April 7, 2009

Financial Services Report

Special Report

An Overview of the Public-Private Partnership Investment Program

On March 23, 2009, the U.S. Department of the Treasury ("*Treasury*") and the Federal Deposit Insurance Corporation (the "*FDIC*") jointly announced initial details surrounding the Public-Private Partnership Investment Program ("*PPIP*"). PPIP is composed of two components: (1) the Legacy Loans Program and (2) the Legacy Securities Program.[1] Below, we briefly discuss highlights of each program, based on current publicly available information. We will supplement this information in the future as further details emerge and as changes and clarifications are made to each program.

The Legacy Loans Program and the Legacy Securities Program are expected to be very different, and there are many initial questions that exist regarding each program. The legal, tax, accounting and practical consequences of participating, in any capacity, in either program should be carefully considered. PPIP, even with its known uncertainties and those to be uncovered as the program takes final form, presents a potentially attractive avenue for private investors to expend capital, while sharing in risk allocation with other private investors and Treasury.

I. Legacy Loans Program[2]

Under the Legacy Loans Program, participating banks and savings associations insured by the FDIC ("*Seller Banks*") will identify to the FDIC a pool of their "eligible assets" available for sale to a public-private investment fund (generally, a "*PPIF*"; a PPIF established in connection with the Legacy Loans Program is referred to herein as an "*LP PPIF*," and a PPIF established in connection with the Legacy Securities Program is referred to herein as an "*LS PPIF*"). The FDIC will conduct a public auction to determine the purchaser of a pool of eligible assets. The FDIC, using analysis from a third party, and Seller Banks will determine the pricing of a pool of eligible assets and other relevant details with respect to such purchases. A Seller Bank will have the right, within a time frame to be established, to reject the final bid for the purchase of such pool of eligible assets. While the definition of an "eligible asset" for purposes of the Legacy Loans Program is under review by the FDIC, it is expected that the collateral supporting such assets will be real estate loans and related security, situated predominantly in the United States.[3]

Potential private investors must (i) be pre-approved by the FDIC to participate and (ii) provide a refundable deposit (currently expected to be 5% of their bid value). Groups of investors also must be approved by the FDIC. Generally, an eligible private investor (or investors), together with Treasury, will invest in the equity of the LP PPIF, in equal proportions. Alternatives to such a split are under consideration. Private investors may not participate in an LP PPIF purchasing assets from a Seller Bank if they (i) are affiliates of such Seller Bank or (ii) would represent 10% or more of the aggregate private capital in such LP PPIF. It is expected that Treasury's equity investment will be noncontrolling and that private investors will generally be responsible for managing the pool of eligible assets.[4]

Leverage (up to a maximum of 6:1 in the form of an FDIC guarantee of the debt issued by the LP PPIF) will enable the LP PPIF to purchase the eligible assets from the seller bank. The FDIC will charge a fee (not yet announced) for such guarantee. The guarantee will be secured by the eligible assets purchased.

Section 111(b) of the Emergency Economic Stabilization Act of 2008 ("*EESA*") will not apply to "passive" private investors in the Legacy Loans Program.[5] As required by EESA, Treasury would obtain warrants in each LP PPIF, but the materials provided to date are silent as to the issuer of such warrants.

II. Legacy Securities Program[6]

Generally, the Legacy Securities Program (i) expands the availability of the Term Asset-Backed Securities Lending Facility ("*TALF*") for financing certain asset-backed securities, including residential and commercial asset-backed securities and (ii) permits the use of an LS PPIF (established and managed by one of several prequalified fund managers[7], each an "*LS Manager*") to purchase "eligible securities" from eligible selling financial institutions ("*Seller Institutions*").

A. *TALF Expansion.* Under TALF, prior to the expansion under the Legacy Securities Program, participating borrowers could obtain nonrecourse loans for investing in newly or recently originated assets. Treasury, together with the Federal Reserve Bank, through the Legacy Securities Program intends to make available financing for (i) nonagency residential mortgage backed securities, originally rated "AAA," (ii) commercial mortgage backed securities currently rated "AAA" and (iii) other asset backed securities currently rated "AAA." As discussed below, an LS Manager may, in its discretion, elect to obtain debt financing under the Legacy Securities Program through TALF, thereby increasing available leverage.

B. *Purchase of Legacy Securities.* Each LS Manager will be primarily responsible for administering and controlling an LS PPIF, including selecting the assets to be purchased and determining the purchase price.[8] It is expected that "eligible securities" will include only asset-backed securities issued prior to January 1, 2009, initially rated "AAA" (or the equivalent) by two or more nationally recognized rating agencies (without giving effect to ratings enhancement) that are secured directly by mortgage loans, leases or other assets (but excluding certain other securities, such as CDOs and synthetic RMBs and CMBs), the underlying assets of which must be situated predominantly in the United States.

Seller Institutions (i) must be "financial institutions" from which the Secretary of the Treasury may purchase assets pursuant to section 101(a)(1) of EESA and (ii) may not be (A) affiliates of the related LS Manager that established the LS PPIF or any private investor that has committed at least 10% of the aggregate private capital raised by such LS Manager or (B) LS Managers for other LS PPIFs under the Legacy Securities Program, or their respective affiliates.

