TREASURY UNVEILS PUBLIC-PRIVATE INVESTMENT PROGRAM

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To Our Clients and Friends:

Yesterday, the Treasury Department released the latest installment of its plan to rid U.S. financial institutions of their "toxic assets" – the mortgages and other financial assets that are creating uncertainty around their balance sheets. Although the release provides the outline for the structure of the Public-Private Investment Program and an expansion of the Term Asset-Backed Securities Loan Facility (the "TALF"), a number of significant questions remain.

The Public-Private Investment Program is the newest aspect of the Treasury's financial stability plan announced on February 10 to address the financial crisis and thaw the credit markets.[1] The Treasury Department expects that by leveraging $75 to $100 billion of Troubled Asset Relief Program ("TARP") capital with private investments and debt financing from or guaranteed by the government, the Public-Private Investment Program will generate $500 billion in purchasing power to buy mortgage loans and mortgage-backed securities – with the potential doubling of the program to up to $1 trillion in the future.

The Public-Private Investment Program contains two components:

- the Legacy Loans Program through which multiple public-private investment funds ("PPIFs") will purchase unsecuritized loans now held by insured banks and thrifts, or "legacy loans," auctioned directly from the banks and thrifts using debt guaranteed by the FDIC, and
- the Legacy Securities Program through which PPIFs run by several to-be-designated private asset managers will purchase eligible previously-issued asset-backed securities, or "legacy securities," directly from financial institutions as that term is defined in the Emergency Economic Stabilization Act of 2008 (the "EESA") with TARP financing. In conjunction with the Legacy Securities Plan, the TALF will be expanded to provide federal

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[1] *For a discussion on other aspects of the financial stability plan, please see TALF Program Nears Launch, Debevoise & Plimpton LLP Client Update, March 3, 2009 and A Week of Developments for the U.S. Financial System, Debevoise & Plimpton LLP Client Update, February 28, 2009. Copies of these memoranda are available upon request or on our website.*

funding for the purchase of certain legacy securities that were previously ineligible under the program.

Under both legacy programs, the Treasury Department will participate as an equity investor alongside private funding sources and the government will provide or guarantee financing for the PPIFs.

LEGACY LOANS PROGRAM

Participating banks will identify to the FDIC pools of assets to be sold under the program. Eligible assets will include loans and other assets to be determined based on criteria to be provided by the FDIC. The FDIC will run auctions with pre-qualified private investors bidding on the pools of assets with the banks having the option to accept or reject the highest bids. It is unclear what criteria the FDIC will use to qualify private investors, but the participation of "individual investors, pension plans, insurance companies and other long-term investors" is particularly encouraged.

If a bank accepts a bid for a particular pool of assets, a PPIF will be created to purchase the assets using equity investments from the private investor and the Treasury, with the Treasury putting up no more than 50% of the total equity. The PPIF may then issue debt (to be guaranteed by the FDIC) in an amount previously determined by the FDIC based on its consultant's analysis of the particular pool of assets, subject to a maximum debt-to-equity ratio of 6-to-1, for which the FDIC will receive a guarantee fee. If the maximum 6-to-1 leverage is provided, assuming a 50% government equity stake, the private investor would have an exposure equal to approximately 7% of the purchase price.

Once the pool of assets is purchased, private investors will control the asset management of the PPIFs, subject to "rigorous" oversight from the FDIC, although the scope of the oversight is unclear. Private investors and the Treasury will share any profits or losses ultimately realized by the PPIF based upon equity.

The Treasury materials provide that "passive" private investors will not be subject to the executive compensation restrictions applicable to financing institutions that have received TARP money.

LEGACY SECURITIES PROGRAM

The Treasury will select fund managers ("Fund Managers") upon applications due April 10, 2009 to manage PPIFs that will purchase certain legacy securities. The Treasury expects to initially select five domestically-headquartered Fund Managers, which must satisfy certain qualifications, including a "demonstrated capacity" to raise $500 million of private capital and having a minimum of $10 billion of similar securities under management. The standards for the selection process remain unclear, though applicants are required to indicate their fee structure and expected fundraising period.

Each PPIF under the Legacy Securities Program will have two equal equity investors: the Treasury and an investment vehicle (the "Private Vehicle") controlled by the Fund Manager. At the option of the Fund Manager, the Treasury will also provide non-recourse financing in an amount equal to 50% (or up to 100% in some cases) of the equity capital of the PPIF to be secured by the assets held by the PPIF (as long as the private investors do not have voluntary withdrawal rights). Treasury equity and debt financing is to be provided concurrently with drawdowns made on the Private Vehicle's passive investors, but the Treasury reserves the right to cease funding its equity or debt financing in its sole discretion.

Eligible legacy securities will initially include commercial and residential mortgage-backed securities originally rated AAA and issued prior to 2009. As opposed to the Legacy Loans Program, where assets will be auctioned under the supervision of the FDIC, it appears that the purchases of legacy securities are to be conducted opportunistically under the direction of the relevant Fund Manager. Fund Managers are meant to have full discretion over investment decisions of the PPIF, but it is not clear how this discretion will mesh with the program's stated objective of having the Fund Manager follow a predominantly long-term buy-and-hold strategy.

The Treasury materials also provide that "passive" private investors will not be subject to executive compensation restrictions, although they do not specifically address the question of whether Fund Managers will be subject to such restrictions.

Expansion of the TALF

In connection with the Legacy Securities Program, the TALF will be expanded to include non-agency residential mortgage-backed securities that were originally rated AAA and outstanding commercial mortgage-backed securities and other asset-backed securities that are currently rated AAA. Terms of the TALF loans for such assets have not yet been released, but it is expected that the duration of the loans will take into account the duration of the underlying assets and that the haircuts applicable to these loans will be greater than the haircuts applicable to currently-eligible assets.

CONCLUSION

The unveiling of the Public-Private Investment Program provides more information about the government's plan to deal with assets that are impairing the balance sheets of U.S. financial institutions. But many significant questions remain, including:

1. How will the FDIC exercise its rigorous oversight of legacy loan PPIFs?

2. Will Fund Managers of legacy security PPIFs be independent, given the long-term investment objectives?

3. What qualifies investors as passive, and will non-passive investors and Fund Managers be subject to compensation restrictions?

4. When will the government provide details of missing key economic terms, such as the terms of the debt financing?

5. Under what circumstances will the Treasury use its sole discretion to cease providing funding to legacy security PPIFs?

6. What criteria other than those summarily outlined in the Treasury materials will drive the selection of Fund Managers?

7. When will the announced programs actually be implemented?

As with other government initiatives to stem the financial crisis, the terms of the Public-Private Investment Program will undoubtedly evolve as the Treasury negotiates with financial institutions and private investors. Only time will tell whether the plan outlined by the Public-Private Investment Program will help bridge the gap between the purchase prices currently offered for legacy assets by private investors and the current asking prices of U.S. financial institutions.

Please feel free to contact us with any questions.

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