

Client Advisory

Treasury Secretary Paulson TARP Update

The Treasury is changing its original plan to buy troubled mortgage assets, as it no longer believes that purchasing troubled assets is the most effective way to use the \$700 billion in TARP funds. At a press conference on November 12, Secretary of the Treasury Henry Paulson said that although the financial situation is still fragile, the steps taken to date have helped America's financial system. He stated that the Treasury had acted quickly and in coordination with other systems around the world, but that the market turmoil is not likely to end until the housing crisis is over.

Describing the stability of the financial system as the Treasury's highest priority, Secretary Paulson set forth three "critical" priorities for remaining TARP funds following the \$250 billion in direct investments of capital in U.S. banks: (i) to strengthen the capital base of the financial system; (ii) to support the asset-backed securitization market that is critical to consumer finance; and (iii) to increase foreclosure mitigation efforts.

To strengthen the capital base of the financial system, Paulson stated that the Treasury is carefully evaluating programs which could attract private capital, potentially through matching investments. Paulson stressed that both banks and non-bank financial institutions provide credit that is essential to U.S. businesses and consumers. Paulson acknowledged that a second capital purchase program may be introduced that would consider the needs of banks and non-banking financial institutions. Up until now, the Treasury has only directly invested in banks. Paulson stated that the second capital purchase program would focus on non-banking financial institutions, and may present difficulties in implementation since many non-banking financial institutions are not directly regulated by the federal government and are active in a wide range of businesses.

To support consumer access to credit outside the banking system, Paulson stated that the Treasury and the Federal Reserve are exploring the development of a potential liquidity facility for highly rated AAA asset-backed securities. Paulson also said that the Treasury is looking at ways to use the TARP to encourage private investors to come back to the asset-backed securitization market by providing them access to federal financing, with taxpayer protection. "The asset-backed securitization market has played a critical role for many years in lowering the cost and increasing the availability of consumer finance ... Addressing the needs of the securitization sector will help get lending going again, helping consumers and supporting the U.S. economy. While this securitization effort is targeted at consumer financing, the program we are evaluating may also be used to support new commercial and residential mortgage-backed securities lending."

Paulson acknowledged that the Treasury is also examining alternative strategies to mitigate mortgage foreclosures and achieve more aggressive mortgage modification standards, now that the plan to purchase illiquid mortgage assets, distressed debt and other assets has been eliminated. On November 11, in a joint effort by the Treasury Department, the Federal Housing Finance Agency, the Department of Housing and Urban Development, government-sponsored enterprises Fannie Mae and Freddie Mac, and the HOPE NOW

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alliance, the “Streamlined Modification Program” was announced, tasked with providing thousands of delinquent borrowers other alternatives to foreclosure. The streamlined modification process applies to agency-owned or guaranteed mortgage loans, and FDIC chairman Sheila Bair has been quick to suggest the program doesn’t go far enough. Nonetheless, Paulson said in his remarks on November 12 that the Streamlined Modification Program was modeled after the FDIC’s modification program at IndyMac Federal Bank. Paulson also said that although the loan modification program might require some government spending, “maximizing loan modifications, nonetheless, is a key part of working through the housing correction and maintaining the quality of communities across the nation, and we will continue working hard to make progress here.”

With respect to the struggling automobile industry, Paulson said, “My focus is on the financial sector.” Thus, while declaring that “we care about our auto industry,” he seemed to rule out any role in the TARP effort for bailing out the auto manufacturing sector, an issue that is now occupying Congress, President-elect Barack Obama and President George W. Bush.

The complete text of Secretary Paulson’s prepared statement is available at <http://www.treas.gov/press/releases/hp1265.htm>.

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