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EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

On October 3, 2008, following a week of heated debate with a backdrop of economic turmoil in the U.S. and global financial markets, President Bush signed the Emergency Economic Stabilization Act of 2008 ("EESA" or the "Act") into law. The stated purpose of EESA is to "*provide authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers, to amend the Internal Revenue Code of 1986 to provide incentives for energy production and conservation, to extend certain expiring provisions, to provide individual income tax relief, and for other purposes*."

EESA is a principles based framework, vesting the Secretary of the Treasury (the "Secretary") with broad authority to take immediate action under the Act, provided that he develops and publishes promptly thereafter more granular policies and procedures that serve to restore liquidity and stability to the U.S. financial system. In granting the Treasury significant purchasing power under EESA, it is hoped that liquidity will be afforded to the financial markets, with resulting increased financial stability for many financial institutions.

Consistent with the foregoing, and given that in the ten days since the passage of the Act credit markets have remained frozen and the global financial system has continued to spiral downwards, the Secretary has announced the immediate formation under the Act of a capital purchase program (the "Capital Purchase Program") whereby the Treasury will purchase up to $250 billion of senior preferred shares in qualifying financial institutions. The details of the Capital Purchase Program have been memorialized in a standardized term sheet and banks must elect to participate prior to 5:00 pm (EDT) on November 14, 2008. Nine large financial institutions have already indicated their intention to subscribe to the program in an aggregate amount of $125 billion, and it is anticipated that an array of small- and medium-sized banks and thrifts will also elect to participate on the same standardized terms.

We have prepared this memo to highlight certain key provisions of Title I of EESA that may have a direct impact on our clients, and to provide certain updates regarding the Treasury's progress in implementing the Troubled Asset Relief Program.

TROUBLED ASSET RELIEF PROGRAM

Establishment of TARP

Perhaps most significant to the financial markets, EESA authorizes the Secretary to establish the Troubled Asset Relief Program ("TARP"), which will script the manner in which the Treasury will implement its broad authority to deal with financial institutions to buy, sell, guarantee, insure and/or manage troubled assets, including mortgage-related assets, and to purchase any other financial instrument that the Secretary, in consultation with the Federal Reserve Chairman, deems necessary to stabilize our financial markets. This will be accomplished through the newly established Office of Financial Stability (the "OFS"), a division of the Treasury, which will be headed by an Assistant Secretary of the Treasury to be appointed by the President. On October 6, 2008, the

Secretary appointed Neel Kashkari, a former Vice President at Goldman Sachs, as the Interim Assistant Secretary of the Treasury for the OFS pursuant to EESA (the "Assistant Secretary"), and granted him authority to oversee TARP. Mr. Kashkari, since joining the Treasury in 2006, contributed to the development of the Treasury's response to the housing crisis, the HOPE NOW Alliance, the subprime fast-track loan modification plan, and the Treasury's initiative to kick-start a U.S. covered bond market. Despite the pervasive use of the word "*troubled*" in the Act, the Secretary intends to design programs that encourage healthy institutions to participate, as evidenced by the Capital Purchase Program where a number of large relatively healthy financial institutions were targeted.

In recent remarks before the Institute of International Bankers, the Assistant Secretary explained that the Treasury's strategy was to develop multiple tools under TARP to help financial institutions remove illiquid assets from their balance sheet, and attract both private and public capital. This "*toolkit*" would be designed to help financial institutions of all sizes and to attack the capital and troubled asset problem from multiple directions. Thus far, the Treasury has announced the development of three programs under TARP (together with corresponding executive compensation and corporate governance standards which are discussed herein):

- the Capital Purchase Program, which is designed to provide equity capital under standardized terms directly to certain qualifying financial institutions, as discussed above;
- the Troubled Asset Auction Program, which is being designed to purchase troubled assets through an auction format and for which program guidance will be issued in the coming weeks; and
- Programs for Systemically Significant Failing Institutions, which are being designed to potentially provide direct assistance to certain failing firms on terms negotiated on a case-by-case basis.

Although the Secretary can commence acting under TARP immediately, certain program guidelines are required to be published before the earlier of the end of the two-business day period beginning on the date of the first purchase of troubled assets and the end of the 45-day period beginning on the date of enactment of EESA. Although the Secretary originally indicated that it was expected to be several weeks before the Treasury's first purchase, it now appears that under the Capital Purchase Program the Treasury will swiftly commence purchasing preferred equity, with purchases of mortgage-related or other troubled assets pursuant to an auction process to occur sometime thereafter. It is not known when the Treasury will develop or act under any Programs for Systemically Significant Failing Institutions.

