



March 2009

Public-Private Investment Program Announced

Federal Government and Private Investors to Co-invest in Funds to Purchase Distressed Assets

On March 23, 2009, the U.S. Department of Treasury and FDIC announced a program under which a number of investment funds could begin purchasing distressed assets from financial institutions.

BACKGROUND

In the last several months, the U.S. government has announced a number of economic recovery initiatives, including the Treasury's Financial Stability Plan and the American Recovery and Reinvestment Act. None of these programs has been successful in helping financial institutions remove illiquid "legacy assets"—both direct real estate loans ("Legacy Loans") and commercial or residential mortgage backed securities ("Legacy Securities")—from their balance sheets. On Monday, March 23, the Treasury, the FDIC and Federal Reserve Board announced the Public-Private Investment Program. The program calls for the formation of Public-Private Investment Funds or "PPIFs" for the purpose of purchasing legacy assets from financial institutions.

The governmental agencies made clear that there are three overriding principles in structuring the Public-Private Investment Program: (1) maximizing the impact of each taxpayer dollar, (2) shared risk by the private sector who will invest alongside the taxpayer, and (3) private sector price discovery through private sector investors competing to establish price.

The Public-Private Investment Program involves the use of \$75 to \$100 billion in TARP funds, additional capital from private investors and indebtedness issued by the PPIFs, to create approximately \$500 billion in funds available for the purchase of legacy assets. There are two components of the Program, the first dealing with the purchase of Legacy Loans and the second dealing with the purchase of Legacy Securities.

THE LEGACY LOANS PROGRAM

The Legacy Loans Program is a program under which FDIC guarantee of debt financing plus a combination of equity capital from private investors and the Treasury are to be used to fund PPIFs' purchase of Legacy Loans. Under the Program, the FDIC will hold auctions of loan pools that banks desire to sell. Bidders will have the ability to form a PPIF in which the Treasury will co-invest with the private investor(s) (with the initial goal being equal shares of equity held by the Treasury and private investor(s)). The PPIF will also have the ability to issue debt that will be guaranteed by the FDIC, thereby leveraging the PPIF's ability to purchase loan pools. The FDIC will determine the maximum debt-to-equity ratio.

Under this Program, banks will identify pools of loans they would like to sell. The FDIC will then determine the amount of funding it would be willing to guarantee in connection with the purchase of such loans (leverage will not exceed a 6-1



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debt to equity ratio). The FDIC then will hold an auction of the loan pool with bidders making a full purchase price offer, based on the debt-to-equity ratio established by the FDIC.

One of the goals of the Legacy Loans Program is to have a number of private investors involved in the bidding so that the established price is market driven. This will reduce the likelihood that the government will overpay for the Legacy Loans.

It is anticipated that many different types of investors will participate in the Legacy Loans Program, including individuals, private capital, pension plans and insurance companies. The Legacy Loans Program is available to any investor with sufficient available capital. However, the purchase of direct loans by the respective PPIF's will trigger due diligence issues, as the defenses and rights of borrowers will remain available against the PPIF. Moreover, other factors, such as condition of property and title, default status of loans, prior collection efforts and existence of loan origination and servicing documents may affect the ultimate value of particular loans.

LEGACY SECURITIES PROGRAM

The Legacy Securities PPIFs will deploy funds to invest in Legacy Securities. The PPIFs will have access to debt financing from the Federal Reserve and the Treasury (through the Term Asset-Backed Securities Loan Facility or "TALF") and equity capital from the private sector and the Treasury.

The TALF is a lending facility established by the Federal Reserve Bank of New York to offer loans to eligible investors who purchase asset-backed securities. Eligible investors under the TALF are U.S. companies, U.S. branches of foreign banks that maintain reserves at the Federal Reserve, or U.S. managed investment funds. The TALF may lend as much as \$1 trillion to such investors with the TALF loans secured by the asset-backed securities purchased by the borrowing investor.

Prior to the announcement of the Public-Private Investment Program, the types of asset-backed securities that qualified as eligible collateral for the TALF were limited to recently issued, "AAA" rated securities backed by car, real estate or college education loans. While the types of new eligible assets are not entirely clear, they are expected to include certain residential mortgage-backed securities that were originally rated "AAA" and commercial mortgage-backed securities and other asset-backed securities that are rated "AAA".

The PPIFs will be managed by pre-qualified private sector Fund Managers who, among other attributes, have demonstrated the capacity to raise at least \$500 million in private capital and have a minimum of \$10 billion of legacy securities under management. The number of Legacy Securities PPIFs' will be limited with the Treasury initially selecting approximately five participants in the Program.

The Fund Managers will have a period of time to raise private equity capital which will then be matched by an investment by the Treasury. The PPIF would then be eligible to borrow funds from the Federal Reserve under the TALF. In addition, the PPIFs can borrow senior debt from the Treasury in the amount of up to 50% of the fund's total equity (and under certain circumstances up to 100% of the fund's total equity capital).



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Each PPIF's Fund Manager will have discretion of investment decisions, but it is expected that the Fund Manager's would predominately follow a "buy and hold" strategy.

The limited number of Legacy Securities PPIF's renders entry into the marketplace viable for only a handful of large institutional Fund Managers. However, their purchases may free up the credit markets, including the consumer credit markets, thereby providing opportunities throughout the financial services industry.

CONCLUSION

Materials released by Treasury stated that executive compensation restrictions will *not apply* to either the Legacy Loan Program or the Legacy Securities Program. Additional details of the programs will need to be fleshed out by Treasury through additional informal guidance or rule-makings, which Treasury expects to issue soon. We will continue to monitor the process and communicate updates.

As always, if you have any questions about this program or another financial services matter, please contact a member of the [Economic Stability & Solutions Team](#) at [Womble Carlyle Sandridge & Rice](#). Readers are urged to consult their regular contacts at Womble Carlyle, [Donald Lampe](#) at 704-350-6398 or [Bob Donlon](#) at 704-331-4964.

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