

US Department of Treasury

Public-Private Investment Program

Opportunities, Issues and Considerations
for Fund Sponsors and Investors



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On March 23, 2009, the US Department of the Treasury (“Treasury”), in conjunction with the Federal Deposit Insurance Corporation (the “FDIC”) and the Board of Governors of the Federal Reserve System (the “FRB”), released the initial outlines of its Public-Private Partnership Investment Program (the “PPIP”). The Treasury issued some additional guidance through a revised FAQ on April 6, 2009. The PPIP is part of Treasury’s broad-based Financial Stability Plan (“FSP”), announced on February 10, 2009, and represents Treasury’s most direct effort to provide for the purchase of certain “legacy assets,” including real estate-related loans and mortgage-backed securities, held by many financial institutions.

The PPIP embodies significant opportunities for sponsors, managers and servicers of investment funds, as well as investors in those funds. These funds may offer the opportunity to invest in distressed, but attractive, alternative assets in the long term, with very substantial leverage and capital provided by Treasury and the FDIC. Though much of the specific detail of the PPIP remains unissued, the initial outlines of the PPIP provide sufficient basis to consider these opportunities and some initial issues.

The PPIP will consist of two distinct components: (i) a program to address certain real estate whole loans and other approved assets (“Loans”) held on the books of insured depository institutions (the “Legacy Loans Program”) and (ii) a program to help create price discovery and a more liquid secondary market for certain securities tied to residential and commercial real estate (“Securities”) held by a broader variety of financial institutions (the “Legacy Securities Program”). Treasury expects that the PPIP will allow the purchase of up to \$500 billion in Loans and Securities, with the potential to expand up to \$1 trillion, and has reserved the flexibility to expand the PPIP to include additional asset classes, based upon market demand.

For further background concerning the PPIP, please see our March 26, 2009, Client Update, “Treasury Department Releases Details on Public-Private Partnership Investment Program,” which can be found at <http://www.mayerbrown.com/publications/article.asp?id=6402&nid=6> (“MB PPIP Client Update”).

Overview of PPIFs

Treasury has determined that current prices for certain legacy assets reflect substantial liquidity discounts due to the current financial crisis, and, as a result, that the market values of those assets are significantly below the values that would be set in normally functioning markets. In an attempt to restore both market price discovery and market liquidity for these legacy assets, Treasury intends to provide private sector investors the opportunity to create a series of Public-Private Investment Funds (“PPIFs”) that will purchase legacy assets from banks and other financial institutions using private sector funding alongside government-provided equity capital and debt support.

Although the specific structure of a PPIF will differ under the Legacy Loans Program and the Legacy Securities Program, Treasury expects that private sector investments under either program will represent 50% of the equity of each PPIF, with Treasury holding the other 50%, matching private sector equity investment dollar for dollar. The PPIF will also make several forms of government-supported leverage available to PPIFs. In addition, Treasury, along with the FRB, will expand the FRB’s Term Asset-Backed Securities Lending Facility (“TALF”) as one element of the Legacy Securities Program to provide non-recourse loans to fund purchases of Securities backed by, for example, commercial or residential mortgages. As currently formulated, the expansion of TALF will not include whole Loans targeted by the Legacy Loans Program.

To finance the components of the PPIF, Treasury will employ \$75 to \$100 billion in funds from the \$700 billion initially allocated for Treasury’s Troubled Asset Relief Program (“TARP”), as well as FDIC guarantees of debt and financing from TALF. Treasury expects that its dollar-for-dollar matching of private investment in the equity of the PPIFs, along with the provision of government-supported leverage, will increase both the willingness of private capital to participate in the market for legacy assets and the number of participants, thereby enhancing both the liquidity of the market and the effectiveness of price discovery.

Legacy Loans Program

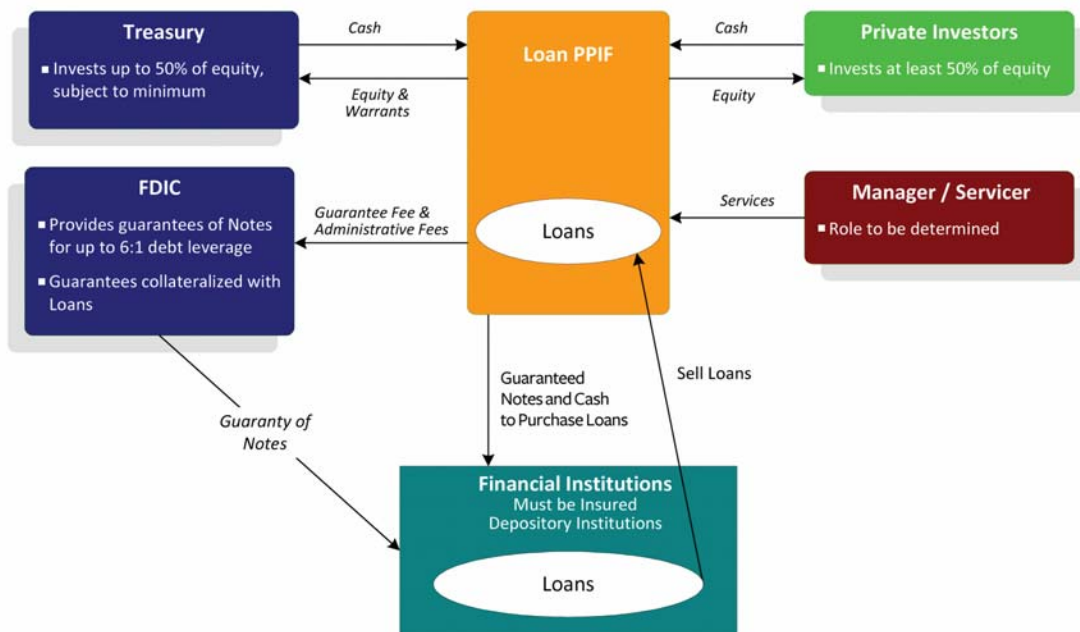
The Legacy Loans Program will allow eligible insured depository institutions (“Participant Banks”) to sell Loans through an FDIC-managed auction process to PPIFs established specifically to own and manage those assets (“Loan PPIFs”). Our prior MB PPIF Client Update describes this auction process.

General Description of Loan PPIFs

Treasury expects that eligible private investors and Treasury will invest in approximately equal proportion in the equity of the Loan PPIFs. The FDIC will guarantee debt issued by a Loan PPIF to allow a Loan PPIF to leverage its equity up to a maximum 6-to-1 ratio. These debt issuances will allow Loan PPIFs to finance their purchase of Loans as determined in connection with particular Loan PPIFs. The FDIC will charge the Loan PPIF a fee for its guarantee (a portion of which will be allocated to the Deposit Insurance Fund), and the

guarantee will be secured by a pledge by the Loan PPIF of the Loans purchased by the Loan PPIF.

Assuming that a Loan PPIF obtains full leverage from FDIC guaranteed debt, private investors in the Loan PPIFs would effectively invest approximately \$1 of equity for every \$14 worth of eligible Loans (which presumably reflects discounts from face value) in the Loan PPIF. Based on the proposals from Treasury, the diagram below illustrates the Legacy Loan Program.



Loan PPIF Management and Operations

There is very little guidance, at this point, as to the role, if any, of sponsors, managers, general partners or servicers in relation to the Loan PPIFs. This contrasts with the Securities PPIFs described below, where the role of a fund manager, including in connection with fundraising from private investors, is expressly contemplated. By disclaiming any interest to control or manage the Loan PPIFs and also encouraging private investor and fund management participation, Treasury presumably believes that there will be typical sponsor, manager, general partner and servicer roles in relation to the Loan PPIFs played by the private fund community. As such, we expect that an investment management firm will serve as the sponsor of the equity capital being raised by a Loan PPIF from private investors (with affiliates of that firm serving as the general partner and investment manager of the Loan PPIF).

Nonetheless, Treasury and the FDIC will have a very significant oversight and monitoring role. Treasury will be responsible for “overseeing and managing” its equity contributions to Loan PPIFs. The FDIC will be responsible for providing general oversight regarding the formation, funding and operation of Loan PPIFs and for overseeing and managing its debt guarantees to the Loan PPIFs. The FDIC and Treasury are also required to establish governance procedures for the management, servicing, financial, operating and reporting requirements of the Loan PPIFs, exit timing and alternatives for each of the Loan PPIFs and their Loans. Furthermore, each Loan PPIF must agree to “waste, fraud and abuse protections” to be defined by Treasury and the FDIC, and each Loan PPIF also must agree to provide access, as needed, to information required by the Special Inspector General of the TARP and the US Government Accountability Office. The details of the oversight, monitoring and compliance requirements of Treasury and the FDIC have not yet been published.

