The Creation of the TALF Program, the Citigroup Bailout and Other Recent Developments Related to the Emergency Economic Stabilization Act of 2008

Since the Emergency Economic Stabilization Act of 2008 (the "Act") became law on October 3, 2008, the United States government has taken unprecedented steps to bolster troubled credit markets and to protect and stabilize key lending institutions. Over the past several weeks, there have been several major announcements regarding programs to be implemented by the United States government.

Term Asset-Backed Securities Loan Facility

On November 25, 2008, the United States Department of Treasury ("Treasury") and Board of Governors of the Federal Reserve System (the "Federal Reserve") announced the creation of the Term Asset-Backed Securities Loan Facility program (the "TALF Program"). Under the TALF Program, the Federal Reserve Bank of New York (the "FRBNY") will make up to $200 billion of loans (the "TALF Loans") available to eligible borrowers. Eligible borrowers are United States persons[1] that own eligible collateral.

Eligible collateral is defined to include United States dollar-denominated cash asset-backed securities ("ABS") that have a long term credit rating in the highest investment-grade rating category from two or more nationally recognized statistical rating organizations and that do not have a long-term credit rating of below the highest investment-grate rating category from a major nationally recognized statistical rating organization. The underlying credit exposures of eligible ABS initially must be auto loans, student loans, credit card loans or small business loans guaranteed by the United States Small Business Administration. The permissible underlying credit exposures of eligible ABS may be expanded later to include commercial mortgage-backed securities, non-Agency residential mortgage-backed securities or other asset classes. The underlying credit exposures cannot include exposures that are themselves cash or synthetic ABS. Eligible collateral for a particular borrower cannot be backed by loans originated by such borrower or an affiliate of such borrower.

Each of the TALF Loans shall be fully secured by eligible collateral and shall be non-recourse to the borrower. The amount of each of the TALF Loans will be equal to the market value of the ABS less a haircut established by the FRBNY for each class of eligible collateral. Haircuts will be determined based on the price volatility of each class of eligible collateral. The TALF Loans will have a one-year term, with interest payable monthly, and the term may be lengthened later "if appropriate." The TALF Loans will not be subject to mark-to-market or re-margining requirements and will be made available to eligible borrowers until December 31, 2009.

[1] A United States person is defined as a "natural person that is a U.S. citizen, a business entity that is organized under the laws of the United States or a political subdivision or territory thereof (including such an entity that has a non-United States parent company) or a U.S. branch or agency of a foreign bank."

Each month, the FRBNY will offer a fixed amount of loans under the TALF Program. Such loans will be awarded to borrowers on a competitive, sealed bid auction process. Each bid must include the desired amount of credit and an interest rate spread over one-year overnight index swap ("OIS"), with the FRBNY setting minimum spreads for each auction. Borrowers will have to pay a non-recourse loan fee at the inception of each loan transaction.

The Treasury will provide $20 billion of credit protection to the Federal Reserve in connection with the TALF Program. Treasury Secretary Henry Paulson said of the TALF Program, "By providing liquidity to issuers of consumer asset backed paper, the Federal Reserve facility will enable a broad range of institutions to step up their lending, enabling borrowers to have access to lower cost consumer finance and small business loans."

Originators of the credit exposures underlying eligible ABS must comply with or already be subject to the executive compensation provisions set forth in Section 111(b) of the Act[2].

Citigroup Bailout

On November 25, 2008, the United States government announced an agreement with Citigroup that will provide Citigroup a package of guarantees, liquidity access and capital. Specifically, the agreement with Citigroup includes two distinct programs, one consisting of a guarantee from the Treasury and Federal Deposit Insurance Corporation ("FDIC") and the other consisting of $20 billion investment program by the Treasury pursuant to provisions of the Act. As a result of its acceptance of assistance from the Federal government, Citigroup will have to comply with the executive compensation requirements of the Act.

Eligible Asset Guarantee

The Treasury and FDIC have agreed to provide protection against the possibility of "unusually large losses" on a Citigroup asset pool presently valued at approximately $306 billion. The asset pool shall consist of loans and securities backed by residential and commercial real estate, their associated hedges and "such other assets as the U.S. Government has agreed to guarantee."

Citigroup will be required to absorb all losses in the portfolio up to $29 billion. Losses in excess of $29 billion will be shared by the United States government, 90%, and Citigroup, 10%. The United States government's share of losses will be allocated between the Treasury (via the Troubled Assets Relief Program ("TARP") under the Act), which will take a second loss position of up to $5 billion, and the FDIC, which will take a third loss position of up to $10 billion. Thereafter, the Federal Reserve will fund the remaining pool of losses with a non-recourse loan, subject to Citigroup's 10% loss share, at a floating rate of OIS plus 300 basis points. Interest payments under such loan will be recourse to Citigroup.

In return for the Federal guarantees, Citigroup will issue $7 billion of preferred stock with an 8% dividend rate, $4 billion of which shall be issued to the Treasury and $3 billion of which shall be issued to the FDIC. Citigroup will be prohibited from paying common stock dividends in excess of $.01 per share per quarter for three (3) years without consent from the Treasury, FDIC and the Federal Reserve Board. In connection with the guarantee program, the United States government shall provide Citibank with a template to manage guaranteed assets, including a template adopted by the FDIC to modify mortgages.

