

Toxic Asset Disposition Plan

April 2, 2009

To expedite the removal of troubled “legacy” loans and securities from books of U.S. financial institutions, the U.S. Treasury Department (the Treasury) announced on March 23 the next in a series of initiatives designed to address the financial crisis—the Public Private Investment Program, or PPIP. The administration believes that these legacy loans and securities have created uncertainty around the balance sheets of financial institutions, compromising their ability to raise capital and their willingness to lend. The PPIP has two parts, one addressing legacy loans on the books of FDIC-insured banks, the other aimed at securities held by banks, insurance companies, pension funds, mutual funds, and funds held in individual retirement accounts. The PPIP has attracted a good deal of early interest, with approximately 2,700 parties participating in a conference call hosted by the FDIC last week, according to the *American Banker*.

The Legacy Loan Program

Also labeled as “toxic” loans, these legacy loans or loan portfolios will be identified by FDIC-insured banks and given to the FDIC. The FDIC will pool loans from one or more banks and determine the amount of the pool’s funding it is willing to guarantee. Leverage will be determined on a pool-by-pool basis by the FDIC in consultation with outside advisors but will not exceed a 6-to-1 debt-to-equity ratio. The FDIC will conduct an auction for these pools of loans, with the highest bidder gaining access to the PPIP to fund 50% of the equity requirement of its purchase. If the seller accepts the bid, the buyer’s financing will be FDIC-guaranteed debt, collateralized by the purchased assets. The FDIC will receive a fee in return for its guarantee—with the fees earmarked for the Federal Deposit Insurance Fund, as the industry-funded fund will support any losses incurred by the FDIC in the PPIP. Any shortfalls will be made up by a special assessment against all FDIC-insured banks—whether or not they participate in the PPIP.

Once the legacy assets have been sold, private asset managers to be hired and overseen by the FDIC will control and manage the assets until they are liquidated. Investors will share profits and losses in proportion to the equity invested. It is anticipated that investors will include financial institutions, individuals, insurance companies, mutual funds, publicly managed investment funds, and pension funds. The FDIC is in the process of resolving whether banks or thrifts owned by foreign banks can qualify as sellers in the PPIP, and has requested comment on a series of questions related to the Legacy Loan Program, with comments due no later than April 10, 2009 (<http://www.fdic.gov/llp/progdsc.html>). The FDIC intends to review public comments before developing the final details of the Legacy Loan Program, and then move quickly to implement this part of the PPIP.

The Legacy Securities Program

The second prong of the PPIP is a two-part plan aimed at restarting the market for legacy securities. The first part of the program would create a lending program to attack securities tied to residential and commercial real

estate and consumer credit. It will expand the Federal Reserve's existing Term Asset-Backed Securities Loan Facility (TALF) to include legacy securitization assets such as nonagency residential mortgage-backed securities that were originally rated AAA, and outstanding commercial mortgage-backed securities and asset-backed securities that are currently rated AAA.

The second part of the Legacy Securities Program will see the Treasury making co-investment/leverage available to private capital providers. It will do so in two ways. The Treasury will approve up to five proven asset managers, who will be given a period of time to raise private capital to address designated asset classes. Managers will receive matching Treasury funds under the PPIP. Treasury funds will be invested one-for-one on a fully side-by-side basis with the investors. A second partnering opportunity will enable certain asset managers (if their investment fund structure meets Treasury guidelines) to subscribe for senior debt for a Public-Private Investment Fund from the Treasury Department in the amount of 50% of the total equity capital of the fund. The Treasury will consider requests for senior debt for the fund in the amount of 100% of its total equity capital subject to further restrictions.

Sellers into the Legacy Securities Program can be banks, insurance companies, mutual funds, pension funds, and other types of financial institutions. Loans and other assets underlying the eligible assets must be "predominantly" situated in the United States. To purchase these legacy securities, the Treasury will utilize \$75 billion to \$100 billion in capital from the Trouble Assets Relief Program (TARP), as well as capital from private investors.

Parties considering participating in the PPIP will want to focus on the final details of the program and any open-ended regulatory commitments that may be required in order to participate, particularly in light of the evolution of the requirements associated with the TARP program.

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