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TARP and the Various Federal Tent Poles: Will it be Enough?

There are daily, and sometimes hourly, changes in the regulatory environment and governmental reaction to the current banking and financial market crisis. A pivotal point in the process has been the recent enactment of the Emergency Economic Stabilization Act of 2008. We have taken a snapshot of where we are today and provide an overview of significant governmental actions taken during 2008, as follows:

Emergency Economic Stabilization Act of 2008

On October 3rd, the President signed into law the Emergency Economic Stabilization Act of 2008 (Act), which authorized the Treasury Secretary (Treasury) to establish the Troubled Assets Relief Program (TARP). The Act gives broad authority to Treasury to purchase, manage, modify, sell and insure the troubled mortgage related assets that triggered the current economic crisis as well as other "troubled assets." EESA includes additional provisions directed at bolstering the economy, including:

- Assistance to homeowner provisions requiring each of the FDIC, the conservator of Fannie Mae and Freddie Mac and the Federal Reserve Board (Federal Reserve), in their capacity as direct or indirect property owners, to maximize assistance to homeowners
- Authority for the Federal Reserve Banks to pay interest on depository institution balances
- Amendment to the HOPE for Homeowners Program
- Temporary increase in FDIC insurance coverage from $100,000 to $250,000 through December 31, 2009
- Mandating reports and studies on crisis related topics from the Treasury, the Comptroller General, the Congressional Oversight Panel and the Securities and Exchange Commission (SEC)
- Federal Reserve is required to report to Congress any actions taken under existing authority to make loans directly to individuals, partnerships or corporations

- Authorized the SEC to suspend mark-to-market accounting requirements for any issuer or class or category of transactions

EESA follows and has been followed by numerous actions by the Federal Reserve, Congress, Treasury, the SEC, and others to address the current liquidity and credit crisis that has followed the sub-prime meltdown that commenced in 2007. Following the discussion of the Act below, we take a look at the year in review. See also our previous reports referenced throughout.

Troubled Assets Relief Program Overview[1]

The Act permits Treasury to establish programs to buy and to insure financial institutions' troubled assets. The outstanding program obligations will be $700 billion, subject to the requirements and limitations set forth in the Act. The purchase program will be conducted using either auctions or direct purchases of troubled assets. Participating financial institutions will be required to issue securities to Treasury in connection with anything other than de minimis sales of troubled assets. In addition, Treasury will impose limitations on executive compensation for participating financial institutions.

It is worth noting the speed with which the Act was passed and its unique transition from a three-page outline initially provided by Treasury to the over 150-page series of acts that ultimately were approved on October 3rd. Not surprisingly, there are some drafting inconsistencies. While the purchase program is defined as the TARP, that same term is used in various places to refer to both the purchase program and the insurance program. For example, the Special Inspector for the TARP is responsible for both the purchase program and the insurance program. We expect that the guidelines, procedures and reports released from Treasury will clarify how the programs will work.

Who Can Participate and What Assets Are Covered?

Treasury will be able to purchase or insure troubled assets of financial institutions.

A *Financial Institution* is any institution established and regulated under U.S. laws and having significant operations in the U.S.

> The definition includes a non-exclusive list of institutions, including: any bank, savings association, credit union, security broker or dealer or insurance company.
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> It is expected that U.S. branches of foreign financial institutions, if their U.S. operations are significant, would qualify. Institutions owned by a foreign government and foreign central banks are expressly excluded. However, to the extent that a foreign financial authority acquired troubled assets as a result of extending financing to a financial institution that has failed or defaulted on the financing, those assets are eligible for purchase. For example, if a foreign financial institution with a significant U.S. presence, such as a branch, became significantly undercapitalized or failed, its home jurisdiction banking authority would take action. If, as a result of a bailout or other emergency measures, the home country banking authority acquires troubled assets, those troubled assets could be eligible for purchase under the program.
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> The Act also requires that Treasury take into consideration protection of retirement security of Americans. See "*Treasury Secretary to Consider Protecting Some, but Not All Employee Benefits*" below.
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> Treasury must also consider the impact of the current environment on public instrumentalities, including the increased costs and losses faced by counties and cities. It is currently unclear how the TARP will remediate the impact to public instrumentalities, as a municipality would not appear to be a "financial

[1] See Morrison & Foerster LLP's News Bulletin "Economic Stabilization Act: Overview of Transactions involving Troubled Assets" at http://www.mofo.com/news/updates/files/14548.html

institution." The most straightforward approach may be to conduct auctions to purchase, and rebuild price stability in, securities issued by counties and cities. That in turn raises questions regarding the allocation of funds of the TARP and its goals of reestablishing the broader markets, protecting taxpayer resources and preserving homeownership. We expect that this, as with many other areas, will be addressed in guidance and reports to be released by Treasury in the coming days and weeks.

Troubled Assets are broadly defined in two broad categories.

The first category includes residential or commercial mortgages and any securities, obligations or other instruments that are based on, or related to, such mortgages. To qualify, an asset must have been originated or issued on or before March 14, 2008. Additionally, Treasury must make a determination under the program that the acquisition of the asset promotes financial market stability.

Second, Treasury can include other financial instruments if, after consultation with the Chairman of the Federal Reserve, it makes a written determination that the purchase is necessary to promote financial market stability, and that determination is provided to the appropriate committees of Congress. We would note that there is no approval process, only a requirement that notice be provided to Congress.

Under this second category, Treasury announced the development of the *TARP Capital Purchase Program* on October 14th. See below for a detailed description of the program. See also a summary of the related executive compensation and governance requirements as a result of participation under "*Bailout Related Tax Changes and Impacts.*"

How Will the Programs Work?

Purchase Programs

Program guidelines for the purchase program will be established within two business days of the first purchase, or at the end of the 45 days after passage of the Act. Based on the announcement with respect to the purchase of equity of banking institutions, program guidelines are required this week. Given the speed with which the bank equity purchase program was established, we would expect additional detail on other troubled assets to come in amendments to any program guidelines issued this week, and, in any event, no later than the expiration of the 45-day period.

The Act provides some guidance on the key components of the TARP. Treasury is directed to use market mechanisms, such as auctions and reverse auctions, wherever possible to achieve the purposes of the Act. Where an auction would not be feasible or appropriate, Treasury may engage in direct purchases. For example, distressed financial institutions are expected to need structured and negotiated direct sales.

The Act directs Treasury to prevent unjust enrichment of the participating financial institutions, including by preventing the sale of a troubled asset to Treasury at a higher price than what the seller paid to purchase the asset. However, methods to price and value the troubled assets are yet to be established. There are extensive and detailed reporting obligations, as described more fully under "*Reporting and Information*" below. Additional information will become available through the initial sales disclosures, release of the program guidelines and through periodic reports required under the Act. As described under "*TARP Advisors*" below, Treasury has already made significant progress in recruiting the external contractors that will conduct auctions, manage and hold assets and perform other key functions.

On October 13, Treasury officials described the creation of policy teams, including three related to specific purchase programs:

- *Mortgage-backed securities program*: This team is working to identify which troubled assets should be purchased, from which financial institutions, and what purchase mechanism will best meet Treasury's policy objectives. The team is designing detailed auction protocols and will work with the vendors selected to run the program.
- *Whole loan purchase program:* This team is working with bank regulators to identify which types of mortgage loans should be purchased first to alleviate the strain on regional banks, how to value the mortgage loans and which purchase mechanism will best meet Treasury's policy objectives.
- *Equity purchase program*: This team is designing a standardized program to purchase equity in a broad array of financial institutions. Treasury announced that the program would be voluntary and designed with attractive terms to encourage participation from healthy institutions, while encouraging firms to raise new private capital to complement the public capital.

On October 14, 2008, Treasury announced that work was ongoing to develop a program to potentially provide assistance to failing institutions. The Program for Systemically Significant Failing Institutions will have terms negotiated on a case-by-case basis. As described in more detail in our discussion of executive compensation, one key element of this program will be the prohibition of golden parachute payments.

On October 14, 2008, Treasury announced that it had developed the TARP Capital Purchase Program and nine financial institutions had agreed to participate in the program.

TARP Capital Purchase Program

On October 14, 2008, in a joint statement with the FDIC and the Federal Reserve, Treasury announced the development of the TARP Capital Purchase Program. Treasury has earmarked the first $250 billion from the Act for the program, and has allocated the first $125 billion to nine major financial institutions, reported to include: Bank of America, The Bank of New York Mellon, Citigroup, Goldman Sachs, J.P. Morgan Chase, Merrill Lynch, Morgan Stanley, State Street Corp., and Wells Fargo. The terms of the program are standardized and any financial institution may elect to participate by notifying their federal banking agency by November 14, 2008, 5:00 p.m. After notification of elections to participate, Treasury will consult with the appropriate regulator and determine eligibility and allocations.

The principal terms are as follows:

- Subscription amounts: minimum available is one percent of risk-weighted assets and the maximum amount is the lesser of $25 billion or three percent of risk-weighted assets
- Each participating financial institution will issue securities to Treasury, including senior preferred shares, which will:
  - qualify as Tier 1 capital
  - be senior to common stock
  - be pari passu with existing preferred shares (other than junior preferred shares)
  - pay a dividend of 5% per year for the first five years, and 9% per year thereafter; the dividend will be cumulative unless the financial institution is a bank that is not a subsidiary of a holding company
  - pay dividends quarterly beginning February 15
  - permit Treasury to elect two directors if dividends are not paid for six consecutive quarters

- be non-voting (other than class voting rights on matters that could adversely affect the shares or similar market provisions)
- be callable at par after three years (and otherwise redeemable with the proceeds of an offering of replacement equity securities that provide Tier 1 capital)
- restrict the ability of a financial institution to increase common dividends until the third anniversary of the investment (unless Treasury has transferred the investment)
- require Treasury's consent before any share repurchases other than in connection with a benefit plan or in the ordinary course of business consistent with past practice until the third anniversary of the program
- be transferable by Treasury
- be covered by a shelf registration statement filed by the financial institution as soon as practicable and be subject to piggyback registration rights
- be funded by Treasury by December 31, 2008

- In connection with each investment, Treasury will also receive warrants to purchase common stock with an aggregate market price equal to 15 percent of the senior preferred instrument. The exercise price on the warrants will be the financial institution's 20-day average market price prior to issuance. The term will be 10 years, and the warrants will be immediately exercisable. The financial institution will be required to file a registration statement as soon as practicable after the investment, grant piggyback registration rights to Treasury, and apply to list the underlying common stock on the relevant exchange. There are limitations on Treasury's ability to transfer warrants and the exercise price for the warrants is subject to reduction upon successful completion by the financial institution of an offer of equity securities generating Tier 1 capital. If the financial institution does not have a sufficient number of authorized shares of common stock, it is required to take all actions necessary to increase the number of authorized shares. If unsuccessful, the exercise price of the warrants will be reduced every six months until the number of authorized shares is sufficient, or the reduction reaches 45%. In the event the financial institution is unable to obtain approval to increase the number of authorized shares, or its common stock is no longer listed, the warrant will be exercisable for senior term debt or another instrument.
- Financial institutions will be subject to the executive compensation requirements described below for participants in the TARP.
- Eligibility requirements for financial institutions are set forth in the program Term Sheet published by Treasury and Treasury will determine eligibility of interested participants. The definition of a qualified financial institution under the program (QFI) is narrower than the definition of a financial institution under the Act. QFIs include banks, savings associations, bank holding companies and savings and loan holding companies, in each case that are U.S. entities not controlled by a foreign bank. U.S. entities are those organized under the laws of the United States, any state, the District of Columbia or any territory or possession of the U.S. There are also requirements that bank holding companies or savings and loan holding companies only be engaging in permitted activities under Section 4(k) of the Bank Holding Company Act (BHC) or whose depository institution subsidiaries are the subject of an application under Section 4(c)(8) of the BHC.

Treasury has also released information regarding the executive compensation and governance requirements for participation in the program, as described below.

Insurance Program

Less is known about the insurance program, due in large part to its legislative history. Not part of the original plan submitted by Treasury, the insurance provision is believed by the members of Congress that argued for its inclusion to be a less costly alternative. The program is referenced inconsistently throughout the Act, and we expect that this is also due to the last minute nature of the addition. Treasury has announced the creation of an insurance program policy team. And on October 10, 2008, Treasury submitted a public Request for Comment to solicit the best ideas for structuring the insurance program. Responses are due by October 28, 2008 and design of the program will commence immediately thereafter.

Guidelines for an insurance program are not required on a specific time frame, unlike the purchase program. The Act does set forth a limited number of requirements and principles around which those guidelines will be based, focusing on the establishment and treatment of premiums. Premiums will be established and collected by Treasury in exchange for guaranteeing no more than 100% of the interest on, and principal of, troubled assets. These premiums will be deposited in the new Troubled Assets Insurance Financing Fund (Fund), which will in turn invest those proceeds in Treasury securities, cash or deposits.

The Act requires that premiums be established at a level to create reserves sufficient to meet anticipated claims against the troubled assets. Treasury has the authority to charge risk-based premiums based on the credit risk of particular assets, but Treasury must publish the methodology for setting those premiums. Moreover, Treasury must set the premiums at rates "necessary to create reserves sufficient to meet anticipated claims, based on actuarial analysis, and to ensure that taxpayers are fully protected."

Authority

As noted, Treasury will be buying, selling, managing and insuring assets. The authority granted to Treasury to undertake these actions is flexible and broad. With respect to management, Treasury has the ability to exercise all security-holder rights that accompany any acquired assets. This will include, among others, voting rights, contract rights and the exercise of rights against collateral. Treasury also has broad authority with respect to monetization and disposition of assets. It may sell assets or enter into securities loan agreements, repurchase transactions or "other financial transactions in regard to" any asset held under the program. See also the discussion below regarding foreclosure mitigation efforts.

We expect Treasury will follow the Act's mandate to encourage private investment in troubled assets, including through the use of loans. As several market participants have noted, some elements of the Resolution Trust Corporation model may be used for the private/public partnership elements of the Act.

