ALSTON & BIRD

STRUCTURED FINANCE SPECTRUM

in this issue

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Editor's Note

The past four months have turned our lives upside down. This time for me, and I imagine for many others, feels like the Great Hiatus—plans, dreams, hopes, and normal life all on hold for the time being. We'll get through it, but it's shot through with anxiety, unrealistic expectations of juggling work and homeschooling and making it all appear seamless, the sameness of each day, and the scariness of tomorrow. Maybe the upshot of life being in suspension right now is that there are fewer distractions that could impede focus on the one thing that simply can't remain in stasis any more—and that is equality and equal opportunity for all. As we look internally within our own institutions, we must ask the question—are we doing all we can to foster such change? To ensure real opportunities to advance exist for all? To expand our talent pool? To recruit, retain, and promote minorities, women, and diverse talent of all kinds? This is a time for making real change because we all win when that happens.

Our sector in particular could stand major improvement in these areas. Accordingly, we continue to strive to promote diversity and inclusion here at Alston & Bird and in Finance. I'd like to take this opportunity to highlight that many of this issue's articles were written by our highly skilled diverse attorneys, and we encourage you to reach out to them with any questions or follow-up. Please enjoy and stay safe!

Aimee Cummo
Partner, Finance

Turbulent Times for Aircraft Finance and the Aviation Industry

Aircraft finance is a complicated world that most people take for granted. They book a flight on a particular airline, arrive at the airport and check in at that airline's counter, board the aircraft painted with the colors of that airline, and then fly to their destination without ever wondering whether or not that airline actually owns the plane they are flying on. Behind the painted logo of that aircraft is a complicated finance industry. While some aircraft are owned by the airlines and have been financed through private equity, capital markets, export credit agencies, hedge funds, insurance companies, or otherwise, others may be a part of a large operating lease structure where a third-party lessor leases their aircraft to the airline. Under this lease structure, lessors allow the airline to paint and brand the aircraft to match its fleet, and the cash flow from the aircraft's operation is used to make the rental payments back to the lessor.

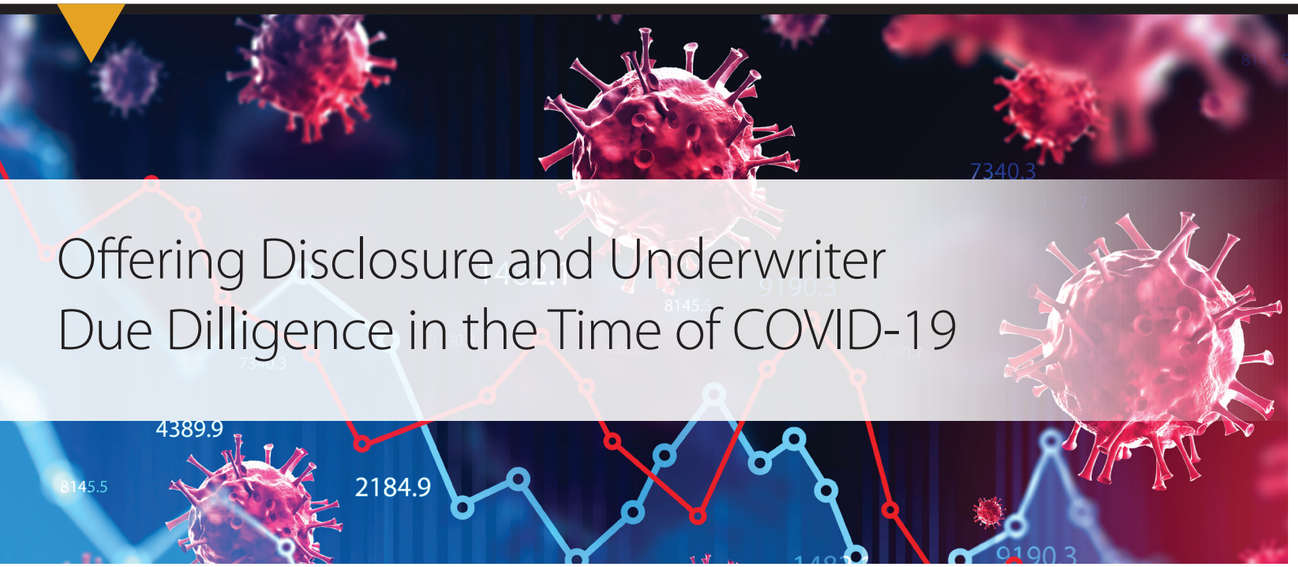
The aircraft finance industry started 2020 off with high expectations and plentiful opportunity. Passenger growth was projected to continue its year-over-year increase, and airlines were looking to continue their strong 2019 financial performance. COVID-19 had other plans. Early in the pandemic, the promising growth expectations started to temper in the Asian markets (as the world initially assumed COVID-19 was going to be a localized issue) but remained positive for the rest of the world. Once COVID-19 was officially declared a worldwide pandemic, these expectations came screeching to a halt across the aviation industry. As the world learned more about COVID-19 and travel restrictions were implemented by governments, the oversold flights that had become the norm for airlines became empty. Revenue streams dried up, and airlines began to scramble to adapt to the sudden changes. Financially, airlines needed to find options to allow them to weather the storm.

Currently, there is a significantly reduced volume of finance transactions for new aircraft as airlines attempt to preserve cash. Airlines are navigating operating leases that have historically been structured on the concept of "hell or high water"—the airline's obligation to pay rent to the lessor remains no matter what happens to the aircraft during the lease term. In this COVID-19 market, that means airlines remain on the hook for rental payments to the lessor even when they are prohibited to fly the aircraft and generate cash flow to pay the rent. Operating leases function as intended when the aircraft is in use and the cash flow from the lease is used by the airline to make rental payments to the lessor, and the lessor uses those rental payments to service the underlying debt on the aircraft and for other operational needs.

Typically, the airline is responsible for covering costs of insurance, maintenance, crew, and any other operational costs. In a typical market when the airline fails to pay the rental payments, the lessor can repossess the aircraft and remarket/re-lease it to another airline to continue the cash flow to the lessor. In this market, repossessing and remarketing to a new airline would be extremely difficult since all airlines are feeling the effects of the COVID-19 pandemic. If a lessor exercised its rights to repossess and was unsuccessful in remarketing the aircraft, the lessor would be stuck with a depreciating asset that isn't generating any cash flow, and the lessor would be responsible for paying any underlying finance cost of the aircraft along with the maintenance and storage costs of the aircraft on its own. Therefore, lessors have been incentivized in the current environment to work with airlines to modify or defer rental arrangements (or make other structural changes to the lease documentation) to maintain at least some of the benefits of their lessor/lessee relationships.

