Treasury Public-Private Investment Program For Troubled Assets
Tuesday, March 31, 2009

The Treasury announced further details on its Public-Private Investment Program which targets “legacy assets,” i.e., distressed loans and mortgage-backed securities originated prior to 2009. To fund the Program, a series of Public Private Investment Funds (Funds) will be formed to invest in both legacy loans and legacy securities. The Treasury has initially devoted $75 to $100 billion of TARP Funds to the Program which, when combined with private capital and several leverage mechanisms discussed below, is hoped to generate at least $500 billion in purchasing power that may be expanded to as much as $1 trillion. The Treasury has stated that passive private investors in the Program will not be subject to executive compensation restrictions.

The Legacy Loan Program. The Legacy Loan Program intends to attract private capital to purchase eligible legacy loans from participating banks through the provision of FDIC debt guarantees and Treasury equity co-investments. Private investors may not participate in any Fund that purchases assets from sellers that are affiliates of the private investor or represent 10% or more of the aggregate private capital in the Fund. The exact requirements and structure of the Legacy Loans Program will be subject to further rulemaking.

Banking organizations should work with their primary banking regulator to identify and evaluate eligible assets for sale under the Program and the corresponding financial impact from the sale of such assets. After identifying these assets, the bank should notify the FDIC that it intends to participate in the Legacy Loan Program. Assets eligible for purchase ultimately will be determined by the participating banking organizations, the primary banking regulators, the FDIC, and the Treasury. The FDIC will guarantee up to $6 of debt issued by the Fund for every $1 of capital invested in the Fund by the Treasury and private investors. Participating banks will pay a fee for the FDIC guaranty. Such loans, with committed financing by the Fund, will then be auctioned to qualified private investors, who will bid for the opportunity to contribute 50% of the equity, with the Treasury contributing the remainder. The winning bid, together with the amount of FDIC-guaranteed debt, will define the price offered to the selling bank. Private investors will control and manage the assets until final liquidation, subject to FDIC oversight.

Example.

The following sample transaction illustrates the process for legacy loans:

1. A bank with a pool of residential mortgages with $100 face value that it is seeking to divest approaches the FDIC.
2. The FDIC determines, according to the above process, that for this pool the agency is willing to leverage the pool at a 6-to-1 debt-to-equity ratio.
3. The pool is then auctioned by the FDIC, with several private sector bidders submitting bids. The highest bid from the private sector – for example, $84 – is the winner and

forms a Fund to purchase the pool of mortgages.

4. Of this $84 purchase price, the FDIC provides guarantees for $72 of Fund debt under its 6:1 debt/equity ratio. Some or all of the $72 of FDIC-guaranteed debt may be issued directly to the seller as part of the purchase price.
5. The Treasury then provides 50% of the equity funding required on a side-by-side basis with the investor. In this case, the Treasury invests approximately $6, with the private investor contributing $6.
6. The private investor manages the pool, subject to FDIC oversight.

The Legacy Securities Program. The Legacy Securities Program consists of debt financing from the Fed under an expansion of the Term Asset-Backed Securities Loan Facility ("TALF") and matched public/private capital.

TALF. Non-recourse loans will be made available to investors to fund purchases of legacy securitization assets. Current eligible assets under TALF (asset backed securities relating to auto loans, student loans, credit card loans, equipment loans, floorplan loans, small business loans fully guaranteed as to principal and interest by the U.S. Small Business Association, or receivables related to residential mortgage servicing advances) will be expanded to include certain non-agency residential mortgage-backed securities ("RMBS") that were originally rated AAA, and outstanding commercial mortgage-backed securities ("CMBS") and asset-backed securities that are rated AAA.

Legacy Securities Funds. The Treasury will partner on a side-by-side basis with private fund managers to support the market for legacy securities, initially by targeting non-agency RMBS and CMBS originated prior to 2009 with a AAA rating at origination (consistent with the expanded TALF program). Such eligible assets will be purchased from U.S. banks, savings associations, credit unions, securities broker-dealers, and insurance companies. Private investment managers may apply for qualification as a Fund manager; initially, the Treasury expects to approve approximately five Fund managers. Approved managers will raise private capital through private investment vehicles and receive matching equity capital from the Treasury.

The Fund may issue to the Treasury non-recourse senior debt in the amount of up to 50% of a Fund's total equity capital, or (subject to Treasury approval) additional non-recourse senior debt in the amount of up to 100% of a Fund's total equity capital. This senior debt will have the same duration as the underlying fund 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 Fed under the TALF.

Example.

The following sample transaction illustrates the Program process for legacy securities:

1. A fund manager submits a proposal and is pre-qualified to raise private

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capital to participate in joint investment programs with the Treasury.

2. The Treasury agrees to match every dollar of private capital that the fund manager raises and also to fund-level leverage for the proposed Fund.
3. The fund manager raises $100 of private capital for the Fund, and the Treasury provides $100 equity co-investment, and a $100 loan to the Fund. The Treasury will also consider requests from the fund manager for an additional loan of up to $100 to the Fund.
4. As a result, the fund manager has $300 (or, in some cases, up to $400) in total capital and commences a purchase program for targeted securities.

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