THE SHAPE OF THE BAILOUT

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Glossary

“CPP” = Capital Purchase Program established by the Treasury under the TARP

“EESA” = Emergency Economic Stabilization Act of 2008

“Federal Reserve” = Federal Reserve System

“FDIC” = Federal Deposit Insurance Corporation

“FHFA” = Federal Housing Finance Agency (the regulator of Fannie Mae, Freddie Mac and the Federal Home Loan Bank System)

“TARP” = the Troubled Assets Relief Program provided for by the EESA

“Treasury” = United States Department of the Treasury

INTRODUCTION

The current credit crisis began in August of 2007, as the markets began to perceive the extent to which residential real property and mortgage-related assets were over-valued during the housing boom of 2002-2006. Acting under existing statutory authority, the Federal Reserve, the Treasury and various other federal agencies began to take ad hoc steps to contain the crisis. These steps included reducing interest rates, expanding Federal Reserve credit facilities, and providing credit support for J. P. Morgan's acquisition of Bear, Stearns in March 2008. In addition, Congress created a new, stronger regulator for the housing-related government-sponsored enterprises, the FHFA.

In September 2008, a series of events led policy makers to conclude that the previous steps and existing legal authorities were not sufficient to contain the crisis. These events included the conservatorships of Fannie Mae and Freddie Mac, the bankruptcy of Lehman Brothers, the emergency sale of Merrill Lynch to Bank of America, and a run on insurance giant AIG that was halted only by a massive loan from the Federal Reserve. As a result of these events, and the related further disruptions in the credit markets, the Treasury requested that Congress appropriate $700 billion to "clear the credit markets" of distressed real estate assets.

On October 3, 2008, after a week of political wrangling, President Bush signed the EESA, authorizing the United States Treasury to purchase up to $700 Billion of "troubled assets" from the nation's financial institutions. Before TARP could be implemented, however, it became apparent that the asset purchase program contemplated by the EESA was not going to resolve the crisis. Market turmoil continued, in part as a result of uncertainty about the workings of TARP. In addition, Great Britain introduced a package of aid that included direct investments in the equity of banks rather than asset purchases. Most observers argued that the British approach was superior.

As a result, on October 13, 2008, Secretary Paulson, Chairman Bernanke and FDIC Chairwoman Sheila Bair announced a new initiative to stem the credit crisis, relying on their authorities under the EESA, the Federal Reserve Act and the Federal Deposit Insurance Act. Those initiatives include:

1. Purchase by the Treasury of up to $250 million in preferred equity in banks and bank holding companies;

2. Temporary FDIC guaranties of all interest-free transaction accounts regardless of size, and of certain short and medium-term bank holding company senior debt; and

3. Purchase by the Federal Reserve of corporate and asset-backed commercial paper.

The purpose of this report is to summarize the steps Federal authorities have taken over the past 15 months to address the credit crisis. We will provide an overview of the government's principal actions to date, and information concerning ongoing programs. This information is designed to be helpful in seeking to assess the risks and opportunities resulting from the federal government's unprecedented activities in the financial system.

I. CAPITAL PURCHASE PROGRAM

After EESA was enacted, Treasury concluded that a portion of the funds available to acquire troubled assets should be used to invest in the preferred stock of qualified financial institutions through the CPP. The program is designed to attract broad participation by healthy institutions. The government hopes that the CPP will attract private capital to financial institutions as well. The additional capital is supposed to improve the ability of participating financial institutions to address problems in their own loan portfolios and rebuild the confidence necessary to return the credit markets to normal functioning.

It also appears that the program will encourage stronger institutions to pursue acquisitions of weaker institutions, driving further consolidation in the industry. The acquisition of National City Corp. by PNC Financial Services Group is the first example of this use of the CPP. National City was encouraged by the Office of the Comptroller of the Currency, its primary regulator, to find a buyer after posting significant third-quarter losses. PNC agreed to buy the troubled bank for $5.2 billion after getting $7.7 billion in capital from the Treasury. The PNC-National City deal may serve as a template for takeovers of other troubled banks.

The CPP has been characterized as an investment program, not an expenditure, with Secretary Paulson stating that "there is no reason to expect this program will cost taxpayers anything." Treasury has emphasized that the preferred share investments should be paid back with a reasonable return from dividends plus the value of warrants for the participating institution common stock

A. Legal Authority

Section 101(a) of EESA authorizes the Secretary of the Treasury to establish TARP to "purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary…." Section 3(9)(b) of EESA defines troubled assets as including "any other financial instrument that the Secretary after consultation with the Chairman of the Board of Governors of the Federal Reserve, determines the purchase of which is necessary to promote financial market stability…." Using this authority, $250 billion has been committed to investments in the preferred equity of financial institutions pursuant to the CPP. While a summary of the terms of the investment program and an application form and procedures are available, no interim or proposed rule has been issued to govern the program, other than regulations addressing the executive compensation restrictions that are a condition to participation.

B. "The Big 9" and Other Eligible Institutions

The CPP was introduced with the announcement of the program and the "voluntary" participation of nine of the largest financial institutions in the country: Citigroup, Bank of America, JP Morgan Chase, Goldman Sachs, Morgan Stanley, Wells Fargo, Bank of New York Mellon, State Street, and Merrill Lynch. Treasury allocated $250 billion of the bailout fund to the CPP, with half of that going to these nine institutions.

With respect to other eligible institutions, Secretary Paulson has stated that CPP is not being administered on a first-come-first-served basis and that sufficient capital has been allocated so that all qualifying institutions can participate. However, that does not mean every applicant will be approved. As of October 28, 2008, another 10 of the largest banks have announced they will participate in CPP. Included in this next wave of announcements is PNC, which will not only receive their maximum CPP amount but, in acquiring National City, will receive the CPP amount allocated to National City as well. The PNC announcement came on the heels of news that National City would not be eligible for CPP on a stand alone basis, highlighting the use of CPP as a tool for Treasury to arrange and support acquisition of weaker institutions.

While Treasury has worked with the Office of the Comptroller of the Currency ("OCC"), FDIC, the Board of Governors of the Federal Reserve and the Office of Thrift Supervision ("OTS") to establish streamlined evaluations using a standardized process to ensure consistency, the specific criteria for approval have not been disclosed. An assessment of the long term viability of a financial institution seems to be a major factor, as evidenced by the fate of National City. Treasury has stated that it welcomes the expertise of the federal bank regulators and will give considerable weight to their recommendations, which will no doubt take into account the examination reports and ratings of financial institutions applying to participate.

Treasury is encouraging banks and thrifts of all sizes to participate in the program. However, the investment terms announced to date focus on participation by public companies. The challenges for smaller, non-public institutions include: (1) prompt filing of a shelf registration covering the preferred stock and the warrants and related common stock, (2) warrant pricing calculated using the 20 day average market price of the issuer's common stock, and (3) the use of preferred stock as the investment vehicle, which institutions taxed as subchapter-S corporations may not issue. Despite this, CPP application form allows an applicant to indicate whether or not they currently have publicly traded shares and Treasury has indicated that they are working on terms for private financial institutions that will allow them to participate on the same general economic terms. Until these terms are known, private financial institutions faced with a November 14th application deadline may decide to apply and provide a comprehensive list of the terms and conditions that cannot be satisfied as the program is currently structured. If and when private investment terms become available, these institutions would presumably be given the opportunity to amend their application to indicate whether they are willing or able to participate.

News reports over the last week raised the possibility that insurance companies might also become eligible institutions under CPP. At this point, there is no official word from Treasury. In some news reports, MetLife was identified as a potential CPP participant. However, MetLife has a bank subsidiary and is a financial holding company. As a result, it is close to fitting into the scope of the program without significant alterations. Other insurers do not come as close to fitting CPP definition of eligible banking organizations. Speculation on the inclusion of insurance companies may be based on the interests of state insurance regulators and insurers in the development of a program for the insurance industry, rather than any hard evidence that Treasury is considering them for inclusion in CPP.

