Economic Stabilization Advisory Group | October 21, 2008

Financial Institutions in a Time of Global Market Turbulence

Opportunities, Issues and Risks

Since the middle of 2007, the financial markets have been facing severe stress as a result of the credit crunch. National governments have adopted different strategies, often executed at lightning speed, to resolve the crisis and restore confidence in the financial system. These strategies present opportunities for market participants but also pose risks which need to be minimized if institutions are to navigate the situation successfully and emerge with stronger businesses.

Shearman & Sterling LLP ("Shearman & Sterling") has been advising financial institutions, corporations and investors in identifying and exploiting these opportunities and tackling issues that have arisen in the wake of the financial crisis. This note is written for financial institutions and investors dealing with unfolding events and government initiatives around the world.

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EXECUTIVE SUMMARY

Financial markets and institutions are in the process of unprecedented structural change. Governments across the world have taken, and continue to take, a variety of extraordinary measures to deal with the global financial crisis. These include equity capital injections, guarantees of bank liabilities and the acquisition of illiquid assets from banks. These measures are designed to restore confidence in the financial markets and to protect systemically important financial institutions from collapse.

Despite recent efforts by international policy makers to coordinate and harmonize the national responses to the situation, individual governments have adopted different approaches to its resolution, tailored to the unique structures of their financial systems, the specific events that have unfolded in their local markets and domestic affordability. As a result, the measures taken differ in terms of objective, scope of coverage, operational details and cost.

Regardless of their differences, the various measures adopted to date fall into one of the following general categories: (i) guarantees of bank liabilities; (ii) retail deposit guarantees; (iii) central bank liquidity measures and interest rate cuts; (iv) bank recapitalization through equity investments by private investors and governments; (v) open-market or negotiated acquisitions of illiquid or otherwise undesirable assets from weakened financial institutions; and (vi) measures designed to restore the orderly functioning of equity markets such as restrictions on short selling.

These measures are creating new business and operational opportunities for financial institutions, investors and other market participants. They also raise significant new legal risks or add new perspectives to old risks. In most instances, the same potential event (e.g. change of accounting standards or valuation techniques for financial assets) creates both risks and opportunities.

A summary of some of the most significant opportunities, issues and risks generated by the above measures is provided in this note. By way of overview, the key points are as follows:

1. National Initiatives to Strengthen Bank Capital. Recapitalization measures have taken various forms but the programs announced thus far largely involve the purchase by governments of preferred or common equity securities issued by eligible financial institutions. Government ownership of equity securities of financial institutions will have a significant impact on the financial markets, providing further opportunities for business combinations, dispositions and acquisitions. As financial institutions benefiting from government rescue capital are put under pressure to divest non-core and non-domestic operations and to re-focus their business strategies on providing credit to domestic markets, acquisitive firms will have opportunities to make strategic investments. Another issue to be considered by non-U.S. banks receiving equity injections from their home country governments is how this affects their opportunities to expand in the United States. The Federal Reserve's traditional view is that any credit institution with equity invested by the home country government, including the United States, should not be allowed to expand in the United States. At the same time, eligible financial institutions, and their competitors, should review extensively the legal, regulatory and operational repercussions of participation in government-led recapitalization programs, including effects on their tax position, corporate control and lending policies.

2. Purchase of Distressed Assets. The use of taxpayers' funds by the official sector to purchase distressed assets from troubled financial institutions will create a range of opportunities and risks. First, the initial sale of the assets to the government will set a market price for such assets, causing non-cash losses or gains for institutions holding the same or comparable assets when applying mark-to-market accounting. Second, an important objective of such programs is the resale by the government in due course of troubled financial assets to private investors such as banks, investment funds and other investors. For purchasers, successfully pricing such assets will require robust due diligence on change of control provisions, mandatory repurchases or redemption, transfer provisions, transfer limitations, as well as, in the case of asset-backed securities, a deep understanding of the underlying assets and the legal rights relating to those assets.

3. Central Bank Liquidity Measures. New tools have been devised to enable central banks to revive interbank lending, keep interbank rates within policy targets and extend liquidity to institutions faced with an evaporation of liquidity in many instruments. Significant reforms are underway to extend the scope of coverage of these programs to a wider range of financial institutions. In response, financial institutions and other businesses around the world are already considering the available programs and planning to restructure their financial assets into collateral that will be used in order to secure funding through these facilities.

4. Sovereign Guarantees of Bank Liabilities. Sovereign guarantees of bank liabilities enhance banks' ability to access the international capital markets. The provisions of guarantees of bank liabilities on both sides of the Atlantic and across the world is already creating interesting opportunities for exploiting pricing differentials in international debt capital markets. Through appropriate selection of the entity to issue the guaranteed debt securities, international financial institutions may exploit their pricing strengths in certain markets, and the strengths of the relevant sovereign guarantees, while making funds available for operations in other markets. To take advantage of these opportunities, institutions benefiting from such unilateral guarantees must examine the existing documentation of their capital raising programs to assess the implications of the guarantees on the required level of sovereign disclosure in offering documents and any necessary revision of purchase agreements, bond indentures, agency agreements and other supporting documentation.

5. Protection of Retail Depositors. Governments have been extending the scope of coverage of their existing deposit guarantee programs. In addition, regulators and central banks in some jurisdictions have been or are to be given powers to make partial transfers of healthy assets and retail deposit liabilities out of a failing bank and into a "bridge" bank. Such measures raise questions, more than ever before, with respect to the equal treatment of banks' creditors. They enhance the credit risk of counterparties in the interbank market, whose rights are effectively subordinated to those of retail depositors.

6. M&A Transactions. There will be numerous future M&A opportunities in the financial sector. The use of taxpayers' funds to rescue financial institutions is likely to generate political pressure for securing the swift return of capital and, consequently, direct government instructions to these institutions to sell non-core businesses. Financial institutions scaling down activities or deleveraging balance sheets will also make assets available for further M&A activity. In the medium term, there will be other sources of M&A transactions if: (i) recent measures fail to stabilize the financial system; (ii) governments decide to sell their new investments; (iii) some recently announced transactions fail to achieve their strategic or earnings objectives; and/or (iv) governments decide to re-tighten anti-trust laws and regulations. With respect to non-financial M&A transactions, the economic downturn and distressed conditions in credit markets may encourage companies to sell operations in order to repay borrowings or re-focus their corporate strategy.

7. Legal Risks and Relevant Opportunities in Various Types of Financial Assets. We also identify a number of significant legal risks relating to aspects of the present crisis, including: (i) the need for public companies to draft appropriate disclosure, and the opportunity for banks to provide advisory services, with respect to the effects of the present crisis on their operational results and financial position; (ii) the legal uncertainties resulting from cross-border insolvencies of complex financial groups, counterparty insolvency in derivatives transactions and the legal regime governing assets placed in custodian accounts or prime brokerage accounts in the event of custodian or prime broker insolvency; and (iii) the ability of lenders to invoke "market disruption" clauses in loan documentation and the various ways to protect against market disrupting events such as setting a LIBOR floor, lowering the percentage of lenders required to invoke the market disruption provisions, adding an increase to the margin when Eurodollar market disruption occurs, or redefining LIBOR by reference to the higher of several rates. Internally, financial institutions are generally expected to strengthen their capacity for robust credit analysis through operational and organizational changes and the recruitment of additional credit analysts.

8. New Regulatory Requirements. Regulatory or supervisory failures and the existence of unregulated markets have been partly blamed as causes of the financial crisis. We expect a number of regulatory reforms, in some cases sweeping, to be implemented in the near future. This publication discusses some of the likely reforms, both in the short and longer term, including new bank capital adequacy rules, increased regulation of broker dealers and investment funds, reform of the regulatory and supervisory structure in the United States, possible establishment of a European (or even wider) financial markets regulator, regulation of executive compensation, regulation of credit rating agencies, proper regulation of the credit default swaps market and of monolines, regulation of short selling and other initiatives in securities markets regulation, including reforms of standards for fair value accounting.

9. Disputes and Law Enforcement. There is likely to be a substantial increase in private litigation and arbitration by investors and financial institutions who are counterparties to insolvent and nationalized banks, and others who have suffered losses. Financial institutions will need to design and implement a robust litigation strategy to minimize the risks and identify opportunities for financial gain through the recovery of losses or other improvements in their legal position. Such strategy should, at minimum, include: (i) keeping up-to-date with relevant litigation and developing case law; (ii) selecting the appropriate forum of litigation in light of the approach adopted by various national courts; and (iii) developing a strategy to deal with law enforcement agencies, securities regulators, local authorities and others (e.g. Attorneys General in the United States), likely to drive enforcement actions and settlement discussions in the future.

10. Pension Plan Fiduciaries. We will discuss briefly the key implications of the crisis for pension fund fiduciaries, including the importance of reviewing counterparty risk and rethinking the suitability of investments generally regarded as safe.

11. Tax Changes. Finally, we provide a short overview of the main tax issues engaged by the various measures and actions discussed.

1. OPPORTUNITIES TO RAISE CAPITAL, ENHANCE LIQUIDITY AND STABILIZE FUNDING SOURCES

The current financial crisis began as a systemic liquidity crisis in the financial sector. It has now deteriorated into a global crisis of market confidence about the ability of a large number of financial institutions to meet their obligations and remain solvent. Accordingly, the main policy objectives of the various measures adopted by governments and central banks to address these issues have been to:

- ensure that banks and other financial institutions have broad access to liquidity and funding in the short term;
- prevent the failure of financial institutions in circumstances where such failure would generate further loss of market confidence in a financial system that has already been under enormous stress;
- ensure that banks can raise additional capital from various sources in sufficient amounts to serve as a cushion to further losses and restore the ability of banks to meet their obligations and resume lending; and
- bolster the deposit guarantee programs in order to dissuade depositors from withdrawing vital funding from the banking sector.

In the absence of an international organization or body with power to initiate and coordinate global corrective measures, national governments initially moved unilaterally to restore confidence in their domestic financial systems.

Eventually, it has become apparent that unilateral policies taken at a national level are insufficient to resolve what is a global crisis. Consequently, governments representing the leading industrialized nations have agreed to a broad global framework for further action with a view to facilitating capital raising by financial institutions, providing additional liquidity and stabilizing retail and interbank funding sources.[1]

The following sections describe the various measures taken at a national level, the agreed global framework of corrective action, and the opportunities, risks and wider issues raised by these developments.

1.1 OPPORTUNITIES TO RAISE CAPITAL: NATIONAL INITIATIVES TO STRENGTHEN BANK CAPITAL

Sufficient amounts of equity capital, including reserves, and other deeply subordinated liabilities are fundamental pillars of the stability of individual banks and the financial system as a whole. Strong capital ratios protect banks from the effects of excessive leverage and provide a cushion for loan book and trading losses.

Similarly, depleted levels of equity capital, whether due to operating losses or asset write-offs or other reasons, limit the ability of banks to increase or even maintain their lending activities and, in extreme circumstances of market turmoil, may lead to rapidly diminishing confidence in a bank's ability to meet its obligations and remain solvent.

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[1] On October 10, 2008, the G-7 group of industrialized nations (the "G-7") agreed to a five-point action plan to adopt common measures designed to stabilize the financial markets. The finance ministers and central bank governors of the G-7 pledged to take the following steps: (i) take decisive action and use all available tools to prevent the failure of systemically important financial institutions; (ii) take all necessary steps to unfreeze credit and money markets and ensure that banks and other financial institutions have broad access to liquidity and funding; (iii) ensure that banks and other major financial intermediaries can raise capital from public as well as private sources, in sufficient amounts to re-establish investor confidence and permit them to continue lending to households and businesses; (iv) ensure that national deposit insurance and guarantee programs are robust and consistent so that retail depositors continue to have confidence in the safety of their deposits; and (v) take action, where appropriate, to restart the secondary markets for mortgages and other securitized assets.

Many commentators have been calling for a bold recapitalization of the global financial system through equity investments by private investors (in the public markets or through negotiated transactions) and governments. The need to recapitalize weakened financial institutions has been expressly endorsed by the G-7.

Policy makers now broadly agree that an extensive program of recapitalization of the banking sector is essential to restore confidence in banks' ability to operate and meet their obligations and continue providing credit to the economy. Some banks have agreed to accept government capital injections in what are effectively part-nationalizations. Other banks have refused to accept government assistance and, instead, managed or are planning to raise capital from private sources (including sovereign wealth funds).

1.1.1 Brief Summary of Bank Recapitalization Initiatives

Government programs for the recapitalization of national banking systems provide funds for the purchase by governments of common or preferred equity securities issued by eligible financial institutions. In effect, financial institutions now have another source – the government – for raising equity capital, in addition to private investors and sovereign wealth funds.

In the United States, up to $250 billion of federal funds will be used by the government to buy preferred stock in banks. Half of this will be invested in nine large financial institutions, and the other half in smaller lenders and thrifts. In the United Kingdom, £25 billion of taxpayers' money is made available by the government for equity investments in order to raise banks' Tier 1 capital ratios, with a further £25 billion being available for further support should the need arise. Certain systemically important financial institutions will likely receive substantial equity investments, and at least one institution (The Royal Bank of Scotland Group ("RBS")) will be partially nationalized if, as is likely, existing shareholders do not take up the new shares that RBS is currently offering in the £15 billion rights issue that it is planning. In France, the six largest banking groups will receive a €10.5 billion capital injection from the government in the form of subordinated debt securities issued by the banks without voting rights. Government funds have also become available in other countries to recapitalize financial institutions, including Germany (€100 billion), Austria (€15 billion), Italy, Switzerland (SFr 6 billion), Spain, The Netherlands (€20 billion plus another €10 billion for ING Groep N.V. ("ING")) and Belgium (€4.7 billion).

Common equity investments by governments will, at least in some instances (e.g. the United Kingdom), be made as a measure of last resort: for example, if rights issues to the banks' existing shareholders fail to attract sufficient investor interest. In those rights offerings underwritten by governments, institutional investors without existing equity holdings will also be allowed to take up any new shares offered but not subscribed for by existing shareholders. The expected level of subscription prices in government-underwritten rights offerings, compared to the public trading price of the relevant common stock, may present investment opportunities to investors with a long-term view on the profitability of the banking sector.

1.1.2 Opportunities, Issues and Risks

The use of taxpayers' funds to rescue the banking system has put governments under political pressure to ensure that banks do not generate further losses. This political environment will lead, among other things, banks benefiting from government programs to consider dispositions of non-core and/or international businesses. The argument is likely to be that financial institutions that have received government support (at a cost to taxpayers) should focus their core lending operations on the domestic markets and abandon international activities, especially lending activities, which would not generate benefits to such markets. This issue may be particularly relevant to those countries such as the United Kingdom where local banks have a disproportionately large share of their business in foreign markets compared to the size of their business in their respective domestic market.

Another issue to be considered by non-U.S. banks receiving equity injections by their home country governments is their opportunity to expand in the United States. The Board of Governors of the Federal Reserve System (the "Federal Reserve") has traditionally held the view that any organization with equity invested by its home country government, including the United States, should not be allowed to expand in the United States. Whether it will take this view in light of the uniqueness of recent events is unclear. In addition, the apparent fact that nine major U.S. institutions were effectively coerced to accept government equity would likely cause the Federal Reserve to moderate any such thoughts.

The terms, scope of coverage, pricing and future implications of the various national recapitalization plans differ significantly from country to country. Eligible financial institutions will naturally review extensively the legal, regulatory and operational repercussions of participation in such plans. However, other market participants and investors also need to be familiar with the conditions attached to these equity injections in order to assess their implications. Key aspects to consider include: (i) the cost of capital to participating institutions; (ii) associated limits on and rules regarding executive compensation and executive compensation policies; (iii) voting rights and board representation; (iv) broader changes to corporate governance; (v) ability to formulate or change lending policies; (vi) tax treatment; and (vii) substantive and procedural conditions for future dispositions by governments of the relevant equity investments.

