# CMSA Comments on Legacy CMBS TALF Program

> *TALF for legacy CMBS is a well conceived program that blends the risk tolerance of the U.S. Government and the needs and objectives of the CMBS marketplace while still adhering to the overall objective of legacy CMBS TALF to '…restart the market for legacy securities and…to stimulate the extension of new credit by helping to ease balance sheet pressures on banks and other financial institutions.'*

The CMBS market responded well to the announcement of the Legacy CMBS TALF program, and looks forward to the release of further details. CMSA members would like to thank the Federal Reserve Board of New York (FRBNY) and Treasury for providing a clear and concise description of the program. CMSA understands that not all facets of the program have been determined. With this in mind, CMBS members carefully reviewed the program as currently outlined and provide here their views and suggestions as to how to ensure that the program enjoys strong sponsorship from market participants. The views expressed here represent a large spectrum of CMBS market participants, including CMBS investors, trading desks, rating agencies, lenders, and the master and special servicing community. Thank you in advance for the opportunity to comment.

**Size of Legacy CMBS TALF Program**

The market has yet to learn the overall sizes of the new-issue and legacy CMBS TALF programs, or their individual monthly allowances/targets. The terms and conditions document that was posted on May 19, 2009 noted that FRBNY may limit the volume of TALF loans secured by legacy CMBS, and is considering whether to allocate such volume via an auction or other procedure. Perhaps the biggest near-term risk to benchmark spreads would be that the program size falls well short of what the market anticipates. With some $400 billion in potentially eligible collateral, a first-subscription size of under $10 billion would likely be met with disappointment and spread widening, particularly if there is no indication of future monthly subscription targets.

*CMSA Recommendation:* The FRBNY be very transparent with the market regarding monthly subscription and overall program sizes.

**Auction Mechanism for TALF Capacity**

The need for an auction process will be dictated in large part to the size of the monthly subscription amounts. CMSA requests more clarity on the limits on TALF loans for CMBS, including what are the minimum and maximum loan amounts and how will the auction process work to allocate capacity? Is it really best price wins or first-come, first-served? All previous documentation on TALF was first come, first serve. An auction for the financing will likely create hesitation in the market and potentially work counter to the program's objectives of tightening triple-A CMBS spreads. The higher financing costs that an auction process implies means that investors will want more spread, not less for the bonds they intend to pledge as collateral. Does the auction increase capacity or create supply/demand issues?

*CMSA Recommendation:* The auction should be first come, first served.

**Logistics / Operations**

The operational issues associated with such an important new program will dictate just how much participation the program enjoys, particularly as it relates to those looking to pledge their current holdings into TALF to free up balance sheet and alleviate capital pressures. This is particularly true for life companies. Potential users of TALF loans need to determine if they are eligible borrowers and get to work with TALF legal documents; all of this needs to be accomplished in less than 40 trading days. One factor that could help is allowing those investors/borrowers in established new-issue TALF programs to apply already completed documentation to the Legacy CMBS TALF program. Will the process be the same as exists for ABS TALF? For example, using the same MLSA document, customer agreement, custodian, KYC requirements, same pre-certification process for TALF borrowers?

*CMSA Recommendation:* The same ABS TALF documents should be used for the Legacy CMBS TALF program.

**Length of Program**

The stated final subscription date for all TALF programs remains December 31, 2009, with the FRBNY reserving the option to extend the facility. With a projected July 2009 start date for the Legacy CMBS program, what is the likelihood the final subscription date will be extended and for how long?

*CMSA Recommendation:* The length of the program should be extended beyond December 31, 2009 and the FRBNY should endeavor to inform the market as quickly as possible about the new program length.

**Pricing Mechanism for CMBS**

CMSA is requesting more clarity and perhaps a re-thinking on the price discovery issue for bonds pledged as CMBS Legacy TALF collateral. As currently outlined, FRBNY is considering granting TALF loans on recent secondary-market CMBS purchases only, with ‘recent’ meaning about a one- to three-day window. Such a purchase requirement means that those holding CMBS in portfolio will not be able to pledge collateral directly, and instead will be forced to sell their CMBS holdings into the marketplace and purchase it back within a very tight time period. Such CMBS holders may be hesitant to conduct such sales as they would trigger a mark-to-market event in which the negative generated by the lower dollar price of the bond outweighs the capital relief benefit from selling the security. Additionally, if TALF participants are required to transact over a short time period each month prior to each subscription date, it is highly likely to fan spread volatility and limit trading on the days just prior to and after the monthly subscription date. Does TALF financing need to be in conjunction with a purchase or can any inventory be submitted for financing?

