FROM BUTLER, SNOW, O'MARA, STEVENS & CANNADA, PLLC

QUARTERLY REPORT

MID-SOUTH REGULATORY COMPLIANCE GROUP

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# THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

On Friday, October 3, the House approved the Senate's version of H.R. 1424, the Emergency Economic Stabilization Act of 2008. The President signed the bill into law later that same day. This historic legislation not only grants sweeping authority to the Department of the Treasury to implement a massive plan to help rescue frozen financial markets, it also includes over 100 tax provisions and more than $150 billion in tax incentives for both individuals and businesses. In addition to tax measures aimed at rescuing the financial markets, the law includes a patch for the alternative minimum tax, extension of a number of expiring tax reductions, energy incentives and disaster relief among other measures.

Troubled Assets Relief Program. Title I gives the U. S. Treasury Department broad authority to both purchase and guarantee troubled assets held by any financial institution in the U.S. That includes any bank, savings association, credit union, securities broker/dealer or insurance company in the U.S., other than a central bank or institution owned by a foreign government.

"Troubled assets" are residential or commercial mortgages and securities or obligations based on those mortgages originally issued on or before March 14, 2008. Treasury may include additional types of financial instruments if the Secretary determines, after consulting with the Chairman of the Fed, it is necessary to promote financial market stability.

The purchase program, called the Troubled Asset Relief Program, or "TARP", is to be overseen by a newly created Office of Financial Stability. Treasury is given the authority to hire employees, contract for services, designate financial institutions as financial agents and establish vehicles to purchase, manage, hold and sell troubled assets and issue obligations. Treasury must publish program guidelines within two business days after the first purchase, but no later than forty-five days after enactment, outlining the mechanisms for purchasing troubled assets, the methods for pricing and valuing assets, the procedures for selecting asset managers and the criteria for identifying assets to be purchased.

The Act also authorizes Treasury to establish a program to guarantee troubled assets. It creates the Troubled Assets Insurance Financing Fund and authorizes Treasury to set and collect premiums from participating financial institutions. Treasury is to publish

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the methodology for setting the premiums for various classes of assets and the types of assets appropriate for inclusion in the program. Premiums are paid into the fund and the amount of guaranteed obligations in excess of the fund balance counts against Treasury's overall dollar limit on asset purchases under TARP.

The programs are to be overseen by a Financial Stability Oversight Board composed of the Treasury Secretary, the Fed Chairman, the Director of the Federal Housing Finance Agency (the conservator of Fannie Mae and Freddie Mac), the Chairman of the SEC and the Secretary of HUD. In addition, the Treasury is required to report periodically to certain designated committees of the House and Senate.

Purchase Limit. Treasury's authority to purchase troubled assets was limited initially to a maximum of $250 Billion outstanding at any one time. That amount was increased to $350 Billion upon certification by the President and may be subsequently increased to $700 Billion unless Congress passes a joint resolution of disapproval within fifteen days of receiving the President's report of the Secretary's plan to exercise that authority.

The Capital Purchase Program. On October 14th, the Treasury Department announced the formation of the Capital Purchase Program ("CPP") under the umbrella of the TARP. Under this approach, Treasury will use the initial $250 billion to purchase senior-preferred shares from banks and thrift institutions. Nine large bank holding companies have subscribed to the first $125 billion, and the remaining $125 billion will be used to inject capital into other banks that apply for the program. Time is of the essence since the deadline to apply for the CPP is November 14, 2008. The federal regulatory agencies are encouraging banks to participate.

A bank holding company, financial holding company, insured depository institution or savings and loan holding company engaged predominantly in activities permissible to financial holding companies are all "eligible institutions" and able to participate in the CPP.

Under the CPP, an eligible institution will be able to issue senior-preferred stock equal to one percent (1%) of its risk-weighted assets, as a minimum, and up to three percent (3%) of its risk-weighted assets, as a maximum. These senior-preferred shares initially will carry a five percent (5%) dividend rate for the first five years, and a nine percent (9%) rate thereafter, thus creating a significant incentive to redeem the preferred shares.

