Removing toxic assets from balance sheets: Structures based on the good bank-bad bank model

Anna T. Pinedo
Received 15th April, 2009
Morrison & Foerster LLP, 1290 Avenue of the Americas, New York, NY 10104-0050, USA. Tel: +1 212-468-8179; Fax: +1 212 468-7900; E-mail: apinedo@mofo.com

Anna T. Pinedo is a partner in Morrison & Foerster’s New York office. She concentrates on securities and derivatives, representing issuers, investment banks and financial intermediaries in financings, including public and private offerings of equity and debt securities, as well as structured products and innovative financial products. In the derivatives area, Anna counsels financial institutions acting as dealers and participants in the derivatives markets. She advises on structuring issues, as well as on regulatory issues and hedging techniques.

ABSTRACT
Financial institutions and regulators in the USA and abroad have taken many measures to address the lingering effects of troubled assets on bank balance sheets. Several governments announced asset guarantee programmes whereby government entities share losses associated with pools of troubled assets ring-fenced from financial institution balance sheets. Another approach has been a series of initiatives to sell off troubled assets. A third approach has been the formation of ‘good banks’ and ‘bad banks’ wherein financial institutions cleave off troubled assets and discontinued business lines and operations into a new entity. This paper discusses the merits of these differing approaches.

Keywords: good bank-bad bank, toxic assets, troubled assets, financial institutions, restructuring, non-performing loans, valuing assets, asset guarantees

INTRODUCTION
With global financial markets in varying states of disarray, financial institutions and government officials continue to seek to stabilise the banking industry and restore the flow of credit. Financial institutions have been plagued by continuing losses from troubled assets on their balance sheets. The application of mark-to-market accounting has resulted in the announcement of new write-downs each quarter. These write-down announcements sap investor confidence in financial institutions and lead to stock price declines and increased volatility. This chain of events has overshadowed efforts to refocus attention on business prospects. Over the course of 2008, the scope of troubled assets broadened, from subprime mortgage-related assets, to auction rate securities, to derivatives, to commercial real estate-related assets. Now, in 2009, research analysts and economists warn that we should anticipate losses in connection with loan portfolios. Uncertainty regarding future losses and whether and when market and asset values will hit ‘bottom’ inhibit private investment in financial institutions.

On 3rd October, 2008, Congress
authorised the creation of the US$700bn Troubled Assets Relief Program, proposed by former Treasury Secretary Paulson to purchase troubled assets from financial institutions. However, for a variety of reasons, including concerns regarding the appropriate valuation of those assets to be purchased, by 12th November, 2008, Secretary Paulson abandoned the initial plan. Instead, the government proceeded with direct capital injections into financial institutions, through the Capital Purchase Program. In recent months, market participants and regulators both in the USA and in Europe have debated alternative measures for restoring financial stability and investor confidence. There are two principal alternatives (and many permutations of these) that have been put forth: an asset guarantee model and a good bank-bad bank model. Both alternatives are intended to mitigate or ring-fence troubled assets and limit the detrimental effect on financial institutions of subsequent losses from portfolios of troubled assets.

Along these lines, after much anticipation, on 10th February, 2009, Treasury Secretary Geithner announced a plan to establish partnerships with private investors to remove troubled assets from financial institutions’ balance sheets. Additional information about the Public-Private Investment Program and its two sub-programs, the Legacy Loans Program and the Legacy Securities Program, was announced on 23rd March, 2009. The programs were intended to leverage government investments to encourage private investors to purchase ‘bad’ or troubled assets, now identified as ‘legacy’ assets, from core financial institutions. In recent statements, regulators have indicated that these programs will be delayed or put on hold.

Financial institutions may wish to consider independently implementing the ‘good bank-bad bank’ model, whereby the core financial institution, or good bank, separates off troubled assets into a newly formed bad bank. Below, we discuss some of the structuring considerations for good bank-bad bank models and compare and contrast these to asset guarantee models and the Public-Private Investment Program.

OVERVIEW OF THE GOOD BANK-BAD BANK STRUCTURE

In a good bank-bad bank structure, a financial institution establishes a separate entity for its ‘bad’ assets. Free of troubled assets, the resulting ‘good’ bank can expect restored investor and market confidence, allowing it to raise capital more easily and at more affordable rates, and resume normalised lending. In structuring a bad bank, consideration must be given to the ultimate goal of the bad bank: whether its purpose is solely to liquidate bad assets or whether it will also house business operations. That decision influences other decisions, including ownership of the bad bank, the legal and regulatory structure, capital and liquidity requirements, management, composition of the asset pool to be transferred and valuation of those assets.

If the bad bank is left to focus entirely on loan recovery and self-liquidation, then funds recovered from the troubled assets in the bad bank are paid to shareholders of the bad bank in the form of a dividend or interest payment after any repayment of debt raised by the bad bank to fund the purchase of the troubled assets.

Structure

The goal of the good bank-bad bank structure is to ‘clean up’ the balance sheet of the good bank by transferring to the bad bank assets that are illiquid, non-
performing or otherwise resulting in write-downs and depleting capital. In order to separate the problem assets, care must be taken to ensure the newly formed bad bank is not under common control with the good bank such that for accounting or regulatory purposes the balance sheets are consolidated. Accordingly, although a bad bank may be initially established as a subsidiary of a good bank, sufficient external capital is required to deconsolidate the bad bank subsidiary. At most, the good bank may maintain a non-controlling minority interest in the bad bank.

In forming a bad bank, consideration must be given to corporate, banking and securities laws. Assuming the bad bank’s sole purpose is to liquidate troubled assets, limited regulatory oversight is required. Although the new entity is referred to as a ‘bad bank’, whether the new entity needs to be chartered as a bank depends on the assets transferred to it and the business activities of the new entity. Transfer of ongoing business operations, in addition to troubled assets, is more likely to require a banking charter or satisfaction of relevant regulatory requirements.

**Funding the Bad Bank**

The bad bank must be capitalised. It will obtain a limited amount of capital from reserves allocated to the acquired assets. After that, a bad bank is typically funded primarily by selling equity or debt securities. In 2008, private investors experienced significant losses as a result of sizable investments in financial institutions, inhibiting their willingness to step forward now and invest in troubled institutions. However, investment in discrete pools of assets may attract private investors interested in targeted and concentrated ownership with significant control over the new entity. Private investors specialising in work-out situations or distressed assets will be more interested in a bad bank investment opportunity over which they can exercise asset management control, than in an investment in a global financial services enterprise. Depending on the needs of the financial institution and the size of the portfolio of bad assets, among other factors, a bad bank may be established through a negotiated transaction with a private investor or private investor group.

