

Management Alert

Executive Summary:

The Emergency Economic Stabilization Act of 2008

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the "Act"). The Act provides the Secretary of the Treasury (the "Secretary") with unprecedented "authority and facilities" designed to restore liquidity and stability to the financial system of the United States. For your convenience, set forth below is a thematic executive summary of the Act's provisions.

Troubled Asset Relief Program

Under the Act, the Secretary is authorized to establish the Troubled Asset Relief Program (the "TARP"). The TARP will be implemented through a new Office of Financial Stability within the Department of Treasury. The Office of Financial Stability will be headed by an Assistant Secretary of Treasury who will be appointed by the President and confirmed by the Senate.

The Act provides the Secretary with the power to purchase troubled assets from any financial institution. Troubled assets are defined to include residential or commercial mortgages and any securities, obligations or other instruments related thereto, so long as they were originated or issued on or before March 14, 2008. Troubled assets also include any other financial instrument, originated or issued at any time, the purchase of which the Secretary determines, after consulting with the Chairman of the Board of Governors of the Federal Reserve (the "Chairman"), are necessary to promote financial market stability. Financial institutions are defined to include institutions such as banks, savings associations, credit unions, security brokers or dealers or insurance companies. Further, to qualify as a "financial institution" under the Act, an institution must be 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 Mariana Islands, Guam, American Samoa or the United States Virgin Islands, and must have "significant operations" in the United States. Central banks or institutions owned by foreign governments do not qualify as "financial institutions" under the Act.

Under the Act, the Secretary has the right to manage troubled assets, to sell troubled assets and to enter into "securities loans, repurchase transactions or other financial transactions." Financial

For a detailed summary of the Act, [click here](#).

institutions are prohibited from selling assets to the Secretary at a profit, except with respect to troubled assets acquired in a merger or acquisition or acquired from a financial institution in conservatorship or receivership or that has initiated bankruptcy. The Secretary has been given the power to waive specific provisions of regulations applicable to purchases by the Federal Government if “urgent and compelling circumstances make compliance with such provisions contrary to public interest.”

The Secretary has been granted immediate authority to purchase up to a total of \$250 billion of troubled assets (the “Purchase Authority Limit”¹). Upon certification to the Congress by the President that additional funds are needed, the Secretary’s Purchase Authority Limit shall increase to \$350 billion. And, following another certification to the Congress by the President and the failure by Congress to pass a joint resolution of disapproval, the Purchase Authority Limit shall increase to \$700 billion.

Under the Act, the Secretary also has the power to establish an insurance program to guarantee troubled assets. Upon the request of a financial institution participating in such program, the Secretary may guarantee the timely payment of up to 100 percent of principal of, and interest on, a troubled asset. The Secretary shall collect premiums from financial institutions participating in the guarantee program. Such premiums shall be in an amount determined by the Secretary and may vary based upon the credit risk associated with the particular troubled asset. The premiums received by the Secretary pursuant to the guarantee program shall be placed into a Troubled Assets Insurance Financing Fund and shall be used to fulfill the obligations of the guarantees provided by the Secretary. The Purchase Authority Limit shall be reduced by an amount equal to the difference between the total of the outstanding guaranteed obligations under the insurance program and the balance in the Troubled Assets Insurance Financing Fund.

Subject to certain exceptions to be established by the Secretary, the Secretary may not purchase or make any commitment to purchase any troubled asset without first receiving (i) from a publicly traded financial institution, a warrant giving the Secretary the right to receive nonvoting common stock or preferred stock or voting stock with respect to which the Secretary agrees not to exercise voting power, as determined by the Secretary, or (ii) from a financial institution that is not publicly traded, a warrant for common or preferred stock or a senior debt instrument. In order to maximize the value for taxpayers and to maximize the return on investment for the Federal Government, the Secretary may sell, exercise or surrender the warrants or senior debt instruments, as the Secretary deems fit.

In addition to having the power to purchase troubled assets, the Secretary is also authorized to take such action as the Secretary deems necessary to carry out the purposes of the Act including, without limitation, hiring employees, entering into contracts, designating financial institutions as fiscal agents of the Federal Government, and establishing vehicles to purchase, hold and sell troubled assets and issue obligations.

The Secretary is required to use his or her authority under the Act to minimize the potential long-term negative impact on the taxpayers by holding assets to maturity or by holding assets for resale until such time as the Secretary determines that the market is optimal for selling such assets. The Secretary shall sell such assets at a price determined by the Secretary so as to maximize return on investment for the Federal Government.

¹ The Act does not contain provisions limiting the amount of troubled assets that the Secretary can buy from a single financial institution.

