PROSKAUER ROSE LLP

Economic Crisis Response Group

Newsletter

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Special Master of Compensation Named by the Treasury Department

On June 10, the Treasury Department appointed Kenneth Feinberg as Special Master of TARP Executive Compensation to oversee the compensation of employees at institutions that have received exceptional financial assistance under TARP, including the American International Group, Citigroup, Bank of America, General Motors, Chrysler and the financing arms of the two automakers. Feinberg will have broad discretion to review and approve salaries and bonuses for each company's five most senior executives and its twenty highest paid employees and will have the right to review compensation for the 100 highest paid employees and any other executives. Each company under Feinberg's supervision will have 60 days to submit for Feinberg's review the pay packages for its 5 senior executive officers and 20 most highly compensated employees. In determining the appropriateness of the pay, Feinberg is instructed to consider such criteria as the profitability of the company, the general marketplace for compensation, the ability of the company to repay its taxpayer loan, and the extent to which the pay package encourages excessive risk-taking.

The Treasury Department instituted new rules applicable to TARP recipients beyond the congressionally mandated pay limitations that would, among other things, require TARP recipients to disclose any employee perks worth more than $25,000 and the hiring of compensation consultants to structure employee pay; the new rules would also bar tax gross-ups for the 5 most senior executive officers and 20 most highly compensated employees. The new rules also allow shareholders to vote on pay levels with a non-binding resolution and require public companies to strengthen the independence of board committees that set executive compensation. The rules would prohibit companies from paying severance to executives. For other financial institutions that have received federal assistance, Feinberg will play an advisory role in establishing compensation structure, but will not have authority to set the exact level of pay. In addition, he will determine whether it would be in the public interest to force executives at companies receiving assistance to return money if they may have been overpaid based on, for example, inaccurate profit and revenue figures.

SEC Chairman Issues Statement on Executive Compensation

On June 10, Mary Schapiro, Chairman of the SEC, discussed new proxy disclosure rules related to executive compensation. She stated that the SEC will be considering several proposals requiring greater disclosure regarding a company's overall compensation approach, potential conflicts of interest by compensation consultants, and director nominees.

G–8 Finance Ministers Begin Planning End of Economic Stimulus Measures

Finance ministers from the Group of 8 industrialized countries have started discussing strategies for scaling back their responses to the current financial crisis. Top finance officials have asked the International Monetary Fund to help determine the best strategy for cutting budget deficits, withdrawing support from banks, and tightening monetary policy. The ministers noted that these "exit strategies" will vary from country to country, but are essential to promote a sustainable recovery over the long term.

As the financial crisis intensified in late 2008, many governments increased their borrowing in an effort to maintain aggregate demand, leading to an unprecedented increase in government debt. Without a plan to scale back debt, governments fear yields on their bonds may rise significantly, increasing the cost of borrowing and threatening to undermine economic recovery.

IMF Chief Dominique Strauss-Kahn and U.S. Treasury Secretary Timothy Geithner both stressed the need to ensure that a recovery had taken hold before reducing government efforts to stimulate the economy. Geithner emphasized the importance of continuing to reinforce global demand and the need to lay the foundation for a durable recovery, noting that it is too early for policy shifts towards restraint.

IMF Publishes Study on the Effect of Tax Policies on Financial Crisis

A new study by the International Monetary Fund concluded that tax policies favoring debt financing may have worsened the current financial crisis. The study found that tax policies that permit the deduction of interest payments, but not returns on equity, may have contributed to over-leveraging by corporations and households, by providing a disproportionate tax benefit to debt financing relative to equity.

In particular, favorable tax treatment of housing and mortgage interest tax deductions also played a role in encouraging over-leverage by households. The IMF study recommended that countries consider granting corporations a tax deduction for an imputed return on equity. Under this proposal, tax would be levied only on profits in excess of a notional rate of return. The IMF also suggested that the deductibility of debt could be pegged to the same notional rate of return, making the choice between debt and equity financing options tax neutral.

Among the potential problems identified by the IMF, such a proposal could potentially result in corporate income going untaxed, reducing government revenues. From 1994 to 2001, Croatia implemented a deduction for return on equity that may have reduced corporate tax revenues by as much as one-third.

Developments in Regulation of Derivatives

On June 17, the Obama administration unveiled a comprehensive proposal for regulatory reform of the financial sector that, among other things included proposed regulation of all OTC derivatives, including credit default swaps, in an attempt to prevent activities that would pose risk to the financial system, promote transparency and efficiency, prevent market manipulation and fraud, and ensure that such derivatives are not marketed to unsophisticated parties. House and Senate committees held hearings on the proposal on June 18.

At a recent House Financial Services Committee hearing on regulating over-the-counter derivatives, testimony on the need to maintain a single trade repository for OTC derivatives was received. Concerns were expressed that requiring all OTC derivatives to trade over exchanges and imposing initial and variation margin requirements could have the effect of increasing costs and administrative burden for companies that engage in hedging activities, ultimately driving OTC derivatives business overseas.

In Europe, two European trade clearinghouses are jointly developing a clearinghouse specifically for hedge fund dealer derivatives trades. These clearinghouses will net and guarantee equity and OTC derivatives trades between participating funds and their prime brokers, and will route them to the proper European central securities depository. This service is scheduled to launch in 2010 and will cover fifteen European equity markets.

CDS-Protected Bondholders Less Accommodating in Workouts with Issuers

On June 8, Moody's Investors Service announced the results of a report on the effects of credit default swaps ("CDS") on workouts with distressed issuers, showing that bondholders protected by CDS are likely to be less accommodating in workout negotiations than bondholders without CDS protection. CDS can create an incentive for protected bondholders to prefer a default because a default allows these bondholders to (a) recover their entire investment and (b) recover much faster than through a long-term workout outside bankruptcy, even if the workout would produce a higher recovery (ignoring the CDS payments) than a bankruptcy.

HUD Increases Grants for Housing Counseling

On June 16, the Department of Housing and Urban Development ("HUD") announced that it would make $58 million in grants available for housing counseling services this year. This represents a 23 percent increase over last year's grants. The grants will be awarded competitively to HUD-approved housing counseling agencies as well as state housing finance agencies. Most of the funding will subsequently be distributed by these national and regional agencies to community organizations that directly engage homebuyers and homeowners to help individuals find and maintain housing.

The counseling services supported by these grants are primarily targeted at lower and middle income families. Approximately $47 million of the grants will be used to fund general and comprehensive housing counseling services; $8 million of grants will be provided to programs that counsel homeowners about qualifying for and obtaining reverse mortgages. The remaining $3 million of grants will provide supplemental funding for counseling and/or analysis pertaining to loan document review and Fair Lending and Mortgage Fraud Analysis and Counseling.

FASB to Release Accounting Standards Codification

The Financial Accounting Standards Board ("FASB") recently announced the upcoming release of its Accounting Standards Codification ("Codification") on July 1, 2009. The Codification will consolidate thousands of U.S. GAAP pronouncements issued by FASB, the American Institute for Certified Public Accountants, and the Emerging Issues Task Force; these pronouncements will be organized into approximately 90 accounting topics, together with related SEC guidance. Pronouncements in the Codification will supersede all existing accounting standard documents and will make all accounting literature not included in the Codification non-authoritative. The Codification will be effective for interim and annual reporting periods ending after September 15, 2009.

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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