The level of capital required by the bad bank will be based on the anticipated losses on the pool of transferred assets. Independent analysis of potential losses will be important for private investors evaluating investments in bad bank structures. As we note below, the required capitalisation will depend on the asset mix, valuation of the assets, the anticipated loss levels on the assets and a number of other related factors.

In a liquidation model, a bad bank’s funding needs will be limited to include, for example, ongoing management costs and debt service. A bad bank established with a model other than the liquidation model must consider additional costs, including ongoing financing for an unknown or perhaps indefinite period and more variable management, legal and regulatory costs. Given the current widespread, sustained and unprecedented dislocation in the markets, the bad bank plan should include sources of ongoing funding and liquidity that do not rely exclusively on the capital market and new investors. Private investors will need to consider carefully their ongoing funding commitment and the commitment of any other partners in a bad bank enterprise.

**Ratings Impact**

Transferring troubled assets to a bad bank is likely to improve the credit ratings of
the good bank, reducing borrowing and financing costs for the good bank and ultimately increasing earnings potential. Coordination with rating agencies is essential in order to ensure that the desired benefits of the good bank-bad bank structure can be obtained. As a good bank evaluates the composition of the assets to be transferred to the bad bank, consideration should be given to the impact on credit ratings.

Valuing Assets
A challenge in establishing a bad bank is the valuation of troubled assets. Financial institutions have reported significant concerns with the current interpretations of mark-to-market accounting requirements for assets in illiquid markets. In illiquid markets, such as the markets for most troubled assets, assets required to be marked-to-market may be held at a valuation based on the institution’s internal model. Internal models are based on management’s assessments of various factors that may include limited market price information, credit expectations, whether payments are current or delinquent and anticipated losses. These models will vary by institution, resulting in different carrying values for similar assets and asset classes.

Financial institutions and their financing partners will need to determine the transfer prices of troubled assets, including whether to transfer at book value or at recent trading prices, if different. Assets transferred at less than carrying value will require an additional write-down by the good, transferring bank. Current investors and regulators can be expected to raise questions regarding any asset write-downs in connection with establishing a bad bank. The financial institution’s book value for an asset, however, may not reflect the price at which a private investor is interested in acquiring the asset.

Balancing these independent interests requires detailed negotiation with private investors, and flexibility in determining the appropriate composition of the asset portfolio to be transferred.

The German Government recently announced a plan under consideration to establish a middle ground between valuing the transferred assets at carrying value and at an illiquid market value. German banks would value their troubled assets at carrying value and above current illiquid market prices, preventing further write-downs by the transferring institution. If, in the future, the bad bank recovered less than the transfer value of the troubled asset, the good bank would be required to make the bad bank whole. For such a solution to be implemented in the USA, new accounting guidance would be required permitting such a transfer, notwithstanding the retained interest in the performance of the asset by the good bank, to be considered a ‘sale’ of the asset by the good bank.

Asset Selection
Selection of the asset portfolio is a critical factor in the ultimate success of a good bank-bad bank transaction. Financial institutions must transfer a significant portion of their bad assets in order to achieve the benefits of a bad bank model, without stripping their balance sheets of performing assets. An institution also should consider the overall size of the resulting good bank. There are regulatory, market, ratings and counterparty benefits to maintaining a large-size good bank.

Portfolio mix will be important to the bad bank’s ability to achieve its goals. Given the limited market for troubled assets, it is unlikely a bad bank will achieve a short-term goal of liquidation. An institution must structure the bad bank to align the goals of the private investor with the capital structure of the
new entity and the asset pool characteristics. For example, a bad bank funded with interest-bearing debt needs to hold a portfolio of assets generating current returns sufficient to satisfy the debt obligations.

As the recession continues, financial institutions are challenged to identify all of their bad assets. The benefit of relieving management from the burden of managing troubled assets and focusing on write-downs rather than business operations will not be achieved if the retained assets continue to negatively impact the balance sheet. Institutions will need to be confident that they can transfer a sufficient amount of bad assets to prevent additional announcements of significant write-downs following the creation of a bad bank.

Care should also be taken to define the optimal balance sheet for the resulting good bank. Asset transfer decisions should be consistent with business plans and strategies for the retained businesses. The benefits of establishing a bad bank, including increased investor, rating agency and counterparty confidence, could be diminished if the retained assets do not align sufficiently with the ongoing businesses and meaningful management resources are still required to manage or liquidate a portfolio of troubled assets.

**Asset Management**

The good bank must consider the ongoing management of the transferred assets. Options include having the good bank transfer management resources to the bad bank, providing management services on a contract basis, or having the private investors manage, or hire asset managers for, the portfolio.

Managing assets through the new bad bank entity should simplify and target decision-making with respect to the troubled assets. An independent bad bank established to liquidate or obtain the best current price for an asset will not face the conflicting price of maintaining long-term lending and banking relationships with borrowers. As a result, decisions focused on the goals of the bad bank — such as liquidation or obtaining current value for an asset — will take priority over borrower-focused goals or longer-term asset-performance goals. A bad bank with more diverse or long-term operating goals may face ongoing conflicts in managing troubled assets. If a bad bank is concerned with its long-term business prospects, care should be taken to align the entity’s interests with those of its investors to ensure management of troubled assets is conducted in a manner consistent with all parties’ objectives.

**Benefits of the Good Bank-Bad Bank Structure**

Benefits of the good bank-bad bank structure include a renewed focus on the long-term core operations of the good bank without the ongoing distraction of the troubled assets. Management’s focus can return to building or rebuilding the financial institution and reporting on results of operations rather than performance of the troubled assets. Removing troubled assets from the balance sheet should have a positive impact on the view of credit rating agencies, investors, potential investors, lenders, depositors and borrowers. Additionally, removing troubled assets will relieve pressure on capital from the troubled assets, enabling the institution to engage in more profitable and growth-oriented business activities, including lending.

As we note above, many factors need to work together to achieve the benefits of a good bank-bad bank structure. A financial institution should develop its views on the optimal portfolio of bad assets to structure a transaction that
reflects the institution’s long-term goals. At the same time, the institution must retain the flexibility necessary to identify and work with the best private partner available to finance and structure the bad bank.

**Models of good bank-bad banks**

The good bank-bad bank model has been used in the USA and internationally with some success, as we describe briefly below.