Funding Limits

TARP may have access to a maximum of $700 billion to fund troubled assets, to be released in the following stages: (i) effective immediately upon enactment of the Act, $250 billion may be outstanding at any one time; (ii) immediately upon the President providing written notice to Congress, $350 billion may be outstanding at any one time; and (iii) if the President delivers a written report to Congress detailing the Treasury's plan for additional funds, and Congress does not issue a joint resolution of disapproval for such additional amount within 15 days, $700 billion may be outstanding at any one time. The TARP fund is therefore a revolving facility, with the stated dollar amounts being measured by the aggregate purchase prices paid for the assets. Note that the Treasury has already allocated $250 billion to the Capital Purchase Program. In accordance with the foregoing, however, an additional $100 billion (over the initial $250 billion) could be made available to the Secretary in relatively short order.

Authority of the Treasury Secretary

Although the Secretary is required to consult with various other governmental authorities (*e.g.*, the Board of Governors of the Federal Reserve, FDIC, Comptroller of the Currency, Director of Office of Thrift Supervision, Secretary of Housing and Urban Development, and others), he has fairly broad powers and actual approval of any such authorities is generally not required. The Secretary is authorized to take any actions it deems necessary to carry out the purposes of the Act including, *inter alia*, hiring employees, entering into contracts, designating financial institutions to act as agents, asset managers and advisors, establishing vehicles to purchase, hold, and sell troubled assets and issue obligations, and issuing any other necessary or appropriate regulations and guidelines. As mentioned above, before the earlier of two business days following the first purchase and 45 days following the date of enactment of the Act, the Secretary is required to publish guidelines regarding (i) mechanisms for purchasing troubled assets, (ii) methods for pricing and valuing troubled assets, (iii) procedures for selecting asset managers and (iv) criteria for identifying troubled assets for purchase.

In furtherance of the foregoing, the Treasury posted three solicitations on October 6, 2008, for financial agents to provide services for TARP, including whole loan asset managers, securities asset managers, and custodian, accounting, auction management and other infrastructure services, and has additionally published procedures regarding the selection of asset managers. Responses to such solicitations were due on October 8, 2008. The Secretary has stated that any applicant selected by the Treasury to serve in any role under EESA will be considered a financial agent of the United States and as such "*will have a fiduciary responsibility to perform all services in the best interest of the United States*." This raises the question as to how potential conflicts of interest will be managed as firms with the relevant financial expertise to be of service to TARP may also hold assets eligible for sale into the program or otherwise participate in TARP. In that regard, as required by EESA, the Secretary has recently published interim guidelines setting forth procedures for addressing potential conflicts of interest, which procedures include, *inter alia,* obtaining confidentiality agreements, requiring disclosure of potential conflicts of interest and, in the event of potential conflicts, requiring the establishment of a mitigation or neutralization plan (which would become part of the contract between the agent and the Treasury). This implies that any financial agent under TARP would be required to establish or revise internal policies and procedures to satisfy the TARP conflict standards and likely informational and functional walls and ongoing monitoring thereof would have to be implemented.

The Secretary has stressed the importance of structuring the TARP procurement of contractors and agents to encourage the participation of small businesses, veteran-owned businesses, and minority and women-owned businesses including, where it is beneficial to taxpayers that a contract or position be awarded to the most experienced firm which does not happen to fall into one of the foregoing categories, on a sub-contractor basis. In addition, if the Treasury waives its requirement to comply with certain federal regulations regarding the awarding of government contracts to minorities in any given solicitation or contract, it must develop procedures "*to ensure, to the maximum extent practicable, the inclusion and utilization of minorities ... and women, and minority- and women-owned businesses ... in that solicitation or contract.*"

Financial Institutions

Only "*financial institutions*" within the meaning of EESA may participate in TARP. A financial institution is defined to mean "*any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, the District of Columbia [or certain other specified U.S. associated jurisdictions], and having significant operations in the United States, but excluding any central bank of, or institution* *owned by, a foreign government*" (emphasis added). The definition would include federal or state chartered banks, bank holding companies (or potentially affiliates thereof), savings and loan associations, certain savings and loan holding companies, credit unions, broker-dealers, registered investment companies and investment advisors and insurance companies. It should be noted, however, that the term sheet for the Capital Purchase Program, which is offered only to "qualifying financial institutions" ("QFI") thereunder, defines QFI to include only certain U.S. banks, U.S. savings associations, U.S. bank holding companies, and U.S. savings and loan holding companies "*organized*" under the laws of the United States or any State, the District of Columbia, any territory or possession of the United States, or certain other specified U.S. associated jurisdictions, and to exclude any bank holding company, savings and loan holding company, bank or savings association that is controlled by a foreign bank or company. Given that the express requirement under TARP is for an institution to be merely "*established*" under U.S. law, consideration should be given to whether a branch of a foreign bank would be deemed to be "*established*" under U.S. law and to have "*significant operations"* in the United States, and thereby qualify as a "financial institution" for other programs under TARP.

