

**U.S. BAILOUT PLAN UPDATE**

On Sunday morning, September 28, 2008, the news media reported that congressional leaders and the Bush administration reached a tentative agreement on the terms of a bailout plan and that a bill would likely be brought to the House floor on Monday. A draft bill (the “Sunday Discussion Draft”) reflecting the latest discussions has only just been released at the time of this writing and will be summarized in a future client memorandum, but we have previously reviewed a “summary” (the “Pelosi Summary”) of the major provisions of the package issued by Speaker Pelosi’s (D-CA) office, a copy of which is attached to this memorandum. The Pelosi Summary provides limited detail on how the key elements of the package will function. The major moves that appear to have created the consensus are the Democrats’ agreement to drop bankruptcy court authority to adjust mortgage principal and to permit the Republican proposal for an insurance fund for troubled mortgages and mortgage-based assets to be available as an alternative to the government’s purchasing such assets outright. Other changes appear to represent adjustments to the terms of the “Discussion Draft” that was released by Senate Banking Committee Chairman Christopher Dodd (D-CT) and House Financial Services Committee Chairman Barney Frank (D-MA) on Friday afternoon (the “Friday Discussion Draft”), many of the terms of which appear to have survived the weekend discussions.

As of Sunday afternoon, House Republicans are still trying to test support for the compromise package announced early this morning. We understand that Speaker Pelosi made obtaining a majority of House Republican votes in favor of the package a condition of Democrats’ agreement to include the mortgage insurance option in the legislation. As of 2 p.m. Sunday, one of the key members of the House Republican leadership, House Chief Deputy Minority Whip Eric Cantor (R-VA) said he has not signed on yet.

Set forth below are additional details on the package from Republican sources; they primarily concern items proposed to be dropped or modified from the Friday Discussion Draft. However, based on our initial review of the Sunday Discussion Draft, it appears that some of these items remain open as of the end of the day Sunday.

- Dropping any requirement that 20 percent of profits from asset sales be deposited into an affordable housing fund. In the Sunday Discussion Draft, this language remains bracketed and is presumably still subject to further discussion.
- Eliminating provisions requiring participating entities to provide new shareholder proxy access rights and permit advisory votes on executive compensation.
- Adding a requirement that if the program has not recovered its costs after five years the President must submit a proposal to recover the losses from the financial industry. House Democrats had tried to add a surcharge on participants to cover such losses but Republicans refused.

- The bailout restrictions on executive compensation will apply to entities that sell assets directly to the Treasury. Sellers of assets over \$300 million would be prohibited from deducting excess compensation exceeding \$500,000 to certain senior executive officers (a reduction from the current limit of \$1 million).
- Golden parachutes would be prohibited for any entity from which the Secretary purchases assets directly and for any entity from which the Secretary purchases over \$300 million of assets through an auction process. Firms would be permitted to seek repayment of bonuses or other incentives paid on the basis of inaccurate financial statements.
- The legislation would require Treasury to adopt a program to reduce foreclosures and to coordinate with the Federal Housing Finance Agency, Federal Reserve Board (the “Board”) and Federal Deposit Insurance Corporation (“FDIC”) regarding modifications in at-risk mortgages and making foreclosed properties available to state and local governments.
- The provisions permitting Treasury to take warrants would apply to auction purchases as well as direct purchases.
- The already-operating insurance program for money market mutual funds would be folded into the overall bailout and new revolving funding authority would be added.
- The bailout program would be open to entities licensed, but not organized, in the United States. This is a change from the draft that would have applied only to firms that are organized and regulated, and have substantial operations, in the United States. In the Sunday Discussion Draft, this language remains bracketed and is presumably still subject to further discussion.
- The Government Accountability Office would be required to complete a study of the impact of suspending the Securities and Exchange Commission (“SEC”) mark-to-market accounting rules on any category of issuers. Republicans wanted an actual suspension, but Democrats refused.

Given that the legislative language has just become available at the time of this writing, we have set forth below the contours of some of the material provisions of the Friday Discussion Draft that appear to have survived this weekend’s discussions and endeavored to highlight some of the key differences in the Sunday Discussion Draft.

Immediately prior to circulation of this memorandum, a further discussion draft purporting to represent the final legislative proposal was released. We are in the process of reviewing this further discussion draft and intend to circulate additional updates shortly.