C. Investment Terms & Process

In general, the CPP provides for Treasury to invest in preferred stock issued by qualified institutions, that will be accompanied by warrants for the common stock of each institution. Although a number of the program's details remain in flux, interested institutions must apply to participate by November 14, 2008.

1. Investment Terms

Treasury may invest in an amount of Senior Preferred equal to not less than 1% of an issuer's risk-weighted assets and not more than the lesser of (i) $25 billion and (ii) 3% of risk-weighted assets.

The Senior Preferred will be included in the issuer's Tier 1 capital, will have a liquidation preference $1,000 per share (although this amount may be adjusted depending upon available authorized shares), and will be senior to common stock and pari passu with existing preferred shares other than preferred shares which by their terms rank junior to any other existing preferred shares

The Senior Preferred shall pay dividends quarterly, in arrears, at a rate of 5% per annum until the fifth anniversary of the investment and at a rate of 9% per annum thereafter. Dividends will be cumulative except for issuers without holding companies, in which case dividends will be non-cumulative.

The Treasury will also receive ten year warrants to purchase common stock of each issuer with an aggregate market price equal to 15% of the Senior Preferred amount on the date of investment, subject to reduction as set forth below. The initial exercise price for the warrants, and the market price for determining the number of shares of common stock subject to the warrants, shall be the market price for the common stock on the date of the Senior Preferred investment (calculated on a 20-trading day trailing average ending on and including the last trading day prior to the execution of the investment agreements), subject to customary anti-dilution adjustments.

The Senior Preferred may not be redeemed for a period of three years from the date of investment, except with the proceeds from a Qualified Equity Offering (defined as the sale by the issuer after the date of the CPP investment of Tier 1 qualifying perpetual preferred stock or common stock for cash) which results in aggregate gross proceeds to the issuer of not less than 25% of the issue price of the Senior Preferred. After the third anniversary, the Senior Preferred may be redeemed, in whole or in part, at any time and from time to time, at the option of the issuer. Following the redemption in whole of the Senior Preferred held by Treasury, the issuer shall have the right to repurchase any other equity security of the issuer (i.e., the warrants and common stock) held by the Treasury at fair market value. All redemptions of the Senior Preferred shall be at 100% of its issue price, plus (i) in the case of cumulative Senior Preferred, any accrued and unpaid dividends and (ii) in the case of noncumulative Senior Preferred, accrued and unpaid dividends for the then current dividend period (regardless of whether any dividends are actually declared for such dividend period), and shall be subject to the approval of the issuer's primary federal bank regulator.

For as long as any Senior Preferred is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Senior Preferred, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Senior Preferred), nor may the issuer repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Senior Preferred or common shares; unless (i) in the case of cumulative Senior Preferred all accrued and unpaid dividends for all past dividend periods on the Senior Preferred are fully paid, or (ii) in the case of non-cumulative Senior Preferred the full dividend for the latest completed dividend period has been declared and paid in full. Subject to the foregoing, the Treasury's consent shall be required for any increase in common dividends per share or for any share repurchases (other than (a) repurchases of the Senior Preferred and (b) repurchases of junior preferred shares or common shares in connection with any benefit plan in the ordinary course of business consistent with past practice) until the third anniversary of the date of the Senior Preferred investment, unless prior to such third anniversary the Senior Preferred is redeemed in whole or the Treasury has transferred all of the Senior Preferred to third parties.

The Senior Preferred shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Senior Preferred, (ii) any amendment to the rights of Senior Preferred, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Senior Preferred. Treasury will not exercise voting power with respect to any shares of common stock issued to it upon exercise of the warrants. If dividends on the Senior Preferred are not paid in full for six dividend periods, whether or not consecutive, the Senior Preferred will have the right to elect two directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

If stockholder approval is required for the authorization of enough shares to reserve for the exercise of the warrants or for the issuance of such shares, the warrant exercise price shall be reduced by 15% of the original exercise price on each six-month anniversary of the issue date such approvals are not obtained (subject to a maximum reduction of 45%). In the event the issuer is no longer listed or traded on a national securities exchange or securities association, or the consent of stockholders described above has not been received within 18 months after the issuance date of the warrants, the warrants will be exchangeable, at the option of the Treasury, for senior term debt or another economic instrument or security that appropriately compensates for the value of the warrant. In the event that the issuer has received aggregate gross proceeds of not less than 100% of the issue price of the Senior Preferred from one or more Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of common stock underlying the warrants then held by the Treasury shall be reduced by 50% of the number of shares originally underlying the warrants (taking into account all adjustments).

The Senior Preferred will be held initially by Treasury but will not be subject to any contractual restrictions on transfer. The warrants will not be subject to any contractual restrictions on transfer; provided that the Treasury may only transfer or exercise an aggregate of one-half of the warrants prior to the earlier of (i) the date on which the issuer has received aggregate gross proceeds of not less than 100% of the issue price of the Senior Preferred from one or more Qualified Equity Offerings and (ii) December 31, 2009.

The issuer must file a shelf registration statement covering the Senior Preferred, warrants and the common stock underlying the warrants as promptly as practicable after the date of this investment and, if necessary, shall take all action required to cause such shelf registration statement to be declared effective as soon as possible. The issuer will also grant to the Treasury piggyback registration rights for the Senior Preferred, warrants and the common stock underlying the warrants and will take such other steps as may be reasonably requested to facilitate the transfer of the Senior Preferred, warrants and the common stock underlying the warrants including, if requested by the Treasury, using reasonable efforts to list such securities on a national securities exchange. If requested by the Treasury, the issuer will appoint a depositary to hold the Senior Preferred and issue depositary receipts.

2. Executive Compensation

As a condition to the closing of Senior Preferred investment, the issuer and its senior executive officers shall modify or terminate all benefit plans, arrangements and agreements (including golden parachute agreements) to the extent necessary to be in compliance with, and following the closing and for so long as Treasury holds any equity or debt securities of the issuer, the issuer shall agree to be bound by the executive compensation and corporate governance requirements of Section 111 of EESA and any related guidance or regulations. The issuer and its senior executive officers shall grant to the Treasury a waiver releasing the Treasury from any claims that the issuer and such senior executive officers may otherwise have as a result of the issuance of any regulations which modify the terms of benefits plans, arrangements and agreements to eliminate any provisions that would not be in compliance with the executive compensation and corporate governance requirements of Section 111 of EESA.

3. Application and Approval Process

Any Qualifying Financial Institution ("QFI") may apply to participate in the CPP. An interested QFI must first consult with its primary federal regulator and then complete and file an application. For organizations with holding companies, the application must be filed by the holding company and the QFI should consult and file applications with its holding company regulator as well the regulator of its largest insured depository institution. Applications are due November 14, 2008. Upon review of each application, a QFI's primary federal regulator(s) will send the application and its recommendation to Treasury. Upon receipt of an application and primary regulator recommendations, Treasury will review and then decide whether to make a capital purchase, and if so in what amount. Investments will be announced within 48 hours of execution. No announcement will be made for applications that are withdrawn or denied. Approved applicants will have 30 days from notice of approval to submit the required investment agreements and related documentation.

A QFI is (i) any U.S. bank or U.S. savings association not controlled by a Bank Holding Company ("BHC") or Savings and Loan Holding Company ("SLHC"); (ii) any U.S. BHC, or any U.S. SLHC which engages only in activities permitted for financial holdings companies under Section 4(k) of the Bank Holding Company Act, and any U.S. bank or U.S. savings association controlled by such a qualifying U.S. BHC or U.S. SLHC; and (iii) any U.S. BHC or U.S. SLHC whose U.S. depository institution subsidiaries are the subject of an application under Section 4(c)(8) of the Bank Holding Company Act, except that any BHC, SLHC, bank or savings association that is controlled by a foreign bank or company is not a QFI.

