



BROWN RUDNICK'S STRUCTURED RESOLUTION GROUP

# US TREASURY BAIL-OUT ALERT

***Breaking News ... Bail-Out Bill signed into law.***

**OCTOBER 3, 2008**

In a major reversal of Monday's surprise rejection of the bail-out plan by the House of Representatives, the House this afternoon, by a vote of 263-171, approved the financial rescue plan that passed the Senate two days earlier. The House vote was the result of (a) a strong lobbying effort by Democratic and Republican Congressional leaders, (b) the addition of tax relief and incentive provisions that had been pending in other bills, and (c) the temporary increase in FDIC insurance from 100,000 to 250,000. But the strongest inducement for the vote shift came from the market and its 777+ point drop in response to the negative vote on Monday. The constituents in the districts took this to mean that the predictions of a financial meltdown may in fact be true, and sent the message to their representatives that a relief measure was necessary even if it ran counter to their ideology.

The rescue bill approved by the House is substantively identical to the Senate version. Summarized in our prior bail-out alerts, the legislation includes the following key provisions:

- **Purchases by 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 bill's provisions, \$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:** The 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.
- **Limit on Executive Compensation:** With respect to the financial institutions from which the Treasury purchases assets directly, the bill prohibits golden parachutes and incentives on risky behavior while allowing for claw-back mechanisms. For institutions that sell to the Treasury through the auction mechanism, the limitations are fewer 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 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.
- **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 further provides for other forms of homeownership assistance.
- **FDIC Insurance Limit:** The bill would *temporarily* raise the Federal Deposit Insurance Corporation's insurance cap on most bank accounts from \$100,000 to \$250,000 per account. The \$100,000 limit was set in 1980. The increase,



however, would only be in effect until December 31, 2009. This change appears to have broad Congressional support, and both Sens. John McCain and Barack Obama endorsed the idea. Moreover, the bill temporarily allows the Federal Deposit Insurance Corporation to borrow unlimited amounts from the Treasury in connection with the increased deposit insurance limit.

- **Mark-to-Market Accounting:** 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 1<sup>st</sup>. 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 bill to 2 years from the date of the bill’s enactment.
- **Energy Improvement and Extension Act of 2008:** Attached as a separate division to the bill, this act would provide for an institution and/or extension of various renewable energy and other energy-related tax credits. The 149-page act includes renewable energy incentives, transportation and domestic fuel security provisions and provisions relating to carbon and coal mitigation and energy efficiency and conservation.
- **Alternative Minimum Tax Relief and Other Tax Extensions:** The legislation includes the following tax incentives: (i) relief from the Alternative Minimum Tax for, mostly, upper middle-class taxpayers, (ii) extension of individual tax provisions (such as deduction for state and local sales taxes, deduction of qualified tuition and related expenses and additional standard deductions for real property taxes for non-itemizers), (iii) extension of business tax provisions (including credits for economic development, training and environmental remediation costs) and (iv) disaster relief and other tax incentives. The bill includes the “Mental Health Parity and Addiction Equity



Act of 2008," which would require medical insurance companies to provide mental illness coverage at parity with physical ailments.

Acting with deliberate speed, President Bush signed the bill into law on the same date as passage. However, this is only the beginning. While the measure has grown considerably from the 3-page bill submitted by the Treasury two weeks ago, the Treasury needs to develop specific regulations as to the details (such as pricing and administration) of the program. This is easier said than done but, with the approval of the House, the most difficult procedural hurdle is out of the way.

Future Alerts will examine the details.

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](mailto:jblack@brownrudnick.com)  
Ronald S. Borod at +1.617.856.8373 / [rborod@brownrudnick.com](mailto:rborod@brownrudnick.com)  
Steven B. Levine at +1.617.856.8587 / [slevine@brownrudnick.com](mailto:slevine@brownrudnick.com)  
Robert J. Stark at +1.212.209.4862 / [rstark@brownrudnick.com](mailto:rstark@brownrudnick.com)  
Edward S. Weisfelner at +1.212.209.4900 / [eweisfelner@brownrudnick.com](mailto: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.*

