



The Public-Private Investment Program (PPIP): OUTLOOK AND OPPORTUNITY

Following a comprehensive two-month application, evaluation and selection process, the nine firms pre-qualified to participate as fund managers in the initial round of the Public-Private Investment Program (PPIP) were named in the July 8, 2009 joint statement by U.S. Treasury Secretary Timothy Geithner, Federal Reserve Chairman Ben Bernanke and Sheila Bair, Chairman of the FDIC.

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Although PPIP has been widely discussed in the media for some time, few people truly understand how it was created, how it will work and why money managers view it as a compelling investment opportunity.

The Public-Private Investment Program (PPIP): Outlook and Opportunity was created to explain PPIP and provide information on its implications for the economy, the U.S. government, taxpayers, money managers and investors. It offers details on the events that led up the creation of PPIP, how PPIP will work, why it is viewed as a compelling investment opportunity by some managers and the challenges of the Program.

All investments involve risk including loss of principal.

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

EXECUTIVE SUMMARY

THE PUBLIC-PRIVATE INVESTMENT PARTNERSHIP (PPIP)

The Public-Private Investment Program, announced by the U.S. Treasury on March 23, 2009, was designed to help restore health and confidence to the U.S. financial system and economy by combining public and private financing, government loan guarantees and private sector investment expertise in order to purchase legacy loans and securities from banks and other financial institutions and to restore secondary market liquidity for these assets. PPIP calls for a joint effort between the private sector and the U.S. government to buy and manage legacy assets. PPIP has two parts, addressing both the legacy loans and legacy securities clogging the balance sheets of financial firms.

THE CHALLENGE

A key challenge from the outset was whether the institutions holding legacy loans and securities would be willing to sell them at the sufficiently discounted prices that would be necessary to attract buyers — especially legacy loans. Additionally, small banks felt that the design of PPIP would make it difficult for them to participate and both potential sellers and buyers expressed concern about the risk of doing business with the government.

This resulted in the downsizing of the Program, which was originally projected to be as large as \$1 trillion, but will now target removing just \$40 billion in legacy assets from the

Anatomy of the CRISIS

	HOUSING BUBBLE (2002 – 2004)	HOUSING DOWNTURN (2005 – 2006)
GOVERNMENT	<ul style="list-style-type: none"> • Low interest rates and easy money • Government policy promoting more home ownership • Ratings agencies assign AAA quality to residential mortgage-backed securities and collateralized debt obligations 	<ul style="list-style-type: none"> • The Fed raises short-term interest rates, tightening monetary policy
CORPORATE	<ul style="list-style-type: none"> • Proliferation of nontraditional mortgages • Lax lending standards • Wall Street securitization, repackaging and marketing of derivative mortgage-backed products • Excessive use of debt • Homebuilding boom 	<ul style="list-style-type: none"> • Delinquencies begin to increase • Lending standards begin to tighten • Homebuilder optimism peaks in mid-2005 • Construction spending peaks in early 2006
MARKETS	<ul style="list-style-type: none"> • Rising pre-payment risk lured investors into higher-yielding nontraditional mortgages 	<ul style="list-style-type: none"> • Market interest rates begin to rise • Home sales and home prices peak • The S&P 500 Homebuilders Index peaks in mid-2005
CONSUMER	<ul style="list-style-type: none"> • Home purchases rise • Home prices rise • Mortgage equity withdrawal surges • Some homebuyers overreach • Speculation in residential real estate surges 	<ul style="list-style-type: none"> • Many adjustable-rate mortgages (ARMs) reset, resulting in higher mortgage payments

balance sheets of banks and other financial institutions, at least in this initial phase. The Treasury Department will match the expected \$10 billion in equity capital from the private sector and make loans of up to another \$20 billion to the Program (see illustration on page 8 for more information).

THE OPPORTUNITY

Despite the Program's challenges, many money managers view PPIP as a compelling investment opportunity because it offers a chance to purchase bank loans and mortgage securities at attractive prices and with very generous

provisions. These provisions include the guarantee of financing through the FDIC for the bulk of the funding as well as a "floor" that limits potential losses to no more than 10 or 20 percent of what private sector investors put up. Many managers also believe that once packaged into various vehicles such as closed-end funds, private-equity funds, hedge funds, and Real Estate Investment Trusts (REITs), PPIP assets have the potential to deliver attractive returns to their institutional and retail clients.

