



# THOMPSON HINE

October 2008

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## Summary of the Troubled Assets Relief Program (“TARP”)

Minutes ago the U.S. House of Representatives passed the Emergency Economic Stabilization Act of 2008 (the “Act”), which the U.S. Senate passed on Wednesday. The President is expected to sign the Act into law immediately. The Troubled Assets Relief Program (“TARP”), the fundamental component of the Act, gives broad authority to the Secretary of the Treasury (the “Secretary”) to purchase troubled assets. A summary of TARP follows.

### TRoubLED ASSETS RELIEF PROGRAM

The goal of the Act is to restore liquidity and stability to the financial system of the United States. However, the broad authority granted to the Secretary under the Act must be exercised in a manner that protects home values, college funds, retirement accounts and life savings; preserves homeownership; promotes jobs and economic growth; maximizes overall returns to the taxpayers of the United States and provides public accountability for the exercise of such authority.

**Purchase of Troubled Assets.** The Secretary has broad power to take the actions he deems necessary to purchase troubled assets from any financial institution. These powers include designating financial institutions as financial agents of the Federal Government and establishing vehicles that purchase, hold, and sell troubled assets and issue obligations.

The Secretary, however, must consider several specified factors when deciding to purchase troubled assets, including: protecting the interests of taxpayers, providing stability to the financial markets, preserving homeownership, the long-term viability of the financial institution, ensuring participation of all financial

institutions regardless of size or other characteristics, assisting retirement plans that hold troubled assets and the needs of local communities.

**Troubled assets** means:

- residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages that in each case were originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and
- any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress.

**Financial institution** means:

- 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 or any State, territory, or possession of the United States, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa or the United States Virgin Islands, and having significant operations in the United States but excluding any central bank of, or institution owned by a foreign government.

**Establishment of Purchasing Standards.** Within 45 days from the enactment of this Act (or sooner if the Secretary purchases troubled assets before then), the Secretary will publish program guidelines setting forth:



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- the mechanisms for purchasing troubled assets,
- methods for pricing and valuing troubled assets,
- procedures for selecting asset managers, and
- criteria for identifying troubled assets for purchase; but note that no troubled asset may be purchased at a higher price than what the seller paid to purchase the troubled asset (unless the troubled asset was acquired from the financial institution under receivership, conservatorship or bankruptcy).

The Act directs the Secretary to make such purchases at the lowest price that the Secretary determines to be consistent with the purposes of this Act and to ensure that prices paid for assets are reasonable and reflect the underlying value of the asset.

**Management/Sale of Troubled Assets.** The Secretary will also have authority to manage troubled assets purchased under this Act and to sell or enter into securities, loans, repurchase transactions, or other financial transactions with respect to any troubled asset purchased under this Act. The proceeds of such sales will be paid into the general fund of the Treasury for reduction of the public debt.

**Insurance of Troubled Assets.** Once the Secretary establishes the TARP program, he is also required to establish a guarantee program for the payment of principal and interest of the troubled assets. This guarantee program is available to financial institutions as an alternative to the purchase program. Any financial institution may request a guarantee and will be charged premium payments. The premium payments will be deposited into the Troubled Assets Insurance Financing Fund and payments will be made from the fund to fulfill obligations under the guarantees. The ability of the Secretary to purchase troubled assets will be reduced by an amount equal to the difference of the total outstanding guaranteed obligations and the balance in the Troubled Assets Insurance Financing Fund.

### **Oversight.**

**Oversight Board.** A Board comprised of the Chairman of the Board of Governors of the Federal Reserve System, the Secretary, the Director of the Federal Housing Finance Agency, the Chairman of the Securities Exchange Commission, and the Secretary of Housing and Urban Development has the authority to review the exercise of authority under the Act; to make recommend-

ations, as appropriate, to the Secretary regarding use of the authority under this Act; and to report any suspected fraud, misrepresentation, or malfeasance to the Special Inspector General for the Troubled Assets Relief Program or the Attorney General of the United States.

**Comptroller General.** The Comptroller General of the United States is given the authority to monitor the activities and performance of TARP and of any agents and representatives of TARP, including vehicles established by the Secretary under this Act.

**Judicial Review.** The Act provides that the standard with respect to the Secretary's acts is limited to arbitrary, capricious, an abuse of discretion or not in accordance with law. There is no injunctive relief permitted with respect to purchases of troubled assets, insurance of troubled assets, management of troubled assets or foreclosure mitigation efforts. All other injunctions must be granted on an expedited basis. Unless expressly set forth in a written contract with the Secretary, no financial institution may bring an action or claim against the Secretary.

