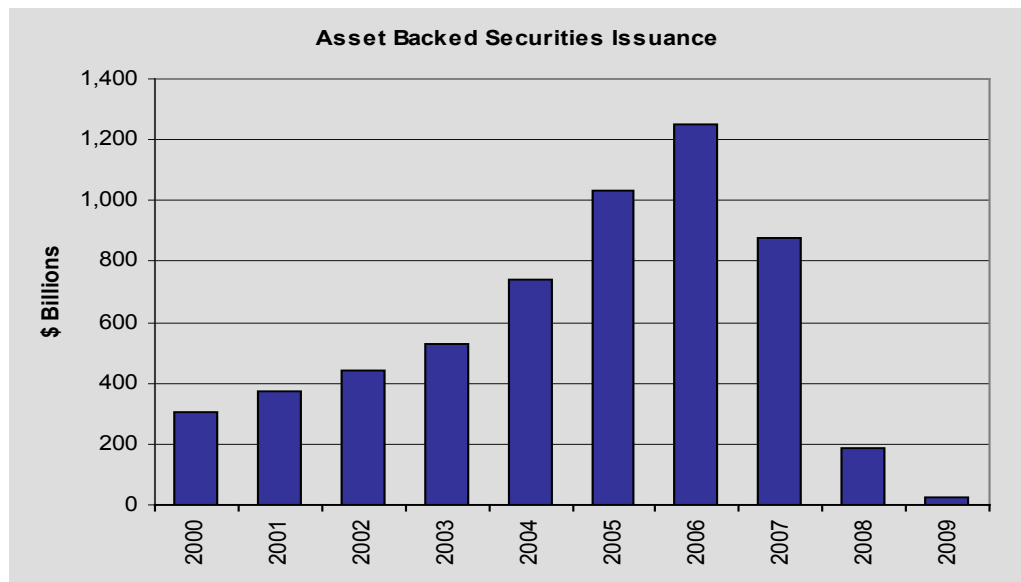




Term Asset-Backed Securities Loan Facility

Background

The global financial crisis has manifested itself in the fixed income markets with historically high levels of volatility and credit spreads, and the freezing of lending to US consumers and corporations. Not only has lending stalled since mid 2007, the asset securitization market, which had reached over \$1.2 trillion dollars in new issuances during 2006, has all but disappeared since 2007. The securitization market, often considered the “shadow banking system,” had helped fuel a large portion of the growth in consumer and commercial lending in the US. The frozen credit market has caused the government to acknowledge and recognize the importance of aggressively jump starting consumer lending as a way to avoid a drawn out domestic recession.



The chart includes issuances backed by credit card receivables, auto loans, student loans, etc. It does not include residential or commercial mortgage-backed securities. 2009 is YTD through mid-April.

With this in mind, the US Federal Reserve and the Department of the Treasury have actively sought to address and to attempt to increase activity in consumer credit. To this end during the first quarter of 2009, the government announced the Term Asset-Backed Securities Loan Facility (TALF) program. TALF represents between \$200 million and \$1 trillion in financing committed by the US government. These funds will be provided in the form of relatively low cost loans made by the Fed directly to investors who will use the loans to purchase newly issued AAA-rated securities backed by Fed-approved assets. In effect, the Fed and the Treasury are providing relatively inexpensive loans to investors who will then purchase newly issued asset backed securities (ABS) that are not subject to any mark-to-market requirements.

When the government first announced TALF, the loan program was geared towards supporting credit card receivables, auto loans and leases, student loans, and small business loan issuances. The Federal Reserve has the option to expand the program to include other types of securities such as commercial and residential mortgages. TALF eligible assets are expected to continue to broaden as the year progresses. The program is open to investors until December 31, 2009 with issuances and loans to be made monthly until the end of the year.

What Are the Particulars of TALF?

