



**CAPITAL ALPHA**  
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***Capital Call (December 3, 2008): Auto Bailout;  
Mortgages/Bond Insurers; Student Loans; Credit Rating  
Agencies; Health IT; Dingell Challenge & Health Reform***

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## DISCUSSION

**Auto Industry Bailout.** We'd now raise to just above a tossup our odds of the "Detroit Three" winning federal bridge loan support before the end of December – and, in any event, would project higher, three-in-four odds of assistance flowing by mid-February.

Having presented restructuring and funding-use plans (complete with noticeable commitments to steer toward fuel-efficient cars, and perhaps-optimistic market share forecasts – available at <http://financialservices.house.gov/>), the CEOs of General Motors, Chrysler and Ford are scheduled to arrive in Washington this week sporting a more contrite tone and "fanny-fatigue" from having ridden to the capital in "green-trending" vehicles of their respective companies' making.

Though the humbled chieftains will appear before the Senate Banking Committee on Thursday, December 4, at 10AM<sup>1</sup> and the House Financial Services Committee on Friday, December 5 at 9:30AM<sup>2</sup> the main event(s) will take place behind the scenes – particularly in the still-narrowly-split 51-49 Senate, where auto-state Senators George Voinovich (R-OH), Kit Bond (R-MO), Carl Levin (D-MI) and Debbie Stabanow (D-MI), among others, will be working on a bipartisan basis to piece together an assistance plan that can pass with 60 votes on the floor.

Also a necessary ingredient will be an agreement by House Speaker Nancy Pelosi to allow at least some emergency funding to be tapped from the already-appropriated \$25 billion authorization for loans helping the auto manufacturers to retool in order to meet higher fuel efficiency standards. Per one source, one scenario would see lawmakers remove the constraints on this funding – providing at least some immediate assistance to flow through, to the particular benefit of GM and Chrysler (which in their restructuring/fund-use statements claimed an inability to last the month without a bridge loan) – then the constraints might be added back in a second tranche of funding available early next year.

**Mortgages/Bond Insurers: The 4.5 Percent (And TARP Capital-Match) Solutions?** Per sources, the bond insurers may be granted access to TARP capital infusions soon, *perhaps in the context of a set of major announcements coming from the Treasury Department as early as this Friday, December 5, or Monday, December 8.* [Some \$6 billion to \$10 billion of capital may be involved, most of it flowing to industry giants MBIA and Ambac; whether the money might be offered only as a match for funding the financial guarantors raise in the private markets remains uncertain. Still left wanting for the near-term (evidently): the life insurers.] Meanwhile, just two weeks after Treasury Secretary Paulson announced that he planned to leave untouched the second half of TARP (Troubled Asset Relief Program) funding, sources report that a formal request to tap into the remaining \$350 billion *may* be forthcoming after all – perhaps simultaneous or near-simultaneously to announcement of a separate mortgage financing proposal that would allow refinancing homeowners and prospective buyers to tap into 4.5%, 30-year agency-guaranteed loans. The beauty of the cut-rate government mortgage proposal, politically, may be that it might at least partially slake lawmakers' thirst for help for homeowners – and thus

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<sup>1</sup> <http://banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Detail&HearingID=299be20f-5e40-4c5f-89ee-2ade064d4226>

<sup>2</sup> [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/hr120508.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr120508.shtml)

facilitate Paulson's otherwise contentious return to the Hill to formally request additional TARP money (as he is required to do under the language of the Emergency Economic Stimulus Act). Although Treasury's signoff on the idea and (if so) any final details are as yet uncertain, a proposal industry representatives began pitching in late October may be serving as a general outline. Under that proposal (per sources), the loans would: 1) essentially be issued by housing GSEs Fannie Mae and Freddie Mac; 2) use existing infrastructure (i.e., banks and mortgage brokers); 3) be available to all individuals who want to refinance their existing mortgage or purchase an existing primary residence; 4) not require the refinancing homeowner to undergo a full re-underwrite, but simply have the mortgage rate taken down to 4.5%; 5) pay mortgage originators a flat fee because the amount of work they'd have to do would be limited; 6) require borrowers in purchase money mortgages to undergo a full underwrite to specified standards; and 7) would be available to everyone, not just owner-occupied primary residence homeowners. As one observer noted, "This proposal would not solve all problems (e.g., pay option ARMS and severely negative equity), but would help to begin to broadly stabilize the real estate markets." To view our updated *Mortgage Crisis Chronology*, visit:

<http://capalphadc.com/datafiles/1228252676MortgageTimeLine120208.pdf>.

