PROSKAUER ROSE LLP

Economic Crisis Response Group
Newsletter

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Economic Crisis Response Group

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Treasury Announces Repurchase and Disposition Process for Warrants Issued under Capital Purchase Program

On June 26, the Treasury Department announced its policy for the repurchase and disposition of the outstanding warrants issued to the U.S. Government by publicly-traded banking institutions that repaid Treasury investments under the Capital Purchase Program ("CPP"). Upon repayment, publicly-traded banking institutions have the option to repurchase the warrants at fair market value. The Treasury outlined a four-step process for determining the fair market value of the warrants:

1. Banks wishing to repurchase the warrants submit a fair market value determination to the Treasury within 15 days of repayment of the CPP investment.

2. Within 10 days of such submission, the Treasury will decide whether or not to accept the bank's proposed valuation. The Treasury, with the assistance of private asset managers, will evaluate the proposed valuation using available market data and financial models (including binomial and Black-Scholes pricing models).

3. If the Treasury rejects the bank's initial valuation and cannot reach agreement with the bank, the Treasury and the bank will each select an independent appraiser to value the warrants.

4. If the appraisers cannot agree on a fair market value for the warrants, the appraisers will engage a third appraiser to conduct a valuation of the warrants and a composite valuation of the three appraisals will be used as the warrant repurchase price, subject to certain limitations.

If a bank elects not to repurchase the warrants, then the Treasury will sell the warrants to bidders at auction in the months following repayment. The Treasury is expected to release guidelines for the warrant auction process in the near future.

Supreme Court gives State Authorities Ability to Prosecute Nationally Chartered Banks

The U.S. Supreme Court's ruling on June 29 in Cuomo v. The Clearing House Association LLC et al. permits state attorneys general and bank regulatory authorities to prosecute nationally chartered banks for violations of state law. Partially overruling the federal district court and the U.S. Court of Appeals for the Second Circuit, the Supreme Court held that state law, including consumer protection laws for financial products, is not preempted by federal regulations promulgated under the National Bank Act. The decision reverses a rule established by the Office of the Comptroller of the Currency (the "OCC") in 2000 that was intended to centralize bank regulation (the OCC is the federal agency that charters, regulates and supervises all national banks, and supervises The Clearing House Association, a consortium of banks).

The case stems from a dispute in 2005, when former New York Attorney General Eliot Spitzer launched an investigation into possible discriminatory lending practices by certain nationally chartered banks. The OCC and The Clearing House Association filed a suit in federal court to block the investigation, claiming that the state did not have jurisdiction over national banks.

Writing for the 5-4 majority, Justice Scalia noted that while the OCC has exclusive rights to "visitorial powers," i.e., the power to request all information from national banks, state authorities have the right to enforce state laws. At the same time, Justice Scalia affirmed the lower court ruling that states cannot file administrative subpoenas for information from nationally chartered banks, requiring that such subpoenas receive court approval.

SEC Proposes Rule Amendments for Money Market Funds

On June 24, the Commissioners of the SEC voted unanimously to propose rule amendments designed to increase the resilience of money market funds to economic stresses and to reduce the risks of runs on such funds. The proposed amendments would require retail money market funds to hold at least 5 percent of their assets in cash or securities convertible into cash within one day and at least 15 percent of their assets in securities convertible into cash within one week; the thresholds for institutional money market funds, which have experienced greater problems with liquidity, would be 10 percent and 30 percent, respectively. In addition, the amendments would require money market funds to disclose portfolio holdings on a monthly basis and make such information available online to investors. To reduce the risk of runs on money market funds, the amendments would permit funds with a net asset value ("NAV") below $1.00 a share (i.e., "bring the buck") to suspend redemptions to permit an orderly liquidation of assets. This proposal attempts to address investor concerns that some preferred clients would be fully redeemed at a cost to other investors by removing the incentive to redeem prior to a run precipitated by a fund breaking the buck. The amendments would also increase liquidity by shortening the weighted average maturity limits for the funds from 90 to 60 days, and would require all fund investments to be made in securities given the highest quality rating by SEC-recognized credit rating agencies.

The SEC is currently seeking comment on additional changes to the regulation of money market funds including whether to require such funds to have the ability to redeem investors by distributing the fund's underlying assets in kind rather than cash in order to stem the dilutive effect of redemptions and to maintain a stable NAV. The SEC is also seeking comment on the use of a floating NAV rather than the current industry practice of maintaining a stable NAV per unit of $1.00. Currently, there is incentive for investors to redeem their shares at the first hint of trouble in order to get the full $1.00 of redemption. A floating NAV would only allow these investors to redeem for the actual NAV, thus reducing the incentive to start a run on the fund.