**Resolution Trust Corporation**

The Federal Deposit Insurance Corporation (‘FDIC’) in public statements has indicated that it will consider a process for the purchase of troubled assets that closely resembles the Resolution Trust Corporation (‘RTC’), established to manage and dispose of assets acquired by the government during the savings and loan crisis of the 1980s. The RTC both sold assets and, when faced with illiquid markets and depressed asset prices, partnered with private investors to manage and transfer ownership of assets.

**Mellon Bank Corporation**

In 1987, although not insolvent, Mellon Bank Corporation (a predecessor of The Bank of New York Mellon) faced significant liquidity and other issues as a result of a decline in real estate values and the price of oil. Mellon Bank Corporation (‘Mellon’) created a new institution, Grant Street National Bank (‘GSNB’), which purchased Mellon’s bad loans, valued at US$1.4bn when originated; they were written down 53 per cent when sold to GSNB. GSNB was capitalised with US$123m from Mellon and with US$513m in short-term bonds sold by Drexel Burnham Lambert. GSNB hired a non-bank subsidiary of Mellon to manage the troubled assets with a goal of liquidation. Mellon’s earnings increased following the sale of the bad loans to GSNB. GSNB liquidated all of the loans and wound down in 1995.

**UBS AG**

In October 2008, UBS AG (‘UBS’) sold US$60bn of its troubled assets to a special-purpose vehicle acting as a bad bank for UBS. To capitalise the bad bank, UBS raised US$6bn through share sales to the Swiss Government, giving the government a 9 per cent ownership stake in UBS. In addition, the Swiss National Bank loaned the bad bank US$54bn to help pay for the troubled assets. In the transaction, UBS diluted its shareholders’ interests by 9 per cent (as a result of the government ownership stake), invested US$6bn in a bad bank, and removed US$60bn of troubled assets from its balance sheet.

**Citigroup**

In January 2009, Citigroup issued a press release announcing its decision to divide itself into two banks: Citicorp and Citi Holdings. The bank’s ‘core’ assets will be held in Citicorp and Citicorp will focus on its future growth opportunities. Citigroup’s non-core assets will be transferred to Citi Holdings, including Citigroup’s brokerage and retail asset management, local consumer finance and special asset pool. The management of Citi Holdings will focus on obtaining value from the non-core assets and managing risks and losses. Citigroup noted in the press release that it is still looking for managers for Citi Holdings. At the time of the announcement, Citigroup was seeking necessary regulatory approvals, resolving tax issues and working to address the interests of all stakeholders. The Citigroup proposal includes a transfer of substantive operations into the ‘bad’ bank, Citi Holdings, a more complex model than the liquidation bad
bank. As discussed, impact on credit ratings, funding and liquidity needs and regulatory requirements will be important considerations as Citigroup structures its two entities.

THE ASSET GUARANTEE MODEL
In November 2008, Citigroup announced an agreement whereby Treasury, the Federal Reserve Board (‘Federal Reserve’) and the FDIC will guarantee and provide funding for a pool of troubled assets. Bank of America entered into a similar agreement several weeks later. Each of the Citigroup and Bank of America transactions fall under Treasury’s Asset Guarantee Program, used in coordination with significant capital investments by Treasury under its companion Targeted Investment Program. The key difference between asset guarantees and a good bank-bad bank model is the retention, in the asset guarantee model, of the troubled assets on the institution’s balance sheet.

The financial institution identifies a pool of troubled assets using a process similar to that used in the good bank-bad bank model, but without the same limitations. Because the assets are retained, the institution will not need to align the characteristics of the asset pool with the funding requirements for the bad bank. A pool of assets that might not be appropriate to transfer to a bad bank, for example, because they are not generating reliable cash flow, would be appropriate to retain in the asset guarantee pool. These assets are then segregated or ring fenced from other assets. The most straightforward method of segregating assets is to annotate in the institution’s records that the assets are subject to the guarantee. Alternative approaches are possible, including transferring the assets to a newly formed, wholly owned subsidiary.

Valuation considerations are not eliminated in the guarantee approach, but will not result in additional write-downs. The guarantor provides the guarantee for defined losses, which may be all losses up to book value or another agreed-upon value, or may be losses after a first loss is absorbed by the financial institution. Under Treasury’s Asset Guarantee Program, the financial institutions retain losses up to a threshold and Treasury and the FDIC share 90 per cent of losses up to a second threshold. Thereafter, the Federal Reserve will loan the institution funds for any further losses on the asset pool. Determining the point at which the guarantee coverage attaches and terminates, and the premium for the coverage, can be as complex as determining the valuation for transferring assets to a bad bank, but the impact to the balance sheet is less transparent. An additional benefit of the government guarantee may be a lower risk-weighting assigned to the asset pool. In the Citigroup programme, the risk-weighting for the troubled assets in the pool is 20 per cent.

There are some disadvantages to the government guarantee approach, most notably the executive compensation and corporate governance requirements imposed on participating institutions. Participation in the Targeted Investment Program and the Asset Guarantee Program requires compliance with the executive compensation and governance requirements of the Emergency Economic Stabilization Act of 2008 (‘Stabilization Act’), as interpreted through Treasury’s evolving rulemaking and as amended by the American Recovery and Reinvestment Act of 2009. In addition, each of the participating institutions must comply with corporate governance agreements limiting corporate dividends and certain corporate spending. Notwithstanding the unique benefits of a
government guarantee, serious consideration must be given to the longer-term impact of the accompanying restrictions. Asset guarantee models are also being considered outside the US. The approach requires limited initial government expenditure, providing policymakers with a more politically acceptable solution in light of the extensive spending and rescue programmes already announced. Additionally, independently negotiating attachment points for the guarantee with each institution provides more flexibility than purchasing whole assets under an aggregator bank model.

**Treasury’s Asset Guarantee Program**

As originally presented to Congress, former Treasury Secretary Paulson’s bailout proposal did not include a guarantee programme. Members of Congress, concerned that the proposal would result in significant US Government ownership of troubled assets, pushed for inclusion of an alternative insurance, or guarantee, programme. Although a programme to guarantee assets reduces the initial expenditure of taxpayer money and retains private ownership of troubled assets, Treasury has found it challenging to implement the programme. In addition, a guarantee, while protecting a financial institution against future losses, does not provide the institution with new capital or liquidity.