COVID-19's impact on the global aviation industry has begun to push airlines into bankruptcy. Since April 2020, major airlines like LATAM (Latin America's largest airline), Avianca (Latin America's second-largest airline), and Virgin Australia (Australia's second-largest airline) have all filed for Chapter 11 bankruptcy or the equivalent, and the industry expects more major airlines to follow suit. In the U.S., the Coronavirus Aid, Relief, and Economic Security (CARES) Act set aside $25 billion for airline assistance loans and another $25 billion in federal aid so that they can continue paying employee wages and avoid layoffs. As of the U.S. Treasury's statement on July 7, 2020, the four largest airlines in the U.S. (along with a few smaller airlines) have all signed letters of intent setting out the terms on which the U.S. Treasury is prepared to extend loans under the CARES Act.

At this moment, the future of the aviation industry post-COVID-19 is uncertain, and it remains to be seen which airlines will survive or collapse. Until passenger levels return to normal (which could take multiple years post-COVID-19), airlines, lessors, financiers, and governments will have to continue to work together for solutions to keep the industry moving forward. ■



Offering Disclosure and Underwriter Due Dilligence in the Time of COVID-19

The COVID-19 pandemic has led to abrupt and unprecedented disruptions to the securitization market. The securitization gears ground to a near halt the week ending March 13, when approximately 10 U.S. asset-backed securities (ABS) and mortgage-backed securities (MBS) deals priced. A month later, following the Federal Reserve's announcement of the renewed Term Asset-Backed Securities Loan Facility (TALF) and several other economic stimulus programs, there was an uptick in deal execution, and around 20 U.S. ABS and MBS transactions priced in the second half of April—seven of them auto loans (both prime and non-prime), and the remainder included deals backed by consumer loans, equipment loans and leases, and residential mortgages. Although second-quarter deal activity was noticeably down compared to last year, in June, around 64 U.S. ABS and MBS securitizations priced, which provided a much-welcomed boost to the capital markets.

Not surprisingly, offering documents that have been in the market since mid-March reflect enhanced disclosures related to the pandemic. With a strong re-entry into the securitization market, public auto issuers effectively helped create the framework for enhanced COVID-19 disclosure. Many of the disclosure updates have been incorporated into the framework of existing risk factors, but given the far-reaching implications of the pandemic, these new disclosures include the following:

- Implementation by originators and servicers of enhanced business continuity strategies to allow traditionally in-house functions, such as credit underwriting, payment processing, and collections, to function in a remote work environment.
- The impact of COVID-19 on third-party suppliers and businesses because portions of the workforce across the industry are unable to work effectively due to facility closures, ineffective remote work arrangements, or technology failures.
- The ability of originators and servicers or other transaction parties to perform their obligations under the transaction documents because of COVID-19-related regulatory actions, including the enactment by federal, state, or local governments of laws, regulations, executive orders, or other guidance that requires servicers to permit obligors to forgo making scheduled payments for some time or preclude creditors from exercising certain rights or taking certain remedies against the collateral, including temporary moratoriums on foreclosures and repossessions.
- Servicing and collection policies and procedures, and modifications to such policies and procedures, to address COVID-19 relief, including goodwill extensions or deferral programs with deferments ranging from 30 to 90 days.
- The potential impact of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which was signed March 27, 2020, and enacted to address the effects of the COVID-19 pandemic.

Outside the risk factors, there has been enhanced disclosure around servicing and collection activities, which address the use of existing loss mitigation tools, including deferments, late-fee waivers, and other assistance programs. Specifically, in contrast with recent hurricanes and natural-disaster-related events, most servicer COVID-19 deferment or extension programs have been offered nationwide, rather than to obligors in a specific impacted geographic location. In addition, some offering documents include discussion of the treatment of deferments for servicer reporting purposes. Based on a servicer's underlying servicing and collection policies, if an obligor qualifies for a deferment, the servicer may bring the obligor's status contractually current for reporting purposes.

Relatedly, in some new securitizations where loan modifications were previously permitted subject to an agreed-upon cap, servicers are distinguishing permitted COVID-19-related modifications from other types of modifications. Servicers' approach varies, but in most cases, the monthly servicing reports identify both types of modifications if a distinction is provided for in the underlying documents.

The COVID-19-related disclosures for June issuances have also started to focus on the status of states reopening their economies or modifying or lifting stay-at-home and shelter-in-place orders. As COVID-19 cases continue to spike nationwide, and the market braces itself for the potential second wave, it remains to be seen whether the pendulum will swing back to more robust disclosure. In addition, now that the TALF program is operational, some recent offering documents include reference to TALF.

The underwriter due diligence process reflects the disclosure updates noted above. Underwriting banks have approached the COVID-19 pandemic by either expanding the existing market standard questions or by developing a separate list of COVID-19-related questions, and in some cases, banks are undertaking to hold a separate COVID-19-specific due diligence call. Additional questions have focused on:

- Material changes, or any anticipated changes, to collection and servicing policies relating to COVID-19.
- The impact, if any, of COVID-19 on the servicer's ability to service the underlying loans in the securitization pool.
- Information around the volume of obligor requests for forbearances and/or deferrals due to COVID-19.
- The impact of COVID-19 in the near term and long term on the sponsor's or parent's financial condition, and loss of access to any previously available sources of liquidity.
- Notices relating to ratings downgrades or negative watches concerning the sponsor's existing securitizations or parent's corporate ratings.

Until there is a vaccine or more certainty in market conditions, it is likely that banks will continue to conduct a heighted level of due diligence scrutiny of the effect of the COVID-19 pandemic on issuers, originators, and servicers. ■

Coast to Coast: Diversity and Giving Back During COVID-19

Two Asian American associates from Alston & Bird's California and New York offices share how COVID-19 has affected them and influenced their vision and legal work

Can you talk about the influences your diverse background has had on your legal career/work?

Sue Chang: Just as I don't wake up every day thinking about how I am going to live my "best minority life," I don't think about how best to counsel clients as a female Asian American attorney. However, I *am* aware of the impact my racial and gender status may have on my legal career. In fact, I've been invited to many diversity and inclusion (D&I) forums discussing the glass ceiling phenomenon, unconscious bias, low retention, promotion, and inclusion in the workforce I may face as an attorney of color.

Naturally, I care deeply about my employer's commitment to D&I—not just bringing in diverse talents but also including them in leadership positions. When I decided to join Alston & Bird, it mattered to me that many partners with significant books of business were women.

How has COVID-19 affected you or your legal practice?