Loan PPIF Equity and Equity Distributions

While Treasury initially proposed that both Treasury and private investors invest 50/50 in the equity of Loan PPIFs, Treasury has also signaled some flexibility so that private investors may be able to provide more than 50% of a Loan PPIF’s equity, subject to a currently undefined minimum equity investment by Treasury. In the Legacy Loans Program FAQ for the Loan PPIF, Treasury stated that it would consider alternatives for its capital contribution that neither diminish the pari passu sharing of profits and losses with private investors nor alter capital neutrality compared with the outlines of the PPIP. Treasury has also expressed a willingness for participating financial institutions to retain a residual equity interest in the Loan PPIF. Also, the FDIC specifically stated in its Loan Program Conference Call that it is open to considering comments during the rulemaking process that present alternatives to a 50/50 split of equity. Regardless of the final division of equity, Treasury and private investors are expected to generally share profits and losses in proportion to the equity invested.

Treasury guidance also will be necessary to determine whether Treasury would consider any flexibility regarding any tiering or slicing of equity participation among Treasury, as an equity investor, and the private investors and Loan PPIF sponsors or managers, if utilized (as well as whether Loan PPIFs can be structured with different classes of equity interests that are issuable to private investors). If utilized, Loan PPIF sponsors or managers should likely be able to establish tiering of equity returns at least with regard to the equity capital provided by private investors, possibly including an incentive or carried interest participation in relation to private investor equity capital. Consideration is required as to whether a Loan PPIF can be structured with scaled incentive fees based upon the makeup of its private investors or the risk profile of the Loans acquired by the Loan PPIF.

The term or duration of the Loan PPIFs is also unclear (which contrasts with the express 10-year term of the Securities PPIFs) and remains to be specified. To a degree, the term will depend on whether a Loan PPIF will be permitted and expected to retain cash flow or recycle distributable or distributed proceeds to equity investors, including Treasury.

A Loan PPIF will receive interest and fee proceeds, as well as principal, refinancing and other payments, from the Loans that it acquires. Consideration is required as to the requirements, if any, for distribution and/or retention and reinvestment of these proceeds and the priority of payments, and whether, if distributed, they can be subject to mandatory recycling or reinvestment into the Loan PPIF. In particular, the prioritizing and slicing of cash flow initially between reinvestment, further acquisitions of assets and recycling, and then among debt, equity and managers as to the payment of fees (including incentive fees), expenses, costs and indemnities to managers, servicers and sponsors, FDIC fees, debt and guaranty fees, interest and amortization and tax distributions as well as distributions of income, refinancing, sale and disposition proceeds, will all require further discussion and negotiation.

The distribution, allocation and recycling provisions of a Loan PPIF will likely be driven by whether a Loan PPIF is structured as an open-end or closed-end vehicle. For example, an open-end fund usually has broad rights to recycle capital assuming no significant outstanding redemption requests, while a closed-end vehicle usually has broad rights to reinvest and recall capital during the investment period and more limited rights to reinvest capital thereafter. These structuring considerations will also impact the mechanics regarding the incentive fees and carried interest participations payable to sponsors and managers of Loan PPIFs. For example, the incentive fee for an open-end fund is typically calculated based upon its net asset value, and the carried interest participation for a closed-end fund is typically calculated on a cash-in/cash-out basis.

Distributions by a Loan PPIF to its equity holders will also be subject to distribution and other restrictions set forth in the notes issued by the Loan PPIF, as well as the guaranty and collateral arrangements of the FDIC, which have not yet been detailed. These types of restrictions are likely to be similar to the covenants that lenders require when they provide fund-level, as well as asset-level, financing to private funds. Nevertheless, the capital call mechanics for a Loan PPIF will need to focus on whether equity capital from private investors can be drawn down or recalled to repay the obligations of the Loan PPIF.

Eligible Equity Investors and Participant Banks for Loan PPIFs

Entities eligible to sell legacy assets to Loan PPIFs under the Legacy Loans Program include any insured US bank or US savings association. For purposes of this program, “US bank” and “US savings association” mean a bank or savings association organized under the laws of the United States or any state of the United States, the District of Columbia or any territory or possession of the United States. Banks or savings associations that are owned or controlled by a foreign bank or company are not currently eligible to participate as Participant Banks in the Legacy Loans Program.

For Loan PPIFs, Treasury expects private investors to constitute an array of different types of investors, including financial institutions, individuals, insurance companies, mutual funds, publicly managed investment funds, pension funds, private equity funds and hedge funds. To assure broad indirect individual participation, the PPIF program encourages the participation of mutual funds, pension plans and insurance companies, as well as participation by small,

veteran-, minority- and woman-owned firms, in the Loan PPIFs. Potential private investors will be pre-qualified by the FDIC to participate in a Loan auction.

We expect that the Loan PPIFs will be structured so as to comply with the 3(c)(7) exception from the Investment Company Act of 1940, as amended (“Investment Company Act”), which will largely limit direct investors in the Loan PPIFs to “qualified purchasers” or significant institutional investors, as described below. Investment Company Act Rule 3a-7 may also be available, depending upon the structure and asset management strategy, in which case investors would not be limited to “qualified purchasers.” However, Rule 3a-7 contains restrictions that are likely inconsistent with the expectations of the PPIFs, including restrictions on the sales and reinvestment of assets.

The FDIC has indicated that it is open to comment as to whether (i) the identities of investors in a Loan PPIF should be made publicly available; and (ii) the initial investors in a Loan PPIF be permitted to pledge, sell or transfer their interests in the Loan PPIF (and if so, how the FDIC should ensure that subsequent investors meet the program’s criteria for investors). Several considerations arise with respect to such private investors.

US Retail Investors

Retail investors might indirectly participate in Loan PPIFs through certain funds that in turn qualify as “qualified purchasers” and could invest in the Loan PPIFs. Such retail funds would likely be organized as closed-end funds registered under the Investment Company Act, offered to the investing public and listed on a national securities exchange.

Non-US Investors

Non-US banks, companies, funds and investors should be able to invest in the Loan PPIFs.

However, the Legacy Loans Program FAQ references “foreign investors with a headquarters in the United States.” The Securities PPIF program does not so restrict non-US investors. No other Legacy Loans Program materials refer to a US-headquarters limitation for investors, but this suggests that the FDIC and Treasury may need to clarify this point. Presumably, for example, it would be permissible to have a US-headquartered subsidiary of a particular non-US investor serving as manager, sub-manager or sub-adviser. Currently, investment funds and other entities (other than insured US banks and thrifts and US branches and agencies of foreign banks) controlled by foreign governments are not eligible investors under TALF and they likely would not be eligible investors in Loan PPIFs. Because private investors will be pre-qualified by the FDIC, there will be a subsequent opportunity to determine whether a Non-US investor is “eligible.”

Non-US investors confront several US taxation issues inherent in the Loan PPIF structure, with respect to both the nature of the underlying assets and the scope of permissible activities (which at this point remain unclear) that may be performed with respect to those assets.

Non-US investors, moreover, may be reluctant to expose themselves to the potential requirements of TARP and TALF, as well as other aspects of US law. Depending on the details of the Loan PPIF, non-US investors might consider investing through an unleveraged, side-by-

side or parallel fund structure that provides exposure and participation in the Loans of the Loan PPIF but without leverage from the FDIC, TARP or TALF. Alternatively, depending on the details of Treasury's approval of non-US investors, non-US investors might indirectly participate in a Loan PPIF through a total return swap in respect of the Loan PPIF and structured by an eligible US institutional investor.

ERISA and US Pension Plans

The PPIF proposal encourages the inclusion of plans subject to the Employee Retirement Income Security Act of 1974, as amended from time to time ("ERISA"), and other pension fund investors. Such investors may invest in private funds that invest in distressed loans and other alternative assets, subject to general prudence and diversification considerations. ERISA plans are also subject to prohibitions on direct and indirect transactions with persons, called "parties in interest," who have certain specified relationships to the plan, including the plan sponsor, fiduciaries and service providers to the ERISA plan and their affiliates. These "prohibited transaction" rules could limit an ERISA plan's ability to invest in a Loan PPIF sponsored by a party in interest to the ERISA plan, unless an exemption is available.

Affiliated Investors

Private investors may not participate in any Loan PPIF that purchases assets from sellers that are affiliates of such private investors or that represent 10% or more of the aggregate private capital in the Loan PPIF.

Loan PPIF Warrants

In its materials, Treasury states that each Loan PPIF will be required to issue warrants to Treasury. These warrants, we expect, are in addition to the equity provided to Treasury and may or may not equally dilute both Treasury and the private investors. The specific economic attributes of these warrants require further guidance, including their percentage participation interest, exercise price (if any), duration, protective covenants (if any) and dilution protections or adjustments in connection with future capital issuances by the Loan PPIFs. Clarification as to such financial terms is critical, of course, for purposes of analyzing the financial returns available to private investors in the Loan PPIFs.

