Treasury Department Releases Details on Public-Private Partnership Investment Program

THE PPIP IN BRIEF

- This newly announced Treasury program includes two components — the Legacy Loans Program and the Legacy Securities Program.
- The PPIP seeks to combine private sector investment, government capital, and government-supported leverage to create as much as $1 trillion in purchasing power.
- The PPIP is designed to create a more liquid market for troubled "legacy" assets, including whole mortgage loans and certain mortgage-backed securities.
- Many significant questions remain regarding the operation of the two components and the practical consequences of participating as a seller, asset manager, or investor.

Legacy Loans Program

- Eligible sellers will identify to FDIC pools of loans and other eligible assets to sell into the program.
- FDIC will auction these pools to private investors.
- Private investors will hold the pools in specially created funds.
- Treasury will invest side-by-side with private sector equity investment, with fund leverage provided by FDIC-guaranteed debt in an amount up to six times equity.
- Eligible sellers are insured US banks or thrifts, but excluding those US banks or thrifts owned or controlled by a foreign entity.
- The class of eligible private sector investors is broad, but subject to pre-approval by the FDIC.
- The FDIC is seeking public comment on several aspects of the Legacy Loans Program through its web site: http://www.fdic.gov/llp/progdesc.html. Comments may be submitted until April 10.

Legacy Securities Program

- The Federal Reserve Board will expand the TALF program to accept certain legacy mortgage- and asset-backed securities.
- Separately, Treasury will allow the private sector to create funds to purchase eligible legacy mortgage- and asset-backed securities.
- Treasury will approve a limited number of fund managers through an application process, which will then establish funds to purchase and hold these securities. Applications for fund managers must be submitted by April 10, 2009.
- The funds will be capitalized by the private sector, with funding and leverage also provided by Treasury.
- Eligible sellers are "financial institutions" as broadly defined under the EESA.
- Generally no limit to scope of eligible investors, but may be limited in practice by fund structure.

More on PPIP >

Introduction

On March 23, 2009, the US Department of the Treasury (Treasury), in conjunction with the Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System (FRB), released the long-anticipated details of its Public-Private Partnership Investment Program (PPIP). The PPIP is the most recent program to be announced under Treasury's broad-based Financial Stability Plan (FSP), announced February 10, 2009, and represents Treasury's most direct effort to purchase "legacy assets," both real estate-related loans and mortgage-backed securities, held by many financial institutions.

As described further below, the PPIP will consist of two distinct components: (i) a program to address certain real estate 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 backed by loan portfolios 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 legacy assets, 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.

While broad parameters have been set forth, various key details concerning both components remain unclear, and it will still be some time before they are up and running. For example, the information released on Monday indicates that the "exact requirements and structure" of the Legacy Loans Program will be subject to an FDIC rulemaking proceeding involving the opportunity for public comment. FDIC is requesting public comment on several aspects of the Legacy Loans Program through its web site at http://www.fdic.gov/llp/progdesc.html. Comments may be submitted until April 10, 2009.

We analyze the PPIP as described in the materials released to date, and identify several of the issues that remain to be resolved. Additional analysis of the structure and practical implications of the PPIP will be forthcoming as details are announced.

Overview

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 percent of the equity of each PPIF, with Treasury holding the other 50 percent, matching private sector investment dollar-for-dollar. The PPIP 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 certain legacy securities backed by, for example, commercial or residential mortgages.[1] As currently formulated, the expansion of the TALF will not expand the TALF to include whole loans or similar assets targeted by the Legacy Loans Program.

To finance the components of the PPIP, 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 the 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.

EXECUTIVE COMPENSATION RESTRICTIONS

To help encourage participation, and presumably to help assuage concerns arising from recent congressional actions in response to the AIG bonus issue, 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, nor does it provide similar assurances for financial institutions selling assets into the PPIP or the asset managers for assets that are sold.

FDIC Chairman Sheila Bair, during the FDIC's March 23, 2009, "Press and Technical Briefing Conference Call on Legacy Loans Program," expressed her view that those sellers of assets into the Legacy Loans Program that are not already subject to executive compensation restrictions (e.g., because of participation in Treasury's Capital Purchase Program) should not be subjected to those restrictions as a consequence of selling assets to a PPIF. In support of this position, Chairman Bair noted that sellers are being asked to receive market prices that may result in losses.[2]

This logic would likely support a similar view regarding sellers of assets under the Legacy Securities Program. However, this view thus far has not been stated in the formal guidance issued in connection with either component of the PPIP, and the political risk of these and other limitations subsequently being applied to participants in the PPIP clearly must be taken into account.

