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Heads Up

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In This Issue:

Considerations Regarding the Emergency Economic Stabilization Act of 2008

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On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 ("the Act"). One of the objectives of the Act is to:

> [R]estore liquidity and stability to the financial system of the United States . . . in a manner that —
>
> (A) protects home values, college funds, retirement accounts, and life savings;
>
> (B) preserves homeownership and promotes jobs and economic growth;
>
> (C) maximizes overall returns to the taxpayers of the United States; and
>
> (D) provides public accountability for the exercise of such authority.

This *Heads Up* summarizes key provisions of the Act, and the accompanying appendixes describe the accounting, tax, and business issues raised by the Act that may require consideration in the upcoming weeks. These issues may affect **all** entities, because transactions executed in accordance with the Act may affect overall market liquidity and investment valuations. The discussion focuses only on issues specific to the economic stabilization provisions of the Act (i.e., the Troubled Assets Relief Program and related budgetary and tax provisions). Provisions and tax incentives included in the same law as the Act that are not directly related to the government's economic stabilization efforts are beyond the scope of this analysis (e.g., energy production incentives, tax extenders, and Alternative Minimum Tax Relief).

Throughout the discussion, references to pertinent sections of the Act are provided to assist readers seeking additional detail. **The ultimate determination of the appropriate accounting or tax treatment for many of the issues raised in this discussion will depend on details of regulations or guidelines that are not yet finalized.** Section 101 of the Act states that program guidelines still to be published include:

(1) Mechanisms for purchasing troubled assets.

(2) Methods for pricing and valuing troubled assets.

(3) Procedures for selecting asset managers.

(4) Criteria for identifying troubled assets for purchase.

Overview

The Act grants the secretary of the Treasury ("the secretary") authority to purchase troubled assets from financial institutions (as defined below). The full authorization permits up to $700 billion of such assets to be outstanding at any one time. Initially, the secretary's authority is limited to $250 billion outstanding at any one time; however, that cap may be increased to $350 billion upon the president's written request to Congress. The remaining $350 billion of the authorization can be obtained only if (1) the president submits a written report to Congress detailing the secretary's plan to use the additional authority; and (2) during the ensuing 15-day window, Congress chooses not to pass a joint resolution disapproving the increased authorization (§115).

Asset purchases will be made through the Troubled Asset Relief Program (TARP), which will be administered by the newly formed Office of Financial Stability (§101). Additional oversight will be provided by (1) the Financial Stability Oversight Board, comprising the chairman of the Federal Reserve, the secretary of the Treasury, the director of the Federal Housing Finance Agency, the chairman of the SEC, and the secretary of Housing and Urban Development (§104); (2) the comptroller general (§116); (3) a special inspector general for the TARP (§121); and (4) the Congressional Oversight Panel (§125).

The Act defines a "financial institution" as "any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State . . . and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government" (§3). The Act emphasizes that all financial institutions are eligible to participate in the program, regardless of their size, location, or nature of their troubled assets (§103).

Editor's Note: Determining whether a specific type of private entity is a qualifying financial institution will depend on future interpretations of whether the entity is "regulated" or has "significant" U.S. operations.

The "troubled assets" that financial institutions may sell are defined primarily as "residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008," but may also include any other financial instrument whose purchase is "necessary to promote financial market stability." (Such determination must be based on consultation with the chairman of the Federal Reserve and submitted in writing to the appropriate congressional committees) (§3). The Act also requires the secretary to consider "the utility of purchasing other real estate owned and instruments backed by mortgages on multifamily properties" (§103).

Editor's Note: The Act provides the secretary with significant discretion in determining what troubled assets are eligible for purchase by the government. The eligibility of non-mortgage-based securities (e.g., credit-linked securities) for sale to the program will depend on the secretary's determination of whether government purchases of such securities are necessary to promote financial market stability.

