

THE DICKINSON WRIGHT ECONOMIC RECOVERY TEAM

A Volume
of Insight
On the Nation's
Economic Recovery
Programs

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Our nation's economy – and the world's economy -- is experiencing unprecedented turmoil. Every aspect of business is changing, and organizations need to be positioned to respond to these changes.

In light of the current economic crisis in the United States and around the world, Dickinson Wright PLLC formed the firm's Economic Recovery Team. Dickinson Wright's Economic Recovery Team includes attorneys specializing in every area of law impacted by the recent financial crisis, including real estate, insolvency, banking, corporate, litigation, municipal finance, regulatory and tax law. These attorneys take a cross-disciplinary approach to helping clients address the risks and realize the opportunities inherent in today's ever-changing economic environment. They integrate their vast knowledge and expertise to provide clients with turn-key legal solutions that can meet their needs during these difficult times.

In the fall of 2008, the Economic Recovery Team held an interactive teleseminar from three locations – Washington D.C.; Grand Rapids, Michigan; and Troy, Michigan. The free seminar, entitled "An Inside View on the Credit Crisis from Washington: What You Can do to Survive and Thrive," featured a number of key Washington D.C. policymakers. Members of the Economic Recovery Team discussed the new regulations and laws created to address the current crisis, and what they mean to businesses.

While Dickinson Wright's Economic Recovery Team is new to the firm, seeing clients through challenges is not. For more than 130 years, Dickinson Wright has counseled clients during economic upheavals, from the Great Depression to the 1987 stock market crash to today's economic crisis. In recent months, this team has authored a series of Client Alerts and newsletters about the changing economic landscape, which are compiled here and address a number of the issues facing businesses in today's complicated financial world.

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FBI Ramps Up Investigation of White Collar Crimes as Part of Financial Crisis

by Micheal L. Volkov, November, 2008

The FBI is under intense political and public pressure to investigate and prosecute companies involved in the financial crisis. Recently, the FBI opened up investigations into Fannie Mae, Freddie Mac, Lehman Brothers, and American International Group, the four companies at the heart of the \$700 billion bail out.

There are approximately 26 financial institutions currently under criminal investigation, and that number is expected to increase exponentially. Over 400 individuals have been indicted with mortgage fraud and there are 1400 pending white-collar investigations related to the crisis. There are 40 task forces nationwide looking at the fraud of the heart of the subprime scheme.

The political pressure is increasing for the FBI to act. House Judiciary Committee Chairman John Conyers and other Members recently wrote the Justice Department seeking an explanation for the FBI's investigation and the steps taken to date. As a new Administration takes the reins of power, the FBI will be under even more pressure to bring a large number of criminal cases against businesses and responsible officials.

More media attention has been paid to alleged "culprits" involved in the financial crisis. CEOs and other officers of various mortgage companies, investment banks and banks will be obvious targets.

A commentator wrote, "[t]he subprime mortgage and asset-backed paper scandals constitute one of the biggest frauds ever perpetrated. They have resulted in mass foreclosures, writedowns, bankruptcies, firings and billions lost. The \$10-trillion U.S. home-lending sector was, and perhaps still is, rotten. At the top were mortgage lenders, then Wall Street and others who exported junk debts to lenders around the world after prettying them up."

With the number of impending criminal investigations, businesses must act quickly to get their houses in order by conducting internal investigations to root out any problems, correct any deficiencies, and identify any employees who may have crossed the line.

Dickinson Wright has extensive experience in conducting internal investigations, dealing with regulators and prosecutors, and representing clients before various agencies and Congress in Washington, D.C. With a staff of former prosecutors, trial attorneys, and Congressional staff, Dickinson Wright is able to represent business clients facing serious civil and criminal inquiries.

"Bailout Bill" Green Energy Provisions Can Benefit Small and Medium Sized Businesses

by David A. Malson, Jr., November, 2008

In response to the current economic climate, Congress enacted the Emergency Economic Stabilization Act of 2008, which was signed into law on October 3, 2008. More commonly referred to as the "Bailout Bill," the most publicized aspect of this legislation is the Troubled Assets Relief Program, which provides assistance to financial institutions, financial services firms, regional banks and community banks holding mortgage-backed securities. However, the Act also includes a number of other provisions which provide tax and other financial incentives to small and medium sized businesses, including provisions that are geared to encourage investments in "green" energy technologies.

One opportunity under the Act that applies to all businesses involves a 30 percent tax credit for investing in new equipment related to certain "green" energy sources. Further, for companies engaged in the development of new, green energy sources, the Act also includes provisions providing benefits to businesses engaged in the development of new green energy technologies involving wind, solar, geothermal and ocean energy sources. The Act also extends tax credits to companies for producing electricity from wind and refined coal facilities through 2009.

The green energy opportunities also include opportunities for all businesses to obtain additional tax credits for investments in new hybrid cars and trucks. For example, tax credits ranging from \$2,500 to \$15,000 per car and truck are available for businesses that buy new hybrid cars and trucks and place the same into service for business use.

Also, businesses that add new energy efficient "idling reduction devices" which eliminate the need to use the truck's engine to run the truck's heating and air conditioning systems, as well as other features that require electricity, will also receive tax breaks, including exclusion from the heavy truck excise tax.

