



Troubled Assets Relief Program: Recent Developments Regarding Tracking and Monitoring Use of Capital Purchase Program Funds

The U.S. Department of the Treasury (“Treasury”) announced its Capital Purchase Program (the “CPP”) as part of the Troubled Assets Relief Program (the “TARP”) under the Emergency Economic Stabilization Act of 2008 (the “EESA”) late last year. Under the CPP, Treasury purchases from financial institutions preferred stock and warrants to purchase common stock. To date, Treasury has invested approximately \$200 billion into more than 300 institutions nationwide, and has stated that it intends to invest a total of at least \$250 billion under the program.

The CPP has been the subject of mounting criticism, particularly with regard to the use of the funds by the participating institutions. Treasury has stated that the program’s general goals are to increase the flow of credit to U.S. consumers and business, and to encourage financial institutions to work to modify the terms of existing residential mortgages in order to strengthen the U.S. housing market. These goals are stated in the “recitals” section of the CPP Securities Purchase Agreement – Standard Terms (the “SPA”), but there currently are no specific guidelines or requirements regarding the use, monitoring, or tracking of funds in the CPP documents or the relevant laws or regulations, and many observers have been critical of the program’s failure to impel actions toward these goals. Accordingly, it appears likely that participating institutions will be encouraged, if not required, to take identifiable actions toward these goals and monitor their use of the TARP funds in the near future.

I. Criticism to Date

A. GAO Report

A December 2008 U.S. Government Accountability Office (the “GAO”) Report to Congress entitled “Troubled Assets Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency” (the “GAO Report”) was the first significant criticism of the CPP. Among other aspects of the program, the GAO Report criticized the lack of control and monitoring mechanisms for the participating institutions’ obligations under the CPP agreements, especially with regard to the general goals of the CPP under the TARP. The GAO suggested that Treasury work with bank regulators to implement a controlled and defined system for banks and regulators to track, monitor, and report the use of funds by the institutions.

B. More Recent Criticism and Actions

In connection with the establishment of the TARP, President Bush appointed Neil Barofsky as Special Inspector General for the TARP as a “watchdog” to monitor and report on how the government spends the EESA “bailout” money under the programs. On January 22, 2009,

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Barofsky wrote a letter to Senator Charles Grassley (R-Iowa), the Ranking Member of the Senate Finance Committee, indicating his concerns with the effectiveness and transparency of the TARP, particularly with regard to the CPP participants. Barofsky stated that answering the basic question, “Where did the money go,” is critical, and described requests under preparation by his office for each CPP-participating institution requesting information including: (i) a narrative response outlining its expected use of TARP funds; (ii) copies of relevant supporting documentation to support the response; (iii) a description of its plans for complying with the applicable executive compensation restrictions; and (iv) a certification by an authorized officer of the company as to the accuracy of the response.

On February 6, the Congressional Oversight Panel (the “Panel”) established under the EESA released a report related to the TARP entitled “Valuing Treasury’s Acquisitions” (the “Valuation Report”). The primary focus of the Valuation Report was to conduct a purely financial valuation of Treasury’s transactions under the TARP, including the CPP. The Valuation Report concluded that Treasury substantially overpaid for the assets it purchased under the TARP. In particular, the Panel stated that, with regard to the 10 largest TARP investments made by Treasury during 2008, Treasury paid \$254 billion for assets valued at approximately \$176 billion, or approximately \$66 for every \$100 spent. The numbers under the CPP program only (which comprised eight of the 10 largest transactions) were better, but still indicated overpayment by Treasury, which received about \$78 worth of assets for every \$100 spent.

The Valuation Report expressly declined to judge whether the overall value of the programs resulted in a “fair deal for taxpayers” once the broader policy objectives of the programs were considered (including such benefits as preservation of the financial system generally), stating that such a determination would involve policy debates and an assessment as to whether these investments are part of a coherent strategy to achieve the objectives of the EESA. However, the Panel did identify other, more general concerns regarding accountability, transparency, home foreclosures, and overall strategy under the TARP, and stated that its future reports will address these broader issues more directly.

In addition, with the new administration and the appointment of Timothy Geithner as Treasury Secretary, there has been ongoing recent criticism of the TARP and CPP in particular, including continued inquiries regarding use of the funds. In his responses to questions posed by members of the Senate Finance Committee, Secretary Geithner acknowledged and agreed that oversight and transparency requirements under the CPP agreements to date have been inadequate. He also indicated that future assistance under Treasury TARP programs would come with additional obligations and conditions relating to these goals.

II. Responses to Criticism

A. Treasury Response

Neel Kashkari, Interim Assistant Secretary of the Treasury for Financial Stability and the principal spokesperson for Treasury with regard to the CPP, has repeatedly stated that Treasury is committed to transparency and oversight in the program. In response to the GAO Report, Kashkari stated that Treasury believed a market-monitoring approach, as opposed to tracking individual institutions, is more appropriate for evaluating the overall success of the CPP, but nonetheless acknowledged that Treasury intended to develop a monitoring and enforcement system for the CPP in order to “ensure compliance with the letter and the spirit of the requirements.”