Assuming, that the Loan PPIFs are structured as US partnerships, limited liability companies or other pass-through entities, then several additional considerations arise with regard to warrants in such entities, because warrants are typically used to provide a participation interest in a corporation (as opposed to a partnership or other non-corporate entity). For example, would the warrants participate in periodic current income distributions of the Loan PPIF, or would they only participate in distributions above a certain level equating to an exercise price? The answers to these and similar questions will be crucial to the structuring of the distribution waterfalls (and corresponding allocation provisions) for private investors in Loan PPIFs, as well as the incentive fees and carried interest participations payable to managers of Loan PPIFs.

Guaranteed Notes for Loan PPIF

A third-party valuation firm will estimate the value of a pool of eligible assets and will advise the FDIC on the appropriate level of FDIC-guaranteed leverage that should be offered to the Loan PPIF, while taking into account expected cash flows based on interest rates, the risk of the underlying assets, expected lifetime losses, geographic exposures, maturity profiles and other relevant factors in relation to the Loans. Leverage will be determined solely by the FDIC on a pool-by-pool basis (with the debt-to-equity ratio not to exceed 6 to 1 for each Loan PPIF).

The Loan PPIF will issue notes to the Participant Banks that are guaranteed by the FDIC and the Participant Banks will be able to hold or resell these notes into the market if they choose. The FDIC guarantee will be collateralized by PPIF assets, and the FDIC will charge the Loan PPIF a debt guarantee fee, a portion of which will be allocated to the Deposit Insurance Fund. Financing terms will be as set forth in the FDIC Guaranteed Secured Debt for each Loan PPIF. The specific amount of leverage will be determined by the FDIC in connection with each Loan PPIF, as will the guarantee fee. The other terms of the notes (e.g., rate, maturity, payments, covenants and defaults) and guarantee and collateral agreements (e.g., collateral release, covenants and defaults) require additional explanation by Treasury or the FDIC.

In addition, the FDIC is considering whether issuing notes to Participating Banks is the preferred approach. In particular, the FDIC has requested public comment with respect to the advantages and disadvantages of structuring the program so that the Loan PPIFs issue debt publicly in order to pay cash to the Participant Banks (as opposed to issuing notes to the Participant Banks).

Each Loan PPIF will be required to maintain a Debt Service Coverage Account (“DSCA”) to ensure that available capital for each Loan PPIF is sufficient to meet anticipated debt servicing obligations, interest expenses and operating expenses. A Loan PPIF will initially withhold a portion of the funds payable to the Participant Bank from the sale of eligible assets to cover this DSCA obligation. Once the Loan PPIF has received sufficient income from the eligible assets to replace the withheld funds, the Loan PPIF will pay the Participant Bank the remaining funds and replace those funds in the DSCA with income from the eligible assets.

Fees Payable to the FDIC

The FDIC will be reimbursed for all expenses relating to the eligible asset pool auctions and will also receive administration fees from the Loan PPIFs for the oversight function it performs. With respect to the guarantee fee, Loan PPIFs will pay the FDIC the guarantee fee annually on the anniversary of the transaction closing date. The amount of these fees remains to be specified and will likely be proposed for each Loan PPIF (and the FDIC is considering whether these fees will be adjusted based on the risk characteristics of the underlying pool or other criteria).

Fees and Compensation for Sponsors

There is very little guidance as to the role of sponsors, managers and servicers in connection with Loan PPIFs, including their role, if any, in fundraising from private investors, their role in

managing the Loan PPIF and their fees and compensation from the Loan PPIF. This contrasts with the Securities PPIFs, where the role of a fund manager, including in connection with fundraising from private investors, is expressly provided. Nonetheless, because Treasury will look to private capital to fund and private management to manage the PPIF, we expect that the Loan PPIFs will provide for a typical associated sponsor general partner, manager and servicer of the Loan PPIF and the loans therein, with the selling financial institution (or its servicer) retained to provide certain servicing of the Loans in the Loan PPIF.

The Loan PPIF proposals from Treasury do not place stipulations on management, servicing, administrative or other fees payable by the Loan PPIF to either the sponsor, manager or servicer of the Loan PPIFs or on any incentive, performance or carry fees or participations to the sponsor, manager or servicer. Management fees for Loan PPIFs will likely be comparable to fees for distressed loan funds.

Master servicing and administration fees for performing residential and commercial mortgage loans typically range from 2 to 10 basis points per annum (depending on float arrangements) and would presumably be charged to the Loan PPIF. The sponsor would likely contract for primary servicing back to the financial institution that sold the Loan to the Loan PPIF, which fees typically are 0.25% to 0.50% per annum on the loan balance of residential mortgage loans and 2 to 8 basis points on performing commercial mortgage loans. Non-performing commercial mortgage loans are usually subject to special servicing arrangements that may include a fee of approximately 0-25% per annum in addition to incentive fees tied to resolution. The sponsor, manager or general partner of the Loan PPIF may be able to charge an incentive, services or carry-type fee in relation to the private investor equity capital, but likely not the Treasury equity capital, as such fees could be viewed as providing differing returns for Treasury equity capital as compared to private investor and sponsor capital.

Legacy Securities Program

Treasury and the FRB intend to expand the existing TALF program, which currently applies only to asset-backed securities issued after January 1, 2009, to include certain legacy securities tied to residential and commercial real estate. The Legacy Securities Program will allow the use of PPIFs that are formed and managed by qualifying private sector asset managers (“Fund Managers”) to purchase Legacy Securities from financial institutions (“Securities PPIFs”).

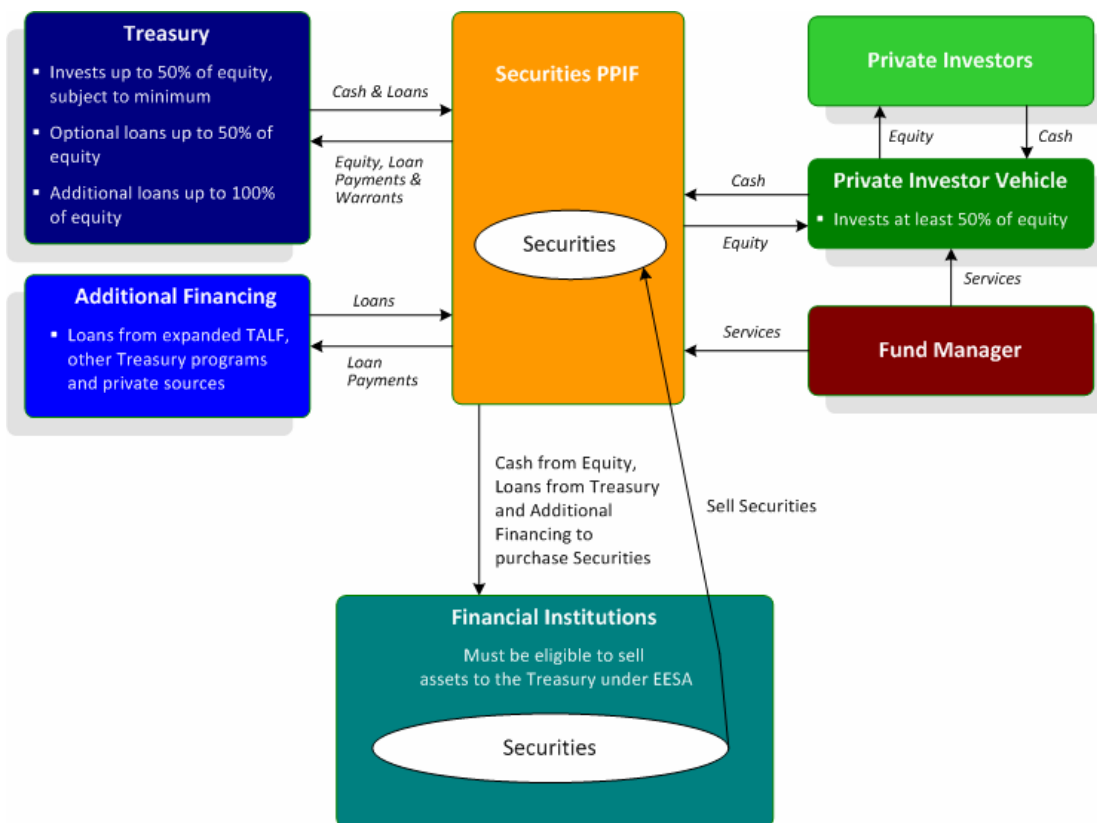
General Description of Securities PPIFs

Treasury initially expects to approve five Fund Managers for Securities PPIFs. Treasury is considering opening the program to smaller Fund Managers (i.e., less than \$10 billion (market value) of eligible assets under management). These Fund Managers will be permitted to establish one or more Securities PPIFs that will raise equity capital from private investors through various investment vehicles (“Investor Vehicles”) that invest in each Securities PPIF. The Securities PPIFs will be long-only investment funds. Each Securities PPIF will also receive matching equity funds and leverage of up to 100% of total equity capital from Treasury to

purchase eligible Securities. Securities PPIFs may also finance the purchase of eligible Securities through borrowings from TALF, any other Treasury program or debt financing raised from private sources; provided that Treasury equity capital and Investor Vehicle capital is leveraged proportionately to the private debt financing sources.

