The Struggle Over the Second Half of TARP

January 12, 2009

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The political struggle has begun over the conditions that will be attached to the release of the second half of the TARP funds. The first public salvo in this struggle was fired by Representative Barney Frank (D-MA), Chairman of the House Financial Services Committee, in the form of the TARP Reform and Accountability Act of 2009 (the "**bill**"), which was rushed out on Friday, January 9th, 2009 with the expressed intent of bringing it to a vote in the House of Representatives the week of January 12th. It has been widely reported in the media, including in remarks by the President-elect himself on a Sunday news show, that the President-elect's transition team is also working on its own TARP revision plan and the Bush White House has made it clear that if it asks for the release of funds it would do so at the request of the President-elect. The legal framework for this struggle, dubbed TARP II by some, was laid out in the original TARP legislation. If the White House asks for the release of more TARP funds, Congress has 15 days to reject the request. If Congress does nothing, the TARP funds are released. If Congress rejects the request, that rejection is subject to a Presidential veto which, in turn, can only be overturned by the usual two-thirds majority. The point of the struggle and the negotiations that will inform it is, therefore, to ensure that Congress, especially, the House of Representatives, does not reject the request when it comes from Treasury.

Given the criticism of TARP's implementation by many, it seems certain that new conditions and priorities will be attached to the release of the second half of the TARP funds. For the moment, the bill is the sole text that attempts to grapple with how new conditions might be imposed or implemented. Even though it is highly doubtful that the bill will become enacted law, it represents both a starting position for the changes that some in Congress would like to see imposed and a good window into the implementation and interpretation issues raised by any attempt to impose new conditions.

This memorandum analyzes the key new priorities that the bill would bring to TARP funds and the new conditions it would impose on the financial sector and notes the important ways in which the bill seeks to limit the discretion of the Obama administration's Treasury Secretary. Much of the bill's focus is on obtaining relief for homeowners and, to this end, the bill would suspend Treasury's ability to use any of the TARP funds remaining on March 15, 2009 if Treasury fails to adopt a foreclosure mitigation program by that date, and requires that a large portion of the remaining TARP funds—at least $40 billion and up to $100 billion—be deployed in such a program. The bill would also explicitly expand the areas where TARP funds can be used to include commercial real estate, municipal and city financing and consumer loans, including auto and student loans. The bill also seeks to limit the Obama Treasury's discretion by imposing by statute conditions on executive compensation and warrants. The bill would severely restrict the ability of assisted institutions to participate in acquisitions, as well as impose increased reporting and monitoring. Finally, the bill, in a provision that seems likely to resurface in other proposed legislation, would authorize the FDIC to impose assessments on both insured depository institutions and their holding companies to cover the cost of open bank assistance provided for systemic risk reasons and makes permanent the increase in federal deposit insurance.

New Conditions for Assisted Institutions

Many New Conditions Could Apply Retroactively

There is a fault line that runs through the bill and which would run through any attempt, legislative or otherwise, to impose new conditions upon recipients of TARP funds, now called "assisted institutions" in a new defined term created by the bill. [1] Will the new conditions apply only to new recipients of TARP funds or would they also apply retroactively to previous recipients of TARP funds such as participants in the capital purchase program? In many respects the text of the bill is unclear on this point. Sometimes it states that the new conditions could be applied retroactively and sometimes it is silent. Throughout the memorandum we have pointed out where the bill makes retroactive application an explicit possibility, but we view the risk to be high that many of the new conditions would apply retroactively even when it is not explicitly stated. This point bears careful thought by those considering any new conditions by whatever means.

Many new conditions could apply retroactively to institutions that are currently receiving or have received assistance under TARP

Crucially, it appears that if an assisted institution receives any additional TARP assistance after the bill's enactment, that institution would be subject to all of the new TARP conditions.

[1] The new defined term, "assisted institution," is any institution that has received a ***direct or indirect*** benefit from TARP. The bill does not clarify, however, what sort of "indirect" benefit would lead an institution to be classified as an assisted institution. We believe it would be preferable to eliminate the indirect benefit concept.