Energy efficient commercial properties will also qualify for certain tax deductions. For example, use of recycled materials in the construction and updating of commercial buildings will provide tax breaks involving shorter depreciation schedules and other related tax breaks. Further, properties utilizing solar energy, fuel cell, and microturbine technology (i.e., an integrated system comprised of a gas turbine engine and other components which result in the conversion of the fuel source into electricity and thermal energy) will also benefit from tax credits. Installation of "smart electric meters", "smart electric grid systems" and "smart grid properties" also will lead to tax breaks by way of accelerated depreciation schedules for the newly installed equipment.

If you are interested in evaluating how this legislation might impact your business, please consult a Dickinson Wright attorney for additional details on this program.



Financial Crisis Fallout in the Real Estate Market – Challenges and Opportunities

by John G. Cameron, Jr., November, 2008

A combination of events, including artificially low interest rates, mark to market, a Congress-based initiative to encourage home ownership by persons previously thought to be unqualified for mortgage loans, rating agency errors, and a general lack of confidence, all have contributed to the cause of the current financial crisis. Many of these factors pertain directly to real estate-based loans. While Congress has attempted to provide relief to at-risk homeowners and capital intended to unlock credit, the most significant action remains likely to lie in two areas—the unwinding of the various loan syndications, and the need for lending to continue even as lenders seek to rid their balance sheets of toxic debt. Challenges and opportunities abound.

Part 1: Challenges

Government Programs

Under the recently-created Troubled Asset Relief Program, commonly called “TARP,” the Treasury Department is authorized to acquire mortgages and mortgage-backed securities and must implement a plan to mitigate foreclosures and encourage servicers of mortgages to modify loans. However, since most mortgages have been bundled and sold, it may be difficult to deal with individual mortgages. One challenge, then, is how to distinguish troubled assets from those that are not troubled. How do you unbundle the bundle? Mortgage servicers need to be aware of the tax ramifications of the mortgage-backed securities market, particularly the adverse tax consequences that can arise when a “qualified mortgage” is modified in an “economically significant manner.” Lenders involved in securitized loans will face a different challenge—how to break through the layers and collect what they are owed. Dickinson Wright lawyers are familiar with these complex regulations and can help guide mortgage servicers through them.

Under the analogous Whole Loan Mortgage Program, loans will be purchased from regional banks one by one. This may present an organizational nightmare. How will the government purchase so many loans one at a time? Will it be possible to provide the kind of relief sought before homeowners are dispossessed? What factors will enable a bank to sell its troubled mortgages before its competitor does? This is a challenge for the government, homeowners and lenders alike.

Credit Challenges

Credit is the lifeblood of real estate. Yet newspaper headlines continue to note the tightening of credit and the unwillingness of lenders to lend. LIBOR hit historic highs. Banks lack confidence in one another, and borrowers are in peril. Even borrowers who have consistently made their payments on time may face acute challenges. A borrower may unwittingly be in default even though no payments have been missed—loan documents typically contain various covenants, particularly financial targets, that must be met. All across the country otherwise reliable borrowers are being denied credit because of lender insecurity, a direct

result of the financial crisis. Borrowers may want to dust off their loan documents and have their Dickinson Wright lawyer review the fine print. And what if your lender is placed in receivership, forcing you to deal with a person less friendly than your former loan officer? Borrowers in that position may wish to seek counsel from a Dickinson Wright lawyer who remembers the Savings and Loan debacle of the late 1980s and who understands how to deal with receivers.

Part 2: Opportunities

As we noted in Part 1 of this client alert, the financial crisis presents many challenges, but also may present opportunities.

Is your loan about to mature? There is no need to panic. Creditworthy customers retain the ability to borrow. However, “creditworthy” has a new definition. The days of a 70-80 percent debt to equity ratio in real estate loan transactions are behind us. The new benchmark is 60 percent or less. Lenders also are demanding a clear path to repayment as a prerequisite to any lending activity. Even then, loans are more expensive today than they were a year ago, both in terms of interest rate and borrowing cost. To protect themselves, borrowers, particularly those with maturing loans, should scrupulously comply with all aspects of their loan documents, maintain regular contact with their loan officers and manage their businesses defensively. A Dickinson Wright real estate lawyer can help you identify potential pitfalls and overcome them.

Mezzanine lenders, whose debt may be treated as equity for purposes of garden-variety borrowing activity, may have opportunities as a result of the commercial banks’ insistence upon greater equity. Carefully structured mezzanine debt may be an attractive way to add equity to a real estate project, and mezzanine loans can be very profitable for the lender and very helpful to the borrower. Dickinson Wright lawyers are experienced in dealing with mezzanine debt.

There also will be opportunities for private equity firms as the government implements the TARP program and Whole Loan Mortgage programs, purchases troubled assets and then offers them for resale. Cash is king, and private equity firms that have or are able to raise cash may well find themselves in a position to purchase assets that, while troubled at their original cost, are bargains as offered for resale. Dickinson Wright real estate lawyers can help structure the deals, perform the due diligence and successfully close the transaction.

Finally, the government is going to need help. Appraisers, brokers, property managers and other industry players should be on the lookout for opportunities to profit from government-contracted work.

Dickinson Wright real estate lawyers can help you overcome the challenges and take advantage of the opportunities that lie ahead in the real estate industry. Contact one of us for dependable, knowledgeable assistance.

