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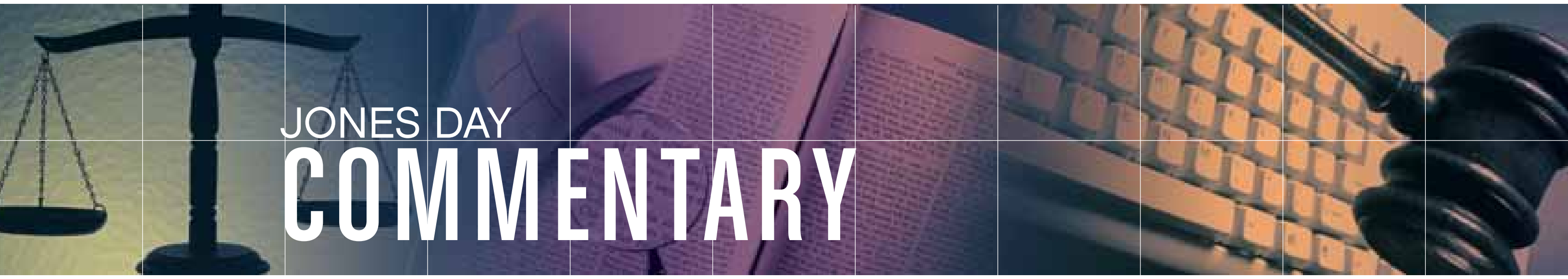

THE HELPING FAMILIES SAVE THEIR HOMES ACT OF 2009 SIGNIFICANTLY CHANGES THE TARP, PPIP, AND TALF PROGRAMS AND FDIC INSURANCE

On May 19, the U.S. Congress overwhelmingly approved the Helping Families Save their Homes Act of 2009 (the "Act"), which amends the Hope for Homeowners Program and contains various provisions related to home loan foreclosures and modifications. The President signed the Act into law on May 20. The Act includes several provisions that affect the Troubled Asset Relief Program ("TARP"), the Department of the Treasury's (the "Treasury") and the FDIC's Public-Private Investment Program ("PPIP"), and the Board of Governors of the Federal Reserve System's (the "Federal Reserve") Term Asset Loan Facility ("TALF").

The Act also amends provisions of the Emergency Economic Stabilization Act of 2008 ("EESA") and the Federal Deposit Insurance Act (the "FDI Act") related to FDIC insurance coverage, and the restoration and funding of the FDIC's Deposit Insurance Fund (the "DIF"). Other provisions provide changes to restore and fund the National Credit Union Share Insurance Fund (the "NCUSIF").

On May 5, the Senate voted 96 to 0 to adopt the Ensign-Pryor-Boxer-Snowe amendment to the Act known as the "Public-Private Investment Program Improvement and Oversight Act of 2009" (the "PPIP Oversight Act"). The PPIP Oversight Act was proposed following the Special Inspector General for the Troubled Asset Relief Program's (the "SIGTARP") April 21 *Quarterly Report to Congress* that the PPIP is "inherently vulnerable to fraud, waste and abuse." The PPIP Oversight Act was slightly modified by the House of Representatives as noted below, and the bill, as amended, passed in the House on May 19 by a vote of 367 to 54. The Senate agreed to the House amendment by unanimous consent.

This *Commentary* focuses on the provisions of the Act related to the TARP, PPIP, TALF, and the FDIC. A separate *Commentary* discusses the Act's housing-related provisions.

CHANGES TO PPIP

The PPIP Oversight Act requires that any federal program established to create a public-private investment fund (each, a "PPIF") shall:

- Require prior consultation with the SIGTARP to impose strict conflict of interest rules on PPIF managers to ensure that securities acquired by the PPIFs are purchased in arm's-length transactions, that fiduciary duties to public and private investors are upheld, and there is full disclosure of relevant facts and financial interests of participants in these PPIFs.
- Provide conflict of interest rules, the form of which will be prepared by the Treasury, which must be implemented by the PPIF manager prior to reserving "Federal Government" financing.
- Require each PPIF to make a quarterly report to the Secretary of the Treasury that discloses the PPIF's 10 largest positions. Each report shall also include accepted industry standard performance data, which will be publicly disclosed by the Secretary of the Treasury at a time when the Secretary determines that such disclosure will not adversely affect the ongoing business operations of the PPIF.
- Allow the SIGTARP access to all the PPIF's books and records, including all records of financial transactions in machine-readable form. The SIGTARP shall maintain the confidentiality of such records.
- Require each PPIF manager to retain all books, documents, and records relating to the PPIF, including electronic messages, such as email.
- Require each PPIF manager to acknowledge, in writing, a fiduciary duty to both the public and private investors in the PPIF.
- Require each PPIF manager to develop a "robust ethics policy" and methods to ensure compliance with the ethics policy.
- Require investor screening procedures for PPIFs.
- Require each PPIF manager to periodically identify for the Secretary of the Treasury, each investor in the PPIF that, individually or together with its affiliates, directly or indirectly holds equity interests in the PPIF equal to at least 10 percent of the equity interests in the fund, including interests in a vehicle formed solely for the purpose of directly or indirectly investing in the PPIF.