### **Purchase of Assets; Authority**

The Friday Discussion Draft (Sec. 101) would establish a program, referred to as the Troubled Assets Relief Program (the “Program”), under which the Secretary of the Treasury (the “Secretary”) would be authorized to purchase residential or commercial mortgages, and securities, obligations or other instruments based on or related to such mortgages, issued on or

before March 14, 2008 *and*, upon the determination of the Secretary in consultation with the Chairman of the Board of Governors of the Fed, any other financial instrument the purchase of which the Secretary determines necessary to promote financial market stability (“Troubled Assets”). However, in the Sunday Discussion Draft, the language permitting purchases of other instruments is bracketed, presumably because it remains an open issue.

Under the Friday Discussion Draft (Sec. 3), the Secretary would be authorized to purchase Troubled Assets from any “institution, including any bank, savings association, credit union, security broker or dealer, or insurance company, organized and regulated under the laws of the United States” and having significant operations in the United States, but excluding any foreign central bank and any institution owned by a foreign government (“financial institutions”). As noted above, it appears that the latest discussions have expanded the universe of eligible institutions to entities licensed, but not organized, in the United States. However, in the Sunday Discussion Draft, the definition of “financial institution” is unchanged from Friday and remains bracketed. In the event that the restrictions on foreign government ownership contained in the Friday Discussion Draft survive, it is not clear what level of foreign government ownership would disqualify an institution from selling assets into the Program. The Friday Discussion Draft also would permit the government to purchase Troubled Assets from pension plans, local governments and small banks.

The Pelosi Summary suggests that the size of the Program has been cut in half, with the second \$350 billion of funding subject to Congressional approval. This seems to be consistent with the authority granted under the Friday Discussion Draft (Sec. 114) and Sunday Discussion Draft (Sec. 115), pursuant to which the Secretary’s authority is graduated such that the purchase price of Troubled Assets purchased by the Secretary that are outstanding at any one time would be limited as follows:

- up to \$250 billion in the aggregate upon effectiveness of the legislation;
- up to \$350 billion if the President submits to Congress a written certification that the Secretary is exercising the increased authority;
- up to \$700 billion if the President submits a written report to Congress setting forth the Secretary’s plan to exercise such authority, unless Congress enacts a joint resolution disapproving the plan within 15 days after receipt of the President’s report.

The Secretary’s authority to purchase Troubled Assets would terminate on December 31, 2009 but could be extended for up to two additional years by the Secretary upon written certification to Congress justifying the extension as necessary to help American families and stabilize financial markets. The Friday Discussion Draft (Sec. 105) gives the Secretary the authority to exercise any rights received in connection with the Troubled Assets purchased under the Program, manage any revenues and portfolio risks therefrom, and to sell or enter into financial transactions with respect thereto.

### **Troubled Assets Relief Program**

***Considerations in Effecting Purchases.*** In considering which assets to purchase, the Secretary would be required (Sec. 102) to consider a number of factors, including providing stability to financial markets, keeping families in their homes and stabilizing communities, purchasing assets directly only from financial institutions that are unlikely to collapse in the short run, offering participation to financial institutions of all types and sizes, assisting financial institutions that serve low income populations, stabilizing U.S. counties and cities and protecting the taxpayer.

***Treasury Guidelines for Program.*** The Secretary would be required under the Friday Discussion Draft (Sec. 101(d)) to publish guidelines including asset purchase mechanisms, pricing and valuation methods, asset manager selection procedures and criteria for selecting Troubled Assets for purchase no later than two business days after the first exercise of authority under the proposed legislation or, if earlier, thirty days after the legislation is effective (forty-five days under the Sunday Discussion Draft).

***Minimization of Long Term Costs and Maximization of Benefits for Taxpayers.*** The Friday Discussion Draft (Sec. 112) directs the Secretary to use market mechanisms, such as auctions and reverse auctions, wherever appropriate in purchasing Troubled Assets; and, to the extent the Secretary makes direct purchases from a financial institution, to employ additional measures to be sure that the price paid is reasonable. The Secretary must also receive from any financial institution from which it buys any Troubled Asset a warrant, if the selling institution is a public company, to receive non-voting common or preferred stock, or, if the selling institution is not a public company, senior debt, in each case in such amounts as the Secretary deems appropriate. The nature of any such warrant or senior debt instrument should be such that the Secretary may participate in the upside of the company's shares or receive a reasonable interest rate, to cover any losses the Secretary may sustain on the purchase and subsequent sale of the Troubled Asset, and to cover the Secretary's costs incurred in purchasing the asset. The Secretary may not (Sec. 101(e)) permit the unjust enrichment of a financial institution and, accordingly, is prohibited from buying any troubled asset for more than the selling financial institution initially paid for the asset.