Will Lee: COVID-19 affected my family. My father, a South Korean immigrant, runs a shoe store in Los Angeles. I have never met someone so hardworking and dedicated to his small business. When the pandemic hit, my father had to temporarily close shop while having employees on payroll, outstanding inventory, and creditors owed money. I signed up to be a frontline volunteer for the Korean Community COVID-19 Pro Bono Hotline supported by the Korean American Lawyers Association of Greater New York (KALAGNY). From my training, I learned that a small business can apply for Small Business Administration (SBA) Economic Injury Disaster Loans (EIDL) and Paycheck Protection Program (PPP) loans, which I helped my father apply for and receive. Our hotline continues to operate seven days a week and has assisted over 600 Korean speakers with inquiries about SBA loans, unemployment insurance, grants, and mortgage payments.

Sue: COVID-19 has presented a unique and unprecedented set of challenges to all of us in varying degrees. My parents and many family friends are first-generation Korean immigrants. Most of them have small businesses—the type of small businesses operated by family members working around the clock to keep labor costs low. They may be highly educated in their home countries but received no education in America and speak limited English. So, when California Governor Newsom declared the state of emergency and later proclaimed stay-at-home orders, they were anxious, to say the least, and had many questions. With their businesses closed, how are they supposed to pay their employees? Were they going to lose their business because they can't pay commercial rents? Can they even support themselves? And now that businesses are starting to reopen, what do they have to do to reopen their businesses? They were losing sleep over these questions, and my heart went out to them.

I did what most attorneys do to counsel their clients on a new set of issues—I learned. I learned about eviction moratoriums, various SBA loan programs, and pandemic unemployment assistance programs and explored their options and counseled them into making the best decisions. I helped them receive EIDL loans and pandemic unemployment benefits.

I soon started getting the same set of questions from my "work" clients, and I felt prepared to assist. At all the D&I forums I've attended, I often heard I should leverage my diverse experiences and use it to my advantage at work. But it was not until this recent personal experience that I knew what it meant. I also had an opportunity to further develop my knowledge on these issues and publish two articles with my mentor debriefing the residential and commercial eviction moratoriums in California and guidelines for reopening business operations in California.

You have been helping your local communities affected by COVID-19 in various ways. Can you talk about your pro bono work?

Will: In addition to volunteering with the Korean Community COVID-19 Pro Bono Hotline, I organized, led, and moderated a small business COVID-19 relief presentation series co-sponsored by the Asian American Bar Association of New York (AABANY) and Alston & Bird. The first presentation addressed labor and employment return-to-work issues, and the second presentation addressed restructuring and bankruptcy options for small businesses. The second presentation featured Alston & Bird's William Hao as a panelist.

I also created the AABANY COVID-19 Student Task Force, composed of 10 student leaders and the Asian Pacific American

Law Student Associations (APALSAs) of 12 law schools. Together, we designed an interactive flyer, launched social media campaigns, and went door-to-door distributing our COVID-19 and remote clinic flyers to Asian small businesses. An AABANY website devoted to pro bono is also in the works.

I also serve as a liaison between AABANY and the Empire Justice Center and supervised a project translating all of Empire Justice's coronavirus FAQ pages to simplified and traditional Chinese. I also separately organized a task force with KALAGNY and law school colleagues to provide Korean translations.

Sue: I learned about Will's great pro bono work volunteering with the Korean community in New York and reached out to him to learn about his experience. We share a desire to help our local community, and we were definitely not the only ones. I connected with many attorneys providing free legal services and soon got plugged into volunteering at the Legal Aid Foundation of Los Angeles and Koreatown Youth and Community Center's Employment Development Department Hotline helping monolingual Korean clients apply for unemployment benefits claims.

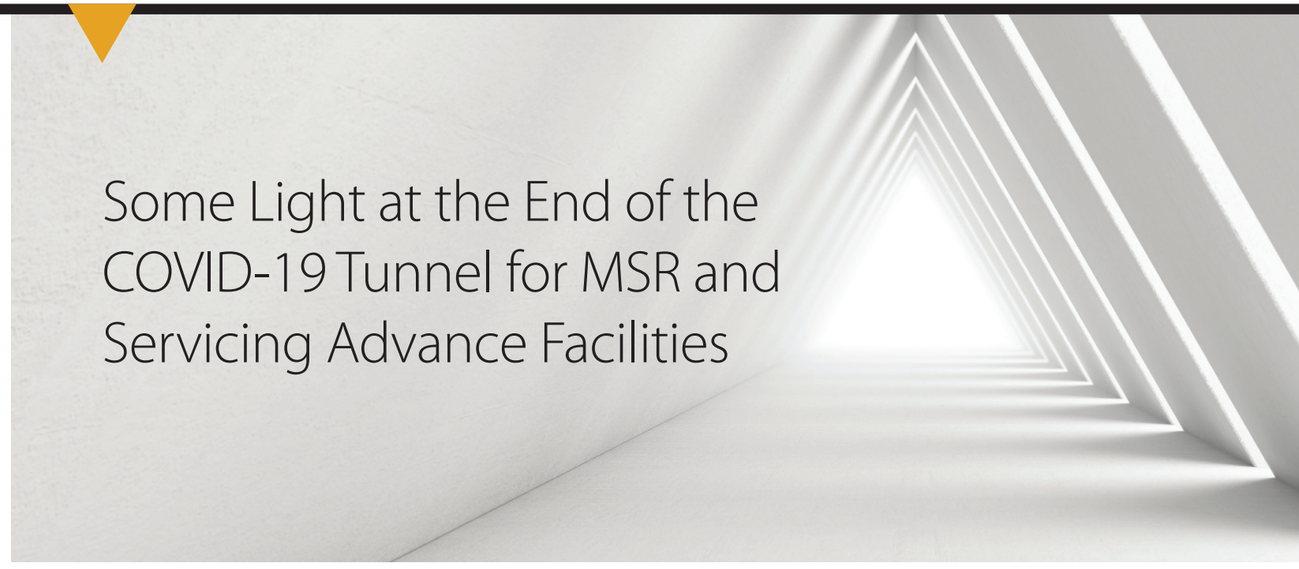
Additionally, I am working on a new initiative with the City of Los Angeles in partnership with Bet Tzedek (a nonprofit law firm) called LA Represents. Through the LA Represents program and with the resources available to me at Alston & Bird, I can provide a broader scope of legal services to more small business owners struggling due to COVID-19.

There has been more discussion by law firms to retain diverse talents. What are some suggestions you have?

Sue: An honest discussion about challenges attorneys of color face is a good start to retaining diverse talent. There also needs to be an acknowledgement that no two diverse attorneys' experiences are the same. In fact, each minority group suffers from a different set of implicit biases. Associates in general are likely to stay when they have mentors and sponsors. Although the best mentor-mentee relations are created organically, diverse attorneys may have a harder time forming meaningful relationships with partners who do not necessarily share the same upbringing or culture. Firms can pair successful partners with diverse associates, include them in client meetings, provide meaningful assignments, share business strategies, and reward partners who successfully cultivated such relationships.

