



BROWN RUDNICK'S STRUCTURED RESOLUTION GROUP

US TREASURY BAIL-OUT ALERT

Breaking News ... As this Alert is being finalized, reports have been received that as the final votes are tallied in the House, the bail-out bill appears to be short of the votes needed for passage. We will continue to monitor the situation in Congress and will supplement this report once reliable information is available.

SEPTEMBER 29, 2008

Last week's effort to agree on a plan aimed at rescuing the battered financial markets resulted in one of the most dramatic weeks in recent Capitol Hill history. Thursday evening's White House meeting among President Bush, House and Senate leaders and Senators John McCain and Barack Obama, far from delivering the needed momentum to finalize the rescue plan, had the opposite effect of fanning the flames of opposition from many Republican lawmakers. As a result, most of Friday's activity consisted of partisan bickering that threatened the week's progress. Nevertheless, by Friday evening both parties had reiterated their willingness to work with each other through the weekend in an effort to find a solution to the financial crisis by Monday. By Sunday morning, it was confirmed that Congressional leaders had reached a tentative agreement, a draft of which was distributed to the public in the late afternoon, after further fine-tuning through the early part of the day. Following is a summary of the key provisions of the bipartisan bill.

- **Authority of Treasury:** The core of the program has remained the same from the outset. The bill authorizes the Treasury Secretary to purchase, and to make and fund commitments to purchase, troubled residential and commercial mortgage-related securities and other financial instruments from any financial institutions organized in the United States and other U.S. territories and having significant operations in the United States. The troubled assets must have been originated or issued on or before March 14, 2008, and the financial institutions covered by the program will include banks, savings association, credit unions, security brokers/dealers and insurance companies. The legislation authorizes the Treasury Secretary to purchase securities through auctions, reverse auctions or direct purchases. The legislation requires the Treasury Secretary, before the earlier of the end of the 2-business-day period beginning on the date of the first purchase of troubled assets or the end of the 45-day period following the enactment of the bill, to publish guidelines on the program's procedures, such as the mechanisms for purchasing troubled assets, methods of pricing and valuation, procedures for selecting managers and criteria for identifying troubled assets for purchase. The Treasury Secretary will have the right to manage and sell any trouble asset purchased under the program.



- **Size of Program:** Under the draft bill, \$250 billion for the purchase of troubled assets will be available immediately and an additional \$100 billion will be made available following the President's request. As to the remaining \$350 billion authorized for the program, Congress has the right to revoke such authorization, by joint resolution within 15 days of the President's notification of intent to use the remaining authority, but such revocation is subject to the President's veto, which will require a two-thirds vote to overturn. The amount of troubled assets purchased by the Treasury outstanding at any one time is not to exceed \$700 billion.

- **Taxpayer Protection:** Upon first reviewing the government's proposal, members of both parties expressed their intention to ensure that protections to the American people are at the forefront of any rescue plan of the financial markets. To that effect, the bipartisan bill establishes as a main objective of the program to maximize benefits to the taxpayers and minimize any long-term negative impacts, which is accomplished through the following provisions: 1) the encouragement of private sector participation, 2) the use of market mechanisms to evaluate purchasing decisions, including auctions and reverse auctions, 3) the requirement of issuance of regulations addressing conflicts of interest as part of the program, and 4) the requirement of the government's receipt of equity stakes in participating financial institutions in the form of warrants (in the case of public companies seeking relief) or senior debt instruments (in the case of private companies). Moreover, in the event of a net loss resulting from the program, upon the expiration of the 5-year period after the bill is enacted, the President will be required to submit a proposal to Congress to recoup losses from institutions that benefit from the program.

- **Executive Compensation:** Another area that, despite initial pushback from the Republicans, members of both parties agreed to make part of the plan was the curbing of excessive compensation for participating companies. For companies from which the Treasury purchases assets directly, the bipartisan bill prohibits golden parachutes and incentives on risky behavior while allowing for claw-back mechanisms. For companies that sell to the Treasury through the auction mechanism, the limitations are more limited but also include a prohibition of golden parachutes if more than \$300 million of assets are sold to the Treasury (a threshold also applicable for direct sales). The bill also includes tax provisions for the treatment of executive compensation, including a tax-deduction limit on compensation above \$500,000.

- **Insurance Option:** The Treasury is required to establish a voluntary insurance program to guarantee the timely payment of interest and/or principal on troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities. The premiums – to be paid by the insured financial institutions – will be determined by category or class of the troubled assets to be guaranteed. The inclusion of the insurance program in the draft bill was introduced by Republican legislators, first as an alternative to the purchase program and then as a way to potentially lessen the financial burden of the government.



- **Foreclosure Relief:** The Treasury Secretary is required to implement a plan to maximize assistance to homeowners and to reduce the number of foreclosures. The Secretary may also use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. The legislation also provides for other forms of homeownership assistance.
- **Mark-to-Market Accounting:** In what could potentially become a very interesting provision, the legislation grants to the Securities and Exchange Commission the authority to suspend the application of mark-to-market accounting rules “with respect to any class or category of transaction if the Commission determines that [it] is necessary or appropriate in the public interest and is consistent with the protection of investors.” The Securities and Exchange Commission is also required to conduct a study on this rule and report its findings to Congress.
- **Oversight and Transparency:** The bill establishes various oversight bodies under the program, including the Financial Stability Oversight Board to review and report on the exercise of authority by the Treasury Secretary, a Congressional Oversight Panel receiving reports from the Treasury every 30 days, and oversight and auditing performed by the Comptroller General of the United States. As part of the program, the Treasury Secretary will be responsible for providing regular reports to the appropriate committees of Congress every 30 days, as well as reports triggered by various levels of commitment and purchases. Moreover, the Treasury Secretary will be required to provide a report providing analysis and recommendations on the current state of the regulatory system of the financial markets, including the much talked about swap markets and other government-sponsored enterprise, by April 30, 2009, as well as a report on the results of a study of the causes behind the current financial crisis by January 1st. Finally, the bill requires electronic dissemination to the general public of pricing information related to the assets purchased under the program within 2 business days of such purchase.
- **Termination:** The Treasury’s purchasing powers under the legislation are set to terminate on December 31, 2009 but the Treasury Secretary, upon submission of a written certification to Congress, may extend the authority provided under the draft bill to 2 years from the date of the bill’s enactment.

