U.S. BAILOUT PLAN

On Friday, October 3, 2008, immediately following approval by the House of Representatives, President Bush signed into law the Emergency Economic Stabilization Act, and a number of other provisions including the extension of certain tax benefits and the granting of certain energy credits, that passed in the Senate on Wednesday (the "Bailout Plan"). The Bailout Plan contains a number of changes from the discussion drafts circulated the previous week, and from the proposed legislation that was voted down in the House earlier this week. The Bailout Plan is summarized briefly below.

Purchase of Assets; Authority

The Bailout Plan (Sec. 101) authorizes the establishment of a program, referred to as the Troubled Assets Relief Program (the "TARP"), under which the Secretary of the Treasury (the "Secretary") is 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 Federal Reserve (the "Board"), which determination must be communicated in writing to Congress, any other financial instrument the purchase of which the Secretary determines necessary to promote financial market stability ("Troubled Assets"). Under the Bailout Plan (Sec. 3), the Secretary is authorized to purchase Troubled Assets from any "institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established 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"). However, a foreign financial authority or bank that holds Troubled Assets on account of having extended credit to a financial institution that failed or defaulted on such credit is nonetheless eligible (Sec. 112) to sell such assets to the Secretary.

Minimization of Long Term Costs and Maximization of Benefits for Taxpayers

Under the TARP, the Secretary is required to maximize the use of taxpayer resources by using market mechanisms wherever appropriate, including auctions or reverse auctions, though the Secretary may alternatively purchase Troubled Assets directly from financial institutions, for reasonable prices, where market mechanisms are not appropriate. Two mechanisms that may be appealing to the Secretary include the reverse auction model, under which financial institutions would bid to sell particular classes of Troubled Assets to the Secretary and the Secretary would buy them at the lowest offered prices; and the descending auction model, where the Secretary would offer to buy a stated amount of Troubled Assets and then buy them at the lowest price at which enough financial institutions are willing to sell that the Secretary may acquire the entire stated quantity. What mechanisms the Secretary will actually use, however, has been left to be determined in the Secretary's guidelines and was not included in the Bailout Plan.

The Secretary is also required to 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, as applicable, to provide additional protection to the taxpayer against losses from the sale of Troubled Assets and the administrative expenses of the TARP.

The Bailout Plan gives the Secretary the authority (Sec. 105) to exercise any rights received in connection with the Troubled Assets purchased under the TARP, manage any revenues and portfolio risks therefrom, and sell or enter into financial transactions with respect thereto.

Guarantee of Troubled Assets

In the event that the Secretary establishes the TARP, the Secretary must also establish (Sec. 102) a program to guarantee Troubled Assets (the "Guarantee Program" and, together with the TARP, the "Programs"). Under the Guarantee Program, the Secretary may guarantee the timely payment of principal of, and interest on, Troubled Assets, on terms and conditions to be determined by the Secretary consistent with the purposes of the Bailout Plan. The Secretary must collect premiums from entities that choose to participate in the Guarantee Program, based on credit risk and in amounts necessary to provide reserves sufficient to meet anticipated claims. Premiums are to be deposited in a Troubled Assets Insurance Financing Fund (the "Fund"), from which any payments due on guarantees will be paid. It is important to emphasize that the Guarantee Program is discretionary, in that institutions may, but are not required to, seek guarantees for Troubled Assets, rather than selling them outright under the TARP.

Limitations on Amount of Purchases and Guarantees

Pursuant to the Bailout Plan, the Secretary's authority is graduated such that the aggregate purchase price of Troubled Assets purchased by the Secretary that are held at any one time, plus the difference between total amount guaranteed under the Guarantee Program and the balance of the Fund reserved therefore, may not exceed:

- $250 billion at the time of effectiveness of the legislation;
- $350 billion if and when the President submits to Congress a written certification that the Secretary needs to exercise the increased authority; or
- $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.

Time Limits on Secretary's Authority

A purpose of the Bailout Plan (Sec. 2) is "to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States"; and the "[e]stablishment of the policies and procedures and other administrative requirements imposed on the Secretary by this Act are not intended to delay the commencement" of the Programs (Sec. 101(a)(2)); but the Secretary is nonetheless required (Sec. 101(d)) to publish guidelines no later than two business days after the first purchase of Troubled Assets under the Bailout Plan (or, if earlier, forty-five days following the enactment of the plan). Such guidelines, which will provide for mechanisms for purchasing, and methods for pricing and valuing, Troubled Assets, procedures for selecting asset managers and criteria for identifying Troubled Assets for purchase, may not be ready shortly enough for the Secretary to make purchases immediately under the plan. The Secretary's authority terminates on December 31, 2009 but can 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.