Legacy Loans Program

The Legacy Loans Program will allow eligible insured depository institutions (Participant Banks) to sell whole loans and other assets (Eligible Assets) through an FDIC-managed auction process to PPIFs established specifically to own and manage those assets (Loan PPIFs).

GENERAL STRUCTURE OF LOAN PPIFS

It is expected that eligible private investors (Private Investors) and Treasury will invest in approximately equal proportion in the equity of the Loan PPIFs.[3] However, Private Investors may be able to provide more than 50 percent of a Loan PPIF's equity, subject to a currently undefined minimum equity investment by Treasury. Also, the FDIC specifically stated in its Loan Program Conference Call that it is open to considering comments received 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 will share profits and losses in proportion to the equity invested. 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 in order to finance its purchase of legacy assets.[4] The FDIC will charge a fee for its guarantee (a portion of which will be allocated to the Deposit Insurance Fund), and the guarantee will be secured by the legacy assets purchased by the Loan PPIFs. As it is likely that the market will continue to have an appetite for essentially risk-free debt, the FDIC guarantee should allow Loan PPIFs to raise funds at an attractively low cost, assuming the FDIC's guarantee fee is reasonable.

The Loan PPIF will generally retain control of servicing the assets it purchases, and servicing typically will be provided by the Participant Bank, unless another arrangement is reached. Treasury is not expected to play a role in asset management, nor will it receive control rights over a Loan PPIF as a result of its equity investment. However, Treasury will be responsible for "overseeing and managing" its equity contributions to a Loan PPIF.

The FDIC also is not expected to play a role in managing or servicing Loan PPIF assets, but 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 will enter into an agreement allocating their respective costs and responsibilities. The FRB will not have any direct responsibilities under the Legacy Loans Program, except where it consults with Treasury or the FDIC in its capacity as a Participant Bank's federal banking regulator.

How Treasury and the FDIC implement their respective oversight roles on a practical basis may have a significant impact on the willingness of Private Investors to participate in the Legacy Loans Program.

PARTICIPANT BANKS

Participant Banks 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 eligible to participate as Participant Banks in the Legacy Loans Program. This eligibility standard currently also would exclude the uninsured US branches of non-US banks, and likely would exclude the few remaining grandfathered, FDIC-insured US branches of non-US banks. No rationale has been provided for excluding foreign-owned US banking operations from the program. Moreover, the exclusion is not required by the relevant statutory definition of "financial institution" in the Emergency Economic Stabilization Act of 2008, as amended, (EESA) and raises issues of national treatment, competitive equity and openness of the United States to foreign investment in the banking sector. Accordingly, non-US banks that maintain US branches or agencies, and US banks or thrifts that are owned or controlled by foreign banks or companies, should consider commenting on this issue.[5]

While insured depository institutions (other than those owned by foreign banks or entities) are eligible, the non-bank subsidiaries of banks, holding companies and holding company subsidiaries are not expressly covered. This may present an issue for banking organizations that conduct their mortgage lending business through an operating subsidiary or a holding company subsidiary.

To the extent that mortgage loans are held in an operating subsidiary of the insured depository institution, it may be possible to transfer these loans to the bank for sale under the program. However, if the loans are held by an affiliate of the bank, the affiliate transaction restrictions imposed by Section 23A of the Federal Reserve Act may complicate the transfer of those loans to the bank. Moreover, even if it were possible from a regulatory and capital standpoint, it is unclear whether a Participant Bank's primary regulator or Treasury would permit the purchase of Eligible Assets from an ineligible third party specifically for the purpose of selling those assets to a Loan PPIF.

In addition to these general eligibility standards, Treasury and the FDIC will make a final determination on eligibility and allocation for specific Participant Banks after consultation with the appropriate federal banking agency. While the PPIP materials do not shed light on what criteria will be used to make this final determination, considerations likely will include the financial and overall supervisory condition of a Participant Bank.