Auction Disincentives

Another fault line that runs through the bill is that it creates disincentives, some of them perhaps accidental, for participation in auction purchases of troubled assets, a solution that many increasingly believe should still be tried. Would any new seller into an auction now become subject to the full executive compensation and warrant conditions that would be imposed by a statutory straitjacket? Would participants in the foreclosure mitigation program be treated as assisted institutions and subject to such terms? If so, there would be severe disincentives to new auction participation and even to participation in the foreclosure mitigation program, especially by smaller institutions.

The bill creates disincentives for participation in auction purchases

To the extent that these are technical glitches, reflecting the speed with which the bill was drafted, they demonstrate the need for careful attention to the question of what conditions apply to whom.

Increasing the Availability of Credit

The bill seeks to increase the availability of credit and encourage the unblocking of the credit markets by several means. First, the bill provides that Treasury's authority includes the power to engage in the following as part of TARP:

- establishing or supporting facilities that support consumer loans, including auto and student loans;
- providing support—including direct purchases and debt guarantees—to state and local governments and other issuers of municipal securities having difficulties accessing capital markets; and
- establishing or supporting facilities that enhance the availability of commercial real estate loans, including through purchases of asset-backed securities.

Second, under the bill, as a precondition to any assistance or investment from Treasury under TARP, every insured depository institution would be required to enter into an agreement with the appropriate Federal banking agency, as defined by the Federal Deposit Insurance Act, setting forth how TARP funds would be used and establishing measurement benchmarks to ensure that the purposes of TARP—which are described as strengthening the soundness of the

Oversight and Examination with Respect to the Use of TARP Funds

» **Insured depository institutions**
- The appropriate federal banking agency must examine at least annually the assisted institution's use of TARP funds and its compliance with the Act and any agreement over use of funds
- The appropriate federal banking agency must require the assisted institution to establish and maintain compliance procedures

» **All assisted institutions**
- Treasury must establish mechanisms to ensure appropriate use of funds and compliance with TARP conditions
- Examination requirements must be no less stringent than those for insured depository institutions

Reporting Requirements

» **Public quarterly reporting by assisted institutions on their use of TARP funds**

» **Treasury may require additional reporting by assisted institutions (including indirect recipients) of assistance or benefit that involves the expenditure, loan or investment of the TARP funds**

» **For insured depository institutions:**
- Reporting requirements will be determined by Treasury in consultation with the appropriate federal banking agency
- Call reports must contain the increase (or the reduction of any decrease) in new lending that is attributable to the receipt of the TARP funds or, if it cannot be quantified, the total amount of increase in new lending

financial system and increasing the availability of credit—are furthered. The bill would also require Treasury to establish conditions of equal stringency on assisted institutions that are not insured depository institutions.

Every institution would be required to enter into an agreement setting forth how the TARP funds it receives will be used

Restrictions on Acquisitions of Banks and Thrifts

The bill would prohibit any institution that, directly or indirectly, received or benefited from any assistance from TARP from merging or consolidating with, or acquiring any of the assets or assuming any of the deposit liabilities of, any insured depository institution unless the Secretary has determined, in consultation with all appropriate federal banking agencies, that the transaction:

» would reduce taxpayer risk; ***or***

» could have been consummated without the use of TARP funds.

This provision would severely disrupt the FDIC's established procedures for resolving failed banks and thrifts like WaMu, Indymac and so forth. The FDIC would have to screen its approved bidder list for assisted institutions and obtain the Secretary's determination that these conditions have been satisfied before entering into any transaction whereby an assisted institution would acquire any deposits or assets of a failed bank or thrift. Conversely, any assisted institution, including both the nine systemically important financial institutions that were required to participate in Treasury's bank capital purchase program and the many institutions that have recently elected to become bank holding companies, might not be able to expand their deposit base by acquiring the deposits of a troubled bank or thrift, with or without FDIC assistance, if these conditions could not be met, even if the Secretary and the other appropriate federal banking agencies believed that the acquisition would be in the best interests of the United States and the stability of the US financial system.

Increased Monitoring and Reporting

As described in the sidebar, the bill also would impose increased monitoring on assisted institutions as well as increased reporting, both publicly and in the examination process.