Under the Stabilization Act, each guarantee reduces the amount available under the Act on a dollar-for-dollar basis, offset only by the amount of any cash premium collected. For example, a guarantee on an asset valued at US$10m would reduce the amount available to Treasury under the Stabilization Act by US$10m, offset only by the amount of any cash premium collected. As a result, the benefits of the guarantees, balanced by the burden of determining a premium, must be weighed against the benefits of the Stabilization Act’s alternative programmes.

A guarantee programme requires detailed negotiation by the parties to each transaction. Treasury and a participant must agree on the valuation of the assets, including whether Treasury will guarantee the full face value, the current marked-down value, or losses within negotiated thresholds. In addition, both parties must agree on the asset pool size and composition, the term and coverage of the guarantee, and associated premiums. As a result of illiquid markets for troubled assets, the assets have been marked down to different values on financial institutions’ balance sheets. Each financial institution holds a unique quantity and composition of troubled assets and each institution is willing, or able, to absorb different losses and pricing premiums. The terms of a guarantee must be negotiated separately with each institution; standardised objective terms cannot be established for an auction process or other broad-based guarantee programme.

The calculation of the premium affects the desirability of the guarantee. Sections 102(c)(2) and 102(c)(3) of the Stabilization Act provide that premiums must be set based on the risk of the troubled asset and to ‘create reserves sufficient to meet anticipated claims, based on an actuarial analysis, and to ensure that taxpayers are fully protected’. A detailed underwriting function is necessary to evaluate the risks and determine the amount of the premium. Given that a high percentage of troubled assets are illiquid, distressed, high risk and in many cases, non-performing, premiums should be high in order for the guarantee programme to meet the statutory guidelines.

Faced with these challenges, on 10th October, 2008, Treasury requested public
input on the guarantee programme, ‘seeking the best ideas on structuring options for the insurance programme’.10 Responses were due by 28th October, 200811 and 10 weeks later, on 31st December, 2008, Treasury issued its report to Congress, establishing the Asset Guarantee Program under section 102 of the Stabilization Act.12

**Asset Guarantee Program Terms**

As announced on 31st December, 2008, the Asset Guarantee Program provides guarantees on troubled assets held by ‘systemically significant financial institutions that face a high risk of losing market confidence due in large part to a portfolio of distressed or illiquid assets’. Treasury has reported that the Program will not be made widely available, and potential participants will be evaluated using the same five factors established for the Targeted Investment Program.

The five factors for the Targeted Investment Program are:

1. The extent to which destabilisation of the institution could threaten the viability of creditors and counterparties exposed to the institution, whether directly or indirectly.
2. The extent to which an institution is at risk of a loss of confidence and the degree to which that stress is caused by a distressed or illiquid portfolio of assets.
3. The number and size of financial institutions that are similarly situated, or that would be likely to be affected by destabilisation of the institution being considered for the programme.
4. Whether the institution is sufficiently important to the nation’s financial and economic system that a loss of confidence in the firm’s financial position could potentially cause major disruptions to credit markets or payments and settlement systems, destabilise asset prices, significantly increase uncertainty, or lead to similar losses of confidence or financial market stability that could materially weaken overall economic performance.
5. The extent to which the institution has access to alternative sources of capital and liquidity, whether from the private sector or from other sources of government funds.

To be eligible for the Asset Guarantee Program, a troubled asset must have been originated prior to 14th March, 2008. Treasury will provide protection against specified losses on each guaranteed asset, determined on a case-by-case basis. Such protection may be structurally similar to that provided in the Citigroup or Bank of America transactions, with one party (the entity holding the asset) assuming the first loss position, and Treasury assuming a secondary loss position. Additionally, the institution will be subject to portfolio management guidelines for the covered assets, to be established by Treasury.

The 31st December, 2008 report on the Asset Guarantee Program notes the unique guarantee accounting mandated by the Stabilization Act and outlines Treasury’s considerations when evaluating a guarantee structure. The guaranteed portion of the troubled asset reduces, on a dollar-for-dollar basis, the funds available for use under the Act, offset by the value of any cash premium received by Treasury. Non-cash premiums, such as preferred stock, will not offset the reduction of available resources under the Stabilization Act. As a result, Treasury will evaluate on a case-by-case basis the troubled assets to be covered by the Program to minimise the impact on available funds.

Treasury also notes ongoing efforts to
continue evaluating the development of other insurance programmes. In doing so, Treasury will be guided by two factors. The first is the Stabilization Act’s accounting for guarantees: that the impact to available Stabilization Act funds is the same for insuring an asset as for purchasing an asset. The second is the risk of adverse selection arising from the complexity of the troubled assets and the challenges of pricing premiums. Any standardised premium established for a class of troubled assets is likely to be attractive to parties for whom the premium was appropriately priced or under priced. As a result, the credit risk would result in greater losses than the premium could cover. As a result, premiums should be priced based on an asset-by-asset review of credit risk.

**Citigroup Transaction**

Treasury completed its first transaction under the Guarantee Program on 16th January, 2009, when it finalised the terms of a guarantee agreement with Citigroup, which was announced on 23rd November, 2008. The agreement with Citigroup provides a package of guarantees, liquidity access and capital, and includes two distinct programmes: a guarantee from Treasury and the FDIC of up to US$30bn and a US$20bn investment by Treasury under the Stabilization Act’s Targeted Investment Program.\(^1\)

**Impact of the Program**

Despite its challenges, the Asset Guarantee Program can be beneficial to the participating institution, as well as to the taxpayer. In exchange for a premium payment, a financial institution that purchases the guarantee will receive the benefits of the original payment stream on a financial instrument that is a troubled asset. A guarantee makes it easier for a financial institution to hold troubled assets to maturity. The mark-to-market effects of declines in market values will be mitigated once the guarantee level is hit, easing pressure to sell as a means of avoiding the risk of future markdowns. If, as has been widely reported, market values currently significantly understate the true economic value of certain assets, a guarantee that facilitates holding those assets to maturity provides significant benefit.

Additionally, the balance sheet benefits may be significant. Troubled assets under the Asset Guarantee Program are assigned a 20 per cent risk-weighting, reducing the associated capital burden. Longer term, if a guaranteed troubled asset becomes a performing asset, the financial institution will benefit from holding a healthier asset.

Finally, the financial institution retains ownership of the troubled assets in the Asset Guarantee Program, enhancing the likelihood of efficient decision-making. If held by Treasury, a new portfolio manager would be responsible for managing a diverse and new pool of troubled assets. The financial institution maintaining ownership retains direct economic incentive to maximise the value of the troubled assets given its ongoing exposure.