CRISIS BEGINS (JULY 2007 – AUGUST 2008)

- Fed begins to lower interest rates
- Fed and other central banks increase liquidity as inter-bank lending slows on growing mistrust
- Warnings about home price declines and housing recession spilling over into the general economy
- Fed brokers sale of Bear Stearns to JPMorgan Chase
- Tax rebate issued to spur consumption

- Some mortgage lenders and hedge funds fail
- Some significant losses reported by major financial companies due to sub-prime exposure, which is by now discovered to be widespread
- Need to deleverage (reduce debt) causes "fire sales"
- The U.S. economy begins to contract, as evidenced by lower Gross Domestic Product (GDP)¹ growth

- Mini credit market freeze in 2007
- Liquidity spreads widen
- Trading of many mortgage-related securities begins to dry up
- Financial stocks peak in the summer of 2007, with the S&P 500 reaching a new high on October 9, 2007

- Personal consumption slows
- Household net worth begins to decline
- Mortgage equity withdrawals begin to decline
- Unemployment begins to rise

CRISIS ACCELERATES (SEPTEMBER 2008 – EARLY 2009)

- Government seizes Fannie Mae and Freddie Mac
- Government "rescues" AIG
- Reserve Primary Fund "breaks the buck" by falling below \$1 per share, the first time this ever occurred in a money market fund open to the general public. In response, U.S. Treasury establishes program to insure certain money market assets (subject to very specific limitations and guidelines)
- The Fed lowers its target rate effectively to zero and creates numerous new lending facilities to address frozen credit markets
- U.S. government passes the Emergency Economic Stabilization Act, which establishes the Troubled Asset Relief Program (TARP)

- Fear of a serious economic downturn increases
- Businesses cut back sharply on spending and layoffs surge; abrupt halt to economic activity
- The solvency of many banking institutions is questioned
- Bank of America purchases Merrill Lynch
- Lehman Brothers goes bankrupt

- The world's oldest money market fund (Reserve Primary Money Fund) "breaks the buck"
- Inter-bank mistrust surges and credit markets freeze-up
- Market volatility surges to record levels
- Credit spreads blow out to record wide levels
- Global equity markets plummet

- Consumers dramatically reduce spending and borrowing; savings rate begins to increase

SIGNS OF HOPE (SPRING 2009)

- Fed liquidity additions, Treasury Department actions and the actions of other central banks and financial authorities begin to restore confidence to credit markets as banks begin to become more willing to lend to each other and to businesses and consumers

- Inventory levels are aggressively reduced, indicating there may be higher production levels in the future
- Some corporations have profit increases

- Credit spreads begin to tighten
- Stocks rally from bottom
- Volatility begins to abate

- Consumption grows in 1Q09, perhaps setting the stage for inventory rebuilding
- Consumer confidence begins to rise

¹ GDP is the market value of all final goods and services produced within a country in a given period of time.

The POLICY RESPONSE

In response to the present financial and economic crisis, the U.S. government has taken unprecedented actions to help restore health and confidence in the U.S. financial system. In addition to lowering the federal funds target rate to almost zero, the Federal Reserve has created numerous new lending facilities to keep credit flowing through the economy, and for the first time ever has engaged in “quantitative easing” — or the creation of new money to purchase mortgage-backed securities as well as certain U.S. Treasury securities.

As a result of a series of government actions, the U.S. Treasury Department, the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) have all taken on expanded authority to stimulate the flow of credit through the economy and help restore confidence in the U.S. financial system. This is in stark contrast to official action taken in the early stages of the Great Depression, when the Federal Reserve followed policies that allowed the money supply to contract sharply.