Insurance Program (§102)

In conjunction with establishing the TARP, the Act requires the secretary to "establish a program to guarantee troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities." Upon receipt of payment of a premium (which may vary according to the type of asset to be guaranteed) from the financial institution, the secretary "may guarantee the timely payment of principal of, and interest on, troubled assets in amounts not to exceed 100 percent of such payments." Premiums received will be placed in the Troubled Assets Insurance Financing Fund ("the Fund"), which will invest in U.S. treasuries or cash. Any future guarantee payments that the government needs to pay out will be disbursed from the Fund. The Act requires the secretary to set premiums at a level necessary to provide sufficient funding for future payments and to publish the method for determining premium amounts. The secretary's purchasing authority under the Act is reduced by the excess of outstanding guaranteed obligations over the balance in the Fund.

Editor's Note: The insurance program provides the government with an alternative vehicle for assisting the markets that doesn't require the initial investment needed for asset purchases. The attractiveness of this alternative (versus direct asset sales to the government) to financial institutions will depend, in part, on the cost of the premiums and the terms and conditions of the guarantee. Details still need to be established by the secretary.

Foreclosure Mitigation Efforts (§§109–110)

One key objective of the Act is to preserve homeownership. The Act recognizes that in discharging his or her responsibilities, the secretary will acquire mortgages, mortgage backed securities and other assets secured by residential real estate. It also notes that other federal agencies, such as the Federal Housing Finance Agency in its capacity as conservator of Fannie Mae and Freddie Mac will hold, own, or control similar assets. The Act directs these agencies to use their authority to encourage servicers of the underlying mortgages to participate in the HOPE for Homeowners Program[1] or similar programs to minimize foreclosures, while still considering the net present value to the taxpayer. The secretary also may "use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures."

The Act also directs the secretary to coordinate with other federal entities that hold troubled assets "to identify opportunities for the acquisition of classes of troubled assets that will improve the ability of the Secretary to improve the loan modification and restructuring process", and to consent to reasonable loan modification requests, while still considering the net present value to the taxpayer. Modifications, as defined, include rate reductions, reductions in principal and interest, or other similar changes.

Editor's Note: The Act does not specify the process or procedures the secretary or other federal entities will use to modify loans or to encourage servicers to do so. The methods used by the secretary to achieve this objective may trigger certain accounting ramifications.

Troubled Asset Purchase Provisions (§113)

To help "minimize any potential long-term negative impact on the taxpayer," the Act provides the secretary with various means of acquiring troubled assets. The Act also directs the secretary to encourage private sector participation in the purchases of troubled assets and investment in financial institutions.

If possible, the secretary will take advantage of market mechanisms such as auctions or reverse auctions to efficiently use taxpayer resources and ensure that the purchase price paid is the lowest that is consistent with the purposes of the Act. When use of market mechanisms is not feasible, the secretary may purchase troubled assets directly from an individual financial institution (i.e., "direct purchase"), after taking additional steps to ensure that the purchase prices paid are reasonable and indicative of the underlying value of the assets.

[1] The HOPE for Homeowners Program is authorized by section 257 of the National Housing Act.

Regardless of the purchase method, the Act requires that the secretary "prevent unjust enrichment of financial institutions participating" under one of the programs, which includes preventing an institution from selling an asset to the secretary for an amount greater than what it paid originally for that asset unless such assets were acquired in a merger or acquisition or from an institution in conservatorship, receivership, or bankruptcy (§101).

Warrants or Senior Debt

Financial institutions that sell assets to the TARP in other than de minimis amounts (the de minimis threshold cannot exceed $100 million) must provide to the secretary a warrant to purchase the institution's nonvoting common stock or preferred stock (alternatively, they may provide a warrant on voting stock; in such cases the secretary will agree not to exercise any voting power). An institution whose stock is not traded on a national exchange also can provide a senior debt instrument. The secretary is empowered to sell, exercise, or surrender a warrant or any senior debt instrument issued by a participating financial institution.

