PROSKAUER ROSE LLP

Client Alert

Economic Crisis Response Group

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FDIC Announces Test of Funding Mechanism for the Legacy Loans Program

The FDIC issued a press release on July 31 announcing a test of the proposed funding mechanism for the Legacy Loans Program (the "Program"), a key element of the Treasury Department's Public-Private Investment Program ("PPIP") designed to rid banks of distressed whole loans. The FDIC will test the Program's funding mechanism through the sale of receivership assets and will analyze the results of the sale to determine whether the approach will ultimately encourage banks to increase lending activity to further the recovery of the U.S. economy.

Under the proposed funding mechanism, an FDIC receivership will transfer a portfolio of residential mortgage loans on a servicing released basis to a limited liability company (the "LLC") in exchange for an ownership interest in the LLC. An accredited investor, who will be responsible for managing the loan portfolio, will also purchase an equity interest in the LLC. The accredited investor may purchase the LLC interest using one of two financing options. Under the first option, the LLC interest would be purchased on an all cash basis, with an equity split of 80 percent to the FDIC and 20 percent to the accredited investor. Under the second option, the LLC interest would be purchased using leverage, with an equity split of 50 percent to the FDIC and 50 percent to the accredited investor.

The receivership will offer financing to the LLC in the form of an amortizing note guaranteed by the FDIC. The accredited investor may elect to leverage the LLC at a debt-to-equity ratio of either 4-to-1 or 6-to-1. Under the 6-to-1 leverage option, the loan portfolio will be subject to certain performance thresholds including delinquency status, loss severity and principal repayment thresholds. If any of the performance thresholds is triggered over the life of the note, then all of the principal cash flows that would have been distributed to the equity investors would be applied instead to the reduction of the note until the note is paid in full. Under the 4-to-1 leverage option, the performance thresholds will not apply.

The FDIC will be protected against losses on the note guarantee by the limits on the amount of leverage, the mortgage loan collateral and a guarantee fee imposed on the LLC. The Program requires loans to be serviced in accordance with the guidelines established under the Home Affordable Modification Program or the FDIC's loan modification program.

Proskauer's Economic Crisis Response Group includes lawyers with extensive experience representing private and public companies, institutional investors, financial services companies, private equity and hedge funds, lenders, commercial banks and individuals in the complex and interrelated areas impacted by the current financial situation. Our multidisciplinary group brings together the talents of our business and transactional lawyers with our litigation capabilities, particularly as they pertain to acquiring, managing or disposing of distressed assets; issues concerning investments in financial services companies; and complex financial instruments and transactions, including structured finance products, as well as a broad range of other areas such as corporate governance and defense, insurance coverage, reductions in force and other employment and benefit-related issues, securities regulation, and bankruptcy and restructuring matters.

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