A key disadvantage to be carefully considered is the requirement that participating institutions comply with Treasury’s executive compensation restrictions, which continue to evolve. Participation requires compliance with executive compensation rules, corporate governance restrictions, mortgage modification plans and asset management guidelines.

**ALTERNATIVE AND HYBRID PROPOSALS**

**Government ‘Good’ Bank**

Prior to the announcement of the Public–Private Investment Program, dis-
discussed below, the federal government evaluated the merits of establishing an ‘aggregator’ bad bank. Under an aggregator bank model, the federal government would form a bad bank to acquire troubled assets from numerous financial institutions. This aggregator bank could be funded with government capital, or a combination of private and public capital.

An alternative government good bank-bad bank model has been proposed by George Soros. Under the proposal, financial institutions would establish a bad bank into which they would transfer their troubled assets, funded with a transfer of existing capital and debt. Rather than finance the bad bank, Mr Soros proposes that government capital would be better spent re-capitalising the remaining, and capital-depleted, good bank. Existing shareholders would be given interests in the new bad bank, as well as rights to subscribe for new shares of the good bank. Government resources would be used to capitalise the good bank — a more appealing investment for US taxpayers and their policymakers. It would be easier to attract private capital to the good bank than to the bad bank, limiting the cost to the government, a key consideration given the scope of the current crisis.

Losses on the bad bank assets would be borne first by pre-existing shareholders, rather than by new investors. Mr Soros notes that any risk of loss to bad bank debtholders may reduce the ability of financial institutions to borrow in the future, an outcome he finds acceptable given his belief that financial institutions should not be as highly leveraged in the future.

The proposal supports a public policy goal of preventing moral hazard arising from government intervention. Widespread concerns are being discussed that once financial institutions are bailed out by the government, the resulting implied safety net will continuously impede an appropriate level of risk management. This will result in a nationalised banking system in practice, if not in name. In contrast, Mr Soros notes, if financial institutions and their shareholders are made to pay the price of past decisions, they will be more prudent in future corporate and capital allocation decision-making.

**Hybrid Proposal**

The proposal of Max Holmes offers a hybrid approach, including both government intervention and private restructuring. The plan requires that financial institutions establish separate, government-owned bad banks, rather than using a government-sponsored aggregator bank. Government support would come in the form of long-term funding for the separately formed bad banks. Each financial institution would transfer its selection of troubled assets to its new bad bank at most recent quarter-end or year-end valuations, eliminating many of the valuation concerns discussed above with a single aggregator bank. The government would finance the bad banks by assuming outstanding debt of the financial institutions, rather than issuing new Treasury debt. The specific debt instruments would be selected by the government, in an aggregate amount equal to the troubled assets transferred to the good bank. Cash flow from the troubled assets would be used by the government to repay the outstanding debt, with the government absorbing any losses. The portfolio of assumed debt could be structured to match, as closely as possible, the expected cash flows from the bad bank.

Mr Holmes’s proposal focuses on the largest financial institutions 'and perhaps
some others’. The proposal requires mandatory participation by four major financial institutions, but does not provide details on the criteria for including others. If such a proposal were to be adopted, the financial institution stress tests to be performed under Treasury’s Plan could potentially be used to identify additional financial institutions.

The structure of the Program provides some funding advantages. First, funding with long-term debt would permit management of the assets absent pressure to attempt immediate liquidation at current fire-sale prices. Additionally, assumption of debt, rather than printing new money, resolves a frequent criticism and concern expressed over the growing size of the government’s stimulus and stabilisation programmes. Mr Holmes recommends that participating institutions grant transferable warrants to the government, so that the expected upside potential from clean, strong balance sheets could be shared by the US taxpayer.

PUBLIC-PRIVATE INVESTMENT PROGRAM

Background
As noted, prior to the announcement on 23rd March, 2009 of the Public-Private Investment Program (‘Program’), most of the government’s effort to address troubled assets focused on development of an ‘aggregator bank’. Although the aggregator bank model has the advantage of providing a single entity in which to manage acquired assets, the model must contend with the challenges of funding a diverse collection of assets from multiple sellers and developing an efficient and effective pricing methodology. To address the complexity of one aggregator bank managing purchases from multiple institutions, the Program will establish numerous bad banks, each a Public-Private Investment Fund (PPIF), to purchase legacy assets. The pricing methodology for the Program will involve private investors establishing prices on pools of assets or securities, significantly minimising the government’s role in the valuation process.

Program Overview
The Program is a joint effort by Treasury, the FDIC and the Federal Reserve. In addition to the goal of clearing up the balance sheets of financial institutions, the Program seeks to encourage the extension of credit and to restart the markets for legacy loans and securities. Additionally, enhanced confidence in financial institutions’ balance sheets should reduce uncertainty, restore investor confidence and encourage private capital investment in financial institutions. Treasury will contribute US$100bn of funds available under the Stabilization Act. Including capital investments from private investors and loans supported by the Federal Reserve and the FDIC, the Program may ultimately purchase US$1trn of legacy assets. Treasury will invest alongside private investors, contributing half of the capital for each purchase of a legacy loan or legacy security.

The Program leverages the success of two other crisis-related federal programmes, the Temporary Liquidity Guarantee Program, launched by the FDIC and the Term Asset-backed securities Loan Facility (TALF), announced by the Federal Reserve. Treasury and the FDIC will operate the Legacy Loans Program, for the purchase of loans and similar assets, while Treasury and the Federal Reserve will operate the Legacy Securities Program, for the purchase of securities. Each of the Legacy Loans Program and the Legacy Securities Program will be structured based on the
assets to be acquired and the respective authority and experience of each of the FDIC and Federal Reserve.

**Legacy Loans Program**

Under the Legacy Loans Program, Treasury and the FDIC will establish a series of PPIFs with private investors for the purchase of troubled loans and other assets. An eligible financial institution seller will offer a pool of loans for sale through an auction process to be developed by the FDIC. Private investors will bid on the portfolio through an auction process and, after the FDIC selects a winning bid, the financial institution seller can accept or reject the purchase offer. If a bid is accepted, Treasury and the successful bidder will each provide 50 per cent of the equity required for the purchase. The remaining financing will be in the form of FDIC-guaranteed debt issued by the PPIF. Based on the FDIC’s assessment of the credit quality of the pool of assets, the PPIF’s debt-to-equity ratio may be as high as 6-to-1. The FDIC-guaranteed debt is expected to be initially placed with the selling banking entity as partial satisfaction of the purchase price. In summary, the banking entity will be selling its legacy loans for cash and a debt instrument guaranteed by the FDIC. The auction process, the availability of a matching equity investment from Treasury and the low-cost financing supported by an FDIC guarantee are inducements to encourage both financial institutions to offer loans for sale and private investors to place bids acceptable to the selling institutions.