Prohibition on Corporate Jets

The new provisions would prohibit any assisted institution from owning or leasing private passenger aircraft. Any assisted institution that owned or held aircraft before receiving any assistance may continue to do so as long as it demonstrates to the satisfaction of Treasury that it is taking all reasonable steps to divest such aircraft or interest in aircraft. This provision originated in the failed auto rescue legislation and was agreed to by the auto companies as part of the President's auto rescue package.

Board Observer

One of the significant critiques of Treasury's administration of TARP has been that Treasury has not adequately monitored how assisted institutions have used the assistance they have received. It has been widely noted that many European governments have conditioned bailout assistance upon the government's ability to appoint members to the recipient's board. The bill would permit, but not require, Treasury to place an observer at board and board committee meetings of any assisted institution for so long as the assistance is outstanding.

The bill would permit but not require Treasury to place an observer at board and committee meetings of assisted institutions

Option for Insured Depository Institutions to Repay

The bill would give the Secretary discretion to allow any insured depository institution to repay any assistance previously provided without regard to whether the depository institution has replaced such funds from any other source. It is unclear what this provision achieves. The Secretary already has the discretion to waive any contractual provision in the standard capital purchase program documentation with any assisted institution—insured depository institution or otherwise—including the provision that assisted institutions may repay their capital purchase program funds before maturity only if they do so with the proceeds of certain replacement equity offerings equal to at least 25% of the issue price of the preferred stock. The bill does not grant insured depository institutions the right to repay their capital purchase program funds in the absence of such a waiver and it does not grant any similar right to other assisted institutions at all.[2] Moreover, and crucially, the bill does not define when assistance ends so that it is unclear whether even if the existing preferred stock is called by the participating institutions how the warrants would be unwound or whether their continued existence, which is the upside for the taxpayer, would be counted as continued assistance. To the extent that this provision is intended to allow assisted institutions to withdraw from TARP in light of the new more onerous conditions, it fails to achieve that purpose as long as it does not clearly set for the rule for when assistance comes to an end.

Mandated Availability of TARP Funds to Smaller Institutions

The bill requires Treasury to take prompt action to make TARP funds available to smaller community financial institutions and also requires that institutions whose capital purchase program applications are pending (*e.g.*, C corporations and privately held institutions) and institutions for which Treasury has not yet established a capital purchase program application program (*e.g.*, S corporations) receive equal treatment to those institutions that received TARP funding prior to the bill's establishment.

Statutory Limits to Treasury's Discretion

New Warrant Conditions

The original TARP legislation currently requires, as a precondition for the sale of a troubled asset to Treasury, that Treasury take a warrant for nonvoting common stock, preferred stock or a similar debt instrument in every selling institution, and gives Treasury broad discretion in establishing the terms of these warrants, including the exercise price and amount. The bill would significantly rein in Treasury's discretion by codifying the composition, amount, terms and structure of the required warrants and eliminating the *de minimis* exception to the warrant requirement.

For example, it would prevent Treasury from participating in any purchase or guarantee of troubled assets, including any "good bank / bad bank" structure, in which the FDIC, the Federal Reserve, the OCC, Treasury and any other relevant financial regulator determine that it would be in the best interest of the United States and the stability of the US financial system to provide financial assistance without taking warrants equal to 15% of the assistance provided

[2] It is possibly accidental that the ability to repay is only extended to "insured depository institutions" and not also to their holding companies.

based on all the facts and circumstances at the time. This restriction on Treasury's discretion is odd at a time when there is a growing consensus among financial experts and policymakers in both the United States and Europe that taking troubled assets off the balance sheets of financial institutions may be more effective in restoring public confidence in the financial system then direct capital investments.

Warrant Terms under the Bill

The bill would impose specific terms on the warrants granted to Treasury. Treasury would be required to take warrants with a value equal to 15% of the aggregate amount of all assistance received by the assisted institution. Further details of the warrant requirements are set forth in the sidebar.

The requirements in the bill are generally consistent with what Treasury has imposed in the capital purchase program. There are a number of troubling aspects in the bill's treatment of warrants:

» For companies that are not publicly traded, Treasury must take common or preferred stock warrants in the company (or its holding company), and no longer has discretion to take a senior debt security instead. This may create problems for institutions that are unable to issue equity securities without causing collateral negative consequences, as Treasury will no longer have discretion to accept debt securities instead.

