

September 29, 2008

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**Emergency Economic Stabilization
Act of 2008**
Highlights of the Discussion Draft Bill

The following is a brief summary of the attached [Discussion Draft Bill](#), dated Sunday, September 28, 2008, providing for the Troubled Assets Relief Program, which Congress is now considering. This updates our [Friday, September 26, 2008 summary](#) of the Draft Bill. We will provide you with updates and other information regarding this legislation as it progresses.

Please contact any of the following members of our Financial Services Regulation, Distressed Assets, and Executive Compensation Practice Groups for further information.

Highlights of the Discussion Draft Bill
(as of the evening of September 28, 2008)

The numbers in brackets below refer to the page numbers in the Discussion Draft Bill.

- The Act is titled the “Emergency Economic Stabilization Act of 2008.” [1]
- Key defined terms [4-6]:
 - “Financial institution” means any institution, including 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, Commonwealth of Puerto Rico, Commonwealth of Northern Marianas Islands, Guam, American Samoa, or the United States Virgin Islands, and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.
 - “Troubled assets” means 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, the purchase of which the Secretary determines promotes financial market stability; and, upon the determination of the Secretary in consultation with the Chairman of the Board of Governors of the Federal Reserve, any other financial instrument, the purchase of which the Secretary determines necessary to promote financial market stability.
- The Bill contains the purposes of the Act [3] and considerations that the Secretary shall take into account when exercising the authorities under the Act [12-14].
- The Secretary of the Treasury has authority to establish a program, called the “Troubled Assets Relief Program” (the “TARP”), to purchase Troubled Assets

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through an Office of Financial Stability within the Office of Domestic Finance of the Department of the Treasury. [6-7]

- Consultation: In exercising this authority, the Secretary shall consult with the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the FDIC, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and the Secretary of Housing and Urban Development. [7]
- Program Guidelines: The Secretary shall publish guidelines, including mechanisms for purchasing Troubled Assets, methods for pricing and valuing Troubled Assets, procedures for selecting asset managers, and criteria for identifying Troubled Assets for purchase. [8-9]
- Coordination with Foreign Authorities and Central Banks: The Secretary shall coordinate, as appropriate, with foreign financial authorities and central banks to work toward the establishment of similar programs by such authorities and central banks. [33]
- Graduated Authorization to Purchase: The maximum amount of authorized purchases outstanding at any one time is \$700 billion. However, this authority is subject to the following limitations [40-49]:
 - The authority of the Secretary to purchase Troubled Assets shall be initially limited to \$250 billion outstanding at any one time.
 - If at any time the President submits to Congress written notification that the Secretary is exercising the authority, effective upon such submission, the limitation shall increase to \$350 billion outstanding at any one time.
 - If at any time the President submits to Congress a written report detailing the plan of the Secretary to exercise the authority under this paragraph, unless there is enacted, within 15 calendar days of such submission, a joint resolution, effective upon the expiration of such 15-day period, the authority increases to \$700 billion outstanding at any one time. The Bill provides detailed procedural requirements relating to the content and adoption of such a resolution.
- Preventing Unjust Enrichment: In making purchases under the authority of the Act, the Secretary shall take such steps as may be necessary to prevent unjust enrichment of Financial Institutions participating in the TARP, including by preventing the sale to the Secretary of a Troubled Asset at a higher price than paid by the seller. [9]
 - This requirement, however, does not apply to Troubled Assets acquired in a merger or acquisition, or a purchase of assets from a Financial Institution in conservatorship or receivership, or that has initiated Chapter 11 bankruptcy proceedings. [9]
- Mechanisms: The Secretary shall use market mechanisms to make efficient use of taxpayer resources, including auctions and reverse auctions. [33-35]
 - If the Secretary determines that using market mechanisms is not feasible or appropriate, and the purposes of the Act are best met through direct purchases from an individual Financial Institution, the Secretary shall pursue additional measures to ensure that prices paid for assets are reasonable and reflect the underlying value of the asset. [35]
- Conditions on Purchase Authority: The Secretary may not purchase Troubled Assets unless the Secretary receives a warrant giving the right to the Secretary to receive non-voting common stock or preferred stock in such Financial Institution in the case of a Financial Institution that is registered (or approved for registration) and traded on a national

securities exchange or a national securities association. In the case of any Financial Institution other than one described in the previous sentence, the Secretary may not purchase Troubled Assets unless the Secretary receives a senior debt instrument from such Financial Institution. The Bill provides specific requirements for such warrants and debt. [35-38]