Capital raised through the CPP will qualify as Tier 1 capital and will rank on a par with other preferred stock, and senior to common stock.

In order to pay dividends on common stock, the preferred dividend on CPP preferred stock must be paid first.

As an additional enhancement, Treasury will receive warrants equal to 15% of the senior-preferred shares acquired. Valuation and exercise price for the warrants will be determined based on the 20 trading days average prior to the acquisition date. Under the Emergency Economic Stabilization Act, Treasury may substitute a senior debt instrument for stock warrants in the case of non-publicly-traded institutions.

If an institution is interested in participating in the CPP, it must first submit an application to its primary federal regulator.

Once again, the deadline for applying is 5:00 p.m. EDT November 14, 2008.

Considerations. The Act requires Treasury to consider a number of factors in exercising its authority under the programs. These include protecting the interest of taxpayers, stabilizing financial markets, helping families keep their homes, insuring that all financial institutions are eligible to participate and protecting the retirement security of Americans. In a purchase transaction, the Treasury is required to consider the long term viability of the institution and whether purchasing assets from it is the most efficient use of funds. The Act also requires the Treasury to consider providing assistance to small institutions with assets of less than $1 Billion that were at least adequately capitalized as of June 30, 2008, but whose capital will drop one or more levels as a result of the devaluation of Fannie Mae and Freddie Mac preferred stock.

Foreclosure Mitigation and Assistance to Homeowners. The Treasury, FDIC, Federal Reserve and FHFA are all required to implement plans with respect to mortgages and mortgage backed securities they hold or control to maximize assistance for homeowners and encourage loan servicers to take advantage of the HOPE for Homeowners Program or other available programs to minimize foreclosures. Where appropriate, the agencies are required to grant, or encourage loan servicers to grant, loan extensions, rate reductions, principal write downs and other modifications after considering the net present value of the home to the homeowner. The plans should also include loan modifications in connection with residential rental properties to help insure continuation of existing federal, state and local rent subsidies and, where possible, permitting bona fide tenants who are current on their rent to remain in their homes under the terms of the lease.

Minimizing Long Term Costs. The Act requires Treasury to take steps to minimize long term costs and maximize benefits for taxpayers including holding assets to maturity or holding them for resale at appropriate times and selling assets at a price that Treasury determines, based on available financial analysis, will maximize returns for the government. Treasury is required to purchase troubled assets at the lowest price that the Secretary determines to be consistent with the purposes of the Act and, where appropriate, to use market mechanisms such as auctions or reverse auctions. If market mechanisms are not feasible or appropriate, the Secretary has the authority to make direct purchases but is required to take additional, unspecified measures to help insure the price is reasonable and reflects the underlying asset value. Subject to a diminimus exception to be set by the Secretary at no higher than $100 Million, Treasury must obtain warrants, to receive nonvoting common or preferred stock from the selling financial institution as part of any asset purchase. If the financial institution is not a public company, senior debt instruments may be taken in lieu of stock warrants. The terms and conditions are to be established by Treasury but, at a minimum, must be designed to provide for reasonable participation by the Treasury in equity appreciation or a reasonable rate of return in the case of debt instruments to help protect taxpayers against losses from the sale of assets and the administrative expenses of the TARP.

Executive Compensation and Corporate Governance. Institutions that sell troubled assets to Treasury through a direct purchase not involving a bidding process or similar market mechanism will be required to

comply with standards to be set by the Secretary for executive compensation and corporate governance for as long as Treasury holds an equity or debt position in the institution. Compensation to senior executive officers of the institution (generally, the top five most highly paid executives) must exclude any incentives to take unnecessary and excessive risks that may threaten the value of the institution and include provisions allowing the institution to recover any bonus or incentive compensation paid based on earning statements or other criteria that prove later to be materially inaccurate. Golden parachute payments would be prohibited. When Treasury purchases troubled assets through an auction process aggregating more than $300 Million from any one institution, the institution will be prohibited from entering into any new employment contract with the a senior executive officer that provides for a golden parachute in the event of involuntary termination, bankruptcy, insolvency or receivership.

