Questions most often posed to MJX regarding TALF –

1) Is this a first loss or equity investment?

No. The investment is in a triple A rated ABS security with the NY Fed providing financing to the investor for the purchase of the security. The ranking of the NY Fed and the investor in terms of credit loss in the triple A ABS security is that the NY Fed is senior and the investor is subordinate for losses that impact the triple A rated tranche of the ABS securitization. Thus, the NY Fed and investor are not pari passu within the triple A tranche.

Structurally, the investment is more accurately described as a mezzanine triple A ABS bond purchase or a leveraged senior triple A ABS bond purchase. It is important to note that the TALF funded triple A ABS security has a complete capital structure below it that is composed of any or all of the following first loss absorption supports or credit enhancements: (i) lower rated subordinate tranches all the way down to first loss or equity, (ii) overcollateralization and/or (iii) excess spread. Losses will be absorbed by these structural features first in reverse order. It is expected that the issuer of the ABS securitization will hold the below triple A part of the ABS securitization on its balance sheet or, if able, sell these tranches to other investors.

In summary, TALF financings will be provided only for Aaa/AAA rated consumer ABS securities. The investor's haircut or investment will be at risk for credit losses only to the extent that credit losses exceed the credit enhancement that supports the triple A ABS tranche. Currently, for example, certain Aaa/AAA rated Credit Card ABS tranches require 22% credit enhancement (made up of 100% hard subordination).

2) What types of investment funds are eligible?

Investment funds that are organized in the United States and managed by an investment manager that has its principal place of business located in the United States. If an investment fund is controlled by a foreign government or is managed by an investment manager controlled by a foreign government it is NOT an eligible borrower for the purposes of TALF.

3) Ratings/Credit Enhancements?

As mentioned only Aaa/AAA rated tranches are eligible. It is expected that, for example, in prime Auto ABS credit enhancement to the Aaa/AAA tranche will be increased by approximately 40% (depending on the specific issuance) from pre-TALF levels. In prime Credit Card ABS the credit enhancement increase is anticipated to be approximately 55 to 60% (again depending on the specific issuance) to the Aaa/AAA level. Tranches rated Aaa/AAA based on third party support are not eligible.

4) Issuer economics?

Due to secondary market trading levels, and substantially larger amounts of subordination required, is it economically feasible for the issuers? In our view, yes, mainly due to the term funding rates provided by the NY Fed and the sizing of the haircuts. These features of the TALF program combined with an anticipated pent up demand for the securities may allow issuers to fund at feasible all-in levels. Ancillary benefits include balance sheet relief for financial institutions that currently hold the grandfathered collateral along with attractive IRRs for investors that approximate the secondary market trading levels. It also affords the investors the benefit of buying in size with increased hard subordination levels.

5) Buy Side Demand?

Hard to quantify currently. There are investors who are taking the “wait and see” approach, preferring not to participate in the first funding. On the other hand, a separate group of investors see this as an enhanced opportunity due to the lack of certainty. We strongly recommend that investors quantify this for themselves; MJX’s view is closer to the latter.

6) Secondary trading/liquidity?

In the opinion of MJX, we don’t anticipate much of a secondary trading market for TALF funded securities. The spirit of the TALF program is aimed at buy-and-hold investors with the goal of getting the consumer ABS securitization market flowing. Another reason is that the TALF loan has to be paid off if the ABS asset that supports the TALF loan is sold in the secondary market.

Attempting to sell the ABS security and TALF loan as a package will require approval of the NY Fed to transfer the TALF loan. There has been discussion that the NY Fed will grant such a transfer right only if economic hardship is shown which puts a big damper on secondary market trading.

At least initially, it is MJX's view that the most prudent approach to managing a TALF funded asset portfolio is to match the duration of the asset and TALF loan liability and not rely on the liquidity of the secondary market as an exit strategy. It may not be in the portfolio's best interest to attempt to mis-match duration in the TALF transaction, as this can lead to unattainable return expectations.

On the other hand, the TALF transaction should not be considered a static transaction. The assets need to be carefully selected as all Aaa/AAA's are not created equally. The base case modeling assumptions, as well as the construction of the collateral pool need to be very carefully vetted upfront. The ongoing performance of the collateral pools must be monitored and surveilled so the investor is aware of various strategic options. This may provide a roadmap regarding an early exit strategy if deemed appropriate.

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