Any warrant provided to the secretary:

- Must be designed "to provide for a reasonable participation by the Secretary for the benefit of taxpayers in equity appreciation."[2]
- Will have an exercise price established by the secretary.
- Must contain antidilution provisions to protect its value from "transactions such as stock splits, [dividends or distributions, and] mergers and other forms of reorganization or recapitalization."
- Must "convert to senior debt, or contain appropriate protections" for the Treasury (in an amount determined by the secretary) in the event the institution's stock is "no longer listed or traded on a national securities exchange or securities association."

Also, the Act requires each participating financial institution to guarantee that sufficient authorized shares are available to satisfy any warrant that is issued. If insufficient authorized shares are available, "including preferred shares that carry dividend rights equal to a multiple number of common shares," and shareholder authorization for additional shares cannot be obtained, the secretary can choose to accept senior debt that provides value equivalent to the warrants.

Editor's Note: The Act is unclear whether a subsidiary that sells assets to the TARP can provide a warrant for the shares of its parent company (e.g., can a bank issue a warrant for the shares of the bank holding company?) It is anticipated that the secretary will provide guidance in the future to clarify this issue.

Management of Troubled Assets (§§106, 113)

The Act grants the secretary discretion to manage the troubled assets purchased under the TARP, including the ability to "sell or enter into securities loans, repurchase transactions, or other financial transactions" at a price determined by the secretary. Any proceeds received from the management of TARP assets, or from the secretary's disposition of warrants or senior debt, will be used to reduce the public debt. The secretary also may hold the assets to maturity or for resale at the time and price deemed optimal for maximizing the federal government's return on investment.

[2] If a debt instrument is provided, it must provide a reasonable interest rate premium.

Compensation and Corporate Governance Requirements (§111)

The Act places certain compensation limitations on financial institutions that sell troubled assets to the TARP.

If the secretary "receives a meaningful equity or debt position in the financial institution as the result of" a *direct purchase* transaction, the institution must meet certain standards for executive compensation and corporate governance as long as the secretary "holds an equity or debt position in the financial institution." These standards include:

- Compensation limits "that exclude incentives for senior executive officers[3] of [the] institution to take unnecessary and excessive risks that threaten the value of the financial institution."
- A clawback provision that enables the institution to recover "any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate."
- A prohibition on "golden parachute" payments to the institution's senior executive officer.
- Appropriate corporate governance standards.

Fewer restrictions apply to institutions that sell assets to the TARP through auctions. When auction purchases of troubled assets from a financial institution exceed $300 million (including direct purchases), the Act prohibits such an institution from executing "any new employment contract with a senior executive officer that provides a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership" (§111).

Disclosures (§114)

To provide transparency to the markets, the secretary must publicly disclose "in electronic form a description, amounts, and pricing of assets acquired under this Act" within two business days of transactions.

Institutions participating in the program also need to ensure they provide adequate disclosure of their derivatives, off-balance-sheet transactions, contingent liabilities, and similar potential exposures. If the secretary determines that such disclosure is inadequate, the secretary will recommend to the institution's regulators that additional disclosure be provided.

Recoupment Provision (§134)

To ensure that the TARP does not add to the deficit or public debt, the Act requires a report to be submitted to Congress by October 3, 2013 detailing the net amount within the TARP. If a shortfall exists, the president must "submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall."

[3] "Senior executive officer" is defined as one of the top five highly paid executives of a public company whose compensation must be disclosed in accordance with the Exchange Act of 1934 and nonpublic company counterparts.

Mark-to-Market Accounting (§§132 and 133)

The Act does not repeal fair value accounting or supersede FASB Statement No. 157, *Fair Value Measurements*. Rather, it emphasizes that the SEC has the authority to suspend application of Statement 157 "for any issuer . . . or with respect to any class or category of transaction if the [SEC] determines that it is necessary or appropriate in the public interest and is consistent with the protection of investors." The Act also requires the SEC, in consultation with the Federal Reserve and the secretary to conduct a study of Statement 157 and mark-to-market accounting and its effect on financial institutions and submit a report to Congress within 90 days of the Act's enactment.