Financial institutions receiving equity capital from governments, as well as the competitors of such financial institutions, should also consider a range of other technical issues with broader financial or business implications, either as part of their strategic response to the present crisis or, at least, to inform their analysis of available investment opportunities. For example, with respect to the issuance to governments of equity warrants to supplement common or preferred stock investments, existing restrictions in the institution's corporate organizational documents (for example, memorandum and articles of association) may limit the classes of common stock authorized to be issued upon the exercise of such warrants. In particular, the issuance of non-voting common stock, which would make a lot of sense for a passive investor, may not be allowed. As a result, the institution may be unable to issue non-voting or other varieties of common stock other than the authorized class, which may restrict the ability of the parties to structure the investment in a way that is attractive to a sovereign investor without unduly restricting the issuing financial institution. An alternative would be to initiate an amendment of the relevant corporate organizational documents so as to authorize the issuance of a type of equity security that better responds to the requirements of the parties (both issuer and government). In most cases, however, an amendment of the company's corporate organizational documents would require shareholders' meetings and resolutions that could not be processed within the available time to effect the investment. In these circumstances, it may simply not be possible to structure warrants that would provide the government with equity upside but limited voting rights. The two other possibilities would be equity warrants exercisable into voting common stock or equity warrants exercisable into preferred stock (which would deprive the sovereign of equity upside). Another alternative to non-voting common or preferred stock, suitable for passive investors and eligible for regulatory capital treatment, would be the issuance of deeply subordinated debt securities. This approach was adopted by the French recapitalization plan. The issuance of warrants would also trigger additional legal issues that should be carefully considered. Will they have customary anti-dilution adjustments protecting the government from dilution in the event of stock splits, stock distributions, dividends and other dilutive events? Also, what other implications do the issued warrants have on existing commercial or financial agreements, convertible bond indentures or shareholder rights plans ("poison pills")?

1.2 OPPORTUNITIES TO ENHANCE LIQUIDITY AND/OR INVEST

1.2.1 Purchase of Distressed Assets

Distressed or non-performing financial assets, in the form of loans, residential mortgages, asset-backed securities, collateralized debt obligations ("CDOs") and so on, deplete banks' equity capital and limit the ability of banks to make loans, even to creditworthy businesses and individuals. The deployment of taxpayers' funds by the official sector (through special investment funds administered by governments or central banks) to purchase distressed assets from troubled financial institutions aims to free up the selling bank's vital capital resources, provide additional liquidity and revitalize the secondary markets for these assets.

1.2.1.1 Brief Summary of Asset Purchase Programs

On October 3, 2008, President Bush signed into law the U.S. Emergency Economic Stabilization Act of 2008 (the "U.S. Economic Stabilization Act"). The U.S. Economic Stablization Act is intended to provide relief for troubled financial institutions in order to improve the functioning of the credit markets and to help homeowners and financial consumers. The U.S. Economic Stabilization Act sets up the Troubled Asset Relief Program (the "TARP"), which gives the United States federal government the ability to purchase troubled mortgage-related (and potentially other) assets from eligible financial institutions, thereby taking these instruments off the balance sheets of their present owners. The federal government may hold these troubled assets until such time as they can be properly valued and ultimately sold to appropriate investors. The U.S. Economic Stabilization Act also gives authority to the federal government to invest directly in troubled financial institutions. Institutions eligible to benefit from the TARP include institutions beyond banks, insurance companies and the like. For example, the U.S. Investment Company Institute, the trade group for the U.S. regulated fund industry, has said that the U.S. Treasury agrees that regulated funds are eligible financial institutions.

The Spanish government has also adopted a troubled asset purchase program similar to the TARP. It set up the Financial Assets Acquisition Fund to purchase troubled assets from financial institutions. It will be funded by the Spanish government to a minimum of €30 billion and a maximum of €50 billion. In Switzerland, a new entity controlled by the Swiss National Bank (the "SNB") will take over $60 billion of UBS's more illiquid securities.

1.2.1.2 Opportunities, Issues and Risks

Asset purchase programs such as the TARP present unique opportunities to private sector investors. The initial sale of the assets to the government is designed to set a market price for such assets, which will cause financial institutions holding comparable assets to recognize non-cash losses or gains through the use of fair value accounting, depending on the marked price of such assets on their balance sheet and how such price compares to the market price set by the TARP. Financial institutions that have already fully marked down their position in assets eligible for sale under these programs will recognize significant non-cash gains. We understand that a large number of financial institutions have been recently marking down the value of assets that will likely be purchased under the TARP to zero and are therefore set to recognize significant gains following the commencement of asset purchases under this program. Opportunities, however, for intermediaries to make profits by selling assets to governments at higher prices than what such intermediaries paid to purchase such assets will be limited.

In managing the purchase of distressed assets under TARP, under the U.S. Economic Stabilization Act, the U.S. Treasury must prevent unjust enrichment of the participating financial institutions-for example, selling an asset to the U.S. Treasury at a higher price than what the seller paid to purchase the asset is not permitted. Efforts to evade or circumvent the unjust enrichment prohibitions would be very risky. In addition, acting as an intermediary and selling distressed assets acquired from a third party would subject the intermediary to the full scope of the other limitations established by the U.S. Economic Stabilization Act, including the executive compensation, corporate governance and tax rules, which would seem to provide a strong disincentive to act as a TARP intermediary. There is an important exception to the general prohibition of unjust enrichment which was made to encourage acquisitions/rescues of financial institutions under stress. The prohibition against unjust enrichment does not apply to distressed assets acquired in a merger, acquisition or in a purchase from a financial institution in certain insolvency, bankruptcy or similar proceedings. This exception should therefore allow the acquirers of distressed financial institutions, for example in recent emergency takeovers or recent insolvency proceedings, to sell certain distressed assets acquired through these takeovers or proceedings at a financial gain.

In addition to sales of troubled assets to the government, the resale by the government of acquired financial assets to private investors is also generating investment opportunities. Given the limited availability of lending at the moment, the U.S. Treasury is contemplating setting up a special financing program to facilitate purchases of troubled assets by private investors. This may take the form of sales of troubled assets to joint venture vehicles partly owned by private investors and partly owned by the government. It may also involve the U.S. Treasury lending money to private investors directly, but with a right to share any profits achieved by the private investor. In either case, available funding should improve the economic case for investor participation in the TARP. Programs such as TARP will enable investors to purchase assets that may be mispriced and therefore appreciate once conditions in the credit markets and the broader economy improve. Purchasers of such assets from the government, who manage to identify assets that will likely be purchased for less than their expected value in the future, will likely make significant gains if they manage to price such purchases appropriately. Successful pricing of such assets will require robust due diligence on change of control provisions, mandatory repurchases or redemption, transfer provisions, transfer limitations, as well as, in the case of asset-backed securities, a deep understanding of the underlying assets and the legal rights relating to those assets.

Potential participants in the TARP are advised to assess the limitations which will eventually be imposed on them by the U.S. Treasury with respect to their ability to maintain ordinary market operations.

Guidelines establishing the reverse auction or other methods by which troubled assets will be purchased by the U.S. Treasury have not yet been issued. On October 6, 2008, however, the U.S. Treasury announced procedures for the selection of asset managers to manage assets purchased by the U.S. Treasury through the TARP. The firms chosen to serve as asset managers will be announced in the next few days.

1.2.2 Central Bank Liquidity Measures

Unprecedented and coordinated actions by the leading central banks have been a feature of the current turmoil, ever since credit markets ceased functioning properly in the summer of 2007. The level of international coordination increased markedly following the collapse of Lehman Brothers in September 2008. Central banks have injected large sums of reserve funds into the financial system in order to push down interbank rates, which have soared to record levels at times of panic.

1.2.2.1 Brief Summary of Emergency Liquidity Measures

New tools have been devised to enable central banks to intervene in the money markets with a view to reviving interbank lending, keeping interbank rates within policy targets (in the United States) and extending liquidity to institutions faced with an absence of activity of markets in certain instruments (such as Asset-Backed Commercial Paper (“ABCP”)).

These measures include:

- *Auctions of Term Funds by the Federal Reserve and the Bank of England* (“BoE”). Although these two central banks allow depository institutions to approach them for funding, the stigma attached to such an approach has had an adverse effect on distressed banks’ efforts to secure essential funding. The use of auctions was intended in the United States to reduce or remove the stigma, with apparent success.
- *Commercial Paper Funding Facility by the Federal Reserve.* This unprecedented measure will allow a special purpose vehicle (“SPV”) funded by the Federal Reserve to purchase up to three-month unsecured and ABCP directly from eligible issuers.
- *Special Liquidity Programs.* These programs allow the central bank to exchange, for a set term, the government securities on its balance sheet for illiquid mortgage-backed securities (“MBSs”) held by financial institutions (subject to discounts).
- *Interest Accrual on Deposits with the Federal Reserve.* The Federal Reserve has commenced paying interest on commercial bank reserves, giving it an additional tool for conducting monetary policy.
- *Expansion of Eligible Collateral.* Central banks have recently allowed a wider range of collateral to be used for discount or refinancing, which has eased the stress on the liquidity of financial institutions.
- *Promotion of U.S. Dollar Liquidity.* The world’s leading central banks have expended significant efforts in promoting U.S. dollar liquidity: for example, the BoE, the SNB and the European Central Bank (the “ECB”) are conducting tender offers of U.S. dollar funding at 7-day, 28-day and 84-day maturities, while the Federal Reserve provides unlimited funding to these central banks to meet any level of demand for U.S. dollars as a result of their U.S. dollar lending operations.

1.2.2.2 Opportunities, Issues and Risks

The main issue with short-term liquidity programs is the limited number and type of entity that benefits from them. There are now calls for central banks to be prepared to lend directly to non-financial issuers of debt securities, something which the Federal Reserve’s Commercial Paper Funding Facility achieves with respect to corporate issuers issuing investment-grade debt securities. The Federal Reserve has already set up a Primary Dealer Credit Facility (“PDCF”) to enable its primary dealers to have access to funding.

Another significant aspect of the pre-existing central bank lending operations is the stigma often attached to financial institutions seeking funding from these sources. To encourage eligible financial institutions to seek funding, the BoE has announced three significant reforms of its lending operations, which took effect on Monday, October 20, 2008: first, the replacement of the existing “standing facilities” with “operational standing facilities”, with fewer disclosure obligations and a lower fee, which will absorb technical problems in the operation of the money markets and payment systems but will not provide long-term liquidity insurance to stressed firms; second, the establishment of a “discount window facility”, which will enable banks to borrow government securities against a wide range of collateral, at any time, at fees reflecting the type of collateral and the size of drawing; and third, the introduction, after further consultation, of permanent long-term repos against high-quality private sector securities. These significant reforms are designed to enhance access to the BoE’s liquidity support systems and present new opportunities for financial institutions, including financially strong institutions, to increase liquidity.

Furthermore, the Federal Reserve's discount window continues to present unique opportunities as a source of liquidity worldwide. The events that strengthened the role of the Federal Reserve and the Federal Reserve Bank of New York are well-known. Through a number of unprecedented actions and initiatives, the Federal Reserve has profoundly altered the agency's lending operations-historically a routine service offered to depositary institutions in the ordinary course of business-to cover the provision of emergency liquidity assistance to broker-dealers and other types of securities firms and, more recently, money market funds. For example, it provided funding at the discount rate for J.P.Morgan's acquisition of Bear Stearns and also became the lender of last resort to American International Group ("AIG"). The timely and robust response of the Federal Reserve to liquidity calls has prompted various financial institutions and other types of organizations around the world to consider restructuring their financial assets into eligible securities to provide to the Federal Reserve as collateral for obtaining liquidity through the discount window. It is likely that the newly-established BoE discount window will also attract interest from potential borrowers with assets to provide as collateral, in their current form or following any necessary restructuring. Indeed, discount windows and similar short-term liquidity facilities may play an important role in the weeks and months to come. It is already being reported that lending banks are being asked to advance significant sums of money to corporate borrowers under existing facilities as such borrowers try to bolster their cash positions and protect themselves from the possibility that the lending bank may not be able to lend in the future when the funds are required, or that the borrowers will have difficulty meeting the necessary conditions to draw funds in the future.

1.2.3 Emergency Loans to Financial Institutions and Corporate Borrowers

Government assistance has also taken the form of loans to financial institutions and corporate borrowers. Examples include emergency loans to Fannie Mae and Freddie Mac, Hypo Real Estate and UBS. Loans have not, however, come without conditions. Lending governments have often demanded the option to acquire a significant equity stake in the borrower as part of the financing package.

Naturally, the use of taxpayers' funds to finance emergency loans or other forms of assistance to financial institutions is likely to generate political pressure and, consequently, direct government instructions to these institutions to sell non-core and international businesses. This is likely to be particularly relevant for the foreign operations of financial institutions benefiting from direct government assistance (on the basis that governments will discourage the financing of foreign activities with the use of taxpayers' funds). The likely disposition of these non-core and international businesses and assets under government pressure will obviously create opportunities for other organizations to purchase those assets or operations at a better price than might otherwise be the case.

1.2.4 Government Guarantees of Debt Securities and Interbank Liabilities

To relieve strains in the interbank markets - especially markets for longer maturities - leading economists have repeatedly called upon governments to guarantee interbank debt. This suggestion has emerged as central banks find themselves increasingly unable to maintain orderly interbank funding markets using their usual means of intervention.

Some countries (such as Denmark and Ireland) have guaranteed all bank liabilities. In the United Kingdom, the government has announced a special guarantee of interbank liabilities for an interim period. This will take the form of a guarantee provided on appropriate commercial terms to cover new short-and-medium term debt issuance to assist in refinancing maturing wholesale funding obligations as they come due. The proposal envisages the issue of senior unsecured debt instruments of varying terms of up to 36 months, in any of sterling, U.S. dollars or Euros. It is expected that the amounts guaranteed will reach £250 billion. Germany has also guaranteed up to €400 billion of interbank lending. In the United

States, the Federal Deposit Insurance Corporation ("FDIC") will also issue guarantees of newly issued (on or before June 30, 2009) senior unsecured debt of banks, thrifts and certain holding companies. These guarantees will expire on or before June 30, 2012.

1.2.4.1 Opportunities, Issues and Risks

By enabling financial institutions to issue securities internationally with the benefit of a sovereign guarantee, the measures described above open up new avenues for deploying excess funds in potentially safe instruments (in relative terms).

The provisions of sovereign guarantees of bank liabilities on both sides of the Atlantic and across the world is already creating interesting opportunities for exploiting pricing differentials in international debt capital markets. If the ultimate parent company of a complex financial group is headquartered in a European country but has a U.S. branch or subsidiary the liabilities of which are federally insured in the United States, then such financial group may issue debt (i) in the United States, guaranteed by the FDIC, which will be made available through inter-company loans to finance operations in Europe and (i) at parent company level, guaranteed by the relevant European government, which may be made available to the U.S. branch or subsidiary to finance operations in the United States. In both cases, which option the bank will follow will depend on the pricing of the debt in the relevant markets, which will also depend on markets' perception of the value of the relevant sovereign guarantees. The opposite result may be achieved by a financial institution in the United States with a subsidiary company that is eligible to benefit from sovereign guarantees in a European country. Through appropriate selection of the entity to issue the guaranteed debt securities, international financial institutions may exploit their pricing strengths in certain markets, and the strengths of the relevant sovereign guarantees, while making funds available for operations in other markets.

At the same time, it will be important that those institutions benefiting from such unilateral guarantees examine the existing documentation of their capital-raising programs to assess the implications of those guarantees on the required level of sovereign disclosure in offering documents and the appropriate revision of purchase agreements, bond indentures, agency agreements and other supporting documentation.

In particular, as regards to securities offerings in the United States, financial institutions should bear in mind that guarantees issued by foreign governments (or their agencies or instrumentalities) are not exempt from the disclosure requirements of the U.S. federal securities laws. As a result, Securities and Exchange Commission ("SEC")-registered offerings of debt securities benefiting from government guarantees must include appropriate sovereign disclosure as required under the U.S. disclosure standards. Similarly, offering documents for capital raising transactions in the United States pursuant to private resale or private placement exemptions (for example, Rule 144A transactions) are by analogy expected to respond to the same sovereign disclosure requirements applicable to SEC-registered offerings.

In view of the regulatory implications of government guarantees of the debt securities offerings by eligible financial institutions, financial institutions with advisory or underwriting practices have opportunities to develop transactional practices that will assist their financial institution clients to benefit from opportunities to exploit pricing differences in various matters and integrate the newly issued guarantees into their contractual and offering documentation relating to their capital-raising transactions. Simultaneously, they should be reviewing their internal policies and legal approach as to the appropriate level of disclosure, due diligence and legal opinion practices in connection with debt securities offerings that have the benefit of sovereign guarantees.