Assuming that a Securities PPIF obtains full leverage from Treasury (100% of total equity contributions), and assuming, as market participants believe, that Treasury haircuts the Securities by close to 20%, then, as commentators have speculated, with the additional TALF leverage, private investors could effectively invest as little as \$1 of equity through Investor Vehicles for the fair amount of every \$20 worth of eligible Securities (which reflect discounted values from face value) in the Securities PPIF. However, the April 6 FAQ suggests that the amount of leverage is still under consideration, and Treasury may be sensitive to criticisms of providing substantial leverage to private investors in a political climate which ascribes leverage in the financial system as a systemic risk. Securities PPIFs are expected to be designed to generate returns for taxpayers and private investors through a long-term “buy and hold” strategy. Managers will clearly expect some clarification as to the interaction between this objective and its strategies involving sales and dispositions of Securities, substitution of Securities and hedging or other derivative transactions in respect of the Securities.

Based on the proposals from Treasury, the diagram below illustrates the Legacy Securities Program:



Eligible Fund Managers

Private asset managers wishing to participate in the Legacy Securities Program as Fund Managers must submit an application to Treasury as part of the selection process no later than 5:00 p.m. (ET) on April 24, 2009. Treasury expects to inform an applicant of its preliminary approval on or prior to May 15, 2009. Fund Managers will be prequalified based upon criteria that are anticipated to include: (i) demonstrated capacity to raise at least \$500 million of private capital; (ii) demonstrated experience investing in eligible Securities, including through performance track records; (iii) a minimum of \$10 billion (market value) of eligible Securities under management; (iv) demonstrated operational capacity to manage the PPIFs in a manner consistent with Treasury's stated investment objective while also protecting taxpayers; and (v) headquarters in the United States.

In response to concerns about the limited number of organizations that could meet the criteria, Treasury stated, in its April 6 FAQ, that the failure to meet any one of these criteria will not necessarily disqualify a proposal. In an effort to ensure broad based participation in the program, Treasury encourages small, veteran, minority- and women-owned businesses to partner with private asset managers. Treasury will allow smaller firms to partner prior to or after the application deadline, including after the selection of the initial Fund Managers.

Securities PPIF Management and Operations

Securities PPIFs will be created and managed by Fund Managers. Fund Managers will control the process of Securities selection, pricing, asset liquidation, trading and disposition of the Securities PPIF. Treasury will not have "control rights" over the Securities PPIFs.

Fund Managers will be required to present monthly reports to Treasury on Securities purchased, Securities disposed of, current valuations of Securities and profits/losses on Securities included in each Securities PPIF. Prices of Securities for reporting purposes must be tracked using third-party sources and annual audited valuations by a nationally recognized accounting firm. Fund Managers must agree to "waste, fraud and abuse protections" to be defined by Treasury and must also agree to provide access, as needed, to relevant books and records of the Securities PPIFs for Treasury, the Special Inspector General of the TARP and the US Government Accountability Office.

Securities PPIF Equity and Equity Distributions

Once approved by Treasury, Fund Managers will have 12 weeks to set up a Securities PPIF and raise at least \$500 million of private capital to target the designated asset classes and will be required to demonstrate committed capital. Treasury equity capital will be invested on a dollar-for-dollar basis with these private investors in each Securities PPIF. However, if a Fund Manager fails to raise \$500 million of private capital, such Fund Manager would not be eligible for the equity match or debt financing provided by the Treasury. Proceeds received by a Securities PPIF will be apportioned between Treasury and the private investors based upon

equity contributions, except that Treasury will take warrants as required by the Emergency Economic Stabilization Act of 2008, as amended (“EESA”).

Fund Managers will make proposals for the term of a Securities PPIF with the intention to maximize returns for taxpayers and private investors, but no greater than 10 years, subject to extension with Treasury’s consent.

Private investors may be given voluntary withdrawal rights at the level of an Investor Vehicle, subject to limitations to be agreed with Treasury, including that no private investor may have the right to voluntarily withdraw from an Investor Vehicle prior to the third anniversary of the first investment by such Investor Vehicle. (It is unclear whether an Investor Vehicle will be permitted to accept additional commitments from private investors after its Securities PPIF has its initial closing.) However, Securities PPIFs that are funded with equity capital from an Investor Vehicle with a liquidity feature will not be eligible for financing from Treasury.

Treasury equity capital will be drawn down in tranches to provide for anticipated investments (subject to potential limitations). However, as a general matter, Treasury equity capital may only be drawn down at the same time and in the same proportion as private capital. Debt financing provided by Treasury is expected to be funded at the same time as drawdowns of equity commitments. Significantly, Treasury, in its sole discretion, will have the right to cease funding of committed but undrawn Treasury equity capital and debt financing. This unilateral right of Treasury to discontinue their commitment to satisfy equity capital commitments is problematic and raises a number of considerations, including advance notice for such discontinuation, parallel rights for private investor commitments and the impact on the management, operations and profitability of the Securities PPIFs if equity drawdowns and the growth and size of the Securities PPIFs are unexpectedly curtailed. Absent additional guidance regarding what circumstances are likely to trigger Treasury’s exercise of this right, Treasury’s retention of the right could be a practical obstacle to the ability of Fund Managers to effectively plan, fund, market and leverage their Securities PPIFs.

A Securities PPIF will receive interest and fee proceeds, as well as principal, refinancing and other payments, from the Securities that it acquires. The requirements, if any, for distribution and/or retention and reinvestment of these proceeds and the priority of payments, and whether, if distributed, they can be subject to mandatory recycling or reinvestment into the Securities PPIF must be considered. In particular, the prioritizing and slicing of cash flow initially between reinvestment, further acquisitions of assets and recycling, and then among debt, equity and managers as to the payment of fees (including incentive fees), expenses, costs and indemnities to managers, servicers and sponsors, debt and guaranty fees, interest and amortization and tax distributions as well as distributions of income, refinancing, sale and disposition proceeds, will all require further discussion and negotiation.

The distribution, allocation and recycling provisions of a Securities PPIF (as well as its corresponding Investor Vehicle) will likely be driven by whether the Investor Vehicle uses an open-end or closed-end structure. These structuring considerations will also impact the mechanics regarding the management fees, incentive fees and carried interest participations

payable to Fund Managers. The distribution, allocation and recycling provisions of a Securities PPIF will likely be driven by whether a Securities PPIF is structured as an open-end or closed-end vehicle. For example, an open-end fund usually has broad rights to recycle capital assuming that there are not significant outstanding redemption requests, while a closed-end vehicle usually has broad rights to reinvest and recall capital during the investment period and more limited rights to reinvest capital thereafter. These structuring considerations will also impact the mechanics regarding the incentive fees and carried interest participations payable to sponsors and managers of Securities PPIFs. For example, the incentive fee for an open-end fund is typically calculated based upon its net asset value and the carried interest participation for a closed-end fund is typically calculated on a cash-in/cash-out basis.

Distributions by the Securities PPIFs to its equity holders will be subject to distribution and other restrictions set forth in the Treasury and TALF loans to the Securities PPIF. These types of restrictions are likely to be similar to the covenants that lenders require when they provide fund-level, as well as asset-level, financing to private funds. Nevertheless, the capital call mechanics for a Securities PPIF (as well as its corresponding Investor Vehicle) will need to focus on whether equity capital from Investor Vehicles can be drawn down to repay the obligations of the Securities PPIF.

Eligible Equity Investors and Participant Banks for Securities PPIFs

Private investors will invest indirectly in each Securities PPIF through an Investor Vehicle, which, in turn, will invest in the Securities PPIF, which will likely be a fund and which will be “controlled” by a Fund Manager. The Investor Vehicle and Treasury will be the sole equity investors in the Securities PPIF. The governance structure at the Securities PPIF level remains an open question due to lack of detail in the term sheets. Fund Managers will raise capital from private investors to be invested side-by-side with capital contributed by Treasury.

In the Legacy Securities Program, there appears to be no limit imposed by Treasury or the FDIC on the scope of eligible private investors, as with the Legacy Loan Program. Each Fund Manager must include in its application a statement of expectations as to the composition of its expected private investor base, such as financial institutions, foundations, public pension plans, university and other endowments, high net worth individuals and/or retail investors. Several considerations arise with respect to such investors in the Investor Vehicles.

