

ABCs of TARP

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This is an updated version of the summary of financial crisis related programs first compiled on March 8. In the past month the Treasury produced further guidance on the programs through which it will purchase toxic assets in partnership with private investors. The following are the programs discussed in this summary:

AMLF	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ARRA	American Recovery and Reinvestment Act of 2009
CAP	Capital Assistance Program
CBLI	Consumer and Business Lending Initiative
CPFF	Commercial Paper Funding Facility
CPP	Capital Purchase Program
DGP	Debt Guarantee Program
EESA	Emergency Economic Stability Act of 2008
FSP	Financial Stability Program
HAM	Home Affordable Modification program
HASP	Homeowner Affordability and Stability Program
HAR	Home Affordable Refinance program
LLP	Legacy Loan Program
LSP	Legacy Securities Program
MHA	Making Home Affordable program
MMFGP	Money Market Funds Guarantee Program
MMIFF	Money Market Investor Funding Facility
PPIP	Public-Private Investment Program
SSFI	Systemically Significant Failing Institutions program
TALF	Term Asset-Back Securities Loan Facility
TAP	Transaction Account Program
TARP	Troubled Asset Relief Program
TIP	Targeted Investment Program
TLGP	Temporary Liquidity Guarantee Program

The Initial Response: EESA, TARP/PPP, TLGP and the Federal Reserve Liquidity Programs

EESA. On October 3, 2008, Congress passed the EESA to address the crisis gripping the financial markets. Among other things, the EESA established the TARP and raised the FDIC deposit insurance limit to \$250,000.

TARP. The EESA allocated \$700 billion to the TARP in two tranches of \$350 billion each. As its name suggests, the TARP was originally envisioned as a program to purchase distressed assets from banks. The Treasury, however, was given wide latitude in its implementation of the TARP. Instead of buying troubled assets, the Treasury decided to inject capital directly in U.S. banks through the PPP. This was in direct response to a crisis in confidence in banks, which had frozen inter-bank and other lending markets, threatening a broad based economic collapse. Further, the purchase of troubled assets was complicated by issues related to the pricing of such assets.

PPP. The PPP recapitalized U.S. banks by providing capital in return for senior preferred shares and warrants issued to the Treasury. Participation in the PPP was voluntary, except for the nine largest banking organizations who were essentially forced to participate, and initially open only to publicly traded institutions. Terms were later released for privately held banking organizations, S corporations and mutual institutions. Except for mutual institutions, the deadlines for institutions to apply to participate in the PPP have passed, so institutions who have not yet applied no longer have the opportunity to participate in the PPP.

The PPP was intended to support healthy U.S. banks, and as such the Treasury and the appropriate Federal banking agency determined whether a banking organization that wished to participate in the PPP would receive TARP funds. The Treasury used more than the \$350 billion allocated in the first tranche of TARP for the PPP and other rescues of specific institutions and the automotive industry. Because this deviated from the original intent of TARP, to purchase troubled assets and help homeowners, considerable anger was directed towards the TARP and the PPP by members of Congress, the media and the general public. This resulted in the inclusion of stringent executive compensation restrictions in ARRA. The ARRA executive compensation restrictions applied retroactively to all recipients of TARP funds. ARRA also included a provision which allowed TARP recipients to repay their PPP investment without impediment. Because of the ARRA executive compensation restrictions, the negative publicity directed towards TARP recipients and the threat of further retroactive requirements, many participants in the PPP have decided to repay their PPP investment or to not take PPP investments for which they have been approved. This means that in a few short months the PPP has morphed from a program to stabilize healthy banking organizations to one that may soon only include banks which are not healthy enough to repay their initial PPP investment. It is unclear on what effect this will have on the stability and confidence in the financial sector.

SSFI. The SSFI is a program similar to the PPP by which the Treasury may support systemically significant failing institutions on a case-by-case basis. To date, this program has only been used to support AIG.

TIP. The TIP is similar to the SSFI in that it provides additional assistance to institutions on a case-by-case basis, with the distinction that institutions receiving support under the TIP are not necessarily "failing." To date, the TIP has been used to make an additional investments in Citigroup and Bank of America.