The law also takes aim at limiting executive compensation by limiting deductibility of compensation under Internal Revenue Code §162(m) to $500,000 for the CEO, CFO and the three other most highly compensated officers of institutions that participate in TARP auctions and have sold more than $300 Million in the aggregate in troubled assets to the Treasury.

<u>Market Transparency</u>. Treasury is required to make public reports, in electronic form, of asset purchases including a description of the assets along with amounts and pricing within two business days after the purchase.

<u>Mark-to-Market Accounting</u>. The Act gives the SEC the authority to suspend FASB Statement No. 157 concerning mark-to-market accounting with respect to any class or category of transactions. The SEC is also to conduct a study on mark-to-market accounting standards in consultation with the Federal Reserve and the Treasury examining the effect of the standard on financial institutions' balance sheets, the impact of the rule on bank failures and possible modifications and alternatives.

Prior to passage of the bill, the SEC attempted to clarify application of FASB Statement No. 157 in the current crisis where market activity for certain types of securities does not exist. The clarification points out that Statement No. 157 discusses a range of information and valuation techniques that may be used to estimate fair value when market data is unavailable including use of management estimates of future cash flow even if some market quotations are available. The SEC said the results of a disorderly market are not determinative when measuring fair value. Distressed or forced liquidation sales are not orderly transactions and the fact that a transaction is distressed or forced should be considered when weighing the available evidence.

<u>Losses from Sale of Fannie Mae and Freddie Mac Preferred Stock</u>. Banks, savings associations and depository institutions holding companies may treat gains or losses from the sale of preferred stock in Fannie Mae and Freddie Mac sold during 2008 as ordinary income or loss.

*<Cliff Harrison/*
*Ed Wilmesherr>*

## MORE ON THE REG. Z/HOEPA CHANGES

We discussed the Reg. Z/HOEPA changes affecting higher priced mortgages and dwelling secured credit in some detail in the

May issue. Since then, we have had a number of good questions on the new regs and wanted to share those with you. So, here is a short Q&A on some of the issues identified thus far.

**What are the mandatory compliance dates?**
Except for escrow requirements for first lien higher priced mortgage loans, the mandatory compliance date is October 1, 2009. However, since the new rules affect underwriting and disclosures in connection with new loans as well as servicing of new and existing loans, the mandatory compliance date affects different aspects of the regulations differently. The requirements for higher priced mortgage loans concerning verification of income and assets and determination of the borrower's ability to repay, and the restrictions on prepayment penalties will apply to loans based on when the application was received. If the application was received on or after October 1, 2009, then the new regulations will apply. Early Truth in Lending disclosure requirements for dwelling secured loans covered by RESPA will also apply to loans where the application was received on or after October 1, 2009.

Loan servicing requirements (such as crediting of payments as of the date of receipt, the prohibition against pyramiding of late charges, and providing payoff statements within a reasonable time) will apply to all loans being serviced on or after October 1, 2009 (regardless of when applications were received). Likewise, the new advertising disclosure requirements for dwelling secured credit will apply to all advertisements of those products on and after October 1, 2009.

The requirements for escrowing of taxes and insurance for first lien higher priced loans have later effective dates based on when the application was received. Escrow requirements apply to loans where the application is received on or after April 1, 2010 for site built homes and October 1, 2010 for manufactured homes.