Eligible Securities can be purchased only from “financial institutions” from which the Secretary of the Treasury may purchase assets pursuant to Section 101(a)(1) of the EESA. Thus, US depository institutions, broker-dealers and insurance companies, as well as US branches and agencies of foreign banks, should be eligible to sell eligible Securities into Securities PPIFs, as long as they are not owned by foreign governments. The EESA definition of financial institution includes any institution established and regulated under the laws of the United States or any state. Therefore, bank subsidiaries, bank holding companies and non-bank subsidiaries of banking holding companies also should be eligible to the extent that they are organized in the United States.

Non-US Investors

Non-US banks, companies, funds and investors should be capable of investing in the Investor Vehicles. Non-US investors also face several significant tax issues.

ERISA and US Pension Plans

The PPIP proposal encourages ERISA and pension fund investors. Such investors may invest in private funds that invest in debt securities and other alternative assets, subject to general prudence and diversification considerations. ERISA plans are also subject to prohibitions on direct or indirect transactions with persons, called “parties in interest,” who have certain specified relationships to the plan, including the plan sponsor, fiduciaries and service providers to the ERISA plan and their affiliates. These “prohibited transaction” rules could limit an ERISA plan’s ability to invest in a Securities PPIF sponsored by a party in interest to the ERISA plan, unless an exemption is available. ERISA plans also have special tax considerations, as tax-exempt investors.

Retail Investors

Retail investors might indirectly participate through Investor Vehicles that, in turn, qualify as “qualified purchasers” and could invest in the Securities PPIFs. Such retail funds would likely be organized as closed-end funds, registered under the Investment Company Act, offered to the investing public and listed on a national securities exchange.

Affiliated Investors

Each Fund Manager may only purchase eligible Securities from sellers that are not affiliates of such Fund Manager, any other Fund Manager or their respective affiliates and that are not private investors that have committed at least 10% of the aggregate private capital raised by such Fund Manager.

Securities PPIF Warrants

In its proposals, Treasury states that each Securities PPIF will be required to issue warrants to Treasury. These warrants, we expect, are in addition to the equity provided to Treasury and may or may not dilute equally both Treasury and the private investors. The specific economic attributes of these warrants require further guidance, including their percentage participation interest, exercise price (if any), duration, protective covenants (if any) and dilution protections or adjustments in connection with future capital issuances by the Securities PPIFs. The exercise price of the warrants may be set at the implicit value of the assets at the time of the transaction. Clarification as to such financial terms are critical, of course, for purposes of analyzing the financial returns available to private investors in the Securities PPIFs.

Assuming that the Securities PPIFs are structured as US partnerships, limited liability companies or other non-corporate entities, then several additional considerations arise with regard to warrants in such entities because warrants are typically used to provide a participation interest in a corporation. For example, would the warrants participate in periodic current income distributions of the Securities PPIF, or would they only participate in distributions above a certain level equating to an exercise price? The answers to these and

similar questions will be crucial to the structuring of the distribution waterfalls (and corresponding allocation provisions) for private investors in Securities PPIFs, as well as the incentive fees and carried interest participations for Fund Managers.

Fees Payable By the Treasury

For Treasury equity capital, Treasury has indicated that it will accept proposals for fixed management fees (“Treasury Fees”) to apply as a percentage of equity capital contributions for invested equity capital. Treasury Fees and Treasury’s share of Securities PPIF expenses will be paid solely out of distributions with respect to Treasury equity capital.

Debt Financing

Each Fund Manager will have the option to obtain for each Securities PPIF secured, non-recourse loans from Treasury (“Treasury Debt Financing”) in an aggregate amount of up to 50% of a Securities PPIF’s total equity capital. However, Treasury Debt Financing will not be available for any Securities PPIF in which the private investors have voluntary withdrawal rights. Treasury will consider requests for additional Treasury Debt Financing for a cumulative total of up to 100% of a Securities PPIF’s total equity capital (from Treasury and the Investor Vehicles) subject to further restrictions on asset level leverage, withdrawal rights, disposition priorities and other factors Treasury deems relevant. This senior debt will have the same duration as the underlying Securities PPIF and will be repaid on a pro-rata basis as principal repayments or disposition proceeds are realized by the Securities PPIF. In addition, the senior debt will be structurally subordinated to any financing extended to Securities PPIFs under the expanded TALF.

Fund Managers that intend to request this additional Treasury Debt Financing and/or propose additional terms should do so in their applications. The Treasury Debt Financing will be secured by the eligible Securities held by the applicable Securities PPIF, will accrue interest at an annual rate to be determined by the Treasury and will be payable in full on the date of termination of the Securities PPIF.

Securities PPIFs may also finance the purchase of eligible Securities through non-recourse debt under the expanded TALF program, any other Treasury program or debt financing raised from private sources. However, Treasury equity capital and private capital must be leveraged proportionately from those private debt financing sources. Under the expanded TALF programs, market participants currently expect that the haircut that TALF applies to the Securities may exceed the 5-15% range generally applied to eligible Securities under TALF, taking account of the relative illiquidity and riskiness of the Securities, and reach as high as 20%. This additional TALF debt financing can multiply the effective leverage available to the Securities PPIF.

Under the expanded TALF programs to cover the Securities, market participants currently expect that the haircut will be significantly larger than the approximately 5-15% range generally applicable to eligible ABS under TALF. The relative illiquidity and riskiness of the Securities, and the longer term, will likely necessitate larger haircuts for these Securities.

Fees and Compensation for Sponsors

Fund Managers may charge private investors fees in their discretion. Treasury will consider the fees proposed to be charged to private investors when evaluating applications by private asset managers. Treasury will accept proposals for Treasury Fees with respect to its equity capital. Treasury Fees and Treasury's share of the expenses of a Securities PPIF will be paid solely out of distributions with respect to Treasury equity capital. Any fees paid to a Fund Manager or its affiliates in connection with a Securities PPIF, other than Treasury Fees and management or incentive fees charged to private investors, should accrue to the benefit of the Treasury and private investors on a pari passu basis based on equity capital commitments.

The Securities PPIF proposals from Treasury do not, on their face, stipulate management, servicing, administrative or other fees payable by the Securities PPIF to either the sponsor, manager or servicer of the Securities PPIFs or any incentive, performance or carry fees or participations to the sponsor, manager or servicer. Management fees for Securities PPIFs will likely be comparable to hedge funds investing in similar securities. Administrative fees for funds with such asset classes typically range from 0.50% to 0.75% per annum and would presumably be charged to the Securities PPIF. The sponsor, manager or general partner of the Securities PPIF may be able to charge an incentive, services or carry-type fee in relation to the Investor Vehicle equity capital, but likely not the Treasury equity capital (except with respect to the Treasury Fees described above), as such fees could be viewed as providing differing returns for Treasury equity capital as compared to Investor Vehicle and sponsor capital.

Type of Assets and Certain Regulatory Issues Pertaining to Those Assets

Eligible Assets under Loan PPIF Program

Although the FDIC has indicated that it is open to comment on whether it should consider additional asset classes, eligible assets for Loan PPIFs are initially expected to be real estate loans and supporting collateral (e.g., residential and commercial mortgages) that are situated “predominantly” in the United States. Potential Participant Banks will identify and evaluate the eligible Loans to be sold to a Loan PPIF in coordination with their primary bank regulator (and as part of this process, Participant Banks must also demonstrate to the satisfaction of Treasury and FDIC that the contemplated loan pools qualify based upon forthcoming Treasury and FDIC minimum requirement).

As evident from the questions for which the FDIC is seeking public comment, the details with respect to structure and operations of the Loan sales are still being determined. For example, the FDIC has requested public comment as to (i) how it should best structure the valuation and bidding process to motivate sellers to bring assets to a Loan PPIF, (ii) what type of auction process would facilitate the broadest investor participation, (iii) whether it should require investors to bid on the entire equity stake of a Loan PPIF and (iv) whether the program should permit multiple selling banks to pool assets for sale.

Eligible Securities under Securities PPIF Program

Securities Eligible for FRB TALF Expansion

Treasury and the FRB are still in the process of developing the details of the expanded TALF. However, eligible Securities are expected to include certain non-agency residential mortgage-backed securities (“RMBS”), asset backed securities (“ABS”) and commercial mortgage-backed securities (“CMBS”) that were rated AAA at origination. In expanding TALF to cover Securities, Treasury said that the eligible Securities are expected to include RMBS that were originally rated AAA and outstanding CMBS and ABS that are rated AAA. Taken together, we expect that with respect to a Securities PPIF that intends to use TALF, the CMBS or ABS acquired by that PPIF must be originally rated AAA (to meet the PPIF standards) and currently rated AAA (to meet TALF standards).