1.3 STABILIZATION OF FUNDING SOURCES: GOVERNMENT GUARANTEES OF BANK DEPOSITS

Deposit guarantee arrangements are not new. In developed market economies, deposit guarantee arrangements (or deposit insurance arrangements) have been part of the institutional framework of banking regulation and supervision for a long time. Although the various national systems differ in terms of protection, eligibility and operational details, they all share a common principle: deposits held at eligible financial institutions are insured by operation of law, up to a maximum amount per eligible individual deposit, and funded by fees payable by participating financial institutions. Deposit guarantees aim to prevent runs on banks (by reassuring depositors that their deposits are safe even in the event of a bank's insolvency), but the limitation on the maximum amount insured for each eligible deposit aims to create incentives among depositors to exercise caution in placing their savings with financial institutions and prevent them from pursuing the highest interest rate offered by depositary institutions. In the face of the global financial crisis and mounting concerns about the solvency of commercial banking groups with large deposit liabilities, governments around the world have been urged to eliminate the cap on the insured amount and provide blanket guarantees of all bank liabilities or, at least, of all bank deposits.

1.3.1 Brief Summary of Deposit Guarantee Measures

The U.S. Economic Stabilization Act temporarily raised the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. On October 14, 2008, the FDIC also announced a new program, the Temporary Liquidity Guarantee Program, which provides for full deposit insurance coverage for non-interest bearing deposit transactions, regardless of dollar amount. This is intended to cover small-and-medium sized business checking and payroll accounts.

Also, to restore confidence in money market mutual funds ("MMMFs"), the Federal Reserve announced an initiative to extend non-recourse loans at the primary credit rate to U.S. depository institutions and bank holding companies to finance their purchases of high-quality ABCP from MMMFs. The additional liquidity provided through these measures to MMMFs has strengthened the ability of these funds to comply with redemption requests, reassuring such investors that their investments in the form of MMMFs shares are both liquid and safe.

In the countries of the European Union, deposit guarantees are compulsory under the provisions of the E.U. Directive on Deposit Guarantee Schemes (1994/19/EC) (the "Deposit Guarantee Directive"). Currently, the Deposit Guarantee Directive covers savings up to at least €20,000, although certain individual member states have chosen to increase this level. The standard level of protection has remained unchanged since 1994, but is now being reviewed in order to respond to the financial crisis. Under new proposals recently put forward by the European Commission, member states would be required to increase the coverage level to at least €50,000 and within a further year to at least €100,000. The new levels would cover an estimated 80% and 90% of European retail deposits respectively.

Independently from the policies promoted by the European Union, several countries in Europe have responded to the crisis by issuing formal state guarantees of bank liabilities, with Ireland and Denmark guaranteeing all bank liabilities, while most member states (including Germany, France, Italy and Greece) have pledged not to allow retail depositors to suffer losses, albeit without introducing legislation to that effect.

1.3.2 Opportunities, Issues and Risks

The resulting patchwork of guarantees and other official support for liabilities has the potential to create distortions in the market. There have been fears of a flight of deposits and even wholesale funds from countries currently without all-encompassing guarantees (such as the United Kingdom) to countries that have adopted such guarantees (e.g. Ireland). The likelihood of such a flight of savings and other capital will be affected by perception as to the creditworthiness of the sovereign that furnishes the guarantee. There may well be a flight to institutions in those countries with (relatively) stronger sovereign creditworthiness (e.g. Germany, where state-owned savings banks have reported a flood of new deposits). Investors may also want to hold savings in currencies they perceive to be the strongest.

In the United States, banks may accept non-dollar deposits, and those deposits are insured in the same manner as U.S. dollar deposits up to the maximum amount equivalent in U.S. dollars, with the return of U.S. dollars rather than the foreign currency in a liquidation. There is no indication of an intent by the FDIC to exclude non-U.S. dollar deposits from the various guarantee programs recently adopted. In addition, there is no indication of an intent to exclude insured structured deposits, such as those on which interest is calculated on the basis of an equity index or other instrument or instruments, which the FDIC has indicated generally are covered by deposit insurance so long as by their terms the customer would not lose principal. It remains to be seen whether banks or investors perceive any benefit in issuing additional amounts of structured or non-U.S. dollar deposits guaranteed by an enhanced deposit insurance.

Other measures adopted in the interests of protecting retail depositors may be more controversial. In the United Kingdom, under new proposals the BoE will be given the power to make partial transfers of healthy assets and retail deposit liabilities out of a failing bank and into a "bridge bank". It has been argued that these powers, if exercised, would have the effect of preferring one class of the bank's creditors (depositors) over others, as a result of which non-deposit liabilities are necessarily left, following the transfer, with recourse to a smaller pool of the bank's assets, if at all. However, similar laws already exist elsewhere. For example, in the United States, there are strict depositor preference laws. When the chartering authority for an FDIC-insured bank declares it insolvent and the FDIC becomes the receiver (as it must by law for FDIC-insured institutions), the FDIC tries to sell some or all of the bank to a healthy bank. Sometimes it can sell the entire bank, but very often the buyer will only take certain assets or liabilities, sometimes only insured deposits. If the bank has to be liquidated, then depositors have a preference over non-deposit creditors. Generally, this type of retail depositor protection is becoming common around the world but it will raise ongoing questions with respect to the equal treatment of banks' creditors. It is even being argued that the mandatory subordination of all senior and subordinated non-deposit bank liabilities to retail deposit liabilities effected through these measures enhances credit risk in the interbank market to such a degree that the functioning of such market may be adversely affected. That said, such an effect has yet to be observed in practice.

2. MERGERS, DISPOSITIONS AND ACQUISITIONS

The sudden surge of M&A activity in the financial sector, driven largely by the momentous state-led efforts to rescue failed or failing financial institutions, has clearly been one of the most visible aspects of recent market events. In recent weeks the failure of, and the challenges facing, many institutions have presented opportunities for other financial institutions and investors, either on their own or in collaboration with other investors or governments, to acquire assets, lines of business, and whole companies in the financial services sector. In addition to such acquisitions, there have been many injections of capital by investors into financial institutions, involving acquisitions of significant equity investments. Acquisitions and investments by sovereign wealth funds are likely to continue as assets are restructured and made attractive for well funded purchasers. Governmental strategies vary. Europe has seen hybrid solutions involving partial nationalizations and private acquisitions. In one such hybrid transaction (Fortis), certain assets were acquired by the government and certain assets were acquired by the private sector. In another case (Dexia), governments acted jointly with private investors to acquire portions of the troubled bank.

2.1 OPPORTUNITIES FOR M&A TRANSACTIONS IN THE FINANCIAL SECTOR

Assuming the recent government measures succeed in stabilizing the financial system, what will be the future opportunities for further M&A activity in the financial sector in the short-to medium-term?

First, as discussed above, the use of taxpayers' funds to rescue substantial numbers of market participants in the financial sector is likely to generate political pressure and, consequently, government requirements for these institutions to sell non-core businesses and operations. This is likely to be particularly relevant for the non-domestic operations of financial institutions benefiting from direct government assistance (on the basis that governments will discourage the financing of foreign activities with the use of public funds). The likely disposition of these non-core operations and assets under government pressure will obviously create opportunities for other organizations to purchase these assets or operations at attractive prices, which will likely trigger another wave of financial M&A activity.

Deleveraging by institutions will also make assets available for investors. In Iceland, for example, following the implosion of the local financial industry, the government has been putting pressure on banks to deleverage their external positions by selling foreign assets and paying down foreign liabilities. Furthermore, the U.K. government has indicated that it will sell the assets of failed Icelandic banks in order to recoup public funds spent on recovering deposits from these banks. The sale of foreign assets by Icelandic financial groups, or any other financial institutions winding down non-core operations or businesses, will create opportunities for corporate investors and financial institutions to acquire assets in key industries at very attractive prices.

Governmental action is also likely to create acquisition opportunities. The U.K. government's proposed Banking Act would give the authorities wide-ranging powers to deal with failing banks, including powers to transfer such banks to a private sector purchaser, take them into public ownership or transfer them to a "bridge bank" wholly owned by the BoE. These powers include the ability to make partial transfers in order to improve the quality of the balance sheet of the failing bank with a view to making it attractive for a private sector purchaser. If this Act is passed and the powers granted thereunder exercised, there will be many opportunities to acquire market share in the U.K. banking industry by purchasing profitable businesses and franchises of failed banks.

In the medium term, there are four additional sources of M&A deal opportunities in the wider financial sector that the present financial turmoil is likely to generate.

First, it is quite possible that the recent measures and actions will not fully stabilize the financial system. Any further deterioration of the conditions in the credit markets is likely to cause one or more failures of financial institutions that will open a new wave of rescue efforts, equity investment and, ultimately, rescue acquisitions of companies, assets or businesses of failed firms. Financial institutions also may see continuing pressure to sell particular business lines as a means to concentrate on their core commercial activities and/or to raise capital.

Second, governments will eventually want to sell their equity investments in financial institutions when market conditions stabilize and valuations improve. The disposition of common or preferred stock, assets, operations or business segments will no doubt take place over an extended period of time through a variety of mechanisms including equity placements on public markets, negotiated transactions, auctions or dispositions to strategic investors.

Third, recent business combinations in the financial sector may end up failing, with the result that the combined entity will have to be restructured or broken up. In addition to strategic and financial reasons, such dispositions will also be driven by a realization that the initial combination has proven not to have achieved the strategic or earnings goals originally envisaged. There is obviously risk in every business combination, but the conditions in which recent transactions have been completed have certainly increased the risk of post-merger disappointment by the acquiring entity. Many of the completed transactions were consummated at a faster than normal pace, which reduced the time available for due diligence. As the recent acquisitions get appraised by the acquiring entities, there may be future opportunities for other acquisitive firms to exploit.

Fourth, the recent wave of rescue M&A transactions would not have been possible without the relaxation by the relevant governments of applicable anti-trust regulations and review and consent procedures. In some cases, the approach of the authorities was pragmatic in the sense that some of the otherwise applicable regulatory processes were de facto suspended. For example, the combined organization that will emerge after the merger of Lloyds TSB and HBOS will have approximately 30% of the British mortgage market. Such a level of market concentration would ordinarily attract close scrutiny by the competition authorities. (A proposed merger between Lloyds TSB and Abbey was blocked by the competition authorities in 2002.) In view of the considerable uncertainty relating to the application of competition law, the U.K. government has announced its intention to enact legislation that will have the effect of overriding any competition objections to business combinations in the troubled financial industry of the United Kingdom. This regulatory environment, however, will likely be temporary. In due course, competition authorities will review the competitive conditions in their respective financial markets and may come to the conclusion that some deconsolidation of the relevant industries would be beneficial. In tandem, the same authorities may conclude that the emergence of large financial institutions has so undermined competitive conditions that some form of robust regulatory intervention for the benefit of consumers will be necessary. Whether required by regulatory authorities or driven by more stringent regulations, some large financial institutions may decide that they would improve their position by getting smaller. This trend is likely to create further opportunities for M&A activities.

With respect to non-financial M&A transactions, the economic downturn and distressed conditions in credit markets may encourage companies to sell operations in order to repay borrowings or re-focus their corporate strategy.

Last, it should be mentioned that recent events have resulted in thousands of job losses in the financial industry worldwide. These losses have affected a large number of high-quality financial professionals with proven track records in the industry. This pool of available professionals presents expanding financial institutions with a rare opportunity to hire large numbers of very talented personnel.

Three additional areas that raise risks and uncertainties will be discussed below: change of corporate control, state aid and conflicts of interest.

2.2 CHANGE OF CONTROL

Large-scale capital injections, nationalizations (in whole or in part), mergers and other major corporate transactions require close attention to "change of control" provisions in a financial institution's key commercial contracts, license and financial agreements and bond indentures, as well as similar provisions in statutory or regulatory requirements. The impact of business combinations on change of control provisions or legal requirements can be difficult to assess in the case of complex financial groups operating across different countries and business segments, especially in light of the speed of execution of many of today's business combination transactions.

Change of corporate control of financial institutions also triggers requirements for regulatory consents across the world by governments, central banks, financial regulators, competition authorities and possibly others, depending on the administrative and regulatory conditions in each country. The change of control of complex financial groups triggers these requirements not only in the country of incorporation of the holding company but, in most cases, in all countries where its affiliates operate. These regulatory consents normally are quite time-consuming but have sometimes been ignored or suspended in the context of rescue M&A transactions. Financial institutions involved in these transactions will have to initiate proceedings to receive the necessary consents where required or, where possible, request grandfathering relief that ratifies the new arrangements.

2.3 STATE AID

Equity investments in troubled financial institutions, guarantees of financial institution liabilities, encouragement of business combination transactions and injections of temporary liquidity at below market rates have all been measures deployed by European governments to respond to the global financial crisis.

On October 13, 2008, the European Commission published guidance on how Member States can best support financial institutions in the current financial crisis while respecting E.U. state aid rules and so avoid excessive distortions of competition. The guidance is based in particular on EC Treaty rules allowing for aid to remedy a serious disturbance in the economy of a member state. E.U. state aid rules require that measures taken do not give rise to disproportionate distortions of competition, for example by discriminating against financial institutions based in other member states and/or allowing beneficiary banks unfairly to attract new additional business solely as a result of the government's support. Other requirements exist, including that measures must be limited in time and with a view to adequate contributions from the private sector. The European Commission aims to grant swift approval (within 24 hours, if possible) to programs that comply with this guidance.

2.4 CONFLICTS OF INTEREST

Financial institutions are subject to a range of statutory and regulatory requirements, as well as internally-imposed best practices, aimed at limiting conflicts of interest. Business combination transactions among financial institutions are likely to test the application of these rules as extended networks of new affiliates are added to (already) complex corporate structures. To facilitate compliance with these rules in connection with the business combination transactions between Bear Stearns and J.P. Morgan, Lehman Brothers and Barclays, the SEC issued interpretive guidance temporarily relaxing certain of its affiliated transaction rules for investment managers. To date, this guidance has been company-specific and not applicable in other similar situations.

3. LEGAL RISKS CAUSED BY CONTINUED MARKET TURMOIL

The sections below discuss certain identified legal risks (as well as legal opportunities) caused by the continued market turmoil, including disclosure risks in securities offerings or financial reports, risks and opportunities relating to cross-border reorganization or bankruptcy proceedings of complex financial groups, legal issues relating to prime brokerage accounts and derivatives transactions, especially arising in connection with counterparty default or insolvency and the valuation of illiquid derivatives transactions, and the ability of lending institutions to achieve some level of margin protection in the currently distressed credit markets.

3.1 DISCLOSURE ISSUES IN SECURITIES OFFERINGS OR FINANCIAL REPORTS

The global financial crisis creates special challenges for the disclosures required in periodic reports, financial statements, offering circulars or prospectuses filed with securities regulators or stock exchanges and/or distributed to market participants. These disclosures apply equally to issuers of unregistered securities such as investment funds.

The elimination of traditional liquidity sources, the failure of market participants such as Lehman Brothers, the effect of the financial crisis on the health of the economy and the impact of government measures on the operation of financial markets have to be assessed by financial and business disclosures and appropriately addressed in the relevant reports or offering documents.

Under generally applicable requirements for "Management's Discussion & Analysis" ("MD&A") (or, in the European Union, the "Operating and Financial Review" ("OFR")), preparers of financial reports or offering documents are required to identify any known trends, events or uncertainties that will result in, or are reasonably likely to result in, the company's liquidity increasing or decreasing in any way. Moreover, such preparers must provide a full discussion of significant risk factors that make the offering speculative or risky, including risks relating to liquidity, financial position, operating results and capital expenditures.

Preparers should (and indeed have already started to) address some of these disclosure issues by including risk factors and "recent developments" disclosures in the relevant offering documents with particular focus on the liquidity shortages in the international or domestic credit markets and the various government measures that have impacted their industries or operations.

