Toxic Assets Alert: Treasury Department Releases Plan on Toxic Assets

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The United States Treasury Department (the "Treasury") has announced a series of initiatives as part of its Financial Stability Plan to stimulate the purchase of troubled assets comprised of real estate loans held directly on the books of FDIC insured banks ("legacy loans") and securities backed by loan portfolios held by banks and other financial institutions ("legacy securities"). The plan is centered around the formation of the Public-Private Investment Program (the "Program") through which the Treasury will work in conjunction with the FDIC and the Federal Reserve to attract new private capital into the market. The Treasury intends to use between $75 to $100 billion in capital from the Troubled Asset Relief Program (TARP) along with capital from private investors to generate between $500 billion and $1 trillion in purchasing power over time. While the Program launch is still several weeks away, and subject to a specific notice and comment rulemaking period, the Program presents new opportunities for private sector entities to participate in various capacities.

The primary areas of focus of the government's programs are the residential and commercial mortgage sectors, including whole loans and securities backed by loan portfolios. These assets are currently being held by all types of financial institutions.

The Program has two key elements: the Legacy Loans Program (the "Loans Program") and the Legacy Securities Program (the "Securities Program").

Legacy Loans Program

The government plans to spend approximately half of the TARP resources to attract private capital to purchase commercial and residential loans, generally in pools, from participating FDIC-insured banks through the provision of FDIC guarantees of debt issued by a 50% Treasury co-investment. The Treasury expects a broad spectrum of investors to participate in the Loans Program, including individual investors, pension funds, insurance companies, mutual funds, publicly managed investment funds and financial institutions.

Under the Loans Program, banks will identify loans they plan to sell. The FDIC will analyze the loans and will determine the level of debt to be issued by the purchasing entity that the FDIC will guarantee; however the leverage ratio will not be permitted to exceed a 6-to-1 debt-to-equity ratio. The FDIC will then conduct an auction for the loans; private investors will bid for the loans and the bank will then decide whether to accept an offer. The winning bidder will form a Public-Private Investment Fund (PPIF), to which it will contribute 50% of the required equity in excess of the guaranteed debt with the Treasury contributing the remaining 50%. Private investors will be prequalified by the FDIC to participate in the auctions. The FDIC-guaranteed debt would be collateralized by the purchased assets and the FDIC would receive a fee in return for its guarantee. Once the PPIF purchases the assets, the private fund managers will control and manage the assets until final liquidation, subject to FDIC oversight.

Legacy Securities Program

The Securities Program consists of two related elements. It is designed to draw private capital into the markets for legacy securities by providing debt financing from the Federal Reserve under the Term Asset-Backed Securities Loan Facility (TALF) and through matching private capital raised for dedicated funds targeting legacy securities.

- The Treasury and the Federal Reserve are creating the first part of the securities program by incorporating it into the already-existing TALF program. Under this extended TALF program, a lending program will be created that is targeted at legacy securities tied to residential real estate ("RMBS"), commercial real estate ("CMBS") and consumer credit ("ABS"). Through the expansion of the TALF program, non-recourse loans will be made available to investors to fund purchases of legacy securities. The eligible assets are expected to include certain non-agency RMBS that were originally rated AAA and CMBS and ABS that are rated AAA. Borrowers will need to meet certain eligibility criteria, but other details of the plan have not yet been determined.
- Under the second part of the Securities Program, the Treasury will make co-investment and debt available by partnering with private capital providers to participate in legacy securities PPIFs that will invest in legacy mortgage and asset backed-securities that originated prior to 2009 with a rating of AAA at origination. Under this program, several large private asset managers (initially expected to be five) will be selected jointly as a Fund Manager to raise the private capital to invest in these joint investment programs with the Treasury.

As noted above, many of the terms of the Program have not been finalized. We will continue to monitor developments about the Program and provide further updates as details emerge.

Mintz Levin has teams of attorneys with the necessary real estate, securities, finance and creditors' rights experience, who have worked with both purchasers and investment advisors in connection with the analysis and purchase of the types of assets which are the subject of both the Legacy Loans Program and Legacy Securities Program, and who are familiar with the significant complexity and document review these types of transactions involve.

If you have questions regarding any of these programs, please contact one of the attorneys listed below or any member of your Mintz Levin team.

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