Key government initiatives include:

- **Reduction of the Federal Funds Rate.** Beginning in August 2007, the Federal Reserve began lowering the federal funds rate from 5.25%. By December 2008 it was targeting a rate between 0% and 0.25%. The Federal Reserve also created numerous new lending facilities such as the Term Auction Facility, Commercial Paper Funding Facility and Money Market Investors Funding Facility (see Glossary of Terms on page 10 for more information); and has engaged for the first time in what is known as quantitative easing. In effect, the Fed created new money to purchase mortgage-backed securities and U.S. Treasury securities in the open market.
- **The Emergency Economic Stabilization Act (EESA).** This Act, signed into law on October 3, 2008, established the Troubled Asset Relief Program (TARP), which provided the U.S. Treasury Department with \$700 billion to buy troubled assets and inject capital into troubled banks. As a result, the U.S. government has taken direct equity stakes in financial institutions. TARP was later revised to also provide funding for other stabilization measures included in the Financial Stability Plan.
- **The Financial Stability Plan.** This plan, enacted on February 10, 2009, puts in place a series of financial initiatives to help lay the financial foundation for economic recovery, including PPIP.
- **The American Recovery and Reinvestment Act.** This Act, signed into law on February 17, 2009, makes supplemental appropriations for job preservation and creation, infrastructure investment, energy efficiency and science, assistance to the unemployed, and state and local fiscal stabilization, for the fiscal year ending September 2009.

The PUBLIC-PRIVATE INVESTMENT PROGRAM (PPIP)

The Public-Private Investment Program (PPIP) was originally designed to purchase so-called “toxic” loans and securities, now referred to as legacy assets, from banks and other financial institutions. These legacy assets are both real estate loans held directly on the books of banks (“legacy loans”) and securities such as residential mortgage-backed securities (RMBS), asset-backed securities (ABS), commercial mortgage-backed securities (CMBS) and collateralized debt obligations (CDOs) — (“legacy securities”). The intention of PPIP is to help stimulate an economic recovery by helping these institutions improve their capacity to make new loans by taking these assets off their balance sheets.

In its original incarnation, PPIP called for joint effort between the private sector and the U.S. government to buy and manage legacy assets and includes two parts: the **Legacy Securities Program** and the **Legacy Loan Program**. Those money managers (the private sector) selected to participate will have the ability to raise capital via public-private investment funds (“PPIFs”) — vehicles established to purchase pools of legacy loans and/or legacy securities. Private investors (via the purchase of products invested in PPIFs to be offered by a participating money manager) and the U.S. government (taxpayers) will have an opportunity to share in any long-term profits and losses generated in each program.

Legacy Securities Program: a program to combine financing from the Federal Reserve and Treasury through the Term Asset-Backed Securities Loan Facility (“TALF”) with equity capital from the private sector and the Treasury to address the problem of troubled securities — such as non-agency Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and Asset-Backed Securities (ABS).

Legacy Loan Program: a program to combine an FDIC guarantee of debt financing with equity capital from the private sector and the Treasury to support the purchase of troubled loans from insured depository institutions.

As announced on July 8, 2009, the progress of implementing both the legacy securities and legacy loan aspects of PPIP was as follows:²

LEGACY SECURITIES PROGRAM

Designed to support market functioning and price discovery in the asset-backed securities markets, allowing banks and other financial institutions to re-deploy capital and extend new credit to households and businesses. The program consists of two related parts:

LEGACY SECURITIES PUBLIC-PRIVATE INVESTMENT PROGRAM (LEGACY SECURITIES PPIP).

Under this program, Treasury will invest up to \$30 billion of equity and debt in PPIFs established with private sector fund managers and private investors for the purpose of purchasing legacy securities. Initially, the Legacy Securities PPIP will participate in the market for commercial mortgage-backed securities and non-agency residential mortgage-backed securities. To qualify for purchase, securities must be deemed as "Eligible Assets."

"Eligible Assets" are defined as follows:

- Issued prior to 2009;
- Originally rated AAA or an equivalent rating by two or more nationally-recognized statistical rating organizations without ratings enhancement; and
- Secured directly by the actual mortgage loans, lease or other assets and not other securities.

LEGACY SECURITIES AND THE TERM ASSET-BACKED SECURITIES LOAN FACILITY (TALF).

Starting in July 2009, certain high-quality commercial mortgage-backed securities issued before January 1, 2009 ("legacy CMBS") would become eligible collateral under the TALF. The Federal Reserve and the Treasury also continue to assess whether to expand TALF to include legacy residential mortgage-backed securities as an eligible asset class.