TLGP. The TLGP is an FDIC program which consists of two components: (i) the TAP, which guarantees all funds in non-interest bearing transaction accounts and (ii) the DGP, which

guarantees senior unsecured debt until June 30, 2012 or December 31, 2012, depending on the issuance date. The TLGP is not a part of TARP and is self-funding through assessment fees levied on the accounts and debt guaranteed under the program. All FDIC-insured depository institutions and holding companies of FDIC-insured depository institutions were automatically enrolled in the TLGP and given the opportunity to opt out of either or both the TAP or the DGP by December 2008. Most institutions chose to remain in the TLGP. The TLGP has been successful in stopping the flow of deposits out of high balance transaction accounts and lowering the interest rates for guarantee debt, providing a much needed source of funding and liquidity for banks. At the end of February 2009, over \$158 billion of bank debt was guaranteed under the DGP. There was a proposal for a third component to the TLGP, a guarantee of secured debt, however, this was taken off the table in February and it is unclear whether it will return.

MMFGP. Announced on September 29, 2008, the MMFGP is a temporary Treasury program to guarantee to investors that they will receive \$1 for each money market fund share held as of close of business on September 19, 2008. The MMFGP has been extended through September 18, 2009. It currently covers over \$3 trillion of combined money market fund assets.

AMLF. Announced on September 19, 2008, the AMLF is a Federal Reserve lending facility that finances the purchase of high-quality asset-backed commercial paper from money market mutual funds by U.S. depository institutions and bank holding companies. The AMLF is intended to assist money funds that hold such paper to meet the demands for redemptions by investors and to foster liquidity in the asset-backed commercial paper market and money markets more generally.

CPFF. Announced on October 7, 2008, the CPFF is a Federal Reserve facility that enhances liquidity in the commercial paper markets. The CPFF provides a liquidity backstop to U.S. issuers of commercial paper through purchases of three-month unsecured and asset-backed commercial paper directly from eligible issuers.

MMIFF. Announced on October 21, 2008, the MMIFF is intended to provide liquidity to U.S. money market mutual funds and certain other money market investors, thereby increasing their ability to meet redemption requests and hence their willingness to invest in money market instruments, particularly term money market instruments. Under the MMIFF, the Federal Reserve Bank of New York ("FRBNY") can provide senior secured funding to a series of limited liability companies that were established with the private sector. The FRBNY finances the purchase of eligible assets from eligible investors by these LLCs. Eligible assets include U.S. dollar-denominated certificates of deposit and commercial paper that are issued by highly rated financial institutions and have remaining maturities of 90 days or less.

Round Two: The FSP

FSP. On February 10, 2009, the Obama administration announced the FSP, which is the administration's blueprint for handling the financial crisis and spending the second \$350 billion of TARP funds. Sometimes referred to as "TARP II", the FSP is a rebranding of TARP given the negative associations with the TARP to date. However, the FSP is also broader than TARP. TARP funds many of the FSP programs, but several FSP programs are funded through other sources or are a function of regulatory changes. The FSP consists of several component programs: (i) the CAP, which provides additional capital for banks; (ii) the HASP, which provides assistance to homeowners; (iii) the CBLI, which is intended to restart the securitization markets and thereby increase lending; and (iv) PPIP, which is intended to facilitate the purchase of

troubled assets and provide a market pricing mechanism for such assets. The FSP also includes standards for transparency and accountability, which has resulted in new lobbying rules and reporting requirements. New executive compensation guidelines were announced along with the FSP which apply to recipients of new assistance and exceptional assistance. Similar requirements were subsequently applied retroactively to CPP participants by ARRA, as discussed above. The FSP was immediately criticized for lacking detail, however, since first announcing the FSP the Obama administration has provided greater detail on each of the component programs.

CAP. The CAP is the component of the FSP directed at strengthening the capital position of U.S. banking organizations through a capital program similar to the CPP. The CAP consists of two core elements: a supervisory assessment and access to a government capital investment. Participation in the CAP is required for the 19 largest U.S. banking institutions with assets of more than \$100 billion. U.S. banking organizations with assets of less than \$100 billion may also voluntarily participate in the CAP. Applications to participate in the CAP, including those by the large banking organizations who are required to participate in the supervisory assessments, must be submitted by May 25, 2009. Under the CAP banks must evaluate their capital needs under two economic scenarios. The banks will be required to hold sufficient capital to remain well-capitalized under the more adverse economic scenario. If the stress test indicates that a participating banking organization does not have sufficient capital, it has six months to either raise sufficient capital from private sources or it may receive capital from the Treasury under the CAP. Participants in the CAP (i) are required to disclose how the capital they receive expands lending; (ii) must participate in Federal mortgage modification programs; (iii) are subject to executive compensation and lobbying restrictions; and (iv) are subject to dividend, share repurchase and acquisition restrictions.

