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How Federal Actions in Response to the Fiscal Crisis Can Help Securitization and Restart the Economy

March 2009

Timeline

What Happened

Foreclosures rise (2006)

Losses mount on subprime MBS (2007)

Losses spread to other MBS and more complex securities (2007)

Losses continue and confidence in system begins to falter (beg. 2008)

Write-downs continue and broader economy suffers

Nothing gets better

Who Was Blamed

Subprime mortgage lenders

Blame spreads to “originate to sell” model, Wall Street and credit rating agencies

Credit rating agencies targeted

FAS 157 and accounting comes under pressure

Financial industry broadly

Government failed to address root causes of problem – no wonder nothing has gotten better

Reaction

- Call for mortgage reform
- Federal Reserve notes “froth”
- Subprime originators file for bankruptcy
- Wall Street losses perceived as retribution
- Homeowner protection is focus: President Bush calls for public-private partnership to foreclose
- Wall Street losses continue to be seen as isolated – Not “Main Street” problem
- Credit rating agency reform begins in earnest
- Federal Reserve launches series of programs and rate cuts in earnest
- Congress allocates \$700 billion to Treasury
- Bailouts of AIG, Citi, auto industry, broker-dealers become BHCs
- Obama stimulus, foreclosure plan and TALF are focus of government

Federal Government Reaction Timeline Highlights

- **December 2007:** President Bush recommends formation of HOPE Now Alliance – a public-private partnership to address foreclosure
- **Winter 2008:** Federal Reserve launches a series of programs to increase market liquidity
- **Spring 2008:** SEC proposes rules for NRSROs rating structured finance transactions
- **Summer 2008:** Housing Economic Recovery Act creates new regulator for beleaguered GSEs and creates public foreclosure mitigation plan – HOPE for Homeowners
- **Fall 2008:** financial system faces near freeze and Treasury raises \$700 billion from Congress to remove toxicity from the system
- **Winter 2008:** Treasury and FDIC try to increase confidence in banking system with TLGP
- **Winter 2009:** write-downs continue and confidence building efforts aren't getting desired results
- **February 2009:** Federal Reserve, FDIC and Treasury launch new programs to build confidence in banks, restart securitization and reinforce GSEs as lender of choice

Federal Programs and Securitization

Term Securities Lending Facility and Options Facility (Mar '08)	Primary Dealers can borrow against Agency MBS, and buy options for future borrowing to enhance liquidity planning
Primary Dealer Credit Facility (Mar '08)	All tri-party eligible collateral can be pledged at discount window for overnight borrowing of U.S. Treasuries
GSE Programs (Beg. Sept '08)	Treasury commitments in GSEs; Treasury and Federal Reserve each launch programs to purchase GSE securities and support agency MBS market
ABCP Money Market Fund Liquidity Facility (Sept '08)	ABCP can be pledged by money market funds to provide ABCP liquidity and ensure redemption requests can be met
Troubled Assets Relief Program (Oct '08)	Treasury allocated \$700 billion to purchase mortgage-related assets (anticipated to be mortgage-backed securities) from financial institutions
Commercial Paper Funding Facility (Oct '08)	Federal Reserve to purchase CP and ABCP from eligible issuers to provide liquidity to those issuers and markets
Temporary Liquidity Guarantee Program (Oct '08)	FDIC will guarantee newly issued unsecured senior debt. Based on success of program, various efforts are announced to extend the program
Money Market Investor Funding Facility (Nov '08)	New York Fed uses a securitization to facilitate liquidity for money market funds
Term Asset-backed Liquidity Facility (Nov '08)	Purchases of recently issued ABS backed by recently issued collateral funded by non-recourse loans from New York Fed

Term Securities Lending Facility (TSLF and TOP)

- The Programs:
 - Primary dealers can obtain loans collateralized by investment grade MBS and ABS
 - Loans in the form of treasuries
 - 28-day loans
 - Program runs through October 30, 2009
 - Option program lets primary dealers purchase and option to obtain high-quality collateral for specific periods, e.g., quarter-end
- Impact to Securitization:
 - Balance sheet liquidity for primary dealer investors in MBS and ABS
 - Provides higher quality collateral to primary dealers with less liquid securities

Primary Dealer Credit Facility (PDCF)

- The Program:
 - Primary dealers can pledge tri-party eligible collateral for overnight loans
- Impact to Securitization:
 - Continued funding for balance sheet MBS

GSE Programs

- The Programs:
 - Fannie Mae and Freddie Mac enter into preferred stock purchase agreements with Treasury for \$100 billion each – later raised to \$200 billion each
 - Treasury to conduct open market purchases of GSE MBS
 - Federal Reserve to conduct open market purchases of GSE debt and GSE MBS
- Impact to Securitization:
 - Continued support for residential mortgage-backed securities
 - Failure of Fannie Mae or Freddie Mac would have had industry-wide impact: investors, originators, servicers, insurers, etc.

