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RESHAPING THE TARP

On January 9, 2009, Barney Frank (D-MA), chairman of the House Financial Services Committee, introduced H.R. 384, the *TARP Reform and Accountability Act of 2009.* This bill seeks to amend the Troubled Assets Relief Program (TARP) provisions of the *Emergency Economic Stabilization Act of 2008* by, among other things, calling on the U.S. Treasury to take significant steps on mortgage foreclosure mitigation, assist the domestic automobile industry, establish facilities to aid various types of consumer lending and develop programs to stimulate the housing market. Many of the provisions within the legislation will have a direct impact on the residential mortgage- and asset-backed securitization markets. Some of the provisions may affect existing securities, while others promote new issuance or may serve to restart secondary market trading activities. The main provisions of the bill are outlined below:

Foreclosure Mitigation Plan: The bill specifies that use of the second $350 billion of TARP funds is conditional on the use of up to $100 billion, but no less than $40 billion, for foreclosure mitigation beginning no later than April 1, 2009, in accordance with a plan developed by the U.S. Treasury. The plan would apply only to owner-occupied residences and must use some combination of the following foreclosure alternatives: (1) a guarantee program for qualifying loan modifications under a systematic plan that may be delegated to the Federal Deposit Insurance Corporation (FDIC) or another contractor; (2) reducing the cost of HOPE for Homeowners (H4H) loans, either through covering the fees, purchasing H4H mortgages to ensure affordable rates or both; (3) a program for loans to pay down a second-lien mortgage that is impeding a loan modification, subject to any writedown by an existing lender; (4) allowing payments to servicers in connection with the implementation of qualifying loan modifications; and (5) the purchase of whole loans for the purpose of modifying or refinancing the loans (with authorization to delegate to the FDIC). Furthermore, the legislation also provides a safe harbor from liability to servicers who engage in loan modifications as long as the servicer acts in a manner consistent with the duty established in the *Housing and Economic Recovery Act of 2008* (HERA).[1] DBRS believes that establishing a systematic plan that is delegated to a government entity such as the FDIC or another contractor may help reduce the re-default rate on modifications, which is currently at a 58% after eight months.

Consumer Loans: The U.S. Treasury is authorized to establish facilities to support the availability of consumer loans, such as student loans and auto and other vehicle loans, and may do so through the purchase of asset-backed securities, directly or through the Federal Reserve (the Fed). This provision reasserts what the Fed's Term Asset-Backed Securities Loan Facility (TALF) was designed to accomplish. A viable secondary market facility for consumer asset-backed securities should help restart the origination and securitization of these types of receivables.

Automobile Industry: The U.S. Treasury is authorized to provide assistance to automobile manufacturers and their finance affiliates under the TARP in accordance with the conditions first described (but not passed) in the *Auto Industry Financing and Restructuring Act* (H.R. 7321). This support is essential to stabilizing the domestic auto industry and, in combination with TALF, is expected to lead to more auto loan and lease asset-backed securitizations once the capital markets have regained comfort with the financial health and direction of the industry.

HOPE for Homeowners Improvements: In amending the terms for eligible mortgages under the *National Housing Act,* among other administrative simplifications, the bill (1) raises maximum loan-to-value from 90% to 93% for borrowers with a mortgage debt-to-income ratio greater than 31%; (2) reduces the 1.5% annual premium to between 0.55% and 0.75%, based on risk-based pricing; (3) eliminates the 3% upfront premium; and (4) authorizes payments to servicers participating in successful re-financings. This amendment will allow more people to qualify for the program and reduce the costs involved.

Homebuyer Stimulus: The U.S. Treasury is required to develop a program, outside of the TARP, to stimulate demand for home purchases and clear the inventory of properties that will include ensuring the availability of affordable mortgage rates for qualified homebuyers. The program will be executed through the purchase of mortgages and mortgage-backed securities using funding under the HERA.

In all, H.R. 384 serves to both clarify and codify many of the concepts that have been proposed by Congress and the White House over the past several weeks. At the core, the proposals described above are the stabilization of both the housing markets and the auto industry and the stimulation of a viable securitization market for securities backed by consumer loans and receivables and mortgages. Because such a secondary market is crucial to the ability of lenders to further extend capital in the current recessionary economy, the bill represents much-needed assistance to the capital markets at the present time.

For questions or comments, please contact David Hartung at dhartung@dbrs.com.

1. *The Housing and Economic Recovery Act of 2008* requires servicers to (1) maximize the net present value (NPV) of pooled mortgages to all investors as a whole and (2) engage in loan modifications for mortgages that are in default or for which default is reasonably foreseeable. The eligibility requirements include (1) the property must be owner-occupied and (2) the anticipated recovery on the modification would exceed, on an NPV basis, the anticipated recovery through foreclosure.