

## SERT Update

# Executive Summary: Treasury Secretary Timothy Geithner Announces a New “Financial Stability Plan”

On February 10, 2009, in a widely-anticipated speech, United States Treasury Secretary Timothy Geithner announced details of a new “Financial Stability Plan.” According to Secretary Geithner, the Financial Stability Plan has been designed to “stabilize and repair the financial system, and support the flow of credit necessary for recovery.”

For your convenience, set forth below is an executive summary of the Financial Stability Plan, as announced by Secretary Geithner on February 10, 2009.

### Capital Assistance Program/Financial Stability Trust

The United States Treasury Department (Treasury) plans to provide funds to lending institutions in need of capital support through a new Capital Assistance Program (CAP). Under the CAP, lending institutions will sell convertible preferred securities to the Treasury in exchange for cash. Institutions will be able to convert the securities into common equity if such conversion is needed to preserve lending in a worse-than-expected economic environment. The convertible preferred securities will carry a dividend to be specified and will have a conversion price set at a modest discount from the prevailing level of the applicable institution’s stock price as of February 9, 2009.

Capital investments made by the Treasury under the CAP will be placed into a separate entity called the Financial Stability Trust. The Financial Stability Trust will manage the government’s CAP-related investments.

The Financial Stability Trust will serve as a “capital buffer,” (i.e., it will operate as a form of contingent equity that will ensure that institutions have the capital strength to preserve or increase lending in worse-than-expected economic times). Additionally, the CAP funds are intended to serve as a “bridge to private capital” and, as such, the terms of the lending will be designed to encourage the institutions to replace the public assistance from the Treasury with private capital as soon as possible. When making an investment via the CAP, the Treasury will impose conditions that will “help ensure that such funds will be used to generate a level of lending greater than that which would have been possible without government support.”

Institutions that request a CAP investment will be required to undergo a comprehensive “stress test.” The stress test will include an analysis of whether the applicable institution has the capital necessary to continue lending and absorb potential losses that could result from a worse-than-expected economic downturn. All banking institutions with assets in excess of \$100 billion will be required to participate in a coordinated supervisory review and comprehensive stress test. Banking institutions with assets below \$100 billion will be eligible to obtain capital from the CAP after a supervisory review only.

In connection with the implementation of the CAP, the Treasury will be introducing new measures to help increase transparency and improve public disclosure by banks, including current exposures on bank balance sheets.

## Public-Private Investment Fund

The Treasury intends to work with the Federal Reserve, the FDIC and the private sector to establish a Public-Private Investment Trust. Although the details of the program have not yet been announced, the Treasury has stated that the program's goal will be to provide government capital and financing to help leverage private capital that will be used to purchase legacy loans and assets (i.e., troubled or "toxic" assets) from financial institutions. The Treasury's objective is to use private capital and private asset managers to help to provide a market mechanism for valuing such assets. If successful, private sector buyers would determine the price for troubled and previously illiquid assets.

Initially targeted for \$500 billion, the program may be expanded up to \$1 trillion.

This program has received a great deal of criticism from commentators for the lack of detail provided so far.

## Consumer and Business Lending Initiative

The Treasury and Federal Reserve plan to work together to commit up to \$1 trillion to support a "Consumer and Business Lending Initiative." This program "builds off, broadens and expands" the resources of the previously announced Term Asset-Backed Securities Loan Facility (TALF Program)<sup>1</sup>. The Consumer and Business Lending Initiative, like the TALF Program, will target the markets for small business lending, student loans, and consumer and auto finance. Under the TALF, the Treasury intended to use \$20 billion to leverage \$200 billion of lending from the Federal Reserve. Under the Consumer and Business Lending Initiative, the Treasury intends to use \$100 billion to leverage \$1 trillion in lending.

The Consumer and Business Lending Initiative will expand the initial reach of the TALF Program to now include commercial mortgage-backed securities (CMBS). The Treasury will continue to consult with the Federal Reserve regarding a further possible expansion of the TALF Program, one that would include other asset classes, such as non-Agency residential mortgage backed securities (i.e., residential mortgage-backed securities that are not associated with a government agency) and assets collateralized by corporate debt. The goal of the program will be to kickstart the secondary lending markets, bring down credit costs and help get credit flowing to consumers again. As is the case with the TALF Program, the Treasury intends to limit its purchases under the Consumer and Business Lending Initiative to newly packaged AAA rated loans.

## Transparency, Accountability, Monitoring and Conditions

According to Secretary Geithner, a cornerstone of the Financial Stability Plan will be "greater transparency, accountability and conditionality with tougher standards for firms receiving exceptional assistance." The measures the Treasury intends to impose include the following:

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<sup>1</sup> The TALF has not yet been implemented. Further details of the TALF Program may be found in Seyfarth's publication, dated December 9, 2008, entitled "The Creation of the TALF Program, the Citigroup Bailout and Other Recent Developments Related to the Emergency Economic Stabilization Act of 2008." A copy of this publication can be found on our website, [www.seyfarth.com](http://www.seyfarth.com).