GSE Purchase Programs

- Treasury:
 - Announced September 7, 2008 a plan to purchase GSE MBS – amount undisclosed
 - Announced February 18, 2009 a plan to continue purchases of GSE MBS
 - Program authority (under Housing and Economic Recovery Act of 2008) ends December 31, 2009
- Federal Reserve:
 - Announced November 25, 2008 a plan to purchase \$100 billion of debt issued by the housing GSEs and \$500 billion of MBS guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae

ABCP Money Market Mutual Fund Liquidity Facility (AMLF)

- **The Program:**
 - Boston Fed offers non-recourse loans to eligible borrowers to fund their purchase of ABCP from money market mutual funds
 - Maintain liquidity in ABCP market and ensure ongoing ability to money market funds to satisfy redemption requests
 - Program runs through October 30, 2009
- **Impact to Securitization:**
 - Support of ABCP market and implicit support of the use of ABCP by money market funds

ABCP Money Market Mutual Fund Liquidity Facility (AMLF)

Eligible Borrowers:

- U.S. depository institutions
- U.S. BHCs
- U.S. branches and agencies of foreign banks

Loan Term:

- 270 days for non-depository institution borrowers
- 120 days for depository institution borrowers

Eligible ABCP Collateral:

- Purchased under program in place before September 18, 2008 and purchased on or after September 19, 2008 from a 2a-7 money market mutual fund
- Purchased by borrower at amortized cost
- Rated at the time pledged not less than A1/F1/P1 by two or more NRSROs or top category of one NRSRO

Troubled Assets Relief Program (TARP)

- The Pitch to Congress:
 - Mortgage-related assets continue to cause financial institutions harm – write-downs deplete capital, limit lending, distract management, must be segregated
- The Plan:
 - Federal government will purchase these assets from the balance sheets of financial institutions, restoring stability, increasing lending, restarting the economy
- The Issue:
 - At what price does Treasury buy the assets? Too high – taxpayers are harmed. Too low – further losses for institutions
 - How does Treasury buy the assets? Multi-institution auction process for thousands of different asset classes . . .
 - Freeze of inter-bank lending and freeze of credit before Treasury could get a plan together
- The Result:
 - Authorized on October 3 – by November 12 Treasury was no longer going to purchase these assets. TARP funds re-allocated to other purposes to stabilize the economy

TARP: What Did it Do?

- TARP funds have been allocated in support of the Federal Reserve Term Asset-backed securities Loan Facility (TALF)
- TARP funds are being allocated into capital investments in financial institutions
 - Lending is being strongly encouraged. Increased lending may encourage more financing transactions, particularly under TALF
 - Initial program was the Capital Purchase Program, without specific lending requirements
 - Additional lending under Targeted Investment Program
 - Newest program, Capital Assistance Program will require significantly more reporting regarding use of funds and lending

TARP Today

- Mortgage Plan
 - \$75 billion
 - It is expected that these are TARP funds, as the incoming Administration committed to allocate at least \$50 billion from TARP to foreclosure prevention efforts
- Public-private partnership
- Capital Assistance Program
 - All eligible financial institutions can apply for Treasury investment
 - Mandatory convertible preferred to be issued to Treasury
 - Additional capital to be required for institutions identified through special economic assessments conducted on the 19 largest banking institutions based on assets as of year-end

Commercial Paper Funding Facility

- **The Program:**
 - Federal Reserve Bank of New York will make loans to CP issuers
 - CP or ABCP pledged as collateral and held by an SPV
 - Designed to provide liquidity to CP and ABCP issuers
 - October 27, 2008 – October 30, 2009
- **Impact to Securitization:**
 - ABCP issuers can sell ABCP directly to the New York Fed's SPV managed by PIMCO
 - However, the ABCP cannot be extendible paper