Loans From the Government to Provide Some Relief to the Automotive Sector

November, 2008

The North American automotive industry is in extreme turmoil. The domestic OEMs are fighting for survival. At their current pace, some are facing accelerating liquidity challenges. GM, in a recently filed 10-Q, said that “even if we implement the planned operating actions that are substantially within our control, our estimated liquidity during the remainder of 2008 will be at or near the minimum necessary to operate our business.” Bankruptcy is not out of the question in the absence of federal support. Tight credit, poor economy, increased fuel costs and “right-sizing” of the domestic automotive industry, among other issues, are creating enormous challenges. The number of vehicles produced in North America has declined significantly. Experts estimate that as much as twenty percent of the publicly traded automotive suppliers will face financial trouble within the next twelve months. Of privately held companies, nearly half are experiencing some potential financial distress. To make matters worse for the automotive sector, the US and the rest of the world seem to be heading into a recession which some are predicting could last for years.

In response to the crisis, the U.S. government has taken an initial step in trying to help domestic OEMs and their suppliers obtain financing needed to retool plants and equipment to produce energy-efficient vehicles. On November 5, 2008, the Department of Energy (DOE) issued its eligibility and application rules loans under the Advanced Technology Vehicles Manufacturing Incentive Program (ATVMIP). ATVMIP authorizes up to \$25 billion in grants and loans to eligible applicants for the costs of reequipping, expanding, and establishing manufacturing facilities in the US to produce advanced technology vehicles that

Executive Compensation Restrictions on Financial Institutions that Participate in the Capital Purchase Program

by Cynthia A. Moore, November, 2008

Financial institutions that participate in Treasury’s Capital Purchase Program (“CPP”) must comply with four restrictions on executive pay. These limitations apply to each year that the financial institution participates in the CPP.

1. Limit on Deduction. Under existing law, public companies cannot deduct pay to key executives that is greater than \$1,000,000. Under the CPP, financial institutions cannot deduct pay to “senior executive officers” that is greater than \$500,000. In addition to the lower limit, there are several other important differences from the existing limitation:

- The limit also applies to private companies.
- The exception for performance-based compensation does not apply, so items such as performance-based bonuses will be counted in the \$500,000 cap.
- Deferred compensation that is earned in a current year but paid in a future year will be subject to the \$500,000 cap in that future year generally based on the difference between the amount deducted in the current year and \$500,000.

The senior executive officers (SEOs) affected by the limitation are the financial institution’s CEO, CFO and the next three most highly compensated executive officers, generally determined under the SEC’s proxy rules.

2. Limit on Severance Payments. A financial institution must prohibit any golden parachute payment to an SEO. For this purpose, a golden parachute payment is:

- Made to an SEO in the event of (A) an involuntary termination of employment or (B) in connection with any bankruptcy filing, insolvency or receivership of the financial institution; and
- The aggregate present value of the payment equals or exceeds an amount equal to three

times the SEO’s “base amount.” The “base amount” is, generally, the SEO’s prior 5-year average compensation.

3. “Clawback” on Executive Bonuses. Bonuses and incentive compensation paid to an SEO are subject to recovery or “clawback” if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria. This is somewhat similar to, but broader than, the Sarbanes-Oxley Act rule that requires a clawback of CEO and CFO bonuses in the event of material misstatements in financial statements.

4. Risk Assessment. Within 90 days after a purchase under the CPP, the financial institution’s Compensation Committee must review the SEO incentive compensation arrangements with the senior risk officers to ensure that such arrangements do not encourage SEOs to take risks that threaten the value of the financial institution. The Compensation Committee must then meet at least annually with the senior risk officers to discuss the relationship between the financial institution’s risk management policies and the SEO incentive compensation arrangements. The Compensation Committee must certify that it has undertaken these reviews. A public company must include the certification in the Compensation Discussion and Analysis portion of its annual proxy statement and a private company must file the certification with its primary regulatory agency.

Participating in the CPP will likely benefit the financial institution and its shareholders in the long run, but it should also consider the impact on the attraction and retention of key executives in the short run. The financial institution should consider whether agreements with SEOs must be amended to reflect the new restrictions and institute controls to ensure that the restrictions on executive pay are appropriately monitored and applied.

provide meaningful improvements in fuel economy performance, and components for such vehicles. The DOE Rules are effective immediately and allow DOE to begin accepting applications. Although the DOE Rules cover both loan and grant programs, presently, Congress has only appropriated funds for the loan portion of the program.

Applicant Eligibility Requirements

- The applicant must be either an automobile manufacturer with projects reasonably connected to the production of “Advanced Technology Vehicles”, i.e., vehicles 25% more fuel efficient than baseline 2005 vehicles or a manufacturer of components designed for Advanced Technology Vehicles for the purpose of meeting fuel efficiency requirements.
- The applicant must be “financially viable,” without receipt of additional Federal funding associated with the project. “Financially viable” means a reasonable prospect that the applicant will be able to make payments of principal and interest on the loan as and when such payments become due under the terms of the loan documents, and that the applicant has a net present value that is positive, taking all costs, existing and future, into account.
- The manufacturing facilities must be located in the U.S.
- Engineering integration must be performed in the U.S.

Eligible Costs Include

- The loan proceeds can be used to cover costs reasonably related to reequipping, expanding or establishing a manufacturing facility in the US to produce Advanced Technology Vehicles or qualifying components.
- The loan proceeds can be used to cover costs of engineering integration performed in the US for qualifying vehicles or components.
- The loan proceeds can be used for the cost of designing tools and equipment, developing manufacturing processes, and the facilities utilized in producing qualifying vehicles or components.