**Student Loan Industry Enters An 8-10 Week Gauntlet, As New Administration Prepares to Target Budget Savings and Re-Staff DOE.** Perhaps not surprisingly, president-elect Barack Obama – during an October 26 press conference signaling his intention to offset stimulus spending with future budget cuts – offered little detail on specific program cuts or reforms. Nevertheless, the event worried sources within the student loan industry, who fear that, with a premium now placed on projected multi-year savings from “eliminating duplicative programs” and “making government more efficient”, the new administration, in coming weeks, might target assumed savings from a shift to full Direct lending (via the Federal Direct Student Loan Program) from the private-lender-dominated Federal Family Education Loan Program (or FFELP).

Noting “the past assumption of related student loan savings by the Congressional Budget Office” (whose director, Peter Orszag, Obama has named to head his Office of Management and Budget), Capital Alpha wrote that “FFELP stakeholders may have only just entered a multi-week gauntlet during which they will be perceived as being at risk of being targeted by the incoming administration.”<sup>3</sup> The last Congressional Budget Office (CBO) analysis of relative Direct vs FFELP subsidies (from March 3, 2008) seemed to belie the notion that the industry has gained ground on the scoring issue.<sup>4</sup> Separately, the liberal New America Foundation, which is expected to hold sway with the incoming administration, released its own anti-FFELP propaganda in October.<sup>5</sup>

To be sure, per industry defenders, the pencil pushers' analyses of last spring and fall – and Obama's early campaign pledge to save \$3 billion annually by shifting to full Direct lending – likely fail to take into account reduced FFELP subsidy costs in the wake of 2007 reform legislation and the 2008 ECASLA (Ensuring Continued Access to Student Loans Act) “put”

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<sup>3</sup> <http://www.capalphadc.com/newsdetails.php?id=28>

<sup>4</sup> <http://www.cbo.gov/budget/factsheets/2008b/education.pdf>

<sup>5</sup> <http://www.newamerica.net/blog/higher-ed-watch/2008/new-america-foundation-releases-report-exposing-spin-student-loan-costs-7405>.

programs now in place. Moreover, increasingly influential House Education and Labor Chairman George Miller (D-CA) is said to have muted his earlier stance in support of full Direct lending. Nevertheless, Capital Alpha notes that investors in Sallie Mae and other student loan companies may have become unduly sanguine on the scoring issue after last February (amid a perceived sentiment shift at OMB accompanying the Bush administration's FY 2009 budget submission, and rational expectations that the Direct program's cost advantage might diminish due to FFELP-lender subsidy cuts and costly benefits now available only through the FDSLSP) – *and thus may be ill prepared for headline risk should Obama's advisors set him off on a course toward a FFELP phase-out in coming weeks.*

Topping off the winter worry watch: Industry sources are also now on lookout for whether any of a number of notable pro-Direct/anti-FFELP past government officials or Hill staffers might be named by Obama to key posts at the Department of Education (DOE). [Fanning these fears, for instance, has been the positioning on Obama's transition team of former Senate staffer and Clinton administration official Bob Shireman, whose nonprofit group, The Project on Student Loan Debt, recently wrote Treasury Secretary Paulson to urge him to "reconsider the plan" announced last week to allocate funds from the \$700 billion economic rescue package to private student loan providers: [http://ticas.org/pub\\_view.php?idx=392](http://ticas.org/pub_view.php?idx=392).] Such an announcement might signal DOE's shifting from an attitude toward FFELP and its lenders that at times during Bush's second term ranged from "jaundiced" to "working to the rule" to a new regime in which messianic pro-Direct lending forces are seen taking over. [To view our updated *Student Loan Liquidity Crisis Chronology*, click on <http://capalphadc.com/datafiles/1228334171StudentLoanChronology120308.pdf>.]