In order to attract investors and regain their confidence in the rating agencies' ability to identify AAA securities, thereby jump starting the securitization market, the TALF program is offering non-recourse lending by the Fed (authorized under section 13(3) of the Federal Reserve Act) to US domiciled investors for the purpose of purchasing non mark-to-market asset backed securities. As part of the program, the Fed has defined TALF eligible asset-backed securities as newly issued AAA tranches of securitized receivables. Using these securities, the Fed will lend an investor 85% to 95% of the security's purchase cost at issuance using the underlying asset-backed security as the collateral for the loan. In other words, an eligible security will be leveraged between 7 to 20 times. The remainder, which is the purchase price minus the loan, is the percent of the money the investor must provide. The Fed as termed this amount the "haircut" or margin and is the cash deposited with the Federal Reserve's custodian, Bank of New York Mellon. Margin percentages are a function of the underlying asset type (i.e. lower for credit card receivables and higher for auto floor plans) and the average life of the loan (i.e. lower for shorter term and higher for longer term).

TALF Fed loans are structured as follows:

Assets Eligible for TALF	Auto loans and leases, student loans, credit card receivables, and small business loans. It is highly anticipated that commercial and residential mortgage loans will be added
Effective Date	Securities that are issued during 2009
Credit Rating	AAA by at least two rating agencies required
Fed Loan Funding Rate	Libor + 50 to 100 bps
Minimum Required Investment	\$10 million
Eligible Investors	US citizens or US domiciled companies
Loan Term	3 years

The margin provided by the investor is pre-determined by the Fed and will be subordinated to the TALF loan. At the maturity of the three-year loan, if the asset backed security is worth less than the loan amount, the investor can simply return the asset backed security to the Fed to satisfy its loan commitment. If by adding the investor's margin to the price of the security causes the price to exceed par, the portion in excess of par would be returned to the investor. Thus the margin, or an investor's initial capital, is the most the investor can lose in the transaction. By participating in the TALF program, an investor enters into what is called a non-recourse loan with a limited and identifiable potential dollar loss. Furthermore, the investor retains its pro-rata share of all interest and principal cash flows regardless of whether the ultimate loan is fully repaid. This can be substantial for securities with a three year amortization



A non-recourse loan is a loan that is secured by the collateral of the purchased security, but the borrower, in this case the investor, is not personally liable. In addition, neither can the investor be forced by the lender to repay the loan prior to its maturity nor can additional margin be required. Under the TALF loan arrangement, an investor's financing or borrowing cost, is based on the loan amount which can be 85% to 95% of the asset value at issuance. At the same time, an investor can earn a yield on 100% of the asset value minus the financing cost of the loan. With TALF, investors have access to low-cost, fixed term financing and capped risk exposures. However, the underlying securities will act like any other asset backed securities and are affected by changes in interest rates, prepayment rates, and credit quality.

At current yield spreads, managers are designing TALF funds that are targeted to provide investors 8% to 15%+ net annual returns over three years.

Advantages of the TALF Program:

- The federal government has strong motivation to provide liquidity to the securitization market;
- Recourse applies only to the individual securities that each fund purchases and not collectively to the various securities. Nor does the recourse claw back distributed cash flows prior to a securities ultimate amortization;
- A significant portion of the securities not rated AAA, must be held by the issuer, creating an alignment of interest between the investor and the issuer;
- There is reason to believe that credit rating agencies will be considerably more conservative in rating asset backed securities than they had been in the recent past;
- The liberal leverage terms will magnify returns – both positive and negative.
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Primary Risks and Concerns for Investors:

(A more complete list of risks can be found at the end of this document)

- The program may prove very attractive causing prices of eligible securities to rise resulting in lower returns for investors;
- As this is a government program, there is always the possibility that rules will change mid-program, potentially disadvantaging investors. Although, as noted, the government is committed to bringing liquidity to the securitization market;
- This recession may be far deeper than is anticipated and the "enhancement" built into the rating agency's calculation may not be sufficient. In such an event, most other credit and equity investments will suffer;
- The investment advisor chosen to manage a TALF investment portfolio may select securities poorly.