- The Secretary shall establish a de minimis exception to these requirements based on the size of the cumulative transactions of Troubled Assets purchased from any one Financial Institution for the duration of the program, at not more than \$100,000,000. [38-39]
 - In addition, the Secretary shall establish an exception to these requirements and appropriate alternative requirements for any participating Financial Institution that is legally prohibited from issuing securities and debt instruments. [39]
- If the Secretary establishes the TARP, then the Secretary shall establish a program to guarantee Troubled Assets originated or issued prior to March 14, 2008, including mortgage-backed securities. [9-12]
 - In establishing any such guarantee program, the Secretary may develop guarantees of Troubled Assets and the associated premiums for such guarantees.
 - Upon request of a Financial Institution, the Secretary may guarantee the timely payment of principal of, and interest on, Troubled Assets in amounts not to exceed 100% of such payments.
 - The Secretary shall collect premiums from any Financial Institution participating in the TARP, which the Secretary shall deposit into a Troubled Assets Insurance Financing Fund.
 - Any balance in such Fund shall be invested by the Secretary in United States Treasury securities, or kept in cash on hand or on deposit, as necessary.
 - The Secretary shall make payments from amounts deposited in the Fund to fulfill obligations of the guarantees provided to Financial Institutions.
- The Secretary shall determine the adequacy of existing public disclosure requirements for Financial Institutions participating in the TARP. [39]
 - The Secretary has authority to manage Troubled Assets purchased under the Act. [21]
 - The FDIC shall be eligible for, and shall be considered in, the selection of asset managers for residential mortgage loans and residential mortgage-backed securities. [23-24]
 - The Secretary, upon terms and conditions and at prices determined by the Secretary, may sell, or enter into securities loans, repurchase transactions, or other financial transactions in regard to, any Troubled Assets purchased under the Act. [22]
 - Revenues of, and proceeds from the sale of Troubled Assets purchased under the TARP, or from the sale, exercise, or surrender of warrants or senior debt instruments acquired under the Act shall be paid into the general fund of the Treasury to reduce the public debt. [22]
 - Oversight includes the following:
 - A Financial Stability Oversight Board is established to review the exercise of authority, make recommendations, and report any suspected fraud, misrepresentations, or malfeasance to the Inspector General for the Department of the Treasury or the United States Attorney General.

[14-17]

- The Financial Stability Oversight Board may appoint a Credit Review Committee to evaluate the exercise of the purchase authority. [17]
 - The Comptroller General shall conduct ongoing oversight of the activities and performance of the TARP, and the agents and representatives of the TARP, conduct a study to assess the impact of the program, and submit a report of the study to Congress. [49-53]
 - Disclosure to Congress and the public of financial statements of the TARP, which are audited by the Comptroller General. [53-56]
 - A Special Inspector General for the Troubled Asset Program. [62-68]
 - A Congressional Oversight Panel is established in the legislative branch to review the current state of the financial markets and the regulatory system and submit monthly reports to Congress. [70-76]
- Required studies include the following:
 - A study by the Comptroller General to determine the extent to which leverage and sudden deleveraging of Financial Institutions was a factor behind the current financial crisis. [56-57]
 - A study by the SEC, in consultation with the Board of Governors of the Federal Reserve System and the Secretary, on mark-to-market accounting standards as provided in Statement Number 157 of the Financial Accounting Standards Board, as such standards are applicable to Financial Institutions, including depository institutions. [89-90]
- Required reports include the following:
 - Certain reports to Congress and Congressional Oversight Panel by the Secretary. [18-21]
 - Five years from enactment of the Act, reports by the Office of Management and Budget, in consultation with Congressional Budget Office to the President and to Congress on the net amount within the TARP. [90]
 - In any case in which there is a shortfall, the President shall submit to Congress a legislative proposal that recoups from entities benefiting from the program an amount equal to the shortfall in order to ensure that the TARP does not add to the budget deficit or the national debt. [90]
 - Reports by the Office of Management and Budget and Congressional Budget Office to the President and Congress to provide an estimate of the cost of the Troubled Assets acquired under the Act. [91-93]
 - Inclusion in the President's Budget of an analysis of the budgetary effects of the actions the Secretary has taken or plans to take using any authority provided in the Act. [93-95]
 - The Board of Governors of the Federal Reserve System shall report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives relating to the Secretary's exercise of its loan authority pursuant to the third paragraph of Section 13 of the Federal Reserve Act. [84-86]
- Foreclosure mitigation efforts include the Secretary encouraging the servicers of the underlying mortgages to take advantage of the HOPE for Homeowners Program, and the Secretary using loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. [25]
 - The Secretary shall coordinate with the FDIC, the Board of Governors of the Federal Reserve System, the Federal Housing Finance Agency, the Department of Housing and Urban Development, and other Federal Government entities that hold Troubled Assets. [25-56]

