

March 25, 2009

WEATHERING THE STORM U.S. Treasury Private Public Investment Program

On March 23rd, the Treasury Department announced its Public-Private Investment Program ("PPIP"). The PPIP is designed to provide the public support necessary to catalyze the purchase and sale of legacy assets the diminished market for which is presently creating uncertainty on the balance sheets of financial institutions and thereby limiting their access to equity capital, and curtailing their lending activity.

In its plan, the Treasury Department defined "Legacy Assets" to include both real estate loans held directly on the books of banks ("Legacy Loans"), and mortgage-backed securities issued prior to 2009 (both commercial and residential that were originally rated AAA or equivalent by two or more NRSROs without ratings enhancements) ("Legacy Securities"). The secondary market for these Legacy Assets has certainly suffered far worse than most, and that weakening has deflated the value of these assets and cast doubt on the overall capital position of some financial institutions.

To address the unique challenge presented by the limited market for Legacy Assets, the Treasury Department will collaborate with three stakeholders: the Federal Deposit Insurance Corporation (the "FDIC"); the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"); and private investors. The Treasury Department will allocate between \$75 and \$100 billion of already authorized TARP capital on a dollar-for-dollar basis with private investor capital to generate \$500 billion in Legacy Asset purchasing power for the PPIP, an amount that the Treasury Department believes could expand to \$1 trillion over time. The PPIP capital will be aggregated through a series of public-private investment funds ("PPIFs") that are managed by qualifying private sector asset managers. The qualification criteria for asset managers includes, among other criteria, a demonstrated capacity to raise \$500 million of private capital and a minimum market value of \$10 billion of Legacy Securities currently under management. The PPIP capital will be deployed under one of two programs: the "Legacy Loans Program" or LLP; and the "Legacy Securities Program" or LSP. Although the Treasury Department anticipates that initially there will be an even allocation of TARP resources and PPIP capital between LLP and LSP, it will have the flexibility to direct the fund allocation to the program that it believes is having the greatest impact.

Legacy Loans Program. To facilitate the purchase and sale of Legacy Loans, the FDIC and Treasury have instituted the LLP, which will provide FDIC-debt guarantees and Treasury equity co-investments to private capital partners organizing PPIFs. The actual purchases of Legacy Loans will occur through auctions where the private bidders determine the purchase price on a discrete basis.

Sample Investment Under the Legacy Loans Program

Step 1: If a bank has a pool of residential mortgages with \$100 face value that it is seeking to divest, the bank would approach the FDIC.

Step 2: The FDIC would determine whether or not it would be willing to leverage the pool at a 6-to-1 debt-to-equity ratio.

Step 3: If the FDIC is willing, the pool would then be auctioned by the FDIC, with several private sector bidders submitting bids. The highest bid from the private sector – in this example, \$84 – would be the winner and would form a PPIF to purchase the pool of mortgages.

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

Step 5: The Treasury would then provide 50% of the equity funding required on a side-by-side basis with the investor. In this example, Treasury would invest approximately \$6, with the private investor contributing \$6. Treasury will also receive warrants in the PPIF.

Step 6: The private investor would then manage the servicing of the asset pool and the timing of its disposition on an ongoing basis – using asset managers approved and subject to oversight by the FDIC.

Legacy Securities Program. Unlike the LLP, Treasury intends to incorporate the LSP program into the Federal Reserve Board's Term Asset-Backed Securities Loan Facility ("TALF") in order to combine TALF debt financing with matching private capital raised through a PPIF to acquire Legacy Securities. The goal of the LSP is to jumpstart the market for Legacy Securities, allowing banks and other financial institutions to unlock capital and stimulate the extension of new credit. The resulting process of asset valuation will also reduce the uncertainty surrounding the financial institutions holding these securities, potentially enabling those institutions to raise new private capital.

Sample Investment Under the Legacy Securities Program

Step 1: Treasury will launch the application process for managers interested in the Legacy Securities Program.

Step 2: A fund manager submits a proposal prior to 5 PM Eastern time on April 10, 2009 and is pre-qualified to raise private capital to participate in joint investment programs with Treasury.

Step 3: The Government agrees to provide a one-for-one match for every dollar of private capital that the fund manager raises and to provide fund-level leverage for the proposed PPIF.

Step 4: The fund manager commences the sales process for the investment fund and is able to raise \$100 of private capital for the fund. Treasury provides \$100 equity co-investment on a side-by-side basis with private capital and will provide a \$100 loan to the PPIF. Treasury will also receive warrants in the PPIF. Treasury will also consider requests from the fund manager for an additional loan of up to \$100 to the fund.

Step 5: 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.

Step 6: The fund manager has full discretion in investment decisions, although it will predominately follow a long-term buy-and-hold strategy. Upon the fund manager's election, a PPIF would also be eligible to take advantage of the expanded TALF program for legacy securities when it is launched.

The exact requirements and structure of the LLP and LSP will be the subject of notice and comment rulemaking. Importantly, Treasury confirmed that executive compensation restrictions will not apply to passive private investors in a PPIF.

For more information, please contact:

[John Podvin](#)
214.651.5059
john.podvin@haynesboone.com

[Jason Barnes](#)
214.651.5360
jason.barnes@haynesboone.com

[Scott Night](#)
214.651.5523
scott.night@haynesboone.com

[Taylor Wilson](#)
214.651.5615
taylor.wilson@haynesboone.com

[Craig Unterberg](#)
214.651.5057
craig.unterberg@haynesboone.com

[Lenard Parkins](#)
212.659.4866
lenard.parkins@haynesboone.com

[Stephen Pezanosky](#)
817.347.6601
stephen.pezanosky@haynesboone.com

[Kenric Kattner](#)
713.547.2518
kenric.kattner@haynesboone.com

[Sarah Foster](#)
512.867.8412
sarah.foster@haynesboone.com

[Eric Terry](#)
210.978.7424
eric.terry@haynesboone.com