Conclusion

After having reviewed available TALF information and materials, we believe this program has significant merit, despite the risks and uncertainties discussed. We are currently working to identify prudent investment vehicles to present to our clients. At the same time, we recognize that while this opportunity is unique, timing may be of the essence. If this program proves attractive, returns are likely to fall. However, early investors may not find sufficient product to put money to work. There are still some elements that have not been definitively ironed out. Consequently, our recommendation of TALF investment vehicles is subject to change.

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Risks that Investors Should Consider:

- **Political Risk** - The TALF program, still in its formative stage, is being closely monitored by the administration, Congress, and the media. Many investors (as well as potential issuers) are standing on the sidelines given the government's involvement in the program in light of the precedent that was set by significant changes to programs such as the Troubled Asset Relief Program (TARP) in 2008. The administration or Congress, prompted by political, economic or policy considerations arising from the performance, circumstances, or other developments related to the program, could intervene to change terms and conditions of the TALF program in a manner detrimental to the interests of investors. However, the Fed is acutely aware that the US government could negatively affect domestic private capital if the rules were to be changed unfavorably for investors during the life of the program.
- **Credit Risk** - The reliability of credit ratings is an issue. With regard to TALF, investors must either accept the rating agencies' opinion on the newly issued securities or perform their own credit analysis. The rating agencies, as thought of by many investors, are the same institutions that "got it wrong" in the recent past and contributed to the carnage suffered by investors. The Fed has partially mitigated this concern by limiting eligible asset-backed securities to those issued after January 1, 2009. In addition, eligible securities must be rated AAA by at least two rating agencies. In response, rating agencies are now requiring greater credit protection and enhancement on the overall structure of a securitized asset deal to earn an AAA rating. Nonetheless, given the lack of transparency that exists with asset-backed securities, investors may be exposed to the risk of loss at the underlying asset level.
- **Default Risk** - The global economy can certainly worsen and the credit quality of an asset backed security depends on the performance of the underlying assets. These securities are structured by issuers to protect investors from the possibility of defaults through the inclusion of credit enhancement or underlying credit support intended to cover potential defaults within the pool based on conservative expectations. However, defaults could conceivably exceed the credit enhancement provided by the ABS structure. Should economic conditions deteriorate further, asset backed security structures would most certainly be more subject to default risk.
- **Opportunity Risk** - Investors worry that due to high investor demand for TALF loans, potential investment earnings and returns will quickly decrease to the point where the investment opportunity is no longer attractive. While the yields being provided by new issuances have slightly come down, the securities remain extremely attractive in comparison to other current investment opportunities. An expectation is that to the extent that the securitization markets remain moribund, even with TALF being implemented, the Fed would likely respond by lowering margin requirements or the interest rate on TALF loans to keep investors interested and expected returns attractive.

Also, to the extent the program is not as successful as the government would want (i.e. supply is not sufficient enough), committed investments might not be called, portfolios might not be as diversified as expected, and the program could be closed altogether.

- **Illiquidity Risk** - Investors will face a 3 to 4 year lock-up period. In this regard, TALF is similar to a private equity investment in that capital will be called down as investments are made by the fund while preventing investors access to the initial margin deposit for the TALF loan. However, beginning in January 2010 some liquidity will be created. Interest payments will be made at least quarterly and are expected to yield 8% to 12% per annum.
- **Tax Risk** - Concern abounds that Congress will come after profits via special taxes or denying normal tax avoidance structures. The Fed has made the TALF documents clear in that the investing entity has to be onshore. In response, many institutional fund managers have created Cayman feeders for tax-exempt investors that provide a legal structure that avoids Unrelated Business Taxable Income (UBTI). While this is a common structure used by hedge funds and private equity entities, there are no assurances that this will not heighten criticism and scrutiny of such investment structures.
- **Leverage** - The TALF program is a highly leveraged investment. While TALF eligible securities must have an AAA rating from two nationally recognized rating agencies, the 7 to 20 times leverage employed can magnify the other risks associated this investment.