The response to MD&A or OFR disclosure requirements in periods of financial instability or economic crisis is particularly challenging because preparers must provide forward-looking information in a rapidly changing environment. Those difficulties may be compounded by the increased risk of regulatory scrutiny of those disclosures, (especially in the United States where, in periods of crisis, the SEC has historically tended to strengthen the regulatory review of disclosure documents) and of how companies respond to new disclosure requirements in changing business or financial conditions. As a result, companies should be particularly careful in determining what risk factors and forward-looking statements are required in their financial reports or offering documents. Underwriters and counsel should also exercise a great deal of care in performing financial statement due diligence of companies preparing to access the capital markets. Similar issues are also arising in Europe under the disclosure and financial reporting regime established under the E.U. Directive on the prospectus to be published when securities are offered to the public or admitted to trading (2003/71 (E.U.), the "Prospectus Directive") and the E.U. Directive on the admission of securities to official stock exchange listing and on information to be published on these securities (2001/34/EC) (the "Transparency Directive").

These issues present financial institutions with opportunities to strengthen their advisory and underwriting businesses by offering their corporate clients (including other financial institutions as corporate clients) insights into the global financial markets, identifying the relevant trends and uncertainties, and creating a framework of corporate disclosure that is responsive to the disclosure requirements of the investor community and public markets, while at the same time being respectful of the relevant regulatory requirements.

3.2 INSOLVENCY AND BANKRUPTCY REORGANIZATION

3.2.1 International Insolvency Proceedings for Complex Financial Groups

The insolvencies of various financial institutions have given rise a number of legal issues due to the cross-border nature of the insolvency process and the inconsistent national insolvency laws. While the E.U. Regulation on Insolvency Proceedings (1346/2000/EC) (the "Insolvency Regulation") and the UNCITRAL Model Law (which has been adopted in some countries) introduce common conflicts of laws provisions with respect to the applicable insolvency regime in insolvencies of companies operating across different countries, they do not facilitate the harmonization of international insolvencies of different entities of a single financial group operating in different jurisdictions. The Insolvency Regulation does not apply to insolvency proceedings concerning insurance undertakings, credit institutions, collective investment undertakings, or investment undertakings which provide services involving the holding of funds or securities for third parties. Provisions for these are made under separate E.U. regimes. Furthermore, neither the Insolvency Regulation nor the UNCITRAL Model Law harmonizes the substantive insolvency laws or proceedings of the various national jurisdictions.

Insolvency proceedings are often not specifically tailored to financial institutions, and local case law does not provide much precedent in relation to the orderly winding up of an insolvent financial institution, let alone a complex financial group with cross-border operations in several countries. Moreover, much of the insolvency legal framework in the E.U. member states is relatively new and remained largely untested in the previously benign economic climate.

The choice of jurisdiction and procedure for an insolvency or bankruptcy reorganization is critical. Often the applicable insolvency procedure is determined by the location of the debtor's "center of main interests": financial institution holding companies and investment funds may pay more attention to this in determining their geographical location, which in the past has often been driven in the past by tax concerns.

The substantive provisions and procedural quality of a country's bankruptcy regime should also be important factors to consider in placing financial assets or investment funds in custodian accounts. In this respect, there have emerged opportunities for legal arbitrage as some bankruptcy regimes have proven less efficient than expected in the administration of insolvency proceedings and much faster than others in returning financial assets to their beneficiaries upon the insolvency of custodian financial institutions. As security of assets upon insolvency becomes more important than tax or regulatory treatment in times of stress, investment funds and financial institutions should be reviewing the substantive and procedural quality of insolvency arrangements in the jurisdictions where their assets are located. One of the most important qualities of the applicable legal framework is the ability to recognize the property rights of third parties over assets held by financial intermediaries for the benefit of such third parties, especially in the event of insolvency of the financial intermediary. In today's financial markets, financial institutions hold assets in which they, as well as investors, share rights that entitle them to some direct beneficial or equitable interest in these assets. This can occur, for example, in the trading of securities and in prime brokerage accounts. This sharing of rights creates risks in the event of insolvency of one of the financial intermediaries, whereby creditors of the failed intermediary can claim against assets held by the intermediary for the benefit of third parties such as investors or trading funds. This type of "intermediary risk" is extremely important not only because it affects individual third parties but also because it can have systemic repercussions when the failure of an intermediary can cause a chain reaction of failures of institutions that have invested in assets held by the intermediary.

What is the legal status of assets held by these intermediaries for the benefit of third parties? In the United States, Article 8 of the Uniform Commercial Code (U.C.C.) protects third parties from the credit risk of the intermediary by conferring property rights with respect to the assets held by the intermediary for the benefit of the third party. English law reaches a similar position through the mechanisms of trust and co-beneficial ownership arrangements. In civil law jurisdictions, however, the position is generally uncertain in the absence of specific laws enacted to resolve this problem. Indeed, many countries have not fully addressed the legal risks associated with the uncertain property rights over assets held by intermediaries. Despite efforts towards an international resolution of the problem,[2] the issue appears to be resolved only in the United States and perhaps a handful of other countries and, consequently, poses a great threat to the stability of the financial system in the wake of collapses of systemically important financial institutions.

Recent high-profile insolvencies in the financial sector have also highlighted the legal risks and uncertainties generated by the insolvency or default of a member of a lending syndicate in international lending markets. Loan documentation often fails to deal adequately deal with this problem. There may be no right of the surviving syndicate members to replace the defaulting lender, or any such right, if it does exist, may be exercisable only at par. It has also been problematic to persuade new lenders to join a lending syndicate in view of the liquidity problems in the credit markets.

3.2.2 Derivatives

The derivatives industry has had to deal with a number of legal issues arising from the bankruptcy of financial institution counterparties. Derivatives documentation used by investment funds and financial institutions for general trading activity normally contains bilateral events of defaults and termination events with a view to protecting each party from the credit risk and insolvency of the other party. In the structured product context, the events of default and termination rights are often modified and there may be no mechanism specified for replacing an embedded swap in a structured product.

With respect to counterparty risk in derivative transactions, counterparties will need to review their International Swaps and Derivatives Association (the "ISDA") documentation carefully to be certain of their legal rights and obligations resulting from the bankruptcy and administration proceedings that have been initiated with respect to their counterparties. In this respect, it may be necessary to consider, depending on the circumstances, what the implications are of an insolvency or administration order or filing; whether a right of termination exists; whether the ratings downgrade provisions have been triggered; if, and how, a notice of default must be served and the timing and valuation processes for closing out existing transactions; whether a right of set-off exists with respect to payments owed to an insolvent counterparty against other payments owed by such persons and collateral posted under any other financial or other agreements and whether future payments to insolvent counterparties may be withheld under existing transactions. In the United States, counterparties must also consider whether derivatives transactions are subject to any regulatory stays or whether their particular derivatives transactions may benefit from a safe harbor from the stay.

Additionally, counterparties should be evaluating each of these rights prospectively in their ISDA and other derivatives documentation prior to bankruptcy and administration proceedings to determine whether they have the right to terminate and close out transactions, whether they have rights to call for margin or collateral from their counterparties and evaluating the risk that they may not be able to recover any excess collateral posted at the insolvent entity. Market participants are actively focusing on methods to reduce counterparty risk and to protect collateral posted to an insolvent entity. These

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[2] See the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary and the E.U. Directive on Settlement Finality in Payment and Securities Settlement Systems (98/26/EC).

methods range from market-wide solutions such as clearing mechanisms for certain types of derivatives to individually negotiated arrangements such as the use of third-party custodial accounts to hold excess collateral posted in connection with derivatives transactions. The development of a new margin model will need to take account of the effect of restricting rehypothecation on market liquidity in those instruments used for margin purposes (typically cash and treasuries) of restricting rehypothecation. Clearly, if no margin delivered to collateralize derivative transactions could be reused, liquidity in the market for those instruments would dry up and the delivery of margin would become a significantly expensive business.

3.2.3 Prime Brokerage Accounts

The Lehman Brothers' bankruptcy proceedings have led counterparties to examine in detail their prime brokerage and margin lending arrangements with financial institutions. A key concern of large investors such as investment funds is the status of securities held in prime brokerage accounts. The agreements governing these accounts vary between investment funds and financial institutions. The fate of assets held at these financial institutions turns on whether the money and assets held in prime brokerage accounts are ring-fenced from the broker's insolvency or whether there is merely a contractual obligation to re-transfer money and securities held in such accounts. The position depends in part on whether it was the U.S. or U.K. Lehman Brothers entity that was the contracting party, whether the assets were provided by way of security and whether the assets were rehypothecated into the market with the permission of the client. For example, while many investment funds signed prime brokerage documentation with Lehman Brothers Inc., the U.S. regulated broker dealer, most such investment funds also signed a margin lending agreement with Lehman Brothers International Europe pursuant to which such prime brokerage assets were capable of being moved from the U.S. entity to the U.K. entity as collateral for any margin debt. Once Lehman Brothers filed for insolvency and administration in each respective jurisdiction, many investment funds discovered that their assets were actually held in the United Kingdom, under a less familiar regulatory regime. In particular, for the investment funds, some of the agreements in place expressly provide that money received from clients in prime brokerage accounts is not the client's money but merely creates a debtor-creditor relationship between the institution running the account and the investment fund, in the same way that bank deposits, once received by the bank, do not represent the depositor's money but a mere debt owed by the bank to the depositor. Many of the agreements raise other legal and regulatory issues.

The recent issues surrounding the solvency position of major independent broker dealers has led to customer concerns and, in certain instances, asset flows away from those broker dealers without a strong deposit base into broker dealers that are part of financial groups with a deposit-taking network, as clients became increasingly concerned about counterparty risks. This outflow of assets due to perceived or real counterparty risks marks a significant trend in the prime brokerage industry and raises questions as to the viability of the prime brokerage model absent significant re-pricing of its risk consequences.

Additionally, during the time investment funds are unable to recover their assets from Lehman Brothers or another insolvent financial institution, these funds must consider how to value their assets for the purposes of their net asset value in an environment where the recovery of such assets is uncertain and destined to take months if not years to resolve. Valuation issues become more acute as investment funds try to meet redemption and subscription requests. Funds are adopting a variety of tactics to deal with the valuation situation from marking insolvent broker-held assets below market value to putting such assets in side-pockets until there can be a recovery on these assets. Importantly, none of the recent regulatory efforts directed at easing global credit issues have been directly aimed at relieving pressure on investment funds and other market participants from the risks inherent in current prime brokerage practices.

3.2.4 Management of Customer Assets

It is likely that prime brokers will need to adapt their ways of dealing with client money and assets to ensure that these will not become affected by any insolvency situations. In the interim, clients may take measures to shield their assets against the bankruptcy of their prime broker, such as insisting on the holding of certificated securities in their own name wherever possible under the relevant (sub-) custody, clearing and settlement arrangements, insisting on explicit trust relationships or only granting security to the extent of any borrowings. These measures, however, may have cost implications for investment funds.

3.3 MARGIN PROTECTION FROM EFFECT OF DISRUPTION IN CREDIT MARKETS

Quoted LIBOR ("London Interbank Offered Rate") or other interbank lending rates have increased but may not reflect the actual cost of funding of a particular bank. Market participants are likely to seek protection through documentation and the introduction of floors to floating rate loans. Dramatically increased costs of capital are causing many lenders to explore the possibility of invoking the market disruption provisions of credit agreements and facilities agreements (which discontinue LIBOR-based funding obligations) as a consequence of LIBOR benchmarks in such agreements failing to reflect satisfactorily the actual costs of capital to such lenders. Assuming the documentation contains the relevant market disruption language, such language gives lenders the right to recalculate interest by reference to the base or prime rate (or an alternate interest rate mechanism). Typically the exercise of such a clause requires the vote of requisite lenders in a facility. Whilst there is currently much discussion of the market disruption provisions of loan agreements, there has so far been limited invocation. Invoking the market disruption clause where the base or prime rate is very low will result in lower all-in returns to the lenders and is not necessarily in the best interest of the lenders even if LIBOR does not adequately address the cost of funds. There are a number of ways of protecting against market disruption, including setting a LIBOR floor, lowering the percentage of lenders required to invoke the market disruption provisions, adding an increase to the margin when Eurodollar market disruption occurs, or redefining LIBOR by reference to the higher of several rates. There are no similar provisions in documents for base or prime rate loans. We may see new standards or market conventions developing to address dislocation for base/prime rate loans as well as LIBOR/Eurodollar rate loans.

Generally, many institutions have expressed misgivings about the reliability of LIBOR as a benchmark, citing concerns that rates submitted to the British Bankers Association (the "BBA") for calculating LIBOR are too low. The BBA held a consultation this year on this issue and took the view that it would consider expanding all the LIBOR currency contributor panels.

4. NEW REGULATORY REQUIREMENTS

Regulatory or supervisory failures and the existence of unregulated markets have been partly blamed as causes of the financial crisis. We expect that a number of regulatory reforms - in some cases sweeping reforms - will be implemented in the near future. This section discusses some of the likely reforms, both in the short and longer term. Some will clearly take longer to achieve than others.

4.1 GENERAL

The regulatory discourse is almost certain to see overnight change. No longer will the trend be towards regulatory competition by way of the lightening of regulation, the removal of "red tape," light-touch application of regulatory standards or indeed, most likely, "principles-based" regulation. A more stringent and less "commercial" approach to rule-making, more thorough drafting and more legalistic application and enforcement are likely to become the standards to which the top regulators aspire. The emphasis on principles as a significant regulatory tool in the context of substantive regulation and enforcement is likely to be quietly down-played. Principles are in many cases too vague to be fully effective, especially when set against the backdrop of human rights legislation. Their application can lead to anomalies, since they tend towards an approach that is commercial rather than legalistic. Instead, the emphasis will be on more sophisticated, tailored drafting which will need to be kept up-to-date and applied more legalistically to ensure fairness and consistency.

There will be possible regulatory consolidation and renewed talk of a single European regulator. If this were to exist it would most logically fall to be established in London with English-speaking regulators, using the local judicial framework. However, it will need branches in all E.U. member states for enforcement purposes and also to police the regulation of retail financial services.

Globally, a higher status is likely to be given to the Basel Committee on Banking Supervision (the "Basel Committee") and other efforts made at enhanced international regulatory collaboration. Through the Basel Committee and other initiatives there is likely to be the introduction of more common standards to regulation and a more common approach to supervision. The ability to arbitrage between regulators where some regulators use their approach to regulation as a marketing tool is likely to be reduced very dramatically. As has been seen in Europe, the application of common standards is insufficient of itself to prevent such behavior. For example, some European regulators have been quietly attempting to entice business away from London by way of their more "benign" application of common standards. There is likely to be international agreement that this sort of approval is to be counteracted since it ultimately undermines all markets and reduces confidence in their transparency.

It is likely that the main financial jurisdictions will take steps to prevent essentially unsupervised access to their markets from offshore. Market participants are likely to need to be regulated in a first-tier regulatory jurisdiction if they are to enjoy the benefits of the more liquid and developed financial markets. This will take significant international cooperation to achieve, so as to prevent those who are to become properly regulated from moving around the world to avoid the effects of these steps. The current situation has in part arisen as a result of fear on the part of governments and regulators that proper oversight would drive the markets offshore or to more "pragmatic" regulatory jurisdictions. The major countries are likely to find ways to prevent this or to ensure that those trading in looser environments are operating in a very minor pool, with concomitantly minor returns and status. Achieving this will require international consensus on tax laws as well as regulation, so as to deny roving traders the benefits of offshore tax status.

There will most likely be efforts to ensure a level regulatory playing field across all similar areas of economic activity such that supervisory, regulatory and conduct of business standards are harmonized between banking, investment banking, fund management, insurance and reinsurance. This will reduce arbitrage. In particular, the capital standards applied to banks, investment banks, investment funds, insurers and reinsurers are likely to be based on a common approach. This has to some extent been achieved already in Europe, but significant further steps will be needed to be taken globally to prevent anomalies between different licensing regimes.

In the United States, the regulatory reaction is likely to be very strong. It appears that the U.S. Treasury and Federal Reserve decided to allow Lehman Brothers to fail in order to show that moral hazard exists and that no organization is too big to fail. The irony is that the market reaction to the proposition that no organization is too big to fail and that moral hazard will attach to the largest organizations is such that it is now most unlikely that any governmental authority would take a similar approach going forward. Such institutions are likely as a result to be far more heavily regulated and supervised in order to prevent the abuse of their implicit protection from failure.