Inclusion of the funding incentives and pricing by the private investors through an auction process addresses many of the aggregator bank valuation concerns. The FDIC-guaranteed debt is non-recourse to the private investors, secured only by the PPIF’s assets. Although many private investors and banking institutions have been unable to reach mutually agreeable pricing terms, the Legacy Loans Program terms may encourage higher bidding by private investors.

**Legacy Loans Program Participants and Assets**

Only insured US banks or US savings associations are eligible to sell loans under the Legacy Loans Program. Foreign-owned or controlled entities are not eligible to participate. Interested eligible sellers must consult with their respective primary federal banking regulator to identify loans and assets for the Loans Program. The Program initially targets real estate-related assets, including residential and commercial real estate loans and any collateral supporting the loans must be ‘situated predominantly in the United States’.

The Program is designed to encourage participation by private investors. The non-exclusive list of potential investor types includes financial institutions, individuals, insurance companies, mutual funds, publicly managed investment funds and pension funds. Investors and groups of private investors must pre-qualify with the FDIC for participation in auctions.

**Legacy Loans Program Structure and Financing**

As noted, the specific legal form for a bad bank will depend on the assets transferred and the expected activities of the bad bank. The specific legal form for the PPIFs has not been identified, but they will need to be structured to permit multiple equity owners to issue warrants to Treasury as required under the Stabilization Act and to issue debt guaranteed by the FDIC. Potential investors will be interested in ensuring the PPIFs are not subject to securities reporting or registration requirements to minimise the costs.
associated with a Legacy Loans Program investment.

**Considerations for Participants**

Unlike a private good bank–bad bank, the Treasury and FDIC will have an ongoing relationship with the PPIF, including some supervisory authority. Private investors will need to consider the expenses and time commitment required to manage both the assets being acquired as well as the relationship with each of Treasury and the FDIC. Additionally, government participation necessitates a certain degree of transparency, which would not be required in a private transaction; the selling financial institutions and private investors in the PPIF will need to consider what elements of the transactions will be publicly disclosed or available. The FDIC has also indicated that it will be pre-qualifying potential private investors, including their selection for asset manager of the asset pools. As noted above, ongoing asset management is a critical component of designing a good bank–bad bank. Treasury and the FDIC will each have a vested interest in protecting their investment and risk profile, respectively, which may influence asset management decisions.

Another impact of the partnership with the federal government is compliance with other federal programmes, including the Making Home Affordable mortgage modification programme recently announced by Treasury. Private investors evaluating the long-term value of a pool of mortgage-related assets will need to consider the impact of Making Home Affordable on their valuation.

Market participants, accountants and regulators are evaluating the accounting impact of the Legacy Loans Program. Given the advantageous financing available to private investors bidding on pools of legacy loans, prices established through auctions may not be determinative for establishing new values or loan loss expectations for similar assets at the selling financial institution or other financial institutions holding similar assets. However, the longer-term impact of the PPIF transactions cannot be predicted at this time.

**Legacy Securities Program**

Under the Legacy Securities Program, Treasury will hire a limited number of large asset managers to each establish a PPIF for the purchase of troubled securities, with an initial focus on residential and commercial real estate-backed securities. Each asset manager will be responsible for attracting private investors to acquire an interest in their respective PPIF. Treasury will make capital investments alongside the private investors, similar to the 50/50 investment in the Legacy Loans Program. Additionally, each fund can apply for a non-recourse loan from Treasury and, under terms to be announced, a TALF loan from the Federal Reserve Bank of New York.

**Legacy Securities Program Eligibility**

Eligible sellers include those institutions from whom Treasury can purchase troubled assets under the Stabilization Act. These ‘financial institutions’ must be established and regulated under the laws of the US and have significant operations in the USA. The definition includes a non-exclusive list of institution types: banks, savings associations, credit unions, security brokers or dealers, or insurance companies. Expressly excluded are central banks of, or any institution owned by, a foreign government. This group of sellers is significantly broader than the sellers eligible to participate in the Legacy Loans Program and includes many non-banking institutions that have reported losses as a result of real estate-related securities,
including insurance companies.

To be eligible for purchase by a PPIF, a security must be:

1. either a residential or commercial mortgage-backed security;
2. originally issued prior to 1st January, 2009;
3. originally rated in the highest rating category by at least two NRSROs, without ratings enhancement;^{24}
4. secured by loans or other eligible assets situated predominantly in the US;
5. backed by loans and not other securities or derivatives (subject to limited exceptions); and
6. eligible under other criteria to be established by Treasury.

### Legacy Securities Program Structure and Financing

The proposed structure requires private investors to work through an asset manager to invest in legacy securities. Unlike the private good bank–bad bank structures described above, the Program’s investors will not directly negotiate and select the assets in which they are investing. While asset managers are expected to provide investors with detailed investment and management guidelines, the Legacy Securities Program will attract investors that are comfortable delegating significant responsibility to the asset managers.

Detailed information is not currently available on the Federal Reserve’s role in providing financing to the Legacy Securities Program. As in other good bank–bad bank structures, potential investors will need to consider the funding available from Treasury in the form of capital and debt, as well as Treasury’s exit strategy for its investment. Similarly, the terms of loans available from the Federal Reserve may require repayment prior to the maturity of the securities purchased by the PPIF, as is the case currently under the TALF program. Private investors will need to consider any potential additional funding requirements as Treasury and Federal Reserve investments become unavailable.

### Considerations for Participants

As is the case for participants in the Legacy Loans Program, the potential participants in the Legacy Securities Program will need to consider the relationship with Treasury and, in this case, the Federal Reserve, when evaluating the costs of participating in the Program. Similarly, the accounting impact of transactions in distressed securities is not clear at this time. Unlike the Legacy Loans Program, the Legacy Securities Program requires that private investors work through an asset manager; they will need to be comfortable with the PPIF’s investment and asset management guidelines and the level of discretion maintained by the asset manager.

### Evaluation of the Program

Legacy assets continue to impede economic recovery, as realised losses and the perceived risk of future losses prevent private investment in financial institutions. Development of a federally sponsored Program to develop a series of bad banks may enhance market perception of financial institutions’ balance sheets. Significant additional operational and structural information is required for potential participants to more fully assess their interest in the Program. The Program addresses many of the concerns raised about an aggregator bank model, including how the federal government would price troubled assets. The outline of the Program raises new questions, including the imposition of an asset manager between the private investor and the pool of assets to be acquired in the transaction.