Editor's Note: Statement 157 defines fair value and provides guidance on how fair value should be measured. It also requires enhanced fair value disclosures. Statement 157 does **not** address **when** assets and liabilities should be measured at fair value. Suspension of Statement 157 would not, therefore, suspend a financial institution's obligation to record certain troubled assets at fair value and to recognize impairments as required by other generally accepted accounting principles. Instead it may affect how the fair value of such assets and liabilities is measured.

Tax Provisions (§§301 and 302)

The Act also modifies a number of tax regulations, notably:

- The gain or loss recognized on a financial institution's (as defined) sale of qualifying preferred stock is treated as ordinary income or loss. Qualifying preferred stock includes Fannie Mae and Freddie Mac preferred stock that was held on September 6, 2008, or "was sold or exchanged by the applicable financial institution on or after January 1, 2008, and before September 7, 2008." Other special rules also may apply.
- The allowable deduction for certain executive compensation under section 162(m) of the Internal Revenue code will be reduced to $500,000 for financial institutions having a specified level of participation in the TARP (generally, if the amount of assets sold under the program exceeds $300 million). Furthermore, an excise tax and deduction limit also is applicable to golden parachute payments made by these institutions.

Note that the above summary of the Act is not comprehensive; readers and their counsel should review the Act carefully and fully understand all of its provisions before making any business, tax, or accounting decisions.

The following appendixes outline a number of accounting, tax, and business issues that provisions of Act may raise.

Appendix A: Accounting and Reporting Considerations

The table below notes possible ramifications of certain provisions in the Act and the related accounting guidance **all** entities should consider (see Appendix D for complete citations of standards). **For many of these considerations, the final accounting treatment will depend upon specific rules or guidelines that need to be established to implement the Act's provisions.** As further details become known, additional accounting considerations may be identified, or the considerations listed below may change.

