



April 24, 2009

## PUBLIC PRIVATE INVESTMENT PROGRAM (PPIP)

### PRIVATE CAPITAL AND INVESTMENT FUNDS ALERT

On March 23, 2009, the United States Treasury Department, in conjunction with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve, announced its Public Private Investment Program (PPIP). The PPIP is intended to provide a market for "legacy" assets as part of an attempt to remedy illiquidity in the market for mortgage-backed securities and to create a market for troubled loans presently held on the balance sheets of U.S. financial institutions.

The PPIP is divided into two components: the Legacy Securities Program and the Legacy Loans Program. Although many key terms of the PPIP remain undetermined, the U.S. Treasury Department issued a Summary of Proposed Terms and updated lists of Frequently Asked Questions on April 6 and 21, 2009, with respect to the Legacy Securities Program. Published guidelines on the Legacy Securities Program and the Legacy Loans Program are discussed separately below.

### LEGACY SECURITIES PROGRAM

Under the Legacy Securities Program, there are two parallel programs. One is operated by the Federal Reserve and is an expansion of the existing TALF program (the "Term Asset Backed Securities Lending Facility"). This program was designed to provide liquidity for the new-issue consumer-based asset-backed securities market by offering qualified investors who purchase the securities very attractive financing. Under the newly announced Legacy Securities Program, the existing TALF program was expanded so that eligible collateral now also includes existing, non-agency residential and commercial mortgage-backed securities.

The second part of the Legacy Securities Program is commonly referred to as the Public Private Investment Funds ("PPIF") program. Under this program, the final terms and conditions of which are expected to be defined prior to the time when funds will be raised from private investors, the U.S. Treasury Department will select at least five private sector fund managers to form both a private investment vehicle (a "Private Fund") and a public-private investment fund (a "Legacy Securities Fund"). Each PPIF will pursue a long-term buy and hold strategy, although limited trading will be allowed. The term of the PPIFs will be no greater than ten years, subject to extension with the consent of the Treasury. Investors will invest into the Private Fund, and will be prohibited from withdrawing from the Fund for at least three years from the date of the first investment by the PPIF. The Private Fund will invest alongside the Treasury in the PPIF, with each investing 50% of the required equity. The Treasury and the Private Fund will invest and divest in the assets of the PPIF proportionately, and on the same terms and conditions. Gains and losses will be shared equally, subject to the Treasury's right to receive warrants, as is required by the Economic Stabilization Act of 2008 (EESA). No specific guidance has been published to date with respect to the warrants, although the general assumption is that they will be issued in addition to the Treasury's 50 percent equity stake, in recognition of the debt financing to also be provided by the Treasury. The Treasury also has a unilateral right to terminate its unfunded commitments of equity and debt to a PPIF in its sole discretion.

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The other economic and governance terms of the PPIFs are largely unresolved, such as the amount of management fees, the terms of indemnification obligations, and whether recycling will be allowed, although it has been made clear that fees and expenses owed by the Treasury in its role as an investor in a PPIF will be paid solely out of distributions attributable to equity contributions made by the Treasury to the PPIF. In addition, although a fund manager will control the trading and disposition of PPIF assets, it is unknown (although considered unlikely) whether the Treasury will be required to consent to dispositions by a PPIF. Additional regulatory guidance on these issues is expected.

Securities eligible for purchase by a PPIF ("Eligible Assets") will initially include only certain non-agency residential and commercial mortgage-backed securities that were originally rated AAA or an equivalent rating (in either case without enhancement) by two or more nationally recognized statistical ratings organizations. In addition, the securities must be secured directly by the actual mortgage loans, leases, or other assets, and not by other securities, with the exception of certain swap positions, as determined in the Treasury's sole discretion. The securities must be purchased from "financial institutions" as defined in the EESA. Additional classes of assets may be eligible for purchase as the program develops, and the Treasury expects to solicit comments from PPIF managers on this issue. Private Fund investors in a PPIF are not permitted to be informed in advance of potential asset acquisitions.

Entities that desire to be selected as one of the managers of a PPIF should have submitted applications to the Treasury, April 24, 2009, and the Treasury expects to inform an applicant of its preliminary approval as a fund manager on or prior to May 15, 2009. Applicants must have at least \$10 billion of Eligible Assets under management, provide performance track records, and be headquartered in the United States. Applicants must also submit a fundraising plan, including the types of investors it will seek to invest in the Private Fund, as they will have a limited period of time (approximately 12 weeks) from the date of preliminary approval to raise at least \$500 million of private capital before they receive final approval from the Treasury. The Treasury, in its April 6, 2009, updated Frequently Asked Questions, stated that, after the initial pre-qualification of large fund managers, it will consider opening the program to entities with less than \$10 billion of Eligible Assets under management.

Each PPIF manager has the option to subscribe for non-recourse loans from the US Treasury (secured by the PPIF's Eligible Assets) up to an aggregate amount of 50 percent of the Fund's total equity, as long as the investors in the Private Fund are restricted from withdrawing from the Fund. It is unclear whether this restriction on withdrawal would extend for the life of the financing. Each PPIF manager may also request additional debt financing from the Treasury, up to 100 percent of total equity, subject to restrictions on asset level leverage, withdrawal rights, disposition priorities, and any other restriction the Treasury deems relevant. Fund managers may also seek private financing, TALF financing, and financing through other Treasury programs. Debt financing must be drawn down concurrently with equity capital, and, if private financing is used, Treasury equity and Private Fund equity must be leveraged proportionately.

The PPIFs were designed to create a private sector market mechanism for pricing the relevant assets. This will provide the Treasury the ability to assure U.S. taxpayers that the government obtained the best price available. However, valuation of the assets to be purchased by a PPIF is obviously a concern for all involved parties. Financial institutions may

be encouraged by federal regulators to participate in the program, and sellers will be required to market assets that they sell (and similar assets that remain on their balance sheets). Potential investors in the Private Funds should be mindful of the process of third party valuations and auctions, as the information becomes available.

## LEGACY LOANS PROGRAM

The second component of the PPIP is the Legacy Loans Program. At present, it appears that this program is only available to domestic investors and foreign investors with headquarters in the United States. Although the scope of these restrictions is far from clear, additional guidance is expected from the FDIC in the near future. Through the Legacy Loans Program, the FDIC will establish investment funds ("Legacy Loan Funds"). The Treasury will invest equity alongside private investors directly into a series of Legacy Loan Funds. The Treasury will also be issued warrants as required by the EESA. Each Legacy Loan Fund will issue debt guaranteed by the FDIC, not to exceed a 6:1 debt to equity ratio.

Each Legacy Loan Fund will purchase "eligible assets" from U.S. banks and thrifts through an auction held by the FDIC. The FDIC will review and select the winning bid, although the selling bank may accept or reject the winning bid.

"Eligible assets" include loans and pools of commercial and resident loans where the loans and any supporting collateral must be located primarily in the U.S. Eligible assets must also satisfy certain requirements to be set out jointly by the FDIC and the Treasury. These requirements have not yet been published. A Legacy Loan Fund can not purchase assets from affiliates of its private investors or from investors who own more than 10 percent of a Legacy Loan Fund.

The FDIC will arrange for a third-party appraiser to provide an initial valuation of an eligible asset and will use this valuation to determine the debt to equity ratio that it will guarantee. Private investors and the Treasury will share profits and losses on proportion to the amount of equity each invested.

We will continue to monitor developments and specific published guidelines surrounding the two PPIP programs, and will keep you updated as the information is released. If you have any questions or concerns, please do not hesitate to contact us. Thank you.

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