- In addition, foreclosure mitigation efforts include the Secretary's authority to consent to reasonable loan modification requests for residential mortgage loans. [26]
- Provides for a systematic homeowner assistance program by the FDIC, the Board of Governors of the Federal Reserve System, and the Federal Housing Finance Agency, including modification of loans secured by residences, and tenant protections in the case of mortgages on residential rental properties. [26-30]
- Executive compensation [30-33]:
 - In cases of direct purchase of Troubled Assets, which is coupled with a meaningful equity or debt position for the government in the selling Financial Institution, the Secretary shall require that the Financial Institution meet appropriate standards for executive compensation, including limits on incentive compensation that encourages unnecessary or excessive risks that threaten the value of the Financial Institution, a clawback for a bonus or incentive compensation where the executive has made a materially inaccurate public statement about the firm's financial position and prohibition on golden parachute payments to senior executive officers during the period that the Secretary holds an equity or debt position in the Financial Institution. "Senior executive officer" is defined as those 5 officers whose compensation is required to be disclosed for securities law purposes.
 - In cases of auction purchases of Troubled Assets, when a Financial Institution's sales to the government in the aggregate exceed \$300,000,000 (including direct purchases), the Secretary shall prohibit such Financial Institution from entering into any new employment contract with a senior executive officer that provides a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership.
- Judicial Review [58-61]:
 - Any actions of the Secretary pursuant to the authority of the Act shall be held unlawful and set aside only if found to be arbitrary, capricious, an abuse of discretion, or not in accordance with the law.
 - The bill provides for limitations on the grant of equitable relief against the Secretary for actions taken pursuant to the Act.
 - The terms of a residential mortgage loan that is part of any purchase by the Secretary shall remain subject to all claims and defenses that would otherwise apply.
 - The bill provides a savings clause for the claims or defenses that would otherwise apply with respect to persons other than the Secretary.
- The authority of the Secretary to purchase Troubled Assets under the Act terminates on December 31, 2009, unless extended. [61]
- Includes amendments to Section 257 of the National Housing Act regarding the HOPE for Homeowners Program. [69-70]
- Includes amendments to Section 18(a) of the Federal Deposit Insurance Act (12 U.S.C. 1828(a)), adding prohibitions on false advertising, misuse of FDIC name, and misrepresentation to indicate insured status, and grant of enforcement authority in the case of violation to the appropriate federal banking agency, which is to be determined by the FDIC. The bill provides various enforcement mechanisms available to the FDIC. [76-83]
 - Any Federal financial regulatory agency shall cooperate with the Federal Bureau of Investigation and other law enforcement agencies

investigating fraud, misrepresentation, and malfeasance with respect to development, advertising, and sale of financial products. [84]

- Includes amendments to the Truth in Lending Act (15 U.S.C. 1638(b)(2)), as amended by section 2502 of the Mortgage Disclosure Improvement Act of 2008 (Public Law 110-289), regarding mortgage disclosure requirements. [86-87]
- The Secretary shall reimburse the Exchange Stabilization Fund established under section 5302 of Title 31, United States Code, for any funds used for the temporary guaranty program for the United States money market mutual fund industry, from funds under the Act. The Secretary is prohibited from using the Exchange Stabilization Fund for the establishment of any future guaranty programs for the United States money market mutual fund industry. [87-88]
- The SEC shall have the authority under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) to suspend, by rule, regulation, or order, the application of Statement Number 157 of the Financial Accounting Standards Board (mark to market accounting) for any issuer (as such term is defined in section 3(a)(8) of such Act) or with respect to any class or category of transaction if the Commission determines that is necessary or appropriate in the public interest and is consistent with the protection of investors. [88]
- Tax Provisions, including tax provisions related to Executive Compensation:
 - The gain or loss from the sale or exchange of any applicable preferred stock in FNMA and FHLMC (Fannie Mae or Freddie Mac) by any applicable Financial Institution during 2008 prior to September 7th (subject to extension in some cases), shall be treated as ordinary income or loss. [96-99]
 - The exclusion from income for the discharge of principal residence indebtedness is extended 2 years to January 1, 2013. [110]
 - For periods after a Financial Institution has sold \$300,000,000 in Troubled Assets to the government (excluding direct sales for this purpose), no deduction shall be allowed for executive remuneration paid to the CEO, CFO and 3 highest paid executive officers (covered executives) in respect of such taxable year, to the extent that the amount of such remuneration exceeds \$500,000 for a public company, under Section 162(m) of the Internal Revenue Code [99] and the same limitation shall apply with respect to a compensation deduction that is deferred to a future year in respect of a taxable year covered by this provision. In addition, once an executive is a covered executive, that individual will retain that status for purposes of this provision even if he or she would otherwise cease to be a covered executive. [100]
 - The golden parachute provisions of Section 280G of the Internal Revenue Code are amended to extend their application to a covered executives receiving severance payments from a Financial Institution having sold in excess of \$300,000,000 in Troubled Assets to the government, on account of an involuntary termination, or in connection with its bankruptcy, liquidation or receivership, without regard to whether or not there is a change in control of the entity. The Secretary is authorized to make parallel changes to Section 4999, which imposes a non-deductible 20% excise tax on the executive. [106-109]

Distressed Assets Practice

Day Pitney's Distressed Assets Practice Group is a multi-disciplinary team serving buyers and sellers in connection with acquisitions, dispositions, restructurings, and workouts of distressed companies, including their securities and assets. The group

services national and regional clients from our offices in New York, Connecticut, Massachusetts, New Jersey and Washington DC. As a result of the 2007 merger of Day, Berry & Howard and Pitney Hardin, Day Pitney has harnessed each firm's respective history of providing sophisticated distressed assets advice.

For more information about the Distressed Assets Practice Group, please contact co-chairs Robert G. Siegel and James J. Tancredi at rgsiegel@daypitney.com and jjtancredi@daypitney.com.

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