Generally, and in contrast to the direct investment in an LP PPIF under the Legacy Loans Program, Treasury, together with an entity established and controlled by the applicable LS Manager, would invest in the equity of the LS PPIF. Private investors would have an indirect investment in the LS PPIF. As a general matter, Treasury equity capital (made available in tranches, in anticipation of further investments) may be drawn down only at the same time and in the same proportion as private capital. Treasury, in its sole discretion, will have the right to cease funding of committed, but undrawn, Treasury equity capital. Private investors may be granted voluntary withdrawal rights from their investment in an LS PPIF, subject to limitations to be agreed upon with Treasury, including that no private investor will have the right to voluntarily withdraw prior to the third anniversary of its first investment. However, as described in the paragraph below, debt financing made available by Treasury will not be available for any LS PPIF in which private investors have voluntary withdrawal rights.

At the option of the LS Manager, the LS PPIF may apply to Treasury for a nonrecourse loan, which, typically, will (i) not exceed 50% of total equity capital of the LS PPIF and (ii) be secured by the eligible securities purchased. Debt financing provided by Treasury is expected to be funded at the same time as drawdowns of equity commitments. Again, Treasury, in its sole discretion, will have the right to cease funding of committed but undrawn debt financing. Proceeds received by an LS PPIF will be allocated (pro rata based on their respective equity contributions) between Treasury and private investors. As required by EESA, Treasury would obtain warrants in each LS PPIF, but the materials provided to date are silent as to the issuer of such warrants.

The LS Managers may, in their discretion, charge fees to private investors and Treasury, provided that, in the case of Treasury, such fees are fixed and based on the percentage of equity invested by Treasury.

Section 111(b) of the EESA will not apply to "passive" private investors in the Legacy Securities Program.[9] It is expected that the entity established and controlled by the applicable LS Manager to invest equity with an LS PPIF will be structured so that "benefit plan investors" (within the meaning of Section 3(42) of the Employee Retirement Income Security Act of 1974, as amended) will be eligible to participate as indirect investors in the LS PPIF.[10]

In the coming weeks, Treasury and the FDIC are expected to address the initial comments to the Legacy Loans Program and announce the initial approved LS Managers under the Legacy Securities Program. Changes and clarifications to each program may also be forthcoming and new questions and issues will arise. These programs, coupled with input from the financial services sector and the investment community, may present attractive opportunities for participation by a wide range of private investors. Please feel free to contact any Vedder Price P.C. attorney with whom you normally communicate or **Vivek G. Bhatt** (312-609-7880 / vbhatt@vedderprice.com) with any questions on developments related to PPIP.

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[1] Treasury provided updated guidance on the Legacy Securities Program on April 6, 2009 ("April 6 Press Release"), which is available at www.ustreas.gov/press/releases/tg82.htm.

[2] The Legacy Loans Program Summary of Terms ("LP Summary of Terms") is available at http://www.fdic.gov/llp/LLPtermsheet.pdf.

[3] *See*, *e.g.*, Public-Private Investment Program White Paper, at pg. 2 ("PPIP White Paper"), which is available at http://www.treas.gov/press/releases/reports/ppip_whitepaper_032309.pdf.

[4] PPIP White Paper at pg. 3.

[5] *See* Public-Private Investment Program for Legacy Loans Frequently Asked Questions, at pg. 3, which is available at http://www.treas.gov/press/releases/reports/legacy_loans_faqs.pdf.

[6] The Legacy Securities Program Summary of Terms ("LS Summary of Terms") is available at http://www.treas.gov/press/releases/reports/legacy_securities_terms.pdf.

[7] It is currently anticipated that five initial LS Managers will be approved by Treasury. *See* LS Summary of Terms under the heading "Treasury Funding." Prequalification will be based on criteria including, but not limited to, "… a proven ability to raise capital, demonstrated experience investing in the eligible asset classes and minimum threshold of eligible assets under management…. [t]hese criteria will be viewed on a holistic basis, and it is anticipated that failure to meet any one criteria will not necessarily disqualify a proposal." *See* the April 6 Press Release. The April 6 Press Release also extended the deadline for e-mail submission of applications for the initial LS Managers to 5 p.m. ET on Friday, April 24, 2009 (application available at http://www.treas.gov/press/releases/reports/legacy_securities_ppif_app.pdf). After the initial LS Managers are selected, Treasury will consider opening the program to other managers.

[8] It is expected that the LS Managers selected will be required to, among other things: (i) provide monthly reports to Treasury detailing eligible securities bought and sold and current valuations thereof, (ii) determine asset prices of eligible securities using third-party sources, (iii) obtain annual audited valuations from a nationally recognized accounting firm, and (iv) agree to provide access to relevant books and records of the LS PPIF to Treasury and other governmental offices. *See* LS Summary of Terms under the heading "Governance and Management."

[9] *See* Legacy Securities Public-Private Investment Funds Frequently Asked Questions, at pg. 3, which is available at http://www.treas.gov/press/releases/reports/legacy_securities_faqs.pdf.

[10] *See* LS Summary of Terms under the heading "Fund Structure Detail."

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