



BROWN RUDNICK'S STRUCTURED RESOLUTION GROUP

US TREASURY BAIL-OUT ALERT

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As of this release, the Congress and the Bush administration are in their second day of debate over the largest government bail-out plan in U.S. history aimed at rescuing the ailing credit markets by having the U.S. Treasury acquire the toxic assets that are clogging the financial system.

The original draft of the yet-to-be-named bail-out proposal—prepared by Treasury and submitted to the lawmakers on Saturday—provided the big picture of the government's plan but was very short on the actual details of its implementation. (Under the bill the details are to be determined by Treasury, without Congressional oversight or judicial review.)

Under the original Treasury bill, the Secretary of the Treasury would be authorized to exercise the following powers:

- Purchase mortgage-related assets (defined to mean residential or commercial mortgages and any securities, obligations or other instruments based on or related to such mortgages, originated or issued on or before September 17, 2008) from any financial institution having its headquarters in the United States and on such terms and conditions as determined by the Secretary
- Appoint employees, enter into contracts, designate financial institutions as financial agents of the government, establish vehicles to purchase mortgage-related assets and issue new securities
- Issue such regulations as are necessary or appropriate to carry out such actions
- Report to Congress, within three months of the first exercise of the authority granted by such legislation, and semiannually thereafter, on actions taken under this legislation
- Exercise any rights received in connection with mortgage-related assets purchased under this legislation, manage such assets, or sell or enter into other transactions with respect to such assets
- Purchase mortgage-related assets aggregating up to \$700 billion *at any one time*

OTHER KEY HIGHLIGHTS:

- Decisions by the Secretary pursuant to the authority under this legislation would be non-reviewable by any court or administrative agency
- The authority of the Secretary to purchase the mortgage-related assets would expire after two years following the enactment of this legislation.
- The purchases would be funded through the general fund of the Treasury, and borrowing to support the program will be subject to the U.S. debt limit, which will be increased by \$700 billion

By Sunday afternoon, the proposal had already been widened to accommodate the concerns of foreign banks requesting the inclusion of their U.S. units and of financial institutions seeking coverage for broader asset classes to be included in the rescue plan.

On Monday afternoon, the Senate and House Democratic leaders indicated that they had reached a tentative agreement on their conditions to approving the government's proposal, and a Senate bill had been introduced. Among the conditions for Democratic approval of the rescue plan are the following:

- **Increased Oversight:** the establishment of an oversight board to monitor the program and the creation of an inspector-general position
- **Reporting:** monthly reports to Congress
- **Term:** termination of Treasury's special authority by December 31, 2009
- **Reduction of Foreclosures:** assistance to homeowners to avoid foreclosures, through loan modification or restructuring, among other efforts
- **Conflicts of Interest:** Regulations would be promulgated to prevent selling firms or individuals from benefiting from purchasing or managing assets.
- **Profit Potential:** institutions selling their assets would have to give the government shares or senior debt to ensure that taxpayers share in any industry upside
- **Curbs on Executive Compensation:** firms selling their assets would have to agree to limits on executive pay and severance and may have to get back previously paid incentive bonuses
- **Bankruptcy Law Changes:** bankruptcy courts would be authorized to require modification of a chapter 13 bankruptcy filer's primary residence mortgage.

The last three provisions of the Democratic counterproposal promise to generate quite a bit of pushback from the banking and securities industries and further complicate the debate and approval of the bill. Moreover, some conservative Republicans have already expressed their dissatisfaction with the proposal, as being contrary to general GOP non-interventionist principles. This counterproposal, therefore, challenges the Bush administration's notion that a "clean bill" with minimum to no revisions would be approved in line with their calls to swift action after circulating their rescue plan.