Will: I strongly agree with Sue. I am a believer in facts and numbers: a firm's identity and its commitment to pro bono and diversity are directly tied to its genetic makeup of minority associates and projects. Alston & Bird is an incredible firm that supports diversity and pro bono at all levels. Never once has the firm said "no" when I floated a pro bono idea or requested funding. There is a strong sense of camaraderie and a support system that unconditionally supports all social causes. Alston & Bird's pro bono community not only co-sponsored all of my pro bono projects but also inspired me to "go big" every time by offering advice, resources, and encouragement.

My parents sacrificed everything to give me an opportunity to learn and work in this great country. We are standing on the shoulders of giants who paved the way for generational progress. We owe it to our predecessors who faced greater adversity. Just performing at a high level is not enough. We have an obligation to give back. ■



Some Light at the End of the COVID-19 Tunnel for MSR and Servicing Advance Facilities

It's no secret that the COVID-19 pandemic has upended the mortgage servicing industry. Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, borrowers with federally backed residential mortgage loans experiencing financial hardship due to COVID-19 may request a forbearance on mortgage payments of up to 180 days (which may be subject to an extension of an additional 180 days). During the forbearance period, mortgage servicers are expected to continue carrying out their servicing obligations. With more forbearances and as mortgages begin to default, mortgage servicers could be facing potential liquidity issues.

To take a step back, a mortgage servicer is generally responsible for managing the collection of borrower payments of principal, interest, taxes, and insurance; remitting payments to investors of mortgage-backed securities (MBS); and performing loss mitigation and foreclosure activities on delinquent mortgage loans. In exchange, mortgage servicers are typically paid a servicing fee from a portion of the monthly interest payment received on a mortgage loan. The contractual right to service a mortgage loan in return for payment of a servicing fee is a mortgage servicing right (MSR). Ideally, when a mortgage loan is performing, the servicing fee is higher than the actual cost of administering the loan. However, a tipping point exists when there is not enough positive cash flow to cover the servicer's costs.

An MSR is an important asset for a mortgage servicer because it is a transferrable asset that can be financed. There are various financing structures that can be utilized to finance MSRs, including sales of the excess servicing strip, loans (bilateral and syndicated structures), repurchase facilities, and securitizations, including master trust structures. These MSR financing options give mortgage servicers valuable opportunities to manage risk and obtain liquidity.

A mortgage servicer's obligation to advance payments to MBS investors ("servicing advances") are usually repaid from amounts received from the related mortgage loan. When a servicing advance is made by a servicer, it becomes a receivable that can be pledged as collateral. A servicer advance facility (SAF) is a financing that allows mortgage servicers to pledge their rights to reimbursement for advances (receivables) as collateral for financing. The structures for SAFs are wide-ranging, from revolving lines of credit (or repurchase facilities) secured by a pledge (or sale) of the servicer's receivables to securitization structures, including master trust structures allowing combinations of term asset-backed securities and revolving variable funding notes, backed by receivables. SAF structures have been used to finance servicing advances related to private label servicing and agency portfolios.

We are seeing new opportunities arise in the MSR and servicing advance financing space. In June, New Residential Investment Corp. issued a series of notes collateralized by Fannie Mae mortgage servicing rights. Also, notably, Ginnie Mae approved the inclusion of servicing advances under its acknowledgment agreement program. The Ginnie Mae program uses an existing MSR securitization structure to support a separate SAF within the existing structure.

In addition to financing from private lenders, Ginnie Mae, Fannie Mae, and Freddie Mac are also providing some relief to mortgage servicers. Ginnie Mae recently expanded the Pass-Through Assistance Program (PTAP) to assist Ginnie Mae issuers facing a temporary liquidity shortfall because of COVID-19 (PTAP/C19). The specific requirements governing PTAP/C19 assistance are set forth in the Ginnie Mae MBS Guide. It should be noted, however, that PTAP/C19 is intended to be used as a last resort. Ginnie Mae MBS issuers should first seek assistance from sources other than Ginnie Mae. Mortgage servicers and third-party lenders should also be aware that until Ginnie Mae has been reimbursed for all advances made under PTAP/C19, repayment obligations to third-party lenders for any mortgage loans that are subject to a request and repayment agreement under PTAP/C19 will be subordinate to the repayment of amounts advanced by Ginnie Mae.

Additionally, recently the Federal Housing Finance Agency (FHFA) announced that it was aligning Fannie Mae's and Freddie Mac's policies so that servicers of Fannie Mae and Freddie Mac single-family mortgage loans that are in forbearance because of COVID-19 will have an obligation to advance only four months of missed principal and interest payments. While this is not a liquidity option, this does provide a cap on servicer advancing obligations and gives mortgage servicers a general scope of their expected responsibility.

As the market evolves, we expect to see continued positive developments in the mortgage servicing industry. Given the number of homeowners that have already and that are expected to use a forbearance plan because of COVID-19, mortgage servicers should give great consideration to the liquidity needs that they will face over the coming months. ■

What's Poppin' with the LSTA? LIBOR, COVID-19, and Other Developments

With all that's going on, does anyone remember that LIBOR is ending relatively soon? Oh right, the memory is hazy, but the UK's Financial Conduct Authority announced in 2017 that LIBOR would be no more after 2021. The Loan Syndications and Trading Association (LSTA), together with other organizations, including the Alternative Reference Rates Committee, have been continually and steadily working to nail down a replacement interest rate and related language for loan agreements to facilitate a smooth transition away from LIBOR.

The Secured Overnight Financing Rate (SOFR) has emerged as the winning replacement rate, although the devil is, of course, in the details. It's still not clear whether we will end up with a forward-looking term SOFR, a compounded SOFR, some other form of SOFR, or a non-SOFR alternative. Even with the urgency of LIBOR's end drawing nigh (the end of 2021 for those of you who have blocked it out), LIBOR discussions have dwindled as COVID-19 has rattled the markets and focus has shifted to more immediate concerns about a radically shifting world economy. Not surprisingly, some market participants have wondered if COVID-19 might force extending the end of LIBOR. No such extension seems likely—the LSTA has indicated that we should all continue to plan for the end of LIBOR in 2022. In fact, the LSTA continues to be active in providing draft documents and forms to help with the transition.

Last year, the LSTA promulgated a form credit agreement referencing a compounded SOFR in arrears concept. More recently, the LSTA has had other drafts in the works, including a form credit agreement referencing a simple SOFR in arrears concept (released in March and is currently open to market feedback), as well as a draft concept credit agreement that references daily simple SOFR and daily compounded SOFR that is expected to be released in the near future.