There is no current guidance on the extent to which the requirement of having "*significant operations in the United States*" will be a limiting factor for institutions attempting to qualify as "financial institutions" under the Act. However, in exercising its authority under the Act, Treasury also has to "*ensure that all financial institutions are eligible to participate in the program, without discrimination based on size, geography, form of organization, or the size, type and number of assets eligible for purchase*." Therefore, an institution's size will not likely be a factor in testing significance.

Other parts of EESA indicate that the Treasury may also purchase troubled assets held by or on behalf of an eligible retirement plan (such as a U.S. employer-sponsored 401(k) plan). It is unlikely that hedge funds and private equity funds that are incorporated in offshore jurisdictions such as the Cayman Islands and that are primarily unregulated would qualify under TARP. EESA does, however, give the Treasury the additional power to issue such other guidance or regulations that may be necessary to further refine the definition of financial institutions and various provisions of EESA. It is therefore possible that the scope of TARP could be broadened to cover a larger group of financial institutions. Although the definition of financial institution specifically excludes foreign central banks from participation under TARP, the Act does make one exception for central banks or foreign financial authorities that hold troubled assets as a result of extending financing to financial institutions that have failed or defaulted on such financing.

Eligible Assets

Under EESA, the Treasury has the authority to purchase "*troubled assets*" which are defined quite broadly to mean: "*(A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008,*[1] *the purchase of which the Secretary determines promotes financial market stability; and (B) any other financial instruments that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress*." Troubled assets under clause (A) would include mortgage notes, participations, CMBS, RMBS, loan syndications, and probably derivative instruments related to mortgage

[1] This is the date on which JP Morgan agreed to acquire Bear Stearns.

products. Clause (B) of the definition is a catchall clause that gives the Secretary broad authority to add asset classes (including non-mortgage related asset classes) with no prior approval other than the Federal Reserve consultation required above; thus the Secretary is authorized to make the determination and can arguably simultaneously transmit such determination to Congress. The Secretary has now stated that it determines "equity securities" to be a financial instrument captured under clause (B), and that it intends to imminently inject capital into banks in return for non-voting equity securities. As mandated by the Act, certain policies and procedures relating thereto, including a TARP Capital Purchase Program term sheet and several Treasury press releases, have already been published. Additional asset classes under the catchall clause could potentially include student loans, auto loans and credit card debt.

Unjust Enrichment

In implementing TARP, the Treasury is specifically directed to take steps to prevent unjust enrichment to financial institutions participating in the program. Accordingly, no financial institution may sell a troubled asset to the Treasury for a price higher than the price paid by the financial institution, unless the troubled asset was acquired through a merger or acquisition or a purchase of assets from another financial institution in conservatorship, receivership or one which has filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. Therefore, although there is no reselling of assets purchased at a discount to the Treasury for a profit, there could be an exception for financial institutions acquiring assets in connection with an emergency acquisition, conservatorship or receivership or a Chapter 11 bankruptcy. The unjust enrichment provisions of TARP would prevent, or at least discourage, a company that does not itself qualify as a financial institution from participating indirectly in TARP by selling assets through a qualifying financial institution.

Purchase and Pricing Mechanisms

The Treasury is required, in purchasing, managing and selling troubled assets, to minimize long-term negative impact to the taxpayer, and in furtherance of this goal, the Secretary may (i) hold assets to maturity or for resale when the market is optimal for selling, and (ii) sell such assets at a price the Secretary determines will maximize return for the government. The Secretary is further to use "*market mechanisms, including auctions or reverse auctions, where appropriate,*" to purchase the assets at the lowest price that it determines to be consistent with the purpose of EESA. The Act does not define market mechanisms for this purpose or set forth the procedures that would apply to any auction or reverse auction, leaving the design of any such program to the Treasury. Note that the use of market mechanisms and auctions are clearly preferred with regard to certain types of troubled assets (particularly mortgage related assets) under EESA, however, if the Treasury determines that the use of market mechanisms is not feasible or appropriate, it may purchase troubled assets directly from an individual financial institution.