Important details:

- The Legacy Securities PPIP will work together with the TALF program for legacy assets, but they remain separate. The Legacy TALF will be a Federal Reserve lending program with its own set of terms, conditions and eligibility requirements.

- Legacy TALF will be made available to investors (who meet Federal Reserve eligibility standards) regardless of whether or not they participate in the Legacy Securities PPIP. A qualified investor utilizing Legacy TALF will do so on the same terms and conditions as a Legacy Securities PPIP investor utilizing Legacy TALF, making the funding of legacy assets available to a broad range of market participants.

LEGACY LOAN PROGRAM

The Legacy Loan Program is intended to boost private demand for distressed assets and facilitate market-priced sales of troubled assets. The FDIC would provide oversight for the formation, funding, and operation of a number of vehicles that will purchase these assets from banks or directly from the FDIC. Private investors would invest equity capital and the FDIC will provide a guarantee for debt financing issued by these vehicles to fund asset purchases. The FDIC's guarantee would be collateralized by the purchased assets. The FDIC would receive a fee in return for its guarantee.

Important details:

- The FDIC has announced that it will test the funding mechanism contemplated by the LLP in a sale of receivership assets this summer.
- This funding mechanism draws upon concepts successfully employed by the Resolution Trust Corporation in the 1990s, which routinely assisted in the financing of asset sales through responsible use of leverage. The FDIC expects to solicit bids for this sale of receivership assets in July.

² Source: U.S. Treasury press release, July 8, 2009, "Joint statement by Secretary of the Treasury, Timothy F. Geithner, Chairman of the Board of Governors of the Federal Reserve System, Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System and Sheila Bair, Chairman of the Federal Deposit Insurance Corporation," www.FinancialStability.gov.

What are the goals of PPIP?

By tapping into private sector expertise, PPIP hopes to bring about price discovery — a price for these assets that buyers and sellers can agree upon in the secondary market. If price discovery occurs, then liquidity and therefore functionality could be restored to the secondary market. If successful, PPIP could help U.S. banks and other financial institutions remove legacy assets from their balance sheets, which would enable them to get back to the business of extending credit to the sidelined economy.

Without a remedy, some banks could find their capital greatly reduced as losses are realized, or if they continue to hold assets of uncertain value on their balance sheet. Adequate capital is required to make loans, so with less means, banks could find themselves unable to make new loans, which could threaten their very viability and hamper economic recovery as well. In addition, PPIP also seeks to protect the U.S. government's substantial financial exposure with rigorous oversight by the FDIC.

Who is participating?

After receiving over 100 applications to participate in the **Legacy Securities PPIP**, the U.S. Treasury pre-qualified nine firms to participate as fund managers in the initial round of the program. They are (in alphabetical order):

- AllianceBernstein, LP and its sub-advisors Greenfield Partners, LLC and Rialto Capital Management, LLC
- Angelo, Gordon & Co., L.P. and GE Capital Real Estate
- BlackRock, Inc.
- Invesco Ltd.
- Marathon Asset Management, L.P.
- Oaktree Capital Management, L.P.
- RLJ Western Asset Management, LP.
- The TCW Group, Inc.
- Wellington Management Company, LLP³

Fund managers were pre-qualified based on the following criteria, but failure to meet any one criterion did not necessarily disqualify an application:

- Demonstrated capacity to raise at least \$500 million of private capital;

- Demonstrated experience investing in Eligible Assets, including performance track records;
- A minimum of \$10 billion (market value) of Eligible Assets under management;
- Demonstrated operational capacity to manage the Funds in a manner consistent with Treasury's stated Investment Objective — to generate attractive returns for taxpayers and private investors through long-term opportunistic investment in accordance with the stated Investment Strategy. As defined by the U.S. Treasury, the Investment Strategy is as follows: The Funds (PPIFs) will seek to achieve the Investment Objective by following predominantly a buy-and-hold strategy, but Treasury will consider other strategies involving limited trading; and
- Headquarters in the United States.³

The pre-qualified managers for the Legacy Securities program will have up to 12 weeks to raise at least \$500 million of private capital for the public-private investment funds ("PPIFs"), which are the vehicles that will purchase legacy securities. The equity capital raised from private sector investors will be matched by the Treasury (up to certain limits). Each pre-qualified manager will also invest a minimum of \$20 million of firm capital in the PPIF. Upon raising this private sector capital, pre-qualified Legacy Securities PPIF fund managers can begin purchasing Eligible Assets.⁴