Price Transparency

The Act provides for significant pricing transparency. Within two business days of any purchase, trade or other disposition of a troubled asset, Treasury is required to publicly disclose pricing information. The disclosure, which must be made electronically, will include a description of the troubled assets and the quantity involved in the transaction as well as the price. Treasury has yet to announce the form or location of these publications, and we expect there may be some adjustments through the first auctions. Additionally, numerous reports that include information regarding sellers, troubled assets, prices and the determination of pricing information are required. Market participants have raised concerns as to whether the pricing information from the TARP will constitute market pricing under FAS 157. We expect interpretations to follow the initial reports of purchases and sales. See the *Reporting Appendix* for more information about the reports that are required under the Act.

Duration of Programs

The troubled asset purchase and insurance programs will terminate on December 31, 2009. Upon written certification to Congress identifying the expected cost, Treasury may extend the programs until October 3, 2010, provided the extension is necessary to achieve the goals of the Act.

Executive Compensation

As noted, financial institutions selling troubled assets to the Treasury will be subject to executive compensation requirements. See "*Bailout Related Tax Changes and Impacts*" below for a description of the Act's requirements.

Treasury to Acquire Securities from Sellers

Consistent with the Act's requirements for protection of the taxpayers' investment, Treasury must acquire securities of each financial institution that sells troubled assets. The type of security and structure of the investment depends on whether the financial institution has publicly traded securities.

> *Public Companies*: A financial institution that is traded on a national securities exchange will be required to provide Treasury with equity securities. These can be in the form of warrants for non-voting common stock or preferred stock, or warrants for voting common stock. In the case of voting stock, Treasury will agree not to exercise voting rights, other than class voting rights on matters that could adversely affect the shares. If Treasury later sells the warrant, the voting rights would transfer to the purchaser. The warrant of any public company must contain a provision protecting Treasury if the financial institution is no longer publicly traded; either a provision converting it to senior debt, or "appropriate protections" against that risk.
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> *Non-public Companies*: A financial institution without listed securities may sell Treasury a warrant for common or preferred stock, or senior debt.

Where a holding company has publicly traded common stock, we would expect its troubled assets to be held at a subsidiary in most, if not all, cases. Given the benefit of holding publicly traded securities of the parent institution, we would expect Treasury, looking at the purposes of the Act and its responsibility to protect the taxpayer investment, to establish procedures to accept securities of the parent financial institution.

Exceptions. Treasury may establish a de minimis exception to the requirement that the financial institution issue securities. However, the Act requires that Treasury cannot establish a threshold higher than $100 million; any financial institution selling more than $100 million of troubled assets, or such lower amount as Treasury may establish, must issue securities. Additionally, there is an exception for issuers that are legally unable to provide securities to Treasury. Treasury shall arrange an "appropriate alternative requirement" for that seller of troubled assets that does not have the legal authority to issue securities. An example would include a purchase by Treasury of troubled assets from a foreign financial authority or foreign central bank that had acquired those troubled asset from a financial institution it had rescued. Finally, in the event a financial institution does not have a sufficient number of authorized shares to issue warrants, senior debt will be acceptable, if the terms will provide equivalent value.

Structuring Warrants. With respect to the equity underlying warrants, financial institutions may have limitations in their organizational documents authorizing only one class of common stock, rendering them unable to issue non-voting common stock. As a result, we would expect that these financial institutions will prefer a preferred stock structure. All warrants must contain market standard anti-dilution provisions to provide for adjustments in the event of stock splits, stock distributions, dividends and other distributions, mergers and other forms of reorganization or recapitalization. In structuring warrants, the initial financial institutions will need to avoid 'death spiral' provisions. Any increase in the number of shares that results from a decline in the trading price of common stock will result in the Treasury, or the third party to whom it subsequently sells the warrants, taking an ownership interest larger and with greater dilution for existing holders than initially planned.

Participating financial institutions will also need to look carefully at their other limitations on issuing equity securities, in addition to their authorized amounts. For example, financial institutions will need to consider stock exchange limitations, triggers in poison pills or other limitations or triggers in corporate agreements. We expect the initial warrants issued will be duplicated quickly and a limited number of 'standard' forms of Treasury-held warrants will be established.

The terms and conditions of the individual securities granted under this provision will be largely in the discretion of Treasury, subject to compliance with the purposes of the requirement. Treasury is charged with acquiring assets that protect the taxpayers' investment through participation in the appreciation of equity securities or the return of a reasonable premium. Additionally, the investment provides additional economic protection against losses incurred through sales of troubled assets as well as the administrative expense of running TARP. We expect that the other TARP programs will mirror the TARP Capital Purchase Program, including the requirement for registration statements with respect to the securities received by Treasury. For private companies, the terms will need to provide similar economic benefit to Treasury. Treasury has the authority to sell, exercise or surrender any security received under these provisions, but must protect taxpayers when acting under the programs.

Governance Structure and Oversight Controls

Governance for the Programs

A new position, *Assistant Secretary of Treasury for Financial Stability*, was created to supervise the implementation of the programs under the Act.

The *Office of Financial Stability* within the Department of Treasury will be headed by the Assistant Secretary for Financial Stability. The Assistant Secretary will be appointed by the President, with the consent of the Senate. On October 6th, Neel Kashkari was named Interim Assistant Secretary for Financial Stability by Secretary Paulson until a permanent Assistant Secretary is appointed. On October 13th, Mr. Kashkari announced that several key positions of the Office of Financial Stability had been filled with interim leaders. These interim leaders have been charged with setting up the office, hiring permanent staff, operationalizing the programs and identifying each of their respective permanent successors.

As described above in part, within the Office of Financial Stability, seven policy teams have been created to develop tools to implement Treasury's responsibilities under the Act. These are:

- Mortgage-backed securities purchase program team (discussed above)
- Whole loan purchase program team (discussed above)
- Insurance program team (discussed above)
- Equity purchase program team (discussed above)
- Homeownership preservation team: The team is working with the Department of Housing and Urban Development to maximize the opportunities to help as many homeowners as possible, while protecting taxpayers.
- Executive compensation team: The team is developing requirements for financial institutions to participate in three possible scenarios: an auction purchase of troubled assets, a broad equity or direct purchase program and intervention to prevent impending failure of a significant institution.
- Compliance team: This team will manage the numerous compliance responsibilities under the Act, including coordination with the Oversight Board, on-site engagement of the General Accounting Office, and creation of the Special Inspector General for the TARP, among others.

The new *Financial Stability Oversight Board* is currently comprised of:

- Chairman Bernanke (Federal Reserve),

- Secretary Paulson (Treasury),
- Director Lockhart (Federal Housing Finance Agency (FHFA)),
- Chairman Cox (SEC), and
- Secretary Preston (Housing and Urban Development);

and will be comprised of their successors when named by the new administration. The Board will oversee the Office of Financial Stability and the programs developed by Treasury under the Act and make recommendations to Treasury. The Board will remain in place until 15 days after the last troubled asset has been sold or transferred or the last insurance contract has expired. The Board's first meeting occurred last week, selecting Chairman Bernanke as its Chairman.

The *Special Inspector General* for the Troubled Asset Relief Program, appointed by the President, with the consent of the Senate, will head the Office of the Special Inspector General for the Troubled Asset Relief Program. The Special Inspector will be selected based on integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations, and will conduct audits and issue reports to Congress. The Office of the Special Inspector General will remain in place until the last troubled asset is sold or transferred or the related insurance has expired.

Congress also established a *Congressional Oversight Panel* to review the current state of the financial markets and the regulatory system and submit reports to Congress. The leadership of each party in each of the House and Senate will appoint a member to the panel, and the fifth member will be appointed by the Speaker of the House and majority leader of the Senate, after consultation with the minority leader of the Senate and the majority leader of the House.

The *Comptroller General* of the United States was also given specific responsibilities for oversight, auditing and reporting under the Act. The Comptroller General will be providing periodic reports to committees of Congress at least every 60 days as well as an annual audit of the financial statements of the TARP. The Comptroller General has responsibilities until the last asset is sold or transferred or the related insurance has expired.

Consultation

The provisions for the establishment of the purchase program specifically identify those with whom Treasury shall consult in its exercise of authority. These include the Federal Reserve, FDIC, Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Chairman of the National Credit Union Administration Board, and the Secretary of Housing and Urban Development.

Reporting and Internal Controls

Each of the groups or individuals referenced above in the governance structure for the programs is required to make special or regular reports to the Congressional committees with responsibility for the financial industry. An overview of these may be found in the Reporting Appendix at the end of this article. Many of the special reports are described below under "*Other EESA Impacts*."

Treasury has also announced its commitment "to an open and transparent program" and noted that "[t]ransparency will not only give the American people comfort in our execution, it will give the markets confidence in what form our action will take."

Spending Authority

Treasury currently has $250 billion available under the Act. An additional $100 billion will be immediately available to Treasury when the President certifies to Congress that it is needed. Thereafter, the President can submit to Congress a report detailing Treasury's plan to exercise authority under the Act. Unless Congress passes a joint resolution disapproving the plan within the tight timeframe provided in the Act, the final $350 billion will be made available. Detailed provisions have been included for fast track review by Congress of any such report.

Offset by the Insurance Fund

Amounts on deposit in the Troubled Assets Insurance Financing Fund will offset the amounts outstanding under the insurance program for purposes of determining the aggregate amount outstanding under the Act. The aggregate value of the securities being insured will be reduced by the amount on deposit in the Fund and such net amount will be applied to reduce the amount available under the Act.

Money Market Guarantees

Any funds expended by Treasury to guarantee money market funds under the Treasury Money Market Guarantee Program announced on September 29, 2008, must be reimbursed from funds under the Act. This guarantee program is scheduled to terminate on December 31, 2008, and the Act specifically prohibits the establishment of any future guarantee programs under the Exchange Stabilization Act for the money market industry. As a result, any future programs would have to be developed under the authority given Treasury under the Act. Recent reports have disclosed that numerous sponsors of money market funds have signed up for the guarantee program to provide market confidence for investors.

Funds for Oversight

The Office of the Special Inspector General for the TARP, established by the Act, will have numerous auditing, inspection and reporting responsibilities. Funds in the amount of $50 million have been earmarked for the Special Inspector, from the amount authorized under the Act.

Recoupment

If, after five years, the TARP results in a net shortfall, the President will be required to submit a proposal to recoup from the financial industry the shortfall. The proposal must be a legislative solution preventing the program from adding to the deficit. The recoupment provision provides no additional detail, including no identification of the constituent members of the "financial industry."

TARP Advisors: Government Contractors under the Act[2]

It is clear from the broad scope of the Act that Treasury will need a lot of help implementing the requirements of the Act, including asset managers, servicers, property managers, expert consultants, and other similar service providers. While tremendous opportunities are presented by the Act for service providers with the requisite capabilities and resources to contract with Treasury, there are commensurate risks for anyone not experienced in contracting with the federal government. As demonstrated in other emergency or urgent situations such as Hurricane Katrina and the Iraq War where contractors rushed in without carefully considering the pitfalls of dealing with the government, missteps can and do result in not only financial, criminal, and civil liabilities, but also suspension and debarment from any future contracting with the federal government.

Treasury's Waiver Authority

The Act grants Treasury broad authority to waive specific provisions of the procurement regulations, the Federal Acquisition Regulation (FAR), upon a determination that "urgent and compelling circumstances make compliance

[2] See Morrison & Foerster LLP's News Bulletin "Recovery Legislation Creates Both Opportunities and Risks for Government Contractors" at http://www.mofo.com/news/updates/files/14545.html

with such provisions contrary to the public interest." The intent of this waiver authority is to streamline the process by which Treasury enters into contracts with firms for the full range of services Treasury will need to carry out the Act. The Act requires that Treasury develop and publish program guidelines for implementing the Act, but it is not clear from the language in the Act whether all or any potential contractors will be fully relieved from the cumbersome and often risky rules and regulations normally associated with federal procurements, particularly since many of the most burdensome requirements are imposed by statutes.

Use of Streamlined Procurement Procedures

Treasury announced last week that it anticipated awarding a number of procurement contracts under the FAR using other than full and open competition. Normally, the Competition in Contracting Act requires federal agencies to award procurement contracts by considering offers from all interested and responsible parties. A Federal agency may, however, limit competition when, *inter alia*, the need for the supplies or services is of such "unusual and compelling urgency" that the government would be seriously injured unless it could limit competition. Based on the current circumstances, Treasury has already awarded a number of contracts under the FAR using other than full and open competition. In addition, Treasury has issued several procurement documents and established a formal procurement process and review committees. Treasury is also seeking to retain financial agents under separate statutory authority to conduct transactions on its behalf, for example where Treasury needs the services of an asset manager. Contracting opportunities will be posted at www.fedbizopps.gov and/or www.fpds.gov. Businesses may submit capability statements to the Treasury at ootpe@do.treas.gov and would be well advised to do so to position themselves for sole source awards or other awards based on limited competition.

While Treasury has the authority to waive many of the FAR provisions governing administration of the contracts, it is likely that the contracts awarded by Treasury will retain many of their traditional FAR characteristics and, of course, the obligations and risks associated with them. For example, the Act imposes requirements that are already covered to some extent in the FAR, such as:

- participation of minorities and women in the contracting process to the maximum extent practicable,
- safeguarding against conflicts of interest by contractors or advisors, as well as those purchasing or managing troubled assets,
- post-employment restrictions for certain employees, and
- total access by the Comptroller General and the Inspector General to audit contractors' books and records.

As a result, potential contractors and service providers that are new to federal contracting would be well advised to review the terms and conditions of any such contracts very closely to ensure they understand the risks and the internal compliance infrastructure they will need to implement these government-unique requirements.

