

# Client Alert

This summary was jointly prepared by Goodwin Procter's Real Estate/Real Estate Capital Markets and Financial Services Groups

## Congress Passes and President Signs Into Law Emergency Economic Stabilization Act of 2008

Congress has passed the Emergency Economic Stabilization Act of 2008, H.R. 1424 (the "Act"), authorizing the Administration's \$700 billion U.S. economic rescue plan, and President Bush has signed the Act into law. The House passed the bill today by a vote of 263-171, following Senate approval Wednesday by a vote of 74 to 25. The House vote today was its second vote on the rescue plan, after a similar bill failed to pass on Monday. A number of sought-after tax and health provisions were attached to the economic rescue legislation, as well as an increase in FDIC deposit insurance, in order to secure passage. The Act contains the following major provisions:

### **Troubled Asset Relief Program (TARP)**

The bill authorizes a troubled asset relief program ("TARP") to be administered by the Secretary of Treasury ("Treasury") through a new Office of Financial Security ("OFS") under the Assistant Secretary for Domestic Finance. The OFS is to exercise its authority in consultation with the FRB, OCC, OTS and HUD. Section 101. The program expires on December 31, 2009, but is subject to extension to not later than two years from enactment by Treasury certification. Section 120.

- **Purchase Authority.** The TARP has graduated authority to purchase directly or through auction up to \$700 billion in financial institution assets (including whole loans or securitized assets from all institutions of all sizes), of which \$250 billion will be available for purchases immediately, \$100 billion will be available with Presidential certification, and \$350 billion will be available for purchases only following a Presidential request and a 15-day waiting period in which Congress may object by joint resolution. Section 115. Treasury may manage and sell troubled assets or enter into securities loans, repurchase transactions or other financial transactions in regard to any troubled assets purchased. Section 106.
- **Eligible Financial Institutions.** Financial institutions eligible for the program include, but are not limited to, banks, broker-dealers and insurance companies established and regulated under U.S. law (or state, territory or possession law) and having "significant operations" in the U.S., but exclude foreign central banks and institutions owned by foreign governments. With regard to foreign banks, the Act's language appears to include their licensed U.S. branches and agencies. Section 3(5).

- **Eligible Troubled Assets.** Troubled assets eligible for the program are residential or commercial mortgages and any securities, obligations or other instruments that are based on or related to such mortgages, in each case originated or issued before March 14, 2008, or other financial instruments that Treasury determines are necessary after consultation with the FRB Chairman. Section 3(9).
- **Program Operation and Asset Pricing.** Treasury has broad authority to design and implement the program. The Act sets broad (potentially conflicting) program “considerations” that include goals to minimize negative impact to the taxpayer by maximizing return, encourage private participation, stabilize and prevent disruption of financial markets, keep families in their homes and stabilize communities, consider the long term viability of sellers in determining whether an asset purchase is the most efficient use of funds, and open TARP to all financial institutions without regard to geography, form of organization, asset size or type, or number of troubled assets. Section 103.

Pricing is to be the “lowest price ... consistent with the purposes” of the Act. Treasury may use auctions if feasible. In making direct purchases, Treasury is to take steps to ensure that direct purchases are at “reasonable” prices and reflect the “underlying value of the asset.” Section 113. Treasury is not to purchase assets at a price higher than the seller’s purchase price, except with respect to troubled assets acquired in a merger or acquisition or from a financial institution in conservatorship, receivership or Chapter 11 of the Bankruptcy Code. Section 101.

Treasury must issue program guidelines within the earlier of 2 business days of the first purchase or 45 days of enactment. The guidelines must include 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. Section 101(d). Treasury can waive certain federal contracting regulations, but is directed to provide opportunities for minority and women owned businesses. Section 107. Treasury is required to issue regulations or guidelines to address conflicts of interest as soon as practicable after enactment. Section 108.

- **Price Transparency, Reporting.** The bill contains transparency provisions intended to provide more certainty to market participants in trading the types of assets covered by the program. Treasury is required to disclose in publicly accessible electronic form all asset purchases, trades and other dispositions, including a description, amounts and pricing within 2 business days. Treasury is also to determine the adequacy of disclosure requirements for each type of financial institution that sells troubled assets and make any recommendations to relevant regulators. Section 114. In addition, Treasury is required to provide a detailed tranche report within a week after each \$50 billion is expended that includes all transactions, terms, the pricing mechanism and justification of pricing, and impacts of transactions on the financial system. Treasury must report to Congress within 60 days of its exercise of authority under the TARP or the insurance alternative (see

Alternative Industry Funded Insurance Program below), and every 30 days thereafter. Section 105.

