From: ExecSecProcessUnit
Sent: Tuesday, April 24, 2012 10:29 AM
To: TFG75
Cc: ExecSecProcessUnit; ExecSecStaff
Subject: California and Nevada Trip Notes
Attachments: _R LA and Vegas Trip Notes 2012-04-24.docx

Sir,

Please find pasted below and attached a note from U/S Miller regarding her recent travels to California and Nevada. Sam Valverde is available for any comments for questions that may arise.

NOTE FOR SECRETARY GEITHNER
DEPUTY SECRETARY WOLIN

FROM: Mary Miller, Under Secretary for Domestic Finance

SUBJECT: California and Nevada Trip Notes

I traveled to Los Angeles last week to meet with a variety of investment managers in advance of a speech in Nevada to the National Federation of Municipal Analysts and a meeting with the Nevada Hardest Hit Fund. I was accompanied by Bret Hester.

In Los Angeles, we met with equity and fixed-income portfolio managers and analysts from Capital Group, TCW, and Western Asset Management Company (WAMCO). All of the investors we met with asked a number of questions about both the progress and substance of regulatory reform implementation. They were interested in the implications for the financial sector in particular, both from the perspective of their investment decisions and from the perspective of how liquidity and capital commitments provided by their bank counterparties might be affected. They were also all very interested in the status of housing finance reform, and the capping of support under the Preferred Stock Purchase Agreements (PSPAs) at the end of this year. Finally, all were interested in our debt management strategy, including the possible issuance of floating rate notes, and plans for dealing with the fiscal cliff at the end of 2012.

Regulatory Reform Implementation:

The Capital Group team asked a number of questions about the bank stress tests. While noting that the Comprehensive Capital Adequacy Review (CCAR) is far more credible than the European Banking Authority stress tests, they questioned whether the CCAR is still overly countercyclical. They suggested that it would be useful to run a variety of more speculative scenarios and assess how the potential fallout from those scenarios might affect capital levels.

All of the investors that we met with expressed considerable concern about money market fund reform. TCW noted that it is closing its relatively small money market fund (approximately $100 million), due to both the marginal economics of running the fund in the current interest rate environment as well as uncertainty about upcoming regulatory changes. They noted that, unlike other mutual fund products where it is important to

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establish an investment track record for purposes of marketing, it would be relatively easy to restart a money market fund in the future because money market funds are sold on the basis of the reputation of the manager and their current yield rather than their track record.

WAMCO discussed the various money market fund proposals the SEC is reportedly considering and thought that the capital buffer offers the most promise for a workable solution. Their view is that the holdback proposal would have very negative implications for the industry. With respect to floating NAV proposals, they indicated that they would likely be able to maintain a significant investor base under such a scenario, but that other fund complexes would likely lose significant assets. They also noted that they thought one likely outcome of the reform proposals overall would be for a much more concentrated industry, centered around bank sponsors. WAMCO also noted that the SEC had signaled to WAMCO that the SEC was being pressured to push forward with reform by other regulators, the Federal Reserve in particular.

WAMCO also asked about the implications of financial regulatory reform with respect to financial institutions' willingness to commit capital and provide needed market liquidity. They noted that liquidity has decreased significantly from pre-crisis levels (although has recently showed signs of rebounding) and that dealers' inventory positions have shrunk meaningfully. They acknowledged that much of the reduced liquidity is attributable to the economic environment and firms' "damaged risk profiles" but asserted that reduced liquidity is also attributable to uncertainty about regulatory requirements. As one example, they pointed to the fact that all stand-alone proprietary trading desks have been shuttered and that alternative liquidity providers have not yet emerged. WAMCO also acknowledged, however, that the market is perhaps returning to a more normalized liquidity environment, and that the "instant liquidity" environment that prevailed in the decade leading up to the crisis did not necessarily reflect an optimal scenario. Finally, they noted that trading is increasingly dominated by a smaller fraction of the market; in other words, the most liquid issues and biggest names (e.g., Ford) are trading more frequently whereas less liquid issues are trading less.

We also briefly touched on Moody's anticipated downgrades of the banking sector. Capital Group indicated that they were not particularly concerned, but were avoiding the weakest names in the sector, which they identified as Morgan Stanley, followed by Goldman Sachs. They noted that bank funding models continue to strengthen, with more terming out of repo and less reliance on non-traditional repo. They also believe that strong deposit bases are helping to reduce banks' reliance on short-term funding. Investment banking operations are the exception to this general trend.

Housing Finance Reform:

All of the investors we met with were very interested in the status of housing finance reform. They were generally pessimistic about the prospects of any legislative developments this year but indicated that further guidance from the Administration about its views on the future of housing finance and Fannie Mae and Freddie Mac would be helpful to the market. There was considerable interest in any plans to address the PSPAs before they are capped at the end of this year. Capital Group indicated that it had done a fair amount of work analyzing the sufficiency of the PSPAs and thought that they provide "adequate protection" for investors. WAMCO and TCW asked if there were any plans for Fannie and Freddie to dispose of assets and recognize additional losses before the PSPAs are capped. WAMCO also noted that it did not believe the market was sufficiently focused on the fact that the PSPAs will be capped at the end of 2012.