Not surprisingly, the effects of COVID-19 have also led to increased activity in the secondary trading market. With an increasing number of businesses filing for bankruptcy, there has been an inevitable increase in distressed loan debt trading. The LSTA has risen to the occasion and has assured market participants that it has measures in place to ensure business continuity and continued loan market function (even with the LSTA's inevitable work-related complications tied to COVID-19).

The LSTA's forms for the secondary trading market are regularly updated, including updates in May 2019 and even as recently as March of this year. Last year's updates included adding several representations, warranties, and covenants, including disgorgement rights, expanding tax gross-up obligations placed on sellers, a no "bad acts" covenant, and revisions to the form so that voting rights are no longer automatic.

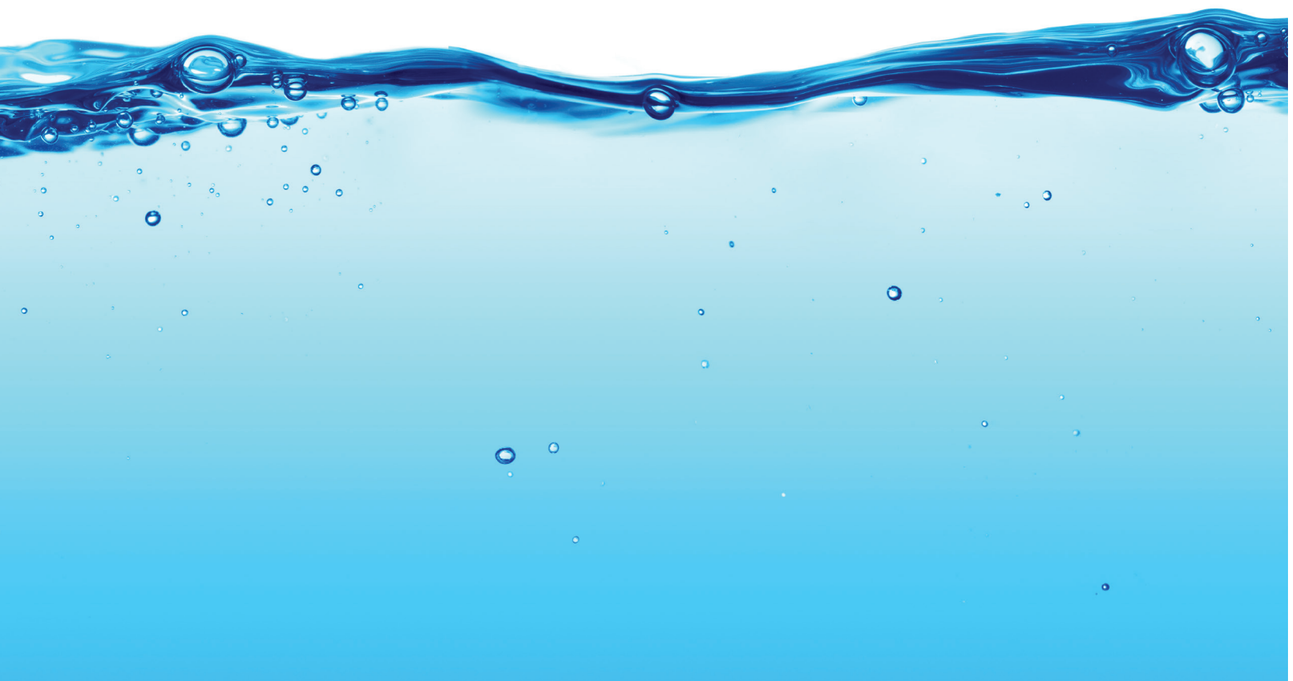
Furthermore, the March updates included adding language to existing forms providing delayed compensation to syndicated new money facility lenders.

Other LSTA Developments

Other recent and upcoming updates from the LSTA include: (1) revised language to the par/near par confirm to provide protections when trading English law loans (providing certain protections to English law loans that were already being provided to New York law loans); (2) the issuance of Guidance on Green Loan Principles (which addresses questions about green loans, including how and when they can be used for refinancing new and existing green projects); (3) the issuance of Guidance on Sustainability Linked Loans (which includes answers to common questions, as well as guidance on certain sustainability performance targets); and (4) the release of its Environmental, Social, and Governance Questionnaire (a voluntary questionnaire aimed at helping borrowers provide increased information to lenders).

Overall, the LSTA continues to provide ongoing guidance and support to the U.S. syndicated loan market, including the secondary loan trades market, even amid the COVID-19 pandemic. As the end of LIBOR approaches, we are sure to see further updated drafts, forms, and guidance for as smooth a transition as possible to whatever awaits the financial market in 2022. ■

TALF 2.0—Everything You Need to Know to Dazzle and Delight at (Socially Distanced) Cocktail Parties



In response to the economic impact of the COVID-19 pandemic, on March 23, 2020, the Federal Reserve announced the enactment of programs designed to help businesses and consumers. The Term Asset-Backed Securities Loan Facility (TALF) was one such program. TALF was first introduced in 2008 in response to the financial crisis and its impact on the securitization market. "TALF 2.0" introduced this past March differs from the original TALF program in several respects. TALF 2.0 is a $100 billion nonrecourse facility funded by the Federal Reserve Bank of New York (FRBNY). TALF can be utilized by U.S. borrowers that invest in certain asset-backed securities (ABS), static collateralized loan obligations (CLOs) backed by leveraged loans only, and commercial mortgage-backed securities (CMBS) issued before March 23, 2020. To the continuing dismay of the market, newly issued CMBS, commercial real estate CLOs, and servicing rights are not eligible collateral.

The TALF lender is a special-purpose vehicle that will make nonrecourse loans to eligible borrowers that pledge eligible collateral. TALF loans will have three-year maturities, interest will be payable either monthly or quarterly, and each loan must be at least $5 million. To apply for a TALF loan, a borrower must enter into a customer agreement with a financial institution that the FRBNY has designated as a "primary dealer." A primary dealer will act as the borrower's TALF agent. The TALF agent will enter into the master loan and security agreement (MLSA) with the TALF lender, The Bank of New York Mellon as custodian and administrator, and the TALF agent on behalf of itself and its borrowers. Under the MLSA, the TALF agent will assist the borrowers with providing the information necessary to obtain a TALF loan to the custodian, TALF lender, and FRBNY.

To be considered an "eligible borrower" for purposes of TALF, a borrower must be a business entity created or organized in the U.S. or under U.S. law that has significant operations and a majority of its employees in the U.S. and maintains an account with a TALF agent. An entity with a foreign government as a material investor is ineligible for TALF. Under the MLSA, each borrower must certify that it is an eligible borrower, and such representation must remain true for the term of the TALF loan.