The guarantee will be in place for 10 years for residential assets and 5 years for non-residential assets.

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[2] Further details of the executive compensation requirements under the Act may be found in this Firm's publication, dated October 17, 2008, entitled "Executive Summary of the Emergency Economic Stabilization Act of 2008" and this Firm's publication, dated October 31, 2008, entitled "Recent Developments Related to the Emergency Economic Stabilization Act of 2008." Copies of these publications can be found on the Firm's website, www.seyfarth.com.

Treasury Investment

The Treasury will invest $20 billion in Citigroup from the TARP in exchange for preferred stock with that will pay cumulative dividends at a rate of 8%. The dividends shall be payable quarterly, in arrears, on February 15, May 15, August 15 and November 15 of each year. Citigroup will be prohibited from paying common stock dividends in excess of $.01 per share per quarter, for three (3) years without consent from the Treasury. The preferred stock shall be non-voting, other than class voting rights on matters that could adversely affect the preferred shares. If dividends on the preferred shares are not paid in full for six dividend periods (consecutive or otherwise), the Treasury will have the right to elect two (2) directors. The right to elect directors will end when full dividends have been paid for all prior dividend periods (in the case of cumulative preferred shares) or four consecutive dividend periods (in the case of non-cumulative preferred shares).

The $20 billion investment by the Treasury is part of the Capital Purchase Program[3], the program under which the Treasury has purchased approximately $250 billion of senior perpetual preferred shares from qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities.

Citigroup will issue a warrant to the Treasury for an aggregate exercise value of 10% of the total preferred shares issued to the United States government in both Citigroup bailout programs (i.e., $2.7 billion). The strike price will be equal to $10.61 per share and the warrants issued to the Treasury are not subject to reduction based on additional offerings. The term of the warrant will be ten years.

$600 Billion Purchase Program—Fannie Mae, Freddie Mac and Ginnie Mae

On November 25, 2008, the Federal Reserve announced that it would initiate a program to purchase (i) the direct obligations of the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Government National Mortgage Association ("Ginnie Mae") and (ii) mortgage-backed securities backed by Fannie Mae, Freddie Mac and Ginnie Mae. Purchases of up to $100 billion in direct obligations are to be conducted through a series of competitive auctions, starting the week of December 1, 2008. Purchases of up to $500 billion of mortgage-backed securities are to be conducted by asset managers selected via a competitive process, starting before the end of 2008. Purchases of both assets are expected to take place over the next several quarters.

By implementing this purchase program, the Federal Reserve hopes "to reduce the cost and increase the availability of credit for the purchase of houses, which in turn should support housing markets and foster improved conditions in the financial markets more generally."

Loan Modification Program

On November 11, 2008, the Federal Housing Finance Agency (the "FHFA") announced that it would be creating guidelines for a streamlined modification program ("SMP") for the modification of Fannie Mae and Freddie Mac mortgage loans. The program is designed to provide relief to homeowners with unaffordable mortgages and to reduce foreclosures through a "consistent, efficient" mortgage modification process that will have uniform eligibility requirements.

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[3] Further details of the Capital Purchase Program may be found in this Firm's publication, dated October 31, 2008 and entitled "Recent Developments Related to the Emergency Economic Stabilization Act of 2008."

Guidelines for the SMP are to be announced on December 15, 2008, but the FHFA has indicated that the program will be designed for borrowers that have missed three payments or more, that own and occupy their property as a primary residence, and that have not filed for bankruptcy. Eligible borrowers would contact their mortgage servicer, provide the servicer with financial information and, if certain criteria are met, the borrower would be eligible for a fast-track mortgage modification. The mortgage modification would be designed to provide the borrower with a new "affordable mortgage payment." An affordable mortgage payment is a mortgage payment, inclusive of association dues, of no more than 38% of the household's monthly gross income. The affordable mortgage payment would be achieved through a mix of a reduction in the interest rate, an extension of the life of the mortgage loan and/or a deferment of principal. Servicers would have flexibility of how to achieve the goal of an affordable mortgage payment and, if unable to achieve such goal, the servicer would further evaluate the borrower's situation through a "customized process," the parameters of which are to be announced.

In a letter dated November 24, 2008, FHFA Director James Lockhart urged more than 40 private label mortgage-backed securities ("PLS") servicers and trustees to support the SMP and to make it an accepted and broad based industry standard. In the letter, Director Lockhart noted that PLS, while representing less than 20% of all mortgages, represent 60% of serious delinquencies (i.e., those delinquencies involving borrowers that have missed three or more consecutive mortgage payments), while Fannie Mae/Freddie Mac owned or guaranteed mortgages only represent 20% of serious delinquencies. As such, Director Lockhart stated that, "It is critical that servicers of the loans backing PLS and trustees for those securities acknowledge a standard approach to expedite a cost-efficient program of loan modifications." Director Lockhart believes that acceptance of the program's standards would not only be in the best interests of the homeowners and investors, but also would allow consistency in the treatment of a servicer's portfolio loans and those serviced under PLS pooling and servicing agreements.

Conclusion

The Federal government has taken significant actions and has committed significant resources over the past few weeks. We will continue to monitor events related to the Act and keep you apprised of any significant future developments.

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