Application Requirements

Applications will be reviewed in quarterly tranches. The first tranche applications, which must be submitted by December 31, 2008, will be reviewed as they are submitted. Subsequent applications will be reviewed at the end of the quarterly tranche periods (i.e., March 31, 2009, June 30, 2009, etc.) as long as funds are available. The application must include:

- a description of the project, including key milestones;
- an explanation of how the project qualifies under law to receive the loan;
- a detailed estimate of the total project costs together with a description of the methodology and assumptions used to produce that estimate;
- an overall financial plan and business plan for the project;
- an analysis of projected market use for any product (vehicle or component) to be produced by or through the project;
- financial statements for the last 3 years;
- a listing of assets to serve as collateral;
- proof that applicant is financially viable; and
- assurances that the laborers and contractors will be paid prevailing wage rates.

Factors That May Create Priority

Priority may be given to:

- those facilities that are oldest or have been in 1. existence for at least 20 years, even if such facilities are idle at the time of application;
- the technical merit of the components, with greater 2. weight to those relating to improved fuel economy and have a greater potential contribution to improve fuel economy;
- promotion of the use of advanced fuel (e.g. E85, 3. ultra low sulfur diesel) and potential reductions in petroleum use;
- economic development and diversity in technology, 4. company, risk, and geographic location;
- the adequacy of the proposed provisions to protect 5. the Government, including offers of participation in project gains, sufficiency of the collateral and priority of lien position in the collateral (note that the government must have a priority security interest in any property purchased with loan proceeds, unless waived by the DOE Secretary); and
- lower percentage of the project to be financed with 6. the loan (the Federal loan may constitute up to 80% of the project's cost).

Also, note that at least 10% of available funds are set aside for automotive suppliers with less than 500 employees.

OEMs and suppliers that want to take advantage of this program will need to act quickly. Dickinson Wright can assist in the application process. For more information, please contact your primary Dickinson Wright attorney.

FDIC Breaks Ranks with Administration on Mortgage Loan Modifications

by John K. Lawrence, November, 2008

In a potentially significant harbinger of coming developments, the Federal Deposit Insurance Corporation published on November 14 a proposal to promote mortgage loan modifications as a key element of the Federal government's response to the continuing credit crisis. The announcement comes only two days after Secretary of the Treasury Henry Paulson mentioned, but did not endorse, the plan.

Under the FDIC's proposal, the Federal government would provide mortgage servicers up to \$1,000 to cover the expenses associated with each mortgage loan modification, and would share up to 50% of the losses resulting from a re-default on a loan modified in accordance with the program. The FDIC estimates that 1.4 million loans not involving Fannie Mae or Freddie Mac were 60 days or more delinquent in June, 2008, and that an additional 3 million such loans will become delinquent by the end of 2009. The agency believes the program could successfully be applied to one-half, or 2.2 million, of those 4.4 million mortgage loans.

Temporary Liquidity Guarantee Program Deadline Approaches; FDIC Announces Changes

by John K. Lawrence, November, 2008

With a December 5 deadline approaching, financial institutions must decide whether to continue to participate in the Temporary Liquidity Guarantee Program ("TLG") of the Federal Deposit Insurance Corporation ("FDIC"). The FDIC made substantial changes to the program on November 21.

The TLG was established by the FDIC last month to preserve confidence and encourage liquidity in the banking system. The TLG has two parts. The first is the Debt Guarantee Program. It has automatically provided a temporary FDIC guarantee of eligible senior unsecured debt (other than overnight debt instruments) issued on or after October 14, 2008 (and before June 30, 2009) by FDIC-insured banks or savings associations, their qualifying holding companies, and by affiliated entities approved by the FDIC. The temporary guarantee of debt of eligible entities expires if the entity opts out of the Debt Guarantee Program, or at the earlier of maturity of the debt or June 30, 2012.

The second part of the TLG is the Transaction Account Guarantee Program. It provides an FDIC guarantee, of amounts in excess of the recently-revised FDIC insurance maximum of \$250,000 per account, for all non-interest bearing transaction accounts.

The TLG has applied, without charge, to all eligible institutions until the December 5 opt-out deadline. Going forward, however, the FDIC will assess fees on participating entities. As originally adopted,

the FDIC was to assess an annualized flat fee of 75 basis points on the amount of senior unsecured debt guaranteed, and a fee of 10 basis points on non-interest bearing transaction account balances exceeding \$250,000.

On November 21, the FDIC modified both parts of the TLG. Among other things, the Debt Guarantee Program was revised to (i) exclude from the FDIC guarantee all debt obligations having a maturity of 30 days or less, (ii) change the pricing of the debt guarantee, from a flat fee for all guaranteed debt, regardless of maturity, to a sliding scale of annualized fees ranging from 50 basis points for qualifying debt with a maturity of 180 days or less, to 100 basis points for obligations with a maturity of 365 days or more (with higher fees for obligations of certain entities), (iii) clarify that the FDIC would make scheduled payments of principal and interest to holders of guaranteed debt upon a payment default by the participating entity (rather than only after the entity's insolvency or bankruptcy), and (iv) require each participating entity to enter into a Master Agreement with the FDIC. The FDIC also expanded the Transaction Account Guarantee Program to include certain low-interest negotiable order of withdrawal (NOW) and other accounts.

