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EESA/TARP UPDATE

The Department of the Treasury is continuing to develop the details of the operation of the Troubled Asset Relief Program (the "TARP") established under the Emergency Economic Stabilization Act of 2008 (the "EESA"). Other government agencies and the Executive and Legislative branches are also working to develop related programs to address the current credit crisis. Detailed below are some of the more pertinent details of three (3) new initiatives that have been announced by the Department of the Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve Board.

Treasury's TARP Capital Purchase Program

On October 14, 2008, the Treasury announced the creation of the Capital Purchase Program (the "CPP"), a voluntary program under which the Treasury will purchase up to \$250 billion of senior preferred shares in qualifying financial institutions. Notable features include the following:

- Available to qualifying U.S. controlled banks and saving associations, certain bank holding companies, and certain savings and loan holding companies
- Minimum subscription of 1% of the risk-weighted assets; maximum subscription of the lesser of \$25 billion or 3% of risk-weighted assets
- Shares will be senior preferred shares (the "Senior Preferred") qualifying as Tier 1 capital; the Senior Preferred will be senior to common stock and *pari passu* with existing preferred stock (except preferred stock that by its terms is junior to any existing preferred stock)
- The Senior Preferred will not be subject to any contractual restrictions on transfer
- Dividends will be paid quarterly in arrears at a rate of 5% per annum for the first 5 years and 9% thereafter (these dividends to be cumulative; except for banks which are not subsidiaries of holding companies, which shall pay non-cumulative dividends on the same terms); there are certain restrictions on the payment of other dividends while the Senior Preferred is outstanding; if dividends are not paid for 6 periods (whether or not consecutive), the Senior Preferred will have right to elect 2 directors
- The Senior Preferred will be non-voting, other than certain class voting rights with respect to actions that would affect the Senior Preferred (e.g., issuance of shares senior to the Senior Preferred; modification of terms of the Senior Preferred)

- Limitations on redemption for 3 years (except for certain redemptions with proceeds of qualifying equity offerings with gross proceeds to the financial institution of not less than 25% of the issuance price of the Senior Preferred); callable at par following the 3 year period
- The TARP-mandated executive compensation limits for “direct” investments will apply to financial institutions participating in the program (for additional details, please see Section D of our Plain & Simple newsletter of October 7, 2008)

The concept of direct injection of capital into banks is not something that is specifically stated in the EESA or the TARP – the focus throughout the TARP is on moving toxic mortgage-related assets away from banks to free up liquidity. However, the Treasury is presumably relying on, among other things, (a) the wide definition of “troubled assets” (which includes “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”), and (b) the fact that the TARP provides specific guidance on the issuance of equity interests and warrants in connection with certain “direct” purchases of assets.

The Treasury announced that 9 large financial institutions have already agreed to participate (with reports listing Citigroup, JPMorgan Chase, Bank of America, Wells Fargo, Goldman Sachs, and Morgan Stanley as institutions allegedly participating in the CPP).

This new focus on direct capital injection, however, does not mean that the purchase of toxic assets from troubled financial institutions is off the table – the Treasury indicated that it “continues to develop a program to purchase troubled mortgage-related assets through an auction format, and will be issuing program guidance for this program in coming weeks.”

In addition, the Treasury stated that it is developing a third program for “Systematically Significant Failing Institutions” that would potentially provide direct assistance to certain failing firms on terms negotiated on a case-by-case basis. Specific details have not been provided, other than that executive compensation in firms participating will be subject to similar restrictions as under the other TARP initiatives (although the Treasury signals that golden parachute restrictions will be even more strictly prohibitive under this new program).

For additional details, please see announcements on the Treasury’s website: <http://www.ustreas.gov/press/releases/hp1207.htm>.

The Federal Deposit Insurance Corporation’s Temporary Liquidity Guarantee Program

The FDIC has announced the creation of the Temporary Liquidity Guarantee Program (the “TLGP”), a voluntary program under which the FDIC will guarantee (1) certain eligible unsecured senior debt of eligible financial institutions, and (2) the full amount of any non-interest-bearing transaction deposit accounts maintained at any FDIC-insured institution. Important features of the TLGP include the following:

- Available to FDIC-insured institutions and other U.S. bank holding companies, U.S. financial holding companies, and certain U.S. savings and loan holding companies
- The debt guarantee element of the TLGP applies to new senior unsecured debt issued on or before June 30, 2009, “including promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt”

