March 27, 2009

CLIENT ALERT

FDIC CLARIFIES LEGACY LOANS PROGRAM

Earlier this week, the U.S. Treasury Department and the Federal Reserve Bank jointly announced a Public-Private Investment Program (Program). Pursuant to the Program, Treasury will co-invest in whole loans sold at auction by banks insured by the Federal Deposit Insurance Corporation (FDIC), and the FDIC will facilitate purchase money financing through a loan guarantee program. The Program is described in greater detail in our client alert of March 26, 2009 ("U.S. Treasury Announces New Public-Private Investment Program").

Yesterday, the FDIC held a conference call for bankers to provide an overview of the Program and to respond to initial questions and comments about the Program. FDIC Chairman Sheila Bair emphasized the FDIC's desire for transparency in implementing the Program. She encouraged the public to submit comments during the next two weeks in response to questions posted by the FDIC on its Web site in order to get the Program up and running as soon as possible. A copy of these questions is attached to this alert.

Chairman Bair stated that the FDIC was particularly interested in comments from the private sector in three areas:

- the appropriate percentage of government equity participation to maximize returns for taxpayers while assuring integrity in the pricing of Legacy Loans by private investors
- how best to encourage a broad and diverse range of participation in auctions by private investors

- how best to manage the Legacy Loans after purchase by public-private investment funds (PPIFs).

FDIC's Chief Operating Officer John Bovenzi indicated that there would be more conference calls in the future, as needed, to assist the FDIC in tailoring the Program to the needs of participating banks and private investors.

INITIAL FOCUS

The FDIC stated that its initial focus will be the sale of loans secured by mortgages on residential and commercial properties, including construction loans. All or some of the loans in a portfolio may be non-performing. The FDIC is eager to have private industry input on the sizing and composition of loan pools and the desired frequency of auctions.

AUCTION PROCESS

The FDIC is seeking the private sector's advice on the auction type (e.g., Dutch or English "open outcry" auction) and procedures (e.g., online or sealed bid). The FDIC also encouraged comment on the advantages and disadvantages of PPIFs paying selling banks all cash for assets by selling public debt versus use of purchase money financing to pay the non-equity portion of the purchase price. Although the FDIC plans to issue a term sheet setting parameters for such debt, the terms (including maturity date and interest rate) and loan to equity ratio will vary from transaction to transaction.

All bidders must be prequalified pursuant to a qualification process that will be developed by the FDIC (taking into account public input) as the Program launches over the next few months.

The FDIC intends to seek to engage private valuation firms to undertake due diligence on portfolios proposed for sale and to conduct the auctions. Such firms will be selected through an FDIC-managed procurement process. It will consider the qualifications of responding firms, as well as their pricing for services. These firms will set up data rooms (both online and physical) for the pre-auction inspection of loan documents by qualified bidders.

Selling banks and the winning bidders will negotiate representations and warranties and post-sale loan buy-back requirements on an individual basis. The FDIC does not anticipate that the Program will include any post-sale due diligence period for winning bidders. It has yet to be determined, however, whether there will be a "loan kick-out" mechanism to rid a subject pool of loans that do not conform to the seller's representations and warranties.

PROGRAM COSTS

If a PPIF defaults on its obligations to pay its notes issued in connection with its purchase of a loan pool, the FDIC will be required to perform under its guarantee. As such, the FDIC's goal is to price its guarantee fees such that the sum of all guarantee fees collected will be equal to or greater than the sum of all losses incurred by the FDIC pursuant to the Program. The amount of the guarantee fees will therefore reflect the FDIC's assessment of the likelihood that a given portfolio will decline in value to an amount less than the outstanding balance of the debt issued by the PPIF to purchase the portfolio.

To the extent that the total pool of guarantee fees collected in relation to the Program are insufficient to cover the FDIC's losses in connection with the Program, the FDIC will make a special assessment on all member banks, without regard to their participation in the Program. Any guarantee fees remaining when the debt is fully paid will be placed in the FDIC's Deposit Insurance Fund.

The Treasury will pay some of the administrative costs of the Program. Sales costs will be paid by the selling banks from loan portfolio sales proceeds.

QUALIFIED PRIVATE INVESTORS

There will be different qualifications for bidders for each loan portfolio, taking into account the size and associated risks. Private investors under common control with (as defined in the Bank Holding Company Act), or owning a 10 percent or more interest in, a selling bank may not own equity in the purchasing PPIF. The fact that a private investor has participated in prior partnerships or investments with the FDIC will not be considered in determining a private investor's qualifications to bid on a particular loan portfolio.

SERVICING AND POST-SALE CONSIDERATIONS

All portfolios will be sold on a servicing released basis. Participating banks will have an obligation, however, for some period after the sales close to continue servicing the portfolios.

RESTRICTIONS ON THE EXERCISE OF REMEDIES

The FDIC indicated that PPIF-owned loans will probably be subject to restrictions with respect to loan modifications and, particularly with respect to loans secured by residential mortgages, the exercise of remedies. Because funds from the Troubled Assets Relief Program (TARP) will be used for the Treasury's equity investment in PPIFs, loans secured by residential mortgages may be subject to foreclosure restrictions set forth in the TARP.

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