

Client Alert

A report
for clients
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of the Firm **October 2008**

President Bush and the U.S. Treasury Department Announce First Steps under TARP

Treasury's Seven "Policy Teams"

On October 13, 2008, Neel Kashkari, the newly appointed interim Assistant Secretary of the U.S. Treasury in charge of overseeing the Troubled Asset Relief Program ("TARP"), provided an update on its implementation of TARP under the Emergency Economic Stabilization Act of 2008 ("EESA"). Speaking before the Institute of International Bankers, Kashkari stated that Treasury's strategy under TARP is clear and focused on one simple goal: "to restore capital flows to the consumers and businesses that form the core of our economy." This effort will remove illiquid assets from the balance sheets of financial institutions and attract both public and private capital. Kashkari noted that the overriding priority under TARP was to achieve this goal while protecting taxpayers by making the best use of their money.

Kashkari initially noted that the Treasury was working with domestic and international regulators to identify the quickest and most efficient method to purchase equity in financial institutions.

Although very few specifics were announced, Kashkari next described the seven "policy teams" created to focus on the variety of problems that must be addressed:

- **Mortgage-Backed Securities.** A mortgage-backed securities purchase program team is identifying troubled assets to purchase, from whom they should be purchased, and which purchase mechanism will best meet the Treasury's policy objectives. This team is in the process of designing
- detailed auction protocols and will work with vendors to implement the program.
- **Whole Loan Purchase Program.** A whole loan purchase program team is working with bank regulators to identify which type of residential loans to purchase first, how to value them and how to purchase them.
- **Insurance.** A team has been established to insure troubled assets. This team is working on designing the structure of this insurance program and is awaiting comments from the public on ideas of how best to structure such a program.
- **Equity Participation.** Another team is focused on designing a standardized program to purchase equity in a broad array of financial institutions. The equity program will be voluntary and designed with attractive terms to "encourage participation from healthy institutions."
- **Home ownership.** A team is examining how to help homeowners, consistent with other federal programs such as HOPE NOW, when purchasing mortgages and mortgage-backed securities, to enable homeowners to keep their homes while also protecting taxpayers.
- **Executive Compensation Team.** TARP sets forth important requirements regarding executive compensation for firms that participate in the program. A team is working on defining those requirements for financial institutions to participate in one of three possible scenarios: an auction purchase of troubled assets, a broad equity or direct purchase program, and intervention to prevent the impending failure of a systemically significant financial institution.
- **Compliance.** The final team is focused on compliance to make sure that the oversight and

compliance structures mandated by TARP are properly structured and implemented.

Kashkari also noted that some key interim hires have been made under TARP, including Tom Bloom, the CFO of the Office of the Comptroller of the Currency, who will serve as the interim CFO of the Office of Financial Stability (“OFS”), and Rueben Jeffrey, former Chairman of the CFTC, who will serve as interim Chief Investment Officer.

Further, the Treasury Department is retaining private firms to assist in running the program under TARP. Ennis Krupp has been chosen as TARP’s investment management consultant and will begin working immediately. Kashkari expects that decisions on the master custodian firm, securities asset manager and whole loan asset manager will be announced in the next few days.

Finally, Kashkari indicated that OFS has taken important steps to ensure transparency and oversight in this process, as mandated by Congress under the EESA. For example, the Financial Stability Oversight Board was established; its first meeting was held; and Ben Bernanke, Chairman of the Federal Reserve, was elected Chairman of the Oversight Board. OFS also is working with the White House to identify candidates for possible nomination and confirmation as Special Inspector General under TARP, as mandated by Congress in the EESA. Additionally, the General Accounting Office has established a physical presence at Treasury to monitor TARP under Acting Comptroller General, Gene Dodaro.

Treasury and Federal Reserve officials met on Monday, October 13, 2008, with top executives from the financial industry to discuss details on how best to implement TARP. According to the press, officials from the financial industry who attended the meeting included Ken Lewis, CEO of Bank of America; Vikram Pandit, CEO of Citigroup; Lloyd Blankfein, CEO of Goldman Sachs; Jamie Dimon, CEO of JP Morgan Chase; and John Mack, CEO of Morgan Stanley.

President Bush Announces Four-Step Plan

On October 14, 2008, before the U.S. stock markets opened for trading, President Bush announced that the Treasury will begin implementing some of the measures called for by the \$700 billion financial rescue plan enacted on October 3, 2008. President Bush outlined four steps the federal government will be taking to address the financial crisis.

Treasury will use \$250 billion of the \$700 billion to inject capital into financial institutions in return for equity shares in those financial institutions. This use of taxpayer dollars “is an essential short-term measure to ensure the viability of America’s banking system.” It is anticipated that those banks that take the capital will eventually buy the shares back from

the government when the markets stabilize and they are able to raise capital on their own.

To thaw the freeze on lending, effective immediately, the FDIC will temporarily guarantee most new debt issued by insured banks to encourage banks to lend to each other and to consumers.

The FDIC will immediately and temporarily expand government insurance to cover all non-interest bearing transaction accounts, a move which will allow small businesses to cover the costs of their day-to-day operations.

The Federal Reserve will shortly unveil a new program to serve as a buyer of last resort for commercial paper.

Joint Statement by the Treasury, Federal Reserve and FDIC

Treasury Secretary Paulson, Federal Reserve Chairman Bernanke and FDIC Chairwoman Sheila Bair issued a joint statement explaining the actions that will be taken by their respective agencies to address the financial crisis.

First, Treasury announced a voluntary capital purchase program designed to encourage U.S. financial institutions to raise capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy. Under this program, Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms directly from certain financial institutions in an effort to facilitate their continued lending in the capital markets. A “broad array” of financial institutions will be eligible to participate in this program.

Financial institutions that participate in the program must adopt the Treasury’s standards for executive compensation and corporate governance for the period during which Treasury holds equity issued under this program. These standards include:

- Ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution;
- Requiring a clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate;
- Prohibiting a financial institution from making any golden parachute payment to a senior executive based on the Internal Revenue Code provision; and

- Agreeing not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive.

These standards will generally apply to the chief executive officer, chief financial officer, and the next three most highly compensated executive officers. Treasury will be issuing interim final rules for these executive compensation standards.

Second, the FDIC will invoke the “systemic risk” exception to the FDIC Act, which will enable the FDIC to temporarily guarantee the senior debt of all FDIC-insured banks and their holding companies, as well as deposits in non-interest bearing deposit accounts. Regulators will work on implementing an enhanced supervisory framework to ensure that the guarantee is not misused.

The Treasury announced that nine major financial institutions have already agreed to participate in both the capital purchase program and the FDIC guarantee program and have committed as participants in this program to prevent “unnecessary foreclosures” and to “preserve homeownership.”

Third, in an attempt to unfreeze the credit lending markets, the Federal Reserve Board announced its implementation of the Commercial Paper Funding Facility program. Under this program, beginning on October 27, the Federal Reserve Bank of New York will begin funding purchases of unsecured and asset-backed commercial paper from eligible issuers through its primary dealers. Only highly-rated, three-month commercial paper will be financed.

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