

January 21, 2009

HOUSE PASSES “TARP REFORM AND ACCOUNTABILITY ACT OF 2009” (H.R. 384)

On January 21, 2009, the U.S. House of Representatives passed the “TARP Reform and Accountability Act of 2009” (H.R. 384). The bill will now be sent to the Senate for consideration where its future remains uncertain in light of speculation that the bill may be intended to serve more as a blueprint for the Obama Administration rather than legislation to enact. Barney Frank, Chairman of the House Financial Services Committee, introduced the measure on January 9, 2009, just one business day before President Bush requested the additional \$350 billion draw-down of TARP funds from Congress pursuant to Section 115(a)(3) of the Emergency Economic Stabilization Act of 2008 (EESA).¹ The request for the funds was granted January 15, 2009 following a Senate vote to block a resolution of disapproval (S J Res 5) that would have prevented disbursement of the additional funds. This Senate vote followed a week of lobbying by the Obama Administration in which the President promised Senators that \$100 billion of the \$350 billion would be dedicated to foreclosure relief.²

I. Executive Summary

Chairman Frank’s legislation to amend EESA sets forth conditions for the draw-down of the next \$350 billion of EESA funds to ensure that Treasury uses the funds to achieve Congress’ goals for stabilizing the economy and preventing foreclosure. For example, the bill would require Treasury to direct \$40 billion to \$100 billion of remaining EESA funds for foreclosure mitigation efforts. In addition, the bill includes oversight provisions for recipients of EESA funds, including requiring recipients to file quarterly reports on recapitalization efforts under the Capital Purchase Program (CPP) and corporate governance provisions such as possible inclusion of board observers from Treasury at board meetings of recipients of bailout funds.

Notably, the bill places more restrictive executive compensation limits on institutions participating in EESA programs such as the Troubled Asset Relief Program (TARP). These limits include, among other things, a prohibition on paying bonuses and other incentive compensation to their top 25 paid employees and a prohibition against any compensation plan that would encourage manipulation of earnings to enhance compensation. The bill would allow Treasury to apply the executive compensation parameters retroactively to TARP recipients.³

II. Discussion of Key Elements of Legislation

The following is a summary of selected key provisions of H.R. 384, including (1) foreclosure relief (2) safe harbor for loan servicers (3) oversight of TARP funds: quarterly disclosures, limits on use of funds; (4) corporate governance: board observers, prohibition on foreign customer service centers; (5) executive compensation limits; and (6) clarification of TARP authority for additional purposes.

1. Foreclosure Relief and Loan Modification Plans

A centerpiece of the bill is the Title II requirement that Treasury commit at least \$40 billion and not more than \$100 billion of EESA funds to foreclosure relief measures within seven days of enactment of the bill. The bill requires that at least \$20 billion be used by Treasury to implement a comprehensive plan to prevent and mitigate foreclosures on owner-occupied residential mortgages, after consulting with FDIC and HUD, and receiving approval from the Financial Stability Oversight Board by combining any or all of the following components:

- 1) A guarantee program for qualifying loan modifications under a systematic plan, which may be delegated to the FDIC or other contractor;

¹ White House Press Release dated January 12, 2009, President transmitting report to Congress requesting additional funding under Section 115(a)(3) of EESA.

² To deny the President’s request for funds, both the Senate and House would have needed to vote to reject the request through Resolutions of Disapproval within 15 days after the request.

³ “TARP Reform and Accountability Act of 2009” (H.R. 384), introduced by Chairman Frank on January 9, 2009.

- 2) Bringing costs of Hope for Homeowner loans down either through coverage of fee, purchasing H4H mortgages to ensure affordable rates, or both;
- 3) A program providing for loans to pay down second lien mortgages that are impeding a loan modification, subject to any write-down by existing lender, that Treasury may require;
- 4) Servicer incentives/assistance - payments to servicers in connection with implementation of qualifying loan modifications; and
- 5) Purchase of whole loans for the purpose of modifying or refinancing the loans (with authorization to delegate to FDIC).⁴

Alternatively, Treasury may implement alternative foreclosure prevention and mitigation actions (other than the five noted above), provided Treasury receives approval from the Financial Stability Oversight Board for such alternative actions, and that Treasury believes the alternative actions would provide equivalent or greater impact on foreclosure mitigation.⁵

2. Safe Harbor for Loan Servicers for Loan Modifications and Workout Plans

To encourage loan workout plans, the bill provides an explicit safe harbor for loan servicers that enter into loan modifications, workout plans, and other loss mitigation plans initiated before January 1, 2012.

To qualify for the safe harbor, the following criteria must be satisfied:

- (1) Default on the payment of the mortgage has occurred or is reasonably foreseeable;
- (2) The property is owner-occupied (such that the property securing the mortgage is occupied by the mortgagor);
- (3) The servicer reasonably and in good faith believes that the anticipated recovery on the principal outstanding obligation of the mortgage under the workout plan or modification or other loss mitigation action will exceed, on a net present value (NPV) basis, the anticipated recovery on the principal outstanding obligation of the mortgage to be recovered through foreclosure.⁶

Notably, the bill requires servicers that engage in loan modifications or workout plans subject to the safe harbor to report to Treasury on a regular basis regarding the extent, scope and results of the servicer's modification activities. The bill instructs the Treasury to prescribe regulations clarifying the form, content, and timing of such reports.