***Executive Compensation and Corporate Governance Requirements.*** The Sunday Discussion Draft has significantly changed from the Friday Discussion Draft and we are in the process of reviewing the new proposals. Under the Friday Discussion Draft (Sec. 110), any institution that participates in the Program would be required to meet standards for senior executive officer compensation in order to be eligible to participate. Based on the latest information available to us, it appears that the bailout restrictions on executive compensation will apply to all entities that sell assets directly to the Treasury. Furthermore, Sellers of assets over \$300 million would be prohibited from deducting excess compensation exceeding \$500,000 to certain senior executive officers (a reduction from the current limit of \$1 million), and golden parachutes would be prohibited for any entity from which the Secretary purchases assets directly and for any entity from which the Secretary purchases over \$300 million of assets through an auction process. Firms would be permitted to seek repayment of bonuses or other incentives paid on the basis of inaccurate financial statements.

## **Oversight**

The draft legislation would subject the Secretary to considerable oversight in the exercise of the authority granted thereunder:

1. *Financial Stability Oversight Board.* The Sunday Discussion Draft (Sec. 104) calls for the creation of a Financial Stability Oversight Board (the “Oversight Board”), consisting of the chairperson of the Board, the Secretary, the Director of the Federal Home Finance Agency, the chairperson of the SEC and the Secretary of Housing and Urban Development. The Oversight Board would be charged with reviewing the Secretary’s actions under the Program, making recommendations to the Secretary with respect to those actions and reporting any fraud or misrepresentation on the Secretary’s behalf to appropriate law enforcement agencies.
2. *Ongoing Reporting; Transparency.* Under the draft legislation (Sec. 104), the Secretary would be required to report to the relevant Congressional committees every thirty days regarding the actions taken under the legislation and the administrative expenditures made during such period and expected to be made during the following period together with detailed financial statements with respect to the exercise of authority under the Program. In addition, the Secretary would be required to publish weekly the total amount of assets purchased and sold. The Secretary would also be required to provide to the relevant Congressional committees a description of all transactions and the pricing mechanisms used, a justification of prices paid, a description of the impact on the financial system, a description of challenges that remain and an estimate of actions that will be required still to be taken not later than seven days after each \$50,000,000,000 of purchases are made under the Program. To enhance market transparency, the Friday Discussion Draft (Sec. 113) would also require the Secretary to publish, in electronic form, a description, the amounts and the pricing of assets purchased pursuant to the Program within two business days of their purchase or sale. The Secretary would also be required to determine (and, if necessary, make recommendations to the relevant regulators) whether the level of disclosure by participating financial institutions is sufficient with respect to off-balance sheet transactions, derivatives and similar sources of potential exposure.
3. *GAO Review Oversight and Audits.* Under the Friday Discussion Draft (Secs. 115 and 116), the Comptroller General would be required to oversee the activities and performance of the Program on an ongoing basis, including its performance with respect to foreclosure mitigation, consumer protection, cost reduction and stabilization of the financial system as well as the Program’s financial condition and internal controls. The GAO will also be required to oversee the type, frequency, prices paid and other relevant terms of transactions; and the Program’s management of conflicts of interest and contracting procedures. The Comptroller General will be required to report its findings every 60 days to the relevant committees of Congress and the Inspector General for the Department of the Treasury. The Program will be required to prepare annual financial statements that will be audited by the GAO.