4.2 CAPITAL REQUIREMENTS

While finance ministers and central bankers are working hard to increase liquidity in the credit markets and prevent further failures of systemically important financial institutions, regulatory officials have increased the frequency of their meetings at the various international regulatory and supervisory organizations, most importantly the influential Basel Committee, with a view to setting the regulatory agenda for the aftermath of the global financial crisis.

Not surprisingly, a range of regulatory or supervisory mechanisms have been identified as targets for future regulatory reforms.

In April 2008, the Basel Committee announced a series of steps to help make the banking system more resilient to financial shocks, including enhancing various aspects of the Basel II framework such as the capital treatment of complex structured credit products and credit exposures held in the trading book; strengthening standards for liquidity risk management and the supervision of stress testing; and enhancing market discipline through better disclosure and valuation practices.

Leading bank supervisors from central banks and regulatory agencies endorsed the Basel Committee's recommendations on September 25, 2008. Moreover, on October 10, 2008, the Financial Stability Forum ("FSF"), a forum of senior representatives from central banks and regulatory agencies, presented to the G-7 finance ministers and central bank governors a set of recommendations for further regulatory reform in five areas:

- strengthened prudential oversight of capital, liquidity and risk management;
- enhancing transparency and valuation;
- changes in the role and uses of credit ratings;
- strengthening the authorities' responsiveness to risks; and
- robust arrangements for dealing with stress in the financial system.

An exceptional amount of work is underway by national authorities and international bodies in each of these areas, the broad outcome of which is not difficult to predict.

Existing capital adequacy regimes are likely to be strengthened, and this will be combined with the proper application of Basel II standards globally across equivalent financial services sectors. Regulators will revisit the issue of regulatory capital and consolidated supervision standards across all financial sectors (including insurance), in particular to ensure that capital charges are adequate throughout the boom times so that they can enable the institution to withstand market stress. There are signs that jurisdictions may move towards central bank regulatory capital (or even organizational) supervision, leaving other regulators to supervise conduct of business on the basis that the central bank has economists on staff with access to, and an understanding of, up-to-date financial data. This move would also bring together monetary policy supervision with systemic supervision.

As regards capital charges, Tier 1 capital ratios have already been enhanced to 9% of risk-weighted assets in the United Kingdom and many other countries are following suit. The regulators may end up requiring an amount of Tier 1 capital higher than 9%. There are likely to be better measures to address capital adequacy issues arising from off-balance sheet entities, liquidity risks and structured instruments, including enhanced risk-weightings to be attached to such instruments. Rules may well be introduced to restrict institutions' ability to leverage to the degrees witnessed in recent times. Moves towards central counterparty clearing services for the CDS market to reduce risk will be a key element in potentially mitigating increased capital requirements in other areas.

The economic environment will force certain changes. Recent events and unprecedented volatility will need to be factored into regulatory capital risk models. For example, the exceptional rate of decline in house prices in the United Kingdom and the United States will have an impact on how capital charges for mortgage-based assets are calculated in the future; and the risk-weightings of bank deposits in OECD countries may need re-evaluation in light of bank failures.

Provisions in credit agreements allowing lenders to pass on increased costs of capital or reduction in return to lenders through regulatory changes are likely to be reviewed.

In addition, the market has been changing itself. The perceived value of bank capital adequacy rules for safety and soundness of financial institutions, coupled with access to the Federal Reserve's liquidity and funding windows, were among the reasons that led Goldman Sachs and Morgan Stanley to request to become "bank holding companies" subject to capital adequacy regulation by the Federal Reserve.

4.3 INCREASED REGULATION OF BROKER-DEALERS AND INVESTMENT FUNDS

The viability of many business models has been called into question by the market turbulence. Broker dealers, operating outside the capital adequacy framework that governs commercial banks, have either collapsed, been acquired or converted into commercial banks or bank holding companies. Banking models that relied upon a high proportion of wholesale funding such as Northern Rock have also been discredited by the crisis.

Unregulated investment funds may face a renewed effort by the authorities to regulate them and bring them onshore to a state hosting the most relevant financial market. Investment funds may be denied the benefits of being established offshore while having managers that are lightly regulated (if at all) onshore. If regulation is imposed properly on investment funds and investment fund managers, and there is a requirement for investment funds to be established and operate onshore (so that they assume principal liability for regulatory compliance in a meaningful way), then the burden on investment funds will likely encompass not only increased transparency requirements but also the usual organizational and conduct of business requirements that apply to regulated firms. Enhanced transparency would have a negative impact on hedge funds that rely upon secrecy to ensure the effectiveness of their trading strategies.

Sovereign wealth fund activity may increase in the coming years, especially if oil prices rise again and reserve accumulations by economies like China and the OPEC countries continue. On October 11, 2008, the International Working Group of Sovereign Wealth Funds ("IWG") presented the 'Santiago Principles' to the International Monetary Fund. These voluntary principles are intended by the IWG to guide sovereign wealth fund activity in the world's financial markets. They cover the following areas: (i) legal framework; (ii) institutional framework and governance structure; and (iii) investment and risk management.

4.4 ANTICIPATED REFORM OF THE FINANCIAL REGULATORY STRUCTURE IN THE UNITED STATES

Even before the events of the last few weeks, policy makers in the United States understood that the U.S. regulatory structure for financial markets was outdated and modernization was inevitable. The U.S. regulatory system has been largely established over the last 75 years. Pieces have been put into place for particular reasons at different times, in response to circumstances that often no longer exist.

The current U.S. regulatory framework for financial services providers includes:

- five federal depository institution regulators in addition to state-based supervision;
- one federal securities regulator, additional state-based supervision of securities firms, and self-regulatory organizations with broad regulatory powers;
- one federal futures regulator; and
- insurance regulation that is almost wholly state-based, with over 50 regulators.

This structure also has an international dimension that can be inefficient, costly and harmful to U.S. competitiveness.

In March, 2008, the U.S. Treasury released its Blueprint for Stronger Regulatory Structure (the "Blueprint"). The Blueprint recognized the shortcomings of the present system and set out its recommendations for short-term and longer-term reforms.

The cataclysmic events that followed the collapse of Lehman Brothers in September 2008 transformed the financial markets in the United States beyond recognition and – it is probably safe to predict – accelerated dramatically the timetable for effecting the expected structural reforms in the system of regulation and supervision of markets, services and products. Although concrete proposals have yet to become available, the Blueprint favored an entirely new regulatory structure consisting of a market stability regulator, a prudential regulator and a business conduct regulator with a focus on consumer protection.

4.5 ENHANCED REGULATION OF EXECUTIVE COMPENSATION

Firms should expect enhanced regulation of executive compensation and bonuses, together with a renewed focus on qualifications of senior executives and board members in terms of relevant experience and an understanding of risk.

Any financial institution that sells troubled assets under the TARP, or participates in the TARP Capital Purchase Program, is subject to the limits imposed on executive compensation by section 111 of the U.S. Economic Stablization Act. In the case of institutions from which direct purchases of assets are made without any bidding process or availability of market prices and where the government receives a meaningful equity or debt position in the institution as a result, the restrictions will, among other things, include a prohibition on the institution making any golden parachute payment to its senior executive officers during the period the government holds the equity or debt position. In the case of the TARP Capital Purchase Program, participating financial institutions must adopt the U.S. Treasury's standards for executive compensation and corporate governance, for the period during which the U.S. Treasury holds equity investments issued under this program. Each participating financial institution must: (i) ensure that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (ii) require clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (iii) not make any golden parachute payment to a senior executive for the period during which the U.S. Treasury holds an equity or debt position in the financial institution; and (iv) not deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. The U.S. Treasury has issued interim final rules for these executive compensation standards.

The U.K.'s Financial Services Authority (the "FSA") has published a letter it is sending out to regulated firms informing them about the FSA's views on good and bad remuneration policies. Although the letter does not constitute formal FSA guidance, it urges firms to consider their remuneration policies in the light of recent market developments to ensure they are consistent with sound risk management. It also sets out criteria for good and bad remuneration policies. Some of the hallmarks of a bad policy include: (i) remuneration calculated on the basis of revenues, without any counterbalancing risk controls; (ii) remuneration that does not take risk or capital cost into account; (iii) employee bonuses calculated solely on the basis of financial performance; and (iv) no deferral in the bonus element. Good practices include: (i) bonuses awarded that take into account appraisal of other performance measures, including risk management skills, adherence to company values and other behaviors; (ii) deferred bonuses so that the impact of the performance can be evaluated; and (iii) appropriate mix of cash and equity-linked remuneration which is designed to encourage good corporate citizenship.

4.6 REGULATION OF CREDIT DEFAULT SWAPS & MONOLINES

4.6.1 CDSs

CDSs fall outside the definition of a "security" for the purposes of U.S. securities laws (though they may be subject to anti-fraud and related provisions applicable to securities). In September 2008, the SEC exhorted Congress to confer authority upon the SEC to regulate CDSs within the definition of "securities". Other regulators, including the Federal Reserve and the Commodity Futures Trading Commission, have also taken an interest in the credit derivative markets. The question of appropriate oversight may end up being determined as part of regulatory reform proposals more generally. In Europe, CDS trading is already caught by regulation to a certain degree, but no doubt a fresh look will be taken at the rules that should apply.

Separately, the New York State Department of Insurance (the "Department") announced in a circular letter dated September 22, 2008, that, as of January 1, 2009, it would begin treating certain CDSs as "insurance contracts". CDSs were previously not considered to be insurance contracts for the purpose of the New York Insurance Law, and indeed other laws across the common law world, on the grounds that the payment by the protection seller is not conditional upon the incurrence of an actual pecuniary loss by the protection buyer. Based on public statements, the Department is expected to issue new guidance that, when the buyer of the CDS holds or reasonably expects to hold a "material interest" in the underlying security or risk on which he is buying protection (that is, in "covered" CDS contracts), then the swap will be regarded as an "insurance contract". Accordingly, such swaps would be subject to New York state insurance regulation and therefore could only be issued in New York state by sellers licensed to conduct insurance business. Based on its public statements, the Department would not purport to regulate so-called "naked" CDSs, where the buyer of the CDS does not own the underlying security or risk on which it is buying protection.

These proposals would in many ways exacerbate the currently balkanized state of U.S. regulation. Many anomalies would arise, including distinctions (with no obvious rationale) between situations in which a CDS is purchased by someone in possession of a bond issued by the reference entity and those in which the purchaser only bought the bond a couple of days later; or bought it through an affiliate. Significant administrative issues would arise for large banks with multiple trading strategies where one part of the bank may fortuitously hold the bond while another buys CDS protection for entirely different hedging purposes. And this could provide a drag factor on the establishment of an effective, market-wide, CDS central counterparty system since the central counterparty would appear in principle to require insurance regulatory status while in the non-covered context it would most likely require Federal Reserve oversight.

4.6.2 Monolines

There are growing concerns about the inability of financial guaranty (or "monoline") insurers to meet obligations relating to non-performance of securities backed by mortgages and other assets.[3] By a circular letter dated September 22, 2008, the Department set forth best practices which the superintendent expects monoline insurers to adhere to. According to those best practices, monolines should not insure Asset-Backed Securities ("ABSs") that are collateralized by successive pools of ABSs, or issue policies on CDOs except in very limited circumstances. The Department also strongly criticized the practice of monoline insurers using minimally capitalized SPVs to write the CDSs and guarantee the obligations of the SPVs. The Department intends to promulgate regulations or seek legislation, as necessary, to formalize these guidelines.

For a more comprehensive discussion of the issues relating to insurers in the wake of the financial crisis, readers should refer to Shearman & Sterling's recent client publication, U.S. and *European Insurance/Reinsurance Issues Arising Out of the Credit Market Turmoil*, October 14, 2008.

4.7 SHORT SELLING RESTRICTIONS AND OTHER REGULATORY INITIATIVES FOR SECURITIES MARKETS

4.7.1 Short Selling

Regulators across all the major jurisdictions have enacted new rules regulating the practice of short selling[4], mainly in respect of financial company shares. The measures were prompted by concerns that heavy selling pressure caused by short selling was responsible for steep declines in stock prices, especially those of financial institutions. Authorities feared that capital raising by troubled institutions would be seriously impeded if their stock prices collapsed.

In the United States, the SEC adopted temporary orders (which expired on October 8, 2008) prohibiting the short sale of certain financial sector companies, and also certain additional permanent regulatory measures, including requirements for closing out failed settlements of short trades, transparency of short selling positions and presumptions of fraud for misleading statements about ability to successfully settle short positions.

In the European Union, where member states have implemented common market abuse rules pursuant to the E.U. Directive on Insider Dealing and Market Manipulation (2003/6/EC) (the "Market Abuse Directive"), several financial regulators, including the U.K.'s FSA, have adopted similar rules that (i) effectively regard the creation of a net short position or the increase of an existing net short position in specified financial sector stocks to be market abuse; (ii) impose disclosure requirements on those holding net short positions in such stocks above a certain threshold;[5] and (iii) impose additional disclosure requirements on those holding net short positions in stocks[6] subject to a rights issue.[7] Some jurisdictions, such as

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[3] Such entities are known as monoline insurers because, under New York state insurance law, they may only insure repayment of third-party debt and may not insure any other obligations.

[4] Short selling is the practice of profiting from declines in share prices. It involves the selling of shares that the seller does not own, but which the seller borrows from another party. The seller returns the shares to the lender by buying them back from the market at the later date (in the hope that the price will, in the mean time, have fallen). Traders can also take a short position in a share by, among other things, buying an equity put option or put covered warrant or selling a single stock future.

[5] Usually 0.25% or more of the issued share capital of the relevant financial sector company, taking into account any economic exposure to the issued (ordinary and preference) share capital of the company, including exposures arising due to a derivative instrument (OTC or exchange-traded).

[6] And not just financial sector stocks.

[7] This particular requirement in relation to rights issue securities has been adopted in the U.K.

Belgium, have stopped short of banning short selling of financial stocks and instead prohibit naked short selling.[8] In almost all cases, there are exceptions for market makers, although the provisions go into some detail in specifying the narrow class of entity that qualifies for the exemption.

The restrictions on short selling will cause serious problems for investment funds (especially those pursuing equity long/short or global macro strategies) that rely upon short selling as an integral and essential part of their trading and investment approach. Those engaged in such activities must now review their internal strategies, systems and processes to ensure they do not fall foul of the new restrictions.

At the same time, some jurisdictions are actually moving towards liberalizing the practice of short selling, on the grounds that it promotes liquidity. Thus, there are plans currently afoot in China to permit margin trading and short selling, although only carefully selected brokerages will initially be allowed to operate short selling facilities for clients.

For a more detailed discussion of the issues relating to short selling and an overview of the regulatory measures taken in the major financial jurisdictions, readers should refer to Shearman & Sterling's recent client publication, *Global Clampdown on Short Selling: An Overview* October 17, 2008.

4.7.2 Other Regulatory Initiatives for Securities Markets

Securities regulators around the world have worked closely with the finance ministries and central banks domestically and internationally to protect investors and ensure the orderly operation of deeply dislocated securities markets.

In the United States in particular, the SEC has:

- initiated enforcement measures and actions against market manipulation, and brought enforcement action against traders spreading false rumors designed to drive down stock prices;
- initiated a review and study on mark-to-market accounting standards;
- asked financial institutions to provide additional disclosure regarding off-balance sheet positions and the application of fair value to their financial instruments;
- in coordination with the staff of the Financial Accounting Standards Board, the Office of Chief Accountant issued additional guidance to clarify issues regarding fair value accounting;
- introduced measures to strengthen the regulation of credit rating agencies, and performed examinations that have led to new rules to reduce rating agency conflicts of interest; and

Based on historical precedent and the influence the SEC has over the agenda of reform of international securities and markets regulation, it is very likely that some of the initiatives of the SEC (for example, the reform of the rules governing the authorization, organization and operation of credit rating agencies or its revised views on valuation techniques and accounting standards) will be imitated by securities regulators elsewhere.