Government Contract-Unique Requirements

By way of example, the FAR already provides for the acquisition of "commercial items," including services, using streamlined procedures and terms and conditions that are more in line with standard commercial practices than traditional federal procurements. For one, Commercial Item Acquisitions conducted under FAR Part 12 generally relieve the contractor —and subcontractors —from some of the most troublesome and highest risk requirements of traditional federal procurements, such as the Cost Accounting Standards (CAS) and the Truth in Negotiations Act (TINA). Even so, when commercial companies enter into Commercial Item contracts with the federal government, they are subject, *inter alia*, to the requirements identified below. Compliance with each of these requirements involves training, periodic internal audits, and the establishment, maintenance, and adherence to government contract-unique systems and procedures.

- *Bribery and Illegal Gratuities*. Contractors are prohibited by criminal statutes and regulations, with limited exceptions, from providing gifts or gratuities to federal employees. These prohibitions encompass many activities that are common in the commercial arena (*e.g.*, providing meals to customers). Employees must be trained to avoid providing illegal gratuities.

- *Conflicts of Interest*. Contractors are prohibited by criminal statutes and regulations from discussing employment with certain federal employees. Similarly, former federal employees are limited in the types of services they may perform if later retained by a contractor. Compliance with these requirements involves the establishment and use of comprehensive screening procedures by Human Resources personnel.
- *Anti-Kickback*. Contractors are prohibited from receiving a kickback, the purpose of which is to improperly obtain or reward favorable treatment in connection with a federal prime contract or subcontract. Purchasing personnel must be trained to identify and refuse kickbacks.
- *Lobbying Restrictions*. Contractors are prohibited from using federally appropriated funds to lobby for the award of a government contract.
- *Procurement Integrity*. Contractors are prohibited from obtaining contractor bid or proposal information, or sensitive agency procurement information, prior to the award of a federal contract. Employees must be trained to refrain from soliciting or obtaining this type of information.
- *Service Contract Act*. Service contractors must pay their service employees not less than the wages set forth in the applicable Department of Labor wage determination. Contractors must implement procedures to ensure that all service employees who perform services under the contract are paid as required by the wage determination.
- *Equal Opportunity and Affirmative Action*. Contractors must not discriminate against minorities, women, disabled individuals, disabled veterans, and Vietnam era veterans. Contractors must establish written affirmative action programs and comply with the extensive regulations promulgated by the Department of Labor (including reporting requirements).
- *Subcontracting*. Contractors must establish a written subcontracting plan that details the efforts the contractor will make to assure that small business, small disadvantaged business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone, and women-owned small business concerns will have an opportunity to compete for subcontracts. The contractor must strive to meet the total and percentage dollar goals for subcontracting to these entities identified in the subcontracting plan.
- *Record Retention*. Contractors must retain all directly pertinent records involving transactions related to particular contracts for specified periods of time (two to three years depending upon the requirement).

Whether Treasury has retained or will retain any of the requirements identified above is unknown, but even pared-down FAR requirements can impose additional burdens on commercial companies, requiring modification of existing policies and procedures to accommodate the government-unique requirements and implementation of programs to ensure continued compliance. Notably, a recently awarded contract for investment management services contains traditional non-commercial item FAR provisions.

Conflicts of Interest

Treasury also set forth interim guidelines for conflicts of interest (COI). Conflicts of interest, whether actual or potential, can exist at the organizational level or pertain to an individual employee. Organizational conflicts of interest may arise where the substance of a contractor's work affects other interests of the contractor, such as another business unit or affiliate. They may also arise where the contractor has access to sensitive, non-public information about its competitors or future solicitations, for example. Personal conflicts of interest may arise because of an individual employee's previous work with the government or because of his or her own financial interests. To address potential conflicts of interest, the COI guidelines set forth a number of steps that Treasury should consider in soliciting and awarding contracts, including, *inter alia*:

- Obtaining non-disclosure agreements and COI agreements;
- Requiring potential offerors to disclose actual or potential COIs and to submit COI mitigation plans;
- Evaluation and negotiation of COI mitigation plans during source selection;
- Establishing minimum standards for COI mitigation plans; and
- Notifying contractors that they will owe a fiduciary duty to Treasury and incorporating that duty into contracts.

Contractors that are unable to mitigate a COI adequately will generally be ineligible for award. However, the COI guidelines do suggest that a COI may be waived after coordination with the Treasury Senior Procurement Executive.

Pending Opportunities

Treasury released Process for Selecting Asset Managers Pursuant to the Emergency Economic Stabilization Act of 2008 and Procurement Authorities and Procedures, outlining broadly the process it will undertake to retain asset managers under its financial agent authority. Asset managers will be financial agents of the United States and not contractors. Treasury also outlined the procedures it would use to obtain supplies and services under the FAR, noting that it anticipated that a number of contracts would be awarded using other than full and open competition.

On October 6th, Treasury released three Notices for Financial Institutions soliciting responses from institutions seeking to provide (1) securities asset management services, (2) whole loan asset management services or (3) custodian, accounting, auction management and other infrastructure services. The deadline for responses under each Notice was October 8th. On October 13th, Treasury announced that it had entered into a contract with an investment management consultant. This consultant was retained by Treasury to review the asset manager proposals and commenced work immediately reviewing the hundreds of submissions for securities asset manager and whole loan asset manager. Also announced was the retention of a law firm to provide advice on the equity program structuring.

On October 14th, Treasury announced that it entered into a three year contract with The Bank of New York Mellon to act as custodian under the TARP, and to provide the accounting of record for the portfolio, hold all cash and assets in the portfolio, provide for pricing and asset valuation services, track unique asset attributes as required by the Act, such as linkages to executive compensation limits and to warrants received from financial institutions, support the acquisition of securitized assets by serving as auction manager and conducting reverse auctions for the troubled assets and provide all related infrastructure needs. Treasury hired Bank of New York Mellon using its financial agent selection authorities.

As described above, Treasury recently announced equity investments in several financial institutions. Additional contracts will be entered into with two accounting firms to provide auditing services and implement internal control systems.

Mortgage Loss Mitigation and Homeowner Protection

The Act's purpose statement includes, and requires that in implementing its programs Treasury consider: protection of home value, preservation of homeownership and stabilization of communities. Specific provisions exist to encourage foreclosure mitigation efforts.

Treasury must coordinate with the Federal Reserve, the FHFA and the FDIC (together with Treasury, the "Federal property managers"), each in its capacity as an owner of mortgages and mortgage-related securities, to identify opportunities for the acquisition of classes of troubled assets that will improve Treasury's ability to improve loan modification and the restructuring process. Modifications of existing mortgages are encouraged through use of the

HOPE for Homeowners Program, as well as by effecting term extensions, rate reductions, principal write-downs, increases in the proportion of loans within a pooled structure allowed to be modified, or removal of other limitations on modifications. With respect to multi-family dwellings, the Federal property managers are required to ensure continuation of existing rental subsidies and undertake modifications that provide for sufficient cash flow to maintain decent and safe conditions at the property.

Additionally, Treasury must consent, where appropriate, to any reasonable loan modification requests. This includes requests related to individual loans, including term extensions, rate reductions and principal write-downs, as well as requests related to pools of mortgages, including amending contracts to permit an increased proportion of loans in a pool to be modified or other removal of limitations on modifications.

Treasury must balance its many purposes, including these foreclosure mitigation efforts and helping the homeowner, with protecting taxpayer resources and providing stability and preventing disruption to the financial markets.

Other EESA Impacts

Treasury Coordination with Foreign Authorities and Central Banks

The Act requires that Treasury coordinate, as appropriate, with foreign financial authorities and central banks to work toward the establishment of similar programs by such authorities and central banks. This reflects the concern by many in Congress that U.S. taxpayers should not assume sole responsibility for the bailout of non-U.S. financial institutions. As discussed below, on October 10, 2008, the G-7 finance ministers and central bank governors issued a *Plan of Action* that outlines a commitment to work together to take action to address the current liquidity, banking and market environment. While establishment of a purchase or insurance program is not specifically identified, the goals outlined in the Plan align with the purposes of the Act. And in the following days, Treasury has clarified its commitment to purchasing equity of U.S. financial institutions to improve capital and encourage lending.

Additionally, as noted above, the Act's provision on coordination with foreign authorities provides that where a foreign financial authority or central bank holds troubled assets as a result of extending financing to financial institutions that have failed or defaulted on such financing, such troubled assets qualify for purchase under TARP.

Mark-to-Market (Fair Value) Accounting[3]

The Act requires that the SEC conduct a study on "mark-to-market" accounting and authorizes the SEC to suspend the application of the accounting rule for any issuer or category of transactions if the SEC finds it is necessary or appropriate, in the public interest and consistent with the protection of investors. "Mark-to-market" accounting, required by Statement 157 of the Financial Accounting Standards Board (FASB), mandates that financial assets be recorded based on their current fair value. When possible, fair value is determined based on the current market price of the asset. In recent months, when faced with increasing losses, write-downs, reduced capital and tightening liquidity, institutions sold mortgage-related securities at increasingly reduced prices. These stressed sales then established increasingly lower floors for the determination of the "market" value of the same and similar mortgage-related securities. It has been suggested that, in many cases, the resulting balance sheet value given to mortgage related assets is less than the present value of the expected cash flows from those assets, even after taking into consideration the current housing environment and increased expected losses on mortgage related securities.

On September 30, 2008, the SEC and the FASB Staff issued a statement providing clarifications on fair value reporting. On October 10, 2008, the FASB followed with FASB Staff Position 157-3, *Determining the Fair Value of*

[3] See Morrison & Foerster LLP's News Bulletin "Fair Value and the Recent Market Turmoil" at http://www.mofo.com/news/updates/files/081013FairValue.pdf

a Financial Asset When the Market for That Asset Is Not Active. The statements provide clarification that where there is no active market for a security, the institution making a fair value determination may under the appropriate circumstances consider the future value of cash flows. At this time, it remains unclear whether the additional guidance will result in corporations modifying valuations with their accountants' blessing in future periods.

By January 2, 2009, the SEC must deliver to Congress a report undertaken in consultation with Treasury and the Federal Reserve. The study must consider, at a minimum:

- the effects of FAS 157 on a financial institution's balance sheet,
- the impact of such accounting on bank failures in 2008,
- the impact of such standards on the quality of financial information available to investors,
- the process used by the FASB in developing accounting standards,
- the advisability and feasibility of modifications to such standards, and
- alternative accounting standards to those provided in FAS 157.

The Act requires that the SEC assess the impact on financial institutions, including depositary institutions, and include any administrative and legislative recommendations in the report.

On October 7, 2008, the SEC announced initial steps to conduct the study, including the appointment of Deputy Chief Accountant for Accounting James Kroeker as staff director for the study. The SEC also published a request for public comment on October 8th and comments are due by November 13, 2008.

Treasury Analysis of Financial Disclosure Generally

Treasury is required to determine, for each type of financial institution that sells troubled assets, whether certain current public disclosure requirements are adequate to provide the public with sufficient information as to the true financial position of the institution. The specific areas of financial disclosure are: off-balance sheet transactions, derivatives instruments, contingent liabilities and "similar sources of potential exposure." If Treasury determines that the existing disclosure requirements are not adequate for the public to assess the true financial position of the institutions, it is required to make recommendations for additional disclosure requirements to the relevant regulators.

There are no deadlines or time requirements imposed upon Treasury with respect to this requirement.

To undertake an assessment of this nature Treasury will need information that is broader in scope than that which we would expect to see gathered to conduct an auction or reverse auction. In the case of direct purchases, the institution under stress may be more likely to share this level of information with Treasury. As with many of the reporting provisions of the Act, it remains to be seen what level of detail will be undertaken and, particularly absent a deadline, when a report may be submitted.

Regulatory Modernization Report[4]

By April 30, 2009, the Secretary of Treasury must deliver to Congress a regulatory modernization report. Treasury must conduct a review of the current state of the financial markets and the regulatory system, analyzing the effectiveness of the system in overseeing financial market participants. Both the over-the-counter derivatives market and the government-sponsored enterprises (GSEs) must be included in Treasury's analysis.

[4] See Morrison & Foerster LLP's News Bulletin "Credit Default Swaps as Insurance: One Regulator or Many?" at http://www.mofo.com/news/updates/files/081006CreditDefault.pdf

The report should identify whether any financial market participants currently outside the regulatory system should become subject to the regulatory system. It should also include any recommendations related to enhancement of the clearing and settlement of over-the-counter swaps.

We would expect many of the recommendations would mirror those found in *The Department of Treasury Blueprint for a Modernized Financial Regulatory Structure*, published in March 2008. The Blueprint includes short term, intermediate term and long term recommendations for a stronger regulatory structure. Changes proposed in the Blueprint include, among others, conversion of the federal thrift charter to a national bank charter over a two-year period accompanied by a merger of the Office of Thrift Supervision and the Office of the Comptroller of the Currency, merger of the SEC and the Commodities Futures Trading Commission, and establishment of an optional national insurance charter.

Report on Margin Authority

By June 1, 2009, the Comptroller General must submit the results of a study to determine to what extent leverage, and the sudden deleveraging of financial institutions, was a factor behind the current crisis. The study must include an analysis of (1) the roles of government parties to monitor leverage and their actions, if any, in curtailing leverage, (2) the authority, process and actions of the Federal Reserve regarding leverage and margin requirement setting and (3) recommendations on the authority of the Federal Reserve.

Report on Regulatory Reform

By January 20, 2009, the Congressional Oversight Panel must submit to Congress a special report on regulatory reform. The report should analyze the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers. The Panel should make specific recommendations for improvements in those areas, including whether and why any unregulated financial market participants should be regulated, and whether there are any gaps in existing consumer protections.

Federal Reserve Paying Interest on Reserves

The Act authorized the Federal Reserve Banks to begin paying interest on deposits held by or on behalf of depository institutions. The Financial Services Regulatory Relief Act of 2006 had authorized the interest payments commencing in October 2011, but the Act removed the waiting period. By paying interest on required reserve balances as well as excess deposits, the incentive for depository institutions to remove any excess on deposit at a Federal Reserve Bank has been removed. Additionally, the opportunity cost associated with maintaining the required balances has been reduced, which the Federal Reserve believes will enhance efficiency for banks. The necessary revisions to Regulation D to permit the payment of interest were made, effective October 9, 2008.

