Economic Stabilization Advisory Group | March 25, 2009

Public-Private Investment Program: Cleansing Bank Balance Sheets

On Monday, March 23, 2009, the Treasury Department ("Treasury") announced a two-pronged program that is intended to deal with troubled assets on financial institution balance sheets. Treasury, in conjunction with the Federal Deposit Insurance Corporation ("FDIC") and the Board of Governors of the Federal Reserve System ("FRB"), has established the Public-Private Investment Program ("PPIP"), the purpose of which is to purchase the troubled assets owned by financial institutions through a combination of private and public capital, utilizing private-sector expertise and the resources of the U.S. Government.

The PPIP will apply to two kinds of so-called "legacy" assets. The Legacy Loans Program will combine an FDIC guarantee of debt financing with equity capital from the private sector and the Treasury to support the purchase of troubled loans from insured depository institutions.[1] The Legacy Securities Program will combine financing from the Federal Reserve and Treasury through the FRB's Term Asset-Backed Securities Loan Facility[2] ("TALF") with equity capital from the private sector and the Treasury to purchase troubled securities.[3] A side-by-side summary of important elements of the two programs is provided on pages 4 and 5.

Legacy Securities Program

The Legacy Securities Program consists of two related parts: (1) debt financing from the Federal Reserve under the TALF and (2) matching private capital raised for dedicated funds targeting legacy securities. It is intended to facilitate the creation of Public-Private Investment Funds ("PPIFs"), which are investment funds that will invest in legacy securities. They will be managed by qualifying private sector asset managers ("Fund Managers"), which will raise equity capital from private investors and receive matching equity funds from the Treasury.

Structure

The Treasury will initially select five managers to participate in the program and may increase this number depending on applications received. Approved managers will have a period of time to raise private capital to target the designated asset class, and approved managers that raise private capital will receive matching equity funds from Treasury based on the amount of private capital raised. Treasury equity capital will be invested on a *pro rata* basis with equity capital from private investors. Treasury will also receive warrants in the Legacy Securities PPIFs. Investors will aggregate their investments in a vehicle that in turn will invest in the PPIF alongside Treasury.

Asset managers will have the ability, to the extent their fund structures meet certain guidelines, to obtain debt financing for a PPIF from Treasury in an amount up to 50% of the total equity capital in such fund. Treasury will consider requests for loans from Treasury in amounts up to 100% of the total equity capital of a Legacy Securities PPIF

[1] The summary of terms for the Legacy Loans Program is available at http://www.ustreas.gov/press/releases/reports/legacy_loans_terms.pdf and the Legacy Loans Program FAQ's is available at http://www.treas.gov/press/releases/reports/legacy_loans_faqs.pdf.

[2] For more details on TALF, see http://www.shearman.com/talf-update-new-guidance-available-program-to-launch-this-month/.

[3] The summary of terms for the Legacy Securities Program is available at http://www.treas.gov/press/releases/reports/legacy_securities_terms.pdf and the Legacy Securities FAQ's is available at http://www.treas.gov/press/releases/reports/legacy_securities_faqs.pdf.

subject to restrictions on asset level leverage, withdrawal rights, disposition priorities and other factors Treasury deems relevant. Fund Managers will have the opportunity to request this additional Treasury leverage and propose additional terms in their applications.

How to Become an Asset Manager

Fund Managers will be pre-qualified based upon the following criteria:

- Demonstrated capacity to raise at least $500 million of private capital.
- Demonstrated experience investing in eligible assets, including through performance track records.
- A minimum of $10 billion (market value) of eligible assets under management.
- Demonstrated operational capacity to manage the Funds in a manner consistent with Treasury's stated investment objectives, while also protecting taxpayers.
- Headquarters in the United States.

Fund Managers must agree to certain protections against waste, fraud and abuse. Fund Managers must also agree to provide access to relevant books and records for the Treasury, the Special Inspector General of the TARP, the Government Accountability Office and their respective advisors.

Private asset managers wishing to participate in this program must submit an application no later than 5:00 p.m. ET on April 10, 2009, which must be delivered by courier or in PDF format via email to Treasury.[4]

Treasury expects to inform an applicant of its preliminary qualification on or prior to May 1, 2009. Applicants will have a limited period of time to raise at least $500 million of committed private equity capital before receiving final approval from Treasury. Applicants will be asked to describe the amount of time they anticipate needing to raise the private capital in their applications. There are no stated limitations on eligible investors in PPIFs.

Eligible Assets

Eligible assets include commercial mortgage-backed securities and residential mortgage-backed securities:

- Originally issued prior to 2009; and
- Originally rated AAA or an equivalent rating by two or more nationally recognized statistical rating organizations without ratings enhancement.

The assets must:

- Be secured directly by the actual mortgage loans, leases or other assets, and not by other securities (other than certain swap positions); and
- Be situated predominantly in the United States.

Eligible assets may be purchased solely from U.S. FDIC-insured banks and thrifts and U.S. branches and agencies of foreign banks not controlled by a foreign government. Each Fund Manager may only purchase Eligible Assets from sellers that are not affiliates of such Fund Manager, any other Fund Manager or their respective affiliates or any investor that has committed at least 10% of the aggregate private capital raised by such Fund Manager. Private investors may not be informed of potential acquisitions of specific Eligible Assets prior to acquisition.

Fees

Fund Managers may charge private investors fees at their discretion. Treasury 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 each PPIF's 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 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.

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[4] The application for private asset managers is available at http://www.treas.gov/press/releases/reports/legacy_securities_ppif_app.pdf.

Executive Compensation

The executive compensation restrictions will not apply to “passive” private investors in Legacy Securities PPIFs. The announcement does not discuss the meaning of “passive”.