» Treasury must take warrants with a "value" equal to 15% of the assistance received, but the bill does not define how "value" will be determined—in the capital purchase program, Treasury received warrants with an exercise price aggregating 15% of the assistance received, but a typical option pricing model would likely value those warrants at less than such amount.

» Most importantly, by imposing specific provisions on the pricing and amount of warrants, the bill will limit Treasury's discretion to tailor specific deals or to adjust to changed market conditions. For example, the exercise price of the common stock warrants would be statutorily mandated to be set at a 15-day trailing average of the stock price right before the assistance is provided. While this is a common provision and has been widely applied in previous TARP funding, codifying it in a statute would eliminate Treasury's discretion in times of market

Warrant Requirements

» **Value equal to 15% of aggregate amount of all assistance provided**

» **The warrants shall entitle Treasury to purchase:**
- Nonvoting common stock of the assisted institution (or for non-public institutions, their holding company), up to a maximum of 15% of issued common stock; and
- Preferred stock with a liquidation preference of 15% of the assistance provided, net of the value of any warrants for nonvoting common stock

» **Common stock warrants**
- Exercise price is mandated as the 15-day trailing average of the stock price (or for non-public institutions, the economic equivalent), as of the day before the TARP assistance commitment was made

» **Preferred stock warrants**
- The initial exercise price is the greater of $0.01 and the minimum par value per share
- Right to immediately exercise the warrants
- May be redeemed at any time after exercise at 100% of its issue price, plus any accrued and unpaid dividends

volatility. It would seem to be preferable to leave these details to regulatory discretion.

» Finally, the bill provides that the exercise price of any preferred stock warrants will be the greater of $0.01 or the specified minimum par value per share. This effectively means that preferred stock warrants, unlike the common stock warrants, would be an additional issuance of preferred stock for virtually no consideration. It is not clear why preferred stock warrants should be treated differently than the common stock warrants.

By contrast, a number of the clarifications in the warrant provisions are helpful, such as the language that clarifies that in the case of assistance to a non-public institution the warrants can be taken in its holding company. The bill would, however, as noted above, eliminate the option to take senior debt in a non-public institution. It also eliminates the *de minimis* exception to the warrant requirement for assistance of less than $100 million.

Executive Compensation Restrictions

As originally enacted, the original TARP legislation included a number of limitations on the compensation and severance that an assisted institution could provide to its senior executive officers, essentially the institution's top five officers. Although the original TARP legislation gave Treasury discretion in applying certain of these limitations, Treasury has applied these restrictions fairly broadly.

Nonetheless, various constituencies have increasingly called for greater executive compensation restrictions. Significantly greater restrictions were agreed, to for example, in connection with the special TARP arrangements provided to Citigroup and the assistance provided to AIG and the auto industry outside of TARP. The auto industry relief legislation that passed the House in December but failed to clear the Senate included Chairman Frank's prescription for more stringent executive compensation restrictions. This prescription forms the basis of the executive compensation and corporate governance provisions in the bill.

The new executive compensation restrictions may also be imposed retroactively at the discretion of Treasury

Executive Compensation Restrictions that Would Become Mandatory

- **Adoption by assisted institutions of measures to avoid incentive compensation that encourages senior management to take excessive risk**
- **Clawback of any bonus or incentive compensation paid to a senior executive officer based on financial statements or performance metrics later determined to be materially inaccurate**
- **Limitation of senior executive officer severance benefits to not more than three times the executive's trailing five-year annual taxable compensation**

The new provisions are mandated for any institution receiving assistance after the bill is passed and are permitted to be imposed retroactively at the discretion of Treasury on any institution that has previously received TARP assistance.

In part, the new provisions mandate the application of certain restrictions that are already included in the previous legislation, as set out in the sidebar. These restrictions have been agreed to by all the institutions that have already received TARP funding, but the bill makes clear that going forward these provisions will be mandatory elements of any funding arrangements provided under TARP.

While under the terms of the funding made available to date these restrictions apply to an assisted institution for the period that Treasury continues to hold equity or debt in the institution, the bill mandates that these limitations apply for the duration of the period that any TARP assistance is outstanding to an institution, even if that period extends beyond the date that Treasury ceases to hold an interest in the institution. The bill also augments the clawback provision, described in the sidebar, by adding a new prohibition on any compensation arrangements that would encourage manipulation of a participating institution's reported earnings to enhance the compensation of any employee.