Applications are filed using a two page uniform application form. Applicants are required to review the standard form investment agreements and related documentation, when available on Treasury's website, and indicate if applicant cannot comply with any terms and conditions of those agreements by November 14, 2008. For any terms and conditions that cannot be complied with by that deadline, an applicant is required to provide a one page written explanation, including the reasons the terms or conditions cannot be met, and a time line for achieving compliance. If the form investment agreements and related documentation are not available at the time an application is filed, an amended application must be filed after the agreements and documents become available and have been reviewed.

Applicants are also asked to prepare and submit a one page description of any mergers, acquisitions or other capital raisings that are pending or under negotiation and the expected consummation date.

Applicants may request confidential treatment of specific portions of an application, giving an applicant the opportunity to request confidential treatment of information regarding transactions under negotiation, compliance with the terms and conditions of the program and other sensitive information. Decisions on confidential treatment will be made by the primary federal regulator(s). Given Treasury's plan not to announce denials or withdrawals of applications and the potentially severe impact of a failed application, applicants should seek to obtain confidential treatment of the entire application until approved.

D. Implementation Issues

While the investment terms of CPP seem relatively straightforward, the specific criteria to be applied for approval of applications are less clear. The long term viability is of an applicant appears to be a criteria and some healthy institutions are being encouraged to apply while some weaker institutions are apparently being told they are not eligible. Treasury has indicated they will rely heavily on the assessment of an institution's primary federal regulator, although they will no doubt continue to take into account systemic risk issues in evaluating certain larger bank applicants.

A significant part of the application is review and consent to the terms and conditions of the form investment agreement and related documents, which are not yet available. While the application form appears to contemplate non-public applicants, the current investment terms present significant compliance issues for non-public institutions, subchapter S corporations and other small institutions. There is also some speculation that the investment agreements will prescribe or encourage particular uses for the capital. Applications filed before the form investment agreements are available are required to amend their application to address any issues raised by those agreements, essentially producing a two step application process for some.

F. The Rest of TARP

As previously described, under EESA, the Treasury must establish implementation guidelines to address mechanisms for purchasing troubled assets; methods for pricing and valuing troubled assets; procedures for selecting asset managers; and criteria for identifying troubled assets. The guidelines must be published within 45 days after enactment of the Act (i.e., by November 17, 2008) or within 2 days after the first purchase under TARP.

The Treasury has published guidelines on procurement authorities and procedures, conflict of interest mitigation procedures, and asset manager selection procedures.

With respect to other guidelines due, Treasury has reported that it has policy teams working to identify which mortgage-backed securities and loans to purchase, from whom to buy them, and how to value them. They are also structuring the purchase mechanisms and reviewing asset manager proposals. It continues to develop a program to purchase the assets through an auction format, and will be issuing program guidance in the coming weeks.

Treasury has also announced the following additional developments:

- Insurance program. Treasury has requested public comment to solicit ideas on structuring options for the program to insure troubled assets. The request was posted on October 16 and responses were due by October 28.

- Homeownership preservation. A policy team is working with HUD to identify opportunities to help the homeowners of purchased mortgages and mortgage-backed securities.

- Executive compensation. Companies participating in TARP programs must adopt Treasury's standards for executive compensation and corporate governance. Treasury issued executive compensation guidelines on October 14 for three TARP programs.

- Office of Financial Stability. Treasury has named interim leaders for several key positions in the new Office of Financial Stability created to implement the Act. The Financial Stability Oversight Board was established, and the Chairman of the Federal Reserve Board will chair the group.

II. EXPANDED DEPOSIT INSURANCE

A. Increase in Deposit Insurance Cap

EESA temporarily increased the maximum deposit insurance limit for both banks and credit unions from $100,000 to $250,000 per depositor, through December 31, 2009. The FDIC implemented the increased deposit insurance cap immediately upon passage of EESA and has applied the higher limits in subsequent bank closings.

The $250,000 limit applies to all types of "deposits" as defined in the Federal Deposit Insurance Act, including checking, savings and trust accounts, and certain securities accounts. Each depositor is insured up to the federal limit for all deposits held in a particular capacity (i.e., the limit is applied separately to individual accounts, joint accounts, corporate accounts, retirement accounts and trust accounts).

Financial institutions' insurance assessments have not been increased to pay for the higher insurance limits. Instead, the FDIC and the National Credit Union Administration Board are authorized to borrow from the Treasury Department as needed to fund insurance payouts. Unless the increase is extended by Congress, the deposit insurance limit will reset to $100,000 on January 1, 2010, and will be increased gradually after that date in accordance with previously approved inflation adjustments that take effect starting in January 2011.

B. Temporary Liquidity Guarantee Program

On October 14, 2008, the FDIC announced its Temporary Liquidity Guarantee Program ("TLG Program") to provide additional liquidity to banks and bank holding companies. The TLG Program has two prongs: unlimited insurance for deposits in non-interest bearing transaction accounts and a guarantee of senior unsecured bank debt. The FDIC published an Interim Rule establishing the parameters of the program on October 23.[1]

The TLG Program was authorized under the FDIC's power to take extraordinary measures in circumstances involving systemic risk.[2] To exercise this power, the FDIC and the Federal Reserve Board must make a joint written recommendation to the Treasury Secretary, who can then make a determination that systemic risk exists, after consulting with the President. Secretary Paulson made such a determination on October 13. The FDIC's recommendation was based on concerns about the high cost of short-term bank funding, the movement of deposits from community banks to larger (and theoretically more stable) institutions and the potential for a flight of capital to foreign financial institutions after other governments increased their deposit guaranties.

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1 *See* Draft Interim Rule at http://www.fdic.gov/news/news/press/2008/pr08105.html (the "Interim Rule").

2 12 U.S.C. § 1823(c)(4)(G). The FDIC is authorized to make loans to, make deposits inc, purchase assets or securities of or assume liabilities of any insured depository institution (not just failed institutions) "when severe financial conditions exist which threaten the stability of a significant number of financial institutions or of insured depository institutions possessing significant financial resources."

Three categories of financial institutions are automatically eligible to participate in the TLG Program: (a) FDIC-insured depository institutions, (b) bank holding companies and financial holding companies that have at least one operating insured depository institution, and (c) savings and loan holding companies that have at least one operating insured depository institution and do not engage in any activities other than those permissible for a bank holding company under Section 4(k) of the Bank Holding Company Act. The TLG Program is not available to the investment banks that recently applied to become bank holding companies, or to savings and loan holding companies that also own other, non-banking commercial businesses. However, the Interim Rule does permit affiliates of the three types of institutions mentioned above to apply to the FDIC for inclusion in the program. Although this provision could provide an avenue by which non-bank affiliates of eligible financial institutions can participate in the debt guarantee program, the FDIC has indicated its unwillingness to extend such benefits to commercial enterprises affiliated with industrial loan companies or thrifts.[3]

The TLG Program will be funded by fees charged to participating institutions. If the fees prove insufficient to fund program outlays, the FDIC can levy an industry-wide assessment to make up the shortfall. Any excess fees will be transferred to the deposit insurance fund when the program expires. Except for those affiliates that must apply for inclusion in the program, all eligible institutions are automatically covered under both the deposit insurance and debt guarantee programs without charge until November 12, 2008. Institutions that do not wish to participate may opt out before that date; those that do not opt out will continue to be covered after November 12 and will be subject to fees as outlined below. An eligible institution may opt out of one or both prongs off the program, but all eligible entities within a holding company structure must make the same opt-out or opt-in decision.