- **Judicial Review.** Injunctions and equitable relief are restricted with regard to Treasury purchases, asset management or actions to mitigate foreclosure and, when such actions are permitted, they will be expedited. Actions by persons that sell assets to Treasury (and certain other actions against Treasury) are limited to judicial review under the Administrative Procedure Act unless otherwise provided by contract with Treasury. Homeowners will not lose rights with respect to assets sold to Treasury. Section 119.
- **Coordination with Foreign Authorities and Treatment of Foreign Troubled Assets.** Treasury must coordinate with foreign financial authorities and central banks to work toward establishing similar programs. Troubled assets held by foreign financial authorities or banks as a result of extending financing to financial institutions that have failed or defaulted on such financing are eligible for TARP purchase. Section 112.
- **Alternative Industry Funded Insurance Program.** When Treasury establishes the TARP program, Treasury is also required to establish an alternative program to guarantee payment of troubled assets of financial institutions through private risk based premiums – at no cost to the taxpayer. Treasury is required to establish risk-based premiums sufficient to cover anticipated claims. Treasury must report to Congress on the establishment of the guarantee program within 90 days of enactment. Section 102.
- **Government to Receive Warrants Subject to Possible \$100 Million “De Minimis” Exception.** A government stake in an institution that benefits from the program may be required. Treasury may not purchase or commit to purchase any troubled assets without receiving non-voting common or preferred stock warrants from publicly held institutions or a senior debt instrument from other institutions. Warrants are to provide “reasonable participation” by Treasury for the benefit of taxpayers in equity appreciation (or a reasonable interest rate premium in the case of a debt instrument) – leading to questions regarding the potential dilutive impact. However, a “de minimis” exception may be applied to cumulative transactions of troubled assets purchased from any one financial institution for the duration of the program not exceeding \$100 million. The bill permits the development of alternative forms of stakes for financial institutions legally prohibited from issuing warrants and debt instruments. Section 113. In addition, if there is a shortfall in the fund after 5 years, “recoupment” from the industry may be required by legislation. Section 134.
- **Executive Compensation and Golden Parachutes.** Executive compensation limits, including restrictions on golden parachutes, apply to financial institutions that sell troubled assets to Treasury. When Treasury purchases assets directly, the institution must observe executive compensation and corporate governance standards to be set by Treasury for the duration of the

period that the Treasury holds a debt or equity position in the financial institution. These limits apply to the named executive officer group (in the case of reporting companies) and their counterparts (in the case of non-public companies) and include limits on incentives to take unnecessary and excessive risks, prohibitions on golden parachutes and claw-back provisions to recover bonuses or incentives based on earnings or other criteria that later turn out to be materially inaccurate. When assets are purchased at auction, an institution that has sold more than \$300 million of assets (including direct purchases) is prohibited from entering into any new employment contract with a senior executive officer that provides golden parachute payments in the event of an involuntary termination, bankruptcy filing, insolvency or receivership. This prohibition applies while the Act is in effect. Treasury must issue guidance within 60 days. The Act also amends Section 162(m) of the Internal Revenue Code to limit the annual deductible compensation to \$500,000 in any year that the Act is in effect for a covered executive (CEO, CFO, or one of the top three most highly compensated employees) of a financial institution that has sold more than \$300 million of assets. The Act further amends Section 280G of the Internal Revenue Code to impose the 20% golden parachute tax, as well as the loss of corporate tax deduction, on severance payments received by covered executives of the financial institutions participating in the relief program even in the absence of a change in control. Sections 111 and 302.

- ***Oversight of TARP.*** The program is subject to review and recommendations by a Financial Stability Oversight Board, consisting of the FRB Chairman, Treasury Secretary, Director of the Federal Housing Finance Agency (“FHFA”), SEC Chairman, and HUD Secretary. Section 104. GAO will also have oversight and audit authority. Section 116. An independent Office of Inspector General also is established for TARP. Section 121. In addition, a Congressional Oversight Panel is created to report to Congress. Section 125.