Many critical aspects of the program, such as eligibility criteria for borrowers, lending rates, minimum loan sizes, loan durations and required collateral haircuts remain to be determined. Once these critical terms are set, the process for obtaining TALF loans to fund purchases of securities should be relatively straightforward, given that several TALF deals closed in March and other are expected to close in April of 2009. For a more detailed description of the TALF program and process, please see our Client Update, “The Rubber Hits the Road for the Term Asset-Backed Securities Loan Facility,” which can be found at <http://www.mayerbrown.com/FinancialMarkets/article.asp?id=6338&nid=9774>.

Certain Political and Regulatory Risks

Political Risk

The full scope of the political ramifications for participants in various aspects of the PPIF and other programs will be an ongoing issue. As has been observed over the course of the broader development of the TARP, “bank bailouts” and the perceived divergence of interests between “Wall Street” and “Main Street” have riled a Congress that, on both sides of the aisle, has shown a renewed enthusiasm to address certain pockets of public sentiment about the financial crisis. In perhaps the most dramatic example of the results of the frothy political climate created by the financial crisis, the US House of Representatives passed, as a response to the AIG bonus issue, what would have amounted to a retroactive 90% tax on certain 2008 compensation granted to employees of a significant number of recipients of government capital.

In addition, in the name of protecting the US taxpayer, Congress has also shown a willingness both to propose and to enact measures that may be viewed, to a certain extent, as discriminatory against non-US individuals and entities. For participants in the PPIFs, which will utilize favorable leverage and guarantees from TALF and TARP, there is unquestionably some concern about whether these retroactive attacks on excessive compensation might in the future be applied to perceived excessive or windfall profits from PPIFs and whether non-US participants could be subject to special focus.

Although Treasury, the FDIC and the FRB have all made it clear that they understand that the PPIP cannot be successful without participation from the private sector, it remains to be seen whether the appearance of excess compensation of various participants will be subject to the existing restrictions on executive compensation or hiring H-1B visa workers, or require participation in other programs, such as the administration's mortgage loan modification program. Furthermore, even if these restrictions are not included in the initial terms of the PPIP, participants will likely remain concerned that subsequent legislation could impose similar or more draconian provisions at a later date, and possibly with retroactive effect.

There is no effective means of mitigating or hedging the risk that Congress will retroactively impose restrictions on PPIP participants if the public perception is that the institutions that created the products that caused the crisis are now benefiting from those now-toxic assets being sold to the US taxpayer. These provisions could conceivably include: new taxes applied to "excessive" profits earned by participants; prohibitions on payment of proceeds to non-US employees, affiliates or counterparties; a re-allocation of the investment risks; or the government's withdrawal from the program at an earlier than expected date. While sellers and sponsors of PPIPs likely have the greatest exposure to political risk, private investors should also consider the political risk of participating, particularly where a potential investor is not a financial institution already subject to any TARP-imposed restrictions.

Depending on further guidance, we recognize that participants may pursue various inquiries to address the risk of the broad, retroactive and unexpected application of such rules through establishing new entities and funds (and not using existing entities and funds) to participate, and through investor approaches of utilizing non-controlled feeder funds, investment programs that do not utilize TALF funds or possibly investing in total return swaps that derive value and payments in relation to a PPIF.

Executive Compensation and Travel & Entertainment Restrictions

To help encourage participation, and presumably to help assuage concerns arising from recent congressional actions in response to compensation issues, Treasury has expressly stated in materials accompanying the announcement of the PPIP that passive private investors in PPIFs will not be subject to executive compensation restrictions solely as a consequence of that investment. Presumably, this means that passive private investors not otherwise subject to executive compensation restrictions will not be subjected to new restrictions as a result of investment in a PPIF under either program. However, the PPIP does not yet define the parameters of what makes one a "passive" private investor and whether an initially "passive" investor could lose that characterization if they exercised any voting rights or general partner or manager removal rights typically associated with many private investment fund structures.

More problematic is the implication that non-passive investors would be subject to executive compensation restrictions. "Active" investors, such as those associated with any manager, servicer, general partner or sponsors, may therefore be regulated by those executive compensation restrictions. Equally unclear is the question as to whether these excess compensation provisions will reach beyond any entities established to invest in, sponsor,

manage or advise PPIFs to any parents or affiliates. This will certainly require further clarification from Treasury.

H-1B VISA Worker Restrictions

The Employ American Workers Act applies the H-1B dependent employer rules to companies that receive money under TARP and to those companies that receive funding under Section 13 of the Federal Reserve Act. On March 31, 2009, the Federal Reserve stated that only the entity that directly borrows from a Federal Reserve bank is a “recipient of funding.” If the borrower is a special purpose entity, then any entity that owns or controls 25% or more of the special purpose entity is also a “recipient.” The application of this 25% test to the equity and equity securities of the PPIFs will be important, because if it is contrived to be measured by reference to each class of PPIF equity interests, as opposed to total equity, then slices of equity allocated to particular investors, or as carry interests to sponsors, may be unexpectedly reached if the measurement is for each class of equity. More information can be found in our March 31, 2009, Client Alert, “Visa Restrictions for TARP/TALF Recipients,” available at <http://www.mayerbrown.com/publications/article.asp?id=6412&nid=6>.

The guidance also describes who is a “recipient of funding” under various credit facilities operated by the Federal Reserve. The guidance can be found at <http://federalreserve.gov/monetarypolicy/files/eawafaq.pdf>. It is unclear how the visa restrictions will apply to participants in the PPIP, although this may provide a basis for the position that only the PPIF itself, and not its investors, managers or servicers, is viewed as such a recipient or a recipient of funding.

Licensing for the Legacy Loan Funds

There are approximately 12-18 US states that may require a license or registration to purchase or hold residential mortgage loans. These licensing requirements arguably apply even if the loans were originated by a licensed lender or exempt entity and are being serviced by a licensed servicer. Thus, PPIFs purchasing legacy Loans as part of the PPIP may be subject to state mortgage loan licensing requirements. HUD licensing may also be required to hold or service certain residential mortgage loans. With respect to commercial mortgage loans, PPIFs will need to carefully consider the licensing laws in California to determine whether the structure would require licensing for the fund.

Banking Organizations as Asset Managers and/or Investors

In addition to participating as sellers, banking organizations may seek to participate in the PPIP as asset managers and/or investors. Each banking organization must carefully consider whether its participation in this manner is authorized under the complex and distinctive regulatory requirements applicable to it. As a general matter, bank holding companies, thrift holding companies, national banks and federal thrifts and most state-chartered banks and thrifts have broad authority to engage in asset management, servicing and collection activities for third parties with respect to loans and other assets that they may originate and own directly, including real estate loans and mortgage-backed securities. Certain issues may arise,

however, as in the case of foreclosed properties, which banking organizations generally may only own for limited periods of time, or non-investment grade MBS.

The ability of a banking organization to participate as an investor in PPIFs will depend primarily on the nature and amount of the proposed investment, the structure and type of assets held by the PPIF and where in the organization the investment is held (e.g., depository institution, depository institution subsidiary or elsewhere in the holding company structure).

Generally, most banking organizations may make controlling or non-controlling investments in limited partnerships or other limited liability investment vehicles that invest solely in assets (such as loans or MBS) that the banking organization can own directly. However, because the Securities PPIFs are targeted at legacy MBS that were “originally” rated AAA, it is possible that some PPIFs might look at non-investment grade MBS (although these may not be TALF eligible). Most depository institutions generally are prohibited from investing directly or indirectly (e.g., through subsidiaries) in non-investment grade securities, although there may be some flexibility in particular circumstances, particularly for thrift institutions. Bank holding companies generally have broader authority to make such investments, although issues may arise depending on the specific structure and assets.

Certain Investment Company Act, Advisers Act and Securities Act Issues

Loan PPIFs and Securities PPIFs will be established in accordance with exceptions from the Investment Company Act’s definition of “investment company.”. The exception most likely to be used will be the 3(c)(7) exception that generally requires each investor in the PPIF to be a “qualified purchaser.” Generally, a “qualified purchaser” is any individual who owns at least \$5 million in investments or any entity (e.g., an institutional investor) that owns and invests on a discretionary basis at least \$25 million in investments. In connection with the 3(c)(7) exception, any investment fund established for the purpose of investing in the PPIFs, if 3(c)(7) entities themselves, must, in turn, also be such “qualified purchasers.” If a 3(c)(7) entity is deemed to have been formed for the purpose of investing in a private fund, that entity will likely be “looked through” to its investors in order to determine if they are 3(c)(7) investors.

Consequently, the PPIFs, as well as any funds or investment vehicles formed for the purpose of investing therein, including such vehicles for private investors in the Loan PPIFs and the Investor Vehicles (any such vehicles formed for such purpose and investing therein), will have to meet the qualified purchaser definition.