ELIGIBLE ASSETS

The exact structure and requirements of the Legacy Loans Program will be established pursuant to a rulemaking proceeding subject to public comment. Eligible Assets are expected to be real estate loans and supporting collateral (e.g., residential mortgages) that are situated "predominantly" in the United States.[6] Potential Participant Banks should work with their primary bank regulators to identify and evaluate the Eligible Assets to be sold to the Loan PPIF and the corresponding financial impact on the Participant Bank resulting from the sale of those assets. Treasury and the FDIC are encouraging regulators and Participant Banks to identify and sell assets "with a view to restoring maximum confidence for depositors, creditors, investors and other counterparties." The intention is probably to encourage Participant Banks

to dispose of their most troublesome Eligible Assets first, and Chairman Bair noted on the Loan Program Conference Call that the supervisory process may include examiners identifying, at least informally, certain Eligible Assets that should be sold.

After identifying a pool of assets to sell, potential Participant Banks and their regulators will contact the FDIC to express interest in participating in the program. Participant Banks must then demonstrate to the satisfaction of Treasury and the FDIC that the contemplated loan pools qualify based upon forthcoming Treasury and FDIC minimum requirements. FDIC staff noted on the Loan Program Conference Call that, as part of the process of creating the structure for the Legacy Loans Program, a pooling mechanism may be established for smaller Participant Banks with fewer loans to sell that will permit them to aggregate those loans into a larger pool of Eligible Assets.

ELIGIBLE PRIVATE INVESTORS

Private Investors are expected to include an "array of different investors," including financial institutions, individuals, insurance companies, mutual funds, publicly managed investment funds and pension funds. Potential Private Investors will be pre-qualified by the FDIC to participate in an Eligible Asset pool auction. Despite the program's reference to an "array" of Private Investors, the structure of the auction process will likely hinder the ability of individuals and small entities to participate directly as asset purchasers. Instead, these Private Investors presumably will participate in the Legacy Loans Program by purchasing interests in Loan PPIFs set up by winning bidders.

The PPIP does not state that foreign companies and their US subsidiaries are ineligible to participate in the Legacy Loans Program as Private Investors. Therefore, it appears that, unlike the definition of Participating Bank, non-US investors, including non-US funds and the US and non-US offices of foreign banks, should be able to invest. However, it should be noted that the Legacy Loans Program FAQ references a non-exhaustive list of potential Private Investors that includes, among others, "foreign investors with a headquarters in the United States." No other Legacy Loans Program materials refer to a US-headquarters limitation for investors, but its presence in the FAQ document suggests that the FDIC and Treasury may need to clarify this point. Currently, investment funds and banks controlled by foreign governments are not eligible investors under TALF. Because Private Investors will be pre-qualified by the FDIC, there will be a subsequent opportunity to determine whether an investor is "eligible." In addition, Private Investor *groups* must be approved by the FDIC, but cooperation between Private Investor groups will be prohibited once the auction process begins.

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

THE AUCTION PROCESS

When a pool of Eligible Assets is ready to be sold to a Loan PPIF, the FDIC will oversee initial due diligence and the preparation of marketing materials, and will conduct the auction process.[7] The Participant Bank will be required to make information available to the FDIC and Private Investors to facilitate the bidding process. Although the specific information that the Participant Bank will be required to provide has not yet been described, the requirement to make any information available to Private Investors likely reflects the FDIC's sensitivity to investor concerns regarding the scope and adequacy of due diligence that Private Investors will be permitted to perform on the assets underlying Loan PPIFs.

For each pool of Eligible Assets to be auctioned, the FDIC will receive independent valuation advice from a third-party valuation firm (Third Party Valuation Firm). This Third Party Valuation Firm's analysis will assist the FDIC in discussions with Participant Banks to determine the valuation of Eligible Assets, inform initial views on appropriate leverage and provide information about the structure and value of bids.

The Third Party Valuation Firm will estimate the value of a pool of Eligible Assets, and will advise the FDIC on the appropriate level of leverage to offer.[8] Leverage will be determined on a pool-by-pool basis,

although it is anticipated that the debt-to-equity ratio will not exceed a maximum of 6-to-1 for any potential Loan PPIF.

