

# Publications

## Client Alert: Financial Crisis Update 4

### Related Services

Corporate and Business Organizations

Government Relations

Litigation

Taxation

**CLIENT ALERT** | 10.6.2008

H.R. 1424, commonly referred to as the Financial Bailout Bill, was passed by Congress and signed into law by President Bush on October 3, 2008. A selective summary of the pertinent provisions in each of the Bill's three divisions is provided below. A longer Executive Summary also appears on [www.vorys.com/f-40.html](http://www.vorys.com/f-40.html), as does a PDF of the entire Bill.

### **Division A, Titles I-III: Emergency Economic Stabilization Act of 2008 ("EESA")**

#### **Troubled Asset Relief Program**

EESA creates the Troubled Asset Relief Program, or TARP, which authorizes the Treasury to purchase "troubled assets" from "financial institutions," and then manage and sell them. TARP mandates the Treasury to also encourage private sector purchases of troubled assets. In addition, TARP authorizes the Treasury to offer insurance for troubled assets, as an alternative to outright purchases.

**Oversight.** TARP will be overseen by numerous entities, including Congressional committees, the U.S. Comptroller General, a TARP Inspector General, a Financial Stability Oversight Board comprised of agency heads, the executive and legislative budget offices, and the public, through an online database of purchases of troubled assets. Judicial review of the Treasury Secretary's actions under TARP is only available for arbitrary, capricious, or illegal acts, and courts can only enjoin those of the Secretary's actions which are constitutional violations.

#### **Key definitions.**

- "*troubled assets*" are any instruments connected to residential or commercial mortgages, which is potentially much broader than just mortgages and mortgage-backed securities
- "*financial institution*" means any entity – not just banks or entities in the financial industry – established, regulated, and with significant operations in the U.S. (central banks and institutions of foreign governments are not financial institutions, but are eligible for TARP if

they acquired troubled assets due to defaults of financial institutions)

**Policies.** EESA requires TARP to be implemented in harmony with EESA's stated policy considerations, which include minimizing impact on taxpayers, stabilizing financial markets to protect American jobs and savings, preserving home ownership, protecting multifamily rental properties, stabilizing governmental entities, protecting retirement, and assisting banks that (1) are likely to be viable in the long term, (2) are of diverse sizes, geography, and portfolio composition, and (3) have less than \$1 billion in assets, were adequately capitalized on June 30, 2008, and dropped at least one capital level due to losses in Fannie Mae and Freddie Mac stock.

**Details.** The Treasury has begun, and will continue for at least the next six weeks, to promulgate regulations implementing EESA, which include criteria for identifying troubled assets for purchase, mechanisms for purchasing troubled assets, methodology for valuing troubled assets, procedures for selecting asset managers, and conflict of interest policies. §§ 101(c), 108

To date, EESA and the Treasury have provided the following guidance on these details:

- in identifying troubled assets for purchase, the Treasury must consult with other agencies to identify assets whose purchase would help mitigate foreclosures, while protecting residential tenants § 109(b)
- the Treasury must buy troubled assets through auctions, except where infeasible or inappropriate and where EESA's purposes would be met with a direct purchase
- in a direct purchase, the Treasury must pursue "additional measures" to ensure that the prices it pays both are reasonable and reflect the troubled assets' value § 113(c)
- the Treasury can never pay more than the seller paid for the troubled assets, except where the seller acquired them in a merger, an acquisition, or a purchase from a financial institution in conservatorship, receivership, or bankruptcy § 101(e)
- the Treasury's purchasing authority expires Dec. 31, 2009 or, if extended, Oct. 3, 2010
- asset managers may be from the private sector or the FDIC, and
  - there will be separate types of asset managers for securities, and for whole loans
  - asset managers will be financial agents (fiduciaries), not contractors, of the Treasury
  - the U.S. Treasury website will list open notices of openings for asset managers
- compliance with federal contracting law (FAR) is required, but the Treasury may waive provisions of FAR upon a determination that urgent and compelling circumstances make compliance contrary to the public interest
  - if provisions relating to inclusion of women- and minority-owned businesses are waived, they must be replaced with procedures designed to ensure such inclusion § 107(b)
  - the Treasury has already announced one such replacement procedure, where women- and minority-owned businesses that do not meet qualifications to be asset managers will have opportunities to be designated as sub-managers

**Stake in Sellers.** The Treasury must receive an equity or debt stake in participating financial institutions, on terms designed to provide a reasonable participation in equity appreciation or a reasonable interest rate, and to protect taxpayers against losses and administrative expenses.

- publicly traded financial institutions: must provide a warrant to purchase nonvoting stock if it reaches a specified exercise price
- other financial institutions: must provide either a warrant or a senior debt instrument
- exceptions to “stake in seller” requirement:
  - certain *de minimis* purchases defined by regulation (no greater than \$100 million)
  - financial institutions that cannot issue securities (seller must agree to alternative)

**Limits on Executive Compensation.** New limits on deducting executive compensation apply to all participating financial institutions. Also:

- *auctions*: financial institutions that sell to the Treasury \$300 million or more in troubled assets through auctions may not enter new contracts that contain golden parachutes for senior executives in event of bankruptcy and other insolvency proceedings § 111
- *direct purchases*: where the Treasury has a “meaningful” equity or debt position in the seller, it must require *appropriate standards* for governance, including:
  - ban incentives for unnecessary and excessive risks during government ownership
  - clawback senior executive bonuses for earnings later found materially inaccurate
  - prohibition on golden parachute payments during government ownership

**Foreclosure Mitigation.** The Treasury, as well as certain other federal agencies that hold troubled assets, must use its role as buyer and holder of troubled assets to reduce foreclosures, including as follows:

- consent to reasonable requests for *loan modifications*, including increasing the proportion of loans in a pool that can be modified, in addition to typical measures
- modifications must *preserve rental subsidies and protections*, and accommodate the need for operating funds to maintain decent living conditions in rental housing § 110(b)
- implement a plan to mitigate foreclosures and encourage loan servicers to take advantage of *foreclosure mitigation programs*, including the HOPE for Homeowners Program
- if a government agency merely holds an interest in a pool of mortgage-backed bonds, it must encourage loan servicers to implement the loan modifications adopted by the agency and assist in facilitating such modifications if possible § 110(c)

### **Accounting and Insurance Provisions**

**TARP Guarantee Program.** The Treasury will establish a guarantee program for principal and interest payments on troubled assets, in exchange for risk-based premiums. The Treasury must also encourage private sector purchases of troubled assets and investments in financial institutions.

**Mark-to-Market Accounting.** EESA gives the SEC authority to suspend and replace mark-to-market accounting if the SEC determines that doing so will protect investors. § 132

**Federal Deposit Insurance Increases.**

- FDIC insurance is increased effective October 3, 2008, from \$100,000 to \$250,000 through 2009
- limits on bank and credit union borrowing from Treasury are accordingly increased
- temporary increases are not considered in setting premiums or adjusting for inflation

**Money Market Mutual Fund Guarantees.** The Exchange Stabilization Fund (ESF), which has recently been used to guarantee programs relating to money market mutual funds, will no longer be used for future guarantees of these programs, and Treasury must use TARP to reimburse ESF for any expenses it incurs in fulfilling guarantees under the existing guarantee program. § 131

**Tax Provisions**

**Sale or Exchange of Preferred Stock.** Gain or loss from the sale or exchange of preferred stock in Fannie Mae and Freddie Mac by qualifying financial institutions or financial institution holding companies is to be treated as ordinary income or loss, if the stock was held by the financial institution on September 6, 2008, or was sold or exchanged by the financial institution on or after January 1, 2008, and before September 7, 2008. § 301

**Executive Compensation.**

- for employers participating in TARP that meet specified thresholds, the deductible amount of executive compensation for each of the top five highly paid executives (including the CEO and CFO) is limited to \$500,000, and the definition of executive compensation is expanded to include performance pay and stock options § 302
- golden parachute payments for each of the top five highly paid executives are prohibited prospectively in the case of termination, bankruptcy, insolvency, or receivership of the financial institution § 302

**Exclusion of Income from Discharge of Indebtedness.** The Act provides a 3-year extension, through 2012, of the current exclusion of income from discharge of qualified principal residence indebtedness (i.e., forgiveness of mortgage debt). § 303

**Division B, Titles I-IV: Energy Improvement and Extension Act of 2008**

The following credits have been extended, expanded, and/or modified:

- *Renewable Energy Credits:* wind and refined coal facilities, closed and open loop biomass facilities, geothermal or solar energy facilities, small irrigation power facilities, landfill gas facilities, trash combustion facilities, qualified hydropower facilities (Section 101)
- *Energy Credit:* solar energy property, qualified fuel cell property, and qualified microturbine property (Section 103)
- *Small wind property credit* (Section 104)

- *Energy credit for geothermal heat pump systems* (Section 105)
- *Credit for residential energy efficient property* (Section 106)
- *Advanced coal project investment credit* (Section 111)
- *Coal gasification investment credit* (Section 112)
- *Carbon dioxide sequestration credit* (Section 115)
- *Biodiesel and renewable diesel credits* (Section 202)
- *Alcohol fuels credit and biodiesel fuels credit* (Section 203)
- *Alternative fuel credit* (Section 204)
- *Qualified plug-in electric drive motor vehicles credit* (Section 205)
- *Alternative fuel vehicle refueling property credit* (Section 207)

Bonds were created for clean renewable energy (Section 107) and qualified energy conservation (Section 301).

Additional Noteworthy Provisions:

- Special rule to implement FERC and State electric restructuring policy (Section 109)
- Certain income and gains relating to industrial source carbon dioxide treated as qualifying income for publicly traded partnerships (Section 116)
- Extension of suspension of taxable income limit on percentage depletion for oil and natural gas produced from marginal properties (Section 210)
- Energy efficient commercial buildings deduction (Section 303 – 5 year extension)
- Accelerated recovery period for depreciation of smart meters and smart grid systems (Section 306 – 10 years unless property qualifies under shorter recovery schedule)
- Qualified green building and sustainable design projects (Section 307 – extends authority to issue bonds through end of 2012, and clarifies reserve account rules)
- Limitation of deduction for income attributable to domestic production of oil, gas, or primary products thereof (Section 401)

### **Division C, Titles I-VII: Tax Extenders and Alternative Minimum Tax Relief**

#### **Title I – Alternative Minimum Tax Relief:**

- increases AMT exemption amount from \$44,350 to \$46,200 (individuals) and \$66,250 to \$69,950 (married couples filing jointly)
- extends and modifies AMT credit allowance against Incentive Stock Options to allow 50% of long-term unused minimum credit to be refunded over a 2-year period instead of 20% over a 5-year period

**Titles II-VII:** Extends and expands a number of individual and business tax provisions and extends Katrina Emergency Tax Relief Act provisions to include taxpayers in presidentially-declared major disaster areas.

[Click here for Financial Crisis Update 1](#)

[Click here for Financial Crisis Update 2](#)

[Click here for Financial Crisis Update 3](#)

This communication is for general information purposes only and does not constitute a full legal analysis of the subject matter discussed herein. The information in this email should not be relied upon as specific legal advice.