In addition, the PPIP Oversight Act requires the Secretary of the Treasury to (1) consult with the SIGTARP and (2) issue regulations governing interaction among the PPIP, TALF, and other similar public-private investment programs to address potential concerns regarding excessive leverage that could result from interactions among such programs.

The PPIP Oversight Act authorizes the allocation of $15 million of EESA funds to the SIGTARP to perform audits and investigations of recipients of nonrecourse federal loans under PPIP, TALF, or any other program that is funded by appropriations under the EESA. The audits and investigations are intended to determine and disclose any collusion between a loan recipient and the seller or originator of the asset used as collateral or any other conflict of interest that may have caused the loan recipient to intentionally overstate the value of the asset used as collateral. The SIGTARP must prioritize its audits or inspections of any program funded in whole or in part by the EESA consistent with its mission.

CHANGES TO TARP

Section 403 of the Act eliminates the Treasury's obligation to liquidate at the market price any warrants received by the Treasury in connection with a TARP recipient's repayment or retirement of TARP loans or investments, including those under the PPIP. The Treasury now "may" liquidate such warrants at the market price. In response to industry requests to be allowed to exit TARP in light of the compensation limits added to TARP by the American Recovery and Reinvestment Act of 2009's (the "ARRA") Dodd Amendment, Section 111(g) to EESA was incorporated into the Dodd Amendment when Congressman Barney Frank agreed to let TARP recipients repay TARP assistance. The valuation and repayment costs of TARP warrants have been an issue in the repayment of TARP preferred by various banking institutions.

Two interesting TARP-related amendments were introduced as part of the consideration of the Act but were rejected. Senator Thune's amendment would have required the Secretary of the Treasury to use any amounts repaid by a financial institution that is a recipient of TARP assistance to reduce the authorized level of TARP and would have prevented the recycling of TARP funds. Senator Thune's amendment was rejected by a vote of 47 to 48. Senator DeMint proposed an amendment that would prohibit the use of TARP funds for the purchase of common stock and for other purposes. Senator DeMint's amendment failed by a vote of 36 to 59.

FDIC DEPOSIT INSURANCE CHANGES

Section 204 of the Act amends Section 136 of EESA by extending the amount of FDIC insurance coverage per insured depositor to $250,000 by four years ending December 31, 2013. This increased insured deposit amount can be assessed for FDIC insurance.

This Section also makes significant changes to the restoration plan for the FDIC's DIF and the funding of such restoration plan. The FDIC can now fulfill its restoration plan under Section 7(b) of the FDI Act in eight years instead of five years. Perhaps most importantly, the FDIC's borrowing capacity from the Treasury is increased from $30 billion to $100 billion. Additional increases of up to $500 billion of borrowings are authorized at any time through December 31, 2010, upon the written recommendation of the FDIC Board of Directors and the Federal Reserve Board, in each case upon a vote of not less than two-thirds of such boards' members, as well as by the Secretary of the Treasury in consultation with the President, that additional amounts are necessary. If the FDIC's borrowing authority is increased above $100 billion, the FDIC must promptly submit a report to the Senate Banking Committee and the House Financial Services Committee describing the reasons and need for the additional borrowing authority and its intended uses.

The FDIC may not use this additional borrowing authority from the Treasury to fund FDIC obligations as part of a PPIP or other assistance program under the EESA involving the purchaser guaranty of assets.

The FDIC has never exercised its borrowing authority from the Treasury. The borrowing authority was last increased in December 1991 from $5 billion as part of the Federal Deposit Insurance Corporation Improvement Act of 1991, commonly called "FDICIA."

Section 13(c)(4)(G)(ii) of the FDI Act is amended to expand the use of systemic risk special assessments by the FDIC to further fund the DIF. The new provision directs the FDIC to recover any loss to the DIF from any action taken or assistance provided with respect to an insured depository institution with one or more special assessments on insured depository institutions and, with the concurrence of the Secretary of the Treasury, through assessments on depository institution holding companies, or both, as the FDIC determines appropriate.

The FDI Act, Section 13(c)(4)(G), provides for systemic risk assistance upon a two-thirds vote of the FDIC Board of Directors and of the Federal Reserve, and a determination by the Secretary of the Treasury in consultation with the President. Any action or assistance by the FDIC would avoid or mitigate serious adverse effects on economic conditions or financial stability. Prior to the Act, the FDI Act directed the FDIC to recover the loss to the DIF arising from such actions and assistance expeditiously through one or more emergency special assessments on insured depository institutions. The FDIC shall determine the assessment rates and the amount of each insured depository institution's average total assets during the assessment period, minus the institution's average total tangible equity and the amount of the institution's average total subordinated debt.