HASP. The HASP is the component of the FSP directed at assisting individual homeowners through a three-part plan to: (i) help 4 million to 5 million borrowers that are “underwater” refinance their mortgage through Fannie Mae and Freddie Mac, (ii) help 3 million to 4 million additional borrowers through the creation of a \$75 billion Homeowners Stability Initiative, which includes a \$10 billion loan guarantee plan with the FDIC, and (iii) provide an additional \$200 billion of funding to Fannie Mae and Freddie Mac (each receiving \$100 billion). The \$200 billion of funding for Fannie Mae and Freddie Mac does not come from the TARP, but rather the Housing and Economic Recovery Act of 2008. The size of the retained mortgage portfolios of Fannie Mae and Freddie Mac were increased by \$50 billion to \$900 billion.

MHA. The MHA implements the first two parts of HASP by offering assistance to as many as 7 to 9 million homeowners through the HAR and the HAM.

HAR. The HAR is available to 4 to 5 million homeowners who have a solid payment history on an existing mortgage owned by Fannie Mae or Freddie Mac. Normally, these borrowers would be unable to refinance because their homes have lost value, pushing their current loan-to-value ratios above 80%. Under the HAR program, many of these homeowners will now be eligible to refinance their loans to take advantage of today’s lower mortgage rates or to refinance an adjustable-rate mortgage into a more stable mortgage, such as a 30-year fixed rate loan.

HAM. Originally announced as the Homeowners Stability Initiative, the HAM will help up to 3 to 4 million at-risk homeowners avoid foreclosure by reducing monthly mortgage payments. Working with the Federal banking and housing agencies, the Treasury developed guidelines that are expected to become standard industry practice in pursuing affordable and sustainable mortgage modifications. The HAM will work in tandem with an expanded and improved Hope for Homeowners program. Under the HAM, lenders are asked to modify loans so that monthly

mortgage payments are no more than 38% of a borrower's income. Further reductions in interest payments would be matched dollar-for-dollar by the Treasury to bring the ratio down to 31% of a borrower's income. The lower interest rates are intended to be in place five years. Lenders may choose to reduce principal balances, with the Treasury sharing in the cost. Servicers will receive \$1,000 for each eligible modification under the HAM and up to \$1,000 each year for three years as long as the borrower stays current on the loan. Servicers also may receive \$500, and mortgage holders \$1,500, for modifications to at-risk loans in which the borrower is still current on payments. Borrowers may receive up to \$1,000 a year for up to five years to reduce principal balances if the borrower stays current on loan payments. Holders of mortgages modified under the HAM would be provided with a partial guarantee from the FDIC linked to declines in the home price index. Any institution receiving assistance through TARP or FSP funds in the future will be required to adhere to the HAM guidelines.

CBLI. The CBLI is the component of the FSP directed at increasing lending by stimulating the securitization markets through the TALF. Additionally, the guarantee for Small Business Administration ("SBA") loans has been increased and SBA lending fees have been reduced.

TALF. On November 25, 2008, the Federal Reserve announced the creation of the TALF. The FSP expanded the size of the TALF from \$200 billion to as much as \$1 trillion. Under the TALF, the FRBNY will lend up to \$1 trillion in the aggregate to finance the purchase of top-rated newly-issued domestic asset-backed securities ("ABS") backed by newly and recently originated auto, credit card, student and SBA-guaranteed loans. The Treasury has announced that in conjunction with the PPIP, future loans under the TALF may be secured by ABS collateralized by non-agency residential and commercial mortgage-backed securities and other assets. The loans are secured by the purchased ABS, have a three-year term and are without recourse to the borrower. Eligible borrowers include U.S. companies (including investment firms such as private equity and hedge funds), U.S. subsidiaries of foreign companies that conduct significant activities in the U.S. and U.S. branches and agencies of foreign banks. Eligible ABS must have received the highest rating from two of the major rating agencies and no major rating agency can have rated the security below the highest rating or placed it on watch for downgrade (subsequent downgrades or watches, however, do not adversely affect the TALF loan.) Each ABS issuer is required to hire an external auditor to certify that information conveyed to the rating agencies is correct and that the ABS meets the TALF eligibility requirements. The Federal Reserve will determine loan amounts by applying haircuts that depend on the ABS type. If there is a payment default, the Federal Reserve will sell the collateral to a special purpose vehicle established to manage these assets. The SPV will be capitalized in part by an equity investment by Treasury under TARP that will absorb first losses on the ABS collateral.

