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Treasury Outlines Financial Stability Plan - TARP II

On February 10, 2009, Treasury Secretary Timothy Geithner announced the outlines of the Obama Administration's new financial stability plan for restoring confidence in and functioning of the credit markets and banking system. The plan includes three new programs and various other initiatives designed to strengthen the nation's banks, attract private capital to restart lending, and provide direct assistance to the markets that consumers and businesses depend on.

The financial stability plan announced by Secretary Geithner did not include much detail about its various components, disappointing many investors and other market participants who had been expecting a more fully-developed program. Much work clearly remains to be done by Treasury and other Federal regulators to implement the plan. To enhance the transparency of the process (and address a criticism frequently leveled with respect to the opacity of the TARP program), the Treasury has established a new web site, FinancialStability.gov, which contains a fact sheet about the plan and will include information about its implementation. A fact sheet about the plan is also available on Treasury's web site at <http://www.ustreas.gov/news/index2.html>. Following is a summary of the primary components of the plan announced by Secretary Geithner:

I. PUBLIC-PRIVATE INVESTMENT FUND - \$500 Billion

Treasury will work with the Federal Reserve Board (FRB) and the FDIC to establish a Public-Private Investment Fund to purchase "legacy" loans and assets, such as mortgage-related securities, held by any U.S. headquartered bank and make them available for sale to private investors. As explained, the bad investments (the term "bad bank" was not used) will be purchased using the FRB's balance sheet, with FDIC providing a guarantee to investors that participate in the program.

The criteria for determining which investments may be sold to the Public-Private Investment Fund, as well as the pricing and timing of the purchases and subsequent sales remain to be determined. Treasury Secretary Geithner stated that the objective is to use private capital and private asset managers to help provide a market mechanism for valuing the assets. He indicated that Treasury is exploring a range of structures for this program and will seek input from market participants and the public. According to Secretary Geithner, the program will start with \$500 billion in financing capacity, but may grow to \$1 trillion, "based on what works."

II. COMMERCIAL AND CONSUMER LENDING - \$500 Billion to \$1 Trillion

To unfreeze the commercial, student, auto and credit card loan markets, the FRB will expand the previously announced Term Asset-Backed Securities Loan Facility

(TALF) program aimed at acquiring existing loans from financial institutions. In a press release that coincided with the Geithner announcement, the FRB said the expansion could increase the size of the TALF program to as much as \$1 trillion and broaden the eligible collateral to encompass additional types of newly issued AAA-rated asset-backed securities, such as commercial mortgage-backed securities, private-label residential mortgage-backed securities, and other asset-backed securities.

(<http://www.federalreserve.gov/newsevents/press/monetary/20090210b.htm>) The Treasury Department will support the TALF expansion by providing additional funds from the Troubled Asset Relief Program (TARP).

The FRB's press release states that the objective in expanding the TALF is "to provide additional assistance to financial markets and institutions in meeting the credit needs of households and businesses and, thus, to support overall economic growth in the current period of severe financial strains. Decisions concerning the expansion of the TALF, which will be made in consultation with the Treasury Department, will draw on initial experience in administering the program and the FRB's assessment of the likely effectiveness of possible enhancements to the program in advancing its broad economic goals."

The current TALF program allows the Federal Reserve Bank of New York to lend money to eligible owners of qualifying AAA-rated asset-backed securities (ABS) backed by newly and recently originated auto loans, credit card loans, student loans, and SBA-guaranteed small business loans. According to the FRB, the expanded TALF will commence operations at a time to be announced later in February 2009.

III. BANK CAPITAL - FINANCIAL STABILITY TRUST

Secretary Geithner further announced that Treasury, working with the Federal banking agencies, will implement a comprehensive stress test for banking institutions designed to assess their ability to survive a continuing decline in the economy and determine whether any such institutions require additional capital. Regulators will also implement measures to improve public disclosures by banks, including disclosures of the exposures on bank balance sheets. All banking institutions with assets in excess of \$100 billion will be required to participate in this comprehensive stress test.

Institutions requiring additional capital will be able to access a new funding mechanism that uses funds from Treasury. The capital will include conditions designed to encourage banks to resume lending and to replace the public funds with private capital as soon as possible. Although the plan does not mandate how the additional capital is to be used, institutions that receive capital under this initiative will be required to commit to participate in mortgage foreclosure mitigation programs consistent with guidelines to be released by Treasury and will be subject to increased reporting requirements regarding their use of the capital. Additionally, participating institutions will be subject to certain limitations on their ability to pay dividends, repurchase stock, and pursue acquisitions, and will be required to comply with the restrictions on senior executive compensation announced by the Obama Administration on February 4, 2009.

IV. FORECLOSURE RELIEF - \$50 Billion

In conjunction with adoption of legislation empowering mortgage renegotiation in a bankruptcy Chapter 13 proceeding, Treasury will make approximately \$50 billion available to assist homeowners facing foreclosure to rewrite their loans. Criteria for this assistance are being developed, but will likely include situations in which a home's value is less than the loan amount and/or the mortgage loan is high cost or

adjustable rate or both. Secretary Geithner promised a “comprehensive plan” for housing support and foreclosure prevention “soon.”

V. SMALL BUSINESS AND COMMUNITY LENDING INITIATIVE

Secretary Geithner pledged additional steps to reverse a recent decline in Small Business Administration lending and make it easier for small businesses to obtain credit, through expanded federal guarantees of SBA loans and expediting SBA loan approvals, among other measures. According to Treasury’s Fact Sheet, the Administration will announce a Small Business and Community Bank Lending Initiative within days.

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Federal regulators have many details to work out in order to implement the financial stability plan announced by Secretary Geithner and Venable will continue to monitor developments and provide additional information as events warrant. For additional information, please contact any of the attorneys listed on this Alert.

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