Temporary Increase in FDIC Insurance

From October 3, 2008 through December 31, 2009, the amount of deposits insured by the FDIC was increased from $100,000 to $250,000. The same limit increase applies to credit unions as well. As several commentators have noted, it will be challenging for Congress to permit the insurance to lapse back to the lower level.

Bailout Related Tax Changes and Impacts[5]

The Act contains a number of significant tax provisions, particularly in the area of employee benefits and executive compensation. Also attached to the legislation was a package of tax extenders, one year of alternative minimum tax relief, disaster tax relief and energy tax incentives.[6] The tax provisions directly related to the TARP are as follows:

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[5] See Morrison & Foerster LLP's News Bulletin "Bailout Bill Tax Provisions: An Executive Summary" at http://www.mofo.com/news/updates/files/14546.html

Gain on Fannie/Freddie Preferred Stock

Gain or loss realized by banks, savings and loan associations and certain other specified financial institutions on Fannie Mae or Freddie Mac preferred stock held on September 6, 2008 or sold or exchanged on or after January 1, 2008 and before September 7, 2008 will be treated as ordinary rather than capital gain or loss.

Employee Benefit and Executive Compensation Provisions[7]

The Act contains a number of significant employee benefit and executive compensation provisions, some that apply to employee benefit plans generally, and some that apply only to the executive compensation arrangements of financial institutions taking advantage of the relief offered by TARP.

Treasury Secretary to Consider Protecting Some, but Not All Employee Benefits

In exercising authority under TARP, Treasury is required to take various criteria into consideration, including the purchase of troubled assets from certain tax-qualified plans holding such assets. For this purpose, the plans that are eligible for protection include 401(k) plans, defined benefit pension plans, 403(b) plans, and qualified 457 plans of governmental and tax-exempt entities.

Individual Retirement Arrangements (IRAs) are not eligible for protection under this provision. Also, specifically excluded from consideration of protection are any compensation arrangements to which Section 409A of the Internal Revenue Code (Code) applies. Section 409A arrangements generally include unfunded deferred compensation plans, but can also include severance, change in control, and other similar arrangements. Therefore, this provision of the Act does not protect, for example, deferred compensation benefits held by an employer in a "rabbi trust."

Treasury Secretary Given Broad Power over Design and Operation of Certain Financial Institutions' Executive Compensation Arrangements

Financial institutions taking advantage of TARP are subject to new limitations on executive compensation. Where direct purchases of troubled assets are made from a financial institution under TARP where no bidding process or market prices are available and the Treasury Secretary holds a meaningful equity or debt position in the institution, the Treasury Secretary has the power to restrict the executive compensation the institution affords to its executive officers. The criteria the Act permits the Treasury Secretary to consider in limiting a financial institution's executive compensation include (1) excluding incentives for executive officers to take unnecessary and excessive risks that threaten the value of the financial institution, (2) prohibiting any golden parachute payments to the institution's senior executive officers, and (3) providing for the recovery of any bonus or incentive compensation paid to a senior executive officer that was based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate.

In cases where the Treasury Secretary determines that the purpose of the Act is best met through auction purchases of troubled assets, and where such purchases in the aggregate exceed $300 million, the Treasury Secretary is required to prohibit any new employment contract with a senior executive officer that provides a golden parachute upon involuntary termination, bankruptcy filing, insolvency, or receivership. It is not clear how "golden parachute" will be defined for purposes of this provision, but that question may be answered under regulations that Treasury is directed to issue within two months following enactment of the Act. The provision described in this paragraph expires on December 31, 2009, unless extended by certification by Treasury to Congress.

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[6] See Morrison & Foerster LLP's "Summary of Cleantech Provisions in the Bailout Bill" at http://www.mofo.com/news/updates/files/14547.html
[7] See Morrison & Foerster LLP's News Bulletin "Economic Stabilization Act: Employee Benefits and Executive Compensation" at http://www.mofo.com/news/updates/files/14549.html

For purposes of these rules a "senior executive officer" is defined as an individual who is one of the top five highest-paid executives of a public company whose compensation is required to be disclosed under the Securities Exchange Act of 1934, as well as non-public company executive counterparts.

Tax Law Changes Affecting Executive Compensation

In addition to giving Treasury power over the design of executive compensation and benefit plan provisions of financial institutions participating in the TARP, the Act also makes tax law changes that affect such institutions:

Limitation of Employer's Deduction for Compensation over $500,000. With respect to an employer from whom more than $300 million in troubled assets is acquired under TARP (other than an employer whose only sales of troubled assets under the Act are direct purchases), no deduction is allowed to the employer for executive remuneration of a covered executive that exceeds $500,000 in any taxable year. In addition, any deferred compensation that an executive earns in any year cannot be deducted in a subsequent year (when it is ordinarily paid to the executive) to the extent it exceeds $500,000 in the year in which such deferred compensation was earned, reduced by the amount of taxable pay the executive received in the same year.

For purposes of this rule, a "covered executive" includes the chief executive officer, the chief financial officer, and the other three most highly-compensated executive officers for the taxable year. Any individual who is considered a covered executive for any year retains that status for all succeeding years. This provision is included as an amendment to the existing $1 million limit on deductible executive pay under Code Section 162(m), and borrows certain concepts from Section 162(m), but also deviates from the existing provisions in important ways. For example, the $500,000 limitation on deductibility added by the Act applies to private as well as public companies, and also to partnerships. In addition, for purposes of this new rule, "executive remuneration" that is counted toward the $500,000 cap means all amounts taxable to a covered executive in any taxable year, without any offset or reduction for amounts that would be excludable under the $1 million cap under Section 162(m) of the Code, such as commissions, performance-based pay, and existing binding contracts.

Limitation of Employer's Deduction for Severance Pay Equal to or in Excess of Three Times Employee's Base Pay. Another provision in the Act limits the deductibility to an institution participating in the TARP for severance payments it makes to covered executives who are involuntarily terminated from employment by the financial institution, or who terminate their employment in connection with any bankruptcy, liquidation, or receivership of the institution and who receive severance pay that equals or exceeds three times the employees' base amount. An executive's base amount is calculated in the same way as under existing golden parachute rules and generally means the executive's average compensation from the institution over the five most recent years. Once an executive triggers this rule by receiving compensation equal to or exceeding three times the executive's base amount, the amount that is not deductible to the institution is the amount of severance pay that equals or exceeds the executive's base amount (not three times the executive's base amount). In addition, if an executive receives severance pay equal to or exceeding three times the executive's base amount, the Treasury Secretary is given power to implement regulations that would also impose an excise tax on the covered executive equal to 20% of any severance pay he or she receives equal to or exceeding the executive's base amount.

On October 14, the Treasury and the I.R.S. issued Notice 2008-94, clarifying certain technical points about the application of new Sections 162(m)(5) and 280G(e), including guidance on the definitions of "applicable employer," "applicable taxable year," "covered executive," how the rules apply in the case of mergers and acquisitions of financial institutions selling troubled assets under TARP, what constitutes executive remuneration to which the $500,000 limit applies and the application of the limitation to deferred deduction executive remuneration, as well as which executives are "covered executives" and what constitutes a "parachute payment" for purposes of new Section 280G(e).

Extension of Discharge of Mortgage Debt

The current exclusion from taxable income of the first $2 million of discharge of mortgage debt relating to a taxpayer's primary residence is extended through the end of 2012.

2008 in Review: Outline of Significant Federal Actions

Below is an outline followed by a brief summary of some significant regulatory and governmental actions taken to date to attempt to mitigate the impact of the mortgage crisis and the related ripple effects through the securities and credit markets.

- Bank of America announces acquisition of Countrywide Financial (January 11, 2008)
- Federal Reserve lowered federal funds rate 75 basis points to 3.5% (January 22, 2008); lowered by 50 basis points to 3% (January 30, 2008); lowered by 75 basis points to 2.25% (March 18, 2008); lowered by 25 basis points to 2% (April 30, 2008); lowered by 50 basis points to 1.5% (October 8, 2008)
- Federal Reserve increases temporary reciprocal currency arrangements with other central banks (March 11, 2008, May 2, 2008, July 30, 2008, September 18, 2008, September 26, 2008, September 29, 2008 and October 14, 2008) and extended the swap lines to additional central banks (September 24, 2008)
- Federal Reserve Bank of New York guarantees $29 billion of Bear, Stearns debt as the government brokers its acquisition by JPMorgan for $2 per share (March 14, 2008), later raised to $10 per share (March 24, 2008)
- Federal Reserve announces new Term Securities Lending Facility (TSLF) (March 11, 2008); accepts a wider pool of collateral for TSLF (May 2, 2008); TSLF extended through January 30, 2009 (July 30, 2008) and extended eligible collateral (September 14, 2008)
- Federal Reserve authorizes Federal Reserve Bank of New York to create Primary Dealer Credit Facility to provide liquidity to dealers in the securitization markets for up to six months (March 16, 2008); extended the PDCF through January 30, 2009 (July 30, 2008) and extended the eligible collateral (September 14, 2008)
- FDIC is appointed receiver for IndyMac (July 11, 2008), then the largest bank failure since the 1980's; the parent holding company subsequently filed for Chapter 7 bankruptcy protection (July 31, 2008)
- SEC proposes rules in two phases to remedy concerns with the credit rating agencies (June – July 2008)
- Housing and Economic Recovery Act of 2008, establishing the HOPE for Homeowners Program (July 30, 2008)
- SEC takes emergency action against certain short selling practices (July – October 2008)
- Federal Reserve introduces 84-day Term Auction Facility loans (July 30, 2008); Change follows a series of increases in number and size of auctions of 28-day credit throughout 2008 and was followed by increases in the size of the auctions of 84-day credit
- FHFA appointed as conservator for Fannie Mae and Freddie Mac (September 7, 2008)
- Lehman Brothers files for bankruptcy protection (September 15, 2008); Merrill Lynch sells itself to Bank of America (September 15, 2008)
- Federal Reserve agrees to lend AIG $85 billion and the government takes a 79.9% stake in the company and removes CEO in a large scale bailout (September 16, 2008)
- Federal Reserve announces loan program for depository institutions and bank holding companies to finance their purchase of high quality asset-backed commercial paper (ABCP) from money market funds (September 19, 2008)

- Federal regulators seize Washington Mutual in the now largest bank failure in U.S. history and arrange a sale of assets to JPMorgan (September 24, 2008)
- Treasury announces Temporary Guarantee Program for Money Market Funds (September 29, 2008)
- Citigroup announces acquisition of Wachovia businesses in deal brokered by the FDIC and federal regulators (September 29, 2008); followed by an offer from Wells Fargo for the entire bank (October 3, 2008)
- Federal Reserve announced the commencement of interest payments on required and excess deposits at Reserve Banks (October 6, 2008)
- Federal Reserve announces creation of a Commercial Paper Funding Facility to provide back-stop liquidity to commercial paper issuers (October 7, 2008) and releases updated terms and conditions (October 14, 2008)
- Treasury announces coordinated effort with G7 to address liquidity and banking crisis (October 10, 2008)
- FDIC announces Temporary Liquidity Guarantee Program to provide guarantees for bank debt and insurance for all non-interest bearing transaction accounts (October 14, 2008)

Federal Reserve Announces Two Lending Facilities

On March 11, 2008, the Federal Reserve announced an expansion of its securities lending program. The new Term Securities Lending Facility (TSLF) provides up to $200 billion of Treasury securities to primary dealers secured for a term of 28 days (rather than overnight, as in the previously existing program) by a pledge of other securities, including federal agency debt, federal agency mortgage-backed securities and non-agency triple-A rated private-label residential MBS. On May 2, 2008, the Federal Reserve announced an expansion in the collateral that can be pledged in the Schedule 2 TSLF auctions, to include triple-A rated asset-backed securities. On July 30, 2008, the TSLF was extended through January 30, 2009.

On March 16, 2008, the Federal Reserve announced the authorization of a lending facility designed to improve the ability of primary dealers to provide financing to participants in the securitization markets. The facility as initially announced was authorized for six months, though it was later extended through January 30, 2009. The interest rate charged for use of the facility is the discount rate at the Federal Reserve Bank of New York.

SEC Proposes Credit Rating Agency Reform[8]

On June 16, 2008 and July 1, 2008, the SEC issued rule proposals aimed at responding to ongoing concerns regarding the role and importance of credit ratings issued by nationally recognized statistical rating organizations (NRSROs). As a result of the sub-prime crisis, the NRSROs fell under criticism based on assertions that they made inaccurate judgments in their initial ratings of mortgage-backed securities and in their ongoing surveillance of these transactions. Concerns were raised regarding the potential conflict of interest that arises when the issuer that is requesting a rating also pays the NRSRO fee. The proposed rules address conflict of interest concerns and impose restrictions and disclosure requirements based on the interactions between rating agencies and issuers. The disclosure requirements would mandate that significant additional information be publicly provided. Finally, many of the proposed rules were intended to address the SEC's concern that the inclusion of credit ratings throughout its own rules and regulations may have acted as a regulatory "seal of approval" for the ratings such that market participants may have placed "undue reliance" upon them. The proposed amendments would eliminate references to these ratings in numerous SEC rules and forms. As drafted, the proposals would have a significant

[8] See Morrison & Foerster LLP's News Bulletin "SEC Proposes Reforms to Credit Rating Agencies" at http://www.mofo.com/docs/pdf/080702CreditAgencies.pdf and "SEC Proposal for Credit Rating Agency Reform: Potential Impact on the Asset-backed Markets" at http://www.mofo.com/news/updates/files/080805AgencyReform.pdf.

impact on how market participants use credit ratings during the new issuance process, in determining investment suitability, for computing net capital requirements, and in complying with other SEC rules and regulations.

The comment periods have closed and the rule proposals are pending final action by the SEC.