The bill adds a general prohibition on the adoption of any new golden parachute arrangements. As originally enacted, the TARP legislation imposed a prohibition on new golden parachutes only by institutions from which Treasury purchased troubled assets in excess of $300 million in one or more auctions or a combination of auctions and direct purchases. The bill would mandate the "no new golden parachute" rule for the senior executives of all institutions receiving TARP funds, regardless of the amount of assistance or the means by which it is provided. Per the original provisions, this restriction would apply for the term of Treasury's authority under TARP (December 31, 2009, or October 3, 2010 if Congress exercises its authority to extend the period).

Finally, the new provisions prohibit any payment or accrual of any bonus or incentive compensation for the 25 most highly compensated employees of an assisted institution during the period that any TARP assistance is outstanding to the institution. This significant new prohibition does not contain

> Bonuses to the 25 most highly compensated employees are prohibited

Changes to the Financial Stability Oversight Board

» **Three new members would be added to the Board, bringing the size of the board to eight:**
  - The Chairperson of the Board of Directors of the FDIC
  - Two persons nominated by the President and approved by the Senate. These latter two may not be government employees.

» **The Board could overturn any policy decision of the Secretary by a 2/3 vote. The Secretary is one of the eight members, meaning that six of the remaining seven would have to vote against the Secretary to overturn a policy**

the discretionary authority, contained in the President's auto rescue package, for Treasury to waive this condition, although it mirrors a prohibition that was in the failed auto rescue legislation.

Changes to the Financial Stability Oversight Board

The bill would change the composition of the Financial Stability Oversight Board as described in the sidebar. The new power of the Financial Stability Oversight Board to overturn a "policy" decision by the Secretary is troubling. There is no definition of a policy decision and no deadline as to when such changes might take place. As a result, there is a potential for confusion in the markets and among consumers as to when Treasury decisions are final or when a policy decision might be subject to review and change. In the context of some of the decisions taken last fall, such as the guarantee of money market funds or the contours of investments in the capital purchase program, this confusion could lead to heightened market volatility.

Auto Industry Relief

In line with limiting the discretion currently enjoyed by the executive branch, the bill codifies a number of provisions that were in Treasury's indicative term sheets released December 19, 2008 and gives explicit authority to ensure funding is available for the automobile industry. Analysis of the auto bailout is beyond the scope of this memo.

Mortgage Relief and Homeowner Promotion Provisions

The bill would require a number of steps to prevent mortgage foreclosures and promote homeownership.

Foreclosure Relief

The bill would suspend Treasury's ability to use any of the $350 billion of TARP funds remaining unused as of March 15, 2009 if Treasury failed to develop an approved foreclosure mitigation plan by that date. Such a plan would be required to use between $40 billion and $100 billion of the remaining TARP funds and to focus on owner-occupied residences. Treasury would also be required to leverage private capital as much as possible, but otherwise would have broad discretion to implement a plan based on one or more of five program alternatives.

Foreclosure Mitigation Plan

» **Plan Requirements:**
- Use $40 – 100 billion of remaining TARP funds
- Prevent and mitigate foreclosures on owner-occupied residences

» **Required Plan Timeline:**
- March 15: Plan must be approved by Financial Stability Oversight Board
- April 1: Treasury must begin committing funds under the plan
- May 1: Treasury must have used $40 billion (or explain why it hasn't by May 15)
- July 1: Congressional Oversight Panel must submit a report reviewing the plan

Foreclosure Mitigation Program Alternatives

The first alternative is a systematic loan modification program. Such a program would require that participating lenders review their loans using standard net present value criteria established by Treasury and offer to modify their loans, if necessary, to make them more affordable to borrowers based on their debt to income ratios. It could also require that any systematic loan modification program include government loss sharing or guarantees to cover certain losses if a modified loan re-defaults. Any such program also would have to include compensation to lenders and loan servicers to cover administrative costs for loans modified according to required standards. Loans that are modified but have only *de minimis* reductions in monthly payments and loans that are defaulted on soon after modification can be excluded from the loss sharing program. Many of the components that the bill suggests for a systematic loan modification program are similar to what the FDIC implemented in its program at IndyMac as well as what the FDIC has suggested in separate loss-sharing proposals.