**SEC Issues New Regs On Credit Rating Agencies, But (Predictably) Punts Notion of Forcing Changes In Industry's Business Model.** Per an announcement after an open meeting today, the Securities and Exchange Commission (SEC) voted through new regs for credit rating agencies that, while mandating more disclosure of rating methodologies, risk assumptions, verification practices, etc., and restricting agency analysts from consulting with issuers on design of securities, negotiating fees with issuers, and accepting gifts over \$25 – nevertheless punted on other, more contentious proposals, much less anything that would radically alter the industry's business model.<sup>6</sup> As we have written, the Commission appears to be holding off on more intrusive decisions, pending the partisan realignment expected to come when SEC Chairman Cox steps down and is replaced early next year by the incoming Obama administration. Another major factor, per sources, will be a desire to coordinate with foreign regulators. Meanwhile, despite the small measure of insulation heretofore provided by lawmaker's previous swipe at re-regulating the agency (in the form of the Credit Rating Agency Reform Act of 2007 – which tasked the SEC to regulate the industry and remove barriers to entry by competing NRSROs), additional agency-related reforms are expected to make their way into a major financial regulatory reform bill likely to take shape in Congress during 2009.

**Health IT Could Be Connected To Stimulus Package.** President-elect Obama and the Democratic Congressional leadership have signaled that they intend to have another economic stimulus bill drafted before inauguration day on January 20. While nothing is certain yet, key lawmakers have signaled that the package could include Health IT provisions. Obama himself

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<sup>6</sup> To view the SEC's announcement of its actions, visit <http://sec.gov/news/press/2008/2008-284.htm>.

recently remarked that Health IT investment would provide an immediate boost to the economy – a somewhat questionable claim – and on the campaign trail called for a \$50 billion investment in Health IT over the next five years.

Legislators are eyeing a Health IT bill House Ways and Means Subcommittee on Health Chairman Pete Stark (D-CA) introduced in August that would tie physician Medicare reimbursements to their adoption of a standardized health IT platform. The Senate HELP Committee has also approved legislation by Chairman Edward Kennedy (D-MA) and Ranking Member Mike Enzi (R-WY) that has satisfied many privacy concerns earlier versions have generated.

Under the Stark bill, CMS would initially provide incentives to encourage providers to adopt an interoperable Health IT system. The incentives would eventually be phased out, and providers who choose not to adopt the technology would be penalized.

At this early (theoretical?) stage of the economic stimulus development, it's difficult to handicap whether Health IT will be included in any eventual legislation. However, we think an increase in the federal Medicaid matching rate (FMAP) is more likely to happen. An FMAP bump would have a far more immediate economic impact than Health IT adoption, which would take a number of years to implement, and state governors have been lobbying hard for more government Medicaid assistance almost since the economic crisis began. In this deficit be damned era of government, there's no reason to think that Congress couldn't do both, but we expect that Health IT will prove to be too attractive as a cost-savings add on for future health reform efforts that will come under closer budgetary scrutiny. Regardless, Congress will have to act fast if it wants to put a bill together by day one of the Obama administration, so we should start to see some details soon.

**Pallone Seeks to Protect Health Subcommittee Chairmanship from Possible Dingell Challenge.** Just when we thought that that whole Energy & Commerce Waxman-Dingell thing was over, there is speculation in Washington that Rep. John Dingell (D-MI) may make a bid for the Chairmanship of the Health Subcommittee, currently held by Rep. Frank Pallone, Jr. (D-NJ). Pallone reportedly sent a letter on Nov. 20th to committee members asking for their support. Pallone, who had been viewed as a Dingell protégé, surprised many observers when he threw his support behind Rep. Henry Waxman (D-CA) early in his bid for the committee Chairmanship.

The E&C Health Subcommittee is expected to play a major role in the upcoming health reform debate given the Committee's jurisdiction over SCHIP, Medicaid, and the FDA. In contrast to Senate subcommittees, House subcommittees are the front line of policymaking and hold frequent hearings and markups. In his letter, Pallone highlighted subcommittee accomplishments under his leadership, including prescription drug safety, mental health parity, and genetic nondiscrimination legislation. He also notes that the sub-committee will oversee the creation of a legal pathway for the approval of follow-on biologics.

It is difficult to predict how this will turn out. Unlike the full committee Chairman post, the process for determining sub-committee chairs is less formal. The Chairman (Waxman in this case), in consultation with Leadership and his committee caucus, will have a major say in

subcommittee chairmanships. No doubt Waxman feels indebted to Pallone. However, Dingell has the seniority, not to mention impressive credentials on healthcare issues such as SCHIP, and some committee Democrats may feel Dingell deserves some role on the committee beyond being a rank and file member. Ultimately, there's not much difference between Waxman, Dingell and Pallone on healthcare; however, from personal experience we could say that Pallone may be marginally more business friendly as subcommittee chairman, or at least less combative, than Dingell. The E&C Shakespearean drama will wrap up in early January when the House makes subcommittee chair selections.

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