**Do the requirements for higher priced loans apply to manufactured home loans not involving real estate?**
Yes. The new consumer protections for higher priced loans will apply to all consumer loans secured by the consumer's principal dwelling if the APR exceeds the average prime offer rate by 1.5% for first lien loans or by 3.5% for subordinate lien loans. If the loan is secured by a mobile or manufactured home (or houseboat or motorhome) that is the consumer's principal dwelling and the rate exceeds the applicable threshold, the new rules apply whether or not real property is involved. This will include the requirements for verification of income and assets, determination of repayment ability, restrictions on prepayment penalties <u>and</u> escrows on first lien loans for taxes and insurance. The only exclusions are for loans for initial construction of the dwelling, bridge loans with a term of 12 months or less, reverse mortgages and HELOCs.

**Will the early Truth in Lending disclosure requirements for dwelling secured loans apply to manufactured home loans not involving real estate?**
No. The early disclosure requirements will apply to any closed-end consumer loan that is secured by the consumer's principal dwelling that is also subject to RESPA. Since RESPA only applies to loans secured by 1-to-4 family residential real property, a loan secured by a mobile or manufactured home with no real estate would not be covered. RESPA also excludes temporary financing such as

construction loans and bridge loans, and loans on 25 acres or more.

**Will the new early disclosure requirements apply to applications that are declined within 3 business days after receipt?**
No. The existing Reg. Z commentary on that point remains unchanged. If you decline the application within 3 business days after receipt, it will not be necessary to give early disclosures of the terms that would have applied to the declined loan.

**The new Housing and Economic Recovery Act requires early disclosures on all mortgage transactions at least 7 business days prior to consummation of the loan. If the loan terms change between the time the early disclosures are given and loan closing, do you have to re-disclose and then wait another 7 days to close?** No, but you will have to wait at least 3 business days after giving the new disclosures. The Housing and Economic Recovery Act amends the Truth in Lending Act to require early disclosures on all consumer mortgage transactions subject to RESPA no later than 3 business days after receipt of the application and at least 7 business days before consummation. (If the disclosures are given by mail, then closing must be delayed at least 10 business days after mailing the disclosures.) If the early disclosure statement contains an APR that is no longer within the applicable tolerance for accuracy (1/8 of 1% in a regular transaction), the creditor must furnish the borrower with an additional, corrected statement not later than 3 business days before consummation. Nothing is said about what happens if the terms change again during that 3 day window. It seems likely the Fed will make further changes to this section of Reg. Z in light of the new legislation and may, perhaps, answer this question. By the way, as it stands right now, the final regulations will apply to loans covered by RESPA secured by the consumer's principal dwelling. The Housing Act just says "dwelling" and not "principal dwelling". We will have to wait and see if the Fed makes any changes on that point.

*<Cliff Harrison>*

## HMDA/REG. C AMENDMENTS APPROVED

The Federal Reserve Board on October 20, 2008, approved final amendments to Regulation C revising the rules for reporting loan pricing/rate spread information on higher-priced mortgage loans on the HMDA LAR. Regulation C currently requires lenders to collect and report the spread between the APR on a dwelling secured loan and the yield on a Treasury security of comparable maturity if the spread is greater than 3.0 percentage points for a first lien loan or greater than 5.0 percentage points for a subordinate lien loan. The Treasury yield used is the yield as of the 15th day of the month most closely preceding the date the interest rate on the loan was locked. This difference is known as a rate spread.

Under the new regulations, a lender will report the spread between the loan's APR and the "average prime offer rate" if the spread is equal to or greater than 1.5 percentage points for a first lien loan or equal to or greater than 3.5 percentage points for a subordinate-lien loan. The average prime offer rate will be determined by the Federal Reserve based on the Primary Mortgage Market Survey® currently published by Freddie Mac. The Fed will publish the rates weekly in two tables, one for variable rate products and one for fixed rate loans. If necessary, the Fed will conduct its own survey of mortgage loan

rates if it becomes appropriate or necessary to do so. The Fed anticipates updating the average prime offer rate tables on Friday each week effective the following Monday. The spread will be determined based on the most recent average prime offer rate for the particular loan type and maturity in effect at the time the interest rate on the loan is set for the final time before closing.