Knowing the level of leverage offered by the FDIC, Private Investors will be invited to bid for the opportunity to create and contribute 50 percent of the equity to a Loan PPIF with Treasury contributing the remaining equity. The winning bid for the equity stake, together with the amount of debt the FDIC is willing to guarantee (based on the predetermined debt-to-equity ratio), will determine the price offered to the Participant Bank for the asset pool. For example, if the FDIC will offer 6-to-1 leverage, the Private Investor may offer to pay $100 million, knowing that Treasury will pay $100 million; that combined $200 million then may be leveraged up to 6 times for an additional $1.2 billion, for a total offer price of $1.4 billion.

For a bid to be considered in the auction process, the bid must be accompanied by a refundable cash deposit for 5 percent of the bid value. If a bid is unsuccessful, or is ultimately rejected by the Participant Bank, the deposit will be refunded (subject to the bidders' adherence to the material terms of the auction procedures). Although it is not clear from the guidance, we expect that the cash deposit for "5 percent of the bid value" refers to 5 percent of the Private Investor's proposed equity contribution, rather than 5 percent of the total price including debt financing offered to the selling bank.

The FDIC will review received bids and select the winning bids. Once a bid is selected, the Participant Bank will have the option of accepting or rejecting the bid within a to-be-established timeframe. This is a valuable option for Participant Banks that would prevent a Participant Bank from being locked into a transaction at an unacceptably low valuation. However, the practical value of this option may be limited by the risk that the FDIC or an institution's primary regulator may seek to discourage a Participant Bank from rejecting a low bid, particularly where the Participant Bank has been encouraged by its regulator(s) to sell these assets either through the examination process or stress testing.

Consideration paid to Participant Banks in exchange for purchased Eligible Asset pools will be in the form of cash or cash and debt issued by the Loan PPIFs. Debt and equity funding for each Loan PPIF will occur at the closing of each Eligible Asset pool purchase.

Example:

Treasury has provided the following simplified example to illustrate how the Legacy Loans Program will function:

Step 1: A Participant Bank that is seeking to divest a pool of residential mortgages with $100 face value approaches the FDIC.

Step 2: The FDIC determines the ratio at which it is willing to leverage the pool — assumed for the example to be the maximum 6-to-1 debt-to-equity ratio.

Step 3: The pool is then auctioned by the FDIC, with several private sector bidders submitting bids. The highest bid from the private sector — in this example, $84 (i.e., valuing the pool at 84 cents on the dollar) — is the winner and forms a Loan PPIF to purchase the pool of mortgages.

Step 4: Of this $84 purchase price, the FDIC guarantees $72 of debt financing, leaving $12 of equity.

Step 5: The Treasury then provides 50 percent of the equity funding required on a side-by-side basis with the Private Investor. Thus: Treasury invests $6, with the Private Investor contributing $6.

Step 6: The private investor would then manage the servicing of the asset pool and the timing of its disposition on an ongoing basis, with the Participant Bank (or another asset manager approved and subject to oversight by the FDIC) typically providing the servicing.

FEES AND ADDITIONAL DETAILS REGARDING ADMINISTRATION OF THE LEGACY LOANS PROGRAM

While Treasury will not have control rights over a Loan PPIF as a result of its equity investment, Loan PPIFs will be managed within parameters to be established by the FDIC and Treasury (e.g., with respect to management, servicing agreements, financial and

operating reporting requirements, and exit timing), with reporting to and oversight by the FDIC.

The FDIC will be reimbursed by Treasury under a cost-sharing arrangement for all expenses related to conducting Eligible Asset pool auctions. Loan PPIFs will pay administration fees to the FDIC for the oversight functions it performs.

In exchange for the debt guarantee, the FDIC will charge Loan PPIFs an annual guarantee fee (Guarantee Fee). The amount of the Guarantee Fee has not yet been determined, but will be based on outstanding debt balances. Loan PPIFs will pay the FDIC the Guarantee Fee annually on the anniversary of the transaction closing date, and the FDIC will allocate a portion of the Guarantee Fee to the Deposit Insurance Fund.

Each Loan PPIF will be required to maintain a Debt Service Coverage Account (DSCA) to ensure that working capital for each Loan PPIF is sufficient to meet anticipated debt servicing obligations, interest expenses and operating expenses. To that end, 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. The details of this requirement are expected to be described more fully in a forthcoming "FDIC Guaranteed Secured Debt for PPIF" Term Sheet.