When purchasing or guaranteeing troubled assets, the Secretary shall consider a number of factors including, among others, the most efficient way to (i) protect taxpayers by maximizing overall returns and minimizing the impact on the national debt, (ii) provide stability and prevent disruptions to financial markets, (iii) help families keep their homes, and (iv) ensure stability for public instrumentalities such as counties and cities.

The Secretary's powers under the Act expire on December 31, 2009. Upon the submission of a written certification to Congress, the Secretary may extend his or her authority under the Act until October 3, 2010. The certification must include a justification for the extension and details regarding the anticipated cost for such extension.

Oversight, Reporting, and Disclosure Requirements

The Act establishes an Office of the Special Inspector General for the TARP. The head of such office, the Special Inspector General, shall be appointed by the President and confirmed by the Senate and shall conduct, supervise and coordinate audits and investigations of the purchase, management and sale of troubled assets. The Special Inspector General shall have the power to hire employees, sign contracts and request assistance from other governmental agencies. The Special Inspector General is to report to the appropriate committees of Congress on a quarterly basis. \$50 million of the funds available to the Secretary under the Act shall be available to Special Inspector General to fulfill his or her obligations under the Act.

The Act also establishes a new Financial Stability Oversight Board (the "Oversight Board") comprised of the Chairman, the Secretary, the Director of the Federal Housing Finance Agency, the Chairman of Securities and Exchange Commission, and the Secretary of Housing and Urban Development. The Oversight Board shall review the policies implemented by the Secretary pursuant to the Act and analyze the effect of such actions in preserving homeownership, stabilizing financial markets and protecting taxpayers. The Oversight Board also shall make recommendations to the Secretary to improve the TARP and shall report any fraud, misrepresentation, or malfeasance to the Special Inspector General or the United States Attorney General. The Oversight Board is required to meet two weeks after the first purchase of a troubled asset by the Secretary and shall meet monthly thereafter. Further, the Oversight Board is required to report to the appropriate committees of Congress and the Congressional Oversight Panel described below on a quarterly basis, at a minimum.

The Act also establishes a Congressional Oversight Panel. The 5-member panel² shall submit regular reports to Congress detailing, among other things, the exercise by the Secretary of his or her powers under the Act as well as the impact of the TARP on financial markets, financial institutions, market transparency and foreclosure mitigation efforts. Furthermore, the panel is required to submit a special report on regulatory reform by January 20, 2009. The special report shall contain an analysis of the current state of the regulatory system and its effectiveness in terms of overseeing the financial system and protecting consumers. The report shall contain recommendations for improvements to the regulatory system, including recommendations regarding gaps in consumer protection and whether certain participants that are outside the regulatory system should become subject to the regulatory system.

² The five members shall consist of one (1) member appointed by the Speaker of the House, one (1) member appointed by the minority leader of the House, one (1) member appointed by the majority leader of the Senate, one (1) member by the minority leader of the Senate and one (1) member appointed by the Speaker of the House and the majority leader of the Senate, after consultation with the minority leader of the Senate and the minority leader of the House.

The Secretary is required to report to the appropriate committees of Congress every thirty days. The Secretary's reports to Congress shall include an overview of actions taken by the Secretary pursuant to the Act, a summary of obligations and expenditures incurred for administrative expenses and a detailed financial statement regarding the TARP. Further, not later than seven days after the date on which the commitment to purchase troubled assets reaches \$50 billion, and at each \$50 billion interval thereafter, the Secretary is to provide a written report to Congress containing, among other things, a description of the transactions made during the reporting period. The written reports also must include the pricing mechanisms utilized by the Secretary to purchase troubled assets, together with a justification for the price paid. Additionally, each report shall include a description of the impact on the financial system of the actions taken by the Secretary, together with an estimate of additional actions needed to address any challenges that remain in the financial system.

The Secretary also must submit a written report to the appropriate committees of Congress by no later than April 30, 2009. Such written report shall contain an analysis of the current state of the regulatory system and its effectiveness in overseeing the participants in the financial markets. The written report shall provide recommendations as to whether participants in the financial markets that are outside the regulatory system should become subject to the regulatory system. Moreover, the written report also shall contain recommendations for enhancing the clearing and settlement of over-the-counter swaps.

The Act also requires the Secretary to make available to the public, in electronic format, a "description, amounts and pricing" of assets acquired under the Act. Such disclosure shall be made within two business days of purchase, trade or other disposition.

The Comptroller General of the United States shall have ongoing oversight of the TARP, including the activities, performance, financial condition, and efficiency of the TARP. The Secretary is to provide the Comptroller General with space and facilities in the Department of Treasury, and the Comptroller has been provided with broad rights regarding access to data relating to the TARP. The Department of Treasury is required to reimburse the Government Accountability Office for the full cost of all such oversight activities. The Comptroller General shall report to the appropriate committees of Congress and to Special Inspector General no less frequently than once every sixty days. The Comptroller shall also conduct annual audits of the TARP and recommend corrective actions to be taken by the TARP.