## *Reporting*

Recipients of “exceptional assistance” or “capital buffer assistance” will be required to “show how each and every dollar of capital they receive is enabling them to preserve or generate new lending compared to what would have been possible without government assistance.” All such recipients will be required to submit a plan detailing how they intend to use the capital to preserve and strengthen their lending capacity. The plans will be submitted as part of the application process and will be made available to the public after each capital investment has been completed. Also, institutions will be required to detail, in monthly reports, how many new loans they provided to businesses and consumers and how many asset-backed and mortgage-backed securities they purchased. Such reports must contain a description of the lending environment in the communities and markets that such firms serve. A new website, [www.financialstability.gov](http://www.financialstability.gov), will be launched so that the general public can locate all information disclosed or reported to the Treasury in one place.

## *Mortgage Foreclosure Mitigation*

All recipients of capital investments from the Federal government will be required to commit to participate in mortgage foreclosure mitigation programs consistent with guidelines to be released by the Treasury.

## *Restriction on Dividends, Stock Repurchases and Acquisitions*

Institutions that receive new “exceptional assistance” will only be able to pay \$.01 quarterly common dividends. Also, such institutions will be restricted from repurchasing any privately-held shares until the Federal government’s investment is repaid. Further, such institutions will be restricted from pursuing cash acquisitions of firms until the Federal government investment is repaid, with some exceptions for explicit supervisor-approved restructuring plans.

## *Limits on Executive Compensation*

Institutions receiving Federal government assistance will be required to comply with the senior executive compensation requirements announced by the Treasury on February 4, 2009. These requirements include a cap on annual compensation for senior executives of \$500,000 (except for restricted stock that can be cashed in, under almost all circumstances, only after the government has been repaid). The February 4, 2009 requirements also include a “say on pay” standard (i.e., senior executive compensation structure and the rationale for how compensation is tied to sound risk management must be submitted to a non-binding shareholder resolution) and a requirement that boards of directors of companies receiving assistance post an “expenditures policy” on their website (for expenditures related to luxury items such as aviation services, office renovations and entertainment/holiday parties).

## *Preventing Lobbyist Influence*

The Treasury intends to enforce its rules that prevent lobbyists from influencing the applications for, and disbursement of, Financial Stability Plan funds. The Treasury will certify that each investment decision it makes is based only on investment criteria and the specific facts of the case.

### *Posting Contracts and Investment Information on the Web*

The Treasury has committed to posting all contracts into which it enters in connection with the implementation of the Financial Stability Plan on [www.financialstability.gov](http://www.financialstability.gov) within five to ten business days of execution. Further, in connection with all capital investments made by the Treasury, details will be made public concerning the value of the investment, the quantity and strike price of warrants received, and the payment/repayment schedules.

### *Comprehensive Housing Program*

Over the course of the next few weeks, the Treasury will announce a comprehensive plan to stem foreclosures and restructure troubled mortgages. The Treasury and Federal Reserve will continue to work together to spend as much as \$600 billion to purchase government sponsored entity (GSE) mortgage-backed securities and GSE debt<sup>2</sup>. In accordance with “prudent underwriting and long-term loan performance,” \$50 billion will be committed to help reduce monthly mortgage payments of owner-occupied middle class homes to prevent “avoidable foreclosures.” Further, the Treasury plans to bring “order and consistency” to the foreclosure crisis by establishing loan modification guidelines and standards for government and private programs. The Treasury also intends to build more flexibility into the Hope for Homeowners program and the Federal Housing Administration, however, no details of the changes have yet been provided.

### *Small Business Lending*

Over the next several days, President Obama, the Treasury and the Small Business Administration (SBA) will announce details of a new Small Business and Community Bank Lending Initiative. SBA lending sunk 57% last quarter from the same quarter a year ago for 7(a) loans, the most basic and most used type of SBA loan.

The Obama Administration’s new program will make use of the Consumer and Business Lending Initiative described above and it also plans to seek an increase in the guarantee of SBA loans from as low as 75% to as high as 90%. The Administration also will seek reduced fees for certain SBA loans and the implementation of stronger oversight and a speedier, less burdensome loan application process.

### *Conclusion*

Treasury Secretary Geithner warned that the Financial Stability Plan will “cost money, involve risk and take time” and that the Treasury “will make mistakes.” Secretary Geithner further advised that the Treasury will be guided by principles of transparency and accountability and will be dedicated to the goals of restoring credit to families and businesses, and moving the country to a swift and widespread economic recovery.

Secretary Geithner’s speech lacked many specifics. We will continue to keep you apprised as details of his new plan emerge.

*For more information, please contact the attorney within whom you work, or visit the Strategic Economic Response Team (SERT) page on our website ([www.seyfarth.com/SERTALERT](http://www.seyfarth.com/SERTALERT)).*

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<sup>2</sup> Further details of the Treasury and Federal Reserve’s \$600 billion program may be found in Seyfarth’s publication, dated December 9, 2008, entitled “The Creation of the TALF Program, the Citigroup Bailout and Other Recent Developments Related to the Emergency Economic Stabilization Act of 2008.” A copy of this publication can be found on our website, [www.seyfarth.com](http://www.seyfarth.com).



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