1. <u>Temporary Insurance for Non-Interest Bearing Transaction Accounts</u>

This prong of the TLG Program provides unlimited deposit insurance for non-interest bearing transaction accounts through December 31, 2009. Most of the accounts that will be covered by the expanded insurance are commercial payroll and other payment processing accounts. Participating banks will pay a fee of 10 basis points on the amount insured under this program. The FDIC estimates that the TLG Program will add about $500 billion to the $5 trillion in deposits already insured under the new $250,000 insurance cap (out of a total of approximately $7 trillion in insured deposits in all U.S. banks).

All insured banks must prominently disclose whether they have opted in or out of the deposit insurance program, in writing, at their main office and each branch where deposits are taken. In addition, the FDIC will maintain a list on its website showing which banks have opted out of the program and which have stayed in. In the event of a bank failure, depositors will be paid their insured deposits through normal FDIC receivership procedures, which in most cases result in insured funds being made available to the depositor on the first business day after a bank is closed.

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3 *See*, Technical Briefing on the Temporary Liquidity Guarantee Program, October 16, 2008, at http://www.fdic.gov/regulations/resouraces/TLGP/101608.html.

One nuance of the plan concerns sweep accounts. Many banks use arrangements whereby funds in a depositor's transaction account are automatically swept each day to a savings account, money market fund or other investment vehicle. These arrangements are used for two reasons: they reduce the bank's reserve requirements, which are based on the amount of money in transaction accounts, and they enable commercial depositors to earn investment income on their funds (banks are not permitted to pay interest on commercial transaction accounts). The Interim Rule specifies that interest-bearing savings accounts used in these sweep arrangements are not covered by the increased insurance; non-interest bearing savings accounts are covered. In the event of a bank failure, FDIC regulations provide that all sweep arrangements scheduled to be performed before the close of business will be completed before insurance determinations are made. Thus, if a depositor has a sweep arrangement, only funds that remain in the transaction part of the sweep account or another non-interest bearing account after the close of business will be fully insured; funds in the investment part of the sweep account will be limited by the $250,000 per customer cap. The Interim Rule requires banks to inform their sweep customers in writing of the extent to which their accounts are insured.

2. Guarantee of Senior Unsecured Bank Debt

Under this prong of the TLG Program, the FDIC will guarantee new senior unsecured debt issued by eligible institutions between October 14, 2008 and June 30, 2009 (the "availability period"). Debt issued during this period will be guaranteed until June 30, 2012. The debt guarantee is intended to counteract market forces that have increased the price and reduced the availability of interbank funding in recent months.

Debt eligible for the guarantee includes promissory notes, commercial paper, certificates of deposit, federal funds purchased, and international banking facilities and Eurodollar deposits for the account of the eligible institution. To qualify for the guarantee, debt must be noncontingent, in a fixed amount, payable on a date certain and documented by a written instrument that specifies that the debt is "guaranteed by the FDIC." Debt excluded from the guarantee program includes affiliate loans, derivatives, the unsecured portion of secured debt (such as repo facilities) and international banking facilities and Eurodollar deposits held for depositors.

The amount of the guarantee available to each participating institution is capped at 125% of that institution's senior unsecured debt outstanding on September 30, 2008 with a maturity date on or before June 30, 2009. This cap is intended to permit eligible institutions to roll over debt instruments coming due in the next nine months, plus a 25% cushion. The cap is based on the amount of outstanding debt, not the amount available under lines of credit, shelf facilities and the like; a bank receives no credit for the undrawn portion of such facilities. Eligible institutions may apply for exceptions to the cap on a case-by-case basis, including institutions that had no debt outstanding on the cutoff date. Unless exceptions are made for institutions with no unsecured debt outstanding on September 30, 2008, the program will not reach many smaller institutions (which rely on secured borrowing).

Participating institutions will pay a non-refundable fee of 75 basis points (annualized) on all new debt issued during the availability period. If an institution represents that new debt is insured when the debt exceeds that institution's guarantee cap, the fee increases to 150 basis points for all outstanding guaranteed debt. By default, all new debt issued by a participating institution will be guaranteed and will be subject to the fee until that institution reaches its cap. However, an institution may request the ability to issue non-guaranteed debt during the availability period, in exchange for paying a fee equal to 0.375% (37.5 basis points) of its guarantee cap amount.

The FDIC only pays on the guarantee in the event of a bank failure or bankruptcy of a bank holding company. The guarantee does not cover missed payments or other events of default. In the event of a bank failure, the creditor must file a proof of claim with the FDIC, which will be paid through normal receivership procedures. In the event of a holding company bankruptcy, the creditor will need to file a proof of claim with the bankruptcy court and with the FDIC. In most cases, the FDIC will pay the guaranteed amount after the bankruptcy claims bar date and then attempt to recover what it can from the bankruptcy estate.

Certain operational aspects of the guarantee program have not been clarified. For example, it is left to each borrower institution to tell its creditors whether a debt instrument will be guaranteed by the FDIC. If a borrower issues debt to multiple counterparties on the same day and the total amount of such debt causes the borrower to exceed its guarantee cap, the FDIC has not specified how the borrower or the creditors determine who gets the benefit of the guarantee. Banks that sell federal funds through intermediaries may face pricing problems, because they will not necessarily know at the time of sale whether the banks purchasing such funds (borrowers) have FDIC guarantees available. The FDIC may issue further guidance in the form of Financial Institution Letters to address these issues.

C. Temporary Insurance for Money Market Funds

On September 19, 2008, the Treasury Department announced a temporary program to guarantee money market funds. The catalyst for this action was the announcement on September 16 by Reserve Management Company, Inc., that three of its money market funds had "broken the buck" due to write-downs related to the Lehman Brothers bankruptcy, declining in value to 97 cents per share or less.

Funding for the guarantee program comes from the Exchange Stabilization Fund ("ESF"), a Treasury fund used to protect the value of the dollar in international markets. Under the Gold Reserve Act of 1934 (as amended), which created the ESF, the Treasury Secretary, with the approval of the President, may "deal in gold, foreign exchange and other instruments of credit and securities the Secretary considers necessary." ESF assets are currently valued at about $50 billion.

The Treasury Secretary, with the President's approval, decided to use his authority as administrator of the ESF to guarantee the value of money market funds. No formal regulations have been issued for the money market guarantee program. The parameters of the program are set out in statements of the Treasury Department and the guarantee agreements which each participating fund must sign. To be eligible for the guarantee, funds must (a) be regulated under Rule 2a-7 of the Investment Company Act of 1940, (b) be publicly traded and registered with the Securities and Exchange Commission, (c) have a policy of maintaining a stable net asset value of at least $1.00 and (d) must have signed a guarantee agreement by October 10, 2008. To prevent a large-scale transfer of funds out of deposit accounts and other investment vehicles and into money market funds, the Treasury Department has limited the guarantee to money market shares held by investors on September 19, 2008. An investor who held shares in a money market fund on that date may sell and repurchase those shares, but new purchases in excess of the amount held on September 19 will not be guaranteed.

The guarantee is triggered if a money market fund's net asset value drops below $0.995 per share. If that occurs, the fund must notify the Treasury Department no later than the next business day and the fund must be liquidated within 30 days. The Treasury Department will pay shareholders the difference between the fund's liquidation price and its stable asset value. The program is funded by a fee based on each participating fund's total share value.

The guarantee program was initially authorized for three months and may be extended for additional three-month periods by the Treasury Secretary, until September 19, 2009.

EESA prohibits the Treasury from using the ESF for the establishment of any future guaranty programs for the United States money market mutual fund industry.