SEC Proposes New Rules on Executive Compensation

On July 1, the SEC proposed new rules to more closely regulate executive compensation. The Commission voted unanimously to seek comments on a proposal requiring public companies receiving TARP funds to include a non-binding (unless the company elects to make it binding) shareholder vote to approve executive compensation in their proxy solicitations. The SEC directed the agency staff to clarify that the separate shareholder vote would only be required in the proxy solicited for an annual meeting (or special meeting in lieu of the annual meeting) of shareholders for which proxies will be solicited for the election of directors, and clarify that the new rules do not require smaller reporting companies as defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended, to include a compensation discussion and analysis section in their proxy statements.

The Commissioners also decided to seek comments on proposed amendments that would enhance disclosure requirements regarding compensation and other corporate governance matters. The new disclosures would require information about the relationship of a reporting company's overall compensation policies to risk; the qualifications of directors, executive officers, and nominees; company leadership structure; and potential conflicts of interests of compensation consultants.

Interim Final Rule for Mortgage Loans Modified Under the Making Home Affordable Program

On June 26, federal bank regulatory authorities, including the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision, announced an interim final rule that provides that mortgage loans modified under the Treasury Department's Making Home Affordable Program (the "Program") will retain the risk weight applicable to such loans prior to modification.

The interim final rule will provide common interagency capital treatment for mortgage loans modified under the Program. For example, mortgage loans assigned a risk weight of 50 percent prior to modification will retain the 50 percent risk weight after modification, provided other applicable criteria are met. Under some of the rules currently in effect, such loans might be assigned a different risk weight after modification because they qualify as "restructured" loans. The rationale of the interim final rule is that by maintaining the same

risk weight after modification, stability in the banking and financial markets is promoted. Treating modified mortgage loans in this manner also aligns the interests of the borrowers, servicers and lenders because it allows the parties to more easily take advantage of the financial incentives under the Program.

Treasury Announces $90 Million in Financial Assistance for Community Development

On June 29, Treasury Secretary Timothy Geithner announced that $90 million in financial assistance awards will be disbursed to 59 Community Development Financial Institutions ("CDFIs") in 26 states and Puerto Rico in order to help communities most affected by the economic crisis. The awards are being made with funds available under the American Recovery and Reinvestment Act and will support new economic recovery projects in some of the nation's must vulnerable and distressed communities. According to Geithner, the awards "will help generate capital for small businesses, mortgage loans for homebuyers, and funding for affordable housing projects and other facilities in communities across the country."

These awards complement other recent programs implemented by the Treasury Department, including the following: (1) more than $700 million in direct funding for affordable housing projects in dozens of states; (2) $1.5 billion in New Markets Tax Credits to encourage private sector investments in hundreds of communities; (3) $13.8 billion in Build America Bonds issued to municipalities and states; and (4) $25 billion in direct allocations of Recovery Zone Bonds to assist cities and counties to finance development projects.

Senate Hearing on Derivatives

In a hearing before the Senate Banking Subcommittee on Securities, Insurance, and Investment on June 22, the chairmen of the SEC and the CFTC discussed regulation of over-the-counter ("OTC") derivatives as a way to reduce excessive risk and decrease the likelihood of a future economic crisis. The agencies stated that they would divide the regulation of OTC derivatives, with the SEC being responsible for securities-related derivatives, such as credit default swaps and other derivatives related to underlying stocks, bonds and options, and the CFTC being responsible for OTC derivatives related to interest rates, foreign exchange, commodities, energy and metals.

SEC Chairman Schapiro and CFTC Chairman Gary Gensler testified that they wanted the ability to increase capital requirements on OTC derivatives dealers as the level of customization and risk rose on the underlying contact. In addition, consistent with the Administration's proposals, Schapiro and Gensler advocated putting all standardized contracts onto clearinghouses or exchanges, stating that such action would increase transparency in the market and potentially drive down costs. Gensler noted that the effort to regulate OTC derivatives "require[s] close coordination between the SEC and the CFTC to ensure the most appropriate regulation." The agencies are reportedly working together on developing legislation for the regulation of OTC derivatives. These issues are expected to

be revisited on July 10 in the joint hearing of the House Agriculture Committee and the House Financial Services Committee to examine the regulation of OTC derivatives.

Proskauer's Economic Crisis Response Group includes lawyers with extensive experience representing private and public companies, institutional investors, financial services companies, private equity and hedge funds, lenders, commercial banks and individuals in the complex and interrelated areas impacted by the current financial situation. Our multidisciplinary group brings together the talents of our business and transactional lawyers with our litigation capabilities, particularly as they pertain to acquiring, managing or disposing of distressed assets; issues concerning investments in financial services companies; and complex financial instruments and transactions, including structured finance products; as well as a broad range of other areas such as corporate governance and defense, insurance coverage, reductions in force and other employment and benefit-related issues, securities regulation, and bankruptcy and restructuring matters.

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