In determining whether to engage in a direct purchase from a financial institution, the Secretary is required to pursue "*additional measures*" to ensure that the price paid is reasonable to reflect the underlying value of the asset, and to consider the "*long-term viability*" of the financial institution to assess whether the purchase represents the most efficient use of funds under the Act. There is no guidance as to what would constitute sufficient "*additional measures,*" and how "*long-term viability*" comes into play will likely be determined on a case-by-case basis. The direct purchase option is being applied both to the purchase of equity under the Capital Purchase Program, which appears to be primarily aimed at healthy banks, and in its to be developed Programs for Systemically Significant Failing Institutions, which is designed to provide direct assistance to certain failing firms. In a reverse auction process, theoretically the winning bidders would be those financial institutions that are most troubled and most willing to sell at discount prices, as the more solvent banks may tend to drop out of the bidding in a reluctance to sell assets at a price below their perceived value. Also unclear is whether the

Treasury would apply uneven pricing considerations to different institutions for comparable assets based on what those institutions are internally able to sell at or whether there will be there a standardized valuation process applied across asset types (which would be difficult to adhere to in a reverse auction process).

Clearly, price determination is a fundamental issue in the implementation of TARP. There is a question as to whether troubled assets that are "*money-good*" will be valued at their "*hold to maturity*" value or "*mark-to-market*" value, which may be non-existent given the lack of a market for most troubled assets today. If the Treasury purchases assets at deeply discounted prices, problems may arise as described under "Mark-to-Market Accounting" below. Alternatively, if the Treasury overpays for assets, how feasible would it be that those assets can be resold into the market or to the private sector and thereby increase liquidity. Questions further arise as to the extent of the due diligence process that TARP will perform in assessing the value of potential assets, and how various factors regarding assets, particularly mortgage assets, will be factored into the process, including whether recourse will be provided to the selling institution, whether any consent or control rights exist with respect to purchased assets, what the underwriting parameters were, whether there is diversity as to location and property type, seniority levels and payment terms, default history and risk profile of the selling institution or the asset type.

The Secretary is required to establish guidelines regarding the mechanisms for purchasing troubled assets, which could include reverse auction procedures and pricing and valuation mechanics. In connection therewith, the Treasury is expected to consult with private sector advisors and asset managers in determining the scope of the auction process and appropriate market mechanisms for determining the price of the troubled assets. Not surprisingly, the Treasury's proposed purchase of troubled assets in the form of mortgage loans and mortgage-related securities necessitates the development of an elaborate and somewhat complex set of policies and procedures, in addition to the hiring of an experienced advisory and infrastructure staff. This somewhat ambitious endeavor has likely delayed the inception of that aspect of TARP. The Secretary has stated that program guidance for an auction program will be issued in the coming weeks. With regard to the Capital Purchase Program, a term sheet and several Treasury press releases outlining certain policies and procedures have already been published.

Mark-to-Market Accounting

Although price discovery through an auction process is generally preferred under EESA, there could be potential negative consequences for all participants in TARP arising from the price established through such an auction. Concerns have been expressed that prices for troubled assets that are sold at an auction may determine the mark-to-market value for that particular asset class irrespective of whether an institution participated in the auction.

Statement of Financial Accounting Standard No. 157 (Fair-Value Measurements) (FAS 157) requires financial institutions to report the fair value of assets it holds. However, in determining such value, FAS 157 imposes methodologies, rules and complex modeling designed to capture market information that would influence the value of an asset. In liquid markets, generally available pricing information could be used to determine market prices of assets and hence, their values. However, in illiquid markets, such pricing information may not be available or, as we have seen with recent experience, may be significantly distorted. FAS 157 has forced companies and financial institutions to write-down significant losses on their balance sheet and in some cases, income statements, even though the assets they hold are generally regarded as "*money-good*" in the long-term. The price set at an auction of troubled assets run by the Treasury could well set the "*mark*" for similar assets held on the books of many institutions. However, if this mark is significantly different from that which an institution has reported in its books, there could be the risk that such an entity would be forced to further write-down the value of its assets regardless of whether it participated in the auction. Continuous write-downs during periods of prolonged market distortions such as the one we are currently experiencing has a domino effect. Each successive write-down contributes to further depressing enterprise value, creates additional concerns about counterparty risk (thus increasing the spreads of credit default swaps for such counterparties), may result in credit-rating downgrades or decreases in an institution's share price, and further squeezes what limited liquidity may be available to the affected institution.