III. FEDERAL RESERVE INITIATIVES

The Federal Reserve has always offered credit to depository institutions through its "discount window" as a lender of last resort. The discount window offers credit at a rate established by Federal Reserve at least every 14 days (the "primary credit rate"). The discount window remains available only to depository institutions. Loans of federal funds from the discount window are typically for an overnight term and must be secured by collateral specified by regulation. Satisfactory collateral includes commercial, industrial, or agricultural loans; consumer loans; residential and commercial real estate loans; corporate bonds and money market instruments; obligations of U.S. government agencies and government-sponsored enterprises; asset-backed securities; collateralized mortgage obligations; U.S. Treasury obligations; and the obligations of states or political subdivisions. Loans may be for a longer period provided there is adequate collateral and special administrative oversight. The Federal Reserve Banks are under no obligation to make, increase, renew, or extend any extension of credit.

Beginning in August 2007, the Federal Reserve used its existing legal authorities to greatly expand its Lending programs to combat the credit crunch. The major programs involved include a substantial modification of the terms of the primary credit program of the discount window, and the introduction of seven new facilities: the Term Auction Facility, the Term Securities Lending Facility, the Primary Dealer Credit Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, and the Money Market Investor Funding Facility, and swap facilities with several foreign central banks. Together, these programs alter the Federal Reserve's lending programs as follows:

1. longer terms for loans;
2. broader types of eligible collateral;
3. expanded range of eligible counterparties; and
4. reduced cost of borrowing from the Federal Reserve relative to the Federal Funds rate.

Finally, the Federal Reserve has intervened directly to assist with the acquisition of Bear Stearns by J.P. Morgan and to prevent the collapse of AIG.

A. Primary Credit Program of the Discount Window

Since August 2007, the Federal Reserve has made several changes to the primary credit program of the discount window. On August 17, 2007, the maximum term for borrowing was extended to 30 days, renewable by the borrower, and the spread between the discount rate and the Federal Funds rate was reduced from 100 basis points to 50 basis points. On March 16, 2008, the term for borrowing was extended to 90 days, and the spread was further reduced to 25 basis points. This change will remain in effect until the Federal Reserve determines that market liquidity has improved. The Federal Reserve Banks accept a broad range of collateral, including mortgage loans and mortgage-backed securities, and will consider any asset that meets regulatory standards for sound asset quality. Discount window transactions are reflected in the Federal Reserve's weekly public release H.4.1.

B. Term Auction Facility

On December 12, 2007, the Federal Reserve established the Term Auction Facility ("TAF") to provide term funding secured by the same collateral that is accepted at the discount window to depository institutions that are eligible for the primary credit program. Under the TAF, the Federal Reserve conducts bi-weekly auctions at which eligible depository institutions bid on a predetermined amount of funds. The minimum bid rate is equal to the one-month overnight index swap rate, and there are limits on the amount of funds available to any depository institution. TAF permits banks to borrow against a wide range of collateral, including securities that are not widely pledged in private markets, such as commercial loans. TAF originally auctioned 28-day funds, but on August 11, 2008, the Federal Reserve also began auctioning 84-day funds. As of July 30, 2008, the Federal Reserve limits an individual depository institution's total outstanding amount of term primary credit and TAF credit with a term exceeding 28 days to 75% of the lendable value of the depository institution's available collateral. The maximum authorized outstanding TAF credit is $150 billion.

C. Bear Stearns

On Friday, March 14, 2008, in response to a loss of confidence over the course of the preceding four business days, Bear Stearns announced it had secured a funding agreement with JP Morgan Chase and the Federal Reserve Bank of New York. By Monday, March 17, Bear Stearns had agreed to be acquired by JP Morgan Chase, in a transaction materially assisted by the Federal Reserve. The Federal Reserve Bank brokered the deal between Bear Stearns and JP Morgan and pressured Bear Stearns to accept the deal to avoid bankruptcy. The Federal Reserve also provided a $29 billion non-recourse loan to JP Morgan to assist with the acquisition.

D. Primary Dealer Credit Facility

On March 16, 2008, the Federal Reserve announced the creation of the Primary Dealer Credit Facility to extend credit on a recourse basis at the primary credit rate to non-depository institutions that are unable to secure adequate credit accommodations from other banking institutions. This program was initiated in the wake of the Bear Stearns collapse and is intended to provide liquidity to a limited number of major investment banking firms. Primary dealers eligible for advances consist of the largest broker-dealers in the United States and include several foreign banks. Loans may be requested only from the Federal Reserve Bank of New York, and the term is limited to overnight. An advance must be secured by notes, drafts, or bills of exchange satisfactory to the Federal Reserve. The collateral deemed satisfactory was expanded on September 14, 2008 to closely match the full range of repo market collateral. As with discount window lending, information on any loans made by the Federal Reserve under this facility will be made public each Thursday at 4:30 PM in the H.4.1 Release. In addition, under EESA, the Federal Board must report to designated committees of Congress any extensions of credit made pursuant to this facility within 7 days of the advance. This facility is set to expire January 30, 2009.

E. Term Security Lending Facility

This facility was created on March 11, 2008. The term securities lending facility ("TSLF") is a 28-day loan of Treasury general collateral available to the Federal Reserve Bank of New York's primary dealers. Like the TAF, the TSLF is an auction facility, but instead of auctioning loans secured by banking assets it auctions loans of securities secured by other, less liquid securities. Eligible collateral presently includes all collateral eligible for the Primary Dealer Credit Facility as well as investment grade corporate, municipal, mortgage backed, and asset-backed securities. TSLF loans are auctioned weekly to primary dealers. Dealers are limited in their borrowing to an amount no greater than 20% of the par value of the Treasury general collateral offered in any auction. Up to $200 billion in Treasury securities may be offered through TSLF auctions. Summaries of each auction are posted on the Federal Reserve Bank of New York website. Reporting obligations for loans pursuant to this facility are the same as the reporting required for the Primary Dealer Credit Facility. This facility is presently scheduled to expire January 30, 2009.

In addition to the loans available through the TSLF, this facility also offers options to Primary Dealers through the TSLF Options Program ("TOP"). TOP offers options on short-term fixed rate TSLF loans of general Treasury collateral against a pledge of eligible collateral. The TOP is designed to enhance the effectiveness of TSLF by offering added liquidity over periods of heightened market pressures**.** The term of the loan typically spans a short period of traditional collateral market dislocation, such as quarter-end dates. While the price of the loan is fixed, the price of the options is determined by competitive bidding.

TOP is designed to offer options on short-term TSLF loans at a future date. Option holders have the opportunity to exercise the option and borrow up to the amount awarded in the TOP auction at a fixed rate or permit the option to expire without a claim. Loans made through the TOP are shorter in term than the 28-day TSLF loans and will be for a term of two weeks or less. In most cases, it is anticipated that the term and settlement of the loan will not coincide with regularly scheduled TSLF auctions.

Option awards are determined by a competitive bidding process in a single auction format. Primary dealers that have elected to participate may submit up to two bids via FedTrade after 2 PM ET the day following the auction announcement. Only Primary dealers are eligible to bid at the auctions. Bids are limited to 20% of the par value offered at each auction. The options may not be transferred. Primary dealers who have received option awards may exercise the option by participating in a related TSLF auction held on the day the option expires. The Primary Dealer may exercise the option up to an amount of the options held at a predefined fixed rate.