Federal Reserve Authorizes Lending to Fannie Mae and Freddie Mac

On July 13, 2008, the Federal Reserve announced that it had granted the Federal Reserve Bank of New York the authority to lend to Fannie Mae and Freddie Mac should such lending prove necessary. Any lending would be at the primary credit rate and collateralized by U.S. government and federal agency securities. The authorization was intended to supplement Treasury's existing lending authority and to help ensure the ability of Fannie Mae and Freddie Mac to promote the availability of home mortgage credit during a period of stress in financial markets.

SEC Takes Actions against Short Selling[9]

In an effort to address continuing market volatility, the SEC issued a series of emergency orders to limit short sales and require reporting of short positions. Given the speed with which these emergency orders were issued and the questions raised regarding their implementation, the SEC quickly followed with additional interpretive guidance. As of October 8, 2008, the emergency short sale orders have expired, and the emergency short sale reporting order is currently scheduled to expire on October 17, 2008. The new temporary rule and two new permanent rules described below remain in effect.

On July 15, 2008, the SEC issued its first emergency order barring naked short sales of the stocks of Fannie Mae, Freddie Mac and 17 financial firms, including several investment banks. The order was issued in response to a perception that naked shorting might trigger a market stampede away from the securities of the subject institutions. The order was intended to promote investor confidence and reassure investors that the SEC was protecting companies and investors from manipulative short selling. Market makers were excluded from the restriction in an amendment on July 18th. This initial order was extended through August 12th. At that time the SEC indicated that it was considering permanent rulemaking.

On September 17, 2008, following the government rescue of Fannie Mae and Freddie Mac, the failure of Lehman Brothers, the sale of Merrill Lynch and the bailout of AIG, the SEC took emergency action and adopted three rules to prohibit naked short selling.

- The first was the adoption of a temporary rule under Regulation SHO, Rule 204T. The rule imposes a penalty on any participant of a registered clearing agency, and any broker-dealer from which it receives trades for clearance and settlement, for having a fail to deliver position – it requires that short sellers and their broker-dealers deliver securities by the close of business on the settlement date (three days after the sale transaction date, or T+3) and imposes penalties for a failure to do so. Rule 204T has also been proposed as a permanent rule and the SEC has a comment period open.
- The SEC's second action was to adopt amendments to Reg SHO to eliminate the options market maker exception. As a result, options market makers will be treated in the same way as all other market participants, and are required to abide by the new hard T+3 closeout requirements. This change had been initially proposed in August 2007, the comment period was re-opened in July 2008, and the changes are final.
- The third prong of the SEC's approach was to adopt Rule 10b-21 under the Securities Exchange Act of 1934. Rule 10b-21 is intended to highlight the specific liability of persons that engage in the practice of

[9] See Morrison & Foerster LLP's News Bulletins "SEC Clarifies Short Sale Restrictions and Related Disclosure Requirements" at http://www.mofo.com/news/updates/files/080928SEC.pdf; "SEC Takes Emergency Action on Shorting; South Dakota Short Selling Ballot Initiative" at http://www.mofo.com/news/updates/files/080917ShortSell.pdf; and "A Short Summary of Short Selling Restrictions" at http://www.mofo.com/news/updates/files/080730ShortSelling.pdf

deceiving specific persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and then fail to make delivery by the settlement date. The new rule makes clear that those who lie about their intention or ability to deliver securities in time for settlement are violating the law when they fail to deliver. This change was initially proposed in March, and the changes are final.

On September 18, 2008, the SEC issued an emergency order prohibiting short selling, as opposed to "naked short selling," of the publicly traded securities of 799 companies, each classified as an "Included Financial Firm," subject to certain exceptions, including for market makers, short sales occurring automatically as a result of an exercise or assignment under another security, and sales of covered securities pursuant to Rule 144. This most recent emergency order expired on October 8th.

Also on September 18, 2008, the SEC issued an emergency order implementing reporting requirements for institutional investment managers that exercise investment discretion over at least $100 million of securities subject to reporting on Form 13F. If these institutional investment managers conduct short sales of Section 13(f) securities, they must file new Form SH. Form SH is due on the first business day of every calendar week following a week in which short sales were executed. There are additional limitations on the filing requirements. The first Form SH was required to be filed on September 29th and the order requiring Form SH is scheduled to expire on Friday, October 17th, with the final Form SH due on Tuesday, October 14th. Although the SEC initially intended that Forms SH would be made public, it has amended the initial order and will retain as confidential (subject to requests under the Freedom of Information Act), all Forms SH.

Treasury's Temporary Guarantee Program for Money Market Funds

Following the bankruptcy filing by Lehman Brothers on September 15th, a money market mutual fund reported that due to the impact of its holdings of Lehman Brothers commercial paper losing market value, the fund's share value fell below $1.00. As a result, money market funds began reporting a significant increase in withdrawals as investors moved their money to FDIC insured bank deposits.

On September 19, 2008, Treasury announced the establishment of a Temporary Guaranty Program for Money Market Funds for the U.S. money market mutual fund industry. The program insures the holdings of non-government, non-agency publicly offered Rule 2a-7 money market mutual funds. Both retail and institutional funds will be able to participate, for a fee. Treasury made $50 billion available from the assets of the Exchange Stabilization Fund to guarantee the payment to investors of participating money market funds with a net asset value that falls below $1.00. Relief under the guarantee program will be triggered once a participating fund's board of directors acts to liquidate the funds and it is determined that holders would, absent the guarantee program, receive less than $1.00 per share.

On September 29, 2008, Treasury opened the Temporary Guarantee Program, providing coverage to holders for amounts that they held in participating money market funds as of the close of business on September 19, 2008. The program will exist for a three-month term. Following the initial three-month term, Treasury has the option to renew the program up to the close of business on September 18, 2009. The program will not automatically extend for the full year without Treasury's approval, and funds would have to renew their participation at the extension point to maintain coverage. If Treasury chooses not to renew the program at the end of the initial three-month period, the program will terminate. Funds with a net asset value below $0.995 as of the close of business on September 19, 2008, were not eligible to participate in the program. Funds were required to apply by October 8, 2008.

Eligible funds include both taxable and tax-exempt money market funds. Treasury and the IRS issued guidance that confirmed that participation in the Temporary Guarantee Program will not be treated as a federal guarantee that jeopardizes the tax-exempt treatment of payments by tax-exempt money market funds.

On October 8, 2008, Treasury announced that money market funds that have a policy of maintaining a stable net asset value or share price that is greater than $1.00 and had such a policy on September 19, 2008 were eligible to participate in the guarantee program, provided the fund meets all of the other original requirements. The enrollment deadline for these funds that were eligible as a result of this technical correction was October 10, 2008.

As of October 12, 2008, reports indicated that most of the large money market fund managers had entered the Temporary Guarantee Program, in order to boost their investors' confidence.

While the Temporary Guarantee Program was initially authorized under the Exchange Stabilization Act, as noted above, EESA requires that any costs associated with the Guarantee Program be reimbursed from the EESA authorized amounts.

Housing and Economic Recovery Act of 2008

On July 30, 2008, the President signed the Housing and Economic Recovery Act of 2008 (HERA), an omnibus housing bill combining regulatory reform of GSEs, modernization of the Federal Housing Administration (FHA), and provisions to help troubled borrowers. The Federal Housing Finance Regulatory Reform Act of 2008 created the FHFA, a new combined regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The power granted to the FHFA includes the authority to establish capital, management and risk standards, to enforce its orders through cease and desist authority, to put a regulated entity into receivership and review and approve new product offerings. The affordable housing component of the GSEs mission was expanded as was the conforming loan limit.

The HOPE for Homeowners Act of 2008 created a new temporary program within FHA designed to refinance distressed mortgage loans. The program was scheduled to begin October 1, 2008 and expire on September 30, 2011. The estimated number of households able to benefit from the program is 400,000.

The Foreclosure Prevention Act of 2008 modernizes many aspects of FHA lending, including increasing the FHA loan limit, authorizing $3.92 billion in supplemental Community Development Block Grant Funds provided to communities hardest hit by foreclosures, providing funds for housing counseling, and modifications to TILA disclosures.

Conservator Appointed for Fannie Mae and Freddie Mac

On September, 7, 2008, the FHFA, working with Treasury and the Federal Reserve, put Fannie Mae and Freddie Mac into conservatorship. The CEOs of each of the GSEs were replaced with CEOs appointed by the FHFA. At the same time, Treasury announced several steps to increase investor confidence in the GSEs and improve liquidity in mortgage-related products.

First, Treasury agreed to provide up to $100 billion of support to each GSE. In exchange for Treasury's commitment, it received preferred stock with a more senior liquidation preference than outstanding preferred stock or common stock. Beginning in 2010, the GSEs will be required to pay a commitment fee for the facility, at a rate to be determined. Treasury also received a warrant to purchase 79.9% of each GSE.

Second, Treasury established a secured lending credit facility, available to Fannie Mae, Freddie Mac and the Federal Home Loan Banks. The facility will act as a liquidity back-stop to provide funding and liquidity, expiring in December 2009.

Finally, Treasury announced a program to purchase the mortgage-backed securities issued by the GSEs to provide additional liquidity to the market. The purchase program is also set to expire in December 2009. On October 3rd, Treasury announced the retention of Barclays Global Investors and State Street Corp. to manage the debt acquired through this program.

FHFA announced that the primary mission of the GSEs at this time is "to proactively work to increase the availability of mortgage finance, including by examining the guarantee fee structure, with an eye toward mortgage affordability." The GSEs received authority to increase their holdings of mortgage-backed securities through the end of 2009 and, thereafter, are required to reduce their holdings by 10% per year.

These actions were taken under the authority of the Housing and Economic Recovery Act of 2008.

Federal Reserve Board Undertakes Several Initiatives

On September 14, 2008, the Federal Reserve announced several initiatives to provide additional support to financial markets, including enhancements to its existing liquidity facilities. The collateral eligible to be pledged at the Primary Dealer Credit Facility (PDCF) was expanded to closely match the types of collateral that can be pledged in the tri-party repo systems of the two major clearing banks. Previously, PDCF collateral had been limited to investment-grade debt securities.

The collateral for the TSLF was expanded to include all investment-grade debt securities. Previously, only Treasury securities, agency securities, and AAA-rated mortgage-backed and asset-backed securities could be pledged. These changes represented a significant broadening in the collateral accepted under both programs. Schedule 2 TSLF auctions were increased to weekly from bi-weekly and the amounts offered were increased to a total of $150 billion, from a total of $125 billion.

The Federal Reserve also adopted an interim final rule that provides a temporary exception to the limitations in Section 23A of the Federal Reserve Act. It allows all insured depository institutions to provide liquidity to their affiliates for assets typically funded in the tri-party repo market. This exception expires on January 30, 2009, unless extended by the Federal Reserve, and is subject to various conditions to promote safety and soundness.

Federal Reserve Board Liberalizes Rules for Investments in Banks[10]

On September 22, 2008, the Federal Reserve issued guidelines for non-controlling, minority investments in banks and bank holding companies. The guidelines clarify and liberalize the conditions under which an investor can make a minority investment in a banking organization without being regulated as a bank holding company under the Bank Holding Company Act (BHCA). The guidelines should facilitate private equity fund investment in the financial services sector.

BHCA Framework

Under the BHCA, an investor is deemed to control a banking organization if it (1) directly or indirectly owns 25% or more of any class of voting securities of the banking organization; (2) controls the election of a majority of the board of directors of the banking organization; or (3) otherwise exercises a controlling influence over the management or policies of the banking organization. The guidelines deal with the third prong of the test—by addressing, in general terms, which investments do not constitute the exercise of a controlling influence. Ultimately, a determination whether a particular minority investment involves the exercise of "controlling influence" by the investor depends on all the facts and circumstances of each individual investment, but the guidelines are helpful in providing a degree of predictability that should encourage minority investment.

Existing Policy Statement

The prior policy statement in this area was issued in 1982, in the context of stakeholder investments by out-of-state banks seeking to prepare for the advent of interstate banking operations. The 1982 policy statement has served as a compass for controlling influence determinations involving a broad range of proposed investments. In addition,

[10] See Morrison & Foerster LLP's News Bulletin "Federal Reserve Board Liberalizes Rules for Investments In Banks" at http://www.mofo.com/news/updates/files/14497.html

over time, the Federal Reserve has grappled with many "controlling influence" issues not contemplated by the 1982 policy statement, which has resulted in staff-developed policy in the area. We summarize below the general guidance provided by the policy statement with regard to arrangements that have been particularly sensitive in controlling influence determinations.

What degree of director representation may an investor have on a banking organization board without being deemed to exercise controlling influence?

The Federal Reserve generally has regarded board participation by an investor with between 10% and 24.9% of the voting shares of a banking organization as indicative of control. Under the new policy, a minority investor will generally be permitted to have a single representative on an organization's board of directors without being deemed to exercise controlling influence over that organization. The policy statement also permits a minority investor in an organization to elect two directors of that organization's board, subject to the following conditions: (1) board representation must be proportionate to the minority investment; (2) no more than 25% of the board seats can be controlled by the minority investor; and (3) another shareholder, approved by the Federal Reserve, must control the banking organization. Without regard to the number of board seats held, no minority investor's board representative can serve as Chairman of the Board or chairman of any committee without raising control concerns.

What amount of total equity can a minority investor own in a banking organization without exercising controlling influence?

An investor is deemed to exercise control over a banking organization if it controls 25% or more of any class of *voting* securities of that banking organization. The BHCA, however, does not explicitly address the holding of non-voting equity (or a combination of voting and non-voting equity). In the 1982 policy statement, the Board suggested that holding 25% or more of the total equity of a banking organization would be indicative of control. The policy statement liberalized the standards for holding non-voting equity, while continuing to express a belief that a large equity investment (regardless of voting power) can provide an investor with controlling influence over the organization. Under the new policy statement, a minority investor will not be seen to exercise controlling influence if its investment meets the two following criteria:

- Its total equity investment does not exceed one-third of the total equity of the organization, and
- It does not own 15% or more of any class of voting securities of the organization.

In the context of investment in non-voting shares, the Federal Reserve also discusses situations under which rights to convert non-voting shares into voting shares will be deemed to trigger control issues.

To what degree can a minority investor consult with management without being deemed to exercise controlling influence?