UNANSWERED QUESTIONS:

This is obviously a complex, fluid and fast-moving process, with a goal of a final bill by the end of this week. This alert will be updated daily until the final version of the bail-out package is known, at which time we will produce a detailed summary of its contents. Some unanswered questions which must be addressed are:

- ***Pricing (the biggest of them all!):*** What price will the government pay for the assets? Many of the selling institutions have severe capital adequacy issues. Will their capital positions be sufficiently improved if the government buys these assets at their currently depressed market value? Thus far, many institutions have been reluctant to mark down these assets to the reduced prices which buyers have indicated they would be willing to pay. Will they be forced to sell them to the Treasury at these prices? Or, will Treasury pay more so as to provide them with additional capital? While the legislation does not specify how Treasury will go about setting the price or other mechanics for purchase, published reports have indicated that it may adopt a "reverse



- auction" system (whereby the Treasury will be able to choose from the bids submitted by financial institutions). Will this do the trick? How will the government find the equilibrium between paying as little as possible to limit its losses and paying enough to allow the program to have a significant impact on the financial system and stabilize these institutions?
- **Covered Financial Institutions:** Which domestic and foreign financial institutions will be included in the plan? Will the program be limited to investment banks or will it also include commercial banks, hedge funds and other financial institutions? What about the insurers of mortgage-related assets?
 - **Covered Assets:** What assets are going to be included in the program? Will the bail-out remain limited to "mortgage-related assets?" If so, will products such as collateralized debt obligations and other similar structured securities be eligible? Or will tax-exempt bonds and non-mortgage asset-backed securities also be covered?
 - **Fairness Considerations:** Is it fair and equitable to reward the individuals and institutions that held the most toxic assets and dragged their feet in writing them down, without the U.S. taxpayers having a potential upside? Is it enough for the U.S. Treasury to have an upside in the troubled assets themselves if the Treasury is paying a premium to the selling institutions, or should the Treasury also receive warrants or senior preferred debt in the selling institutions to compensate for the premium purchase price as the Senate bill proposes?
 - **Transparency:** To what extent will the regulations and procedures regarding the purchase, management and sale of these assets be transparent and Treasury's decisions be subject to independent review?
 - **Conflict of Interest:** Will there be restrictions preventing the same individuals or institutions who sell assets to the government from profiting by purchasing or managing them as there was with the RTC in the early 1990's?
 - **Cost to Taxpayers:** What will the actual cost to taxpayers be when all the dust has settled? While published reports say the program will cost \$700 billion, that is somewhat misleading since that figure is only the amount which can be outstanding at any time. In that sense, the program will be a revolving facility and the government will be able to purchase more than \$700 billion in assets in the aggregate. At the same time, after recoveries of values inherent in the assets being purchased, the ultimate cost to the Treasury could be substantially less.
 - **Compensation Restrictions:** Will the compensation levels of executives have to be restricted as a price of participating in this program?
 - **Investor Confidence:** Is the bail-out plan enough to restore confidence and liquidity to the financial system? Is \$700 billion the right amount, or will it need to be higher?
 - **Emerging New Paradigms:** Just as the RTC gave birth to the commercial mortgage securities market, will this bail-out also give rise to a new paradigm for packaging large quantities of troubled assets?

For a program of such unprecedented size and complexity, the devil lies not just in the details but also in the overarching concept of the legislation and its perceived fairness in balancing the competing interests which must be served. We will continue to monitor both the micro- and macro-aspects of this plan as it works its way through Congress and provide periodic updates.



If you have any questions or would like more information, please contact one of the following Brown Rudnick attorneys:

Jonathan C. Black at +1.617.856.8484 / jblack@brownrudnick.com

Ronald S. Borod at +1.617.856.8373 / rborod@brownrudnick.com

Steven B. Levine at +1.617.856.8587 / slevine@brownrudnick.com

Robert J. Stark at +1.212.209.4862 / rstark@brownrudnick.com

Edward S. Weisfelner at +1.212.209.4900 / eweisfelner@brownrudnick.com

Yanire Martes and Eugene Solomonov contributed to the development of this alert.

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