F. Swap Lines with Central Banks

In December 2007, in conjunction with coordinated measures to address the stress in the U.S. dollar short-term funding markets, the Federal Reserve announced temporary swap lines with the European Central Bank and the Swiss National Bank, allowing those banks to lend dollars to banks pledging euros or other currencies as collateral. Those lines were increased in March and May 2008. The ECB line was increased in July, and both lines were increased twice in September. In addition, in September new swap facilities' were authorized with the Bank of Japan, the Bank of England, the Bank of Canada, Danmarks Nationalbank, Norges Bank, the Reserve Bank of Australia, and Sveriges Riksbank. These swap lines include both 28-day and 84-day terms. As of September 29, 2008, they totaled $620 billion, with further increases in October. Temporary reciprocal swap facilities are authorized through April 30, 2009.

G. AIG

In September 2008, AIG faced a serious liquidity shortage as a result of margin calls on mortgage-related credit default swaps. AIG, with over $1 trillion in assets, was the world's largest insurer and a major issuer of credit default swaps. On September 17, 2008, in an effort to avoid a catastrophic failure, the Federal Reserve loaned AIG $85 billion in exchange for an 80% equity stake in the company. This loan, however, proved to be insufficient. In early October, AIG was once again in need of liquidity, and the Federal Reserve stepped in with an additional $37.8 billion loan in exchange for investment-grade, fixed-income securities. The size of the AIG bailout is unprecedented. Additionally, the deal was unique because the Federal Reserve received an equity stake in a private corporation.

H. Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility

The Asset-Backed Commercial Paper Money Market Fund Liquidity Facility ("ABCPLF") provides non-recourse funding to U.S. depository institutions and bank holding companies to finance their purchases of high-quality asset-backed commercial paper from money market mutual funds to assist funds that hold such paper in meeting demands for redemptions by investors. ABCPLF was established on September 19, 2008. The maturity date of each advance is the maturity date of the related commercial paper. Eligible collateral must be A1/P1/F1 rated by two rating agencies or rated in the top category by one rating agency, and must have a stated maturity of not more than 120 days (for a bank borrower) or 270 days (for a non-bank borrower). Advances are made by the Federal Reserve Bank of Boston at its primary credit rate. Barring an extension by the Federal Reserve, no new credit advances will issue after January 30, 2009.

I. Commercial Paper Funding Facility

In October 2008, the Federal Reserve announced the creation of the Commercial Paper Funding Facility ("CPFF"), a special purpose vehicle formed as a "liquidity backstop" to U.S. issuers of commercial paper. On October 27, 2008, the CPFF began purchasing 90-day commercial paper issued by eligible entities. The Federal Reserve Bank of New York has committed to lend to the CPFF on a recourse basis secured by the all of the commercial paper assets acquired by the entity. The CPFF will purchase only U.S. dollar-denominated commercial paper (including asset backed commercial paper) rated A-1/P-1/F-1 respectively by the rating agencies. Eligible issuers are U.S. issuers of commercial paper, including U.S. subsidiary issuers with a foreign parent company. The maximum amount of commercial paper from a single issuer the CPFF may own at any time is the largest amount of commercial paper the issuer had outstanding on any day between January 1 and August 31, 2008.

The rates will be based upon the then-current 3-month overnight index swap rate plus fixed spreads dependent on whether the issue is secured or unsecured. In addition, each entity seeking to use the CPFF must file an application and pay a facility fee of 10 basis points of the maximum limit. The CPFF will cease purchasing commercial paper on April 30, 2009 unless extended by the Federal Reserve. This program commenced October 27, 2008 with the initial unsecured rate at 1.88 plus a 100 basis surcharge for an effective rate of 2.88% for unsecured commercial paper. The effective lending rate for asset backed commercial paper was fixed at 3.88%.

J. Money Market Investor Funding Facility

On October 22, 2008, the Federal Reserve implemented a Money Market Investor Funding Facility ("MMIFF"). Under the MMIFF, the Federal Reserve Bank of New York will fund a series of private-sector special-purpose vehicles ("SPV"). The SPVs will then finance the purchase of U.S. dollar-denominated certificates of deposit, bank notes, and commercial paper with remaining maturities of 90 days or less. The assets purchased by each SPV must be issued by one of ten highly-rated institutions designated in the SPV's organizational documents. No more than 15% of each SPV's assets may consist of debt instruments from any one issuer. The SPVs will fund the purchases with MMIFF funds (90%) and with asset-backed commercial paper (10%). The MMIFF funds will be loaned at the primary credit rate, secured by the SPV's assets, senior to the asset-backed commercial paper, and with full recourse to the SPV. The SPVs are authorized to purchase in the aggregate up to $600 billion in eligible assets, 90% of which would be financed by loans from the Federal Reserve.

Initially, eligible investors are limited to U.S. money market mutual funds, but the Federal Reserve may over time expand eligibility to include other U.S. money market investors. The MMIFF is set to expire, subject to Federal Reserve extension, on April 30, 2009.

K. Legal Authority

Most of the actions described in this Section were taken under the Federal Reserve's emergency lending power, Section 13(3) of the Federal Reserve Act, 12 U.S.C. § 343. Under unusual and exigent circumstances a Federal Reserve Bank, upon approval by at least five members of the Board of Governors, may lend directly to any individual, partnership, or corporation unable to secure adequate credit accommodations from other banking institutions. Historically, the Federal Reserve has been reluctant to exercise its lending powers under Section 13(3). The provisions was added in the 1930s, during which the Federal Reserve employed it to ameliorate the Great Depression, making numerous loans to companies and banks. Since that time, however, the provision has fallen into disuse. The Fed's unprecedented activities in the last 15 months constitute its most significant use of Section 13(3) since the Great Depression.

IV. OTHER INITIATIVES

A. FDIC Bank Resolutions

So far in 2008, 16 FDIC-insured depository institutions have failed, including the high-profile closure of IndyMac and the closure and subsequent sale of Washington Mutual to JPMorgan Chase, the largest bank failure in United States history. In addition, the FDIC decided in September 2008 to use its extraordinary systemic risk power (see Section 2.B above) to support Citigroup's bid to acquire some of the assets of Wachovia Bank and thereby prevent Wachovia's failure. Under that plan, which was rendered unnecessary when Wells Fargo stepped in to acquire Wachovia without FDIC assistance, the FDIC would have assumed the risk of nearly $300 billion in nonperforming mortgage assets, in exchange for preferred stock and warrants to purchase stock in Citigroup.

These numbers do not include banks that have been sold in private transactions before they reached the point of failure. One such transaction was the sale of Gateway Bank & Trust of Virginia to Hampton Roads Bancshares in September. Gateway submitted to the sale because it became undercapitalized after having to write down significant holdings of Fannie Mae and Freddie Mac shares when those companies were placed in receivership. No figures are readily available on the number of other institutions that have taken such measures to avoid FDIC intervention.

To put these numbers into perspective, there were three bank failures in 2007, none in 2006 or 2005, and four in 2004. The number of banks on the FDIC's "problem list" increased to 117 during the second quarter of 2008, up from 61 during the same period in 2007. The FDIC has taken administrative action to prepare for an increased rate of bank failures. In July, it published a new rule requiring the largest banks (those with deposits of $2 billion or more) to modify their data systems so that the FDIC can quickly determine account balances in the event of a failure.

Recent failures pushed the deposit insurance fund below the statutory minimum of 1.15% of insured deposits, even before the deposit insurance limit was raised by the EESA. As a result, banks can expect to see an increase in their insurance premium rates, which may be weighted towards riskier institutions, even though EESA specifies that assessments will not be increased to cover the higher insurance limit.

As receiver for IndyMac, the FDIC has been aggressively promoting loan modifications, in an effort to reduce the number of costly foreclosures and mitigate downward pressure on housing prices. Of the 700,000 loans serviced by IndyMac at the time of its closure, roughly 60,000, or 8% were delinquent, in bankruptcy, in foreclosure or otherwise in default. The FDIC, with the cooperation of Fannie Mae, Freddie Mac and other holders of the loans, will offer loan modifications (such as lower interest rates and lower monthly payments) to as many as 40,000 of those mortgagors. Other large mortgage servicers, including Bank of America (the new owner of Countrywide Financial) are looking at the FDIC's efforts as a model to deal with their bad loans.