As discussed above under ‘Asset Selec-
tion’, financial institutions will need to consider carefully the pools of loans and securities offered for sale to the Program. The selling financial institution will benefit from being able to announce a sale of all or a significant portion of its portfolio of troubled assets. Banking regulators will also have an interest in the portfolio of assets and loans. However, the pool of assets or securities must be attractive to potential bidders.

**SUMMARY**

Each of the structures we discussed, and their numerous variations, have advantages and disadvantages. No structure is ideal for all institutions, which is a continuing challenge for the government as it tries to balance the unique situation and nature of each institution with the goal of creating a programme that can be implemented consistently across the industry.

Below we summarise the points for and against of some of the basic structuring alternatives.

**CONCLUSION**

As the financial crisis continues, the need to remove troubled assets from financial institutions’ balance sheets has become critical. Confidence in our banking and financial system requires confidence in our financial institutions and the ongoing reporting of losses and write-downs continuously hampers progress. The SEC has rejected suspending mark-to-market accounting, which would have helped. Recent guidance from the Financial Accounting Standards Board addressing some of the concerns about mark-to-market and fair value accounting may provide incremental improvements, but is unlikely to dramatically restore balance sheets. Segregation of troubled assets would alleviate the pressures they create

<table>
<thead>
<tr>
<th>Structure</th>
<th>For</th>
<th>Against</th>
</tr>
</thead>
</table>
| Private Good Bank-Bad Bank | • Removal of bad assets from balance sheet  
• Institution can structure an ideal solution tailored to a specific portfolio of troubled assets  
• Bad bank can be established to manage or liquidate a discrete pool of assets or can include operations, either business lines to be phased out or to continue  
• Bad bank will not face conflicts of interest with troubled asset counterparties and will have time to manage assets  
• Depending on structure, shareholders may receive interest in bad bank, retaining some potential upside  
• Permits management to focus on good bank businesses and assets  
• Separate good bank improves rating agency, shareholder, investor and market perception of institution  
• Private structure will not subject institution to executive compensation and corporate governance requirements | • Limited current availability of private investors  
• Must be highly structured to meet the needs of private investors  
• Valuation of assets challenging and highly negotiated; likely to result in either short-term additional write-downs or longer-term opportunity costs  
• May require ongoing management of assets, for example on a contract basis, depending on investors  
• Requires management of shareholder expectations, which may be ongoing, particularly if private investor profits from transaction  
• Establishment of new legal entity may raise regulatory compliance and charter issues |
<table>
<thead>
<tr>
<th>Structure</th>
<th>For</th>
<th>Against</th>
</tr>
</thead>
</table>
| Repackage Troubled Assets for Private Sale Asset Guarantee Program | - Flexibility in selecting portfolio  
- No further involvement with assets  
- Retention of upside  
- Out-of-pocket costs limited to price of premium; potential to issue securities to satisfy premium obligation  
- Ease of transaction execution — no need to establish separate legal entity; valuation questions simpler  
- Asset risk-weighting adjusted to reflect benefit of government guarantee  
- Ability to prepay Federal Reserve loans and terminate guarantee  
- Does not eliminate future option of bad bank  
- No upfront funding requirement for any guarantor  
- Guarantee can be restructured and assets can be restructured | - No current market  
- Institution will be subject to government executive compensation and corporate governance requirements  
- Long-term nature of guarantee results in longer-term imposition of government rules  
- Asset management decisions subject to government rules  
- Assets retained on balance sheet: additional losses to be absorbed; management costs; ongoing management distraction  
- Does not achieve public separation from bad assets, no good bank boost  
- Does not provide funding, bank must continue to finance the assets |
| Government Aggregator Bank (Bad Bank) | - See ‘Private Good Bank-Bad Bank’ above  
- No further involvement with assets, which are removed from balance sheet and managed by government asset managers  
- Unlike Private Good Bank-Bad Bank, government will establish legal entity and structure transaction  
- Unlike Private Good Bank-Bad Bank, government more likely to accept broader scope of troubled asset classes | - Institution will be subject to government executive compensation and corporate governance requirements  
- Unable to participate in upside  
- Unlike Private Good Bank-Bad Bank alternative, bad bank must be limited to troubled assets to be liquidated, no operating businesses  
- Unlike Private Good Bank-Bad Bank, negotiations on price will be more transparent and public  
- Valuation of assets challenging and because they will need to be consistent across all institutions, likely to result in either short-term additional write-downs or longer-term opportunity costs  
- Requires management of shareholder expectations, which may be ongoing, particularly if the government profits from the transaction  
- Establishment of new legal entity will be more complex than using a government aggregator bank (but less complex than Private Good Bank-Bad Bank as structure would have government approval)  
- Current shareholders will be diluted  
- Depending on the size of the portfolio transferred to the bad bank, may create effective nationalisation of good bank |
| Government Sponsored Good Bank (Soros Proposal) | - Removal of bad assets from balance sheet  
- Institution can structure an ideal solution tailored to specific portfolio of troubled assets and funding needs for bad bank  
- No further involvement with assets, which are removed from balance sheet and managed by government asset managers  
- Permits management to focus on good bank businesses and assets  
- Separate good bank improves rating agency, shareholder, investor and market perception of institution  
- Good bank will be well capitalised  
- Assets will be transferred at book value with no additional write-downs | - Institution will be subject to government executive compensation and corporate governance requirements  
- Requires management of shareholder expectations, which may be ongoing, particularly if the government profits from the transaction  
- Establishment of new legal entity will be more complex than using a government aggregator bank (but less complex than Private Good Bank-Bad Bank as structure would have government approval)  
- Current shareholders will be diluted  
- Depending on the size of the portfolio transferred to the bad bank, may create effective nationalisation of good bank |
### Removing toxic assets from balance sheets