Minority investors often seek to protect their investments by communicating to management and/or to the board their views about how best to enhance the value of the organization. Thus, a minority investor's board representative might seek to advocate changes in management; new strategies for the organization; capital or liquidity policies; mergers or acquisitions or other major corporate policies or decisions. Under the policy statement, advocacy in and of itself will not be equated with controlling influence as long as decision-making is left to an organization's board, shareholders or management, as the case may be. Nonetheless, control could be implicated if advocacy were linked to explicit or implicit threats to divest, sponsor proxy solicitations or take other actions that might coerce a banking organization or its management to take a particular course of action.

What other circumstances might demonstrate that a minority investor in fact exercises a controlling influence?

In the past, a non-controlling minority investor has generally been prohibited from conducting any material business transactions or having material business relationships with the banking organization in which it has invested. However, in the past business relationships limited quantitatively and qualitatively, have been allowed particularly if the minority investment were closer to 10% than to 25%. Such relationships will continue to be reviewed on a case-by-case basis to determine whether they might involve a controlling influence.

Past precedent and the 1982 policy statement also recognize that controlling influence might be exercised through the imposition by the investor of particular covenants accompanying the investment. In this regard, there has been particular concern about such covenants that might affect hiring, firing, executive compensation, engaging in new business lines, making substantial changes in operations, raising additional capital or otherwise retaining, disposing of or acquiring material corporate assets. On the other hand, covenants that are protective of the essential characteristics of the security held by the minority investor generally have been viewed as permissible. As the policy statement makes clear, these would include, for example, covenants that might prohibit the issuance of senior securities or the incurrence of senior borrowings that might adversely affect the existing rights or preferences of the security in which the minority investor has invested. Covenants that provide information rights to an investor also do not necessarily trigger control considerations.

The Federal Reserve has moved cautiously in the control area in recent months in anticipation of the issuance of these guidelines. The guidelines should ease the path for action on pending applications that involve controlling influence determinations and encourage minority investment in banking organizations at a time when capital in the industry is sorely needed. In particular, the guidelines provide a constructive framework for private equity funds to invest in the financial services sector.

The Federal Reserve takes Action Relating to AIG

On September 16, 2008, the Federal Reserve Board, with the support of the Treasury, authorized the Federal Reserve Bank of New York to lend up to $85 billion to the American International Group (AIG) under Section 13(3) of the Federal Reserve Act. The secured loan was described as having terms and conditions designed to protect the interests of the U.S. government and taxpayers. The action was taken based on the determination that a disorderly failure of AIG could add to already significant levels of financial market fragility and lead to substantially higher borrowing costs, reduced household wealth, and materially weaker economic performance.

The liquidity facility was designed to assist AIG in meeting its obligations as they became due, to facilitate the sale of certain of its businesses in an orderly manner, with the least possible disruption to the overall economy. The facility has a 24-month term, an interest rate of three-month Libor plus 850 basis points and a maximum draw amount of $85 billion. The loan is collateralized by all the assets of AIG, and of its primary non-regulated subsidiaries, including the stock of substantially all of the regulated subsidiaries. The expected source of repayment was proceeds of the sale of the firm's assets. The U.S. government received a 79.9 percent equity interest in AIG and the right to veto the payment of dividends to common and preferred shareholders.

On October 8, 2008, the Federal Reserve announced a program under which the New York Fed would borrow up to $37.8 billion in investment-grade, fixed-income securities from AIG in return for cash collateral. The securities were previously lent by AIG's insurance company subsidiaries to third parties.

Draws under the existing $85 billion loan facility were used, in part, to settle transactions with counterparties returning these third-party securities to AIG. The new program was designed to allow AIG to replenish liquidity used in settling those transactions, while providing enhanced credit protection to the New York Fed and U.S. taxpayers in the form of a security interest in these securities.

Federal Reserve Approves Bank Holding Company Applications

On September 21, 2008, the Federal Reserve approved, pending a statutory five-day antitrust waiting period, the applications of Goldman Sachs and Morgan Stanley to become bank holding companies.

The Federal Reserve authorized the Federal Reserve Bank of New York to extend credit to the U.S. broker-dealer subsidiaries of Goldman Sachs and Morgan Stanley against all types of collateral that may be pledged at the Federal Reserve's primary credit facility for depository institutions or at the existing PDCF to provide increased liquidity support to these firms as they transition to managing their funding within a bank holding company structure. The Federal Reserve has also made these collateral arrangements available to the broker-dealer subsidiary of Merrill Lynch. In addition, the Federal Reserve authorized the Federal Reserve Bank of New York to extend credit to the London-based broker-dealer subsidiaries of Goldman Sachs, Morgan Stanley, and Merrill Lynch against collateral that would be eligible to be pledged at the PDCF.

Federal Reserve Emergency Action regarding purchases of commercial paper

On October 7, 2008, the Federal Reserve announced the creation of the Commercial Paper Funding Facility (CPFF), and updated program terms and conditions were published on October 14, 2008. As the credit crisis continued to unfold, it has become clear that issuers of commercial paper were encountering increasing difficulty in accessing the commercial paper market to issue new commercial paper or to refinance portions of the approximately $1.5 trillion of commercial paper currently outstanding as it becomes due. The CPFF will be structured as a credit facility to a special purpose vehicle (SPV) authorized under Section 13(3) of the Federal Reserve Act. The Treasury will make a special deposit at the Federal Reserve Bank of New York in support of the CPFF. The Federal Reserve will commit to lend to the SPV at the target federal funds rate and draws on the CPFF will be on an overnight basis, with recourse to the SPV and secured by all assets of the SPV. The SPV will be limited in the amount of commercial paper that it may purchase from a single eligible issuer; it will be limited to the greatest amount of commercial paper outstanding on any day between January 1 and August 31, 2008, less any amount of the issuer's outstanding commercial paper held by investors other than the SPV. Purchases of commercial paper by the SPV will cease on April 30, 2009, unless the Federal Reserve Board agrees to extend the facility. The Federal Reserve will continue to fund the SPV after that date until the SPV's assets mature.

Based on terms and conditions associated with the CPFF published by the Federal Reserve Bank of New York the SPV will purchase 3-month U.S. dollar-denominated commercial paper directly from eligible issuers at a spread over the 3-month overnight index swap (OIS) rate; 300 basis points for ABCP and 100 basis points for unsecured commercial paper. The Federal Reserve has indicated that the SPV will only purchase commercial paper from U.S. issuers, though U.S. issuers with a foreign parent company also will be permitted to sell commercial paper to the SPV.

Commercial paper purchased by the SPV must be rated at least A1/P1/F1 by a major NRSRO and, if rated by multiple NRSROs, is rated at least A1/P1/F1 by two or more major NRSROs. Non-ABCP issuers will be charged an unsecured credit surcharge of 100 basis points per annum unless they can either provide collateral for the commercial paper that is acceptable to the New York Fed or obtain an indorsement or guarantee of its obligations that is acceptable to the New York Fed. Previously, the Federal Reserve has indicated several ways in which non-ABCP commercial paper may be secured:

- the issuer pays the SPV an upfront fee based on the commercial paper initially sold to the SPV and an additional fee based on subsequent commercial paper sales above that amount; or
- the issuer obtains an endorsement or guarantee of the issuer's obligations on the commercial paper sold to the SPV that is satisfactory to the Federal Reserve; or
- the issuer provides collateral arrangements that are satisfactory to the Federal Reserve; or
- the issuer otherwise provides security satisfactory to the Federal Reserve.

Funding will commence on October 27, 2008.

G-7 Finance Ministers and Central Bank Governors Plan of Action

On October 10, 2008, the G-7 agreed that the current situation calls for urgent and exceptional action, and issued a statement of commitment to work together to stabilize financial markets and restore the flow of credit, to support global economic growth. Specifically, the members agreed to:

1. Take decisive action and use all available tools to support systemically important financial institutions and prevent their failure.
2. Take all necessary steps to unfreeze credit and money markets and ensure that banks and other financial institutions have broad access to liquidity and funding.
3. Ensure that G-7 banks and other major financial intermediaries, as needed, can raise capital from public as well as private sources, in sufficient amounts to re-establish confidence and permit them to continue lending to households and businesses.
4. Each country will ensure that its national deposit insurance and guarantee programs are robust and consistent so that retail depositors will continue to have confidence in the safety of their deposits.
5. Take action, where appropriate, to restart the secondary markets for mortgages and other securitized assets. Accurate valuation and transparent disclosure of assets and consistent implementation of high quality accounting standards are necessary.

The actions should be taken in ways that protect taxpayers and avoid potentially damaging effects on other countries. There was agreement to use macroeconomic policy tools as necessary and appropriate.

In addition, a statement was issued in strong support of the International Monetary Fund's critical role in assisting countries affected by this turmoil. There was also a commitment to accelerate full implementation of the Financial Stability Forum recommendations and further commitment to the pressing need for reform of the financial system. On October 10, 2008, the Financial Stability Forum presented to the G-7 Finance Ministers and central bank governors a follow-up report to its April report, *Enhancing Market and Institutional Resilience*. Finally, a statement was made in support of further strengthening cooperation and working with others to accomplish this plan.

FDIC Guarantee of Debt and Deposits: Temporary Liquidity Guarantee Program

On October 14, 2008, the FDIC announced the creation of a new program, the Temporary Liquidity Guarantee Program (TLGP). The purpose of the program is to strengthen confidence and encourage liquidity in the banking system.

Institutions able to participate include (1) FDIC insured depository institutions, (2) U.S. bank holding companies, (3) U.S. financial holding companies and (4) U.S. savings and loan holding companies that engage only in activities that are permissible for financial holding companies to conduct under section 4(k) of the BHC.

Under TLGP, newly issued senior unsecured debt issued on or before June 30, 2009 would be fully protected in the event the issuing institution subsequently fails, or its holding company files for bankruptcy. Debt included in the program includes promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt. The aggregate coverage for an institution may not exceed 125% of debt outstanding on September 30, 2008 that was scheduled to mature before June 30, 2009. Coverage extends to June 30, 2012, even if the maturity of the debt is beyond that date.

In addition, any participating depository institution will be able to provide full deposit insurance coverage for non-interest bearing deposit transaction accounts, regardless of dollar amount. These are primarily payment-process accounts, such as payroll accounts used by businesses. This guarantee will expire on December 31, 2009.

Special fees will be used to fund the program; it will not rely on taxpayer funding. Participants will be charged a 75-basis point fee to protect new debt issues. Current insurance assessments will be increased by a 10-basis point surcharge to fully cover the non-interest bearing deposit transaction accounts. The new coverage will extend to all FDIC insured institutions for the first 30 days without the institution incurring any cost. After that initial period, institutions wishing to no longer participate must opt out or be assessed for future participation. If an institution opts out, the guarantees are good only for the first 30 days.

The FDIC Improvement Act of 1991 authorizes the creation of TLGP upon a determination of systemic risk. The boards of the FDIC and the Federal Reserve made recommendations and, after consulting with the President, Secretary Paulson signed the systemic risk exception to the FDIC Act. As a result of the TLGP, banking regulators will be implementing an enhanced supervisory framework to assure appropriate use of the new guarantee and prevent rapid growth or excessive risk-taking. The FDIC will maintain control over eligibility for the program, in consultation with each institution's primary federal regulator.

Recent IRS and Treasury Guidance[11]

During the last year, the Internal Revenue Service has issued a wave of guidance in response to the credit crisis. This guidance is unprecedented in that it, in effect, relaxes the rules of the Internal Revenue Code to adjust to a changing economy. These changes began in late 2007 with narrow technical guidance aimed at municipal bonds and real estate mortgage investment conduits (REMICs). By late September, the IRS was relaxing the Code's loss trafficking rules apparently in order to encourage the acquisition of failing banks. The following gives a brief description of the significant rulings and other guidance the IRS has issued:

Section 382 Related Guidance-Preservation of Tax Losses

In general, Section 382 of the Code limits the ability of a corporation that undergoes an "ownership change" to utilize its pre-change net operating losses (NOLs) and "net unrealized built-in losses" (NUBILs).[12] In general, an ownership change occurs if the percentage (by value) of stock of the loss corporation owned by any one or more 5% shareholders (by value) has increased by more than 50% compared to their lowest percentage ownership in the prior 3 years. Such an ownership change can result from an acquisition of outstanding stock of the loss corporation (whether taxable or in a tax-free acquisition) or an issuance by the loss corporation of new stock for additional capital. If a loss corporation undergoes an ownership change, post change use of its pre-change NOLs and NUBILs is generally subject to an annual limitation (Section 382 Limitation) equal to the product of the fair market value of its outstanding stock immediately before the ownership change multiplied by a statutorily-prescribed interest rate (applicable long-term tax-exempt rate). This interest rate is currently 4.65%, but is adjusted monthly based on market rates.

Two recent Internal Revenue Service (IRS) Notices designed to help failing banks may (1) open the possibility for a corporate acquiror to acquire a bank's built-in loan losses and use those built-in losses against its taxable income, and (2) ease the application of potential tax loss carryover limitations for corporations that raise additional capital by issuing new stock. We expect that these Notices will make significantly more attractive both the acquisition of U.S. banks with underwater mortgages and the furnishing of new capital to distressed banks.

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[11] See Morrison & Foerster LLP's "Tax Talk" Volume 1, Issue 3 at http://www.mofo.com/news/updates/files/080930TaxTalk.pdf.
[12] NUBILs are generally losses recognized in the 5-year period after the ownership change, but that are attributable to unrealized pre-change declines in asset values. Certain deductions during post-change periods that are attributable to periods before the change date are treated as recognized NUBILs under Section 382(h)(6)(B), and therefore limited.

Notice 2008-78 – Capital Contributions to Loss Corporations

As described above, the Section 382 Limitation is determined by valuing a corporation's stock immediately before the ownership change. Capital contributions that increase the total value of the outstanding stock could have the effect of increasing the annual limitation, and, if made ratably by existing shareholders, could reduce the likelihood that other stock transactions would constitute an ownership change. Accordingly, to prevent these potential abuses, Section 382(l) of the Code presumes (except as provided in regulations) that capital contributions made within a two-year period ending on the change date are part of a tax avoidance plan and therefore excludes such capital contributions in determining the Section 382 Limitation.