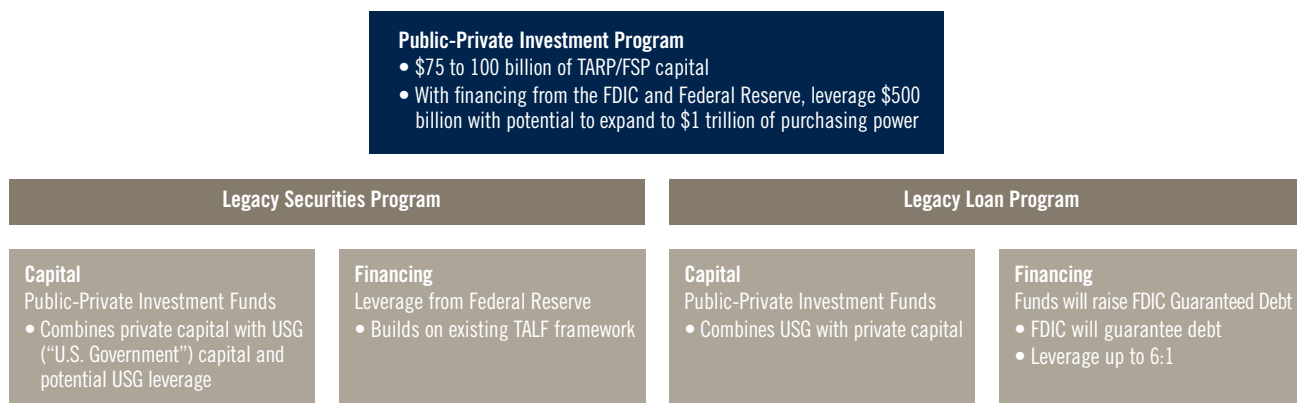
³ Joint Statement by Secretary of the Treasury Timothy F. Geithner, Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke, and Chairman of the Federal Deposit Insurance Corporation Sheila Bair on the Legacy Asset Program, U.S. Department of the Treasury, July 8, 2009.

⁴ Source: "Legacy Securities Public-Private Investment Program (Legacy Securities PPIP) Additional Frequently Asked Questions", July 8, 2009, www.FinancialStability.gov.

How will it work?

In its original design, although technically a public-private partnership, taxpayers will provide most of the funding for both programs within PPIF. As originally planned, approximately \$75 to \$100 billion of the funding was projected to come from the Treasury's TARP program, with additional funding coming from an expansion of the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) program, which was launched on March 3, 2009 to boost consumer spending via the issuance of asset-backed securities. Additional financing, specifically for the legacy loan arm of the Program, would also come from the FDIC.

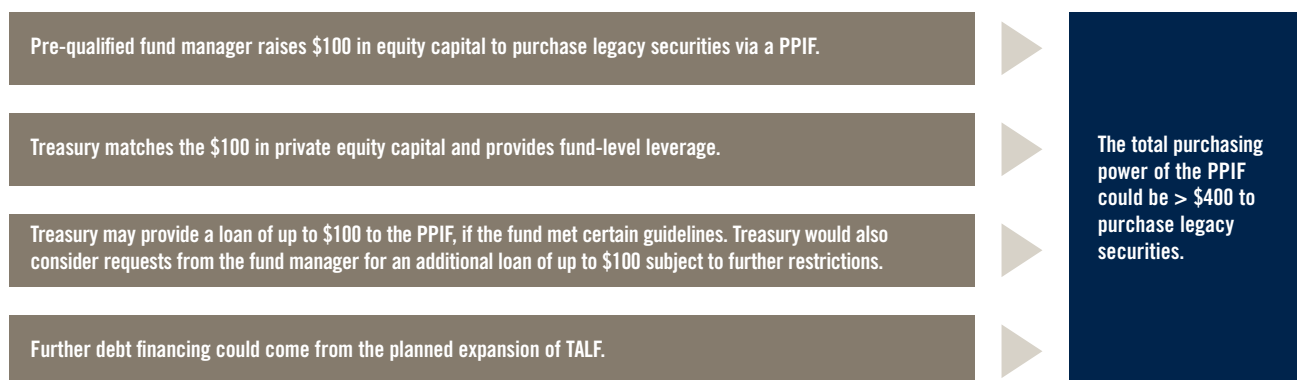
PUBLIC-PRIVATE INVESTMENT PROGRAM (AS INITIALLY PLANNED⁵)



This white paper from this point forward will focus on the **Legacy Securities Program** part of PPIF.

