The Public Private Investment Program (PPIP)

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This plan leans heavily on The Federal Reserve, particularly the Term Asset Backed Securities Lending Facility (TALF). FDIC auction management, regulation and debt assurance are melded with remaining TARP money. The Public Private Investment Program provides non-recourse loans and does NOT cap executive compensation.

The Treasury has stepped in behind the Federal Reserve's expanded TALF ($1.15T) plan announced last week. Still to come, the possible suspension of mark to market pricing that has pushed down the value of assets as firms struggle to determine market prices for securities that have no, thin or jittery markets. Later this week, Treasury Secretary Tim Geithner will discuss regulatory overhaul of the US financial system ahead of the debate coming at the G20 London Summit.

$50 billion in TARP money will be used to back stop private purchases of up to $1trillion in distressed assets (loans and securities comprised of bundled loans). The plan is broken into two parts. One buys whole loans, the other portion buys asset backed securities, bundles of loans for residential, commercial mortgages and consumer credit. TARP monies are to be divided roughly 50-50 between loans and assets. TARP funds will be matched to private capital and then leveraged up 6 to one. If investors put in $1 and win at the FDIC auction, TARP money will also add a $1. The FDIC will gladly underwrite a borrowing of up to $10 against the 2 dollars in capital. Positive returns will be shared 50%, 50% by the private partners and public. Loss to the private partners is capped at $1 and management fees lost. Loss to the government could possibly be the other $11 in a very unlikely worse possible scenario**.**

Legacy Loan Program

The Treasury uses TARP money to spur private investors to buy legacy loans and assets. The Federal Reserve and FDIC will also work on the plan. TARP monies will be combined with private investor monies to double buying power. The FDIC will run auctions of bank's legacy assets. The program will be voluntary and banks will select the loans they sell- under FDIC supervision. FDIC will monitor loans and loan quality. High bidders at auction win the assets. Their victory in auction will entitle them to matching TARP money and FDIC backed low cost capital up to 6 times leverage. Private asset managers will run/manage the pools under FDIC oversight. Then the FDIC will step in and offer guarantees up t o six times the capital/equity to increase the purchasing leverage. Thus, public private partnership is an attempt to restart private markets for distressed loans. The issues remain how these assets are priced, how much risk investors will take and how many more defaults and write downs are coming?

Legacy Securities Program

Before we start with the details, there is a lot that is to be determined here.

To quote: ***Working with Market Participants:*** *Borrowers will need to meet eligibility criteria. Haircuts will be determined at a later date and will reflect the riskiness of the assets provided as collateral. Lending rates, minimum loan sizes, and loan durations have not been determined. These and other terms of the programs will be informed by discussions with market participants. However, the Federal Reserve is working to ensure that the duration of these loans takes into account the duration of the underlying assets*.

This plan piggy backs off of the existing Federal Reserve Term Asset Backed Securities Loan Program. Non-recourse loans will be made to investors to buy asset backed securities including agency and non-agency residential mortgage securities, commercial real estate backed securities and AAA rated consumer credit securities. 5 private asset managers will be selected to raise private capital to deploy buying assets trading at large discounts. Private capital will again be matched to public (Treasury) investment, $1 to $1. As with the loan program, government assured leverage will be provided, up to 100% of pooled capital. Investors have lost confidence in the value of these once AAA securities as underlying loans and asset construction have been shown to have significant and developing problems. These problems will remain but, purchasing will increase. This program vastly increases the amount of money chasing the asset backed securities. In no way does it address the underlying issues with the securities.

We have to assume that the large use of leverage, FDIC assurance and Fed partnership is designed to avoid the politically explosive issues raised by asking Congress for more money. Using private sector investors to establish prices is a cornerstone of the plan. However, private investors have failed to establish accurate prices for these assets several times. Private mortgage originators mis-priced these assets. Then the assets were bundled and sold at incorrect prices. Ratings agencies gave ratings that mis-priced these assets and now they trade at inaccurate prices. The problem is that today's prices are not consistent with bank balance sheet health, in many cases, solvency. Thus, our plan to use private pricing is no sure thing. In addition, it is unclear that government hiring of private buyers using half private, half public monies with FDIC auction and assurance should still be considered private sector pricing?

The problems have been missing markets and highly risk-averse investors. Other than TARP monies and FDIC assurances, it is not clear what this program changes. The risk is still there, more of it is moved onto government books and asset prices will be inflated by rising leverage and government funded purchasing.