3. Oversight of TARP Funds: Quarterly Disclosures; Limits on Use of Funds

The bill includes a variety of oversight components, including: (1) reporting requirement that TARP recipients file reports on at least a quarterly basis disclosing their use of such assistance; (2) requires financial regulators to review the quarterly reports filed by insured depository institutions receiving TARP funds on at least a yearly basis to ensure compliance with executive compensation limits and other terms; (3) requiring Treasury to

⁴ "TARP Reform and Accountability Act of 2009" (H.R. 384), Title II, introduced by Chairman Frank on January 9, 2009, and passed by the House on January 21, 2009.

⁵ "TARP Reform and Accountability Act of 2009" (H.R. 384), Title II, Section 201(d), Alternative Components.

⁶ "TARP Reform and Accountability Act of 2009" (H.R. 384), Section 205, introduced by Chairman Frank on January 9, 2009.

condition TARP assistance to individual institutions on an agreement that the funds will be used to advance the purposes of EESA, strengthen the soundness of the financial system, and increase the availability of credit in the economy; and (4) requiring federal banking agencies to promulgate regulations requiring assisted insured depository institutions to establish and maintain procedures designed to monitor EESA compliance.

The bill also prohibits use of TARP funds for mergers and acquisitions without the prior approval of Treasury. Specifically, the bill prohibits Federal banking agencies from approving any direct or indirect acquisition of assets, assumption of liability to pay any deposits made in any insured depository institution under Section 18(c) of the Federal Deposit Insurance Act, while TARP assistance is outstanding, without prior approval from Treasury.⁷ In reviewing requests for mergers and acquisitions, Treasury must make a determination, in consultation with any relevant Federal banking agencies, that (1) such action will reduce risk to the taxpayer or (2) the transaction could have been consummated without TARP funds.

Further, Rep. Walz's amendment to the bill would require that any assisted institution publicly report, not less than quarterly, on the institution's use of the assistance, and would require the Treasury to make those reports readily available online. In addition, Rep. Hinchey's amendment to the bill would require Treasury to immediately obtain information from recipients of TARP funds and their precise use of funds allocated prior to January 1, 2009, and require the Treasury to conduct an analysis of the use of those funds within 30 days of enactment.

4. Corporate Governance: Board Observers, Prohibition on Foreign Customer Service Centers

The bill includes a corporate governance measure that would allow the Treasury Secretary to appoint a board observer that would attend board meetings of companies receiving TARP assistance on or after October 3, 2008. Further, the board observer could be required to attend meetings of any committees of the board of directors while any TARP assistance to the company is still outstanding.

Further, Rep. Myrick's amendment to the bill prohibits TARP recipients from entering into a new agreement, or expand a current agreement, with any foreign company for provision of customer service functions, including call-center services, while any TARP assistance is outstanding.

5. Executive Compensation Limits

The bill includes measures to strengthen Treasury's oversight of executive compensation of companies receiving TARP funds by amending Section 111 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5221). Among the non-tax executive compensation limits included in the bill are:

- 1) a prohibition from paying or accruing any bonus or incentive compensation to the 25 most highly compensated employees;
- 2) a prohibition of any compensation plan that would encourage manipulation of earnings to enhance compensation;
- 3) limits on compensation that exclude incentives for senior executive officers of an assisted institution which received assistance under this title to take unnecessary and excessive risks that threaten the value of such institution during the period that any assistance under this title is outstanding;
- 4.) recovery by institutions receiving TARP assistance of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later found to be materially inaccurate; and

⁷ "TARP Reform and Accountability Act of 2009" (H.R. 384), Section 101, New Conditionality for TARP-Assisted Institutions.

5) a prohibition on institutions receiving TARP assistance from making any golden parachute payment to a senior executive officer during the period that the assistance under this title is outstanding.⁸

Further, a Manager's Amendment to the bill clarifies that Treasury may apply the new executive compensation restrictions retroactively to institutions that have already received TARP assistance.⁹

6. Clarification of TARP Authority for Additional Uses

Title IV provides clarification on the Treasury's authority to use EESA funds for a number of purposes, including:

Consumer loans – The bill clarifies Treasury's authority to establish facilities to support the availability of consumer loans, such as student loans, and auto and other vehicle loans. Such support may include the purchase of asset-backed securities, directly or through the Federal Reserve.

Commercial Real Estate Loans and MBS – The bill clarifies Treasury's authority to provide support for commercial real estate loans and mortgage-backed securities.

Municipal securities – The bill clarifies Treasury's authority to provide support to issuers of municipal securities, including through the direct purchase of municipal securities or the provision of credit enhancements in connection with any Federal Reserve facility to finance the purchase of municipal securities.¹⁰

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Note: This summary highlights several specific key provisions of the measure and not the entire bill, which includes seven titles relating to, for example, auto financing plans, Hope for Homeowners improvements, homebuyer stimulus, and permanent increases in FDIC limits. Further, the contents of the legislation may change as the legislation moves to the Senate for further consideration.

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⁸ "TARP Reform and Accountability Act of 2009" (H.R. 384), Section 102, introduced by Chairman Frank on January 9, 2009. (Specifically, Section 102 language includes: (1) "a prohibition on such institution paying or accruing any bonus or incentive compensation, during the period that the assistance under this title is outstanding, to the 25 most highly-compensated employees; (2) "a prohibition on any compensation plan that would encourage manipulation of such institution's reported earnings to enhance the compensation of any of its employees." and (3)

⁹ In addition to the Manager's Amendment, Section 102 of H.R. 384 includes a provision that the Secretary may apply the requirements of and the standards established under this subsection to any assisted institution that received any assistance under this title on or after the date of the enactment of the TARP Reform and Accountability Act of 2009."

¹⁰ "Frank Introduces TARP Reform and Accountability Legislation" (Press Release), issued by House Financial Services Committee on January 9, 2009.