EESA states that the SEC has the authority to suspend the application of FAS 157 for any issuer or with respect to any class or category of transaction if the Commission determines it "*is necessary or appropriate in the public interest and is consistent with the protection of investors*." Because of the concerns with mark-to-market accounting, EESA directs the SEC to conduct a study of FAS 157 and its impact on the balance sheet of financial institutions and depository institutions. The study is also required to consider the impact of FAS 157 on bank failures in 2008 and the "*advisability and feasibility of modifications to such standards*." The SEC is required to report to Congress the findings of such study within 90 days from the date EESA came into effect.

Purchasing Vehicles and Management of Troubled Asset Portfolio

As discussed above, the Treasury is given broad powers to implement TARP and exercise the authorities granted to it under EESA. The responsibility for management of troubled assets (including revenues from assets and associated portfolios risks) purchased under TARP is also vested in the Treasury. If the Treasury were to sell the troubled assets purchased by it, EESA permits the Treasury to conduct such sale on terms and conditions it may determine, including entering into securities lending or repurchase transactions. Specifically, the Treasury may create any vehicles needed to purchase, hold, and sell troubled assets "*and issue obligations*." The Treasury is also required to hold the assets to maturity or for resale for or until "*such time as the Secretary determines that the market is optimal for selling such assets in order to maximize the value for taxpayers*." Thus, the Treasury is not required to hold the assets to maturity (and is not expected to). However, it is broadly mandated to sell the assets at a price that it determines will maximize the return on investment for the federal government.

Minimizing Costs and Maximizing Benfits for the Taxpayer—Warrants

One of the principal points of contention by Congressional members opposed to EESA was that TARP required taxpayers to bail out Wall Street with no benefit flowing back to Main Street. Reluctant Congressional members who approved EESA were persuaded that taxpayers may benefit from a potential upside from TARP when fundamentally sound assets which are currently priced at distressed levels due to a liquidity crisis could ultimately be sold at an appreciated value. Other than price appreciation upon a remarketing of troubled assets, it was argued that taxpayers could also gain from owning equity interests in the institutions from which the Treasury is purchasing the troubled assets. Accordingly, any financial institution that sells troubled assets via TARP must grant to the Treasury (i) in the case of a financial institution whose securities are traded on a national securities exchange, a warrant giving the Treasury the right to receive non-voting common or preferred stock in such institution, or voting stock with respect to which the Secretary agrees not to exercise its voting powers, and (ii) in the case of any other financial institution, a warrant for common or preferred stock or a senior debt instrument containing terms that are sufficient to compensate the Treasury for the value of the warrant. Note that the senior debt instrument is an attractive alternative to the grant of a warrant particularly in situations where the seller is unable to grant such warrants or it is inappropriate for the Treasury to hold equity interests in the seller. EESA sets out the general terms governing such warrants but grants the Treasury the discretion to determine the economic terms of such warrants and senior securities. In the event of a direct purchase of assets at a relatively deep discount, the Treasury might require a more significant stake in the participating financial institution. Although clause (ii) does not specify a non-voting requirement, it appears from the Act as a whole and related reports that all warrants issued pursuant to these provisions would be for primarily non-voting stock. There is a *de minimis* exception whereby, if the cumulative purchases of troubled assets from any one financial institution does not exceed $100,000,000, that financial institution is not required to grant warrants to the Secretary.

The grant of warrants may complicate the pricing of the troubled assets to be purchased, as sellers will want to price the combined package of debt or equity and troubled assets, while the Treasury is required to get the best possible price for taxpayers on the troubled assets alone. The value of any warrant, however, is highly dependent on its economic terms (*e.g.*, strike price) and the Treasury has been given the flexibility to determine such terms. Therefore, it is within the Treasury's power to determine whether it wishes to impose onerous terms on the sellers from which it purchases troubled assets. The Treasury may be more willing to use its powers to obtain favorable economic terms in situations where it acquires troubled assets directly from a particular financial institution, particularly in the case of a true bailout of such institution, as opposed to it acquiring troubled assets through the auction process.

Consistent with the foregoing, under the terms of the Capital Purchase Program, the Treasury will be purchasing non-voting senior preferred shares (other than class voting rights on limited matters that could adversely affect the senior shares). If dividends[2] on the senior preferred shares are not paid in full for six dividend periods, whether or not consecutive, the senior preferred shareholders will have the right to elect two directors, which right will end when full dividends have been paid for four consecutive dividend periods. In addition to the senior preferred shares, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the senior preferred investment. The senior preferred shares are (i) redeemable by the institution prior to the end of three years with the proceeds of certain qualifying equity offerings, (ii) redeemable after three years at any time, (iii) callable at par by the holder after three years, and (iv) transferable by the Treasury to a third party at any time.