What can we say with relative certainty about the future of international securities regulation in the wake of this global crisis? From the standpoint of securities laws, there will likely be an emphasis on better market transparency. From the moment

[8] This is the practice of selling shares that one does not own, but where one has not even borrowed or otherwise obtained the shares to make delivery to the buyer.

that the deterioration of lending policies led to the creation of vast amounts of mortgage paper of questionable quality, and even greater amounts in hidden risk, market participants have had enormous difficulty discovering and pricing that risk. Illiquid instruments were concealed behind off-balance sheet vehicles and poorly understood structured securities. We therefore expect that transparency will be high on the regulatory reform agenda. The ratings process will likely be overhauled and new rules developed. The pursuit of enhanced transparency is also triggering a reconsideration of accounting and financial reporting standards, and not just valuation techniques as discussed below. The SEC, for example, is working closely with the Financial Accounting Standards Board to deal with issues such as consolidation of off-balance sheet liabilities and the accounting treatment of bank support for money market funds. These changes are likely to have profound effects on accounting and financial reporting of financial institutions. Finally, it is expected that regulators will re-examine and, if needed, overhaul the effectiveness of broker dealers' controls on preventing the spread of false information into the markets.

4.8 CHANGES IN ACCOUNTING STANDARDS AND RATINGS

4.8.1 Mark-to-market accounting

One of the issues the crisis has highlighted is the difficulty in valuing complex financial products where there is a very specialized market (or no market). Valuation techniques across markets will need to improve, and financial products are likely to be less complex and more transparent in the future.

Mark-to-market accounting, which requires marketable financial instruments held by a firm to be valued by reference to their market price, has been criticized for exacerbating the credit crisis. There have been calls for the rule to be suspended so that financial institutions are not forced to write down investments unnecessarily. Section 132 of the U.S. Economic Stabilization Act allows the SEC to suspend the mark-to-market accounting rule if it is in the public interest and protects investors.

The SEC has already sent a no-action letter to the Investment Company Institute, the trade group for the regulated U.S. fund industry, whereby it permits U.S. money market funds more flexibility to ignore mark-to-market values for their holdings of high-quality, short-term instruments. The letter states that enforcement action will not be taken against a money market fund if it "shadow prices" its portfolio securities by reference to their amortized cost value rather than using available market quotations, unless the particular circumstances, e.g. the impairment of the issuer's creditworthiness, suggest that amortised cost is no longer appropriate. This relaxation only applies to securities that (i) have a remaining maturity of 60 days or less; (ii) are First Tier Securities as that term is defined in paragraph (a)(12) of Rule 2a-7; and (iii) the fund reasonably expects to hold to maturity.

Meanwhile, in accordance with section 133 of the U.S. Economic Stabilization Act, the SEC has commissioned a study on mark-to-market accounting with a view to presenting a report to Congress. The study will examine the effects of the accounting rule on firms' balance sheets, its role in the bank failures of 2008, and the "advisability and feasibility of modifications" to the rule. It remains to be seen what conclusions are drawn by the study and what, if any, proposals are made for revising the rules.

The European Commission has recently adopted amendments to accounting standards, with the unanimous support of the E.U. member states. These amendments ensure that E.U. companies have the same flexibility as their American competitors to reclassify assets held-for-trading into the held-to-maturity category. In these circumstances, financial institutions in the

European Union would no longer have to reflect market fluctuation in their financial statements for these kinds of assets. These changes will apply as from the third quarter of 2008.

4.8.2 Ratings

Early in the cycle of recent events, ratings agencies were criticized for not adequately foreseeing risks when establishing their ratings of various businesses, especially in the context of structured financial product issuances (e.g. SIVs, CDOs, etc.) Later, ratings agencies were criticized for changing tack too abruptly and too sharply in downgrading ratings previously issued, which aggravated investor fears and, in some cases (most notably, the downgrade of AIG), rapidly accelerated corporate obligations as ratings downgrades triggered default provisions in a wide range of contracts. Concerns about the role of the credit rating agencies in the current crisis prompted both U.S. congressional hearings and rulemaking initiatives at the SEC.

In July 2008, the SEC published a report on issues identified in the SEC Staff's Examinations of Select Credit Rating Agencies. The examinations found many shortcomings in the conduct of rating agency business, especially in relation to MBSs and structured finance. The SEC has accordingly proposed a new regime of rules that impose significant restrictions on ratings agencies. Some of these restrictions include prohibitions on Nationally Recognized Statistical Rating Organizations ("NRSRO") from issuing a rating on a structured product unless information on the characteristics of assets underlying the product is available, and prohibitions on practices that undermine the objectivity of ratings. The SEC also opened up for public comment many of its rules that only indirectly relate to ratings agencies (e.g. rules that incorporate references to NRSRO ratings), with the apparent goal of de-emphasizing credit ratings going forward.

5. DISPUTES AND LAW ENFORCEMENT

There is likely to be a substantial increase in private litigation, and where relevant, arbitration, related to every aspect of the market by investors and financial institutions that are counterparties to insolvent and nationalized banks and others who have suffered losses. Highly geared investment funds such as hedge funds that have fared badly in the current crisis may face litigation by investors on grounds of negligence, breach of fiduciary duties or misrepresentation. Major banks that sold or underwrote investment products may also face litigation from investors who have suffered losses. Criminal investigations may also increase as regulators harden their stance and the facts behind certain scandals emerge. Institutional money market funds that "have broken the buck" may also face claims. There are signs that much of the litigation will be international in nature and may involve novel points of law and procedure. For example, the U.K. Treasury has threatened to take the Icelandic authorities to court over their failure to protect British depositors of Icelandic banks.

To date, individual and class action complaints have been filed against: (i) lenders, mortgage brokers and other types of participants involved in the origination process based on alleged improper origination practices, and other unfair and deceptive practices; (ii) trustees and underwriters based on securities fraud actions brought by security holders alleging material omissions or misstatements in offering documents; (iii) hedge funds and financial institutions that entered into financial contracts such as CDSs, repos, prime brokerage agreements, and created markets for subprime-related investments; (iv) directors and officers of all of these organizations and other professionals active in these markets, including bond insurers, public accounting firms and rating agencies; (v) public companies whose share price fell upon discovery of exposure to the subprime or related markets based on securities fraud claims made by shareholders alleging material omissions or misstatements in the companies' public disclosures; (vi) asset managers and fund managers for breach of fiduciary and contractual obligations; and (vii) Lehman Brothers as investment bank, prime broker, counterparty and issuer of public disclosure and final reports in the ordinary course of business relating to its behavior prior to its insolvency.

Initially, litigation relating to subprime residential mortgages or financial assets secured by these mortgages was perceived to be a largely U.S.-centric issue. In fact, litigation with respect to subprime related matters is now proliferating on both sides of the Atlantic. In addition to increasing U.S. litigation, foreign investors, insurers and contract counterparties in Europe and elsewhere have filed similar claims alleging breach of contact, breach of fiduciary duties, negligent omissions or misrepresentations and fraud. It is interesting that foreign claimants are increasingly arguing that their foreign location and lack of experience in the operations of the U.S. MBSs markets should be taken into account when assessing the behavior of the defendants (typically underwriters placing MBSs with European pension funds, local authorities and other types of institutional investors).

Financial institutions cannot afford not to design and implement a robust litigation strategy to minimize the risks and identify opportunities for financial gains through recovery of losses or other improvement in their legal position. In most cases, international financial institutions are likely to be both plaintiffs (for example, in actions against sellers of distressed assets in secondary markets) and defendants (for example, in actions against them by ultimate buyers of securities originated, underwritten or placed by the defendant). Although the relevant position of litigation participants changes radically their perspective, there are certain steps that all financial institutions should take to identify and address litigation risks, as well as litigation opportunities. Keeping up-to-date with relevant litigation in various jurisdictions is essential to understand the trends, jurisprudence and potential risks and opportunities for recovery. A thorough review of offering documents and contractual agreements relating to outstanding securities would also help to identify weaknesses and litigation risks and opportunities. It is also important to understand the impact of the cross-border nature of any relevant proceedings. Identifying the proper forum of litigation is always a key starting point. In the absence of mandatory exclusive jurisdiction clause in the relevant contractual agreement, there are significant opportunities to derive substantive or procedural benefits from selecting the appropriate forum of litigation based on the objectives of the relevant party. The same is true for selection of the applicable law. Enforcing a judgment and recovering legal costs is another crucial point in the litigation strategy. The various jurisdictions are not uniform in the application of the "loser pays" principle.

Government intervention in the economy may also give rise to claims, especially public law claims. In the United Kingdom, the proposed Banking Act (discussed above) will, where expected, give wide-ranging powers to authorities to take over failing banks. There may well be challenges to the exercise by authorities of their new powers. In the United States, the implementation of the U.S. Economic Stabilization Act may also give rise to claims of a public law nature. The purchase by the U.S. Treasury of assets, its participation in negotiations and its general involvement in the markets is likely to cause some grievance among market participants. Given the emergency nature of the U.S. Economic Stabilization Act, however, opportunities for litigation against the U.S. Treasury or its TARP agents will be extremely limited. First, injunctive relief is not available. Second, the actions of the U.S. Treasury may only be judicially challenged if they are proven to be illegal or capricious, which is a very high standard for a plaintiff to meet. Finally, financial institutions that sell assets to the U.S. Treasury may only sue the U.S. Treasury in the case of constitutional violations or as determined in the contract (which the U.S. Treasury will draft in standard form and in strong unilateral spirit).

With respect to law enforcement, prosecutors and enforcement agencies are expected to launch wide-ranging initiatives to bring to justice those responsible for fraud, unlawful enrichment or other illegal practices that triggered the institutional and market failures which contributed to the recent cataclysmic events. The trend so far is indicative of the likely future developments in this area. For example, in the year to date, the SEC's Enforcement Division brought the second-highest number of cases in the agency's history. The SEC has over 50 pending law enforcement investigations in the sub-prime area and seeks to accelerate the pace of its investigations. In recent weeks, the Division of Enforcement has also undertaken a nationwide investigation of potential fraud by issuers of securities in financial institutions, and manipulation of those securities through means including abusive short selling and the intentional spreading of false information. Other enforcement agencies around the world are expected to take a similar tough stance, especially following the large injection of taxpayers' money into the financial system, which has naturally triggered a political demand for punishment of those responsible.

The emergence of other institutional actors as significant players in the law enforcement field should be expected, such as stock exchanges and listing authorities, local governments and administrative authorities. For example, state attorneys general ("AGs") in the United States have been investigating and litigating against subprime lenders, large and small, using a combination of predatory lending, anti-trust, consumer protection and securities fraud laws. They are also examining nearly every aspect of the MBSs market, from the origination of securities by underwriters to their sale to pension funds and other investors. In this respect, they have subpoenaed participants in the MBSs markets, such as credit rating agencies, legal counsel and investment banks. As a result of the law enforcement tactics of AGs, a significant number of financial institutions have now recognized that it is essential to develop a strategy to deal with AGs in the context of their overall litigation risk strategy, usually by being proactive in cooperating with them. As in the past, financial institutions that were active in the relevant securities markets should expect AGs to emerge as significant players in the litigation/law enforcement environment in the wake of the financial crisis by pursuing significant monetary settlements with the financial industry and driving reforms of industry practices and structures. Financial institutions should assess the regulatory and institutional environment in which they operate in order to identify, in a timely fashion, potential sources of litigation and law enforcement risks and opportunities.

6. PENSION PLAN SPONSORS AND FIDUCIARIES

Pension plan fiduciaries will need to re-assess the suitability of many strategies, given the changes in risk-return profiles due to the market turmoil. Thus, securities lending, which had not hitherto posed any significant risks, could pose material counterparty risks that fiduciaries must properly assess. Complex instruments that were used as a means for obtaining uncorrelated returns or adding down-side protection will have to be evaluated in the light of increased counterparty and liquidity risk. The same applies to assets that were conventionally thought to be safe, such as stable value funds or short-term investment funds.

Plan fiduciaries will have to ensure that proper disclosure is made to participants, especially if risks that have materialized were not disclosed to participants at the time of investment.

7. TAX CHANGES

Unexpected, and potentially unwelcome, tax issues frequently arise as a result of situations such as the current one. The particular tax treatment of a transaction may change as the situation evolves. For example, payments due to a financial institution may be capable of being paid free of withholding tax pre-insolvency but, post-insolvency, the same payments may be required to be paid subject to withholding tax (or even grossed-up), resulting in potential compliance issues and additional economic cost.

From a longer-term perspective, the increased reliance on public revenue to fund responses to the current situation could lead to governments needing to increase tax rates. In that event it is possible that profitable financial institutions may seek to relocate business lines – or redomicile corporate entities – in order to mitigate the adverse impact of this.

Finally, general taxation rates may change as revenues fall due to lower profits and decreasing employment. If major economies fall into a sharp recession, government deficit spending will be necessary to maintain aggregate demand. Financing this deficit, especially in the face of strict fiscal rules in European countries, is going to be difficult without raising tax rates.

8. HOW SHEARMAN & STERLING CAN HELP YOU MAXIMIZE THE OPPORTUNITIES AND MITIGATE THE RISKS

Shearman & Sterling's Economic Stabilization Advisory Group brings together lawyers from diverse practice areas to assist clients in navigating the current crisis. Lawyers in this group have experience giving advice on the full range of issues that will arise as the crisis unfolds. We are involved in a number of deals and actions that have arisen directly as a result of the market crisis.

Shearman & Sterling is involved in a number of transactions that comprise the sale of assets or whole institutions. We are acting for Merrill Lynch in its acquisition by Bank of America. We have also acted in the sale of individual assets of firms or businesses, for instance for a potential purchaser of AIG's assets and for a potential acquirer of Washington Mutual's business. Shearman & Sterling is ranked 1st in announced M&A transactions by financial institutions in the United States in the last 12 months, with a total enterprise value of transactions of $487.9 billion. We are also ranked 2nd overall in M&A transactions in the United States for the year to date, advising on 41 deals with total value of $548.9 billion and 3rd in Europe for the year to date, advising on 36 deals with total value of €259.1 billion. Our prominence is notable across all asset classes.

We are involved in numerous capital raising and liquidity programs for financial institutions. For instance, we are involved in the restructuring of German lender Hypo Real Estate following its rescue by the German government and financial sector, and are assisting on the attendant financing. We have also been involved in the recent capital raising exercise by the French bank Natixis.

We are helping many public companies meet their disclosure requirements in response to these unprecedented events.

We are closely involved in dealing with issues arising from Lehman Brothers' bankruptcy, including:

- advising hedge funds and some of the largest financial institutions in the world on the consequences of the insolvency worldwide;
- advising bond and security trustees on issues arising from Lehman Brothers' bankruptcy proceedings and defaults under various derivative instruments on Lehman Brothers-sponsored securitizations.

We have in-depth experience of advising counterparties with exposures to entities in bankruptcy protection proceedings, especially concerning termination rights, netting, close out provisions and collateral rights in the context of New York and English law governed by ISDA-documented transaction, repurchase arrangements, stock lending arrangements, as well as undocumented trading relationships.

Our litigation team has been closely involved in the major actions that have arisen from the credit crisis, including:

- representing hedge funds responding to SEC/United States Attorneys Office ("USAO") subpoenas that seek to determine whether the hedge funds improperly shorted the stock of Lehman Brothers and other financial institutions prior to the crisis;
- representing a group of former employees of a bankrupt mortgage company that issued mortgages and mortgage-backed securities as they respond to USAO investigations into whether the company failed to disclose depreciating assets in a timely manner;
- representing the managing director of a financial institution in connection with an allegation of improper manipulation of the CDO assets in a portfolio under management and which resulted in sizeable writedowns;
- representing a number of Merrill Lynch-related clients, including the company, certain outside directors, the committee overseeing Merrill Lynch pension plans, and certain individual executives. The representations relate to the subprime losses Merrill Lynch suffered and/or the Merrill Lynch and Bank of America merger; and
- representing underwriters in several cases where the issuer's stock price collapsed due to subprime losses and underwriters were accused of failing to warn of such risks.

We are advising InterContinental Exchange (ICE) establishing a central counterparty for CDSs in the U.S.

GLOSSARY OF CERTAIN DEFINED TERMS

"ABSs" means asset-backed securities.

