ALPHABET SOUP - MMIFF & CPFF

by Steve Brown

Over the past few weeks, we have been flooded with calls from community bankers interested in getting more details and information on the finer points of the Treasury Capital Purchase Program ("TCPP"); Troubled Assets Relief Program ("TARP"); FDIC Temporary Liquidity Guarantee Program ("TLGP"); Emergency Economic Stabilization Act of 2008 ("EESA"); and the Money Market Investor Funding Facility ("MMIFF"). While some of this "alphabet soup" the government has cooked up has yet to be finalized, it is all very important, so we have decided to work through one program at a time in order to help community bankers get down to the underlying broth. Our goal over this week is to leave community bankers with a clear idea of the pro's and con's of each program along with suggestions and deeper analysis.

We begin with an outlier - the MMIFF. We do this because it (and its cousin the Commercial Paper Funding Facility ("CPFF")), kicks off today and it is relatively easily covered. The MMIFF is a Federal Reserve program designed to provide liquidity to money market mutual fund investors and short-term corporate borrowers. In a roundabout way, this program helps support bank lending, particularly as it relates to corporations utilizing the commercial paper ("CP") markets.

Through the MMIFF, the FRB provides funding on a secured basis for large bank CDs, bank notes and CP. This is done through a series of special purpose vehicles ("SPVs") that purchase such instruments by borrowing through the MMIFF. To insulate risk, only highly-rated financial instruments (A-1/P-1/F1) with maturities of 90 days or less qualify for the program. The FRB funds 90% of the purchase price of each eligible asset. This gives the FRB protection not only because it is secured, but also because the SPV absorbs the first 10% of any losses incurred.

In all, the MMIFF may purchase up to $600B in eligible assets; however, since the FRB is providing 90% of the financing, the total exposure is actually $540B. Finally, the MMIFF program ends on April 30, 2009 (unless it is extended by the FRB).

The goal of the MMIFF is to allow money market mutual funds in particular to move assets off the books and receive liquidity in return. Community bankers tracking TARP may find the MMIFF's pricing structure interesting. By design, entities selling CP (or other assets) into the MMIFF do so at amortized cost and at an interest rate at least 25 basis points below the interest rate on the assets they sell. Then, when each SPV is eventually wound down, investors receive a distribution of funds that increases the yield on the investor's portion up to 25bp above the yield on the assets it sold into the SPV. In this fashion, sellers move assets off their books at a slight discount, receive financing from the FRB for the life of these investments (up to 90 days) and may even fully recover when the instruments mature. Meanwhile, the FRB provides the liquidity, is secured and earns a return on its money at the Discount Rate.

As stated by the FRB, the MMIFF is designed to facilitate the sale of assets by money market mutual funds in the secondary market and free up balance sheets to purchase longer dated CP.

Finally, one cannot talk about the MMIFF without introducing another FRB program called the CPFF. The CPFF specifically targets investors in CP and is not focused on what is on the books already (like the MMIFF). Rather, the CPFF gives issuers the liquidity to roll over maturing CP. This program allows issuers to sell up to $1B with government backing.

While both of these programs do not directly impact community banks, they do bring stability into the $1.5T market for short-term debt. That debt is most often used by businesses to cover daily or short-term expenses. Both of these programs provide a government backstop, allowing a framework for borrowers and lenders to gain flexibility and be confident in funding longer-term maturities.

Those who may still be teed off that the government is bailing out CP issuers and money market mutual funds are urged not to lose sight of the bigger picture. Recall that investors in CP are not only mutual funds, but also corporations, banks, pension funds, state governments, local governments and insurance companies. Without stability in short-term CP markets, the spillover to all of these investor and issuer groups could have been disastrous and that would definitely have impacted community banks.

Tomorrow we serve up another heaping portion of alphabet soup, as we review the TLGP in detail.

BANK NEWS

Failure #16

Alpha Bank & Trust ($354mm, GA) was closed by regulators Friday. Stearns Bank ($383mm, MN) will assume Alpha's insured deposits and purchase $38.9mm in assets.

Capital Purchase Program

The Treasury approved close to 20 additional banks for capital injections, although it has decided not to publicly disclose the names to limit any risk to reputation. That said, SunTrust, Capital One, Key, Washington Federal, City National, Comerica and First Horizon announced they have received preliminary approval for capital.

Expensive Housing

According to RealtyTrac, the top 3 states for million dollar + home foreclosures were CA, FL and NV. From Jan. to Aug. the percentage of homes valued at more than $1mm that fell into foreclosure surged 89%, while those homes priced at $2mm or more jumped 148%.

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