

# Publications

## Client Alert: Financial Crisis Update 2

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### CLIENT ALERT | 9.26.2008

House and Senate negotiators appeared to have reached an agreement with the Bush Administration on the content of bank bailout legislation yesterday, but the prospects that legislation would be enacted before the markets open on Monday were dealt a very serious blow when conservative House Republicans introduced an alternative approach during a meeting with President Bush at the White House late in the afternoon.

At midday Thursday, House and Senate negotiators announced a four-part agreement on principles for the bailout legislation:

- **Taxpayer Protection** - The bill would require the Treasury Secretary to set standards to prevent excessive or inappropriate executive compensation for participating companies. To minimize the risk to the American taxpayer, the bill would require the federal government to have an equity stake in participating companies. Finally, the bill would require that most profits from the eventual sale of any assets acquired by the government be used to reduce the national debt.
- **Oversight and Transparency** - The bill would prohibit the Treasury Secretary from acting in an arbitrary or capricious manner or in any way that is inconsistent with existing law. In addition, the bill would establish a strong oversight board with cease and desist authority. The bill would require program transparency and public accountability through regular, detailed reports to Congress disclosing how the Treasury Secretary exercised his authority under the program. The bill would also establish an independent Inspector General to monitor the use of the Treasury Secretary's authority. Finally, the bill would require Government Accountability Office audits to ensure proper use of funds, appropriate internal controls and to prevent waste, fraud and abuse.
- **Homeownership Preservation** - The bill would direct the Treasury Secretary to maximize and coordinate efforts to modify mortgages for homeowners at risk of foreclosure and would require loan modifications for mortgages owned or controlled by the Federal Government. The bill would also direct a percentage of future profits

to the Affordable Housing Fund and the Capital Magnet Fund.

- **Funding Authority** - The bill would authorize the Treasury Secretary's request for \$700 billion, but with only \$250 billion available immediately and an additional \$100 billion released upon his or her certification that funds are needed. The expenditure of the final \$350 billion would be subject to a Congressional joint resolution of disapproval.

When House and Senate negotiators met with congressional leaders and President Bush at the White House late yesterday afternoon to discuss the agreement on principles, however, conservative House Republicans proposed an entirely different approach to the illiquidity problem based on a combination of mortgage insurance and tax incentives for private investors. The House Republicans proposal contained six elements:

- **Mortgage Insurance** - Requires the Treasury Department to design a system to charge premiums to holders of mortgage-backed securities to finance insurance for the fifty percent of mortgage-backed securities not already covered by federal insurance.
- **Remove Barriers to Private Investment** - Requires the Treasury Secretary to remove regulatory and tax barriers that are blocking private capital formation.
- **Temporary Tax Relief** - Suspends the capital gains tax for two years to free up capital to maintain operations, create jobs, and encourage lending between private financial institutions, allows for a temporary suspension of dividend payments by financial institutions.
- **Transparency and Oversight** - Requires participating firms to disclose to the Treasury Department the value of their mortgage assets, the value of any private bids within the last year for such assets, and their last audit report.
- **Credit Rating Agencies** - Requires the Securities and Exchange Commission to review the performance of the credit reporting agencies and their ability to accurately reflect the risks of these failed investment securities.
- **Blue Ribbon Commission** - Creates a blue ribbon panel with representatives from the Treasury Department, Securities and Exchange Commission and the Federal Reserve Board to make recommendations to Congress for reforms of the financial sector by January 1, 2009.

The announcement of the conservative House Republican proposal brought the White House meeting to an abrupt end. Treasury Secretary Paulson met with House and Senate negotiators late into the evening to assess the conservative House Republican proposal. Negotiations were scheduled to begin again this morning. Prospects for enactment of any legislation today or over the weekend are uncertain at best.

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