As previously stated, the nine managers pre-qualified will participate in the **Legacy Securities Program**. For the **Legacy Securities Program**, capital will also come from the private sector and the U.S. Treasury (the U.S. government). Additional financing will come from the U.S. Treasury in the form of loans equal to the amount of private equity capital (under certain circumstances it could be up to two times the amount of private equity capital). Further debt financing would also come from the Federal Reserve's expanded Term Asset Lending Facility (TALF).

A SAMPLE SCENARIO: LEGACY SECURITIES PROGRAM⁶



⁵ Source: U.S. Treasury press release, March 23, 2009, Treasury Department Releases Details on Public-Private Investment Program, www.FinancialStability.gov.

⁶ Source: "Public-Private Investment Program — \$500 Billion to \$1 Trillion Plan to Purchase Legacy Assets," www.FinancialStability.gov.

What are some challenges?

The primary challenge for PPIP is whether the institutions holding legacy loans and securities would be willing to sell them at prices low enough to attract buyers. The buyers will need to offer enough to get banks to sell, but not overpay to the point of jeopardizing their ability to earn an acceptable rate of return on their investment. On the other hand, sellers may be hesitant to offer them to prospective buyers via PPIP at such a discounted price, because doing so would require them to realize a substantial loss on their balance sheet. While there is no clear consensus on what these assets are worth, current estimates range from 30% to 60% of the securities' par value, or the value of the security when it was first issued. Banks that have been valuing assets at lower price levels would probably benefit the most from PPIP, since it will presumably be easier to agree on a selling price attractive to buyers.

Nonetheless, in the months following Treasury's announcement of PPIP, many banks expressed reluctance to participate, in large part because of the low anticipated bids from prospective buyers and potential pressure from the government to sell at fire sale levels. Many large banks were able to successfully raise needed funds as financial market conditions improved during the spring, which reduced the sense of urgency for the Program. Additionally, many smaller banks proved hesitant to participate in the Program as originally designed because they were afraid they could not meet the requirement for the minimum amount of eligible securities. Both large and small firms and potential investors were also wary that the terms of the deal could change after the fact or participation could lead to an unacceptable level of government intervention in their business operations.

The prospects for the legacy securities program were always brighter, although its initial phase is smaller than originally conceived. As expected, banks and financial institutions appear more willing to sell the legacy securities (i.e., ABS, CDOs, RMBS) they own rather than the legacy loans they directly hold. The reason for this is because the securities are likely carried on the balance sheet at a price that is "marked to market," or at the current price the market is willing to pay for those securities. On the other hand, the loans are more likely carried on the balance sheet at their face value as long as they are performing (that is, the debtor is making the required payments). However, the U.S. Treasury Department believes that even scaled-back participation in the legacy securities program could improve liquidity conditions in the still frozen secondary market for these assets.

CONCLUSION

In the coming weeks, as pre-qualified managers begin to raise assets for PPIFs, there will be additional information forthcoming about potential investment opportunities. As previously stated, money managers looking to participate in PPIP are in the process of developing specific approaches to manage these assets, and we anticipate that each participating manager will bring their own unique approach to managing the assets.

All investments involve risk, including loss of principal. Fixed-income investments are subject to interest rate risk. As rates rise, the price of fixed-income securities falls. There is also a risk that an issuer will be unable to make principal and/or interest payments.

Mortgage-backed securities involve additional risk over more traditional fixed-income investments including: interest rate risk, implied call and extension risks and the possibility of premature return of principal due to mortgage prepayment, which can reduce expected yield and lead to price volatility.

Investing in asset-backed, mortgage-backed or mortgage-related securities subjects the investment to additional risks, such as prepayment and extension risks.

GLOSSARY of Terms

For additional information on PPIP and the U.S. government's economic policies, we also recommend the following Web sites: <http://www.financialstability.gov> and <http://www.treas.gov>.

