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Investment Opportunity: TALF Loans and PPIP

Federal Reserve/Treasury Offers Favorable Loans to Buy Asset-Backed Securities

The Federal Reserve and the U.S. Department of Treasury recently began new lending to encourage investors to buy securities backed by consumer and small business loans. The lending program, known as Term Asset-Backed Securities Loan Facility (TALF), could be a favorable investment opportunity at the same time that it provides up to $1 trillion in new lending to encourage the issuance of securities backed by consumer credit.

In addition to TALF, Treasury has announced the Public-Private Investment Program (PPIP) to encourage investors to purchase troubled pools of loans from banks through the Legacy Loans Program and to encourage investors to participate with Treasury in funds designed to purchase securities backed by loan portfolios through the Legacy Securities Program.

Term Asset-Backed Securities Loan Facility

Under TALF, the Federal Reserve Bank of New York (FRBNY) will lend a minimum of $10 million to each eligible borrower to buy securities backed by auto loans, credit card loans, student loans, and certain small business loans. The TALF borrower must pledge these asset-backed securities as collateral for a non-recourse TALF loan. If the investment is unsuccessful and the TALF borrower cannot repay the loan, it must surrender the collateral, but the borrower is generally not subject to additional recourse.

- Eligible Borrowers: U.S. businesses and investment funds, such as hedge funds, private equity funds and mutual funds, with U.S. investment managers.
- Eligible Collateral: AAA-rated securities issued mostly in 2009 backed by auto loans, student loans, credit card loans, and small business loans guaranteed by the Small Business Administration. Securities backed by commercial mortgages, certain vehicle fleets, equipment, and private-label residential mortgages may be included in the future.
- Loan Terms: Minimum $10 million loan (no maximum) with a three-year term, a fixed or floating interest rate depending on the collateral, and an administrative fee of 0.05 percent of the loan amount on each

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settlement date. The principal amount of each loan depends on the value of the pledged collateral with borrowers expected to contribute 5 percent to 16 percent of the total investment depending on the collateral.

- Restrictions: TALF loans cannot be secured by loans originated or securitized by the TALF borrower or an affiliate. Each borrower must be approved by the FBRNY in its sole discretion, and the FBRNY may inspect and audit each borrower. Substitution of collateral is not permitted unless the collateral is found ineligible after the loan is made.

Public-Private Investment Program

Additional investment opportunities exist under PPIP, which consists of two programs: (1) the Legacy Loans Program and (2) the Legacy Securities Program. Under the Legacy Loans Program, investors will be able to buy pools of loans directly from banks at a price determined by private auction. The Federal Deposit Insurance Corporation (FDIC) will guarantee financing for as much as six times the amount of equity contributed to purchase such loans, with Treasury contributing 50 percent of the equity funding. The private investor will be responsible for servicing the asset pool using asset managers approved by the FDIC.

Under the Legacy Securities Program, investors will be able to invest in funds managed by fund managers approved by Treasury. The federal government will provide a one-for-one equity match to the fund for every dollar of private capital invested and a loan for an amount between 50 and 100 percent of the equity provided. The fund will then begin buying certain non-agency residential mortgage-backed securities and commercial mortgage-backed securities originated before 2009.

TALF and PPIP Expectations

Treasury and the Federal Reserve hope that TALF and PPIP will encourage consumer credit transactions by allowing lenders to once again pool loans and sell asset-backed securities, a market that has largely collapsed. The two programs may have the added benefit of offering favorable investment opportunities for eligible borrowers and investors. It is unclear which borrowers will take advantage of TALF, but hedge funds, private equity funds, and similar investment vehicles are likely participants. A varied group of investors is also expected to participate in PPIP, including individuals, pension plans, insurance companies, and other long-term investors.

The largest perceived advantage of TALF and PPIP is the opportunity for significant returns with a limited risk to the investor. As credit protection, Treasury will use Troubled Asset Relief Program (TARP) funds to buy and manage TALF loan collateral that is foreclosed upon by the FRBNY.

The FRBNY began accepting subscriptions for TALF loans on March 17, 2009 and will continue to accept subscriptions on the first Tuesday of each month until December 31, 2009 (unless the Federal Reserve extends the program). Updates to TALF can be found at the TALF website, www.ny.frb.org/markets/talf.html. PPIP is a more recent program with significant details still being developed. It is explained in more detail at Treasury's website, www.treas.gov.

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