B. Fannie Mae and Freddie Mac

On September 7, 2008, the FHFA announced that it had placed Fannie Mae and Freddie Mac, the government-sponsored enterprises ("GSEs") that purchase the majority of residential mortgage loans originated in the American market, under conservatorship. The FHFA is a new federal agency, created by the Housing and Economic Recovery Act of 2008, 12 U.S.C. § 4511 et seq., to serve as the primary regulator of the GSEs and the Federal Home Loan Banks. The Director of the FHFA has authority under the Federal Housing Enterprises Financial Safety and Soundness Act to place a GSE in conservatorship if he or she determines that the enterprise has incurred losses that will deplete all or substantially all of its capital and there is no reasonable prospect for it to become adequately capitalized. The details of the conservatorship have been documented through written statements of the FHFA Director and the Treasury Secretary.

The decision to place Fannie Mae and Freddie Mac in conservatorship represented the culmination of a steady decline in the enterprises' capital and market value over the last year. The enterprises have suffered financial losses due to high rates of mortgage delinquencies, while their ability to raise new capital has been hampered by contractions in the market for mortgage-backed securities ("MBS"), the enterprises' primary source of funds. Efforts by the Treasury Department and the Federal Reserve Board in July 2008 to provide capital to the GSEs through increased credit and stock purchases proved ineffective to stop the decline. Thus, the FHFA determined that a conservatorship was necessary to restore confidence in the GSEs and enable them to carry out their missions of providing liquidity to the mortgage market.

Conservatorship is not a reorganization or liquidation proceeding. It is intended to keep the GSEs functioning and to return them to a sound and solvent condition. During the conservatorship, the FHFA will assume the powers of the GSEs' Boards of Directors and their shareholders. The CEOs of the companies were dismissed from their positions but will stay on during a transition period. There is no set time frame for the conservatorship. The FHFA has said that the businesses will continue to operate as usual and will be allowed to grow their MBS portfolios without capital constraints through 2009. The FHFA will develop new regulations during the conservatorship period, including minimum capital standards, safety and soundness standards and portfolio limits.

The most significant components of the conservatorship, however, are three financing facilities provided by the U.S. Treasury. These consist of:

(a) *GSE Credit Facility*. A short term debt facility administered by the Federal Reserve Bank of New York, through which the GSEs can borrow against the value of MBS that they issue.

(b) *GSE Securities Purchase Program*. A program under which the Treasury, acting through independent asset managers, will purchase MBS issued by the GSEs, up to the Treasury's statutory debt limit.

(c) *Senior Preferred Stock Purchase Agreement*. A capital maintenance program through which the Treasury will make capital contributions to the GSEs whenever their total liabilities exceed assets, in exchange for senior preferred stock. The Treasury has committed up to $100 billion to each GSE under this program, the details of which are set out in stock purchase agreements. Upon signing the agreements, the Treasury received $1 billion in senior preferred stock from each GSE, with twenty-year warrants, to purchase up to 79.9% of each GSE's common stock at a price of 1/1000th of one cent per share. The senior preferred stock will pay a 10% dividend per year and will have preference in liquidation over all other preferred and common stock of the enterprises. The stock purchase agreements impose certain restrictive covenants on the GSEs, including restrictions on issuing new debt and new stock, executive compensation and asset sales. The GSEs will also be required to gradually reduce their MBS portfolios, staring in 2010.

Authority for all three of these facilities can be found in the Housing and Economic Recovery Act of 2008.

Since announcing the conservatorships, the FHFA has intervened in all litigation involving Fannie Mae and is seeking a 120-day stay of pending securities and ERISA actions. It has also undertaken new measures to restructure delinquent mortgage loans, including providing enhanced incentives to servicers to arrange loan modifications and providing bridge loans to delinquent borrowers.

C. Mark to Market Accounting Rules

The debate on the effect of fair value or mark to market accounting requirements on the credit crisis has received a great deal of attention. Many commentators suggest that the requirement has worsened the crisis by causing unnecessary, accounting driven "runs on the bank," while other commentators argue that mark to market accounting is essential to establish clearing prices to bring the crisis through a bottoming out process and put the system on the road to recovery. The former commentators take the position that mark to market accounting does not appropriately value assets for which there may be no market, but which are still producing, and are expected to continue to produce, substantial cash flows.

Section 133 of the Emergency Economic Stabilization Act of 2008 passed by the Senate requires the SEC to conduct and complete a study of mark to market accounting within 90 days of enactment. The study is required to address the impact of such accounting on financial institution balance sheets, bank failures and disclosures to investors, as well as on the advisability of, and alternatives for, modifying the existing fair value accounting standards.

Statement of Financial Accounting Standards Board No. 157 – Fair Value Measurements ("FASB 157") provides a framework for measuring the fair value of assets and liabilities under US generally accepted accounting principals for financial statement purposes. This fair value or mark-to-market accounting requirement has resulted in massive writedowns of illiquid securities, including mortgage securities, auction rate securities, swaps and derivative contracts, for which there exists no liquid or active market as a result of the current financial crisis. FASB 157 defines "fair value" as the price that would be received to sell an asset "in an orderly transaction between market participants" at the relevant date.

On September 30, 2008, the SEC's office of the Chief Accountant issued several interpretations to clarify the requirements for determining fair value for securities in an inactive or illiquid market (*i.e.*, markets that lack willing and able market participants, or where forced sale or distress liquidations are taking place). Those interpretations are discussed in our Digest of EESA dated October 6, 2008.

On October 10, 2008, the FASB adopted FASB Staff Position 157-3 ("FSP 157-3") clarifying the application of mark to market accounting rules in a market that is not active. FSP 157-3 provides some new flexibility in applying fair value accounting where there is no active market for a security. The new guidance provides an example of how to determine the fair value of a financial asset in a distressed sale or forced liquidation and in an otherwise inactive market. The guidance states that distressed sales or forced liquidations are not orderly transactions and therefore are not an accurate measure of fair value. But FSP 157-3 also states that even in times of market dislocation, not all sales represent distressed sales. Reporting entities must consider the facts and circumstances surrounding a particular transaction and use judgment in determining if a sale is an orderly transaction or not.

The new guidance is effective and applies to the next reporting period for which financial statements are issued, including for companies with quarters ending September 30, 2008. It allows companies to use estimates of value, taking into account expected risk discounted future cash flows when an active market for a security does not exist.

The reaction to FSP 157-3, was not unanimously positive. On October 13, 2008, the American Bankers Association ("*ABA*") sent a letter to the SEC asking the SEC to override FSP 157-3 which the ABA views as an inadequate response to the issues facing banks as a result of the financial crisis.

Since the adoption FSP 157-3, regulators in Europe and Asia – including Japan and Singapore – have also proposed changes to add flexibility to mark to market accounting requirements. The European changes were approved by the European Parliament on October 15. Thus, a consensus is now emerging that additional flexibility is needed on fair value accounting in light of the financial crisis.

D. The Municipal Market

The jury is still out on how the Federal efforts to assist the financial markets will impact the municipal bond market. The true barometers will become more apparent once the Treasury has promulgated the guidelines for the implementation of the TARP program, as it will be those guidelines that will directly impact the manner in which many effected outstanding municipal issues will be addressed. The ultimate decisions with respect to the types of transactions that will be funded and the manner in which those transactions are dissected and "corrected" could have a broad effect on the liquidity and stability of the municipal market. What has become apparent since the enactment of EESA however, is that the flexibility of the municipal market has been making it one of more resilient markets during the credit crisis. Municipal Bonds have historically been a 'safe' and 'conservative' investment vehicle. A good indicator of the market's opinion on the viability of the municipal market was a recent statement by the executive director of a major issuer of municipal debt, who said "Municipals continue to be a safe investment and perhaps retail investors are looking for that quality that they can't find elsewhere right now." So while the market waits for the final guidelines for the TARP program, signs indicate that the municipal market will likely prove resilient even without direct federal assistance.