**Special Inspector General.** A new Special Inspector General for the Troubled Asset Relief Program will be appointed by the President, by and with the advice and consent of the Senate. The Special Inspector General will conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of the troubled assets by the Secretary; any program established by the Secretary; and the management by the Secretary of any program established.

**Congressional Oversight Panel.** An Oversight Panel consisting of members of the House of Representatives and the Senate is established pursuant to the Act. The Panel will review the current state of the financial markets and the regulatory system and will submit reports to Congress regarding the acts of the Secretary under the Act. The Panel will also submit a special report on regulatory reform to Congress.



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**Reporting Requirements.** Within 60 days of his first exercise of authority under this Act, the Secretary is required to deliver Monthly Reports to Congress that set forth the acts he has taken under TARP, the administrative expenses incurred and detailed financial statements. The Secretary is also required to deliver Tranche Reports to Congress for every \$50 billion in troubled assets purchased that set forth a detailed description of all transactions, a description of the pricing mechanisms used and a justification for the financial terms of such transactions. The final report that the Secretary is required to deliver to Congress is the Regulatory Modernization Report that sets forth the current state of the financial markets, the effectiveness of the financial regulatory system and provides recommendations.

**Foreclosure Mitigation Efforts.** For troubled assets that are mortgages, mortgage-backed securities and other assets secured by residential real estate, the Secretary, in coordination with other federal entities that hold troubled assets, will create a plan that seeks to minimize foreclosures for homeowners. The plan may incorporate the use of loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. The Secretary will also encourage the servicers of the underlying mortgages to take advantage of the HOPE for Homeowners Program. The HOPE for Homeowners Program (effective October 1, 2008) was adopted by Congress to provide assistance for homeowners struggling to meet mortgage payments. Through the program, qualified homeowners may be able to refinance their existing loans into new 30-year fixed rate mortgages with lower, sustainable rates, or other available programs to minimize foreclosures.

To the extent that a federal entity holds, owns, or controls mortgages, mortgage-backed securities and other assets secured by residential real estate, such federal entity will also create a plan that seeks to minimize foreclosures for homeowners. Such federal entity will use its authority to encourage the servicers of the underlying mortgage to take advantage of the HOPE for Homeowners Program or other available programs to minimize foreclosures.

To the extent that a federal entity is not the owner of a residential mortgage loan but holds an interest in pools of obligations secured by residential mortgage loans, the Federal property manager will encourage the loan servicers to implement loan modifications developed by such federal entity to minimize foreclosures.

**Maximization of Benefits for Taxpayers.** The Secretary is to use his authority in a manner that will minimize any potential long-term negative impact on the taxpayer, taking into account the direct outlays, potential long-term returns on assets purchased and the overall economic benefits of the program.

The Secretary may not purchase any troubled asset from a financial institution unless such financial institution complies with the following:

**Publicly Traded Institutions.** Any financial institution that is publicly traded must provide the Secretary a warrant for the right to receive nonvoting common stock or preferred stock in such financial institution, or voting stock, with respect to which the Secretary agrees not to exercise voting power, as the Secretary determines appropriate. The terms and conditions of such warrant must provide for reasonable participation by the Secretary in equity appreciation of such financial institution. The warrant must also contain anti-dilution provisions to protect the value of the securities from market transactions such as stock splits, stock distributions, dividends, and mergers.

**Privately Traded Institutions.** Any financial institution that is not publicly traded must provide the Secretary a warrant for common or preferred stock, or a senior debt instrument from such financial institution. The terms and conditions of such warrant must provide for reasonable participation by the Secretary in equity appreciation of such financial institution and the terms and conditions of such senior debt instrument must provide the Secretary a reasonable interest rate premium. Any warrant representing securities to be received by the Secretary under this subsection shall contain anti-dilution provisions to protect the value of the securities from market transactions such as stock splits, stock distributions, dividends and mergers.

The Secretary does have authority to create *de minimis* exceptions to these requirements based on the size of the cumulative transactions (not more than \$100,000,000).

**Executive Compensation and Corporate Governance.** A financial institution that sells troubled assets to the Secretary under this Act is subject to the executive compensation requirements described below.