Private Sector Participation

EESA requires the Secretary to encourage the private sector to participate in purchases of troubled assets, and to invest in financial institutions, consistent with the goal of minimizing long term cost and maximizing benefit to taxpayers. Accordingly, the Treasury may be attempting to move much of the purchased assets back into the private sector as quickly as possible, either in back-to-back sales to ventures that are jointly owned by investors and the government or to other private equity financed vehicles. This raises the question as to whether, in a back-to-back sale, the ultimate risk of the investment and the due diligence process will rest with the end purchaser. Further, the Assistant Secretary had indicated that any equity purchase program under TARP would be structured to encourage firms to raise new private capital to complement the injection of public capital. Under the Capital Purchase Program, participating institutions may redeem the senior preferred shares purchased by the Treasury (i) prior to the end of three years with the proceeds from a qualifying equity offering of any "Tier 1 perpetual preferred or common stock," and (ii) after the expiration of three years at any time.

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[2] The senior preferred shares will pay cumulative (or, in the case of banks which are not subsidiaries of holding companies, non-cumulative) dividends at a rate of 5% per annum until the fifth anniversary of the date of investment, and thereafter at a rate of 9% per annum.

Executive Compensation

Executive compensation was the subject of much debate during the passage of the bill through both the House and Senate. Although Secretary Paulson initially resisted any provision in the Act that would undermine or limit compensation for senior executives of financial institutions who may wish to participate in TARP (arguing that any such limitation would discourage participation), it was finally recognized that legislation would not likely be passed by Congress without some compensation limitation. EESA provides for two different standards that would apply to executive compensation.

Direct Purchase. EESA provides that where the Secretary acquires troubled assets by direct purchase, and receives a meaningful debt or equity position in the seller, the seller is required to comply with executive compensation and corporate governance standards during the entire time the Secretary holds the debt or equity. These standards include:

- limits on compensation incentives for executives to take "*unnecessary and excessive risks,*" as defined by the Treasury;
- retroactive recovery by the selling financial institution of any bonus or compensation based on earnings or any other criteria later proven "*materially inaccurate*"; and
- prohibition of golden parachute payments to a senior executive officer during the entire time the Secretary holds the debt or equity. (The Act defines "senior executive officer" as an "individual who is one of the top five executives of a public company, whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934, and any regulations issued thereunder, and non-public company counterparts.")

The foregoing restrictions apply to a financial institution for so long as the Treasury continues to hold any equity or debt position, regardless of whether it is meaningful, in the financial institution. The Act does not indicate what might be deemed a meaningful equity or debt position.

Auction Purchase. If a financial institution sells any assets to the Treasury in an auction and the purchases that the Treasury makes from that financial institution in one or more auctions or a combination of auctions and direct sales exceed $300,000,000, then the financial institution is prohibited from entering into any new employment contract with any senior executive officer that provides a golden parachute upon an involuntary termination of employment or upon the occurrence of a bankruptcy, insolvency, or receivership. This prohibition with respect to new employment contracts exists only during the period EESA is in force. Therefore, subject to later amendments in the Act, the maximum time period during which the Treasury could prevent a financial institution from entering such an employment contract is two years. Further, under EESA, a financial institution participating in such an auction purchase may not deduct certain golden parachute payments to its senior executives, and a 20% excise tax will be imposed on the senior executive for these golden parachute payments.

In addition, as part of Title III of EESA, the federal tax code will be amended to provide that employers may not deduct any amount in excess of $500,000 annually with respect to compensation paid to certain executives. Such amendment will be applicable to both the direct purchase program and the auction purchase program.

Pursuant to guidelines established for the Capital Purchase Program, for the period during which the Treasury holds equity issued under the program, companies participating must adhere to the strict executive compensation rules set forth under "Direct Purchase" above (in addition to agreeing not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive), and any guidance or regulations issued by the Secretary on or prior to the date of investment under the Capital Purchase Program. The Treasury has stated that it is issuing interim final rules covering these executive compensation standards. The Treasury has further stated in a recent press release that, in connection with the development of any Programs for Systemically Significant Failing Institutions, the executive compensation standards will be similar to the standards developed under the Capital Purchase Program, with the one significant difference being that golden parachutes will be defined more strictly to prohibit any payments to departing senior executives.