A meeting of the Republican caucus to discuss the draft of the bill on Sunday evening lasted over three hours, and many read this as further evidence of the high level of discomfort felt by many conservative Republicans with this degree of governmental intervention in the financial markets. Moreover, the realities of election year maneuvering have settled in, as many members of Congress that are up for re-election ponder the effects of voting for a bill that continues to be vehemently opposed by their constituents. As such, passage of the bill and the future of the financial markets seems to now rest in the hands of the rank-and-file members of Congress. Many are hopeful there will be a revised bill in the House by Wednesday and in the Senate shortly thereafter. There is every reason to believe this bill will pass, but in what form no one can predict. We will continue to monitor the developments on the voting of the bill and provide you with timely updates on the implications of the final bill.



Questions and Answers

In addition to the overriding question of whether Congress can muster sufficient votes to pass the bail-out package, the following Q&A is offered to highlight some of the bill's features as well as some of its ambiguities:

Q: Does the bill permit the Treasury to purchase non-mortgage related assets?

A: *The bill defines "troubled assets" to include not only residential or commercial mortgages and securities based on such mortgages, but also any other financial instrument that the Secretary, after consultation with the chairman of the Federal Reserve, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination in writing to the appropriate Congressional committees.*

Q: Does the bill mandate the Treasury to utilize the insurance provisions and to impose insurance-related charges on the participating institutions?

A: *While the bill mandates the adoption of an insurance program by the Treasury, it does not appear to require that the Secretary actually utilize insurance guarantees of troubled assets, but instead the bill makes such guarantees and premiums associated therewith subject to the discretion of the Secretary, based on the category or class of the troubled assets.*

Q: Other than the rules limiting deductibility of compensation for certain executives of participating institutions in excess of \$500,000, are there any other caps imposed on salary for participating institutions' executives?

A: *No, although the bill makes several modifications to the Internal Revenue Code, the implications of which we will discuss in an upcoming alert.*

Q: Are changes in the mark-to-market rules mandated by the bail-out proposal?

A: *No. The SEC has the right (and not the obligation) to suspend the mark-to-market rules and is required to conduct a study to determine the impact of the rules.*

Q: Are financial institutions other than those established and regulated under the laws of the United States or any U.S. territory covered by the bail-out plan?

A: *No.*

Q: Can the Government impose governance changes on companies which participate in the bail-out program?



A: *Where the Treasury makes direct purchases of troubled assets and receives a meaningful equity or debt position, the bill requires that the Secretary of the Treasury impose standards for executive compensation as well as corporate governance, and those standards will be effective for the duration of the period during which the government holds an equity or debt position in the institution. The bill as drafted does not specify what governance provisions may be imposed, and therefore this is presumably within the discretion of the Secretary.*

Q: **Does the disallowance of tax deductions for executive compensation of participating institutions in excess of \$500,000 cover all participating institutions?**

A: *This provision is limited to institutions from which one or more troubled assets is acquired where more than \$300 million of assets in the aggregate are acquired, excluding assets acquired through direct purchases. The bill also contains specific provisions governing what employees are covered by this disallowance provision.*

Q: **Are golden parachutes prohibited for any institution participating in the program?**

A: *Golden parachute prohibition applies wherever the government purchases troubled assets where no bidding process or market prices are available; and where the government purchases troubled assets using an auction process and the purchases exceed \$300 million, golden parachutes must be prohibited for any executive who is a "covered executive" under IRC Section 162(m)(5)(D).*

Q: **Does the bill call for judicial review or equitable or injunctive remedies with respect to actions by the Treasury?**

A: *The bill does call for judicial review of unlawful, arbitrary or capricious acts or abuses of discretion, prohibits equitable relief, and provides for limited and expedited issuance of temporary restraining orders, preliminary injunctions, and permanent injunctions.*

If you have any questions or would like more information, please contact one of the following Brown Rudnick attorneys:

Jonathan C. Black at +1.617.856.8484 / jblack@brownrudnick.com
Ronald S. Borod at +1.617.856.8373 / rborod@brownrudnick.com
Steven B. Levine at +1.617.856.8587 / slevine@brownrudnick.com
Robert J. Stark at +1.212.209.4862 / rstark@brownrudnick.com
Edward S. Weisfelner at +1.212.209.4900 / eweisfelner@brownrudnick.com

Yanire Martes and Eugene Solomonov contributed to the development of this alert.

Information contained in this Alert is not intended to constitute legal advice by the author or the attorneys at Brown Rudnick LLP, and they expressly disclaim any such interpretation by any party. Specific legal advice depends on the facts of each situation and may vary from situation to situation.

Distribution of this Alert to interested parties does not establish an attorney-client relationship. The views expressed herein are solely the views of the authors and do not represent the views of Brown Rudnick LLP, those parties represented by the authors, or those parties represented by Brown Rudnick LLP.