4. *Judicial Review.* The Secretary's actions under the Program will be subject to judicial review but, under the Friday Discussion Draft (Sec. 118), may be set aside only if found to be arbitrary, capricious or otherwise inconsistent with the law, or an abuse of discretion, or not in accordance with the law. In addition, the draft legislation contains significant limitations on the availability of equitable relief, stays and injunctions against the Secretary of State. The parameters of these limitations have been the subject of significant debate among the various constituents present at the negotiations and, while it appears that judicial oversight will form part of the package deal, it is not clear whether and to what extent the limitations on equitable relief will survive.
5. *Inspector General for the Program.* The draft legislation (Sec. 120) would create an Office of Special Inspector General for the Program, whose head (the "Special Inspector General") would be appointed by the President. The Special Inspector General would have authority to conduct audits and investigations of the acquisition, management and disposition of assets by the Treasury pursuant to the proposed legislation and to create and oversee systems and controls appropriate to conduct such audits and investigations.
6. *Congressional Oversight Panel.* The Friday Discussion Draft (Sec. 124) would also create a Congressional Oversight Panel (the "Oversight Panel"), whose duties would be to review the current state of the financial markets and the regulatory system and to report to Congress every thirty days regarding the Secretary's use of authority under the Program, the impact of purchases made on the financial markets and financial institutions, the degree to which disclosures have contributed to market transparency and the effectiveness of programs in mitigating foreclosures and minimizing costs to taxpayers. The Oversight Panel would also submit a special report by January 2009 evaluating the current state of the regulatory system and its effectiveness in overseeing market participants and protecting consumers, and making recommendations for, among other things, whether additional financial institutions should be brought within the federal regulatory system. The members of the Oversight Panel would be chosen by the various members of the Congressional leadership.

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This memorandum was prepared by Gregory B. Astrachan and Russell Smith. The Task Force (which includes UK insolvency professionals from our strategic ally, Dickson Minto W.S., and attorneys from our European offices) was formed to respond to client questions and provide targeted advice in connection with the proposed Government bailout and the credit crisis (including the Lehman Brothers Holdings Inc. bankruptcy). If you have any questions about this memorandum, please contact any of the members of the WF&G Government Rescue and Credit Crisis Task Force listed below or the attorney with whom you regularly work.

September 28, 2008

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## REINVEST, REIMBURSE, REFORM

### IMPROVING THE FINANCIAL RESCUE LEGISLATION

Significant bipartisan work has built consensus around dramatic improvements to the original Bush-Paulson plan to stabilize American financial markets—including cutting in half the Administration's initial request for \$700 billion and requiring Congressional review for any future commitment of taxpayers' funds. If the government loses money, the financial industry will pay back the taxpayers.

- Phases of a Financial Rescue with Strong Taxpayer Protections .
- Reinvest in the troubled financial markets ... to stabilize our economy and insulate Main Street from Wall Street
- Reimburse the taxpayer ... through ownership of shares and appreciation in the value of purchased assets
- Reform business-as-usual on Wall Street ... strong Congressional oversight and no golden parachutes

### CRITICAL IMPROVEMENTS TO THE RESCUE PLAN .

Democrats have insisted from day one on substantial changes to make the Bush-Paulson plan acceptable—protecting American taxpayers and Main Street—and these elements will be included in the legislation

#### Protection for taxpayers, ensuring THEY share IN ANY profits

- Cuts the payment of \$700 billion in half and conditions future payments on Congressional review
- Gives taxpayers an ownership stake and profit-making opportunities with participating companies
- Puts taxpayers first in line to recover assets if participating company fails
- Guarantees taxpayers are repaid in full—if other protections have not actually produced a profit
- Allows the government to purchase troubled assets from pension plans, local governments, and small banks that serve low- and middle-income families

#### Limits on excessive compensation for CEOs and executives

- New restrictions on CEO and executive compensation for participating companies:
- No multi-million dollar golden parachutes
- Limits CEO compensation that encourages unnecessary risk-taking

- Recovers bonuses paid based on promised gains that later turn out to be false or inaccurate

#### Strong independent oversight and transparency

- Four separate independent oversight entities or processes to protect the taxpayer
- A strong oversight board appointed by bipartisan leaders of Congress
- A GAO presence at Treasury to oversee the program and conduct audits to ensure strong internal controls, and to prevent waste, fraud, and abuse
- An independent Inspector General to monitor the Treasury Secretary's decisions
- Transparency—requiring posting of transactions online—to help jumpstart private sector demand
- Meaningful judicial review of the Treasury Secretary's actions

#### Help to prevent home foreclosures crippling the American economy

- The government can use its power as the owner of mortgages and mortgage backed securities to facilitate loan modifications (such as, reduced principal or interest rate, lengthened time to pay back the mortgage) to help reduce the 2 million projected foreclosures in the next year
- Extends provision (passed earlier in this Congress) to stop tax liability on mortgage foreclosures
- Helps save small businesses that need credit by aiding small community banks hurt by the mortgage crisis—allowing these banks to deduct losses from investments in Fannie Mae and Freddie Mac stocks