Additionally, the Comptroller General is required to undertake a study to determine the extent to which leverage and sudden deleveraging of financial institutions was a factor behind the current financial crisis. The Comptroller General's findings are to be delivered in a report, which must be submitted to the Senate's Committee on Banking, Housing and Urban Affairs, by June 1, 2009.

Executive Compensation

Financial institutions that sell troubled assets to the Secretary are required to meet "appropriate standards for executive compensation and corporate governance" established by the Secretary. In establishing such standards, the Secretary must (i) set limits on compensation for senior executive officers³ that exclude incentives to take unnecessary and excessive risks

³ Defined as the top five highest paid executives at a publicly traded company whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934 and any regulations issued thereunder, and non-public company counterparts.

that threaten the value of the financial institution while the Secretary holds a debt or equity position therein, (ii) allow for the recovery, by a financial institution, of a bonus or incentive compensation based on earnings, gains or other criteria which is later proven to be materially inaccurate, and (iii) impose a prohibition against making any golden parachute payments. If the Secretary purchases troubled assets at auction from a single financial institution and such purchases, in the aggregate, exceed \$300,000,000 (including direct purchases), such financial institution shall be prohibited, while the Act is in effect, 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.

The Act also provides that Section 162(m) of the Internal Revenue Code (IRC) is amended to limit the deductible compensation, for any year in which the Act is in effect, to \$500,000 for a covered executive⁴ of a financial institution that has sold more than \$300,000,000 of troubled assets to the Secretary. The Act also amends Section 280G of the IRC to impose restrictions on severance payments made to covered executives of the financial institutions participating in a program under the Act.

Recoupment

On October 3, 2013, the Director of the Office of Management and Budget, in consultation with the Director of the Congressional Budget Office, shall submit a report to Congress on the net amount within the TARP. In any case where there is a shortfall, the President shall submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall so as to ensure that the TARP does not add to the deficit or national debt.

Mark-to-Market Accounting Provisions

The Act contains a provision that allows the Securities and Exchange Commission (SEC) to suspend the application of Statement Number 157 of the Financial Accounting Standards Board if the SEC determines that it is “necessary or appropriate in the public interest and is consistent with the protection of investors.” The Act also requires the SEC, in consultation with the Board of Governors of the Federal Reserve System and the Secretary, to conduct a study on market-to-market accounting standards as provided in Statement Number 157 of the Financial Accounting Standards Board, as such standards are applicable to financial institutions. The study shall consider, at a minimum, the effects of such accounting standards on a financial institution’s balance sheet, the impact of such accounting on bank failures in 2008, and the impact of such standards on the quality of financial information available to investors. The study shall also consider the process used by the Financial Accounting Board in developing accounting standards, the advisability and feasibility of modifications to such standards and alternative accounting methods to those provided in Statement Number 157. The SEC shall submit to Congress a report of such study before January 3, 2009.

Miscellaneous Provisions

The Act contains a number of provisions aimed at preventing foreclosures and assisting homeowners. For example, in

⁴ Defined as any employee who (i) at any time during the portion of the taxable year during which the authorities granted to the Secretary under the Act are in effect, is the chief executive officer or the chief financial officer of the applicable employer, or an individual acting in either such capacity or (ii) is one of the three highest compensated officers of the applicable employer for the taxable year (other than the chief executive officer or the chief financial officer of the applicable employer, or an individual acting in either such capacity) determined (a) on the basis of shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (without regard to whether those rules apply to the employer) and (b) by only taking into account employees employed during the portion of the taxable year during which the authorities granted to the Secretary under the Act are in effect.

connection with the Secretary's acquisition of mortgages, mortgage backed securities and other assets secured by residential real estate, the Secretary is required to implement a plan that seeks to maximize assistance for homeowners and seeks to encourage servicers of such mortgages to take advantage of the HOPE for Homeowners Program. Further, the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent "avoidable foreclosures."

The Act also contains provisions temporarily increasing, from \$100,000.00 to \$250,000.00, the standard maximum deposit insurance amounts available under the Federal Deposit Insurance Act and the Federal Credit Union Act. Such increases are not to be taken into account by the Board of Directors of the Federal Deposit Insurance Corporation or by the National Credit Union Administration Board when setting assessments or insurance premium charges. The temporary increases shall be effective until December 31, 2009.

For a detailed summary of the Act, [click here](#). If you would like to discuss the Act, please contact the Seyfarth attorney with whom you work, or any attorney on our website (www.seyfarth.com).



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