Commercial Paper Funding Facility

- Federal Reserve authorized the Commercial Paper Funding Facility on October 7, 2008 under Section 13(3) of the Federal Reserve Act
- Not within the \$700B TARP program
- All sellers must provide collateral acceptable to the New York Fed
- Only U.S. issuers (including those with a foreign parent) are eligible to participate
- CP sold at a discount to the NY Fed, registration and a 10bp fee is charged
- Issuance capped at the maximum amount outstanding between January 1, 2008 and August 31, 2008
- Must be rated A1/P1/F1 by a major NRSRO, and if rated by more than one, must have A1/P1/F1 from at least two

Temporary Liquidity Guarantee Program

- The Program:
 - FDIC announces on October 14, 2008
 - FDIC will provide a guarantee on newly issued senior unsecured debt
- Impact to Securitization:
 - The most publicly successful federal effort to date
 - Serves as a model for other programs
 - Many proposals to extend the program
 - **January 2009: FDIC announced statement of upcoming extension of the program to guarantee collateralized debt**
 - February 2009: No further discussion of the collateralized debt extension, as the new Administration taps program for Capital Assistance Program and direct stabilization of the banking system
 - May be extended further or become a model for other programs – stay tuned

TLGP Debt Guarantee Program

- FDIC guarantees timely payment of principal and interest (subject to the FDIC's regulation)
- Backed by the full faith and credit of the United States
- Covers newly issued senior unsecured debt issued from October 14, 2008 through June 30, 2009, subject to definition of "unsecured debt"
- Guarantee expires on earlier of maturity of debt and June 30, 2012
- Eligible entities had to opt out of program by December 5, 2008, subsequently eligible entities and others can apply to FDIC for "eligible entity" status
- Issuance amount is capped based on prior issuance
- TARP's executive compensation restrictions are not applicable to participants in the TLGP

Money Market Investor Funding Facility (MMIFF)

The Program:

- New York Fed established SPV to purchase eligible assets from funds to enhance funds' liquidity for redemption requests
- SPV uses collateral to issue ABCP
- Loans are recourse
- \$600 billion program expires October 30, 2009

Impact to Securitization:

- Federal Reserve utilizing securitization structure as efficient form of ensuring funding for money market funds

Money Market Investor Funding Facility (MMIFF)

Eligible Investors (list expanded January 7, 2009)

- U.S. 2a-7 money market mutual funds
- U.S.-dollar denominated cash collateral reinvestment fund, account or portfolio associated with securities lending transactions that is managed or owned by a U.S. bank, insurance company, pension fund, trust company, or SEC-registered investment advisor
- Funds managed or owned by a U.S. bank, insurance company, pension fund, trust company, SEC-registered investment advisor or a U.S. state or local government entity, if the fund is required to:
 - maintain a dollar-weighted average portfolio maturity of 90 days or less
 - hold the fund's assets until maturity under usual circumstances
 - hold only assets that, at the time of purchase, have a long-term rating of A (or equivalent) or above by an NRSRO or a short-term rating of A-2 (or equivalent) or above by an NRSRO, or that are the credit equivalent thereof

Money Market Investor Funding Facility (MMIFF)

Eligible Assets

- U.S. dollar-denominated, minimum size of \$250,000
- Date of sale yield at least 60 bps above the primary credit rate
- Certificates of deposit, bank notes and CP maturing within 90 days
- 15% issuer concentration limit (20% at start up)
- New purchases cease upon issuer downgrade

Structure

- Each SPV will have 10 designated financial institution issuers
- Initially 5 SPVs will be formed
- SPV will issue ABCP with a short-term debt rating of at least A1/P1/F1 from 2 or more NRSROs to the investors which will absorb the first 10% of losses
- New York Fed will lend to the SPV 90% of the purchase price of each eligible asset, on an overnight basis at the primary credit rate
- Payments on purchased investments (1) repay New York Fed, (2) repay ABCP, (3) up to 25bp excess spread to investors, (4) remainder to New York Fed

Term Asset-backed Securities Loan Facility

- **The Program:**
 - New York Fed will finance the purchase of ABS by eligible borrowers
 - Non-recourse - ABS must be pledged as collateral and will be transferred to NY Fed SPV upon default
 - Newly issued consumer, small business and commercial real estate ABS backed by newly originated assets
 - Treasury will fund a first loss piece in the SPV
 - Facility size expected to be \$1 trillion
 - Runs through December 31, 2009
- **Impact to Securitization:**
 - Provides investors with no-risk funding for the purchase of ABS
 - Investors cannot be affiliated with the originators of the assets or the sponsor of the program