On September 26, 2008, the IRS issued Notice 2008-78, I.R.B. 2008-41 (Notice 2008-78), in which it announced that it will waive the presumption that a capital contribution within the two-year pre-change period is part of a tax avoidance plan.[13] Notice 2008-78 instead provides a facts and circumstances test in determining whether the contribution is for tax avoidance. It also provides four safe harbors under which a contribution will not have a tax avoidance motive. Under the most relevant safe harbors, a contribution will not be considered as part of a plan for tax avoidance if:

- (i) the contribution is made by a person who is neither a controlling shareholder[14] (determined immediately before the contribution) nor a related party,[15] (ii) no more than 20% of the total value of the loss corporation's outstanding stock is issued in connection with the contribution, (iii) there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change, and (iv) the ownership change occurs more than six months after the contribution; or
- (i) the contribution is made either by a related party provided that no more than 10% of the total value of the loss corporation's stock is issued in connection with the contribution, or by a person other than a related party, and (ii) in either case there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change, and (iii) the ownership change occurs more than one year after the contribution.

Notice 2008-83 – Built-in Loss Limitations of Banks

On September 30, the IRS issued Notice 2008-83, 2008-42 I.R.B. 1 (Notice 2008-83), in which it announced that losses and deductions attributable to loans or bad debts[16] of a bank[17] (including any deduction for a reasonable addition to a reserve for bad debts by a bank) after the date of an ownership change under Section 382 of the Code and which are otherwise allowable, will not be treated as built-in losses or deductions attributable to a pre-change period.[18] Accordingly, Notice 2008-83 effectively removes a potential barrier to acquisitions of struggling banks that have unrecognized loan losses and to equity infusions by prospective investors by assuring that the IRS does not intend to challenge the use of unrecognized losses to offset future taxable income after an ownership change occurs.

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[13] Notice 2008-78 states that the IRS and the Treasury intend to issue regulations to implement the rules described in the Notice. Taxpayers may rely on the Notice until further guidance is issued.
[14] With respect to a public company, a controlling shareholder is a shareholder that owns at least 5% (directly or indirectly) of any class of stock outstanding and who actively participates in the management or operation of the corporation (e.g., a corporate director).
[15] A related party generally would include (but would not be limited to), as determined immediately after the capital contribution: (1) an individual or trust owning more than 50% of the stock (by value) of the loss corporation, (2) a corporation that is a member of the same "controlled group" (meaning generally 50% affiliation by vote or value) as the loss corporation, and (3) a partnership or an S corporation if the same persons own a greater than 50% interest in both such partnership or S corporation and the loss corporation. A related party may include certain coordinated groups.
[16] The Notice does not define the term "loans," however it should be broad enough to include debt interests in securitization vehicles as well as direct interests in residential or commercial mortgages. It does not appear that the Notice would apply to most derivative positions.
[17] In order to qualify for the treatment described in Notice 2008-83, the taxpayer must be a bank as defined in Section 581 of the Code immediately before and immediately after the ownership change.
[18] No effective date is specified in the Notice, so it appears that it may also benefit banks that have already had an ownership change.

Impact of Notice 2008-78 and Notice 2008-83[19]

Capital Raising. Notice 2008-78 means that a bank (as well as other corporations) may now raise capital without creating a concern for existing stockholders and potential investors that the value of the corporation's tax "assets" (*i.e.*, the built-in losses) automatically will be impaired by excluding the new capital from the Section 382 Limitation calculation if circumstances should force a change in ownership within the following two years. Notice 2008-83 means that banks can feel free to issue stock to raise new capital without a concern that losses subsequently recognized on troubled mortgages, including those arising from sales under the TARP, will be treated as NUBILs for purposes of Section 382 of the Code.[20]

Acquisitions. In practice, Notice 2008-83 means that an acquiring corporation, *e.g.*, a bank holding company (Acquiror) can acquire a bank owning underwater mortgages in a basis preservation transaction (*e.g.*, a stock sale or tax-free reorganization), sell the mortgages (including to Treasury under the TARP), and then use those losses recognized on the sale to offset future income of the Acquiror or other members of its affiliated group.[21]

Additional Provisions Modifying Section 382 Treatment (Notice 2008-76, Notice 2008-84 and Notice 2008-100).

On September 29, 2008, the IRS and Treasury announced in Notice 2008-76 that they will issue regulations under Section 382(m) providing that the "testing date" (as defined in Regulations Section 1.382-2(a)(4)) does not include any date on or after the date on which the United States (or an agency or instrumentality thereof) acquires, in a "Housing Act Acquisition," stock or an option to acquire stock in a corporation. The regulations apply after September 6, 2008.

On the same day, the IRS and Treasury issued Notice 2008-84, in which they announced that they will issue regulations under Section 382(m) providing that the "testing date" does not include any date as of the close of which the United States owns a more-than-50 percent interest in a Section 382 loss corporation. The regulations will apply to any taxable year ending after September 25, 2008.

Finally, on October 14, 2008, the IRS and Treasury issued Notice 2008-100, providing very favorable guidance regarding the application of Section 382 to loss corporations whose instruments are acquired by Treasury pursuant to the Capital Purchase Program (CPP) under the Act. The Notice generally provides (1) that shares of stock of a loss corporation acquired by Treasury pursuant to the CPP shall not be considered to have caused Treasury's ownership in the loss corporation to have increased over its lowest percentage owned on any earlier date, but subject to certain exceptions, are considered outstanding for purposes of calculating the ownership percentage of other 5 percent shareholders on a testing date; (2) that once shares of stock acquired by Treasury pursuant to CPP are redeemed by the corporation, such shares are not treated as having ever been outstanding for purposes of measuring ownership shifts of any 5 percent shareholder on any testing date on or after the redemption; (3) that any preferred stock acquired by Treasury pursuant to CPP is treated as stock described in Section 1504(a)(4) for all Federal income tax purposes (and is therefore carved out of the definition of "stock" for purposes of Section 382(k)(6)(A); (4) that warrants acquired by Treasury pursuant to CPP shall be treated as options (and not as stock) for all Federal income tax purposes and that options acquired by Treasury will not be deemed exercised for purposes of Section 382; and (5) that capital contributions made by Treasury to a loss corporation pursuant to the CPP shall not be considered to have been made as part of a plan for purposes of Section 382(l)(1) of the Code.

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[19] See Morrison & Foerster LLP's News Bulletin "Notice 2008-83: The IRS Offers Reassurance to Troubled Banks" at http://www.mofo.com/news/updates/files/14544.html.

[20] Of course, pre-existing NOLs would be subject to the Section 382 Limitation if sufficient shares to constitute an ownership change were issued.

[21] Pre-existing NOLs of the target would still be subject to the Section 382 Limitation (assuming that the acquisition results in a greater than 50 percent shift in the ultimate equity ownership of the target). Section 382 of the Code should displace the consolidated return regulations' limitation on built-in-losses (via the separate return limitation year rules), so that the treatment provided by Notice 2008-83 should apply whether the target bank is merged into the Acquiror (or a disregarded entity of the Acquiror) or remains in existence as a consolidated subsidiary of the Acquiror.

The Notice states that Treasury and the IRS intend to issue regulations setting forth the rules provided in the Notice, but that taxpayers may rely on the Notice unless and until there is additional guidance. Additionally, the Notice states that any future guidance issued contrary to that provided in the Notice will not apply to instruments acquired by Treasury (1) prior to the publication of the contrary guidance or (2) pursuant to binding written contracts entered into prior to the publication of the contrary guidance.

Money Market Share-Price Guarantee

As previously noted, in Notice 2008-81, Treasury announced a Temporary Guarantee Program to enable money market funds to maintain stable $1 per share net asset values, and said that participation in the program will not be treated as a federal guarantee that jeopardizes the tax-exempt treatment of payments by "tax-exempt money market funds" (i.e., money market funds holding enough of their total assets in tax-exempt bonds to be eligible to pay Section 852(b)(5) exempt interest dividends).

In Notice 2008-92, the IRS and Treasury announced that they will not assert that participation in the Temporary Guarantee Program by an "insurance-dedicated money market fund" (a fund with beneficial interests held by investors permitted under Regulations Section 1.817-5(h)(1)) causes a violation of the Section 817(h) diversification requirements in the case of a segregated asset account investing in the fund, or that the fund's participation causes the holder of a variable contract supported by a segregated asset account investing in the fund to be treated as an owner of the fund.

Borrower's Default on Securities Loan Doesn't Trigger Taxable Event to Lender (Notice 2008-63)

Under a securities loan agreement, a borrower typically borrows securities from a lender and posts collateral to secure its obligation to return identical securities. The initial transfer of securities to the borrower and the return of identical securities to the lender upon termination of the securities lending agreement generally do not result in any gain or loss to the lender for U.S. federal income tax purposes, provided the loan agreement meets certain specified requirements under Section 1058. If, upon a borrower default, the lender applies the collateral to purchase securities that are identical to the securities borrowed, the lender would be required to realize gain, if any. In most situations, losses would be expected to be disallowed as a result of the application of the wash sale rules. On September 29, 2008, the IRS published Revenue Procedure 2008-63 to preserve non-recognition treatment and restore symmetrical results in the case of gains and losses. The Revenue Procedure, effective for taxable years ending on or after January 1, 2008, provides that if a borrower defaults under a securities loan agreement as a direct or indirect result of its bankruptcy (or the bankruptcy of an affiliate) and the lender applies the collateral to purchase identical securities as soon as is commercially practicable after the default (but not more than 30 days following the default), then the transaction will not be a recognition event for U.S. federal income tax purposes to the lender.

Relief for Auction Rate Securities

Since the 1980s, closed-end funds, corporations, municipal authorities and student loan organizations have issued auction-rate securities (ARS), typically in the form of bonds with long-term maturities or as preferred stock. The interest or dividend rate on ARS is determined by a Dutch auction mechanism through which investors already holding ARS and investors seeking to acquire ARS indicate their interest in holding, purchasing or selling the ARS at specified rates. Auctions are typically held every seven, twenty-eight, thirty-five or forty-nine days, but with respect to some ARS the auctions can occur daily or at longer intervals such as every six months. For issuers, ARS are beneficial as they can provide financing at rates that are lower than variable rate debt instruments. To investors, ARS are attractive as their yield is typically higher than the yield on deposits or money market funds. The ARS market currently has an estimated size of a few hundred billion dollars. Lately, as a result of the current credit crunch, there has been little or no interest in purchasing ARS resulting in wholesale auction failures. Upon an auction failure, the interest or dividend rate on the ARS defaults to a maximum rate which, generally, is intended to be an above-market rate at original issuance that is intended to compensate holders of the ARS for the illiquidity of the securities. However, due to the credit crisis, some of these rates are now viewed as below market, causing ARS to become even more illiquid.

In response to the illiquidity problem, the IRS issued Notices 2008-27 and 2008-41, providing guidance to issuers of tax-exempt bonds that wish to either convert their outstanding bonds from ARS to bonds with a fixed or floating interest rate to maturity or to purchase their own ARS from the market. Pursuant to these notices, under certain limited circumstances, the conversion of a tax-exempt ARS to a bond with a fixed or floating interest rate will not result in a reissuance for U.S. federal income tax purposes, and, in applying the tax-exempt bond rules, an issuer may purchase its own tax-exempt ARS without such purchase resulting in a retirement of the bonds for U.S. federal income tax purposes, which could potentially result in adverse tax consequences to the issuer.

With respect to ARS issued as preferred stock, in order to preserve their status as "equity" for tax purposes, it is particularly important that investors not be viewed as having the right to put the ARS to the issuer on demand. Notwithstanding, some had proposed that holders of such ARS be permitted to sell, pursuant to a liquidity facility agreement, their shares to a liquidity provider upon a failed auction. This would broaden the market for potential ARS investors as tax exempt money market funds (frequently referred to as 2a-7 funds) would subsequently be allowed to purchase ARS under the '40 Act from issuers that are themselves RICs. Under the proposal, the liquidity provider would try to sell the ARS (including by participating in subsequent auctions). Further, the issuer would be required to redeem the stock after a specified period of time if the liquidity provider is unable to sell the ARS. The proposal was designed to permit new investors to invest in ARS.

In response, the IRS issued Notice 2008-55, confirming that it will not challenge the equity characterization of the ARS if a liquidity facility agreement such as the one described above were entered into. As a result, payments on the ARS should still be characterized as exempt-interest dividends (to the extent of the issuer's exempt interest) and not as taxable interest, which would have been the consequence if the ARS were instead treated as debt for U.S. federal income tax purposes. In general, the notice only applies if, among other requirements, the ARS are issued by closed-end funds that are RICs and that invest exclusively in taxable or tax-exempt bonds, the ARS were outstanding on February 12, 2008 (or issued after that date to refinance ARS that were outstanding on that date) and the liquidity provider is unrelated to the issuer.

The IRS' latest installment of relief provisions for the ARS market provides guidance to holders of ARS in light of recent announcements by Wall Street firms that they will buy back billions of dollars worth of ARS from aggrieved investors. On September 29, 2008, the IRS issued Revenue Procedure 2008-58 (Rev. Proc. 2008-58), providing assurance to investors in the auction rate securities market that the IRS will not challenge certain tax positions taken with regard to settlement of potential legal claims related to such securities.

Rev. Proc. 2008-58 focuses on ARS holders that have the right during a specified "window period" to cause an issuer to buy back the ARS for par amount in order to settle potential legal claims against the issuer (*e.g.*, that the issuer did not properly disclose the potential that the ARS would become illiquid). Alternatively, the ARS holder may borrow the par amount of the ARS from the issuer prior to the window period while securing the "loan" with the ARS. Rev Proc 2008-58 also contemplates a scenario in which the ARS holder does not exercise the settlement right, in which case the ARS holder would continue to receive payment under the maximum penalty rate upon a continued auction failure or receive a return that would fluctuate based on the auction rate-setting process, ultimately affecting the holder's economic return. If the ARS holder were to hold the security after the window period, the ARS holder would continue to be entitled to exercise all voting rights associated with the security and to sell the security to a third party.