In addition to asking about the next steps on housing finance reform, TCW said that it is important to show action towards the goals set out in the White Paper. Their view is that either nothing is happening or the actions that are being taken are going in the opposite direction of the objectives set forth in the White Paper, such as the extension of higher conforming loan limits. While they acknowledged that is important for the housing market to heal before meaningful housing finance reform can proceed, they urged the government (collectively referencing Congress and the Administration) not to send "misleading signals."

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The Capital Group team noted that it is challenging to attract new investors to housing-focused funds while so much uncertainty remains over what the market will look like in the future. As one example, they referenced the difficulty they had recently experienced in writing a prospectus for a new mortgage-focused fund because of the lack of clarity about how investment opportunities might evolve.

Debt Management / Fiscal Situation:

All of the investors we met with were concerned about a repeat of the debt-limit impasse from August 2011, focusing on the fiscal cliff at the end of 2012 when we will approach the debt limit, tax cuts will expire, and the automatic sequester will begin to take effect. The Capital Group inquired whether planning was already underway to allocate the cuts that will be required by the automatic sequester. Despite expressing concerns about the debt limit and the fiscal situation, the teams we met with indicated that these concerns were not currently reflected in their portfolios. The general consensus was that U.S. Treasuries remain the most attractive and safest option compared to other sovereign debt. The investment teams we met with were still concerned about tail risks in Europe and indicated they had been reducing their European exposure into recent strength in those markets.

The fixed-income investors were interested in Treasury's possible issuance of floating rate notes. They did, however, emphasize the importance of maintaining sufficient Treasury bill issuance to support market demand. TCW raised the idea of using a one- or two-year Constant Maturity Treasury (CMT) as the reference rate for a floating rate note, with the note trading at a negative spread to the CMT rate. With respect to making floating rate notes eligible for money market funds, TCW proposed either allowing the note to be puttable at a discount after, e.g., two years, or puttable at par after having been issued at a premium.

Nevada Hardest Hit Fund (HHF):

In Las Vegas, we met with representatives from the Nevada HHF. They are working to help their range of assistance programs reach as many homeowners as possible. They have just started a new program with the Nevada employment assistance agency to identify unemployed individuals who may be able to benefit from HHF programs.

They indicated that the housing market is so bleak that homeowners have been reluctant to seek assistance from the HHF that may only provide limited relief. For example, the prospect of $50,000 of principal reduction may not be enough to encourage homeowners who are hundreds of thousands of dollars underwater to participate. Additionally, they indicated that at least 90 percent of Nevada homeowners have mortgages backed by Fannie Mae or Freddie Mac and have therefore not been able to participate in the Nevada HHF's principal reduction program. The Nevada HHF is working on rolling out a new program as early as May that will work in conjunction with HARP to reach this broader universe of homeowners.

The Nevada HHF identified their second lien relief program as their most successful program to date. Their second lien program requires elimination, rather than just reduction, of any second lien. They indicated that their funds are able to leverage significant additional write-downs, with $16,500 of HHF assistance having facilitated the elimination of a second lien as big $130,000.

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Note Clearance Sheet

Subject: California and Nevada Trip Notes

Drafted: Domestic Finance – Bret Hester, phone 622-1677

Approved: Domestic Finance – Under Secretary Mary Miller (4/23/12)

Cleared: Exec Sec – Sam Valverde (4/24/12)

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

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DEPUTY SECRETARY WOLIN

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All of the investors that we met with expressed considerable concern about money market fund reform. TCW noted that it is closing its relatively small money market fund (approximately $100 million), due to both the marginal economics of running the fund in the current interest rate environment as well as uncertainty about upcoming regulatory changes. They noted that, unlike other mutual fund products where it is important to establish an investment track record for purposes of marketing, it would be relatively easy to restart a money market fund in the future because money market funds are sold on the basis of the reputation of the manager and their current yield rather than their track record.

WAMCO discussed the various money market fund proposals the SEC is reportedly considering and thought that the capital buffer offers the most promise for a workable solution. Their view is

that the holdback proposal would have very negative implications for the industry. With respect to floating NAV proposals, they indicated that they would likely be able to maintain a significant investor base under such a scenario, but that other fund complexes would likely lose significant assets. They also noted that they thought one likely outcome of the reform proposals overall would be for a much more concentrated industry, centered around bank sponsors. WAMCO also noted that the SEC had signaled to WAMCO that the SEC was being pressured to push forward with reform by other regulators, the Federal Reserve in particular.

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Housing Finance Reform:

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In addition to asking about the next steps on housing finance reform, TCW said that it is important to show action towards the goals set out in the White Paper. Their view is that either

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nothing is happening or the actions that are being taken are going in the opposite direction of the objectives set forth in the White Paper, such as the extension of higher conforming loan limits. While they acknowledged that is important for the housing market to heal before meaningful housing finance reform can proceed, they urged the government (collectively referencing Congress and the Administration) not to send "misleading signals."

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Approved:	Domestic Finance – Under Secretary Mary Miller (4/23/12)
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