GOVERNMENTAL PROGRAMS

Capital Assistance Program (CAP). This program was established as part of the Financial Stability Plan, to make capital available for financial institutions to borrow in order to enable them to continue to serve the public.

Commercial Paper Funding Facility (CPFF). This facility was created by the Federal Reserve Board to improve liquidity in short-term funding markets and thereby contribute to greater availability of credit for businesses and households.

Consumer and Business Lending Initiative. This joint Treasury and Federal Reserve initiative, part of the Financial Stability Plan, was established to provide financing to private investors to help unfreeze secondary credit markets and lower interest rates for loans for students, small business, and others.

Emergency Economic Stabilization Act (EESA). This is the legislation that formed the foundation of the Financial Stability Plan, including the establishment of the Troubled Asset Relief Program (TARP).

Federal Reserve Board ("Fed"). The Federal Reserve Board ("Fed") is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

Financial Stability Plan (FSP). This plan is a series of financial initiatives designed by the U.S. government to help lay the foundation for economic recovery, including a broad program to stabilize the housing market (Making Home Affordable Program), a new capital program to provide banks with a safeguard against a deeper recession (Capital Assistance Program), a major new lending program with the Federal Reserve targeted at the securitization markets critical for consumer and small business lending (Consumer and Business Lending Initiative), and a program to set up funds to provide a market for the legacy loans and securities that currently burden the financial system (PPIP).

Making Home Affordable Program. This is a refinance program established as part of the Financial Stability Plan and it is directed at responsible homeowners suffering from falling home prices.

Money Market Investor Funding Facility (MMIFF). This program was created by the Federal Reserve Board to support a private-sector initiative designed to provide liquidity to U.S. money market investors.

Public-Private Investment Program (PPIP). The Public-Private Investment Program was designed to help restore health and confidence to the U.S. financial system and economy by combining public and private financing, government loan guarantees and private sector investment expertise in order to purchase legacy loans and securities from banks and other financial institutions and to restore secondary market liquidity for these assets.

Public-Private Investment Fund (PPIF). The vehicles that will purchase legacy securities.

Term Asset-Backed Securities Loan Facility (TALF). This lending facility was established by the Federal Reserve Board to boost consumer spending to help jumpstart the economy through the issuance of asset-backed securities.

Term Auction Facility (TAF). This lending facility was established by the Federal Reserve Board to help increase liquidity in the U.S. credit markets through short-term loan auctions that allow financial institutions to borrow funds at a rate that is below the discount rate.

Troubled Assets Relief Program (TARP). This program was established initially to buy distressed mortgage-backed securities from financial institutions but expanded to include purchases of corporate debt and equity injections into banks.

FINANCIAL SECURITIES

Asset-backed securities (ABS). A financial security backed by assets such as loans, leases, credit card debt, a company's receivables, royalties, etc. and not by real-estate or mortgage-backed securities.

Collateralized debt obligations (CDOs). A type of structured asset-backed security (ABS) whose value and payments are derived from a portfolio of underlying fixed-income assets. CDOs are assigned different risk classes, or tranches, whereby "senior" tranches are considered the safest securities; more junior tranches offer higher coupon payments (and interest rates) or lower prices to compensate for additional default risk.

Commercial Mortgage-Backed Securities (CMBS). A type of mortgage-backed security that is secured by the loan on a commercial property.

Mortgage-backed securities (MBS). A type of asset-backed security that is secured by a mortgage or collection of mortgages. These securities must also be grouped in one of the top two ratings as determined by an accredited credit rating agency, and usually pay periodic payments that are similar to coupon payments. Furthermore, the mortgage must have originated from a regulated and authorized financial institution.

Residential mortgage-backed securities (RMBS). A type of security whose cash flows come from residential debt such as mortgages, home-equity loans and subprime mortgages. This is a type of mortgage-backed security that focuses on residential, instead of commercial, debt.

Subprime mortgage loan. A type of mortgage that is normally made to borrowers with lower credit ratings who have a larger-than-average risk of defaulting on the loan. Lending institutions often charge higher interest rates on subprime mortgages than on conventional mortgages in order to compensate themselves for carrying more risk.

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