The second alternative is to provide coverage for fees associated with the HOPE program and ensure the affordability of HOPE program-insured mortgages. A third alternative is for Treasury to provide borrowers with new financing to help them modify existing second lien mortgages.

Restructuring Securitized Mortgages

Perhaps the most interesting, and potentially controversial, provisions are the fourth and fifth alternatives, in combination with safe harbor provisions for mortgage servicers. One of the criticisms leveled at mortgage securitizations has been that the programs do not give servicers enough funds, incentives or legal protections to engage in the sort of traditional mortgage modifications that a bank that kept the mortgage loans on its own balance sheet would undertake. To address this situation, as a fourth and fifth alternative for satisfying Treasury's obligation to establish a mortgage modification program, the bill would authorize the Secretary to purchase, or to compensate servicers for modifying, whole mortgage loans, including from pools of mortgage loans underlying or referenced by mortgage-backed securities (MBSs), collateralized debt obligations (CDOs) or credit default swaps (CDSs).

> One alternative is for Treasury to purchase troubled mortgages outright

To protect servicers against potential liability for modifying residential mortgage loans in accordance with any program established by Treasury that meets certain criteria, the bill would create a "safe harbor" to insulate the servicers from any liability they may otherwise have to any of the following persons, including investors in residential MBSs, CDOs or CDSs that are, directly or indirectly, based on the relevant residential mortgage loans:

» any person based on that person's ownership of a residential mortgage loan or any interest in a pool of residential mortgage loans or in securities that distribute payments out of the principal, interest and other payments in loans on the pool;

» any person who is obligated to make payments determined in reference to any loan or any interest referred to in the preceding bullet; or

» any person that insures any loan or any interest referred to in the first bullet point.

The bill would also invalidate any contractual provision between a servicer and any securitization vehicle or any investor that would, with respect to any residential mortgages modified in accordance with any program established by Treasury that meets certain criteria:

The bill would invalidate certain contractual provisions between a servicer and any vehicle or investor

» limit the servicer's ability to modify mortgages, the number of mortgages that can be modified, the frequency of loan modification or the range of permissible modifications; or

» require the servicer to repurchase any loans from or otherwise compensate the securitization vehicle on account of any modification, workout or other loss mitigation plan.

Finally, the bill would require any unsuccessful plaintiff to reimburse the servicer for any legal expenses incurred in defending itself against any actions protected by the safe harbor.

To be eligible for these protections, the servicer must limit its modifications to mortgages that are in default or where default is reasonably foreseeable, where the mortgaged property is owner-occupied and where the servicer "reasonably and in good faith believes" that the anticipated recovery on the principal under

HOPE Act Amendments

- Raise the maximum permitted loan to assessed value ratio from 90% to 93%
- Reduce the initial rate of annual mortgage insurance premiums from 1.5% to between 0.55% and 0.75%
- Eliminate the 3% up-front insurance premium
- Eliminate the prohibition on insurance payouts to mortgagees whose mortgagors fail to make the first payment on their refinanced mortgages

the particular modification or workout plan will exceed, on a net present value basis, the anticipated recovery on the principal through foreclosure. In addition, the protections would not apply to modifications, workouts and other loss mitigation plans initiated on or after January 1, 2012.

A program of purchasing or compensating servicers for modifying mortgages underlying or referenced by MBSs or CDOs could, if the loans were purchased at par or otherwise restructured in a way that added value to the relevant mortgage pools, not only provide benefits to troubled mortgage borrowers, but also increase the market value of the MBSs or CDOs that are based on the relevant mortgage pools. And because many securitization vehicles, directly or indirectly, reference the same pool of mortgage loans, the benefit is not merely one-for-one. Instead, every dollar of value that the TARP creates at the mortgage pool level will typically multiply into many dollars of value enhancement at the levels of the MBSs or CDOs that reference them. Thus, Treasury could use a mortgage purchase program to leverage every dollar of TARP money spent into many dollars of value creation throughout the financial system.