The FDIC's modifications include disclosures which must be made in senior unsecured debt issued by entities participating in the Debt Guarantee Program. Also included are notices to be posted in branch offices and on the website of each FDIC-insured institution offering the types of accounts covered by the Transaction Account Guarantee Program, **whether or not** the institution participates in the program. Those disclosures must be in place by December 19, 2008.

Each institution, generally acting through its top-tier holding company, must file a form with the FDIC not later than Friday,

The FDIC plan would apply only to owner-occupied properties and would require that loan payments be reduced to not more than 31% of the borrower's income. This is a more conservative figure than the 38% maximum included by Fannie Mae and Freddie Mac in their loan modification program, announced on November 11.

To participate in the FDIC plan, mortgage servicers would be required to conduct systematic loan reviews of their entire servicing portfolio, applying a standardized test of each loan's expected net present value ("NPV") compared to an anticipated foreclosure recovery for the loan. A participating servicer would agree that each loan passing the NPV test would be modified.

The government loss-sharing percentage on modified loans would be progressively reduced from 50% to 20% for loans secured by properties having a value less than the mortgage balance, depending on the loan-to-value ratio. In addition, to encourage meaningful loan relief, no loss-sharing would be available if the payment reduction were less than 10%, or if re-default occurred before the borrower had made six payments under the modified loan. Government loss-sharing would expire eight years after the modification took effect.

The FDIC projects that one-third of the mortgage loans modified under its plan would be subject to re-default. Accordingly, the FDIC estimates restructuring of the 2.2 million mortgage loans on the terms proposed would reduce foreclosures by almost 1.5 million homes at a cost to the government of \$24.4 billion. Reduction of loan foreclosures could have a significant stabilizing effect on real estate values.

Sheila Bair, Chairman of the FDIC, has consistently advocated an aggressive approach to restructuring of mortgage loans as a means of ameliorating the liquidity crisis afflicting credit markets. The plan is based on the FDIC's experience in restructuring some 3,500 mortgage loans held by IndyMac Bank. The FDIC is receiver of IndyMac Bank, which failed in July.

The willingness of the FDIC, an independent agency located in the Treasury Department, to publish its plan without the support of the Treasury Secretary is remarkable. The FDIC plan has attracted support from influential members of Congress, including Senator Christopher Dodd (D. Conn.), Chair of the Senate Banking Committee. In the continuing search for solutions to the credit crisis, it may prove to be the basis for further governmental action.

December 5, if it chooses **not** to participate in either or both parts of the TLG. The same election will apply to a holding company and all its subsidiaries. Failure to file a form with the FDIC by December 5 constitutes an irrevocable election to participate in the TLG and to pay the requisite fees.

Treasury's Public-Private Investment Program: The Legacy Loans Program

by John K. Lawrence, March, 2009

On March 23, Treasury Secretary Timothy Geithner detailed the Public – Private Investment Program (“PPIP”) portion of the Financial Stability Plan. In cooperation with private capital, the PPIP seeks to encourage resumption of normal lending by financial institutions through improvement of their balance sheets, and to restore the functioning of secondary markets for securities backed by real estate and consumer loans, in part by reducing uncertainty regarding the values of such securities.

The PPIP has two parts. The first, called the Legacy Loans Program (“LLP”), combines equity capital from the Treasury and approved private investors with loans guaranteed by the Federal Deposit Insurance Corporation (“FDIC”) to permit the purchase of troubled commercial and residential real estate loans and other assets from insured depository institutions. The second part, called the Legacy Securities Program, looks to engage private equity capital with equity from the Treasury and financing provided by the Federal Reserve under its Term Asset-Backed Securities Loan Facility (“TALF”) to stimulate purchases of asset-backed securities. Another Client Alert considers the Legacy Securities Program.

The continued constriction of credit available from banks in part reflects the overhang of illiquid non-performing loans and other assets on their books. The LLP seeks to harness private sector capital and valuation skills with additional equity furnished by Treasury and advantageous debt financing to relieve bank balance sheets and stimulate lending.

Any domestic FDIC-insured bank or savings association, irrespective of size, in consultation with its primary Federal regulator, may identify loans that it would like to sell under the LLP.¹ The FDIC has stated that it will focus initially on troubled residential and commercial real estate loans, although other types of loans and assets may be accepted later. Loans will be assembled into a pool for sale.

Each pool will be purchased by a Public-Private Investment Fund (“PPIF”), formed and operated under the oversight of the FDIC. As announced, the Treasury intends that each PPIF will be funded by equal amounts of equity contributed by Treasury and private investors, together with the proceeds of debt issued by the PPIF and guaranteed by the FDIC. The amount of Treasury equity may vary, subject to a minimum to be established.

The FDIC will hold an auction for each pool, at which approved private investors will bid for the private equity stake. The amount of debt that the FDIC will guarantee for the pool will depend upon the winning private equity bid amount and the FDIC's own analysis of the pool's contents. The maximum debt-to-equity ratio the FDIC will permit for any pool is 6:1.

The amount of the winning bid (together with Treasury's equity contribution and the amount of debt the FDIC will guarantee on the pool) will determine the price to be paid for the pool. If that price were accepted by the selling bank, the pool would be transferred to the PPIF. As announced, the form of payment to be received by the selling bank may be cash or cash and an FDIC-guaranteed note of the PPIF. The private investors will control the pool assets through an asset manager approved and subject to oversight by the FDIC.