Executive Compensation Requirements

Under the Bailout Plan, any institution that participates in the TARP would be required (Sec. 111) to meet standards for senior executive officer compensation in order to be eligible to participate. Any entity that sells Troubled Assets directly to the Secretary under the TARP, and in which the Secretary takes a meaningful equity or debt position, must for any period during which the Secretary holds such position limit compensation to senior executive officers that would provide incentives to take unnecessary and excessive risks; may recover any incentive compensation paid to any senior executive officer on the basis of criteria that prove ultimately not to have been met; and must refrain from making golden parachute payments to senior executive officers. Any entity that sells Troubled Assets to the Secretary pursuant to an auction, in an aggregate amount of over $300 million, is prohibited from entering into any new employment contract with a senior executive officer that includes a golden parachute and may no longer (Sec. 302) deduct excess compensation exceeding $500,000 to certain senior executive officers (a reduction from the current limit of $1 million). Further detail will be provided on the executive compensation requirements of the Bailout Plan in our forthcoming memorandum entitled "Economic Recovery Bill Imposes Narrow Limitations on Executive Compensation".

Oversight

The Bailout Plan creates a number of oversight mechanisms to monitor and make transparent the Secretary's actions under the Bailout Plan. The plan creates a Financial Stability Oversight Board (Sec. 104) to review the Secretary's actions, make recommendations and report any misconduct to appropriate law enforcement agencies. The members of the Oversight Board are the Chairman of the Federal Reserve, the Secretary, the Director of the Federal Housing Finance Agency, the Chairman of the Securities and Exchange Commission and the Secretary of Housing and Urban Development. Given its substantial policy responsibilities it is expected that the Oversight Board will be quite active regarding the TARP and future market reform proposals,

particularly in the new administration. The plan also creates an Office of Special Inspector General (Sec. 121) to conduct audits and investigations of the purchasing, management and selling of assets by the Secretary; and a Congressional Oversight Panel (Sec. 125) to review and report upon the impact of the Programs on the financial markets and financial institutions, the expense to the taxpayer and the mitigation of foreclosures, as well as the current state of the regulatory system and its effectiveness in overseeing financial institutions and protecting consumers.

The Bailout Plan also requires the Comptroller General (Sec. 116) to oversee the performance of the TARP in mitigating foreclosures, reducing costs, stabilizing the financial system and protecting taxpayers, as well as the terms of purchases and sales made by the Secretary and the financial condition and internal controls of the TARP. Pursuant to the responsibilities assigned to the Comptroller General, the Government Accountability Office ("GAO") is authorized to establish a resident office at the Treasury Department to review all aspects of the program. The Secretary must report to Congress (Sec. 105) regarding the actions taken and expenditures made pursuant to the Programs and prepare financial statements reflecting Program activities. The Secretary's actions will be subject to judicial review (Sec. 119) but will be set aside only if found to be arbitrary, capricious, an abuse of discretion or not in accordance with the law. For more information on the oversight provisions of the Bailout Plan, please see our prior memorandum entitled "U.S. Bailout Plan Update", dated September 28, 2008.

Mark-to-Market Accounting

The new law (Sec. 132) reiterates that the Securities and Exchange Commission has the statutory authority to suspend the application of Statement Number 157 of the Financial Accounting Standards Board if the SEC determines that it is in the public interest and protects investors. The law (Sec. 133) directs the SEC to conduct a study on mark-to-market accounting standards as provided in FAS 157 and to report to Congress within 90 days of enactment. In particular, the SEC, in consultation with Treasury and the Federal Reserve, is to review the effects of FAS 157 on balance sheets and the quality of financial information.

Temporary Increase in FDIC Deposit and Share Insurance Coverage

In addition to giving the Secretary the authority to establish the Programs, the Bailout Plan (Sec. 135) increases the standard maximum deposit insurance amount provided by the Federal Deposit Insurance Company ("FDIC") under the Federal Deposit Insurance Act (the "Deposit Insurance Act") from $100,000 per customer account per institution to $250,000, until December 31, 2009. The temporary increase will not affect assessments or inflation adjustments to be made under the Deposit Insurance Act and is accompanied by a temporary elimination of the borrowing limits on the FDIC.

Miscellaneous New Tax Provisions Including Many "Extenders"

The Bailout Plan contains, in addition to the significant changes in the executive compensation area addressed elsewhere, numerous miscellaneous tax provisions affecting both individuals and

businesses. In large part, these miscellaneous provisions extend through 2009 a number of tax relief provisions that had expired at the end of 2007 or were set to expire at the end of this year. A brief description of some of the provisions that we believe may be of most interest to our clients follows.

Provisions Affecting Regulated Investment Companies and Their Shareholders:

(1) Current provisions permitting regulated investment companies ("RICs") to designate, under certain circumstances, all or a portion of a dividend as an "interest-related dividend" or as a "short-term capital gain dividend" have been extended to include dividends paid in taxable years beginning prior to January 1, 2010. Such dividends are generally not taxable to non-U.S. investors.