**Direct Purchases.** Any financial institution must meet “appropriate standards” for executive compensation and corporate governance if the Secretary (i) makes a direct

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purchase of troubled assets from the institution where no bidding process or market prices are available and (ii) receives a “meaningful” equity or debt position in the institution as a result of the transaction. The “appropriate standards” will (and it appears that the Treasury has the authority to add others) restrict incentives that encourage senior executive officers to take “unnecessary and excessive risks”, require “clawbacks” and prohibit “golden parachute” payments.

**Auction Purchases.** If the Secretary purchases troubled assets from a financial institution through an auction process and the purchases in the aggregate (including direct purchases) exceed \$300 million, then the financial institution will be prohibited from establishing any new employment contract with a “senior executive officer” that provides a “golden parachute” payment in the event of an involuntary termination, bankruptcy filing, insolvency or receivership.

Certain tax rules will also apply to executive compensation arrangements when the aggregate purchase price for troubled assets purchased by the Secretary from a financial institution exceeds \$300 million. For example, a participating institution generally may not deduct as a business expense any executive pay over \$500,000 for any “covered executive”. In addition, certain severance payments to these covered executives will be subject to Section 280G of the Internal Revenue Code – the golden parachute tax rules.

**Mark-to-Market Accounting.** Pursuant to the Act, the Securities and Exchange Commission will have the authority to suspend mark-to-market accounting with respect to any class or category of transaction if the SEC determines that it is necessary or appropriate in the public interest and is consistent with the protection of investors. On Tuesday (September 30), the SEC acted to provide some flexibility in the mark-to-market accounting rules as applied to certain securities for which an active market does not exist.

The Act also directs the SEC, in consultation with the Federal Reserve Board and the Secretary, to conduct a study on mark-to-market accounting standards, as such standards are applicable to financial institutions, including depository institutions.

**Recoupment.** The Director of the Office of Management and Budget, in consultation with the Director of the Congressional Budget Office, will submit a report to the Congress five years after the enactment of this Act

calculating the net amount within the Troubled Asset Relief Program. If there is a shortfall, the President will submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt.

**Temporary Increase In Deposit And Share Insurance Coverage.** Until December 31, 2009, Federal Deposit Insurance Corporation and the Federal Credit Union Share Insurance Fund deposit insurance limits will increase from \$100,000 to “\$250,000.”

## For More Information

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Thompson Hine’s Economic Crisis Team is available to answer any questions you may have. Please contact your Thompson Hine lawyer to be connected to a member of the team.

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# OUR CLIENT SERVICE PLEDGE

## What Our Clients Can Expect From Us . . .

### 1. We will know your business.

We make it our business to understand your business. We will invest our time and resources to develop and maintain knowledge of the dynamics that impact both your industry and your organization. Understanding your business will help us provide better counsel to you.

### 2. We will plan our engagements with you.

We know that clients differ in their goals, risk tolerance and a variety of other factors that must be taken into consideration before work can begin on any matter. At the beginning of every significant matter, we will work with you to develop a plan to meet your strategic goals. By agreeing on a plan at the beginning—and adjusting it as needed—we will stay focused on what is most important to you.

### 3. We will manage your work as if we were the client.

We will work with you to manage your costs. We will staff every matter with the right resources, and we will manage the work as if we were the client—delivering the highest quality of service on time and in the most cost-effective manner.

### 4. We will be available when you need us.

We recognize that you often need to make swift decisions and act quickly. We will be ready to act for you when you need us, and we will make ourselves available wherever and whenever necessary.

### 5. We will communicate often.

Our goal is that you will never be surprised about developments in anything we are handling. We will provide regular updates on the progress of your matters, including all significant developments and changes to scope, timeline or budget.

### 6. We will provide the highest-quality counsel.

Above all else, we stand for the highest quality. Our lawyers, paralegals and staff take pride in the work they do. From the boardroom to the courtroom, you can count on Thompson Hine for the highest-quality service.

## What Our Clients Can Do To Help . . .

### 1. We ask you to share your goals.

The more we know about your goals, the better we can manage our services to help you attain them. If your goals change as a matter progresses, we ask that you tell us, so we can adjust our approach to meet your expectations.

### 2. We want to know your preferences for working with us.

We ask you to tell us your preferred methods of communication, invoice and billing procedures, and anything else that is important to you, so that we can deliver our service the way you want it.

### 3. We need your feedback.

We want your feedback on our performance so that we can continue to meet and exceed your expectations.

For more information, contact any of our offices or send an email to: [AskUs@ThompsonHine.com](mailto:AskUs@ThompsonHine.com)

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