- The amount of the debt covered is not to exceed 125% of the debt of such institution that was outstanding as of September 30, 2008 and which is scheduled to mature before June 30, 2009
- Maximum time period that any debt guarantee can remain in place is 3 years
- Under the account guarantee element of the TLGP, the FDIC will guarantee all amounts on deposit in any non-interest-bearing transaction deposit account held by a participating FDIC-insured institution until December 31, 2009
- Any eligible institution will be automatically enrolled in the TLGP for a period of 30 calendar days; before the expiration of such period, the applicable financial institution must inform the FDIC whether it wishes to discontinue participating
- Participating institutions will be subject to “enhanced supervisory oversight to prevent rapid growth or excessive risk taking”
- In a statement by Chairman Bair of the FDIC, it was stressed that the program will be funded through special fees and will not rely on taxpayer funding; in the event any institution continues participating in the TLGP, it will be subject to fees in the amount of (1) 75 basis points per year multiplied by the amount of the guaranteed debt, and (2) 10 basis points multiplied by the current insurance premium being paid by the financial institution on deposits protected by the account guarantee element of the TLGP (to the extent they are not already covered by the existing deposit insurance limit of \$250,000)

The debt guarantee element is intended to help banks fund their operations and to alleviate the problems banks are currently facing with term and overnight lending between banks by allowing banks to roll maturing senior debt into new issues fully backed by the FDIC.

The account guarantee element covers all non-interest bearing accounts at participating institutions, but it is particularly intended to protect accounts such as those that are used by businesses for the processing of payroll and other operations. The hope is that this will stabilize these often large accounts and will stop bank customers from moving accounts away from smaller banks and hopefully avoid the seizure of such banks by the FDIC.

Additional details are provided in the press release on the FDIC’s website: <http://www.fdic.gov/news/news/press/2008/pr08100.html>.

The Federal Reserve Board’s Commercial Paper Funding Facility

Last week, the Board announced the creation of the Commercial Paper Funding Facility (the “CPFF”) and has since released additional information relating to the CPFF, including the following notable features:

- A special purpose vehicle (the “SPV”) will be created which will buy from eligible issuers highly rated unsecured and asset-backed commercial paper that is U.S. dollar-denominated and has a 3-month maturity
- The Federal Reserve Bank of New York (the “New York Fed”), and indirectly the Treasury, will finance the SPV
- Issuers eligible to sell commercial paper to the SPV will be U.S. issuers (i.e., entities organized under U.S. laws or a political subdivision or territory of the United States) of commercial paper (including U.S. issuers with foreign parents)

- The maximum amount of a single issuer's commercial paper that the SPV may own is limited to the greatest amount of U.S. dollar-denominated commercial paper outstanding held by such issuer on any day between January 1 and August 31, 2008
- It is anticipated that pricing will be based on: (i) the then-current 3-month overnight index swap rate plus 100 basis points for unsecured commercial paper (with an additional per annum surcharge of 100 basis points payable unless the issuer provides an acceptable collateral arrangement or guarantee), and (ii) the then-current 3-month overnight index swap rate plus 300 basis points for asset-backed commercial paper
- The SPV will begin buying commercial paper on October 27, 2008 and will cease doing so on April 30, 2009, unless extended; the New York Fed will continue funding the SPV until the SPV's underlying assets mature

The creation of the CPFF is the Board's response to the increasingly shrinking and strained commercial paper market. The CPFF aims to enhance the liquidity by introducing a well-funded purchaser of commercial paper into the market, stimulating investors to return to the market by increasing confidence that the issuers will be able to refinance maturing debt.

For additional details, please see the press release on the Board's website: <http://www.federalreserve.gov/newsevents/press/monetary/20081014b.htm>.

Distressed Real Estate Practice Group

Duval & Stachenfeld has for the past decade positioned itself to be ready for the inevitable downturn in real estate by acquiring and training knowledgeable and talented lawyers in the critical areas for distressed real estate; namely, **real estate**, **bankruptcy**, and **litigation**. In that regard, the Firm has established its Distressed Real Estate Practice Group to provide coordinated expertise in these legal areas and to provide advice and guidance regarding workouts, debt and equity restructurings and recapitalizations, bankruptcies, distressed debt and distressed property acquisitions and dispositions, and related litigation.

If you would like additional information regarding the substance of this Plain & Simple newsletter, please contact one of Duval & Stachenfeld's [Distressed Real Estate Practice Group](#) chairs.

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