E. Private Sector Contracts

The Federal government is turning to the private sector to prepare for the massive task of overseeing mortgages and other financial assets the Treasury and the Federal Reserve will acquire under the programs described in this report.

The Treasury is only hiring about two dozen new employees with expertise in asset management, accounting and legal issues to assist in the execution of TARP, a $700 billion program. The remaining responsibilities will be outsourced to private sector professionals. The Federal Reserve is also outsourcing responsibilities under its expanded lending facilities. Below is a list of firms named so far that are charged with significant roles in the implementation of the programs described in this report and a description of their duties.

1. Simpson, Thacher and Bartlett

Providing legal oversight and counsel during implementation of the EESA will be the New York-based law firm of Simpson, Thacher and Bartlett ("Simpson"). Simpson will assist the Treasury Department in the "formulation of equity participation documentation including, but not limited to, co-investment accompanying private sector investment, shelf facilities for government investment without private sector investment, warrants or senior notes accompanying mortgage-backed securities or whole loan purchases, and other direct investments." Treasury's contract with Simpson will last for six months, and the firm will be paid $300,000 for its work.

2. Pimco

The Federal Reserve selected U.S. bond fund management company Pacific Investment Management Co. ("Pimco") to serve as the asset manager for the Fed's Commercial Paper Funding Facility, a new measure to provide support to troubled markets that corporations rely on for short-term funding. Pimco is a division of Allianz and the world's largest bond fund. State Street Bank and Trust Co. will serve as custodian and administrator of the Commercial Paper Funding Facility.

3. BNY

The Treasury Department has selected the Bank of New York Mellon ("BNY") to serve as its custodian for the implementation of TARP. BNY will assist the Treasury with a variety of services needed to administer the complex portfolio of troubled assets the government plans to purchase. Specifically, under this three-year contract, BNY will provide the accounting of record for the portfolio, hold all cash and assets in the portfolio, and provide for pricing and asset valuation services. BNY will also track unique asset attributes as required by the Act, such as linkages to executive compensation limits. In addition, BNY will support the acquisition of securitized assets by serving as auction manager and conducting reverse auctions for the trouble assets.

4. PricewaterhouseCoopers/ Ernst and Young

PricewaterhouseCoopers LLP and Ernst & Young are charged with assisting the Treasury with accounting and internal controls services needed to administer TARP. PricewaterhouseCoopers will establish internal control procedure and Ernst & Young will provide general accounting support and expert advice. The two contracts last until September 30, 2011. PricewaterhouseCoopers will be paid $191,469.27 and Ernst and Young will collect $492,006.95 in fees.

5. EnnisKnupp and Associates

EnnisKnupp and Associates of Chicago will serve as the Treasury investment adviser as it implements TARP. The investment consultant will provide assistance as Treasury evaluates potential asset managers and other vendors. EnnisKnupp's duties will also include developing and maintaining investment policies and guidelines and assisting with oversight, including helping Treasury determine asset allocations for each manager, evaluating the performance and costs, identifying conflicts of interest and identifying strategic investment and market issues impacting the overall portfolio. Additionally, the firm will identify qualified minority- and women-owned businesses to provide services for the portfolio. This contract will last for one year.

F. International Initiatives

Great Britain was the first European nation to introduce a package of measures to tackle the credit crisis. On October 13, 2008, the British government acquired stakes in three of the five largest British banks in return for an aggregate capital injection of £37 billion, with the stated aim of increasing capital ratios in order to better equip these banks to cope with a possible further decline of the value of their assets. In addition, on the morning of October 13, 2008, the members of the Eurozone (15 nations which have adopted the Euro) met, together with Great Britain, to discuss how to approach the global financial crisis. An agreement was reached in principle to take coordinated action, as well as work with the United States, with the initial aims of restoring confidence in the markets and providing capital to financial institutions. Most of the European measures will be implemented through the end of 2009, with the option to renew for periods of time thereafter. Examples of European initiatives are as follows:

France: On October 13, 2008, the French Government approved a 360 billion Euros bailout package, including a 40 billion Euros recapitalization fund for French banks. On October 20, 2008, the French Government announced a capital injection of 10.5 billion Euros into France's six largest banks to boost their solvency ratios in the light of the credit crisis. The capital injection takes the form of perpetual Tier 1 regulatory capital, which is non-voting, not dilutive and without effect to existing dividend policy. The securities issued in exchange bear interest at a rate of 400 basis points over the base rate and feature a 5 year call option. Banks will be required to provide monthly reports to the Government as to how they are using the funds and will also be required to accept pay restrictions for executives, including restrictions on severance packages and stock-options.

Germany: the German Federal Government created the Financial Market Stability Fund of up to 400 billion Euros, from which banks can request assistance subject to fulfillment of certain requirements. Participating banks will be required to provide business plans, adjustment of compensation packages and details of dividend distributions (and restrictions thereon), among other things.

Great Britain: The British bailout plan set the tone for subsequent European and US bailout plans. The package of measures, in the aggregate amount of £500 billion, included capital injection, a Bank of England facility to boost liquidity and guarantees to boost interbank lending. In addition, there are a package of restrictions imposed on executive compensation, severance pay and declaring dividends. The British plan was among the first of the European bailout plans to be approved by the EU regulators, on the basis of guidelines agreed by eurozone ministers during a meeting in Luxembourg on 6 October.

The Netherlands: On October 23, 2008, the Netherlands announced the implementation by the Dutch State Treasury of a 200 billion Euros credit guaranty scheme, running through 12/31/09, for the issuance of medium term bank debt. The scheme targets senior unsecured loans; ‘plain vanilla’ commercial paper, certificates of deposit, and medium term notes, with maturities ranging from 3 to 36 months. Fees depend on creditworthiness of the banks involved and will be based on historical credit default swap spreads (or an approximation thereof), with an addition of 50 basis points. Maturities of less than a year will have a fixed fee of 50 basis points. The scheme will include loans denominated in US Dollars and British Pounds. Both principal and interest will be covered. All Dutch banks meeting the criteria of the scheme will be eligible for assistance and the Dutch Central Bank will determine the banks’ solvency and liquidity profiles in relation to the requested loans, on application. The scheme also allows for State recapitalization and participating banks are required to agree to additional requirements on corporate governance with respect to bonuses and resignation premiums.

Spain: The Spanish Government announced the creation of a 30-50 billion Euros emergency fund to provide liquidity to the financial system. Bank deposit guarantees were increased to 100,000 Euros. In addition, the Spanish Government introduced new legislation approving up to 100 billion Euros worth of state guarantees for new financing, in the form of CP and bonds, by Spanish banks. This may be extended to cover interbank deposits. The maximum maturity of securities (which will take the form of preferred stock and participation certificates) issued in return for capital assistance is five years.

Switzerland: The Swiss bailout plan is focused mainly on its biggest bank, UBS, which has suffered the majority of Switzerland’s losses in the financial crisis. The Swiss National Bank agreed to inject SFr6 billion into UBS, in return for a 9.3 per cent stake. In addition, UBS will transfer up to $60 billion of assets (the majority of which are in the U.S.) to a newly created fund entity and will capitalize the fund with equity of up to $6 billion. The Swiss National Bank will finance the fund with a loan of up to $54 billion, secured on the assets of the fund, taking over control and ownership of the entity.