Eligible collateral for a TALF loan includes non-synthetic ABS issued on or after March 23, 2020, CMBS issued before March 23, 2020, and SBA Pool Certificates or Development Company Participation Certificates that are issued on or after January 1, 2019. Such securities must have a rating in the highest long-term category (or short-term category if a long-term rating is unavailable) from at least two eligible nationally recognized statistical rating organizations (NRSRO) and cannot have a credit rating below the highest investment-grade rating from an eligible NRSRO. However, eligible ABS collateral backed by the SBA's 7(a) or 504 loan programs do not require an explicit credit rating if the underlying credit exposures, or the ABS themselves, are fully guaranteed by the U.S. government as to the payment of principal and interest. Further, in order to be eligible under TALF, the collateral must be issued by a U.S. domiciled originator and must have an underlying credit exposure to one of the following asset classes: auto loans or leases, student loans, equipment loans and leases, floorplan loans, insurance premium finance loans for property and casualty, credit card receivables (consumer and corporate), certain small business loans guaranteed by the SBA, leveraged loans, or commercial mortgages. A borrower may not use collateral that was securitized by the borrower or any of its affiliates. In addition, under TALF, each borrower must agree to not exercise any voting, consent, or waiver rights or any rights to direct, initiate, recommend, or approve any action involving the eligible ABS collateral without the consent of the FRBNY. If the newly issued ABS contains a redemption option other than a customary cleanup call, it will also be ineligible. The FRBNY has established collateral haircuts for each class of eligible ABS that vary across asset classes. The TALF lender will lend an amount equal to the market value of the pledged collateral minus the applicable haircut. The FRBNY reserves the right to reject any collateral event if it meets the eligibility requirements.

Each month, there will be approximately two loan subscription dates on which submissions of requests for TALF loans will be accepted. Before the dates, the borrower must provide its TALF agent with required information, including the loan request number, borrower's name and the name of its TALF agent, any material investor in the borrower, whether the collateral is a new issuance, whether the collateral has a fixed or floating interest rate, and the collateral weighted average life. On the loan settlement date, the TALF agent will deliver the ABS collateral and an administrative fee of 10 basis points plus a margin amount, if applicable, to the TALF lender's settlement account.

TALF permits the borrower to prepay a TALF loan in whole or in part without the imposition of prepayment penalties or other restrictions. The MLSA contains certain "collateral enforcement events" involving the borrower:

- The failure to pay any TALF loan or related obligation under the MLSA when due.
- The borrower's failure to perform any of its obligations under the MLSA or any other agreement delivered in connection with the MLSA if such failure continues for five business days or if any encumbrances are placed on the collateral and are not discharged within five business days.
- The insolvency of the borrower.

If a collateral enforcement event is occurring, the TALF lender or the FRBNY on its behalf may pursue customary remedies under applicable law as set forth in the MLSA and exercise its rights as a secured creditor under the UCC.

TALF is currently scheduled to expire on September 30, 2020, and no further TALF loans will be made. However, the Federal Reserve Board and the Secretary of the Treasury have the discretion to extend the program depending on applicable factors, including whether TALF was widely used, the performance of the ABS market, and whether there is political support for the program. ■

Doing Good While Making Money: ESG in Finance

Saving the world and capitalism have long been diametrically opposed goals. At long last, there is hope of merging the two. In response to the increasing investor demand for incorporation of environmental, social, and governance (ESG) factors in investment decisions, companies are having to consider integrating these principles in investment and financial transactions. ESG considerations cover a variety of topics such as climate change, diversity, cybersecurity, and human capital management. Some research has indicated that increased receptiveness to ESG matters results in an increase in corporate performance and returns, making ESG a priority for today's corporations, investors and shareholders (both active and passive), boards, and finance professionals. As recently mentioned in *The Wall Street Journal*, "[m]ore than 70% of ESG funds across all asset classes performed better than their counterparts during the first four months of the year," showing they are able to withstand a crisis better than their non-ESG counterparts. As a result, the structured finance market is listening.

Leading the charge are the Loan Market Association, Asia Pacific Loan Market Association, and Loan Syndications and Trading Association, which collectively launched the "Green Loan Principles" and "Sustainability Linked Loan Principles." Green loans are any type of loan instrument made available solely for the purpose of financing or refinancing "green projects," and the related principles provide a framework for the characteristics of such loans. Sustainability-linked loans are any type of loan instrument or contingent facility that seeks to incentivize the borrower to achieve sustainability performance objectives, and similarly, the related principles provide the framework for doing so.

Rating agencies have also gotten into the game. In 2019, Fitch Ratings released its ESG Relevance Scores, rating structured finance and covered bond transactions on a scale of 1 (irrelevant) to 5 (highly relevant). As of this year, Fitch reports that about 4,800 global asset-backed securities (ABS), commercial mortgage-backed securities (CMBS), and residential mortgage-backed securities (RMBS) transactions have been assigned ESG ratings—although notable, these transactions only account for about 2% of the global ABS, CMBS, and RMBS market.

In addition to recent developments of ratings systems, the Sustainability Accounting Standards Board (SASB), an independent nonprofit standard-setting organization that

aims to establish industry standards for disclosing financially material sustainability information to investors, identifies the following sustainability-related issues as directly impacting mortgage finance, and thus should be disclosed to investors:

- Lending practices
  - Number and value of residential mortgages that are hybrid or adjustable-rate mortgages, have prepayment penalties, and are higher-rate mortgages.
  - Number and value of residential mortgage modifications, foreclosures, short sales, or deeds in lieu of foreclosure.
  - Total amount of monetary losses because of legal proceedings associated with communications to customers or remuneration of loan originators.
  - Description of the remuneration structure of loan originators.
- Discriminatory lending
  - Number, value, and weighted average loan-to-value of mortgages issued to minority borrowers.
  - Total amount of monetary losses caused by legal proceedings associated with discriminatory mortgage lending.
  - Description of policies and procedures for ensuring nondiscriminatory mortgage origination.
- Environmental risk to mortgaged properties
  - Number and value of mortgage loans in 100-year flood zones.
  - Total expected loss and loss given default attributable to mortgage loan default and delinquency due to weather-related natural catastrophes.
  - Description of how climate change and other environmental risks are incorporated into mortgage origination and underwriting.

While one would think that such information and metrics would be freely available and easily disclosable to investors, this is not necessarily the case. ESG disclosure, which is meant to help investors understand how companies are assessing and managing ESG risks and opportunities, is largely nondescript and lacks a consistent and comparable language for investors to use in evaluating risks they are willing to take. Adding to the complexity, ESG-related information is often quantitative (e.g., numbers and values of certain types of mortgage loans), but many of the metrics investors are looking to learn more about are qualitative in nature, and thus can be unclear and even unverifiable (e.g., policies surrounding ensuring nondiscriminatory mortgage origination). Additionally, there is no universally adopted framework in the structured finance world, or the global market generally, to provide a guide for the dissemination of this type of information. Although organizations such as SASB are aiming to fill this gap, the lack of a legal requirement or any consensus from a regulatory body makes it difficult for ABS, CMBS, and RMBS prospectuses to provide reliable and informative sustainability disclosures. As a result, offering documents have tended to lean toward mostly standard, albeit constantly evolving, pro forma disclosures.