Implementation of the LLP requires adoption of rules following public comment, which the FDIC requested on March 26, with a submission deadline of April 10. Banks should take the opportunity to comment, as the rules may significantly affect the desirability for them of the terms of the LLP.

TARP Phase II: U.S. Treasury Initiates Capital Assistance Program

by John K. Lawrence, March, 2009

The Treasury Department, in conjunction with the Federal bank regulatory agencies, has launched its latest program to provide capital support to U.S. banking organizations. The Capital Assistance Program (“CAP”) is a core element of the Administration's Financial Stability Plan.

The CAP combines a special forward-looking “stress test” evaluation of the capital position of the largest U.S. financial institutions with the availability of additional capital infusions from the U.S. government for all eligible financial institutions. The “stress test” is a special, coordinated, supervisory capital planning exercise with the nation's largest financial institutions, being undertaken in view of heightened market uncertainty, to restore confidence in the nation's financial system.

The CAP is being implemented initially for publicly-traded institutions. For the largest such banking organizations, participation is mandatory; other publicly-traded institutions which are eligible may choose to apply to participate. Any Qualifying Financial Institution (“QFI”) is eligible. Applications are due by May 25, 2009.

Largest Banking Organizations

The largest 19 banking organizations in the nation, (those having assets in excess of \$100 billion), have been directed by their respective Federal banking regulators to conduct a special self-assessment of capital position on a prospective basis for the next two years. This assessment is to be based on two different sets of economic assumptions; i.e., (i) a baseline scenario, which represents the average consensus projections of several surveys of economists conducted in February, for gross domestic product (“GDP”) (-2.0% in 2009, and +2.1% in 2010), national unemployment (8.4% in 2009, and 8.8% in 2010), and house prices (-14% in 2009, and -4% in 2010); and (ii) a more adverse scenario constructed by the regulatory agencies, projecting a longer and deeper recession, with GDP at -3.3% for 2009 and +0.5% in 2010, national unemployment at 8.9% in 2009 and 10.3% in 2010, and house prices change of -22% in 2009 and -7% in 2010.

Each of the largest organizations will report, in a standard format, the losses on loan and securities portfolios, off-balance sheet commitments, and contingent liabilities and exposures it estimates would result under each of the two scenarios. In addition, each organization will project internal resources available to absorb such losses, such as net revenues and allowance for loan losses.

Each banking organization's assessment will be reviewed on an interagency basis by its Federal regulators, who will also meet with senior management to discuss the forecasts and institution-specific potential losses and resources. Among the factors which the regulators will consider are: asset quality and concentrations; the potential for unanticipated losses and declines in asset values; contingent liabilities (such as implicit and explicit liquidity and credit commitments); the composition, level and quality of the organization's capital; and its ability to raise additional common stock or other capital in the market. Based upon that analysis, the regulators will determine the need for, and amount of, any additional capital cushion. The regulators are to complete these evaluations and make their determinations by the end of April.

If an additional capital cushion is needed, the institution will be required to execute a conditional commitment to issue to Treasury its convertible preferred stock meeting the CAP requirements discussed below in an amount sufficient to provide the additional capital. The institution will be permitted, if it wishes, a period of six months to raise the required amount through private capital markets, and to cancel the commitment without penalty upon successful completion of the private capital issuance. If private capital is not raised, the Treasury will purchase the required convertible preferred stock.

Other Banking Organizations

Publicly-traded banking organizations with assets less than \$100 billion are not required to perform the special "stress test" self-assessment. Moreover, their participation in the CAP is voluntary.

The Treasury has indicated that the selection criteria and process for participation in the CAP will be consistent with those established for the earlier Capital Purchase Program ("CPP") under the first tranche of the Troubled Assets Relief Program ("TARP"). Accordingly, eligibility as a QFI, and approval by both the Treasury Department and the organization's Federal banking regulator, will be required to participate in the CAP. An institution may apply to issue its convertible preferred stock in an amount equal to not less than 1%, and not more than 2%, of its total risk-weighted assets, plus any additional amount if the proceeds are used by the institution to redeem preferred shares it previously sold to Treasury under the CPP.

A common form of Application for the CAP has been jointly issued by the Federal banking agencies. An organization desiring to apply is instructed to consult with its primary Federal regulator before submitting an Application. The definitive agreements and related documents to be executed by successful applicants, including definitive terms and conditions and applicable representations, warranties, and undertakings, have not yet been published.

Applications must be submitted by May 25, 2009. Applications are to be filed with the applicant's primary Federal bank regulatory agency. In the case of holding companies, the Application is to be filed with both the holding company regulator and the regulator of the applicant's largest depository institution subsidiary. Applicants receiving conditional approval will have six months from date of notification to submit all investment agreements and related documentation.