Third-Quarter Considerations	
Issue	**Considerations**
Accounting Considerations for the period ended September 30, 2008 — Assessment of Other-Than-Temporary Impairment (OTTI) and Held-to-Maturity (HTM) Classification as of September 30, 2008 For an impairment to be deemed temporary on a reporting date, an entity must be able to assert that it has both the **intent and ability** to hold the impaired security until forecasted recovery.[1] The Act has no impact on the entity's ability to hold an HTM or available-for-sale security to recovery. The issue is whether an entity's consideration of the Act (i.e., whether it will avail itself of the Act's relief measures) affects its assertion, as of September 30, 2008, that it has the **intent** to hold an impaired security until its forecasted recovery. A similar issue arises with respect to an entity's classification of certain troubled assets as held to maturity as of September 30, 2008. Namely, does an entity's consideration of the Act before the issuance of its September 30, 2008, financial statements affect its stated intent as of September 30, 2008, to hold its troubled assets until their maturity?	Congress still was considering the proposed legislation on September 30, 2008. As of that date it is not reasonable to expect an entity to make a fully informed decision about whether it was in its best interest to participate in the program, because the provisions of the Act still were subject to change. Even after being signed into law, many of the details of the Act's provisions have yet to be finalized by the secretary. The signing of the Act into law on October 3, 2008, represented a substantive change in facts and circumstances occurring after September 30, 2008, that could change an entity's view about whether it intends to hold impaired securities until their forecasted recovery. Accordingly, the Act could affect the entity's intent on October 3, 2008, but not be a factor considered in an entity's assessment of whether, at September 30, 2008, it had the intent to hold its impaired securities until forecasted recovery. The Act has no effect on an entity's assertion on September 30, 2008, that it has the ability to hold its impaired assets to recovery. For more details, see Deloitte's *Financial Reporting Alert* No. 08-15, *The Impact of the Emergency Economic Stabilization Act on the Assessment of Other-Than-Temporary Impairments*. Similarly, the Act's existence should not call into question an entity's assertion on September 30, 2008, that it intended to hold certain debt securities until maturity.
Disclosures	In financial statement filings for periods ended September 30, 2008, an entity should disclose in its MD&A any anticipated impact of the Act on its future financial position, results of operations, cash flows or liquidity.
Fourth-Quarter Considerations	
Issue	**Considerations**
HTM Classification — Statement 115 requires certain debt and equity securities to be classified as held to maturity, available for sale, or trading. To classify a debt security as held to maturity, an entity must have the positive intent and ability to hold the security until maturity.	An entity that participates in the Troubled Asset Relief Program (TARP) should consider whether (1) it still has the positive intent and ability to hold all of its HTM securities until maturity and (2) any sales of securities previously classified as HTM to the TARP would call into question its stated intent to hold other HTM investments until maturity (i.e., whether a sale of certain HTM assets to the TARP would "taint" the remainder of the entity's HTM portfolio).
OTTI Classification — Securities classified as available for sale or held to maturity are evaluated individually to determine whether the fair value of the security is below amortized cost and, if so, whether the impairment is other-than-temporary. In evaluating whether an OTTI has occurred, an entity must assess the cause of the decline in value and the duration and severity of that decline, as well as the entity's intent and ability to hold the security until a forecasted recovery in value.	All entities participating in the TARP must consider whether sale of certain assets to the TARP would call into question an entity's stated intent to hold other similar securities until a forecasted recovery in value. An entity that participates in the Act's insurance program should review the specific characteristics of any guarantee obtained (i.e., whether it is freestanding or attached). FSP FAS 115-1/124-1 notes that an entity cannot combine separate contracts (i.e., a debt security and a guarantee or other credit enhancement) in determining whether a debt security is impaired.
Recognition of Interest Income and Impairment of Beneficial Interests Within the Scope of Issue 99-20 — A beneficial interest (BI) within the scope of Issue 99-20 is considered other-than-temporarily impaired when its fair value is below its carrying amount and an adverse change in estimated cash flows has occurred. An entity must continually update its estimate of a BI's cash flows over the life of the BI for income recognition and impairment purposes. The estimated cash flows represent the holder's best estimate of cash flows that a market participant would use in determining the fair value of the BI.	An entity that holds BIs within the scope of Issue 99-20 should consider whether the government represents a market participant. A BI within the scope of Issue 99-20 that is not considered other-than-temporarily impaired under Issue 99-20 may still be other-than-temporarily impaired under other guidance, such as Statement 115 or FSP FAS 115-1/124-1. An entity also needs to consider the OTTI factors noted above.

[1] This discussion does not address situations in which a security may be deemed other-than-temporarily impaired (e.g., as a result of a credit concern), regardless of the entity's intent and ability to continue to hold the security.