ESG principles and ratings' incorporation in structured finance transactions is in the nascent stage. Some investors have a desire to make informed and responsible financial decisions that can be better addressed through the incorporation of ESG disclosure. Corporations, rating agencies, and financial institutions are considering opportunities to lead the introduction of ESG standards into an evolving financial market.

For more information on recent ESG deals overseas, see ESG During the Coronavirus Crisis – Should You Care? ■

The Fed's Main Street Lending Program—Swing and a Miss?

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act—the largest economic relief package in U.S. history—providing over $2 trillion to qualified individuals and businesses impacted by the COVID-19 pandemic. The Main Street Lending Program (MSLP), established under the CARES Act, is a lending program for businesses that are too large to qualify for loans under the Paycheck Protection Program (PPP) but too small to receive other direct lending available to large corporations under the CARES Act. Administered by the Federal Reserve, the MSLP buys participation rights in loan facilities provided by eligible lenders to provide liquidity to small and medium-sized businesses. Already in its third iteration, it is safe to say that the MSLP is being evaluated and revised in real time and that the future of the program is unclear.

Under the MSLP, the Federal Reserve will provide up to $600 billion to a special purpose vehicle (SPV) that will purchase 95% of loans issued by lenders through the operation of three different credit facilities: the Main Street New Loan Facility (MSNLF), the Main Street Expanded Loan Facility (MSELF), and the Main Street Priority Loan Facility (MSPLF). Participating lenders would sell 95% of the loan amount to the SPV to free up their balance sheets and would retain 5% of each issued loan.

On June 8, 2020, the latest MSLP revisions went into effect. Significant changes to the program included the extension of the maturity date for loans from four years to five years, delayed principal payments for two years rather than one, reduced minimum thresholds of borrowing to $250,000 for the MSNLF and MSPLF, increased maximum thresholds across all facilities, and standardized lender retention percentage across all facilities to 5%.

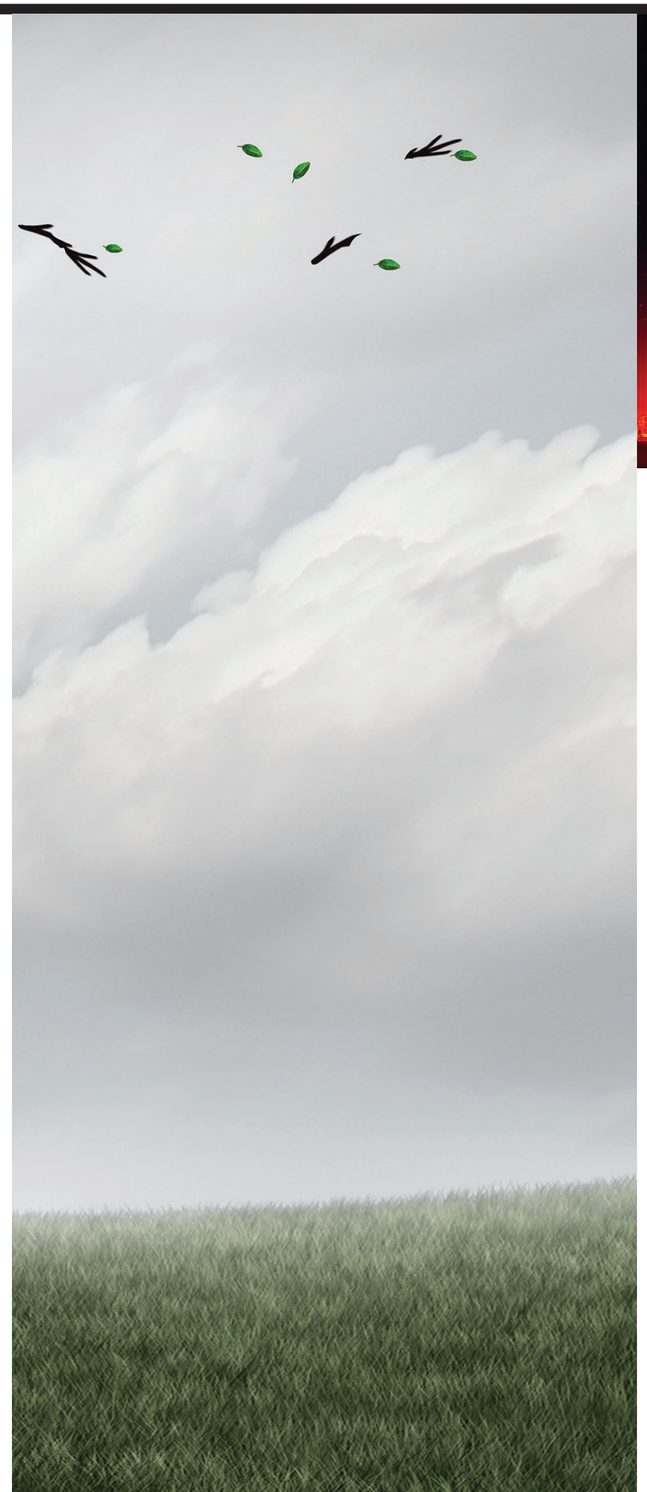
While the three MSLP facilities have been written about extensively, and the Federal Reserve is contemplating adding two additional facilities to the MSLP for nonprofit organizations, there are concerns about the program due to underutilization from lenders and borrowers.

On June 15, 2020, the MSLP officially opened applications for lender registration. However, two weeks later only about 300 lenders had signed up to participate in the program out of approximately 5,000 FDIC eligible banks—with no loans dispersed to eligible borrowers. In contrast, the initial $349 billion allocated under the PPP was completely exhausted within weeks of launching. With less than 10% of FDIC eligible banks registering to lend under the MSLP and no active borrowing, skepticism about the program intensified.

A primary criticism of the MSLP is that it targets too few borrowers and that many of those borrowers—those that actually need access to capital—are unlikely to meet the requirements of the program. For instance, the MSLP financial eligibility requirements for borrowers mean that many borrowers had to be financially strong before the COVID-19 pandemic. However, financially strong borrowers are more likely to have access to capital through traditional means and less likely to find the restrictive distribution and compensation covenants under the MSLP favorable to their business needs. For other potential borrowers, the additional business and legal expense incurred to negotiate the complex terms of the MSLP may be viewed as unnecessarily costly. Others may just be too hesitant to incur additional debt in such a volatile market.