*CMSA Recommendation:* Rather than requiring an actual sale to set prices, allow CMBS trading desks to mark bonds for the FRBNY, just as they mark bonds for investors and the CMBX indices each month. FRBNY could solicit bid-side prices from the six or seven large CMBS dealers outstanding on either the entire eligible CMBS universe or simply those bonds pledged in a given month. As in the CMBX process, FRBNY could throw out the high and low prices and then use the average on the remaining prices to determine price. This also avoids the FRBNY from having different prices on the same bond pledged on the same day.

**Average Life**

CMSA requests more clarity over potential adjustments to the weighted-average life (WAL) calculation (as referenced in the FAQs document). Loan extensions, losses, and prepayments affect a bond's weighted-average life. Thus, monthly movement in the underlying collateral will cause the WAL to change accordingly.

*CMSA Recommendation:* The FRBNY be clear with the market as to what assumptions it is using when projecting extensions, losses, and prepayments.

**'Turbo' Amortization Feature**

What "haircut amount" is used in the denominator when calculating the percentage of excess net interest that is required to pay down the TALF loan? Is it the original haircut balance or is the haircut amount adjusted over time as the TALF loan is paid down?

*CMSA Recommendation:* The FRBNY clarify whether the original loan amount or the reduced loan amount will be used when calculating the percentage of excess net interest.

**Collateral Monitor**

CMSA requests more clarity on the role of collateral monitor. Who would serve in the role? A single monitor or multiple monitors and what are the criteria for monitor selection? Once selected, will the FRBNY and the collateral monitor work together to disseminate more specific eligibility criteria, defining what "unacceptable performance" or "unacceptable concentrations" mean and giving quantitative measures for such? What's more, how will the collateral monitoring process work given that a CMBS pool is changing all the time, and that what may not be eligible one month, may become eligible going forward. Does FRBNY plan to publicly list those bonds that are deemed ineligible in a given month? CMSA asks for confirmation that collateral monitoring is only to monitor application on new TALF loans and that once a TALF loan is granted, the loan can't be called due to poor collateral performance. Under the heading of 'unintended circumstances,' the FRBNY's rejection of a given bond doesn't just disallow its eligibility in terms of TALF, it also triggers the re-pricing of the bond as it means that no other investor will be allowed to pledge it as collateral *and* that the FRBNY has deemed the bond to be inferior.

*CMSA Recommendation:* A more robust definition of the rejection criteria is needed and a mechanism that allows possible sellers or buyers to 'vet' bonds ahead of the subscription date is needed. The FRBNY should consider taking the bond price and adjusted haircut into consideration before deciding on eligibility. In many cases, the market has done sound work in differentiating between like-vintage super-senior triple-A bonds, with the spread differential on super-senior triple-A A4s as high as 400 basis points in some cases. Therefore, the absolute price of the bond already considers credit quality.

**Derivative Issues**

As stipulated by the Legacy CMBS TALF term sheet, the mortgages that collateralize eligible CMBS securities cannot be collateralized by other CMBS, other securities, or interest-rate swap or cap instruments, or other hedging instruments. CMSA would like clarification as to whether fixed-rate eligible SS triple-As off fixed-rate conduit/fusion CMBS with a floating-rate class (created via a balance-guaranteed swap) are eligible. Many 2006 and 2007 CMBS had interest-rate swaps associated with one class to create a floating-rate triple-A class.

*CMSA Recommendation*: The FRBNY confirm that the swap associated with a single class in a fixed-rate deal will not render the balance of the transaction ineligible.

**Re-REMICs**

With the recent announcement by S&P that it is considering large-scale downgrades of originally and currently rated triple-A CMBS fixed-rate bonds, FRBNY may want to consider that re-REMICs be permitted in the program on a very limited basis. If certain re-REMICs are deemed eligible collateral CMBS investors could use a re-REMIC structure to re-tranche downgraded triple-A CMBS to restore a portion of the downgraded triple-A balance to triple-A. The program for re-REMICs could be narrowly defined to include CMBS backed by other CMBS ("Underlying CMBS") that would otherwise have been eligible for direct pledge under TALF but for a downgrade (or placement on watch for downgrade).

*CMSA Recommendation*: With the massive increase in downgrades expected on triple-As resulting from S&P’s proposed ratings methodology and assumptions for CMBS conduit/fusion deals, these bonds will become fodder for low leverage re-REMICs and the FRBNY should consider permitting such re-REMICs in the program on a limited basis.