Issue	Considerations
Accounting by Creditors for Impairment of Loans (Statement 114) — A loan is impaired when, on the basis of current information and events, it is probable that the creditor will be unable to collect all amounts due under the contractual terms of the loan agreement. Impairment is measured on the basis of the present value of expected future cash flows discounted at the loan's effective rate. As a practical expedient, a loan's observable market price, or the fair value of its collateral (if the loan is collateral dependent) also may be used. Statement 15 addresses accounting for troubled debt restructurings.	The Act directs the secretary to implement a plan that seeks to maximize homeowner assistance and encourage servicers of mortgages to participate in the HOPE for Homeowners Program to minimize foreclosures. The secretary also may use loan guarantees and credit enhancements to prevent avoidable foreclosures and must consent, when appropriate, to reasonable loan modification requests. A creditor that holds a loan that is modified as part of the program should consider whether the loan should be accounted for as a troubled debt restructuring in accordance with Statement 114. Other creditors, including those that do not participate in the TARP, should consider whether TARP transactions establish an observable market price that can be used as a practical expedient for measuring loan impairment. An entity that acquires a guarantee for a troubled loan through the Act's insurance program should consider the specific nature of the guarantee and determine whether it may be considered in impairment assessments. A borrower/debtor should consider whether the modification of its loan is a troubled debt restructuring.
Mortgage Banking Institutions (Statement 65) — Mortgage loans held for sale must be reported at the lower of cost or fair value, determined as of the balance-sheet date.	When measuring mortgage loans that are held for sale, an entity should, regardless of whether it participates in the TARP, consider whether TARP transactions are indicative of fair value.
Fair Value — Statement 157 defines fair value and establishes a framework for measuring fair value.	All entities need to consider whether: • The TARP creates a new principal market or "most advantageous" market for determining fair value and whether that market is accessible by the entity. • The TARP market is active or inactive. • The government should be considered a market participant. • TARP transactions should be considered orderly transactions. • The requirements for participation in the TARP give rise to a multiple element accounting arrangement. • Nonparticipants in the TARP must consider TARP transactions when determining fair values. • A TARP participant should use TARP transaction values to determine the fair value of other assets that will not be sold to the TARP.
Warrants and Liability/Equity Classification — Statements 150 and 133, and Issue 00-19, provide guidance on determining the appropriate classification of an instrument that has the characteristics of both liabilities and equity. FSP FAS 150-5 provides guidance on accounting for warrants that may embody obligations to repurchase the issuer's shares or may require the issuer to transfer assets.	The Act requires that (with certain exceptions) each financial institution that sells assets to the TARP program grant the Treasury equity warrants that, at a minimum: • Have an exercise price set by the secretary. • Provide for reasonable participation in equity appreciation. • Contain antidilution provisions. • Convert to senior debt, or contain appropriate protections for the Treasury if the institution's stock is delisted. An entity that issues equity warrants to the Treasury should obtain a full understanding of the warrants' features and consider whether the equity warrants: • Require liability or equity classification under Statement 150, Statement 133, FSP FAS 150-5, and Issue 00-19. • Are derivative instruments subject to the accounting requirements in Statement 133. • Are issued as part of a multiple-element arrangement. • Are participating securities that require application of the two-class method of computing earnings per share.
Guarantee Accounting — Statement 133 provides guidance for determining whether a guarantee should be accounted for as a derivative.	The Act directs the secretary to establish a program in which a financial institution can obtain a guarantee of the timely payment of principal and interest on troubled assets it holds in exchange for payment of a premium that is commensurate with the credit risks of the related asset. An entity that obtains a guarantee should consider whether that guarantee meets the definition of a derivative instrument in Statement 133. If the guarantee is determined to not be a derivative, the entity will have to assess the appropriate accounting for the guarantee.

