured in scope of *SSAP No. 15—Debt and Holding Company Obligations* and reported as “borrowed money.” The disclosures in *SSAP No. 15* shall be completed. Once the cash received has been reinvested, the reporting entity shall report the acquired asset in accordance with the applicable statement of statutory accounting principle.

9. Reporting entity borrowers shall report asset-backed securities pledged to the TALF program as restricted assets with the appropriate code in the investment schedules and disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*, and in General Interrogatory, Part 1: 25.30 – Pledged as Collateral. Assets pledged to the TALF program are subject to the underlying asset risk-based capital charge but are excluded from an additional “restricted asset” risk-based capital charge. (As a carryover from the 2009 TALF Program, existing provisions in the risk-based capital instructions instruct the removal of assets pledged to the TALF program reported as restricted assets in the General Interrogatories.)

10. Reporting entity borrowers are permitted to continue reporting pledged asset-backed securities as admitted assets in the statutory financial statements if the following two conditions are met:

- a. Asset qualified as an admitted asset before it was pledged to the TALF program.
- b. The reporting entity has not committed an uncured contract default.

11. As the TALF program specifically identifies that substitution of pledged collateral during the term of the loan will generally not be allowed, this interpretation provides an exception to existing statutory accounting requirements. Pursuant to *INT 01-31: Assets Pledged as Collateral*, a pledged asset shall be readily substitutable in order to be admitted in the statutory financial statements. With the exception in this interpretation, assets held by the insurance reporting entity (borrower) that are pledged to the TALF program can be admitted even though they are not generally substitutable.

12. Reporting entity borrowers shall not net the obligation to return the liability and the pledged collateral in the statutory financial statements. The criteria for a valid right of offset in *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* has not been met for these transactions. Specifically, the reporting entity does not have the right to offset the amount owed under the TALF program and the reporting entity does not intend to setoff the amount owed. Although the collateral pledged could be claimed under the TALF program in the event that the insurer reporting entity commits a loan repayment default, the ability to claim pledged collateral does not represent a “right of setoff” with the counterparty.

13. Although the transaction is similar to a repurchase agreement accounted for as a secured borrowing, the TALF transaction is not a repurchase transaction. As such, the provisions and disclosures for repurchase agreements are not applicable.

14. In the event that a reporting entity commits a contract default, and the pledged collateral is retained under the TALF program, the reporting entity shall follow the guidance in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, paragraph 20, in removing the pledged assets and liability from the statutory financial statements.

For Reporting Entity Investors - Insurance Reporting Entity Does Not Receive the Loan but is an “Investor” to an Entity that was the Direct TALF Borrower

15. Reporting entity investors shall report the investment in the borrower in accordance with the underlying nature of the investment and the relationship with the borrower. The underlying investments will be subject to the reporting and RBC requirements for the applicable SSAP and reporting schedule:

- a. If the borrower is a limited liability company (LLC), the investment shall be reported in accordance with *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.
- b. If the borrower is a private equity fund (e.g., joint venture), the investment shall be reported in accordance with *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

- c. If the borrower is an affiliate, the investment shall be reported in accordance with *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

16. Reporting entity investors are not permitted to admit assets pledged to the TALF program if they are not the direct borrower. This is because the return of the assets would be contingent on the action of the actual borrower to the TALF program and not the reporting entity. This provision is consistent with *SSAP No. 4—Assets and Nonadmitted Assets*, footnote 2:

If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to *SSAP No. 4*, paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

INT 20-06 Consensus

17. The Working Group reached a consensus to prescribe statutory accounting guidance for insurance reporting entity involvement in the 2020 TALF Program. Pursuant to this consensus:

- a. Reporting entities borrowers who directly receive the TALF loan shall follow guidance in paragraphs 8-14 of this interpretation for the statutory accounting and reporting. As detailed in paragraph 11, this interpretation provides an exception to allow admitted asset reporting for the pledged securities although the TALF program does not permit the pledged assets to be generally substitutable.
- b. Reporting entities that do not directly receive the TALF loan, but are investors to borrowers that receive the TALF loan, shall follow the provisions in paragraphs 15-16 for the statutory accounting and reporting.

18. The provisions detailed in this interpretation are applicable for the duration of the 2020 TALF loan program.

INT 20-06 Status

19. No further discussion planned.

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