Section 204(d) of the Act eliminates any specified method of making a special assessment and provides the FDIC with broad discretion to make any assessment it deems appropriate on insured depository institutions. Further, this special assessment authority has been expanded to include FDIC assessments upon depository institution holding companies, subject to the concurrence of the Secretary of the Treasury.

The FDIC is also given broad authority to prescribe regulations to implement this new statutory provision, which may include:

- defining terms;
- setting the appropriate assessment rate or rates sufficient to cover losses incurred as a result of the actions of the FDIC to mitigate or void systemic risk considering:
- the types of entities that benefit from any action taken or assistance provided;
- economic conditions;
- the effects on the industry; and
- such other factors as the FDIC deems appropriate and relevant to the action taken or the assistance provided.

If amounts collected exceed actual losses, the excess is to be placed in the DIF.

NEW FDIC SPECIAL ASSESSMENT

On the same day that the Act was signed into law, the FDIC announced a special assessment on insured depository institutions. The special assessment is five basis points on each insured depository institution's assets less its Tier 1 capital as of June 30. The special assessment will be collected on September 30. An additional special assessment of up to five basis points later in 2009 is probable, subject to an FDIC determination that an additional special assessment is needed because the DIF's reserve ratio will fall to a level that would adversely affect public confidence or would be close to or below zero. Interestingly, unlike the FDI Act, under Section 13(c)(2)(G)(ii), as in effect prior to the Act, subordinated debt was not deducted from the assets used to calculate the special assessment, and all Tier 1 capital, not just "tangible Tier 1 capital," was included.

This special assessment is expected to raise approximately $5.6 billion for the DIF and keep the DIF and its reserve ratio positive, although close to zero. The FDIC estimates that this special assessment will reduce profitable banks' pre-tax income for 2009 by 5.1 percent and increase unprofitable banks' pre-tax losses by an average of 2.0 percent. The FDIC also now projects losses from failed banks at $70 billion over the next five years, $5 billion more than its February 2009 estimate. The FDIC estimated losses on BankUnited, the largest and most expensive failure to date in 2009, at $4.9 billion when BankUnited was placed into receivership on May 21.

The FDIC also issued Financial Institution Letter FIL-24-2009 on May 22 stating that FDIC examiners will consider the special assessment's nonrecurring nature when evaluating bank earnings, capital, and liquidity, and they will not downgrade a bank's CAMELS rating because of the adverse effect of the special assessment. Banks will be expected to comply with minimum regulatory capital requirements, however.

The Comptroller of the Currency, who is a member of the FDIC's Board of Directors, voted against the special assessment on the grounds that it was procyclical, too large, and would unfairly and disproportionately charge large banks.

CONCLUSIONS

The Act will have significant effects, not just on homeowners and mortgage foreclosure programs, but also on the PPIP, TARP, TALF, and FDIC insurance.

- The additional provisions required under the PPIP for each PPIF may delay the introduction of the PPIP for both legacy loans and legacy securities.
- The additional reporting, conflict of interest, and investment screening, as well as the nature of the certification of fiduciary duties to public and private investors, may discourage persons from participating in the PPIP, depending upon the nature and scope of the final rules.
- Because of the additional constraints imposed by the Act and the rules that are to be drafted, the use of TARP funds in the PPIP is likely to be viewed as less desirable by the market and by market participants.
- Disclosure of investment positions and investment performance by PPIFs may be viewed as undesirable and uncertain because it is subject to the discretion of the Secretary of the Treasury.
- We believe that one of the main attractions of the PPIP was the availability of leverage to investors that is not available privately under current market conditions for assets that are likely to be placed in the legacy loan or legacy securities program.
- The Act's authorization of the SIGTARP to address concerns regarding excessive leverage among the various programs could discourage the use of leverage and reduce the returns of equity holders, especially in light of the reduced desirability of using TARP as capital or debt. It is already uncertain as to the amount of the up to 6-to-1 leverage the FDIC will guarantee to sellers as financing for legacy asset purchases by PPIFs, since most toxic assets are not income generating except in connection with asset sales by the PPIF.

Investors, sellers into the PPIP, and others will want to fully understand the consequences of the Act and the rules to be developed in connection with the PPIP before acting. The greater discretion granted to the Treasury in liquidating TARP warrants may also give the Treasury greater leverage in negotiations as TARP recipients pay back TARP loans or other investments, and it may affect the use of warrants currently contemplated for the PPIP.

The FDIC special assessment provisions were immediately implemented. Their effect on depository institution holding companies is especially noteworthy. The implementation of an assessment based upon total assets less Tier 1 capital is viewed by many as helping smaller banks and adversely affecting larger banks by placing the assessment more on larger institutions. However, it also reinforces the effects of the FDIC's recently adopted risk-based assessment system, which increases deposit insurance assessments based upon high asset growth, reliance on other than core deposits, and wholesale funding. The FDIC's new power to assess depository institution holding companies may further discourage private equity and other investors from taking a "controlling" position directly or indirectly in an FDIC-insured institution, including in connection with the purchase of a failed institution.

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