Troubled Assets Insurance Financing Fund

As an alternative to the purchase of troubled assets and at the request of the House Republican opposition, an insurance alternative was added to the Act. If the Secretary establishes the TARP program, it is required to also establish a program to guarantee troubled assets originated prior to March 14, 2008, including mortgage-backed securities. In that regard, the Secretary may develop guarantees of troubled assets (to the extent of the timely payment of principal of, and interest on, troubled assets in amounts not exceeding 100% of such payments). The Secretary is also required to collect premiums in connection with such insurance, which may vary according to the credit risk associated with the particular troubled asset. The methodology for such premiums must be public, and the premiums must be sufficient to create reserves sufficient to meet anticipated claims and be determined based on an actuarial analysis. All premiums must be deposited in the Troubled Assets Insurance Financing Fund ("TAIFF"), to be reinvested in U.S. Treasury securities or kept in cash. We would query whether the premiums would be affordable for troubled institutions. Keep in mind that the amount available under TARP to purchase troubled assets must be reduced by the difference between the total outstanding guaranteed obligations and the amount on deposit in the insurance fund (which would include the premiums deposited). It is possible that the fund would be established and never utilized, thereby maintaining a zero balance.

One advantage of any insurance program established under TARP is that the provisions of TARP mandating the taking of equity, preferred stock or warrants in connection with a purchase of troubled assets and the restrictions on certain executive compensation for participants in TARP under the direct purchase or auction process would not generally apply.

The Treasury intends to submit to the Federal Register a public request for comment soliciting ideas for structuring an insurance program under TARP, with responses to be required within fourteen days of the date of submission.

Possible Loss Recoupment

It is currently unknown whether TARP will create a net loss or gain for the federal budget. At exactly five (5) years from the date of enactment of the Act, a report must be submitted to Congress on the net amount in TARP. If there is a shortfall, EESA requires the President to submit a proposal to Congress to recoup the shortfall from the financial industry in order to assure that TARP does not add to the deficit or national debt. An interesting point is that EESA provides that the shortfall be recouped from the "*financial industry*" in general — not solely from the financial institutions that directly or indirectly participated in TARP.

Foreclosure Mitigation Efforts

If, through TARP, the Treasury acquires mortgages, mortgage-backed securities and other assets secured by residential real estate, the Treasury is required to implement a plan to maximize the assistance for homeowners and to encourage servicers of mortgages to take advantage of HOPE for Homeowners Program (see below for further details) or other programs to minimize foreclosures, considering the net present value to the taxpayer. The Secretary is permitted to use loan guarantees and credit enhancement to avoid foreclosures. The Treasury is also required to consent, upon any request and where appropriate, to reasonable requests for loss mitigation measures including term extensions, rate reductions and principal write-downs. In addition, federal entities that hold mortgages and mortgage-backed securities, including the Federal Housing Finance Agency, the FDIC and the Federal Reserve Board, are required to develop plans to minimize foreclosures and to work with servicers to encourage loan modifications, considering the net present value to the taxpayer.

HOPE Act

EESA contained an amendment to the HOPE for Homeowners Act (the "HOPE Act"). The HOPE Act was enacted in July 2008 to assist borrowers to refinance into more affordable fixed-rate government insured mortgages. However, the program is voluntary and mortgagees must be willing to write-down their mortgage principal to an amount no more than 90% of the current appraised value of the property. Borrowers under the HOPE Act must have a mortgage debt-to-income ratio of greater than 31%. EESA amends these requirements to include those borrowers who are "*likely to have*" a debt to income ratio of greater than 31% due to a reset of the mortgage terms and also gives the HOPE program the ability to write down the principal on the mortgage loan further.

Reporting

In order to achieve the stated goal of market transparency, the Act requires a significant amount of public disclosure and reporting in connection with many actions taken under TARP. Therefore any participation in TARP will likely become a matter of public record. For example:

- <u>Transaction Reports</u>. The Secretary is required, within two business days of any purchase, trade or other disposition under the Act, to publicly disclose the details of any transaction, including amounts and pricing of assets.

- <u>Monthly Reports</u>. Within 60 days of the first exercise of authority under the Act, and every 30 days thereafter, the Secretary is required to report to Congress an overview of its activities under TARP, including detailed financial statements.

- <u>Tranche Reports</u>. Not later than seven days after the date on which commitments to purchase troubled assets under TARP aggregate $50 billion, and not later than seven days after each additional aggregate $50 billion interval, the Secretary is required to report to Congress a detailed description of all related transactions, a description of the pricing mechanisms used for such transactions, and justification for the financial terms of such transactions.