The IRS stated that it will not challenge the following positions: (1) that the taxpayer continues to own the auction rate security upon accepting (or "opting into") the settlement offer until the tender of the security; (2) that the taxpayer does not realize any income as a result of accepting the settlement offer and does not reduce the basis of ARS from its original purchase price; and (3) that the taxpayer's amount realized from the sale of ARS during the window period to the party offering the settlement is the full amount of the cash proceeds received from that party.

Rev Proc 2008-58 applies to taxpayers that accept settlement offers prior to June 30, 2009 and have such settlement offers in which the window period does not extend beyond December 31, 2012, where such relevant ARS were purchased prior to February 14, 2008. Significantly, a revision to Rev. Proc. 2008-58 on September 29 clarifies that the relief provisions would still apply even if an ARS holder is not required to release claims in connection with the settlement. The new Rev. Proc. serves to eliminate some uncertainty for the throngs of ARS investors that will face various tax issues as a result of these settlements.

Facilitating Intercompany Liquidity

In general, the provisions in the Code applicable to a controlled foreign corporation (CFC) may result in phantom income inclusion to a U.S. shareholder that owns 10% or more of the voting stock of the CFC under certain circumstances. Code Section 956 provides for such an income inclusion when a CFC makes an investment of earnings in U.S. property, which includes certain loans by the CFC to related U.S. persons. The IRS and Treasury had previously announced in Notice 88-108 that final regulations issued under Section 956 will exclude an obligation from the purview of Section 956 where the obligation is collected within 30 days from the time it is incurred. To facilitate liquidity in the near term, on October 10, 2008, the IRS and Treasury announced in Notice 2008-91 that they will issue regulations providing that, for Section 956 purposes, a CFC may choose to exclude an obligation held by the CFC that would otherwise be an investment in “United States property” if the obligation is collected within 60 days from the time it is incurred. The exclusion does not apply if the CFC holds for 180 or more calendar days during its taxable year obligations that would be an investment in “United States property” without regard to the new 60 day rule. Additionally, a CFC may apply Notice 2008-91 or Notice 88-108, but not both. Notice 2008-91 applies for the foreign corporation’s first two taxable years ending after October 3, 2008.

Contacts

Contact your Morrison & Foerster lawyer with any questions.

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Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situation

Appendix A

Reporting Under Emergency Economic Stabilization Act of 2008

Report Author	Distribution[1]	Contents	Timetable	Section
Treasury	Publicly	Program guidelines for troubled asset purchase program, including: mechanisms for purchasing troubled assets, methods for pricing and valuing troubled assets, procedures for selecting asset managers, criteria for identifying troubled assets for purchase	Within 2 business days of first purchase of assets or end of the 45-day period beginning day of enactment (whichever comes first)	101(d)
Treasury	Appropriate Committees of Congress[2]	Description of the insurance program established under the Act	Not later than 90 days after enactment	102(b)
Treasury	Publicly (Note: Unclear there is a requirement to publicly disclose, although Treasury has announced it would provide)	The methodology for setting the premiums under the insurance program for a class of troubled assets together with an explanation of the appropriateness of the class of assets for participation in the program	Not specified (note this requirement should be satisfied through the report required under 102(b) above)	102(c)(2)
Treasury	Appropriate Committees of Congress and Congressional Oversight Panel	• Overview of actions taken, including considerations required by Section 103 (purposes of the Act) and the efforts under Section 109 (foreclosure mitigation efforts) • actual obligations and expenditure of the funds provided for administrative expenses and expected expenditure of funds in	60 days after first purchase or insurance; every 30 days thereafter (until all assets are sold/mature or insurance has expired)	105(b)(1)

[1] We expect that many of the reports listed here will be made publicly available even if not so indicated.
[2] The Committee on Banking, Housing, and Urban Affairs, the Committee on Finance, the Committee on the Budget, and the Committee on Appropriations of the Senate, the Committee on Financial Services, the Committee on Ways and Means, the Committee on the Budget, and the Committee on Appropriations of the House of Representatives.

Report Author	Distribution[1]	Contents	Timetable	Section
		subsequent period • detailed financial statement (including all agreements made or renewed, all insurance contracts, transactions and types of parties, nature of assets purchased, projected costs and liabilities, operating expenses, valuation or pricing method used for each transaction, description of financing vehicles)		
Treasury	Appropriate Committees of Congress and Congressional Oversight Panel	Report that: • describes all transactions made during the reporting period • describes pricing mechanisms • provides a justification for the price paid or other financial terms • describes impact of exercise of authority on the financial system, supported by specific data • describes challenges that remain in system, including benchmarks yet to be achieved • estimates additional actions necessary to address such challenges	7 days after date that purchase commitments first reach $50 billion and not later than 7 days after each additional $50 billion interval (until all assets are sold/matured or insurance has expired)	105(b)(2)
Treasury	Appropriate Committees of Congress and Congressional Oversight Panel	Regulatory Modernization Report: Analyzing current state of regulatory system; its effectiveness at overseeing participants, including the over-the-counter derivatives market and GSEs; providing recommendations as to whether any participants outside the regulatory system should become part of the system; any recommended enhancement of clearing and	April 30, 2009	105(c)

Report Author	Distribution[1]	Contents	Timetable	Section
		settlement of over-the-counter derivatives; and the rationale for such recommendations		
Treasury	Committees on Oversight and Government Reform and Financial Services of the House of Representatives and the Committees on Homeland Security and Governmental Affairs and Banking, Housing and Urban Affairs of the Senate	Notice of and justification for waiver of specific provisions of the Federal Acquisition Regulation upon a determination of “urgent and compelling circumstances” rendering compliance “contrary to the public interest”	Within 7 days of any such action	107
Treasury	Publicly	Implement standards and procedures to ensure, to the maximum extent practicable, the inclusion and utilization of minorities and women, and minority- and women-owned businesses	No time frame referenced	107(b)
Treasury	Publicly	Regulations or guidelines necessary to address and manage or to prohibit conflicts of interest, including with respect to hiring of contractors, purchase of troubled assets, management of troubled assets, post-employment restrictions on employees and any other potential conflict of interest Treasury deems necessary to address	As soon as practicable	108
Treasury	Publicly	Guidance to carry out the executive compensation limitations for auctions	Not later than 2 months after enactment	111(c)
Treasury	Publicly	In electronic form – a description, amounts, pricing of assets acquired under the Act for each purchase, trade or disposition	2 business days after purchase, trade or disposition of a troubled asset	114(a)
Treasury	Relevant Regulators	Whether the public disclosure required for each	No time requirement	114(b)

Report Author	Distribution[1]	Contents	Timetable	Section
		seller financial institution with respect to off-balance sheet transactions, derivatives instruments, contingent liabilities and similar sources of potential exposure is adequate to provide to the public sufficient information as to the true financial position of the institutions. If not adequate – recommend additional disclosure requirements to relevant regulators.		
Treasury	Publicly	Regulations or guidelines necessary to address and manage or prohibit conflicts of interest that may arise, including: • selection or hiring of contractors or advisors • purchase of assets • management of assets held • post-employment restrictions on employees • any other	As soon as practicable	108
Treasury	Publicly; Appropriate Committees of Congress; Congressional Oversight Panel	Audited financial statements, statement regarding management's responsibility for establishing internal control over financial reporting, statement of assessment as of most recent period of the effectiveness of internal controls over financial reporting	Annually (until all assets have been sold/matured or insurance expired)	116(b)(1)
Financial Stability Oversight Board	Appropriate Committees of Congress and Congressional Oversight Panel	Report that reviews: • policies implemented by Treasury under the troubled asset purchase and insurance programs, including appointment of financial agents, designation of asset classes to be purchased and plans for the structure of vehicles used to purchase troubled assets	Quarterly	104(g)

Report Author	Distribution[1]	Contents	Timetable	Section
		• the effect of such actions in assisting American families in preserving home ownership, stabilizing financial markets and protecting taxpayers		
Financial Stability Oversight Board	Special Inspector General for the TARP or the Attorney General of the United States	Report any suspected fraud, misrepresentation or malfeasance	As required	104(a)(3)
Each Federal Property Manager[3]	Not clear	Each develop a plan for homeowner assistance in consultation with each other	Within 60 days of enactment	110(b)
Each Federal Property Manager	Congress	Specific information on the number and types of loan modifications made and the number of actual foreclosures occurring during the reporting period	60 days after enactment and every 30 days thereafter	110(b)(5)
President	Congress	Certification that Treasury needs an additional $100 billion	When needed	115(a)(2)
President	Congress	Report detailing Treasury's plan to exercise authority under the Act with respect to troubled assets (Provided under Section 115(a)(3), to obtain the final $350 billion under the Act)	When needed	115(a)(3)
President	Congress	Legislative proposal to recoup the net cost of the TARP from the financial industry	As needed following report by the Office of Management and Budget of any shortfall	134
Comptroller General of the	Appropriate Committees of	Oversight of performance of program in meeting purposes of the act, including: foreclosure	Every 60 days and annual audit of audited financial statements of	116(a)(3)

[3] Federal Housing Finance Agency, in its capacity as conservator of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation; Federal Deposit Insurance Corporation, with respect to residential mortgage loans and mortgage-backed securities (MBS) held by any bridge depository institution; the Federal Reserve Board with respect to any mortgage or MBS or pool of securities held, owned or controlled by or on behalf of a Federal Reserve Bank (other than open market holdings and collateral)

Report Author	Distribution[1]	Contents	Timetable	Section
United States	Congress and the Special Inspector General of the TARP and Congressional Oversight Panel	mitigation, cost reduction, enhanced market stability, protection of taxpayers; financial conditions and internal controls of the TARP; characteristics of the transactions and future commitments; characteristics of dispositions; efficient use of funds; compliance; conflicts of interest; contracting procedures	Treasury's program Special reports may also be submitted at the discretion of the Comptroller General	
Comptroller General	TARP and Congressional Oversight Panel	Annual audit of audited financial statements of the TARP	Annually (until all assets have been sold/matured or insurance expired)	116(b)
Comptroller General	Committee on Banking, Housing and Urban Affairs of Senate; Committee on Financial Services of House; and Congressional Oversight Panel	Study and report on: An analysis of the roles and responsibilities of the Federal Reserve, the SEC, the Secretary of the Treasury and other Federal banking agencies with respect to monitoring leverage and acting to curtail excessive use of leverage An analysis of the authority of the Federal Reserve to regulate leverage, including by setting margin requirements, and a statement of what process it used to decide whether or not to use its authority An analysis of any usage of the margin authority by the Federal Reserve Recommendations for the Federal Reserve and appropriate Committees of Congress with respect to the existing authority of the Federal Reserve	June 1, 2009	117
Special Inspector General for the TARP	Appropriate Committees of Congress	Failure of anyone to provide information or assistance when reasonably requested	Without delay	121(e)(4)

Report Author	Distribution[1]	Contents	Timetable	Section
Special Inspector General for the TARP	Appropriate Committees of Congress and Congressional Oversight Panel	Report summarizing the activities of the Inspector General for prior 120-day period, including, without limitation, a detailed statement of all purchases, obligations, expenditures and revenues, as well as description of categories of troubled assets purchased, list of assets in each category, reason for purchase of each asset, list of financial institutions, detailed biographical information on each person or entity hired to manage troubled assets, current estimate of troubled assets purchased, amount of assets on books of Treasury, amount of assets sold, profit and loss on each sale or disposition, and list of insurance contracts	Within 60 days after confirmation of the Inspector General and every calendar quarter thereafter	121(f)
Congressional Oversight Panel	Congress	Treasury's use of authority, including contracting and administration; impact of purchases on the financial markets; extent to which disclosures have impacted market transparency; and effectiveness of foreclosure mitigation efforts	30 days after first purchase / insurance and every 30 days thereafter	125(b)(1)
Congressional Oversight Panel	Congress	Special Report on Regulatory Reform: analysis current state of regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers, and providing recommendations for improvements, including recommendations regarding whether any participants in the financial markets that are currently outside the regulatory system should become subject to the regulatory system; the rationale underlying such recommendations; and whether there are any gaps in existing consumer protections	January 20, 2009	125(b)(2)

Report Author	Distribution[1]	Contents	Timetable	Section
Federal Reserve	Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives (to be kept confidential upon request) and to Congressional Oversight Panel	Justification for exercise of the authority under the Federal Reserve Act to make loans to individuals, partnerships or corporations; specific terms of such loans, including collateral or securities received; expected cost to taxpayers	Within 7 days of taking action under Federal Reserve Act, Section 3, paragraph 3; and every 60 days thereafter	129
SEC, in consultation with the Federal Reserve Board	Congress	Study of mark to market accounting • effects of accounting standard on financial institutions balance sheets • impact of accounting on 2008 bank failures • impact on quality of financial information available to investors • process used by FASB to develop standards • advisability and feasibility of modifications to such standards • alternative standards to those provided in FAS 157	90 days after enactment	133
Director of the Office of Management and Budget, in consultation with the Director of the Congressional	Congress	Net amount within the troubled asset relief program under the act. Note: As noted, the TARP is used somewhat inconsistently. The reference here to the TARP would need to include the insurance program to accurately assess costs.	October 3, 2013	134

Report Author	Distribution[1]	Contents	Timetable	Section
Budget Office				
Office of Management and Budget	President and Congress	Estimates of the cost of troubled assets and guarantees of troubled assets. Provides background information used to determine estimates and, beginning with the second report, provides explanations of any differences from prior estimates.	Within 60 days of the first purchase of a troubled asset or December 31, 2008 (the earlier), and semiannually thereafter	202(a)
Congressional Budget Office	Congress	Assessment of the report of the Office of Management and Budget (above)	Within 45 days of receipt of each report	202(b)