Such a program would not be uncontroversial, however, even if it resulted in substantial write-ups in the value of MBSs and CDOs on the books of financial institutions all over the country. Market participants who have bet that the value of these assets would fall and shorted them, for example, by buying credit protection in the form of CDSs, would lose their bets if Treasury establishes a mortgage purchase or modification program that helps to stabilize or enhance the value of MBSs or CDOs for which such credit protection was purchased.

Amendments to the HOPE Act

The HOPE for Homeowners Act (the "**HOPE Act**") was enacted on July 30, 2008 as part of Congress's initial response to the mortgage crisis. The HOPE Act created a temporary and voluntary program designed to help struggling borrowers refinance into more affordable fixed-rate government-insured mortgages. Like the original TARP legislation before it, the bill attempts to increase participation in the HOPE Act.

> The bill attempts to increase participation in the HOPE Act

To encourage the voluntary refinancing of distressed mortgages, the HOPE Act authorizes Treasury to insure eligible refinanced mortgages. The bill would eliminate or change several requirements of the HOPE Act, making eligibility

The Bill's Key FDIC Provisions

- **Permanent increase in deposit insurance coverage to $250,000, with inflation adjustment**
- **Extension of the timeframe for an FDIC restoration plan if the Deposit Insurance Fund falls below its minimum limits from five to eight years**
- **Increase in the FDIC's borrowing authority from $30 billion to $100 billion (and any additional amounts necessary upon Treasury's approval)**
- **Expanded authority for the FDIC to charge systemic risk special assessments on both insured depository institutions and depository institution holding companies**

easier to achieve and participation in the HOPE Act more attractive for all stakeholders, including eliminating certain borrower representations, debt-to-income ratio tests and prohibitions on granting second liens on refinanced properties. The bill would also ease slightly borrowers' income disclosure requirements under the HOPE Act. To make refinancing more attractive to lenders and mortgage holders, the bill makes several amendments, as set out in the sidebar.

The bill would permit Treasury to pay for increased costs to the Federal Government that are a result of the bill with amounts made available to Treasury under the original TARP legislation.

Homebuyer Stimulus Program

The bill directs Treasury to create a new program "to stimulate demand for home purchases and reduce unsold inventories of residential properties" by purchasing, with funding from the Housing and Economic Recovery Act of 2008, debt and securities issued by Freddie Mac, Fannie Mae and the Federal Home Loan Banks. The bill outlines the stimulus program broadly, includes very few guidelines and contains almost no specific requirements. The guidelines are that the homebuyer stimulus program ensure the availability of mortgages with affordable interest rates for home purchases, focus on geographical areas with the highest foreclosure rates and make mortgages available for HOPE Act program refinancings.

FDIC Provisions

Special Assessments for Open Bank Assistance

A provision of the bill that could have a substantial impact on the banking industry, and which seems likely to resurface in other proposed legislation, is the expanded authority for the FDIC to charge special assessments under the systemic risk exception of the Federal Deposit Insurance Act on bank and thrift holding companies as well as insured depository institutions. Under current law, the FDIC can charge systemic risk special assessments only on insured depository institutions subject to a rather specific formula. The bill would expand the FDIC's authority, allowing it to also charge those assessments on depository institution holding companies (*i.e.*, bank holding companies and thrift holding companies) and expanding the FDIC's discretion on how to structure the assessments. The concurrence of Treasury would be required.

Permanent Increase in Deposit Insurance Limits

The proposed amendments to the Federal Deposit Insurance Act would make permanent the temporary increase in deposit insurance coverage to $250,000, which is scheduled to sunset on December 31, 2009. The sunset would be repealed and an inflation adjustment for future coverage would be added. The bill would also expand the FDIC's borrowing authority from $30 billion to $100 billion and such additional amounts in excess of $100 billion as necessary upon Treasury's approval and extend the time limit from five to eight years for the FDIC to restore the Deposit Insurance Fund if it falls below the statutory reserve ratio of 1.15% of total estimated insured deposits.

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References

Below are hyperlinks to

- » The text of H.R. 384, the TARP Reform and Accountability Act of 2009; and
- » The House Financial Services Committee Press Release that accompanied the introduction of the bill.

For further details on the creation of TARP, please see our memoranda on the establishment of EESA and the US government capital injections under the capital purchase program.

We will continue to monitor developments and issue additional newsflashes and memoranda as appropriate.

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