"AIG" means the American International Group.

"ABCP" means asset-backed commercial paper.

"BaFin" means the German Federal Financial Supervisory Authority.

"Basel Committee" means the Basel Committee on Banking Supervision.

"BBA" means the British Bankers Association.

"BIP" means bank insolvency procedure.

"BoE" means the Bank of England.

"CDIC" means the Canada Deposit Insurance Corporation.

"CDOs" means collateralized debt obligations.

"CDSs" means credit default swaps.

"Citigroup" means Citigroup Inc.

"Deposit Guarantee Directive" means the European Union Directive 94/19/EC on deposit guarantee schemes which introduces compulsory deposit guarantee schemes that provide a minimum guarantee of €20,000 per deposit.

"Dexia" means Dexia S.A.

"ECB" means European Central Bank.

"ECOFIN" means the Economic and Financial Affairs Council of the Council of the European Union.

"EESA" means the U.S. Emergency Economic Stabilization Act of 2008.

"FAAF" means the Financial Assets Acquisition Fund.

"FDIC" means the Federal Deposit Insurance Corporation.

"FSCS" means Financial Services Compensation Scheme.

"FSF" means the Financial Stability Forum.

"FSA" means the Financial Services Authority.

"G-7" means the meeting of finance ministers from the group of industrialized nations including Canada, France, Germany, Italy, Japan, United Kingdom, and the United States.

"IndyMac" means IndyMac Bank.

"ISDA" means the International Swaps and Derivatives Association.

"IWG" means the International Working Group of Sovereign Wealth Funds.

"LIBOR" means the London Interbank Offered Rate.

"LTRO" means Longer-Term Refinancing Operations.

"MBSs" means mortgage-backed securities.

"MD&A" means management discussion & analysis.

"MMMF" means the money market mutual funds.

"NRSRO" means Nationally Recognized Statistical Rating Organizations.

"OFR" means operating and financial review.

"PDCF" means the Primary Dealer Credit Facility.

"PIBS" means Permanent Interest-Bearing Shares.

"Prospectus Directive" means the European Union Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading.

"RBS" means The Royal Bank of Scotland Group.

"SEC" means the Securities and Exchange Commission.

"Scheme" means the special liquidity scheme launched by the U.K. government.

"SME" means small and medium enterprises.

"SNB" means the Swiss National Bank.

"SPV" means special purpose vehicle.

"SRR" means special resolution regime.

"Stabilization Act" means the German Financial Markets Stabilization Act 2008.

"Stabilization Fund" means the special fund set up by the German federal state under the Stabilization Act.

"TAF" means term auction facility.

"TARP" means the Troubled Asset Relief Program.

"Transparency Directive" means the E.U. Directive 2001/34/EC on the admission of securities to official stock exchange listing and on information to be published on these securities.

"TSLF" means Term Securities Lending Facility.

"USAO" means the United States Attorneys Office.

"UAE" means the United Arab Emirates.

"UBS" means Union Bank of Switzerland.

"Wachovia" means Wachovia Corporation.

"WAMU" means Washington Mutual.

"Wells Fargo" means Wells Fargo & Co.

APPENDIX

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THE U.S. RESPONSE TO FINANCIAL MARKET TURBULENCE

1. Sale of Bear Stearns to JPMorgan Chase

- JPMorgan Chase purchased Bear Stearns for $236 million or $2 per share. The acquisition price was subsequently raised to $10 per share.
- The Federal Reserve Bank of New York provided a $29 billion credit line to ensure the sale could move forward. JPMorgan Chase agreed to guarantee Bear Stearns' trading obligations.

2. U.S. government Seizes Control of IndyMac Bank

- U.S. federal government took control of IndyMac when the $32 billion Pasadena-based bank transferred control to the FDIC.
- Federal authorities said, based on a preliminary analysis, the takeover of IndyMac would cost the FDIC between $4 billion and $8 billion.

3. U.S. government Seizes Control of Fannie Mae and Freddie Mac

- The U.S. government seized control of Fannie Mae and Freddie Mac and made a commitment to provide up to $100 billion to each company to ensure they would not fall into bankruptcy. Together, the two companies own or guarantee nearly half of the U.S. $12 trillion mortgage market, and by July 2008 operate at leverage ratios of approximately 50 to 1.
- The seizure involved placing both companies in a government conservatorship (analogous to a bankruptcy reorganization) and also replacing senior management. Dividends were eliminated and the U.S. government took an option to acquire 80% of each company's common stock.
- However, the U.S. government did not guarantee the subordinated debt or the preferred stock issued by these companies, which is held on the balance sheets of many banks.
- The Federal Reserve will also begin purchasing short-term debt obligations issued by Fannie Mae, Freddie Mac and the Federal Home Loan Banks in the secondary market.

4. Merrill Lynch Taken Over by Bank of America

- On the same weekend that Lehman Brothers declared bankruptcy (see below), Bank of America acquired Merrill Lynch in an all-stock transaction with Bank of America exchanging 0.8595 shares of Bank of America common stock for each Merrill Lynch common share.

5. American International Group

- Because as AIG was unable to secure a private-sector loan, the Federal Reserve Bank of New York intervened by seizing control of AIG, granting a two-year revolving credit facility of $85 billion in return for an option to acquire an 80% stake in the insurance giant.
- On October 8, 2008, the Federal Reserve Board authorized the Federal Reserve Bank of New York to lend up to $37.8 billion by purchasing investment-grade, fixed-income securities from certain regulated U.S. insurance subsidiaries of AIG.

6. Lehman Brothers Files for Chapter 11 Bankruptcy Protection

- After bailing out Bear Stearns, Fannie Mae and Freddie Mac, the Federal Reserve refused to provide financial support to Lehman Brothers. The subsequent bankruptcy of Lehman Brothers was the largest bankruptcy in U.S. history, with more than $600 billion in debt.
- Equity markets plunged and credit markets froze once news of Lehman Brothers' bankruptcy came out. The decision to refuse to support Lehman Brothers was taken in haste over the weekend of September 13 and 14, 2008.
- Lehman Brothers' bankruptcy contributed significantly to a substantial tightening of the commercial paper market. The Reserve Primary Fund – a $64 billion money market fund – "broke the buck" when it announced that investors would be paid no more than 97 cents on the dollar. The Reserve Primary Fund held $785 million of Lehman Brothers' commercial paper.
- Money market funds, holding $3.4 trillion in assets, are major buyers of corporate commercial paper. Any pull-back by them would severely curtail the ability of major corporates to manage short-term liquidity using commercial paper. Lehman Brothers' bankruptcy resulted in the contagion spreading to other money market funds as outflows began to grow and investors sought the safety of short-maturity U.S. Treasury bills, whose yields began to drop close to zero.
- In an effort to restore confidence in money market funds, the U.S. Treasury announced on September 19, 2008 that, at least temporarily, it would guarantee money market funds against losses of up to $50 billion.

7. Sale of Washington Mutual to JPMorgan Chase

- WaMu, the largest savings and loan association in the United States, was seized by U.S. federal regulators on September 25, 2008.
- Regulators simultaneously brokered an emergency sale of WaMu's banking operations to JPMorgan Chase for $1.9 billion.
- By taking on all of WaMu's troubled mortgages and credit card loans, JPMorgan Chase will absorb at least $31 billion in losses that would normally have fallen to the FDIC.
- WaMu, with $307 billion in assets, is by far the largest bank failure in history, eclipsing the 1984 failure of Continental Illinois National Bank and Trust in Chicago, an event that presaged the savings and loan crisis. IndyMac, which was seized by regulators in July, 2008, was one-tenth the size of WaMu.

8. Sale of Wachovia Corporation

- On September 29, 2008, Citigroup entered into an agreement-in-principle to acquire most of Wachovia's assets and liabilities for $2.16 billion in an FDIC-facilitated transaction.
- Wells Fargo made a subsequent $15 billion offer to acquire Wachovia on October 3, 2008, a move that ignited a $60 billion legal battle between Wells Fargo and Citigroup in U.S. courts.
- On October 6, 2008, at the urging of the Federal Reserve, the two banks agreed to a two-day truce in their legal dispute, setting the stage for a potential settlement.

- Subsequently, on October 9, 2008, Citigroup announced that it would not be pursuing the takeover but will continue to pursue its litigation claims for damages. The Federal Reserve announced approval of Wells Fargo's application to acquire Wachovia on October 12, 2008.

9. U.S. government Loan to the Auto Industry

- In late September 2008, the U.S. Congress approved a spending bill exceeding $630 billion, which included a measure for $25 billion in loans to the auto industry.
- These low-interest loans are intended to aid the auto industry in its push to build more fuel-efficient, environmentally-friendly vehicles. U.S. auto giants General Motors, Ford and Chrysler will be the primary beneficiaries.

10. Troubled Asset Relief Program

- On October 3, 2008, the U.S. Congress approved and President Bush signed into law a revised version of a Bush administration rescue plan to ease the current crisis on Wall Street. Under the terms of this plan, the U.S. Treasury Department will be authorized to purchase up to $700 billion of distressed MBSs and other assets and then resell the mortgages to investors.
- On October 14, 2008, the U.S. Treasury announced the TARP Capital Purchase Program providing for direct equity investments in certain financial institutions.
- On October 14, 2008, the FDIC announced its Temporary Liquidity Guarantee Program issuing guarantees of newly issued senior unsecured debt of certain banks, thrifts and holding companies.

11. The Federal Reserve

Commercial Paper Funding Facility

- On October 7, 2008 the Federal Reserve announced the creation of the Commercial Paper Funding Facility, which will purchase through an SPV three-month unsecured and ABCPs from eligible issuers.
- The Liquidity Fund, which began on September 19, 2008 and ends on January 30, 2009, will lend funds to depository institutions and bank holding companies in order for them to purchase eligible ABCPs from MMMFs under certain conditions.

Primary Dealer Credit Facility (the "PDCF")

- The PDCF, effective September 15, 2008, is an overnight loan facility that will provide funding to primary dealers, who will participate through their clearing banks, in exchange for tri-party eligible collateral.

Term Securities Lending Facility (the "TSLF")

- The TSLF is a 28-day facility that offers general Treasury collateral, such as Treasury bills, notes, bonds and inflation-indexed securities, to primary dealers of the New York Federal Reserve Bank in exchange for other eligible collateral.

Term Auction Facility (the "TAF")

- The TAF, established in December 2007, is a temporary credit facility that allows a depositary institution to place a bid for an advance from its local Federal Reserve Bank at an interest rate determined as a result of the auction. The first auction took place on December 17, 2007.
- Foreign exchange swap lines were also expanded with the ECB, the SNB and additional foreign central banks around the world on September 29, 2008. For example, the swap line amount with the ECB was increased from $120 billion to $240 billion.
- In August 2008 the ECB, in conjunction with the Federal Reserve, began operating 84-day operations in addition to its operations with a 28-day maturity.
- In September 2008 the Federal Reserve announced (1) an increase in the size of the 84-day maturity TAF auctions from $25 billion to $75 billion per auction, beginning on October 6, 2008; (2) two forward TAF auctions amounting to $150 billion and (3) an increase in swap authorization limits with foreign central banks.
- On October 13, 2008, the Federal Reserve announced the expansion of swap lines with, among others, the BoE, the ECB and the SNB. These three European central banks will conduct tenders of U.S. dollar funding at 7-day, 28-day and 84-day maturities. Swap lines with the Federal Reserve will be increased to accommodate whatever quantity of U.S. dollar funding is demanded.

OTHER COUNTRIES' RESPONSE TO FINANCIAL MARKET TURBULENCE

1. European Central Bank and Other Pan-European Initiatives

1.1 Base Rates

On October 8, 2008, the ECB announced a cut in interest rates in response to mounting fears about the impact of the financial crisis on the world economy. In a coordinated move, the Federal Reserve, the BoE, and the central banks of Canada, Switzerland, Sweden and the UAE all cut their main lending rates by 0.5 percentage points several Asian central banks followed suit.

1.2 Special Term Refinancing Operation

- Operated through a standard tender operation, settled on September 30, 2008 and due to mature on November 7, 2008.

1.3 Longer-Term Refinancing Operations

- The ECB has issued several supplementary longer-term refinancing operations ("LTROs") since the first LTRO was issued on August 22, 2007 for €40 billion.
- On October 7, 2008, the ECB announced an increase from €25 billion to €50 billion of the allotment amount of a six-month supplementary LTRO.
- On September 4, 2008, the ECB announced the renewal of a six-month LTRO of €25 billion and two three-month LTROs of €50 billion.

1.4 Deposit Guarantees

On October 15, 2008, the European Commission published proposals to amend Directive 1994/19/EC on Deposit Guarantee Schemes, which will, among other things, increase the coverage level of the Deposit Guarantee Scheme to at least €50,000 and within the next year to at least €100,000. The proposals will also reduce the time allowed for a scheme to pay depositors in the event of bank failure to three days from the current three months (which can be extended to nine months).

1.5 A Pan-European Rescue Package

Attempts to establish a pan-European rescue effort initially proved abortive. At the European Union finance ministers meeting in Luxembourg on October 7, 2008, finance ministers rejected calls for a Europe-wide rescue fund akin to the U.S. plan. However, following the serious deterioration in equity and credit markets in the week ending October 10, 2008, European leaders agreed on a rescue plan that involves a commitment of €1.3 trillion in bank guarantees and the purchase of stakes in major European banks.

2. United Kingdom

2.1 BoE measures

Term Auctions

- In September 2007 the BoE announced that it would conduct four auctions to provide funds at three-months maturity against a wider range of collateral than that used in its weekly open market operations.

- The collateral included U.K. residential mortgages. Banks and building societies with reserve accounts with the BoE or with access to the BoE's standing facilities were eligible to participate in the auctions.
- On October 8, 2008, the U.K. government announced that the BoE would continue to conduct auctions against extended collateral, reviewing the size and frequency of the operations as necessary.

Special Liquidity Scheme (the "Scheme")

- The Scheme, launched in April 2008, enabled banks and building societies with access to the BoE's standing facilities to temporarily exchange their high-quality mortgage-backed and other securities for U.K. government securities.
- The drawdown period of the Scheme was initially six months, due to end on October 21, 2008. This period has since been extended to January 30, 2009.
- On October 8, 2008, the U.K. government announced that at least £200 billion would be made available to banks under this Scheme.
- The BoE is expected to announce plans by mid-October 2008 for a permanent regime for supporting liquidity in the banking system, including a discount window facility.

Recapitalization Scheme

- The U.K. government announced that it is establishing a new facility of £25 billion which will make Tier 1 capital available to eligible institutions.
- Eligible institutions include U.K. incorporated banks which have a substantial business in the United Kingdom and building societies. Applications to be included as an eligible institution will be reviewed.
- The facility is likely to be provided in the form of preference shares or permanent interest-bearing shares ("PIBS"). It is likely that preference shares or PIBS issued by banks will be exempt from the statutory and other rules that give pre-emption rights to existing shareholders; these rules generally apply only to issues of equity shares or instruments convertible into equity shares, although it will depend on the exact terms of the preference shares or PIBS. There are also likely to be U.S. regulatory considerations for institutions that are established and regulated in the United States.
- A further £25 billion will be available as assistance for eligible institutions for ordinary equity fund-raising. The U.K. government would not be subject to bank supervision if it acquired control of a bank through stock ownership. However, in the past the Federal Reserve has frowned on allowing institutions with capital from the government to make expansionary acquisitions in the United States. It is not clear whether Federal Reserve might make an exception in the current circumstances.

U.K. Government Guarantee Scheme

- On October 8, 2008, the U.K. government also announced that a government guarantee of new short-and-medium term debt issuance will be available to eligible institutions for an interim period.

Extension of Eligible Collateral

- The BoE extended the eligible collateral it used in its weekly sterling three-month repo operations to include AAA-rated ABSs of some corporate and consumer loans and approved highly-rated ABCPs, asset-backed commercial paper programs, where the underlying assets would be eligible if securitized.
- The extension of eligible collateral is due to last until November 18, 2008.

2.2 United Kingdom Increase in Guarantee of Savings

- The U.K. government has increased the protection given to savings from £35,000 to £50,000.

