

Client Advisory

Emergency Economic Stabilization Act of 2008/Troubled Asset Relief Program (TARP)

After a weekend of negotiations, Congressional leaders are backing a revised bill entitled the Emergency Economic Stabilization Act of 2008 (EESA), which includes a modified version of the Troubled Asset Relief Program (TARP).

The draft EESA legislation is modeled on the prior draft circulated by House Financial Services Committee Chairman Barney Frank (the Frank Bill). The main differences among EESA, the Frank Bill and the version previously circulated by Senate Banking Committee Chairman Chris Dodd (the Dodd Bill, discussed with the Frank Bill in a [Katten Client Advisory](#) dated September 23, 2008) are the following provisions:

- **Bankruptcy Modifications Not Included** – Both the Dodd Bill and the Frank Bill contained controversial provisions that would have allowed bankruptcy judges to modify the terms of mortgage loans. Those provisions have been dropped and are not included in EESA.
- **Troubled Asset Insurance Fund** – This provision was at the center of the version circulated by House Republicans on Thursday and would require the Secretary of the Treasury to establish a Troubled Asset Insurance Fund to guarantee troubled assets whereby the Secretary would set risk-based premiums to sufficiently cover anticipated claims. The total amount of guaranteed obligations, minus premiums collected, would reduce the amount of the \$700 billion purchase authority granted under the TARP.
- **Equity Sharing Through Warrants** – Requires that the Treasury receive warrants from participating financial institutions giving the Treasury the right to purchase either non-voting common or preferred stock, or senior debt instruments, in order to share in any equity appreciation in those institutions, and to protect taxpayers against losses.
- **Use of Proceeds from Sales of Purchased Assets** – Prior versions of the legislation required a portion of the proceeds from sales of assets previously purchased by the TARP to be deposited in community development and affordable housing funds created under the Housing and Economic Recovery Act of 2008. The draft EESA bill, however, requires all funds to be paid into the Treasury's general fund for reduction of the public debt.
- **Preventing Unjust Enrichment** – The Secretary must take steps to prevent unjust enrichment of participating financial institutions, including selling troubled assets to the TARP at a price higher than what the purchaser paid to purchase the asset (unless the assets were acquired in a merger or acquisition, or purchased from an institution in conservatorship, receivership or bankruptcy).
- **Delayed Authorization of Full \$700 Billion of Purchase Authority** – Initially, the Secretary has immediate access to only \$250 billion of the funds. The Secretary may gain access to an additional \$100 billion upon a Presidential certification of need.

September 29, 2008

**For Additional Information
please contact any of the
following members of
Katten's TARP Task Force:**

Eric Adams, Co-Chair
212.940.6783
eric.adams@kattenlaw.com

Terra K. Atkinson
704.344.3194
terra.atkinson@kattenlaw.com

David J. Bryant
312.902.5380
david.bryant@kattenlaw.com

David R. Dlugie
312.902.5274
david.dlugie@kattenlaw.com

Hays Ellisen, Co-Chair
212.940.6669
hays.ellisen@kattenlaw.com

Mark I. Fisher
212.940.8877
mark.fisher@kattenlaw.com

Andrew L. Jagoda
212.940.8520
andrew.jagoda@kattenlaw.com

Frank Zarb
202.625.3613
frank.zarb@kattenlaw.com

The remaining \$350 billion is authorized if, after a Presidential request, Congress, using fast track procedures, does not pass a joint resolution of disapproval within 15 days.