Issue	Considerations
Modifications of Loans Held in QSPEs — Statement 140 establishes criteria for determining whether a transfer of financial assets is a sale. Special rules are provided for a transaction that involves a qualified special-purpose entity (QSPE). Statement 140 requires that the activities of a QSPE be significantly limited and entirely specified in the legal documents that establish the QSPE trust. Issue 02-9 provides guidance on how to account for a transferor regaining control of financial assets sold.	As noted above, the Act directs the secretary to implement a plan that seeks to maximize homeowner assistance and encourage servicers of mortgages to participate in the HOPE for Homeowners Program to minimize foreclosures. The Act also contemplates that the secretary and other federal property managers (as defined) will facilitate loan modifications or encourage loan servicers to modify loans. If an entity is a party to a transaction that involves a QSPE, it should assess whether modifications made to loans held by the QSPE cause the trust to lose its qualifying status under Statement 140. A loss of QSPE status could have accounting ramifications including: • The trust could fall within the scope of Interpretation 46(R), which would require the entity to assess whether it should consolidate the trust. • If the entity previously transferred assets to the trust and obtained sale accounting, it would need to consider whether the loss in QSPE status results in the entity regaining control of the transferred assets.
Clawback Considerations — Under the Act's direct purchase program, a "clawback" provision (a provision of recovery) is provided for any incentive compensation paid to its senior executives on the basis of earnings, gains, or other criteria that are later proven to be false or inaccurate.	Entities that have entered into direct purchases with the Treasury should consider whether the clawback should be accounted for as a contingency under Statement 5.
Income Tax Accounting	As previously noted, the Act modified various tax regulations, including providing certain financial institutions ordinary loss treatment on losses related to investments in preferred shares of Fannie Mae and Freddie Mac. The tax effects of new legislation are not recognized under Statement 109 prior to the legislation's enactment, which, under U.S. federal jurisdiction, is the date the president signs a tax bill into law. Therefore, the tax effects of the Act should be reflected in the first reporting period that includes the enactment date (October 3, 2008). For example, for calendar-year-end entities, the tax effects of the Act should be reflected in the fourth quarter of 2008. Entities also should consider the appropriate financial statement disclosures relating to the tax effects of the Act.
Disclosure Adequacy — For all financial institutions that sell troubled assets under the Act, the secretary shall determine whether the disclosures required for such financial institutions with respect to off-balance-sheet transactions, derivative instruments, contingent liabilities, and similar sources of potential exposure are adequate to provide to the public sufficient information about the true financial position of the institutions.	The Act does not provide any guidance on what will be considered adequate disclosures related to these items. Financial institutions need to consider whether their current internal controls over financial reporting are adequate to generate sufficient disclosures.

Appendix B: Potential Income Tax Issues

The table below highlights certain tax provisions of the Act that may warrant further consideration by entities.

Issue	Considerations
Character of Gains and Losses on Investments in Government Sponsored Enterprises (GSEs) — Qualifying financial institutions that held preferred stock in GSEs (Fannie Mae and Freddie Mac) on September 6, 2008, or sold or exchanged their investment from January 1, 2008, through September 6, 2008, may treat their losses as ordinary losses for income tax purposes. (Special rules also may apply.)	Recharacterization of losses on sales of GSE preferred stock will allow qualifying financial institutions to reduce their ordinary income taxes payable. As noted in the discussion of income tax accounting in Appendix A, the effects of this law cannot be recognized under Statement 109 before the October 3, 2008, enactment date.
Executive Compensation — For entities that have sold more than $300 million in troubled assets in auctions or a combination of auctions and direct sales under the TARP (1) the allowable deduction under section 162(m) of the Internal Revenue Code of 1986 (IRC) for CEOs, CFOs, and the other three highest-paid executives (as defined by the Act) will be reduced to $500,000 and (2) the golden parachute rules of sections 280G and 4999, which eliminate the deduction on excess parachute payments and impose an excise tax on these payments, are extended to severance benefits made to the same individuals.	For employers who participate in the TARP, the law reduces certain tax benefits that have applied to executive compensation. Entities subject to these provisions should consider the potential impact of the revised section 162(m) limitation when determining the permanent tax differences that will affect the effective tax rate (ETR) used for quarterly reporting purposes. Entities should consider whether any gross up provisions related to the section 280G and the section 4999 excise tax on change-in-control parachute payments would be applicable to severance payments and are required to be accounted for. In addition, entities should consider whether severance benefits that are no longer deductible will affect their ETR.

Appendix C: Other Potential Business Issues

The table below notes additional business issues raised by the Act that entities may want to consider.