To address these concerns, and increase the utilization of the MSLP, the requirements of the MSLP could be revised to allow for more flexibility under the specific loan facilities. For example, the requirements could include factors such as (1) whether a business with a high credit rating should have the same interest rate as a riskier business; (2) whether a business with $5 billion in revenue should be required to meet the same criteria as a business with $10 million in revenue; and (3) whether the financial needs of a business with 15,000 employees are the same as a business with 500 employees.

It is important to note that the MSLP is a lending program established to lend money to businesses, not provide grants. Since many potential borrowers were in sound financial positions before COVID-19, many businesses may not realize the economic impact of the pandemic until later, when the MSLP may be a more attractive avenue for lending. Unless extended, with less than three months until the end of the MSLP, only time will tell whether the highlighted concerns of the program are valid and how much, if any, of the $600 billion will remain. ■



Over the Rainbow: Landmark Ruling for LGBTQ+ Rights

The times, they are a-changin'. On June 15, 2020, the U.S. Supreme Court handed down a landmark ruling in the case of *Bostock v. Clayton County, Georgia*, solidifying the legal protections of the LGBTQ+ community within the workplace—an occasion that was celebrated during Pride Month.

In *Bostock*, the Court resolved a split among federal appellate courts on whether Title VII of the Civil Rights Act of 1964, which prohibits employers from discriminating against someone because of that person's race, color, religion, sex, or national origin, protects individuals from discrimination based on sexual orientation and gender identity. In short, the Court responded yes.

In issuing the *Bostock* decision, the Supreme Court considered three cases: *Bostock v. Clayton* County from the Eleventh Circuit, *Altitude Express Inc. v. Zarda* from the Second Circuit, and *R.G. & G.R. Harris Funeral Homes Inc. v. EEOC* from the Sixth Circuit.

In 2003, Gerald Bostock, a gay man, began working as a child welfare services coordinator for Clayton County, Georgia. During his time at Clayton County, Bostock received positive reviews and feedback on his job performance. After a decade of employment with Clayton County, Bostock began participating in a recreational softball league for gay men. Shortly thereafter, Bostock's participation in the softball league, along with his sexuality, became the subject of disparaging comments and jokes by his co-workers. Clayton County fired Bostock, noting "conduct 'unbecoming' a county employee." Similarly, Zarda's employer fired him from his skydiving instructor position shortly after discovering that he was gay. In *Harris Funeral Homes*, the employer fired employee Aimee Stephens after she transitioned from male to female.

Bostock filed suit against Clayton County, claiming that he was discriminated against because of his sexual orientation. After a series of dismissals, Bostock appealed to SCOTUS. Oral arguments were heard on October 8, 2019 alongside a similar case questioning Title VII protections against discrimination based on sexual identity.

The Court held that an employer that fires an employee for being gay or transgender violates Title VII of the Civil Rights Act of 1964. Justice Neil Gorsuch authored the 6–3 majority opinion for the Court.

Looking to the ordinary meaning of this provision, the Court noted that an employer violates Title VII when it intentionally fires an employee based on, at least in part, sex. Specifically, the Court stated that "an employer who fires an individual for being homosexual or transgender fires that person for traits or actions it would not have questioned in members of a different sex. Sex plays a necessary and undisguisable role in the decision, exactly what Title VII forbids."

While the *Bostock* decision is an undeniable victory for LGBTQ+ rights, it leaves unresolved controversial issues such as locker room access and bathroom usage and the ability of employers to leverage the Religious Freedom Restoration Act to object to practices that otherwise burden an employer's religious beliefs. This case is certainly a huge step forward, but there's clearly more work to be done. ■

Summer Might Be Canceled, but It's Time to Take a Vacation from Volcker

On June 25, 2020, the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, and Securities and Exchange Commission announced final revisions to Section 13 of the Bank Holding Company Act, commonly known as the Volcker Rule, that would relax and clarify some of the restrictions currently in place affecting banking institutions.

The rule went into effect in 2014 as part of the Dodd–Frank Act of 2010 to protect banking customers in the aftermath of the 2008 financial crisis. The rule prevents, with some exceptions, financial institutions from investing using their own funds without observing risk retention formalities ("proprietary trading") and playing an active role in hedge funds and private equity funds ("covered funds").

The proposed revisions will allow banks to more easily make investments by both amending and clarifying restrictions on proprietary trading and covered funds by taking the following actions:

- **Limiting the reach of the rule to certain foreign funds** that are controlled by foreign banking entities and offered to foreign investors, despite the fund's connection to the United States.
- **Simplifying existing exclusions of covered funds to**:
  - Revise restrictions on foreign public funds so that they more closely track restrictions of U.S. registered investment companies.
  - Change two qualifying criteria for loan securitizations by allowing (1) up to 5% of the total assets of a qualifying loan securitization to be debt securities (but excluding asset-backed securities and convertible securities in an effort to maintain generally the same risk characteristics of the securitization); and (2) servicing rights and/or other assets that aid in timely distribution of assets to security holders or are incidental to acquiring the underlying loans to be held as assets of the securitization.
  - Simplify the calculation method of loan securitizations and the 5% rule to take into account only assets of the loan securitization (excluding incidental assets and derivatives held for risk management because these assets are more complex to value and excluding these items results in more straightforward, easy-to-use methodology).
  - Revise exclusions for small business investment companies by allowing them to continue eligibility after voluntarily surrendering their license during a wind-down period, so long as no new investments (other than cash equivalents) are made.
  - Clarify the scope of exclusion for public welfare investments and specifically exclude rural business investment companies and qualified opportunity zone funds because regulators view these as serving a similar purpose to public welfare investments given their promotion of development of rural and low-income areas.
- **Adding new exclusions from the covered fund definition**, including exclusions for venture capital funds, family wealth management, and customer facilitation vehicles.
- **Facilitating capitalization** by allowing banking entities to participate in certain low-risk activities that would have previously been prohibited under covered funds restrictions, such as investing and providing financing for small businesses by methods that were previously prohibited.
- **Easing of the existing restrictions on transactions with affiliated covered funds** by permitting additional activities, including intraday extensions of credit, riskless principal transactions, and payment, clearing, and settlement services, that benefit covered funds by minimizing the need for engaging unaffiliated third parties and therefore allowing banks to increase operational efficiencies, decrease costs, and maintain customer relationships.

After the announcement of the updates to the rule on June 25, 2020, big banks' stocks sharply rose, with many up more than 2%. In the wake of the current recession spurred by COVID-19, the enhanced certainty provided by the proposal will boost banking and investment activity once it goes into effect October 1, 2020, which *Forbes* reported will release up to $40 billion in capital. ■

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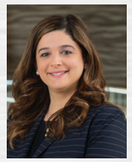

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