In setting the rate spread reporting threshold, the Fed sought to cover subprime mortgages and generally avoid covering prime mortgages. The Fed believes that using benchmarks based on a market survey instead of Treasury security yields will better achieve this purpose and ensure more consistent and more useful data. It remains to be seen whether the result will be more or fewer rate spread loans being reported by HMDA reporting banks.

These changes to Regulation C will conform the threshold for rate spread reporting on the HMDA LAR to the definition of higher-priced mortgage loans adopted by the Federal Reserve under Regulation Z/HOEPA changes issued in July of 2008 with respect to higher priced mortgage loans.

The final rule is effective October 1, 2009. Lenders will use the new rate spread reporting test on loans for which applications are taken on or after October 1, 2009 and for all loans consummated on or after January 1, 2010 (regardless of the application date). Lenders will continue to use the existing rate spread reporting test using Treasury security yields for loans for which applications were taken before October 1, 2009 that close in 2009. For loans for which applications were taken before October 1, 2009 that are closed in 2010 or later, the revised rules will apply. As a result, the 2009 HMDA data reported by most banks will include some rate spread loans of both types.

*<Cliff Harrison>*

## FDIC INCREASES INSURANCE COVERAGE

### (Offers Temporary Liquidity Guarantee Program)

In addition to the actions taken by the U.S. Department of Treasury to establish the "Troubled Assets Relief Program" ("TARP") under the auspices of the Emergency Economic Stabilization Act of 2008, the FDIC has taken certain steps to increase the limits of FDIC insurance coverage and extend other assurances in the form of guarantees, all aimed at bolstering the public's confidence in U.S. financial institutions. In the midst of almost daily announcements of new programs, initiatives and protections, it is understandable that many persons, including some of the media, are confused. Hopefully a simple summary will help to clarify the FDIC's recent initiatives.

First, and most prominently, the Emergency Economic Stabilization Act, passed October 3, 2008, temporarily increased the federal deposit insurance coverage limits from $100,000 to $250,000 per depositor. The increase became effective when the President signed the Act the same day and will remain in effect through December 31, 2009. The legislation did not increase coverage for retirement accounts which were already insured up to $250,000.

In a further move on October 14, 2008, the FDIC announced an additional new program aimed at guaranteeing certain bank debt and

fully insuring balances in non-interest-bearing deposit transaction accounts. This program is referred to as the Temporary Liquidity Guarantee Program, not to be confused with the temporary increase in basic FDIC insurance coverage discussed above.

In order to offer this guarantee program, the Secretary of the Treasury had to invoke what is referred to as the "systemic risk exception" to the FDIC Improvement Act of 1991 in consultation with the President and the Boards of the Federal Reserve and the FDIC, an unprecedented move.

Under the Guarantee Program, the FDIC will guarantee all newly-issued senior, unsecured debt issued by eligible institutions on or before June 30, 2009. This new debt can take the form of promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt. There is a debt limitation under the program equal to 125% of the debt that an institution had outstanding on September 30, 2008, which was scheduled to mature before June 30, 2009. For eligible debt issued before June 30, 2009, coverage would exist under the program for only three years, regardless of maturity.

In an action that will have more visibility to your customers, the FDIC also extended 100% insurance coverage to all non-interest-bearing deposit accounts held by FDIC-insured banks until December 31, 2009. Remember that this unlimited coverage only applies to non-interest-bearing transaction deposit accounts.

Coverage for both of these guarantees is free for the first 30 days. Thereafter, a 10-basis point surcharge will be applied to non-interest-bearing transaction deposit accounts to the extent of coverage over and above the regular $250,000 coverage, and a 75-basis point fee will be charged based on the amount of debt that an eligible institution issues under this program.

Importantly, eligible entities must inform the FDIC prior to the end of the initial 30-day period (November 13, 2008) if they wish to opt out of the program. Institutions opting out should expect that they will need to disclose to depositors whether they have opted out. Every institution should weigh the relative increase in FDIC insurance premiums against the negative implications of opting out and the possible competitive advantage that other institutions might gain by opting in.