Issue	Considerations
Depository Institution Regulatory Capital Requirements — Insured depository institutions are required to maintain certain (1) leverage capital and (2) risk-based capital ratios. Leverage capital requirements prescribe the ratio of Tier 1 capital (as defined) to total average assets on the basis of the institution's rating. Risk-based requirements prescribe the minimum ratio of Tier 1 and total capital as a percentage of total assets, but give weight to the relative risk of each asset, including off-balance-sheet positions.	Depository institutions should consider how their participation in programs established by the Act could affect the risk weighting of their assets and their regulatory capital ratios, both at the bank and consolidated holding company levels. In particular, these institutions should gauge whether such participation will affect (1) their ability to meet the criteria to be well-capitalized or (2) how their capital adequacy is perceived compared to industry peers.
Participation in the Insurance Program — It appears that a number of the provisions in the Act that apply to financial institutions that sell assets to the TARP do not apply to those that solely obtain guarantees through the insurance program.	Financial institutions should carefully consider which program (the asset purchase programs or the insurance program) best meets their needs, taking into consideration their liquidity requirements, the premiums that will be assessed for the insurance program, and the other provisions that may be triggered by participation in the programs.
Executive Compensation — Any financial institution that sells troubled assets directly to the TARP program shall be subject to specified executive compensation and corporate governance requirements when the secretary receives a "meaningful" equity or debt position in the financial institution. Other compensation restrictions exist for entities that sell more than $300 million in assets through auctions and direct sales to the TARP.	Before choosing to sell assets to the TARP, an entity should assess whether the sale is likely to be accomplished through an auction or a direct sale and consider the potential operational ramifications of the form of sale. It is not clear whether regulators will require any specific reporting as a result of this provision for institutions that participate in the asset sales programs.
Private fund manager opportunities — The secretary has the authority to designate financial institutions as financial agents to perform "all such reasonable duties related to this Act" (§101) as well as the authority to contract for services to carry out the provisions of the Act.	Entities involved in these activities should be aware of these opportunities and be able to report on them to their regulators as needed. Entities also should consider the conflict of interest regulations or guidelines that will be issued by the secretary (§108) and weigh these possible restrictions against the potential opportunities.
Available shares — A financial institution that sells assets to the TARP shall guarantee to the secretary that it has sufficient authorized shares of nonvoting stock available to fulfill its obligations with respect to the warrants it must issue to the secretary. If sufficient authorized shares are not available (including preferred shares that may carry dividend rights equal to a multiple number of common shares), and shareholder authorization for additional shares cannot be obtained, the secretary may, to the extent necessary, accept a senior debt note with an amount and terms that will provide value equivalent to that of the warrant.	An entity contemplating sales to the TARP should determine whether it has sufficient authorized shares to fulfill its obligation under the warrants it must issue to the secretary. If sufficient shares are not authorized, the entity should consider seeking appropriate approval from its shareholders to increase the number of authorized shares. If the number of authorized shares is insufficient, or the participating entity is a nonlisted entity, the entity may need to issue senior debt to participate in the program. An entity should consider the operational ramifications of issuing additional debt (e.g., the impact of overall debt levels on existing debt covenants). Consideration should also be given to any regulatory or capital requirements specific to an industry.
Definition of a Financial Institution — The Act defines a financial institution as "any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa, or the United States Virgin Islands, and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government."	An entity should consider whether it is eligible to participate in the TARP. There may be a question whether a private entity such as a private fund would be deemed to be "regulated under the laws of the United States." Consultation with an entity's counsel may be advisable.
Uneforceability of Certain Agreements — Section 126(c) of the Act amends the FDIC Act to declare unenforceable "any provision contained in any existing or future agreement that directly or indirectly . . . limits the ability of, [or] prohibits any person from offering to acquire or acquiring . . . all or part of, any insured depository institution, including any liabilities, assets, or interest therein."	An entity should consider whether this provision may affect its acquisition activity or strategy.

Appendix D: Glossary of Standards

FASB Statement No. 157, *Fair Value Measurements*

FASB Statement No. 150, *Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity*

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement 125

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* — an amendment of FASB Statements No. 5 and 15

FASB Statement No. 109, *Accounting for Income Taxes*

FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*

FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*

FASB Statement No. 5, *Accounting for Contingencies*

FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51

FASB Staff Position (FSP) No. FAS 150-5, "Issuer's Accounting Under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable"

FASB Staff Position (FSP) No. FAS 115-1/124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

EITF Issue No. 02-9, "Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold"

EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"

EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets"

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