Finally, each Loan PPIF must agree to "waste, fraud and abuse protections" to be defined by Treasury and the FDIC; each Loan PPIF will be required to make certain to-be-released representations, warranties and covenants regarding the conduct of its business and compliance with applicable law; 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.[9]

Legacy Securities Program

The Legacy Securities Program consists of two separate components: (i) an expansion of the TALF to include legacy securities; and (ii) the use of PPIFs set up and managed by qualifying private sector asset managers ("Fund Managers") to purchase legacy securities from financial institutions ("Securities PPIFs").

TALF EXPANSION

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 real estate and commercial real estate. Through this expansion, non-recourse loans will be made available to investors to fund purchases of legacy securities.

Although Treasury and the FRB are still in the process of developing the details of the expanded TALF, eligible securities are expected to include certain non-agency residential mortgage-backed securities (RMBS) that were rated AAA at origination, and outstanding commercial mortgage-backed securities (CMBS) and asset-backed securities (ABS) that were rated AAA at origination.[10] However, several 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. Commercial mortgage market participants have asked the FRB to extend the current three year loan term under TALF to 5-7 years for loans secured by CMBS. Treasury and the FRB have indicated that these and other terms of the program will be "informed by discussions with market participants."

GENERAL STRUCTURE OF SECURITIES PPIFS

Treasury will initially approve five Fund Managers. That number may increase depending on Treasury's evaluation of the applications received and the "best interests of taxpayers." These Fund Managers will be permitted to set up one or more Securities PPIFs that will raise equity capital from private investors and receive matching funds and leverage from Treasury to

purchase eligible securities.[11] Securities PPIFs are expected to be designed to generate returns for taxpayers and private investors through a long-term "buy and hold" strategy. However, Treasury will consider other strategies proposed by Fund Manager-applicants involving limited trading. Treasury likely will need to provide additional guidance regarding what it considers to be a "buy and hold" strategy that is consistent with the Legacy Securities Program.

Once approved, Fund Managers will have a to-be-determined period of time to set up a fund 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.

In addition to equity matching from Treasury, Fund Managers will have the ability, to the extent their PPIF structures meet certain guidelines, to access Treasury debt financing for the PPIFs in the amount of up to 50 percent of a Securities PPIF's total equity capital. Treasury will consider requests for additional senior debt for Securities PPIFs in the amount of up to 100 percent of a fund's total equity capital, subject to further restrictions. 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 fund.

These senior loans will be structurally subordinated to any financing extended by the FRB to Securities PPIFs under the expanded TALF.

While Fund Managers will make proposals for the term of a Securities PPIF, a Securities PPIF generally may not have a term greater than 10 years, subject to extension with the consent of Treasury.

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, April 10, 2009**.[12] Treasury expects to inform an applicant of its preliminary approval on or prior to May 1, 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 (defined below), 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 Funds in a manner consistent with Treasury's stated investment objective while also protecting taxpayers; and

(v) headquarters in the United States.[13]

Additional information requirements are described in greater detail in the application.

ELIGIBLE SECURITIES

Eligible Securities will initially be CMBS and RMBS issued prior to 2009 that were originally rated "AAA," or an equivalent rating, by two or more nationally recognized statistical rating organizations without ratings enhancement, and that are secured directly by the actual mortgage loans, leases or other assets and not other securities (other than certain swap positions, as determined by the Treasury).[14] As a result of this limitation, collateralized debt obligations, "synthetic" asset-backed securities, and asset-backed securities that received a AAA rating as the result of a guarantee (e.g., by a monoline insurer) or other rating enhancement will not be Eligible Securities for purposes of the Legacy Securities Program.

As in the case of the Legacy Loans Program, the loans and other assets underlying any Eligible Securities must be situated "predominantly" in the United States. Treasury has not yet issued guidance regarding the meaning of "predominantly" in this context, although, as noted above, the TALF uses the term "all or substantially all" in an analogous context, defined as 95 percent of the pool (by dollar amount). Additional guidance will be needed on this point.

SELLERS OF ELIGIBLE SECURITIES

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.[15]

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. These entities are subject to supervision and regulation by the FRB or another federal bank regulatory agency.

It remains an open question whether otherwise Eligible Securities currently held by ineligible affiliates or outside of the United States can be repatriated or otherwise transitioned to eligible sellers and sold into Securities PPIFs.

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 percent 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 of up to 100 percent of a Securities PPIF's total equity capital subject to further restrictions on asset level leverage, withdrawal rights, disposition priorities and other factors Treasury deems relevant. Fund Managers that intend to request this additional Treasury Debt Financing and/or propose additional terms should do so in their applications.