- <u>Regulatory Modernization Report</u>. Prior to April 30, 2009, the Secretary is required to submit a report to Congress on the current state of the regulatory system and its effectiveness in overseeing participants in the financial markets (including the over-the-counter swaps market and government-sponsored enterprises), and providing recommendations for improvement.

Oversight under EESA

There are various oversight mechanisms put into play under EESA. The Comptroller General is required to commence ongoing oversight of the activities and performance of the TARP and its agents and report on its findings to Congress and the Special Inspector General (described below) at least every 60 days, and must be provided space, facilities and access to records at the Treasury to accomplish these duties. EESA also provides for a newly established Office of the Special Inspector General for the Troubled Asset Relief Program, with a newly created Special Inspector General for the Troubled Asset Relief Program, who will be appointed by the President. That new entity will be partly responsible for supervising and conducting audits and investigations of the purchase, management and sale of assets directly or indirectly by the Secretary. Further, EESA establishes a Congressional Oversight Panel (the "Oversight Panel") to review the current state of the financial markets and the regulatory system and submit related periodic reports to Congress. The Oversight Panel will consist of five members, including one appointed by the Speaker of the House of Representatives, one appointed by the minority leader of each of the House of Representatives and of the Senate, and one appointed by the majority leader of the Senate.

Interest on Federal Reserve Deposits

EESA provides for an acceleration of the effective date, from October 1, 2011 to October 1, 2008, of a provision permitting the Federal Reserve Board to pay interest on balances held on behalf of depository institutions.

Federal Deposit Insurance

The maximum federal deposit insurance amount was temporarily increased from $100,000 to $250,000 until December 31, 2009. The FDIC may fund this increase through unlimited borrowings from the Treasury.

Program Development

In keeping with the Treasury's strategy of creating a toolkit of options to restore liquidity to the market, the Treasury has announced the creation of seven programs for the further development of tools and other important elements that are required under TARP. Those programs and their identified purposes, as set forth in the Assistant Secretary's recent remarks before the Institute of International Bankers, are as follows:

<u>Mortgage-Backed Securities Purchase Program:</u> To identify troubled assets to be purchased, from whom to purchase them, and the purchase mechanism that will best meet the Treasury's policy objectives; to design the detailed auction protocols and work with vendors to implement the program.

<u>Whole Loan Purchase Program</u>: To work with bank regulators to identify types of loans to be purchased, how to value those loans, and the purchase mechanism that will best meet the Treasury's policy objectives (particularly for regional banks which are clogged with whole residential mortgage loans).

<u>Insurance Program</u>: To insure troubled assets; although the Treasury has several ideas on how to structure this program, including how to insure mortgage-backed securities as well as whole loans, it intends to submit to the Federal Register a public Request for Comment to solicit the best ideas on structuring options, with responses to be required within fourteen days thereof, so the Treasury can begin designing the program.

Equity Purchase Program: To design a standardized program to purchase equity in a broad array of financial institutions; as with the other programs, the equity purchase program will be voluntary and designed with attractive terms to encourage participation from healthy institutions; it will also encourage firms to raise new private capital to complement public capital.

Homeownership Preservation: To identify opportunities that may be of help to homeowners, with regard to mortgages and mortgage-backed securities purchased by the Treasury (this goal is consistent with other programs — such as HOPE NOW — aimed at working with borrowers, counselors and servicers to assist borrowers in retaining their homes); to work with the Department of Housing and Urban Development to maximize similar opportunities to help as many homeowners as possible, while also protecting taxpayers.

Executive Compensation: To define the requirements for financial institutions to participate in three possible scenarios: (i) an auction purchase of troubled assets; (ii) a broad equity or direct purchase program; and (iii) a case of an intervention to prevent the impending failure of a systemically significant institution; the Act sets out important requirements regarding executive compensation for firms that participate in the TARP.

Compliance: To confirm that the oversight and compliance structures established under the Act are functioning correctly, including establishment of an Oversight Board, on-site participation of the General Accounting Office and the creation of a Special Inspector General, with thorough reporting requirements.

Termination of EESA

EESA should terminate on December 31, 2009, but may be extended for a period of up to two (2) years from the date it is enacted upon the Secretary's written certification to Congress justifying why the extension is necessary to assist American families and stabilize financial markets. Notwithstanding the termination of EESA, the authority of the Secretary to hold troubled assets purchased under the Act before the termination date, or to purchase or fund the purchase of a troubled asset under a commitment entered into before the termination date, is not subject to termination.

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