

CLIENT ALERT

SIGTARP RECOMMENDS TREASURY CURB PPIP/TALF INVESTING

In his *Quarterly Report to Congress* submitted on April 21, 2009, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) made recommendations to address what the SIGTARP identified as “inherent vulnerabilities” in the Department of the Treasury’s Public-Private Investment Program (PPIP).

Of particular concern to the SIGTARP is the ability of Public-Private Investment Funds (PPIFs), formed pursuant to the Legacy Securities Program, to purchase legacy residential mortgaged-backed securities (RMBS) through the Term Asset-Backed Securities Loan Facility (TALF). The Treasury has previously announced that it will co-invest up to 50 percent of the equity in such PPIFs, and that, in addition, such PPIFs will be eligible to borrow from the Treasury an amount equal to up to 50 percent of the PPIF’s total equity.

Pursuant to TALF, an eligible borrower can finance the acquisition of eligible RMBS by borrowing money on a non-recourse basis from the Federal Reserve Bank of New York (FRBNY). Securities financed through TALF are subject to a mandatory “collateral haircut” established by FRBNY, based on the volatility of the security’s asset class.

As a result of the additional leverage available through TALF, SIGTARP theorizes that, under certain conditions, a private investor could turn a \$500 million equity investment of private funds into a \$7.5 billion pool of assets by combining the co-equity investment and leverage available to the PPIF (from the Treasury under the PPIP) with the asset-level available through TALF (from FRBNY). In effect, the private investors’ equity is used to cover the collateral haircut mandated by TALF.

Based on a 50 percent equity split with the Treasury (and disregarding warrants, if any, issued to Treasury as part of PPIP), the private investor would receive 50 percent of the profits from its enhanced buying power through the combined PPIP and TALF programs, but only be exposed to less than 7 percent of the total losses if the fund were wiped out.

It is the SIGTARP’s view that this represents potential inequity to the U.S. taxpayer, and that the “leverage-upon-leverage” that results from combining Treasury-provided PPIP equity and financing with FRBNY-provided TALF financing creates significant conflicts of interest and collusion issues.

In addition, the SIGTARP believes that, because the private investor will have so little “skin in the game” relative to the size of the asset pool it controls, the private investor’s incentive to diligently underwrite asset acquisitions undertaken by the PPIF may be severely undermined.

Accordingly, the SIGTARP has recommended that the Treasury not allow Legacy Securities PPIFs to finance their holdings through TALF unless significant mitigating measures are included to address conflicts of interest, collusion and underwriting diligence issues. The SIGTARP further suggested that these measures might include prohibiting the use of Treasury-provided PPIP leverage if the PPIF finances its holdings through TALF—or proportionately increasing haircuts for PPIFs that do so.

CONTACT INFORMATION

We also invite you to visit the firm’s [Economic Recovery Resource Center](#) for news and analysis concerning the government’s economic recovery programs and their impact on business and the law.

If you have any questions concerning this alert, please contact—

Corporate

C.N. Franklin Reddick III.....	freddick@akingump.com	310.728.3204.....	Los Angeles
William D. Morris	wmorris@akingump.com	713.220.5804.....	Houston
Rosa A. Testani.....	rtestani@akingump.com	212.872.8115.....	New York

Investment Funds

Burke A. McDavid.....	bmc david@akingump.com	212.872.1083.....	New York
Stephen M. Vine	svine@akingump.com	212.872.1030.....	New York

Government Contracts

Scott M. Heimberg	sheimberg@akingump.com	202.887.4085.....	Washington, D.C.
Robert K. Huffman.....	rhuffman@akingump.com	202.887.4530.....	Washington, D.C.

Public Law and Policy

J. David Carlin.....	dcarlin@akingump.com	202.887.4133.....	Washington, D.C.
Robert J. Leonard	rleonard@akingump.com	202.887.4040.....	Washington, D.C.

Real Estate and Finance

Roberta F. Colton.....	rcolton@akingump.com	202.887.4072.....	Washington, D.C.
Gregory S. Grigorian	ggrigorian@akingump.com	202.887.4106.....	Washington, D.C.
Carl B. Lee	clee@akingump.com	214.969.2726.....	Dallas
Michael S. Mandel.....	mmandel@akingump.com	202.887.4196.....	Washington, D.C.
Randall M. Ratner	rratner@akingump.com	214.969.2893.....	Dallas
Hushmand Sohaili	hsohaili@akingump.com	310.229.1060.....	Los Angeles

Tax

Patrick B. Fenn.....	pfenn@akingump.com	212.872.1040.....	New York
Stuart E. Leblang.....	sleblang@akingump.com	212.872.1017.....	New York