### **FDIC Deposit Insurance Temporarily Increased to \$250,000**

From the date of enactment and extending only until December 31, 2009, the FDIC will insure deposits up to \$250,000 per account, more than doubling the \$100,000 insurance limit that generally applies currently. The temporary increase may not be taken into account by the FDIC in setting assessments. Section 136.

### **SEC Authorized to Suspend Mark to Market Accounting**

The SEC is authorized to suspend, by rule, regulation or order, the application of mark to market accounting in Statement No. 157 of the Financial Accounting Standards Board. Section 132. The SEC is required to study mark to market accounting under Statement No. 157 in consultation with the FRB and Treasury and report to Congress in 90 days. Section 133.

### **FRB Authorized to Pay Interest on Reserves**

The FRB is authorized to start paying interest on reserves on October 1, 2008. Section 128.

### **Foreclosure Mitigation**

Treasury, FRB, FHFA, FDIC and federal property managers are required to seek to mitigate residential mortgage foreclosures. Homeowner assistance provisions allow residential loan modifications including with respect to multifamily housing. Sections 109 and 110.

### **Tax Deduction for Holding Fannie Mae or Freddie Mac Preferred Stock**

The bill contains a provision allowing banks that experienced losses on their investments in Fannie Mae or Freddie Mac preferred shares to deduct their losses as ordinary losses for tax purposes. The bill provides that for purposes of the Internal Revenue Code of 1986, gain or loss from the sale or exchange of any “applicable preferred stock” by an “applicable financial institution” will be treated as ordinary income or loss. “Applicable preferred stock” means preferred stock in Fannie Mae or Freddie Mac that was held by the applicable financial institution on September 6, 2008, or was sold or exchanged by the applicable financial institution on or after January 1, 2008, and before September 7, 2008, and it appears that the tax treatment should apply to Fannie and Freddie auction rate preferred securities held in pass through trusts/partnerships. An “applicable financial institution” is generally a financial institution under Internal Revenue Code section 582(c)(2) or a depository institution holding company as defined in Federal Deposit Insurance Act Section 3(w) (special rules may apply). Section 301.

### **Reporting of Federal Reserve Emergency Lending**

Also, if the FRB uses its emergency lending authority under section 13(3) of the Federal Reserve Act, the FRB must report it to Congress within 7 days (Congress may keep confidential). Section 129.

### **GAO Study of Leverage and Margin**

The bill contains a GAO study of the role of leverage in the financial crisis and margin authority. Section 117.

### **Treasury Study of Regulatory Modernization Including Oversight of Swaps and GSEs**

A regulatory modernization report and recommendations to Congress are due by April 30, 2009. The report must include Treasury's review of the current state of the financial markets and the regulatory system, including its effectiveness in overseeing market participants including the over-the-counter swaps market and GSEs, and whether there should be enhancement in the clearing and settlement of over-the-counter swaps. Section 105.

## Additional Banking Provisions

The bill contains other provisions including: (i) an amendment to the Federal Deposit Insurance Act to strengthen regulation and enforcement with respect to misrepresentation of an instrument's insured status (Section 126), (ii) a directive to the financial regulatory agencies to cooperate with the FBI in investigating fraud and misrepresentation regarding financial products (Section 127), (iii) a "technical amendment" to section 128(b)(2) of the Truth in Lending Act (Section 130), and (iv) an extension until 2013 of the exclusion from taxable income of a lender's discharge of qualified principal residence indebtedness (Section 303).

## Attached Tax and Mental Health Parity Provisions

The economic stabilization legislation was attached to other legislation moving through the Senate and contains numerous tax provisions and mental health parity provisions. Tax provisions include extensions of tax incentives for renewable energy production and conservation and personal tax breaks for college tuition and disaster victims, a renewal of the research and development tax credit that expired last December, and a patch to prevent an expansion of the application of the Alternative Minimum Tax until 2009. The mental health parity provisions amend section 712 of the Employee Retirement Income Security Act of 1974, section 2705 of the Public Health Service Act and section 9812 of the Internal Revenue Code of 1986 to require equity in the provision of mental health and substance-related disorder benefits under group health plans.

If you have any questions about the Act or its potential implications for your business, please contact:

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