Securities PPIFs may also finance the purchase of Eligible Securities through the expanded TALF, 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.

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 PPIF OPERATIONS

Securities PPIFs will be created and managed by Fund Managers and those Fund Managers will control the process of asset selection, pricing, asset liquidation, trading, and disposition. Treasury expects to define final terms and conditions for Securities PPIFs prior to fundraising.

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. 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 and market their Securities PPIFs.

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 EESA. Guidance regarding the terms and amounts of such warrants has not yet been provided, but it is expected that terms and amounts will be determined in part based on the amount of Treasury Debt Financing taken.

Fund Managers will be required to present monthly reports to Treasury on Eligible Securities purchased, Eligible Securities disposed of, current valuations of

Eligible Securities, and profits/losses on Eligible Securities included in each Securities PPIF. Prices of Eligible Securities for reporting purposes must be tracked using third-party sources and annual audited valuations by a nationally recognized accounting firm.

Fund Managers may not purchase Eligible Securities from their affiliates, any other Fund Manager or their respective affiliates or any private investor that has committed at least 10 percent of the aggregate private capital raised by such Fund Manager.

Private investors may not be informed of potential acquisitions of specific Eligible Securities prior to acquisition.

FEES

Fund Managers are free to determine the fees they will charge the private investors in the fund. However, Treasury will take those fee proposals into account when evaluating applications by private asset managers seeking to become Fund Managers. 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. 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.

ADDITIONAL DETAILS REGARDING ADMINISTRATION OF THE LEGACY SECURITIES PROGRAM

Private investors may be given voluntary withdrawal rights, subject to limitations to be agreed upon with Treasury including that no private investor may have the right to voluntarily withdraw prior to the third anniversary of the first investment by that investor. However, as noted above, Treasury Debt Financing will not be available for any Securities PPIF in which the private investors have voluntary withdrawal rights.

It is anticipated that private sector investment in Securities PPIFs will be structured so that "benefit plan investors," within the meaning of Section 3(42) of the United States Employee Retirement Income Security Act of 1974 will be eligible to participate as indirect investors in the Securities PPIFs.

OPEN ISSUES/ADDITIONAL CONSIDERATIONS

The information accompanying the announcement of the PPIP on March 23 provides significant and long-awaited details concerning this key aspect of the Administration's FSP announced on February 10, 2009. However, many key terms and issues remain to be fleshed out, including, for example:

(i) how long it will be before the Legacy Loans and Legacy Securities Programs begin operations;

(ii) the capital impact on individual institutions that either sell these assets or may be forced to reduce the carrying value of similar assets they hold, and the availability of sufficient additional funds under the Treasury Capital Assistance Program to aid those institutions that may need additional capital;

(iii) how compensation limits and transparency, monitoring, and related requirements will be applied to Fund Managers and *sellers* of assets, and, if these requirements are applied, how a participant could "repay" any benefit that caused it to become subject to those requirements;

(iv) the degree of due diligence that will be permitted with respect to various assets being sold;

(v) the extent to which non-US entities will be eligible to participate in the various PPIP capacities, whether directly or through US offices or subsidiaries;

(vi) whether the programs will be expanded in the future to include additional classes of problematic legacy assets (e.g., CDOs or non-AAA RMBS);

(vii) the extent to which it may be possible for ineligible entities to sell otherwise eligible assets to unaffiliated eligible entities that could then be sold into the PPIP, as neither set of program documents currently establishes a

date on which the assets to be sold must have been owned by the selling entity;

(viii) the ability and willingness of the FDIC to pass along any losses it suffers under the Legacy Loans Program to all insured depository institutions;

(ix) whether the Loan PPIFs would require state mortgage lending licenses to hold residential or commercial mortgage loans; and

(x) whether the FRB will use the PPIP to sell the mortgage-related assets acquired from Bear Stearns and AIG.

In addition, both tax and Investment Company Act considerations will play a key role in structuring the relevant investment vehicles.

More generally, the full scope of the political ramifications for participants in various aspects of these programs will be an ongoing question as the PPIP takes shape, and, perhaps most importantly, it remains to be seen whether investors will offer to purchase these legacy assets at prices that will be sufficiently attractive to entice banks and other financial institutions to sell. Despite these uncertainties, the PPIP presents potentially significant opportunities for a broad variety of sellers, investors and asset managers that will need to carefully review and evaluate the terms of the program as they continue to evolve.