Legacy Loans Program

The Legacy Loans Program is intended to facilitate the creation of PPIFs that will purchase pools of legacy loans. Unlike Legacy Securities PPIFs, Legacy Loan PPIFs will be formed at the time that a selling institution successfully sells a pool of loans to bidders, which thereby become investors. There are no established Fund Managers for Loan PPIFs; rather, the selling bank and FDIC are effectively the managers of each Loan PPIF. The term sheet states that the Legacy Loan Program is intended to facilitate buy-and-hold strategies.

Treasury intends to provide approximately 50% of the equity capital in each loan PPIF, with the other 50% coming from private investors. Private investors will manage the pools of assets, with oversight from the FDIC. The loan PPIF will be financed through the issuance of second non-recourse debt guaranteed by the FDIC and collateralized by the assets purchased by the PPIF.

Private investors are expected to include, but are not limited to, financial institutions, individuals, insurance companies, mutual funds, publicly managed investment funds, pension funds, foreign investors with a headquarters in the United States, private equity funds, and hedge funds.

Structure

(1) Banks with troubled loans will decide which asset pools they would like to sell after consultation with their primary bank supervisor. The FDIC will analyze the assets to determine the amount of financing it is willing to guarantee. The FDIC will not provide leverage exceeding a 6-to-1 ratio.

(2) The FDIC will auction the pools of loans. Both the winning bidder and the Treasury will fund 50% of the equity necessary to purchase the pools of loans.

(3) The winning PPIF would be able to finance the purchase of the pool of loans by issuing FDIC-guaranteed debt.

(4) Private investors will control and manage the assets until final liquidation, subject to FDIC oversight.

Treasury will be responsible for overseeing and managing its equity contribution in the PPIFs, while the FDIC will be responsible for overseeing and managing its debt guarantees to the PPIFs. The FDIC will receive a fee for providing its guarantee and administrative services.

Eligible Institutions

Eligible institutions for the Legacy Loan Program include any FDIC-insured U.S. bank or U.S. savings association. Banks or savings associations owned or controlled by a foreign bank or company are not eligible.

Eligible Assets

Assets eligible for purchase will be determined by the participating banks, their primary regulators, the FDIC and Treasury.

Executive Compensation

The executive compensation restrictions will not apply to “passive” private investors in Legacy Loan PPIFs.

Going Forward

There are a great number of details on the mechanics of the PPIP that remain to be announced. For instance, the FDIC will publish a proposed rule for comment that would provide important information on how the Legacy Loans Program would function. There also remain fundamental questions on the appetite of investors for participation in the PPIP and how the assets will be priced, and the political uncertainty raised by the Congressional uproar over bonuses paid to certain executives at American International Group is like to cast a pall. However, the amount of leverage that the U.S. Government is willing to provide will make it worthwhile for investors, fund managers and financial institutions to consider seriously the advantages of participation.

Side-by-Side Summary of Certain Elements of the Programs

Topic	Legacy Securities Program	Legacy Loans Program
Public-Private Investment Fund ("PPIF")	Treasury expects to establish at least five PPIFs	FDIC will establish a PPIF for each pool of loans of a selling bank or thrift ("Seller")
Eligible assets	Commercial and residential mortgage-backed securities issued before 2009, originally rated AAA or equivalent by two organizations and secured directly by loans or mortgages	Loans satisfying criteria to be issued by the FDIC, selected by the Seller after consultation with its banking supervisor
Eligible sellers of assets to PPIF	FDIC-insured banks and thrifts and apparently U.S. branches and agencies of foreign banks not controlled by foreign governments	FDIC-insured banks and thrifts not controlled by foreign banks or companies
PPIF structure	Treasury and a vehicle controlled by the Fund Manager in which private investors invest ("Vehicle") will be sole investors in PPIF	Separate PPIF for each Seller pool of loans with equity capital from Treasury and private investors
Eligible investors	No apparent restrictions in Vehicle except that PPIF cannot purchase from (i) an affiliate or other managed entity of the PPIF's Fund Manager or (ii) an investor that has committed 10% or more of the PPIF's capital	No apparent restrictions, but private investor groups subject to FDIC approval and PPIF cannot purchase from (i) an affiliate or (ii) an investor that has committed 10% or more of the PPIF's capital
Fund managers	Pre-qualified upon application to Treasury, which expects that there will be five Fund Managers	FDIC is manager and Seller is servicer
Equity of PPIF	Provided by Treasury and Vehicle, with no relative amounts specified	Target is 50 percent of equity to be provided by U.S. Treasury, but investors may take less
Debt funding of PPIF	Fund Manager may obtain secured non-recourse loans from Treasury in amount up to 50% of PPIF's total equity, with possibility of obtaining 100% subject to certain restrictions; TALF funding also available	PPIF may issue secured non-recourse debt guaranteed by FDIC based on third party valuation firm's estimate of value of loans, with amount determined by FDIC, but leverage no greater than six to one
Warrants	Treasury will obtain warrants from each PPIF	Treasury will obtain warrants from each PPIF
Fees	Fund Managers may charge Vehicle investors fees in their discretion, subject to Treasury review.	Fees payable to FDIC for administration and for guarantee of debt issued by PPIF
Servicing of PPIF assets	Fund Manager	Seller

Topic	Legacy Securities Program	Legacy Loans Program
Asset purchase/liquidation	Subject to Fund Manager control	Purchase to be determined by auction conducted by FDIC, with prices determined by investor bids for the loan pool; no specification on liquidations
Reporting by PPIF	Monthly to Treasury on assets purchased and disposed of as well as valuations	Monthly to FDIC with copy to Treasury
Term of PPIF	Subject to Fund Manager proposal but no longer than 10 years subject to extension with U.S. Treasury consent	Not specified

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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