Remember that all increases in insurance and offers of guarantees are temporary, and bear in mind the November 13, 2008 opt-out deadline.

*<Ed Wilmesherr>*

## REGULATORS TO SPEAK AT ANNUAL MEETING ON NOVEMBER 18, 2008

The MSRCG will hold its Annual Meeting on November 18, 2008, at the Racquet Club of Memphis in the Large Ballroom located at 5111 Sanderlin Avenue, Memphis, Tennessee. Registration will begin at 9:00 a.m. with the Annual Meeting to begin at 9:30 a.m.. Note our start time is 30 minutes earlier than usual due to our full schedule.

The Annual Meeting will feature speakers from each of the Federal regulatory agencies – Linda Wallace (FDIC), Rusty Cronan (OCC) and Anthony Ricks (FRB) have agreed to take part in a compliance panel discussion devoted to a wide range of compliance topics. Ken Buford will present a Bank Secrecy Act update, and Allen North

(FRB) will address the group regarding the state of the banking industry. Assistant Commissioner Tod Trulove (Bank Division, Tennessee Department of Financial Institutions), Tim Amos and Tausha Carmack (Tennessee Department of Financial Institutions), and Sal Barrientos – ICE representative will be speaking.

As always, the dress code for this occasion is casual, and lunch will be provided. We ask that you fax or e-mail your registration information to Liz Crabtree no later than November 13, 2008, so that arrangements for lunch can be finalized. We look forward to seeing you there.

*<Ed Wilmesherr>*

## MSRCG COMPLIANCE CALENDAR

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| **1/31/05** - Revised FACT Act Notices Effective | **11/1/06** - EPA All Appropriate Inquiries Rule Effective |
| **3/29/05** - Effective Date for Interagency Guidance on Response Programs for Unauthorized Access to Customer Information | **1/1/07** - Mandatory compliance date for Reg. E changes on electronic check conversions, payroll card accounts and ATM surcharge disclosures |
| **4/8/05** - Effective date for OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices | **7/1/07** - Reg. E payroll card account provisions effective |
| **4/26/05** - Joint Guidance on Banking Services to MSB's Issued | **10/01/07** - National Defense Authorization Act Usury Provisions Effective |
| **7/1/05 -** Final Rule on Disposal of Consumer Information (FACT Act) effective | **1/1/08** – FACT Act Affiliate Marketing Rule Effective |
| **7/1/05** - Effective Date for Joint Guidelines for Disposal of Consumer Information | **10/1/08** – FACT Act Affiliate Marketing Rule Mandatory Compliance Deadline |
| **8/1/05** -Disclosures re: Opt Out Rights for Credit Or Insurance (FACT Act) Final | **10/1/08** – Electronic Disclosure Regulation effective |
| **9/01/05** - CRA Final Rule Becomes Effective | **11/1/08** – Red Flag Guidelines compliance mandatory |
| **2/13/06** - OFAC Guidelines Effective | **11/13/08** – Deadline to opt-out of unlimited FDIC insurance for non-interest transaction accounts |
| **4/1/06** - Deposit insurance limits on retirement accounts increased to $250,000 | **11/14/08** – Deadline for application for Treasury Department Capital Purchase Plan |
| **4/1/06** - Effective date for FACT Act regulations on use of medical information in determining credit eligibility | **11/18/08** – MSRCG November Annual Meeting |
| **6/30/06** - Effective Date for use of new SFHD forms | **10/1/09** – HOEPA Regulations changes generally effective |
| **7/1/06** - Reg. DD Amendments on Overdraft Privilege Plans Effective | **4/1/10** – Escrow requirements effective for site-built homes |
| **7/1/06** - Effective date for Reg. CC amendments on remotely created checks | **10/1/10** – Escrow requirements effective for mobile homes |