CAP Capital Instruments

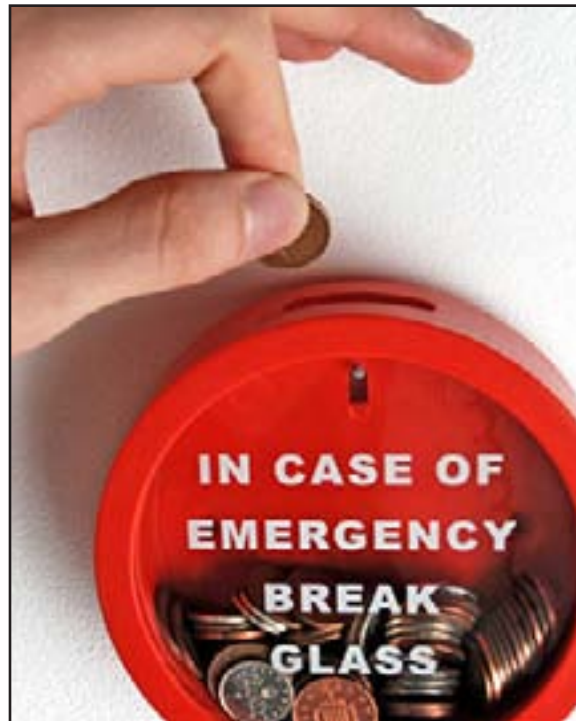
The securities to be issued to Treasury under the CAP will be mandatorily convertible preferred stock carrying a 9% cumulative dividend compounding quarterly ("CAP preferred stock"). The CAP preferred stock will be subject to conversion into common stock at the option of the issuer (with approval by its primary Federal bank regulator), generally at 90% of the average common stock price for the 20 trading days preceding February 9, 2009 (the "Conversion Price"). If not sooner converted or redeemed, the CAP preferred stock will mandatorily convert to common stock seven years after issue at the Conversion Price.

Subject to regulatory approval, the CAP preferred stock may be redeemed by the issuer, in whole or in part, with the cash proceeds of issuances of common stock aggregating not less than 25% of the issue price of the

CAP preferred stock, or from additions to retained earnings. The redemption price will vary depending upon the time of redemption. During the first two years, the preferred stock may be redeemed at par plus accrued and unpaid dividends. At any time thereafter, the redemption price will be the greater of (i) par plus accrued and unpaid dividends, and (ii) the as-converted value.

As holder of the CAP preferred stock, the Treasury will have only class voting rights on limited questions, such as authorization or issuance of shares ranking senior to the CAP preferred stock, or a merger or other transaction that would adversely affect the rights of the CAP preferred stock. In the event of non-payment of dividends for six dividend periods (whether or not consecutive), however, Treasury would be entitled to elect two directors.

If the CAP preferred stock were converted to common stock, Treasury would have the same voting rights as other holders of such common stock. Treasury will publish principles governing its



use of such voting rights, and intends to make reasonable efforts annually to sell at least 20% of the total common stock owned by it on the date of mandatory conversion until its ownership is reduced to zero. In addition, subject to regulatory approval, the organization would be permitted to repurchase, at the greater of the Conversion Price and market price, from cash proceeds of issuance of common stock or additions to retained earnings, any common stock held by Treasury.

As noted above, a banking organization of any size participating in the CAP may include in its issuance of CAP preferred stock an amount sufficient to allow it to use the proceeds to redeem preferred shares sold to Treasury under the earlier CPP. Such proceeds will constitute qualified equity offering proceeds under the CPP, and thus will reduce the number of shares of common stock underlying the warrant issued to Treasury under the CPP.

Organizations participating in the CAP will be subject to a number of restrictions while the CAP preferred stock is held by the Treasury. No dividend may be paid on junior preferred or common equity unless all accrued dividends on the CAP preferred stock are first paid in full. Moreover, the amount of dividends payable on common stock may not exceed \$0.01 per share unless the Treasury consents. In addition, any share repurchases or redemption of junior preferred or common equity would generally require the Treasury's consent.

Participating institutions would also be required to comply with the limits on executive compensation under the Emergency Economic Stabilization Act ("EESA") as amended, and Treasury's regulations implementing them. In addition, each institution must submit a plan concerning its intended use of the capital received to increase lending above the level that would have been achieved in the absence of such investment, which will be made public by the Treasury. Each participating organization will also be required to submit monthly reports on its lending, broken out by category. Those reports will also be made public.

In conjunction with the issuance of the CAP preferred stock, each participating banking organization will be required to issue to Treasury immediately-exercisable, 10-year warrants to purchase a number of shares of the organization's common stock having an aggregate market value equal to 20% of the CAP preferred stock amount on the date of Treasury's investment. The initial exercise price for the warrants, and the market price for determining the number of shares of common stock subject to the warrants, will be the Conversion Price, subject to customary anti-dilution adjustments.

The Treasury has indicated that it will agree not to vote any shares of common stock issued to it upon exercise of the warrants. In addition, following redemption in full of the CAP preferred stock by the banking organization, it will have the right to repurchase the warrants and any common stock held by Treasury under the CAP at fair market value.

Conclusion

The CAP represents an important part of the Administration's Financial Stability Plan. The "stress test" portion of the CAP, by focusing on the largest financial institutions, which control a substantial majority of the nation's banking assets, seeks to address the concerns of the financial markets and restore confidence in the nation's financial system as a whole. The capital provision available under the CAP furnishes an opportunity to bolster the capital position of any eligible banking organization, regardless of size, at a time of continued constriction of supply in private capital markets.



Elements of continuity with the first phase of TARP remain, because the process and criteria to be applied under the CAP seem to be modeled on those applied by Treasury and the Federal bank regulatory agencies under the CPP. That process was characterized by opacity regarding the selection criteria and some well-publicized examples of questionable awards of capital to institutions, some of which may have involved application of improper political influence. Although Treasury Secretary Geithner indicated on his first day in office a determination to eliminate improper lobbying, some questions must remain at this stage concerning the transparency and fairness of the program.

