

November 12, 2008

## Treasury Secretary Announces Major Shift in Bailout Focus

Secretary of the Treasury Henry M. Paulson, Jr. stated today that Treasury will not be using resources available to it under the Troubled Asset Relief Program (“TARP”) to purchase illiquid assets from financial institutions, as had been previously contemplated. Rather, Secretary Paulson indicated that deployment of TARP funds would be focused on: (i) continuing to reinforce the stability of the financial system by building capital in financial institutions, (ii) revitalizing the moribund asset-backed securitization sector with an investor liquidity facility and (iii) mitigating mortgage foreclosures.

### Increased Capital Investment in Financial Institutions

- ***Leverage the TARP Investment***

To increase capital investment in the financial system, Treasury is evaluating proposals to “leverage the impact of a TARP investment by attracting private capital potentially through matching investments,” which may require that participating institutions line up private capital investment prior to receiving Treasury funds.

- ***Non-Banks***

Secretary Paulson noted that non-bank participation in the TARP Capital Purchase Program would not occur until after the initial Capital Purchase Program had been completed and its effectiveness evaluated. The Secretary also noted that non-bank financial institutions participating in the program would present their own challenges, including different regulatory schemes and taxpayer protection considerations.

- ***Auto Industry***

It also appeared from the Secretary’s remarks that, absent Congressional action, Treasury would not deem TARP funds to be available for an automobile industry rescue.

- ***U.S. Bank Regulators Encourage Lending***

In a separate but coordinated action today, the federal banking regulators released an interagency statement in which they urged banks to lend to their creditworthy borrowers and to strengthen their capital position (including reexamining their dividend policies). The regulators also emphasized the need for sufficient loss mitigation procedures and prudent compensation practices.

### Kick-Starting the Securitization Markets

- ***ABS***

Recognizing the vital role of asset-backed securitization in the consumer finance market, Secretary Paulson announced that Treasury, along with the Federal Reserve, is developing a plan for a liquidity facility for private investors in AAA asset-backed securities. This facility, which would provide financing for investors in such consumer finance areas as credit cards, auto loans and student loans, would likely be “significant in size”.

- **RMBS/CMBS**

Secretary Paulson also noted that the liquidity facility, which remains in the early planning stages, could also be used to support investments in commercial and residential mortgage-backed securities.

## **Mortgage Foreclosure Mitigation**

Secretary Paulson described how different approaches to foreclosure mitigation would now be necessary as Treasury is no longer planning to purchase illiquid mortgage assets, which would have given Treasury the ability to exert leverage on the servicers. While noting with approval the loan modification programs implemented by the FDIC with IndyMac and the FHFA with Fannie Mae and Freddie Mac, Secretary Paulson was cautious about loan modification proposals involving direct government spending, which differ qualitatively from the TARP model of investment and expected taxpayer return.

## **U.S. Government Relationship to the GSEs**

Secretary Paulson's remarks also included statements with regard to the commitment of the U.S. government to backstop the obligations of Fannie Mae and Freddie Mac:

“Treasury took responsibility for supporting the agency debt securities and the agency MBS through a preferred stock purchase agreement that guarantees a positive net worth in each enterprise - effectively, a guarantee on GSE debt and agency MBS . . . [W]e will, as needed and promised, purchase preferred shares under the terms of that agreement. The U.S. government honors its commitments, and investors can bank on it.”

The Secretary also indicated that he would share his thoughts in the near future on long term reform to address the lack of clarity that has existed with regard to the government's support for the agencies and the conflict that has existed between the public and private agendas of the agencies.

Please find the full remarks by Secretary Paulson [linked here](#).

## **Contact Us**

Please feel free to contact us with any questions about the above.

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