(2) The "estate look-through" rule has been extended to apply to decedents dying before January 1, 2010. This rule provides that stock of a RIC will not be treated as property for purposes of computing the estate tax in the proportion that (a) the assets held by the RIC which are debt obligations, deposits or other property that would be treated as situated outside the United States if held directly by the estate bear to (b) the total assets of the RIC.

(3) A provision excepting from the Foreign Investment in Real Property Tax Act tax provisions certain RIC shareholders of domestically controlled RICs, regardless of their level of ownership, has been extended through December 31, 2009.

New Broker Reporting Requirements: A new reporting requirement has been imposed on brokers required to file a return under section 6045 of the Internal Revenue Code (the "Code") reporting the gross proceeds from the sale of a "covered security". Such brokers must now include in the return the customer's adjusted basis in the security and whether any gain or loss with respect to the security is long-term or short-term gain. A "covered security" is any share of stock in a corporation (including stock of a regulated investment company), any note, bond, debenture or other evidence of indebtedness, any commodity, certain contracts and derivatives with respect to commodities and any other financial instrument determined by the Treasury Department that (1) was acquired through a transaction in the account in which the security is held or (2) was transferred to that account from an account in which the security was a covered security but only if the transferee broker received a statement now required to be provided by the transferor broker. The new rules generally apply with respect to stock acquired on or after January 1, 2011, but in some instances with respect to regulated investment company stock, the rules apply with respect to stock acquired on or after January 1, 2012, although an election may be made by a regulated investment company or by certain brokers on a shareholder-by-shareholder basis to treat as "covered securities" all stock in the company held by the shareholder without regard to when the stock was acquired.

Provisions Involving Insurers and Certain Financing Companies: The U.S. parent of a foreign insurance company subsidiary is eligible for deferral of tax on such subsidiary's earnings if the subsidiary is predominantly engaged in the insurance business and conducts substantial activity with respect to the insurance business. In addition, the subsidiary must pass an entity level

income test to demonstrate that its income is active, rather than passive, income. This deferral provision has been extended through December 31, 2009. A similar extension has been granted with respect to the deferral of tax on the earnings of certain foreign subsidiaries engaged in the banking and financing businesses.

Look-Through Treatment of Payments between Related Controlled Foreign Corporations: Deferral of tax on certain payments (interest, dividends, rents and royalties) between commonly controlled foreign corporations has been extended through December 31, 2009.

FUTA Surcharge: The .2% surcharge on the rate of Federal Unemployment Tax payable by employers (raising the rate to 6.2% of total wages paid) has been extended through calendar year 2009.

AMT Patch and Additional Relief: The Alternative Minimum Tax exemption amount has been increased to $66,250 from $64,950 for those filing a joint return (and surviving spouses), and it has been increased from $44,350 to $46,200 for those filing separate returns. Additional relief has also been granted for those who had to pay the Alternative Minimum Tax with respect to the exercise of Incentive Stock Options on stock that decreased in value between the date of exercise of the option and the date of sale of the stock.

Extension of Ability to Make Charitable Contributions from IRAs: A provision added to the Code in 2006 permitting the exclusion from income of distributions of up to $100,000 paid to charity from a taxpayer's Individual Retirement Account has been extended through 2009. This provision is only available to taxpayers who are at least 70 ½ years old at the time the charitable contribution is made.

Gain or Loss on Sale by Financial Institutions of Fannie Mae or Freddie Mac Stock: Gains and losses on the sale or exchange of Fannie Mae and Freddie Mac preferred stock will be treated as ordinary gains and losses in certain circumstances. Only "applicable financial institutions" are entitled to take advantage of this provision. The provision applies to a sale or exchange by an applicable financial institution if the stock was (a) held by the institution on September 6, 2008, provided that the institution is an applicable financial institution from September 6, 2008 through the date of sale of the stock or (b) sold or exchanged by the institution on or after January 1, 2008 and before September 7, 2008, provided the institution was an applicable financial institution at the time the stock was sold. In addition, the statute authorizes the Treasury Department to issue regulations permitting the provision to apply in cases in which the Fannie Mae or Freddie Mac preferred stock was (a) sold after September 6, 2008 by an applicable financial institution that did not own the stock on September 6, provided that the stock was acquired by the applicable financial institution in a transaction that resulted in the institution's having the same basis in the stock as the party that owned the stock on September 6, 2008, or (b) held or sold on the relevant dates by a partnership in which the applicable financial institution is a partner. An "applicable financial institution" is, in general, a bank, savings and loan institution, small business investment company operating under the Small Business Investment Act of 1958, business development corporation or depository institution holding company.

Offshore Deferred Compensation: A portion of the revenue losses from the extenders provisions of the new law are offset by changing the tax treatment of compensation paid to participants in certain nonqualified deferred compensation plans of offshore corporations to require that such compensation be treated as ordinary income. The proposal is effective for services performed after December 31, 2008.

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This memorandum was prepared by Gregory B. Astrachan, Russell Smith and James Brown. 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.

October 4, 2008

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