Despite his previous statements on the appropriateness of individual firms’ data, Kashkari has more recently taken action to gather more specific information from individual participating institutions. On January 16, 2009, Kashkari wrote letters to 20 of the largest CPP participants asking for information about business and consumer loans, and mortgage-backed and asset-backed securities purchases. Kashkari stated that this information will help Treasury to gauge the effectiveness of the CPP, but it has not yet publicly provided details on the specific information it has requested. In addition, with the new Obama administration assuming the responsibilities of office, there are indications that the implementation of express obligations and/or monitoring systems may take effect, as discussed further below.

B. Industry Response

Although the focus of most of the criticism has been on the offices and individuals implementing the CPP on the government side, participating institutions, especially those larger companies that received particularly substantial capital injections, have also received direct inquiries and criticism regarding their use of the CPP funds.

Most companies that have received independent non-government requests for information on how the funds are being used have declined to respond. Some cite the fungibility of capital as a cause of the inability to track any particular set of funds. Others have stated that they are simply declining to comment on the matter. A handful of firms have provided limited responses, ranging from general “strengthening of balance sheets to continue lending” to more specifically identifiable programs, such as temporary moratoriums on home foreclosures and specific new loan programs.

On February 3, Citigroup released a formal TARP Progress Report entitled “What Citi Is Doing to Expand the Flow of Credit, Support

Homeowners and Help the U.S. Economy” (the “Citi Report”). Citigroup stated that the Citi Report will be updated quarterly and posted publicly on the firm’s Web Site. The Citi Report details Citigroup’s actions to date and future plans in connection with Treasury’s investment in Citigroup under the TARP, including Citigroup’s formation of a Special TARP Committee to approve, monitor, and track the firm’s use of the TARP funds, and the company’s determination of initial areas for development and focus “which are consistent with the objectives and spirit of Treasury investment program.” The Citi Report is available at Citigroup’s Web Site at

<http://www.citigroup.com/citi/press/2009/090203a1.htm>.

III. Possible Future Actions

As discussed above, Secretary Geithner indicated in response to written Congressional inquiries that, as a condition of federal assistance under the second tranche of funding under the EESA, Treasury would require more assurances in this regard, in particular, increasing lending above baseline levels and providing regular reports with detailed information on lending patterns. For public companies, this information would be provided in conjunction with the release of their SEC 10Q reports.

What remains to be seen, however, is the extent to which any additional conditions imposed will apply to firms that participated in the first tranche under the CPP, if at all. The SPA expressly provides that Treasury may unilaterally amend the agreement to the extent required to comply with any changes in applicable federal statutes after the execution date. Accordingly, the requirements with regard to firms that have received CPP funds may be modified in the future, and, among other requirements, these companies could find themselves subject to new use, monitoring, and tracking obligations under the program.

Even if no formal legal or regulatory requirements are imposed in these areas, many firms will likely find it advisable, whether for purposes of marketing, public relations, or industry best practice, to develop and implement some level of programs to govern use, monitoring, and tracking of funds received under the TARP. Firms that participate, or anticipate future participation in, the CPP or other TARP programs should track, record, and compile data for their general lending and mortgage activities. This data should be used to illustrate proactive and targeted increases in small business, consumer, and municipal lending, and increased focus on avoidance of preventable mortgage foreclosure, especially any actions, policies, or programs that encourage retention of primary residences by consumers.

In addition, institutions should document in detail any new programs or initiatives, or increases in scale of existing programs, implemented in connection with the goals of the TARP and CPP.

These may include formal structured programs, or more general initiatives or focus areas. For example, an institution may modify its consumer and/or business lending policies to expedite or increase the flow of funds to eligible applicants. It may work with existing borrowers to defer or otherwise modify payment terms in order to avoid default or increase access to lines of credit, where appropriate. If a firm decides to target a particular market segment or industry, it should document this program and maintain records of the specific actions taken to effect the new focus.

The lack of formal requirements to date means that institutions have flexibility in implementing plans to achieve the goals of the TARP, but the ongoing criticism and overall trend of developments indicate that it will be prudent for participating firms to document the actions they take to effect those plans.

The Financial Services Practice Group of Winston & Strawn represents a broad range of financial institutions on all regulatory matters, including developments under the EESA and actions designed to restore stability to the financial markets. If you have any questions regarding the matters discussed in this Briefing, or if you need assistance in developing and/or reviewing systems, controls and/or procedures relating to the matters covered by this Briefing, please contact any of the Winston & Strawn attorneys listed below or your usual Winston & Strawn contact:

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