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News Bulletin

November 10, 2008

SIFMA TARP Conference

On Monday, November 10, SIFMA hosted a day-long summit on the Troubled Asset Relief Program. Key speakers included Interim Assistant Secretary of the Treasury Neel Kashkari and Senator Charles Schumer.

Senator Charles Schumer

- Comments focused on the need for, and the plans of, the new administration and Congress to restructure financial regulation, based on the following six principles:
  - Focus on controlling systemic risk and ensuring stability;
  - Unify and simplify regulatory structure (recommended following the UK model - a single strong regulator with broad authority);
  - Regulate currently unregulated parts of the markets (examples included both exotic products and credit default swaps);
  - Global financial markets require a global solution (recognition that a strong regulatory system in the U.S. could push financial activities off shore);
  - Increase transparency among all market participants; and
  - Laissez-faire view and approach of the current Bush administration toward regulation needs to change.
- Discussion of the new administration.
  - An economic team modeled after Clinton administration.
  - New Secretary of the Treasury will be in the mold of former Treasury Secretary Rubin, Secretary Larry Summers, or Tim Geithner of the New York Fed (the latter two are being considered for the post).
- Noted an over reliance on technology as a root cause of the current economic crisis and cited examples of such over reliance, including:
  - Rating agency financial models.
  - Financial institution risk management models.
  - Automated underwriting models for the extension of credit.

Panel Discussion: TARP As We Know It.

- Panel reviewed TARP, Capital Purchase Program (CaPP) and Temporary Guarantee Liquidity Program (TLGP).
- TLGP: Payment of guarantee as "insurance" upon receivership or in bankruptcy continues to raise concerns about the potential scope and utility of the program by potential participants and their counterparties.
- TLGP: On eligibility of institutions not clearly within the definition, the FDIC has indicated it will consider the following:

    1. Extent of the financial institution's activities (are the activities banking related; will providing assistance through the TLGP benefit the system);

    2. Strength and ratings of the institution (e.g., CAMELS); and

    3. Size of the organization (together with the extent of its activities – "too big to fail" and "too interconnected to fail" tests).

- TARP's CaPP: Executive compensation limitations are having minimal impact on participation decisions - smaller institutions are weighing the decision more heavily than larger institutions and executives seeking employment are considering executive compensation limits as significant when weighing employment decisions.
- All panelists agree that we have not yet seen the full toolkit of federal programs needed for economic recovery.

Neel Kashkari, Interim Assistant Secretary for TARP

Prepared remarks are available at: http://www.treas.gov/press/releases/hp1262.htm.

- AIG investment announced on November 10 was a one-off investment under TARP that was deemed necessary for financial stability. It is not part of a new program and does not represent an expansion of the institutions eligible to participate in TARP.
- When asked about asset purchase programs, Assistant Secretary Kashkari indicated that Secretary Paulson will decide when to roll out, and which tools to roll out, under TARP.
- Remarks provided more detail on the application process. Once an application has been submitted to the primary regulator, the regulator will (1) forward to Treasury with a recommendation for an investment, (2) recommend the applicant withdraw the application or (3) forward the application to a Regulatory Council for consideration. The Regulatory Council consists of the four bank regulators with Treasury participating as an observer. The Regulatory Council will make a recommendation for an investment or a withdrawal of the application.
- CaPP Update: Solicitation for asset managers for the bank investments was published Friday and applications are due November 13.

Panel Discussion: The Banking Business Model After TARP

- The federal intervention programs are working:
    - Commercial paper rates falling;
    - Three-Month LIBOR falling;

- CDS spreads on large banks coming down; and
- Money market funds stable.

- Panelists expect significant year end write-downs (one panelist expects an addition $600 billion in write-downs before the crisis ends; another estimates that banks have already taken 75 percent of their write-downs).
- Additional federal programs or additional TARP capacity will be needed.
- Banks need time, and a steep yield curve, to work through a bad credit cycle (based on prior cycles). Divergent opinions of panelists on the impact of mark-to-market accounting.
- Securitization perspectives:
  - TARP asset purchases are expected to include securitization securities before they include whole loans.
  - Expect mortgage securitization market will come back but with better quality assets, less leveraged structures and with a covered bond component as part of the mortgage funding market.
- Panelists do not expect the TARP exit strategy to include private equity investors as a replacement for federal money. Private equity investors like making leveraged investments and the ability to increase their investment above 24.9 percent (which is not possible with a financial institution investment).

Panel Discussion: Creating and Managing an Effective TARP Whole Loan Purchase Program

Panelists discussed the structure of TARP purchasing non-performing loans from securitizations, purchasing performing loans from balance sheets and insuring mortgage related assets. Also observations were made regarding the root causes of the crisis and the role of "moral hazard."

- Estimate that household debt must contract by $3 trillion by the end of 2010.
- Noted the need to act quickly in the residential loan/securitization marketplace.
- Proposal to have Treasury to buy troubled loans to manage modifications that servicers cannot manage.
- Shared appreciation mortgages a good option and prevent against "scam" restructuring.
- Many of the mortgages should not be modified - homeowners cannot afford the homes even with significant principal reductions.
- Panelists recommended more be done in public service announcements/outreach encouraging consumers to work with their lenders. Servicer outreach efforts are being ignored by leary borrowers.
- Modification efforts are going to need to leverage smaller, local, high-touch servicers familiar with local real estate laws and approaches that are effective in communities.

Panel Discussion: Maximizing the Impact of a TARP Securities Purchase Program

Could purchase of securities help? The panelists stated that it could help, but may not be the best use of the TARP funds. The answer depends in part on the ultimate goals of the program. The panelists generally feel that purchasing, insuring and modifying mortgage loans would maximize the impact of TARP resources. However, the panelists expect that Treasury will not rely on just one aspect of the TARP exclusively and that there is some benefit to be derived from purchasing equity interests.

Please also consult our Financial Crisis web site at http://www.mofo.com/news/updates/files/14605.html.

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