Nonetheless, the broad array of investors contemplated by the PPIF could indirectly invest through certain vehicles. Any investment funds or vehicles that are 3(c)(7) eligible not formed for the purpose of investing in the PPIFs could invest. Also, it might be possible for retail investors to invest through closed-end management companies that are registered under the Investment Company Act, frequently offered to the public in an underwritten public offering and listed on a national securities exchange. A closed-end fund may be treated as a regulated investment company (“RIC”) for US federal income tax purposes. One of the requirements for

qualification as a RIC is that such closed-end fund is required to distribute at least 90% of its income each year, which would require carve-outs in the PPIF debt facilities and potentially reduce the ability of the PPIFs to retain and recycle income.

Forming mutual funds registered under the Investment Company Act may not be an appropriate vehicle for retail investors in view of the relative illiquidity of the underlying assets in the PPIFs as contrasted to the liquidity requirements of a mutual fund (generally 85%). However, existing mutual funds may still have the ability to allocate a relatively small percentage investment in PPIF vehicles while remaining consistent with their liquidity requirements. Similarly, it remains to be seen whether forming a business development company electing to be treated as such under the Investment Company Act will be an appropriate structure to bring in retail investors, especially in view of the requirement that at least 70% of their investments be in small businesses and in view of recent SEC scrutiny of certain business.

If PPIFs are 3(c)(7) entities, moreover, their debt financing and debt securities may be limited to debt lenders and investors that, in turn, are 3(c)(7) qualified purchasers. For the notes issued by the Loan PPIFs that are guaranteed by the FDIC (which will be initially issued to the Participant Bank, some of which will then be available for resale by the Participant Bank), we expect that Treasury and the SEC may be requested to relax this limitation because those FDIC guaranteed notes may effectively be viewed as government securities. This FDIC guaranty should qualify these notes as “exempt securities” under Section 3(a)(2) of the Securities Act of 1933, as amended (“Securities Act”), although this may require “no-action” confirmation from the SEC. If this avenue cannot establish retail investor access to the notes of the Loan PPIFs, another alternative would be to seek an exemption for the PPIFs pursuant to Rule 3a-7 under the Investment Company Act, to sell investment grade debt securities to retail investors. However, Rule 3a-7 contains restrictions that are likely inconsistent with the expectations of the PPIFs, including restrictions on the sales and reinvestments of assets.

The managers and any other persons providing investment advisory services to the PPIFs would likely be viewed as investment advisers under the Investment Advisers Act of 1940, as amended (“Advisers Act”), and may therefore be required to register. While they might be able to avail themselves of an exemption from registration for advisers with fewer than 15 clients, we expect that the Treasury, when it provides further details, will likely require such advisers to so register, especially in light of the TARP and TALF funds involved. Moreover, under pending legislation, the PPIFs themselves may be viewed as investment companies subject to registration under the Investment Company Act and may be subject to books and records, anti-money laundering and other requirements. Registration of the advisers, and of the PPIFs themselves, may not realistically subject them to more scrutiny than has already been signaled by Treasury in connection with the PPIF.

The Investment Company Act is replete with myriad restrictions relating to portfolios, capitalization and transactions with affiliates. It remains to be seen as to what, if any, relief

from the SEC would be needed in order for a registered investment company to be employed in connection with the PPIP.

Certain Tax and ERISA Issues for Public Fund Structures

We expect that the Loan PPIFs and Securities PPIFs will be private funds, although they could have investors that operate in effect as feeder or aggregation funds or vehicles for other public funds for retail investors. Certain issues in connection with the PPIFs, as private funds, and the feeders or aggregators, also as private funds, are discussed below.

Tax Issues

IRS CIRCULAR 230 NOTICE. Any advice expressed in this memorandum as to tax matters was neither written nor intended by Mayer Brown LLP to be used and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed under US tax law. If any person uses or refers to any such tax advice in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to any taxpayer, then (i) the advice was written to support the promotion or marketing (by a person other than Mayer Brown LLP) of that transaction or matter, and (ii) such taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.

Generally, the structural tax issues that arise with respect to a public fund, be it a business development company or some other public (or even private) closed-end fund, generally occur at the Investor Vehicle level. In these structures, the PPIF would likely be treated as a partnership for tax purposes. The PPIF would be owned by Treasury and an Investor Vehicle, which would generally be structured for US federal income tax purposes as a corporation that is taxed as a RIC. Under the RIC rules, the Investor Vehicle would generally have to meet certain asset distribution and income requirements. A RIC is subject to US federal income tax but is entitled to a deduction for certain qualifying distributions. As a result, the Investor Vehicle would have to make annual distributions at least equal to its annual income in order to offset its income and avoid entity level tax. Such distributions may be difficult under the PPIP, which might result in Investor Vehicle level tax or even cause an Investor Vehicle to fail to meet its distribution requirements.

It may also be possible to structure the Investor Vehicle as a “real estate investment trust” (a “REIT”). In order to qualify as a REIT, an Investor Vehicle must meet certain income and asset tests, some of which relate to the real estate assets owned by the Investor Vehicle. Because the Investor Vehicle would be viewed for tax purposes as holding directly its pro rata portion of each asset owned by the PPIF, the vehicle may be able to meet the real estate asset tests. A REIT is also subject to US federal income tax but is entitled to a deduction for certain qualifying distributions. Thus, an Investor Vehicle treated as a REIT may also have entity level tax if its distributions are limited under the PPIP.

Distributions by Investor Vehicles that are treated as RICs or REITs to its foreign investors, if any, may be subject to a 30% US withholding tax, unless reduced or eliminated by an applicable US tax treaty.

ERISA Issues

An investment company that is registered under the Investment Company Act is exempt from the requirements of ERISA, regardless of the percentage of the investment company's securities that are owned by ERISA plans. Accordingly, ERISA plans may invest in a registered investment company without the 25% limitation applicable to certain private funds as discussed below.

Certain Tax and ERISA Issues for Private Fund Investors

Tax Issues

We would expect the typical private PPIF structure, whether it is a Loan PPIF or a Securities PPIF, to resemble a typical private equity structure. As such, the PPIF and the Investor Vehicle each would be treated as a partnership for US federal income tax purposes, with income and gain taxable to the investors directly rather than subject to tax at the entity level. The same tax issues typically present in a private equity fund would be inherent in such a structure: foreign investors would be sensitive to "effectively connected income" ("ECI") and US tax-exempt investors would be sensitive to any "unrelated business taxable income" ("UBTI") that would be allocated to them. (If the PPIF has multiple classes of debt, some structuring may be required to eliminate any concern that the PPIF would be treated as a "taxable mortgage pool," which would be taxable as a corporation.)

Unless the PPIF's activities are adequately restricted such that the PPIF would be able to rely on the "securities trading" safe harbor, a foreign investor runs the risk that such activities could cause it to be treated as "engaged in a trade or business within the United States," which would generally cause the income allocated to the foreign investor to be ECI. As discussed above with respect to Securities PPIFs, the PPIF is supposed to operate under a long term "buy and hold" strategy. However, to the extent such strategy yields to profit maximizing opportunistic sales and dispositions of certain PPIF assets, it is unclear whether the PPIF's activities would be adequately restricted to keep the PPIF from being treated as engaged in a trade or business within the United States. Likewise, with respect to a Loan PPIF, any work-out or restructuring activities with respect to Loans held by the PPIF could be problematic unless those activities are effectively restricted to keep them from rising to the level of a trade or business within the United States.

If a foreign investor is allocated income that is ECI, the income would generally be subject to US income tax on a net basis, would trigger a tax filing obligation on the foreign investor, and would be subject to a "branch profits tax" when distributed. A foreign investor may seek to invest in the Investor Vehicle through a foreign company or "feeder fund" that is treated as a corporation for US federal income tax purposes. Such a company would generally "block" the

US federal income tax consequences and limit the affect of the investment on other US source income of the foreign investor. ECI allocated to such a company would still be subject to US income tax on a net basis and possibly branch profits tax. It may be possible, however, to structure the feeder fund as a domestic RIC or REIT, as discussed above in Public Fund Structures – Tax Issues.” In such event, tax at the feeder fund level would be reduced by certain qualifying distributions, but distributions may be subject to a 30% US withholding tax, unless reduced or eliminated by a US tax treaty.

In addition, gain recognized on the sale or other disposition of US real property held by the PPIF (which would generally occur through foreclosure of a mortgage loan held by the PPIF) and allocated to a foreign investor (or, alternatively, the foreign feeder corporation, if applicable) would be treated as ECI. In such a case, the foreign investor (or alternatively the foreign feeder corporation, if applicable) would be subject to US income tax on a net basis on the gain under the Foreign Investment in Real Property Act (“FIRPTA”). Furthermore, if the foreign investor (or alternatively the foreign feeder corporation, if applicable) was not otherwise filing US income tax returns, it would be required to file a return to report the FIRPTA gain. It is expected that any FIRPTA gain would be minimal, as the US real property would generally be acquired upon foreclosure. As a result, a foreign feeder corporation could be used to avoid imposing reporting or filing obligations on the foreign investor without also causing significant tax at the foreign feeder level.