The first funding of the TALF occurred in March, with a subscription of \$4.7 billion. The April TALF funding was much smaller, totaling only \$1.7 billion.

PPIP. The PPIP is the component of the FSP directed at purchasing troubled assets. The PPIP is intended to use public financing to leverage private capital on a scale of \$500 billion, with the ability to expand up to \$1 trillion. It is also intended to allow the private sector to determine the price for currently troubled and previously illiquid assets. The PPIP consists of two main components, the LLP and the LSP. When releasing the details of the PPIP, the Treasury and Federal Reserve stated that the TALF would be expanded to include certain non-agency residential mortgage-backed securities that were originally rated AAA, and outstanding commercial mortgage-backed securities and asset-backed securities that are rated AAA.

LLP. The LLP focuses on real estate loans banks currently hold on their balance sheets. It is intended to attract private capital to purchase eligible legacy loans from participating banks

through the provision of FDIC debt guarantees and Treasury equity co-investment. Under the LLP, banks will auction pools of assets to interested buyers. The buyers will purchase the assets through Public-Private Investment Funds (“PPIFs”). Private investors and the Treasury will each contribute 50% of the capital in the PPIFs. The PPIFs then have the ability to issue debt guaranteed by the FDIC. Banks will receive either cash or the FDIC-guaranteed debt for the loans. The FDIC is currently seeking comments from bankers and investors on the details of how to implement the LLP.

LSP. Under the LSP, the Treasury will select approximately five asset managers to run PPIFs targeted at purchasing non-agency residential mortgage backed securities and commercial mortgage backed securities originated prior to 2009 with a AAA rating at origination. Investors have the opportunity to participate in these PPIFs through an investment vehicle. The Treasury will invest equity capital on a fully side-by-side basis with the private investors in each PPIF. The funds managers of these PPIFs will also have the ability to have the PPIF issue non-recourse senior debt to the Treasury.

What’s next

Perhaps the most important question with respect to the financial crisis is what is next. The FSP provides the outline of the areas the Obama administration plans to address. The administration and members of Congress have also indicated that regulatory reforms will soon be forthcoming.

Expanded TALF. As discussed above, the Treasury has consistently indicated that it is interested in expanding the eligible ABS collateral under the TALF. The Treasury has stated that eligible collateral will be expanded to include non-agency residential and commercial mortgage-backed securities and other assets. Eligible ABS may be further expanded to include such asset classes as collateralized loan and debt obligations, corporate debt, and other ABS not included in the initial rollout, which may include lower-rated or troubled assets.

TLGP expansion. As discussed above, the FDIC previously has considered expanding the DGP to cover secured debt and may consider further guarantees in the future.

Expanded FDIC borrowing. There is legislation currently pending to allow the FDIC to borrow \$500 billion from the Treasury to replenish the Deposit Insurance Fund and permanently raise the level the FDIC may borrow to \$100 billion, which the FDIC could tap without prior approval from the Fed and Treasury. Legislation is also pending that would permanently set the deposit insurance limit at \$250,000.

Regulatory reform. The Obama administration and members of Congress have already begun to address regulatory reform. Upcoming legislation provides for the modification of mortgages in bankruptcy, additional regulation for mortgage lending, and additional regulation of credit card and overdraft practices. There are plans to create or designate a systemic regulator with broad supervisory powers over the entire financial system. Legislation has also been introduced creating a Financial Products Safety Commission, which will have broad consumer protection authority over financial products. These steps are all being taken in conjunction with great international coordination, which can be expected to continue in the future. Further regulatory reform promise to realign the prudential supervisors and base regulation by activity rather than corporate form.

Conclusion

Hopefully this discussion provided you with a broad picture of the programs that have been established to respond to the financial crisis. Originally conceived as a program to purchase troubled assets, the TARP became a recapitalization program for banks, and was accompanied by various liquidity and guarantee programs such as the TLGP. As public opinion quickly turned against the TARP, new regulations were enacted that are currently driving banking organizations out of the CPP.

With the FSP, the Obama administration has taken the second tranche of the TARP funds and created a multi-pronged approach to provide additional capital for banks through the CAP, provide assistance to homeowners through the HASP, restart the securitization markets through the TALF thereby increasing lending under the CBLI and facilitate the purchase of troubled assets and provide a market pricing mechanism for such assets through the PPIP. These efforts will be joined by increasing levels of regulation for all participants in the financial markets, imposed by both the executive and legislative branches.

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