2.3 Nationalization of Bradford & Bingley

- Bradford & Bingley plc was nationalized on September 29, 2008. The company's mortgage book was assumed by the U.K. government and the company's retail deposit book was transferred to Abbey National plc.

2.4 U.K. Government May Acquire Significant Equity Interests in RBS, Lloyds TSB and HBOS

- On October 13, 2008, RBS announced the U.K. Treasury would underwrite £15 billion of ordinary shares (common stock) and purchase £5 billion of preference shares (preferred stock). The U.K. government would have representatives on the bank's board. The bank has announced that it has agreed to maintain the availability of SME and mortgage lending at 2007 levels.
- Similarly, the U.K. government will underwrite £8.5 billion of HBOS ordinary shares and purchase £3 billion of preference shares. The U.K. government will underwrite £4.5 billion of Lloyds TSB ordinary shares and purchase £1 billion of preference shares. The two banks are currently in the process of merging.

2.5 Banking Bill

On October 7, 2008, the Banking Bill was introduced in the House of Commons. The Banking Bill is designed to strengthen the existing U.K. framework for financial stability and depositor protection.

- Part 1 introduces a permanent special resolution regime ("SRR") for dealing with banks that get into financial difficulties. One of the objectives of the special resolution regime is to "protect depositors". The U.K. Treasury, the FSA and the BoE all have a role in the operation of the SRR. The BoE will have the power to transfer a failing bank's business or its shares to a "bridge bank" (i.e. a company wholly owned by the BoE), with a view to restructuring it for onward sale to the private sector. The BoE can also order a direct transfer to a private sector purchaser. The U.K. Treasury is also given the power to nationalize a failing bank.
- The BoE has the power to make partial transfers, so that healthy assets can be transferred out of a failing bank and into a bridge bank. This may result in prejudice to those creditors whose claims are not transferred to the bridge bank.
- Part 2 establishes a new bank insolvency procedure ("BIP"), based largely on existing liquidation provisions of the Insolvency Act 1986 as amended by the Enterprise Act 2002. The BIP provides for the orderly winding up of a failed bank, including prompt payments from the Financial Services Compensation Scheme ("FSCS") to eligible depositors. There are powers to extend the BIP to building societies and credit unions.

- Part 3 establishes a new bank administration procedure, based largely on existing administration provisions of the Insolvency Act 1986, as amended by the Enterprise Act 2002. This procedure is to be used where there has been a transfer of part of a failing bank's business, assets or liabilities to a bridge bank or a private sector purchaser under the SRR, leaving an insolvent residual entity. The procedure is designed to ensure that essential services and facilities that cannot be immediately transferred to the bridge bank or private purchaser continue to be provided for a period of time.

3. Austria

- The Austrian government announced a deposit guarantee plan, which must still be endorsed by Parliament, that provides for an unlimited deposit guarantee for private customers.
- There are also plans to create state guarantees for interbank lending and to provide for the state to intervene to shore up bank capital.
- On October 13, 2008, the Austrian government announced and published draft legislation on stability measures, which will earmark up to €15 billion for recapitalization measures and €85 billion for state guarantees of debt issued by financial institutions. The proposal, which is expected to be approved on October 21, 2008, would allow the state either to establish a separate government-guaranteed entity that will lend money to financial institutions or to provide a direct guarantee on the obligations of financial institutions. Credit institutions holding a license pursuant to the Austrian Banking Act, including subsidiaries of foreign banks, will be allowed to participate. The proposed recapitalization plan would give the Federal Minister of Finance authorization to lend to, acquire shares or other securities in or directly take over financial institutions. The proposed stability measures would also create unlimited deposit guarantees for natural persons.

4. Belgium

4.1 Rescue of Fortis

- The Belgian state bought the remaining 50% plus one share of Fortis Bank from Fortis SA/NV for a total consideration of €4.7 billion in cash.
- A portfolio of structured products with fair value of €10.4 billion was transferred by Fortis Bank to a separately managed entity jointly-owned by the Fortis Group (66%), the Belgian state (24%) and BNP Paribas (10%).
- The Belgian government reached an agreement with BNP Paribas on the subsequent transfer of 75% of Fortis Bank SA/NV; the Belgian state will continue to own the remaining 25% of the company.
- BNP Paribas will acquire 100% of Fortis Insurance Belgium for a total consideration of €5.73 billion in cash, subject to final closing adjustment.
- The government of the Netherlands acquired Fortis Bank Nederland (Holding) N.V., including Fortis' interest in ABN AMRO and other operations, for a total consideration of €16.8 billion.

4.2 Rescue of Dexia S.A.

- The Belgian, French and Luxembourg governments and other investors invested a total of €6.4 billion in Dexia, a specialist in lending to local governments in Europe.

4.3 Bank Deposit Guarantees

- The Belgian government has announced plans to guarantee bank deposits of up to €100,000 – an increase of €80,000. The government has also announced plans to guarantee all new bank loans of "systemic" Belgian banks, i.e. interbank deposits, bonds and institutional investments. Banks will have to pay a fee for the guarantee.

5. Canada

- As of October 8, 2008, Canada's central bank, the Bank of Canada, lowered its key lending rate by 0.5%. Canada's central bank has put less cash into the banking system to unclog markets than other countries, and has not held special auctions of the U.S. dollars that the Federal Reserve supplied to Canada and other countries in mid-September. On October 3, 2008, the Bank of Canada increased the money it put into the banking system to at least C$20 billion ($18 billion) from C$8 billion.
- The Canada Deposit Insurance Corporation ("CDIC") has stated that the financial institutions in Québec and Canada are highly capitalized and the Canadian financial system is resilient to any shocks. The CDIC insures about 80 financial institutions, including the Royal Bank of Canada, the country's largest bank. The CDIC protects funds in savings and checking accounts and some term deposits for as much as C$100,000 ($91,470). Mutual funds are not protected.

6. Denmark

- Similar to the Irish government action, discussed below, Denmark has guaranteed all bank deposits so that all claims by "depositors and other ordinary creditors" are covered. A special liquidation fund of DKK 35 billion will be set up, to which banks will contribute.

7. France

7.1 Dexia S.A. ("Dexia")

- The Belgian government and other investors invested $4.26 billion in Dexia, a specialist in lending to local governments in Europe. The French government agreed to contribute €1.42 billion, the French state-controlled Caisse des Dépôts €2.84 billion and the Luxembourg government €518.82 million.
- The combined French-Belgian holdings will amount to 70% of Dexia's share capital.
- Dexia has confirmed that its exposure to the troubled German bank Hypo Real Estate will have limited impact on its solvency.

7.2 Rescue Package

- On October 15, 2008, the French parliament adopted a new law providing for a state guarantee of up to €360 billion of interbank lending and a possible purchase of stakes in major banks by the French state through a public company. The guarantee is limited to lending issued before December 31, 2009 and for a maximum period of five years. The legislation does not fix the amount dedicated to the recapitalization of banks but, according to a statement from the French president, it could amount to €40 billion.
- On October 20, 2008, the French government announced that France's six largest banks (BNP Paribas, Societe Generale, Credit Agricole, Credit Mutuel, Caisse d'Epargne, and Banque Populaire) would get a total of €10.5 billion

from the government in exchange for issuing deeply subordinated debt securities to the government, without voting rights.

7.3 Trading in Short-Term Commercial Paper and Certificate of Deposit

- As of October 15, 2008, trading in short-term commercial paper and certificates of deposit with a term of less than one year has been authorized on the Paris stock exchange. Banks whose commercial paper is listed on a regulated market are thus eligible for short-term refinancing operations.

7.4 Changes in Valuation Techniques and Accounting Standards

- On October 15, 2008, the National Accounting Board (*Conseil National de la Comptabilité*), the French *Autorité des Marchés Financiers*, the Banking Commission (*Commission Bancaire*) and the Insurance and Mutual Funds Supervisory Authority (*Autorité de Contrôle des Assurances et des Mutuelles*) have issued a joint recommendation on the fair valuation of certain financial instruments due to financial market turbulence.

8. Germany

8.1 Stabilization Act

- On October 17, 2008 the German Financial Markets Stabilization Act (the "Stabilization Act") has been published in the Federal Law Gazette (*Bundesgesetzblatt*) (BGBl. I, p. 1981). The main purpose of the Stabilization Act is to restore and sustain confidence and liquidity in the German financial market.
- Under the Stabilization Act, a financial markets stabilization fund" (*Finanzmarktstabilisierungsfonds*; the "Stabilization Fund") will be set up by the German federal state (*Bund*). The Stabilization Fund is set up as a special fund (*Sondervermögen*) of the German federal state without its own legal personality (*nicht rechtsfähig*). The liabilities of the Stabilization Fund will be guaranteed by the German federal state.

Via the Stabilization Fund three main types of measures may be granted on an application:

(1) Recapitalization of companies in the financial sector; (2) the guarantee of bonds, debentures and deposits, each with a maturity of up to 36-months to provide companies in the financial sector access to liquidity and facilitate the refinancing in the capital markets; and (3) the purchase by the Stabilization Fund of selected assets.

The details and terms of conditions of such stabilization measures are set out in the Regulation regarding the Implementation of the Financial Markets Stabilization Fund Act inanzmarktstabilisierungsfonds-Verordnung; "Stabilization Fund Regulation"), which was released by the Federal Government under the Stabilization Act on October 20, 2008 and which came into force as of the same date.

8.2 Hypo Real Estate

- An agreement was reached among the German federal government, the German Central Bank, the financial regulator ("BaFin") and representatives of the financial services industry on the granting to Hypo Real Estate of a €35 billion credit facility, later increased by an additional €15 billion credit facility, by the financial sector, backed by a €35 billion state guarantee.

8.3 Bank Deposit Guarantees

- The German government has also announced that it will ensure the repayment of deposits. This "political guarantee" of deposits has no legal force and the government said there would be no additional legislation to give further protection to depositors.

9. Greece

- On October 3, 2008, the Greek finance minister said deposits "in all banks that operate in Greece" would be "absolutely guaranteed," amid signs that savers were becoming restless.

10. Iceland

- On October 20, 2008, it was reported that Iceland was about to announce a $6 billion rescue package led by the International Monetary Fund and supported by other central banks.
- Iceland has guaranteed all deposits with the country's banks. The guarantee only extends to domestic deposits and not to deposits with Icelandic banks held overseas. It should be noted that a significant volume of banking business by Iceland's banks is conducted overseas.
- The central bank of Iceland has already purchased a 75% stake in the bank Glitnir.
- Landsbanki, Iceland's second-biggest bank, has also been nationalized (October 7, 2008) and the government is currently negotiating a $5.4 billion loan from Russia to assist in meeting external payments commitments.
- Icesave, the online British arm of Landsbanki, announced that its customers can no longer withdraw or deposit money. More than 300,000 British customers had around £4 billion deposited in Icesave accounts and now face the prospect of making a claim under the U.K. government deposit guarantee scheme. Depositors with more than £50,000 and non-retail depositors are not protected by this scheme.
- Iceland's largest bank, Kaupthing, has been seized by the Icelandic Financial Supervisory Authority. Its U.K. subsidiary, Kaupthing, Singer & Friedlander Ltd., has been placed into administration.
- Relations between Iceland and the U.K. have hit a new low as the U.K. tries to protect savers who deposited their money online with Icelandic banks. There are also concerns about nearly £800 million of funds placed with Icelandic banks by local government authorities and further millions deposited by U.K. charities.
- The U.K. government has invoked powers under the Anti-Terrorism, Crime and Security Act 2001 (passed after the 9/11 attacks) to freeze Landsbanki's estimated £4 billion of U.K. financial assets. The U.K. government plans to use these assets to recoup any sums paid to U.K. depositors from public funds.

11. Ireland

11.1 Depositor Protection

- Ireland has safeguarded all deposits (retail, commercial, institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower Tier 2) with the following banks: Allied Irish Bank, Bank of Ireland, Anglo-Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and the Educational Building Society. These institutions are being charged for the guarantee. The protection does not apply to non-Irish owned banks and the legality of this move under E.U. law has been questioned.

11.2 Wide Powers to Provide Financial Support

- The Credit Institutions (Financial Support) Bill 2008, announced on September 30, 2008, provides that for a two-year period commencing September 30, 2008 the Irish minister of finance is to be given very broad powers to make regulations granting financial support in respect of the borrowings, liabilities and obligations of any credit institution to the [Irish] Central Bank or any other person. Such financial support includes granting loans, guarantees, exchanges of assets and other kinds of financial accommodation and support. The minister is given broad power to provide the support on "such commercial or other terms and conditions as the minister thinks fit." Nationalization (in whole or part) of affected institutions is also pre-authorized and the Bill includes relaxation of merger control.

12. Italy

- The Italian government has set up a program to shore up the banking system through recapitalization or the purchase of assets. A special €20 billion fund has also been set up to serve as an emergency credit line.
- A second grade guarantee fund has been set up for all bank deposits of up to €103,000.

13. The Netherlands

- ING Groep N.V.("ING") announced on October 19, 2008, that it has reached an agreement with the Dutch government to strengthen its capital position, creating a strong buffer to navigate the current market and economic environment. ING will issue non-voting core Tier-1 securities for a total consideration of EUR 10 billion to the Dutch State. The transaction will bring ING's core Tier-1 ratio to around 8%, will strengthen the insurance balance sheet and will reduce ING's debt/equity ratio to around 10%.
- The Dutch's government has trebled the amount of savers' deposits it will protect to €100,000.
- The Dutch government also set aside €20 billion for the financial sector. Funds will be directly available for fundamentally sound and viable banks that run into liquidity or capital problems.

14. South Korea

- On October 20, 2008, South Korea sought to rescue its financial system by guaranteeing $100 billion of lenders' foreign-currency debts and providing $30 billion in U.S. dollars to banks.

15. Spain

- The Spanish government has adopted a troubled asset purchase program similar to the U.S. TARP.
- The government has also implemented the Economic and Financial Affairs Council of the Council of the European Union ("ECOFIN" agreement on raising depositor guarantee levels by raising the level of protection from €20,000 to €100,000 per depositor and institution. The Spanish minister of finance has been authorized by Royal Decree to guarantee new funding operations of Spanish resident banks (including interbank debt).

16. Sweden

- On October 20, 2008, Sweden adopted a program to stabilize its financial system. It includes the creation of a SEK 15 billion stabilization fund to manage solvency problems in any Swedish credit institution. Credit institutions will also receive capital injections from the government in exchange for preference shares with high voting rights.

- On October 8, 2008, Sweden's central bank, the Riksbank, in a coordinated move with central banks across the world, cut its key interest rate by half a percentage point to 4.25%.
- Sweden's central bank will loan as much as 5 billion krona ($700 million) to the Swedish unit of Kaupthing Bank hf., after the subsidiary failed to meet payment obligations and was put up for sale.
- On October 6, 2008, Sweden expanded its guarantee on bank deposits to 500,000 krona, or $71,310, from 250,000 krona.
- On October 6, 2008, the Riksbank extended the lifeline to Sweden's banks by increasing the credit it is making available from 60 billion krona ($8.3 billion) to 100 billion krona.

17. Switzerland

- On October 8, 2008, the SNB cut interest rates for the first time in over five years as part of a coordinated rate cut by major central banks.
- An SNB report published in June 2008 highlighted the need for a "higher capital buffer at big banks". The report revealed that the country's big banks are among the most leveraged in the world. The SNB recommended that UBS and Credit Suisse build a bigger financial cushion to save a repeat of the subprime mortgage disaster.
- Subsequently, the SNB announced on October 16, 2008, the extension of a $54 billion loan to a SPV that will acquire illiquid assets from UBS. The bank will also receive a $6 billion capital injection from the government. A similar scheme was offered to Credit Suisse, but it refused and has proceeded to raise CHF 10 billion in capital from private sources, including the Qatar Investment Authority.

18. The United Arab Emirates

- Although UAE banks had virtually no exposure to Lehman Brothers, following signs that the global liquidity crunch was biting in the oil-rich Gulf states, on September 22, 2008, the UAE central bank launched an emergency funding facility for its banks, pumping as much as Dh50bn (€9.3bn, £7.4bn, $13.6bn) into the banking sector in order to help the local interbank market. On October 8, 2008, the UAE central bank cut its base rate by 0.5% in a move timed to coincide with other central banks.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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