At the same time, the added layers of detailed public reporting of lending activity and restrictions on common stock dividends and executive compensation inherent in the CAP introduce an enhanced level of governmental involvement for participating institutions. Were the CAP preferred stock

to be converted to common stock, the Treasury could become a major or controlling shareholder of the institution. The principles to be followed by Treasury in exercising voting rights on common stock acquired by it under the CAP have not yet been released.

Treasury's Public-Private Investment Program: The Legacy Securities Program REVISED

by John K. Lawrence, April, 2009

On April 6, the U.S. Treasury announced revisions to part of the Public – Private Investment Program ("PPIP") recently detailed by Secretary Geithner. In cooperation with private capital, the PPIP seeks to encourage resumption of normal business and consumer lending by financial institutions through removal of troubled assets from their balance sheets, and to restore the functioning of secondary markets for securities backed by real estate and consumer loans by improving liquidity, and reducing uncertainty regarding the values, of such securities.

The PPIF has two parts. The first, called the Legacy Loans Program, combines equity capital from the Treasury and private investors with loans guaranteed by the Federal Deposit Insurance Corporation to acquire troubled loans from insured depository institutions. The second, called the Legacy Securities Program (“LSP”), looks to engage private capital with equity from the Treasury and financing provided by the Federal Reserve under its Term Asset-Backed Securities Loan Facility (“TALF”) to stimulate purchases of asset-backed securities (“ABS”). On April 6, Treasury extended application deadlines and made other changes to the LSP.

Since last fall, ABS markets have substantially ceased to function. Investors have been unwilling to trade ABS, many of which are complex and difficult to value. Treasury believes this illiquidity has caused ABS to clog balance sheets of financial institutions, impairing credit availability.

The LSP also has two parts. The first will expand TALF to include certain older ABS (“Legacy TALF”). The second involves the creation of Public-Private Investment Funds (“PPIF”), which combine private and Treasury equity capital in investment funds managed by private firms selected by Treasury. PPIF will invest in certain types of ABS.

Legacy TALF

The Federal Reserve announced TALF last November, to finance purchases of ABS backed by newly-generated, non-real estate consumer and small business loans. Treasury previously announced that under Legacy TALF non-recourse loans would be made available to finance ABS backed by real estate mortgages. On April 6, Treasury clarified that participation in LSP will not be required to obtain loans under Legacy TALF. The Federal Reserve has not yet announced the terms of Legacy TALF.

Treasury expects that some ABS originally rated AAA, issued by non-governmental entities and backed by residential mortgage loans, and some ABS currently rated AAA and backed by commercial real estate loans, will be eligible for Legacy TALF. The age of qualifying ABS, eligibility criteria for borrowers, discounts applicable to specific assets, and loan interest rates, minimum amounts, and maturities, have not been determined.

PPIF

As revised on April 6, Treasury will accept proposals through April 24 for pre-qualification as one of five (or possibly more) initial fund managers (“FM”) that will establish and manage PPIF. To be pre-qualified, an applicant must satisfy anticipated criteria, including having capacity to raise \$500 million in private equity and at least \$10 billion in Eligible Assets already under management. Treasury will consider proposals “holistically;” that is, failure to meet one criterion will not necessarily disqualify a proposal. Treasury stated that it is seeking innovative proposals, such as ones involving participation by small and veteran-, minority-, or women-owned firms, or that would raise equity capital from retail investors. Treasury expects to act on FM proposals by May 15. A pre-qualified FM must raise \$500 million in private investor equity within 12 weeks after selection.

PPIF are established to purchase “Eligible Assets;” that is, ABS originally rated AAA (without rating enhancement) and issued by private entities before 2009, that are directly backed by predominantly domestic commercial or residential mortgage loans purchased from domestic financial institutions.

Treasury will make an equity investment in each PPIF, in an amount to be determined in each case, up to 100% of its private capital, simultaneously with the PPIF’s investment of the private capital in Eligible Assets. As required by law, each PPIF will issue warrants to Treasury. Treasury loans may also be available to PPIF.

On April 6, Treasury announced it is considering three debt structures for PPIF. In one, PPIF receiving no LSP loans could obtain debt financing from Legacy TALF, other Treasury programs, or private lenders. In another structure, any PPIF that did not permit private investors to withdraw capital could request secured non-recourse Treasury loans equal to up to 50% of its total equity (or up to 100% of equity if it accepted additional restrictions), but no other debt financing would be permitted. In the third, Treasury would make unsecured loans (up to 50% of PPIF equity) that could be combined with financing from TALF, other Treasury programs, or private loans, subject to total leverage limits to be determined. Interest rates and maturities of Treasury loans would reflect total leverage and market conditions.

Treasury’s intended long-term strategy is “buy and hold,” although it will consider limited trading of Eligible Assets. The FM will control selection, pricing, liquidation, trading, and disposition of the PPIF’s Eligible Assets. An FM may not, however, engage in purchase or sale transactions of Eligible Assets, directly or indirectly, with any of its affiliates, any other PPIF, or any private investor that has committed 10% or more of the private capital of the PPIF. Each FM, but not passive private investors, will be subject to executive compensation and other fraud and abuse restrictions, as well as governmental audits.

Treasury is expected to adopt final terms for PPIF as it selects the FM and investments begin. On April 6, Treasury suggested that smaller FM may be approved following selection of the initial pre-qualified FM.