US tax-exempt investors that are sensitive to UBTI likewise may seek to invest through a foreign feeder corporation or a RIC or REIT. Such a structure would generally have the effect of converting UBTI into “good” investment income for the US tax-exempt investor, because dividend income from the feeder would not be considered UBTI. However, as discussed above, if income allocated to a foreign feeder corporation is ECI, the feeder would be subject to US income tax on a net basis, a tax filing obligation and possibly a branch profits tax. RICs and REITs would also be subject to US income tax to the extent that their income was not offset by a qualifying distribution, and their dividend distribution may be subject to a 30% US withholding tax, unless reduced by a US tax treaty. As an alternative, a US tax-exempt investor should consider investing through an unleveraged, side-by-side or parallel fund structure that provides exposure and participation in the PPIF assets but without leverage from the FDIC, TARP, TALF or private financing sources.

While utilizing a blocker structure is a common structuring technique to address ECI and UBTI issues for investors sensitive to those types of income, recently proposed anti-tax-haven legislation could, if enacted, cause such a blocker (if structured as a foreign feeder corporation) to be treated as a US corporation for US federal income tax purposes, which would subject the feeder fund to an entity level tax and could cause dividend distributions to be subject to a 30% US withholding tax. While the likelihood that this particular proposed legislation would ever be enacted at this point seems remote, the current incendiary climate in Congress coupled with the mere fact that such a provision was even introduced could be enough to scare off potential foreign and US tax-exempt investors.

ERISA and Pension Issues

Less than 25% Approach

A private fund, such as a Loan PPIF or a Securities PPIF, that accepts ERISA investors could itself become subject to the fiduciary and prohibited transaction rules under ERISA if the assets of the private fund are deemed to be plan assets of the ERISA investors. Section 3(42) of ERISA states that “plan assets” are as defined by such regulations as the US Department of Labor may prescribe, but that under such regulations an entity shall not be treated as holding plan assets if less than 25% of the total value of each class of equity interests in the equity is held by benefit plan investors, counting as benefit plan investors only investors subject to ERISA or Section 4975 of the Tax Code (including IRAs). Foreign, governmental and most church plans are not treated as benefit plan investors. The chart below highlights how certain common types of institutional investors are classified for purposes of the less than 25% plan asset exception.

Classification of Investors for ERISA 25% Exception

Investors included for purposes of the Statutory 25% Exception (“Benefit Plan Investors”)	Investors not included for purposes of the Statutory 25% Exception (“Non-Benefit Plan Investors”)
Private US Corporate Retirement Plans (including pension plans, profit sharing plans, 401(k) plans, VEBA trusts and welfare plans)	Plans sponsored by federal, state and local governmental entities
US Labor union (“Taft Hartley”) plans	Foreign pension plans
Individual Retirement Accounts (“IRAs”) and Keogh plans	Foundations and endowments
Certain employer-sponsored tax-deferred annuities (“403(b) plans”)	Certain non-employer-sponsored 403(b) plans
Church sponsored plans electing to be subject to ERISA	Church sponsored plans that do not elect to be subject to ERISA
Entities themselves holding ERISA plan assets (generally on a proportional basis to the extent of ERISA participation), including: <ul style="list-style-type: none"> • Funds of funds • Hedge funds • Insurance company general accounts • Other unregistered commingled investment vehicles 	Registered investment companies
	Private funds that are not subject to ERISA

When applying the less than 25% exception to a PPIF, the interests of the fund manager or general partner and other persons who exercise discretion over fund investment or provide investment advice, and affiliates of such persons, are disregarded. In addition, the 25% exception must be met with respect to each class of equity interest in the PPIF in order for the exclusion to apply to the fund. Therefore, if ERISA investors are permitted to invest in any class of securities of a PPIF, the ERISA class, as well as each other class, must be limited to less than 25% Benefit Plan Investors, even if another class does not include any ERISA investors. ERISA does not define “class.” Accordingly, if offered securities are divided into multiple classes, for example, to permit different fees or to represent interests in segregated portfolios within a PPIF, each class should be tested separately.

The less than 25% exception must be met after each acquisition of an equity interest in any class of securities in the PPIF, including an acquisition in a non-ERISA class of securities or an acquisition by a Non-Benefit Plan Investor. Furthermore, the Department of Labor has stated that the term “acquisition” should be construed broadly and should include, for example, an increase in the interests of the remaining investors caused by the redemption or partial redemption of any investor.

Operating Company Approach

Another plan asset exemption is available under an ERISA regulation for a fund that qualifies as an “operating company.” An “operating company” is defined in regulations under ERISA as an entity that is primarily engaged, directly or through a majority-owned subsidiary or subsidiaries, in the production or sale of a product or service other than the investment of capital. The operating company exception was intended to distinguish between companies that carry on an active trade or business and, therefore, are not likely vehicles for the indirect provision of investment management services, and investment funds that serve as conduits for the provision of such services.

The regulation describes two specific types of operating companies that have characteristics both of operating companies and of investment funds. These are real estate operating companies — entities that invest primarily in actively managed real estate with respect to which the entity participates substantially in the management activities — and venture capital operating companies — entities that invest primarily in operating companies with respect to which the entity obtains rights to participate substantially in the management of the operating companies. Given the nature of the anticipated investments, it is unlikely that a PPIF would be able to qualify for an operating company exception.

ERISA Fund Approach

The manager of a PPIF who does not wish to limit investment by ERISA plans and other Benefit Plan Investors to less than 25% could consider structuring the PPIF to comply with ERISA requirements. Although ERISA would impose a significant amount of additional regulatory requirements on a PPIF, many managers of securities and loan funds operate in compliance with these requirements. Briefly, the major additional requirements that would apply to an ERISA PPIF include:

- The manager of the PPIF must be a registered investment adviser and agree to be a fiduciary under ERISA to each ERISA investor in the fund.
- The management of the PPIF must comply with the ERISA prudence standard of care.
- The manager must act exclusively in the interests of the PPIF and its ERISA investors and may not cause the PPIF to engage in transactions with respect to which the manager has a conflict of interest.
- The fiduciary conflict of interest prohibitions under ERISA would also impose limitations on the structure of the manager's compensation and permissible expense reimbursement, dealings with affiliates, allocation of investment opportunities and other areas of potential conflict of interest.
- The manager may not cause the PPIF to engage in purchase, sale, financing or other transactions with persons who are parties in interest to any ERISA investor unless an exemption is available. Managers of ERISA funds typically comply with these prohibited transaction rules by reliance on one or more of the administrative or class prohibited transaction exemptions available under ERISA.
- The manager must obtain a bond protecting the assets of the PPIF that meets the requirements under ERISA.

Timetable and Next Steps for Treasury and FDIC

The announcement of the Legacy Securities and Legacy Loans Programs set forth major elements that will be fleshed out in the coming weeks by Treasury and the FDIC. With respect to the Legacy Securities Program, it is likely that Treasury will issue reviewed terms and conditions and revised FAQs as it has throughout the financial crisis, acting under its EESA authority. We would expect Treasury to update and revise these issuances over the coming weeks and move quickly in implementing the Legacy Securities Program once Fund Managers have been approved. As noted above, applications to participate as a Fund Manager are due April 24, 2009, and Treasury expects to inform an applicant of its preliminary approval on or prior to May 15, 2009. Barring the emergence of additional details that would slow or halt the progress of implementation, once fund managers have been approved and notified of approval, we would expect that the timetable for the Legacy Securities Program to begin purchasing Securities would be 6-8 weeks.

As to the Legacy Loans Program, the FDIC is currently requesting comments on a series of questions posted on its website (<http://www.fdic.gov/llp/progdesc.html>). These comments are part of what we understand to be an informal process ending April 10, 2009, that may or may not precede a formal notice and comment rulemaking period. If the FDIC determines that formal notice and comment is not required, it will probably proceed quickly to develop the parameters of the program in a manner similar to Treasury (e.g., via the use of additional term sheets and FAQ). Assuming no formal rulemaking is required, we believe the FDIC could potentially begin auctions 6-10 weeks from the time it issues the final structure and the

participation guidance following the informal comment period. If formal rulemaking is required, then it would probably be reasonable to expect that the timeline for rolling out the first auctions would be at least three months from April 10th.

Finally, it remains to be seen whether the ongoing “stress tests” of major US banks will speed the development of the PPIP, or if the newly issued FASB guidance on so-called “mark-to-market” accounting will cause sellers and/or purchasers to hesitate to participate and slow down development, particularly of the Legacy Securities Program (as many loan pools can be held to maturity and are not necessarily subject to the vagaries of “fair value” accounting).

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