- **Executive Compensation** – Although prior versions of the legislation contained provisions restricting executive compensation, under EESA, such restrictions depend on whether subject companies sell troubled assets to the TARP directly, or through an auction.
 - For direct purchases, if the Secretary receives a “meaningful equity or debt position in the financial institution as a result of the transaction” the Secretary must require the financial institution to have (a) limits on compensation incentives that encourage executive officers to take “unnecessary and excessive risk that threatens the value of the institution,” (b) claw-back provisions for bonuses based on earnings figures that are shown to be materially inaccurate, and (c) prohibition on “golden parachutes” to senior executive officers (top five executives, whose compensation must be reported under the Securities Exchange Act of 1934).
 - For auction purchases that exceed \$300 million with respect to any financial institution, the Secretary must prohibit new employment contracts with senior executive officers that contain “golden parachutes” in the event of involuntary termination or the failure of the institution. Additionally, such institutions are subject to a 20% excise tax on golden parachute payments triggered by such events, and tax deduction limits for amounts of compensation above \$500,000.
- **Loss Recoupment from Financial Industry** – Although provisions had been considered to require the financial industry to subsidize the TARP through immediate taxes or fees, any such decisions have been delayed through a requirement that the President submit a proposal to Congress in five years that sets forth a plan to recoup from the financial industry any projected losses to the taxpayer.
- **Required Reports** – The Secretary is required to report to Congress within 60 days of the first exercise of his authority under TARP and every month thereafter. The Secretary is additionally required to report a detailed description of all transactions (including pricing mechanisms used) for every \$50 billion in assets purchased. No later than April 30, 2009, the Secretary must report to Congress, analyzing the current state of the financial market regulatory system and making recommendations to modernize it.
- **Additional Disclosure** – EESA contains provisions similar to the Frank Bill providing for public disclosure, in electronic form, within two business days of any purchase, trade or disposition of assets, of the description, amounts and pricing of such assets. EESA, however, also requires the Secretary to determine if public disclosures about participating financial institutions, including with respect to off-balance sheet transactions, derivatives and other similar sources of exposure, are sufficient, and if not, to make recommendations.
- **Contracting Procedures** – Treasury’s original proposal waived all normal government contracting rules, and the Frank Bill and Dodd Bill reinstated those rules. Under EESA, however, the Secretary would be allowed to waive provisions of the Federal Acquisition Regulation if urgent and compelling circumstances exist, in which case a report must be made to Congress within seven days. If any minority contracting regulations are waived, alternate procedures must be developed to encourage the participation of minorities and women in the TARP.
- **Mark-to-Market Accounting** – Requires a study of mark-to-market accounting standards under FAS 157 and restates the SEC’s authority to suspend FAS 157 if the SEC determines doing so is in the public interest.
- **Tax Provisions** – Includes an extension of current tax law forgiveness for the cancellation of mortgage debts, and modifies the tax treatment for financial institutions of losses on preferred stock of certain GSEs.
- **Termination** – EESA follows the termination provision in the Dodd Bill, which sets the TARP expiration date as December 31, 2009, but provides that the program can be extended an additional year if Treasury certifies such an extension is necessary.

In addition to the provisions described above, the EESA includes provisions similar to those of the Frank Bill and Dodd Bill, including the definition of key terms such as “troubled assets” and “financial institutions,” oversight and audit procedures, foreclosure mitigation, assistance to homeowners, the establishment of a financial stability oversight board, coordination with foreign authorities and central banks, and judicial and administrative review of the Secretary’s actions.

The bill is scheduled to be presented in the House today (Monday, September 29), and although some House Republicans now support it, the number of votes it may receive is still unknown. The bill will reach the Senate immediately after passing the House, but the Senate will likely adjourn from sundown on Monday night until Thursday morning for Rosh Hashanah, so final passage may be delayed until at least Thursday (although some news sources are reporting the Senate will reconvene on Wednesday).

The revised bill can be found on the House Financial Services Committee website at:
http://financialservices.house.gov/essa/ayoo8co4_xml.pdf. Also available is a summary of each section of EESA at:
http://financialservices.house.gov/essa/final_bill_section-by-section.pdf.

Published for clients as a source of information. The material contained herein is not to be construed as legal advice or opinion.

CIRCULAR 230 DISCLOSURE: Pursuant to regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

©2008 Katten Muchin Rosenman LLP. All rights reserved.

Katten

KattenMuchinRosenman LLP

www.kattenlaw.com

CHARLOTTE

CHICAGO

IRVING

LONDON

LOS ANGELES

NEW YORK

PALO ALTO

WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).
London affiliate: Katten Muchin Rosenman Cornish LLP.

9/29/08