Endnotes

[1] Currently, the TALF offers loans only against newly or recently issued asset-backed securities rated AAA (or A-1 /P-1 for short term paper). Under the existing TALF, a limited pool of securities is acceptable as collateral, such as those backed by recently originated auto loans, credit card receivables, student loans and small business loans. The proposed PPIP expansion of the TALF would significantly broaden the eligible ABS collateral that is eligible for TALF loans to include legacy securities, although the precise scope of the securities that will be accepted under the PPIP TALF expansion and the accompanying conditions have yet to be identified by the FRB. Prior to the announcement of the PPIP TALF expansion, FRB already had been considering whether to open the existing TALF program to include commercial or residential mortgage-backed securities, and under what terms (e.g., newly securitized, refinancings, and/or legacy securities). For additional information regarding the TALF, please see our March 17, 2009, Client Update, "The Rubber Hits the Road for the Term Asset-Backed Securities Loan Facility," available at http://www.mayerbrown.com/FinancialMarkets/article.asp?id=6338&nid=9774.

[2] *See*, e.g., FDIC "Press and Technical Briefing Conference Call on Legacy Loans Program," March 23, 2009 (Loan Program Conference Call). An audio recording of the call is available at http://www.vodium.com/MediapodLibrary/index.asp?library=pn100673. The transcript of the call is available at http://www.fdic.gov/llp/transcript.html.

[3] Although equity contributions by Private Investors and Treasury are expected to be approximately equal, Treasury will also receive warrants in each Loan PPIF consistent with requirements under the Emergency Economic Stabilization Act of 2008, as amended (EESA). The terms of these warrants have not yet been established.

[4] Thus, for example, if Private Investors and Treasury each contribute $100 million in equity to a Loan PPIF, that Loan PPIF can issue up to $1.2 billion in FDIC-guaranteed debt to purchase $1.4 billion in Eligible Assets.

[5] The current restriction on participation by foreign-owned banks and thrifts would exclude three of the top twenty largest insured US-chartered commercial banks (ranked by consolidated assets) as well as many smaller firms. See http://www.federalreserve.gov/releases/lbr/current/default.htm.

[6] The FDIC will have to provide further guidance on the scope of the "predominantly" US-situated requirement, which raises the possibility that at least some loans to non-US borrowers or secured by non-US real estate can be included in the Legacy Loans Program. The existing TALF program uses the term "all or substantially all" in a similar context, defined by the FRB as 95 percent of the pool (by dollar amount).

[7] By way of comparison, the FDIC typically establishes a relatively short due diligence timetable when disposing of the assets of a failed bank in resolution. However, this timetable is subject to considerable variation, and generally involves fewer bidders.

[8] In assessing the level of leverage that can support the asset pool, the Third Party Valuation Firm will analyze asset characteristics including expected cash flows based on type of interest rates, risk of underlying assets, expected lifetime losses, geographic exposures, maturity profiles and other relevant factors.

[9] Fund Managers are subject to a nearly identical set of requirements under the Legacy Securities Program.

[10] Specifically, as described below, eligible legacy securities must have been originally rated "AAA" or an equivalent rating by two or more nationally recognized statistical rating organizations without regard to any ratings enhancement, and must be secured directly by actual mortgage loans, leases or other assets and not by other securities (e.g., CDOs would not be eligible).

[11] Fund Managers will hold the portion of the equity of a Securities PPIF owned by private investors in a "private vehicle" separate from capital committed by Treasury.

[12] The application is available at http://www.treas.gov/press/releases/reports/legacy_securities_ppif_app.pdf.

[13] The scope of the US-headquarters requirement may need further clarification. For example, Treasury may need to clarify whether the requirement would be interpreted to disqualify an otherwise-eligible US subsidiary of a non-US entity from participation as a Fund Manager.

[14] In a couple of instances, the program documents refer to CMBS that "are rated AAA." Based upon the overall program structure and the clear language elsewhere, we do not believe that this distinction was intentional.

[15] For purposes of the EESA, the term "financial institution" means any institution, including but not limited to any bank, savings association, credit union, securities broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa, or the United States Virgin Islands, and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.

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