

## First Quarter 2009 Knowledge College

### The Fed and Treasury's Financial Stability Plan

The Federal Reserve and U.S. Treasury continue to take unprecedented policy actions to fight the worst financial crisis in almost eight decades. The following reviews the newly initiated Financial Stability Plan.

On February 10, 2009, the Financial Stability Plan was unveiled. In addition to revising the original **Term Asset-Backed Securities Loan Facility (TALF)**, the Plan introduces the **Financial Stability Trust** for bank investment under the Capital Assistance Program (CAP), the **Public-Private Investment Program (PPIP)** to encourage private investments in legacy assets, the **Consumer and Business Lending Initiative (CBLI)** and the **Small Business and Community Lending Initiative** to help consumer and small business loans, and the **Housing Support and Foreclosure Prevention Plan** to slow mortgage foreclosures. These programs are being implemented to address the capital illiquidity faced by financial institutions and to unfreeze the securitization markets, which had previously provided over half of the lending in the United States.

#### Term Asset-Backed Securities Loan Facility (TALF)

After first authorizing the TALF in November 2008, the Federal Reserve announced on February 10, 2009 that it was prepared to undertake significant expansion of the program. This resource is planned to continue with monthly fundings through December 2009 (or longer if the Fed chooses) in an attempt to aid market participants in arranging and marketing new securitizations of recently generated auto loans, credit card loans, student loans, and SBA-guaranteed small business loans. The first subscription period ended on March 25, 2009 to eligible owners of certain AAA-rated asset-backed securities (ABS).

- ✓ On March 19, 2009, the Federal Reserve announced that qualified collateral for the program would be extended to mortgage servicing advances, business equipment loans, vehicle fleet leases, and floor plan loans.
- ✓ The U.S. Treasury originally planned to lever \$20 billion to \$200 billion of lending from the Federal Reserve. The revised plan will dramatically increase in size by leveraging \$100 billion up to \$1 trillion.

#### Financial Stability Trust

Relevant regulators (The Fed, FDIC, OCC, and OTC) are conducting comprehensive stress tests on banks with assets in excess of \$100 billion to generate a realistic forward-looking assessment of their overall ability to withstand a further decline in economic conditions.

- ✓ The Capital Assistance Program (CAP) was instituted to provide a capital cushion to banks that have undergone the comprehensive stress test to make available contingent equity to preserve or increase lending if it is needed due to a worse-than-expected economic downturn.
- ✓ The Financial Stability Trust was created to manage investment in U.S. financial institutions made by the U.S. Treasury under the CAP.

### **Public-Private Investment Program (PPIP)**

On March 23, 2009, Treasury Secretary Timothy Geithner announced that the PPIP expects to provide financing for \$500 billion in purchasing power to buy troubled legacy assets, with the potential for expansion later (to as much as \$1 trillion). For seed money, the government initially plans to leverage \$75 to \$100 billion in capital from the Troubled Asset Relief Program (TARP) to collaborate with private investors to buy up legacy assets at the center of the credit crisis. The PPIP will consist of two separate programs: Legacy Loans & Legacy Securities.

- ✓ Legacy Loans Program: The U.S. Treasury plans to seed a number of Public-Private Investment Funds (PPIFs) that could purchase these legacy loans using FDIC guaranteed debt. The FDIC, tapping its own credit lines with the U.S. Treasury, would provide up to a 6:1 debt-to-equity leverage ratio on these loans.
- ✓ Legacy Securities Program: The program plans to purchase legacy securities such as consumer credit and residential and commercial real estate related securities using two basic approaches to draw in private capital:
  1. The first approach would provide eligible investors non-recourse financing from the expanded TALF to purchase toxic and legacy securities.
  2. The second approach would involve hiring up to five investment managers with proven track records of managing toxic securities to raise at least \$500 million (per manager) in private capital to run separate PPIFs. The U.S. Treasury plans to match the equity the private investor allots dollar-for-dollar in each PPIF. In addition, the investment manager will have the ability to subscribe to senior debt from the U.S. Treasury for 50-100% of equity, which could enable the manager to direct up to 4 times the dollar amount raised from private investors.

### **Consumer & Business Lending Initiative (CBLI)**

Another component of the Financial Stability Plan, the CBLI, will provide financing to private investors to support the purchase of loans with the intent to thaw markets and lower interest rates for auto, small business, credit card and other consumer loans.

- ✓ The CBLI expands the initial reach of the TALF to include commercial mortgage-backed securities (CMBS) with the possibility that future expansions could include non-Agency residential mortgage-backed securities (RMBS) and assets collateralized by corporate debt (CDOs).

### **Housing Support and Foreclosure Prevention Plan**

The Housing Support and Foreclosure Prevention Plan will look to support distressed borrowers by establishing loan modification guidelines and standards for government and private programs.

- ✓ The program will seek to prevent avoidable foreclosures by committing \$50 billion to reduce monthly payments (in-line with prudent underwriting) of owner-occupied “middle class” homes.
- ✓ A second element of the plan is the continued effort of the Federal Reserve and U.S. Treasury to drive down mortgage rates through spending up to \$600 billion to purchase mortgage-backed securities and debt of Government Sponsored Enterprises (GSEs) such as Fannie Mae and Freddie Mac.

### **Small Business and Community Lending Initiative**

The Small Business and Community Lending Initiative was set up in an effort to improve the secondary markets for small business loans.

- ✓ The Administration plans to increase the guarantee for small business loans from 75% to 90% in an attempt to further minimize credit risk to potential lenders.
- ✓ Additional revisions such as a reduction in interest rates, collateral haircuts, and origination fees will be (or have been) made to encourage greater flows of credit to small businesses.