<table>
<thead>
<tr>
<th>Structure</th>
<th>For</th>
<th>Against</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hybrid: Multiple Government Funded Bad Banks</td>
<td>• Achieves public policy objectives of charging current shareholders for the impact of acquiring troubled assets</td>
<td>• Will increase cost of debt financing (risk of transfer of debt to new entity, risk of loss from bad assets)</td>
</tr>
<tr>
<td></td>
<td>• Removal of bad assets from balance sheet</td>
<td>• Unlike Private Good Bank-Bad Bank alternative, bad bank must be limited to troubled assets to be liquidated, no operating businesses</td>
</tr>
<tr>
<td></td>
<td>• No further involvement with assets, which are removed from balance sheet and managed by government asset managers</td>
<td>• Unlike Private Good Bank-Bad Bank, valuation of assets will be more transparent and public</td>
</tr>
<tr>
<td></td>
<td>• Assets will be transferred at book value with no additional write-downs</td>
<td>• Institution will be subject to government executive compensation and corporate governance requirements</td>
</tr>
<tr>
<td></td>
<td>• Permits management to focus on good bank businesses and assets</td>
<td>• Requires management of shareholder expectations, which may be ongoing, particularly if the government profits from the transaction</td>
</tr>
<tr>
<td></td>
<td>• Separate good bank improves rating agency, shareholder, investor and market perception of institution</td>
<td>• Establishment of new legal entity will be more complex than using a government aggregator bank (but less complex than Private Good Bank-Bad Bank as structure would have government approval)</td>
</tr>
<tr>
<td></td>
<td>• Achieves public policy goal of funding structure through assumption of existing debt, rather than ‘printing money’</td>
<td>• Unlike Private Good Bank-Bad Bank alternative, bad bank must be limited to troubled assets to be liquidated, no operating businesses</td>
</tr>
<tr>
<td></td>
<td>• Ability to raise future debt may be impeded by risk that government can assume debt at any time</td>
<td>• Ability to raise future debt may be impeded by risk that government can assume debt at any time</td>
</tr>
<tr>
<td></td>
<td>• Unlike aggregator bank, valuation not complicated by the need to be consistent across institutions</td>
<td>• Unlike Private Good Bank-Bad Bank, valuation of assets will be more transparent and public</td>
</tr>
<tr>
<td>Public-Private Investment Program</td>
<td>• Removal of bad assets from balance sheet</td>
<td>• Valuation of assets continues to be a challenge, although auctions and purchase programs may develop efficiencies as the program terms are finalized</td>
</tr>
<tr>
<td></td>
<td>• Bad bank (PPIF) will not face conflicts of interest with troubled asset counterparties and will have time to manage assets</td>
<td>• Some participants likely to be subject to executive compensation and corporate governance requirements although which participants remains unclear</td>
</tr>
<tr>
<td></td>
<td>• Permits management focus on good bank businesses and assets</td>
<td>• Ongoing supervision and coordination with two governmental entities</td>
</tr>
<tr>
<td></td>
<td>• Separate good bank improves rating agency, shareholder, investor and market perception of institution</td>
<td>• Impact of Treasury’s requirement to hold a warrant issued by the PPIF is unclear at this time</td>
</tr>
<tr>
<td></td>
<td>• No further involvement with assets</td>
<td>• Federal government’s exit strategy not currently clear</td>
</tr>
<tr>
<td></td>
<td>• Unlike aggregator bank, valuation not complicated by the need to be consistent across institutions</td>
<td></td>
</tr>
</tbody>
</table>
on the individual institutions, and on the financial system. Private investors working with individual institutions have the opportunity to structure bad banks that meet individualised investment needs. Whether a good bank–bad bank structure duplicates past precedent or brings something novel to the table, regulators are highly motivated to approve plans that transfer troubled assets and restore stability.

The Public–Private Investment Program’s ultimate design will be shaped by policy and practical considerations. The creation of the government’s programmes and the PPIFs may serve as a model and springboard from which creative private investors may partner with financial institutions interested in structures that can be tailored to individual circumstances.

References


(9) Treasury faced similar challenges with an asset purchase programme. Assigning values to illiquid and distressed assets requires one-on-one negotiation with counterparties. Additionally, negotiating prices or premiums based on diverse pools of assets is time intensive.


(11) Responses to Treasury’s request are available at: http://www.regulations.gov/search/search_results.jsp?sid=11F5D6AB1377&Ntt=asset+guarantee&Ntk=All&Ntx=mode+matchall&N=8060&css=0&Ne=2+8+11+8053+8054

(13) A summary of the Citigroup agreement terms can be found in Citigroup’s form 8-K, available at: http://idea.sec.gov/Archives/edgar/data/831001/0000950123-08-016585-index.idea.htm.


(15) Max Holmes is an adjunct professor of finance at the Stern Graduate School of Business at New York University and the chief investment officer of an asset management firm.


(17) According to the Legacy Loans Program Summary of Terms, ‘US bank’ and ‘US savings association’ mean a bank or savings association organised under the laws of the United States or any State of the United States, the District of Columbia, any territory or possession of the United States, Puerto Rico, Northern Mariana Islands, Guam, American Samoa, or the Virgin Islands.

(18) The Loans Program is unique among federal crisis programs in limiting participants to FDIC-insured banks and savings associations. Another FDIC program, the Temporary Liquidity Guarantee Program (TLGP), limits participants to insured depository institutions and many of their holding companies. The TLGP program is funded through a special assessment. Any shortfall in the TLGP will result in an emergency assessment of all insured depository institutions but not their holding companies. The FDIC has been criticised for the inequity between the beneficiaries of the Program and those with responsibility for its funding. In response to these concerns the FDIC has taken a number of actions, including requesting legislative changes to permit fee assessments on holding companies, imposing TLGP Program surcharges on many participating holding companies and most recently creating a new surcharge that will not fund the TLGP but will be deposited in the Deposit Insurance Fund (DIF).


(20) Section 113(d) of the Stabilization Act requires that when Treasury purchases any troubled asset, in this case an investment in the PPIF, it must receive a warrant with terms that ‘provide for reasonable participation ... in equity participation or a reasonable interest rate premium’ and protect against taxpayer losses from sale of assets.


(22) Asset managers will be evaluated based on:

1. demonstrated capacity to raise at least US$500m of private capital,
2. demonstrated experience investing in eligible securities, including through performance track records,
3. a minimum of US$10bn market value of eligible securities under management,
4. demonstrated operational capacity to manage legacy securities in PPIFs in a manner consistent with Treasury’s stated objectives for the Program while also protecting taxpayers and
5. being headquartered in the US.
(23) The entity must be established and regulated under ‘the laws of the United States or any State, territory, or possession of the United States, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa, or the United States Virgin Islands’.
(24) We expect that the limit on ratings enhancement will mirror the similar current requirement in the TALF that the rating cannot be obtained as a result of a guarantee or insurance policy; it will not limit enhancement such as overcollateralisation.