Term Asset-backed Securities Loan Facility (TALF)

Eligible ABS

- ABS backed by credit cards, auto loans, student loans and small business loans guaranteed by the SBA
- Auto loans include leases, motorcycles, floorplan, etc.
- All or substantially all of the underlying borrowers must be U.S. domiciled
- ABS issued after January 1, 2009; SBA pool certificates or development company participation certificates issued after January 1, 2009
- If credit card or floorplan, must be refinancing 2009 maturities
- 95% underlying assets from U.S. obligors
- 85% of underlying assets:
 - Auto loans and leases: originated on/after October 1, 2007
 - Student loan: first disbursement date no later than May 1, 2007
 - SBA loans (other than pool certs and DCPCs described above) originated on/after January 1, 2008
- “AAA” rated; not rated below AAA by a major NRSRO
- U.S. dollar denominated
- No synthetics or ABS as underlying assets
- Clear through DTC
- Announced February 2009:
 - Program expanded to include commercial real estate backed securities – no details yet
 - May be expanded to include residential MBS and corporate debt

Term Asset-backed Securities Loan Facility (TALF)

Structure

- NY Fed will loan borrowers money to invest in eligible ABS
- Loans:
 - Three-year maturity, interest due monthly
 - Borrower may elect fixed or floating (rates set by Fed)
 - Non-recourse to borrower (collateralized by the ABS)
 - Non-recourse loan fee payable on loan closing
 - Haircut on ABS based on price volatility of asset class
 - May be pre-paid; no substitution of collateral
 - Minimize loan size of \$10 million
- Treasury funds \$20 billion (up to \$200 billion) first loss through ownership of sub note issued by SPV
- NY Fed holds senior interest in SPV and is repaid first
- Treasury and NY Fed would share any upside
- “Sponsor” of ABS (Reg AB definition) collateralizing the TALF loan required to comply with TARP executive compensation limitation

Term Asset-backed Securities Loan Facility (TALF)

Eligible Borrowers

- U.S. persons holding eligible collateral: U.S. citizens, any business entity that is organized under the laws of the U.S., that conducts significant operations in the U.S., including any entity with a non-U.S. parent and a U.S. branch or agency of a foreign bank that maintains reserves at a Fed bank
- An investment fund: any pooled investment vehicle, hedge fund, private equity fund, mutual fund, organized under the laws of the U.S. that is managed by an investment manager that has its principal place of business in the U.S.
- No entity or investment manager controlled by a foreign government
- Must maintain an account with a primary dealer
- Borrower cannot have as collateral ABS backed by assets originated by borrower or borrower's affiliate
- Authorize primary dealer to execute master loan and security agreement

Term Asset-backed Securities Loan Facility (TALF)

Executive Compensation

- Sponsors must comply with Applies to senior executive officers (CEO, CFO, top three highest compensated officers)
- Compensation committee to review and certify (in SEC documents, if applicable, and to primary regulator) that no incentive structure for excessive risk taking
- Compensation committee meetings with senior risk officers annually
- No golden parachute payments for involuntary termination, receivership or bankruptcy
- Claw-back for bonus/incentive payments made based on statements made in investment period later found materially inaccurate
- No tax deduction for compensation in excess of \$500,000
- Principal Executive Officer certify compliance within 120 days and annually thereafter

Stimulus Plan

- Imposes new executive compensation requirements retroactively
- Application to TALF unclear
- Would cap bonuses of pool of executives at 50% of base pay (application to restricted stock unclear)

Term Asset-backed Liquidity Facility (TALF)

- Sponsor must certify:
 - ABS is TALF-eligible
 - Accountant certification of TALF eligibility obtained
 - Compliance with executive compensation requirements
 - Indemnification of New York Fed
 - Issuance of credit card and floorplan ABS does not exceed 2009 maturities

- Additional Requirements
 - Collateral must be pledged with a custodian
 - Eligible borrowers must authorize custodian to enter into a master loan and security agreement

Conclusion

- Federal Reserve actions demonstrate their supports of securitization as viable model and component of the financial markets
- Broad policy commitment to consumer lending and mortgages
- Politics must run their course
- Securitization, at least cash securitization, will be a part of a recovered, stabilized economy
- Can securitization help the economy stabilize and lending resume?