# National Policy Bulletin

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## Emergency Economic Stabilization Act of 2008

### Executive Summary

President Bush signed into law today the Emergency Economic Stabilization Act (ESSA), H.R. 1424. This occured immediately after the U.S. House of Representatives approved the measure by a vote of 263-171. The House vote followed approval of identical legislation on October 1 by the U.S. Senate by a vote of 74-25. The legislation is designed to alleviate the growing financial crisis that threatens the vitality and sustainability of the U.S. and global economies.

The core provision of the ESSA authorizes the Treasury to establish the Troubled Assets Relief Program, or TARP, to purchase and guarantee troubled assets from financial institutions that hold mortgages and/or mortgage-backed securities. The new law also provides a one year increase in the maximum deposit insurance limit covered by the FDIC from $100,000 to $250,000. In addition, the law also includes the extension of several tax provisions and energy-related programs.

### Description

**Purchase Authority**: Provides $700 billion in purchase authority to Treasury to purchase "troubled assets from any financial institutions," of which $250 billion would be made immediately available and another $100 billion once the President certifies that Treasury needs the authority. The final $350

billion is authorized, but Congress could halt the authority by passing a joint resolution disapproving the action (under fast-track procedures). While provided in installments or "tranches," the law provides the full $700 billion, as initially requested by the Administration to calm the financial markets.

**FDIC Coverage Limits:** Temporarily increases the standard maximum deposit insurance limit from $100,000 to $250,000 through December 31, 2009. In addition, the law temporarily lifts the $30 billion limitation on the FDIC's borrowing authority from the Treasury. These provisions apply to credit unions backed the National Credit Union Administration, as well as the FDIC.

**Financial Institutions:** Defines participating "financial institutions" as any institution that includes, but is not limited to, "banks, savings associations, credit unions, broker-dealers, and insurance companies" that are established, organized and regulated under the laws of the United States or any State, territory, or possession of the United States, including the District of Columbia.


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**Troubled Assets:** Broadens the Treasury Department's original request for mortgage-related assets to a larger class of "troubled" assets." Such assets are defined as "any residential or commercial mortgages any securities, obligations, or other instruments that are based on or related to such mortgages" and "any other financial instrument that the Secretary…determines the purchase of which is necessary to promote financial market stability" (emphasis added). This definition significantly expands the scope of the purchasing program to potentially many more classes of securities (e.g.., those backed by car loans, credit-card debt, etc.).

**Insurance Component:** Requires the Treasury Department to establish a federally-backed insurance program, similar to the Federal Deposit Insurance Corporation (FDIC), for holders of troubled assets, *if* it utilizes its purchase authority (which it is expected to do). Treasury will guarantee up to 100% of the timely payment of principal and interest on certain classes of troubled assets, presumably those worth more than the ones which will be immediately purchased. A risk-adjusted premium will be assessed to holders of these assets to self-finance the program through the participants. The total amount of assets insured by the program, minus the premiums, will offset the purchase authority available to Treasury.

**Private Firms as Financial Agents:** Authorizes Treasury to designate private financial institutions as its agents to carry out such duties as may be required in exercising its new authority. The law directs Treasury to solicit bids from a broad range of qualified firms and to "take appropriate steps to manage conflicts of interest, including requiring potential firms to indentify and disclose… potential conflicts." The FDIC will be among the candidates chosen to manage the purchased assets.

**Priorities:** Requires the Treasury Secretary to exercise its authority in a manner that will protect the taxpayer, provide stability and prevent disruption to the financial market system, the need to help families keep their homes and to stabilize their communities, etc. (in that order).

**Executive Compensation:** Sets executive compensation limits on two classes of firms, 1) those which the federal government directly takes over "AIG-style" and 2) those which sell $300 million or more in assets to the federal government, so-called "high-volume sellers." For those firms directly taken over, the Secretary will establish limits on compensation for taking unnecessary and excessive risk, a prohibition on "golden parachute" payments, and a process for recouping any incentive payments made to "senior executives" (top 5 executives of a public company) based on earning statements later proven to be materially inaccurate. For high-volume sellers, the law bans golden parachute payments and lower the current deduction for executive compensation from $1 million to $500,000.

**Reverse Auctions:** Requires the Secretary to use methods, such as auctions or "reverse" auctions, in purchasing firms' troubled assets, in order to minimize the cost to taxpayers. Treasury intends to use a process whereby it indicates its intent to buy a certain class of troubled assets and competing firms provide the terms for which they would sell. If the process works, Treasury would choose the seller with the lowest sticker price. When these assets are later sold, the proceeds would flow into general revenues.

**Warrants:** Requires the Treasury to receive warrants for non-voting, common or preferred stock in firms that sell more than $100 million in troubled assets to the government. A warrant is a certificate that entitles the holder to purchase securities at a certain price. Giving the federal government a warrant to purchase shares of participating firms provides a mechanism for taxpayers to recoup a portion of the initial

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expense if share prices increase and the shares can later be bought and sold for a profit.

**5-Year Recoupment Plan:** Requires the President after five years to determine whether taxpayers have suffered a net loss as a consequence of the purchase program, and if so, to submit a legislative proposal to recoup that amount from participating firms.

**Market and Program Transparency:** Requires the Secretary to make information regarding each purchase available to the public in an electronic form, including a description, amounts, and pricing of such assets. The language also requires the Secretary to make public the mechanisms for purchasing troubled assets, the methods of valuing assets, the process for hiring asset managers, and the criteria for identifying troubled assets for purchase.

**Foreign Banks and Financial Authorities**: Defines a participating financial institution to include foreign banks if "established and regulated under the laws of the U.S. or any State…and having significant operations in the U.S." A central bank or institution owned by foreign government would generally be excluded.

**Oversight Board:** Establishes a five-person Financial Stability Oversight Board, including the Chairman of the Federal Reserve, the Treasury Secretary, the Director of the Federal Home Finance Agency, the Chairman of the SEC, and the Secretary of Housing and Urban Development, to review the exercise of authority under this legislation and make recommendations to the Treasury.

**Bank Losses on GSE Stock**: Allows banks to treat losses on shares of preferred stock in Fannie Mae and Freddie Mac as ordinary losses to offset ordinary income, not as capital losses (which is capped).

**Discharge of Mortgage Debt:** Extends for two years the exclusion (set to expire on January 1, 2010) from a taxpayer's gross income any discharge of indebtedness income, as long as the debt is for the acquisition, construction, or substantial improvement of the taxpayer's principal home (in addition to certain refinancing).

**Foreclosure Mitigation:** Directs the Secretary of the Treasury, as an owner of mortgages underlying troubled assets, to implement a plan to maximize assistance to homeowners and to encourage servicers of the underlying mortgages to take advantage of foreclosure prevention programs. In addition, the language requires the Secretary to consent to "reasonable requests" from loan servicers for mortgage term extensions, rate reductions, principal write-downs, increases in the proportion of loans within a trust, or the removal of other modification limits.

**Expiration of Authority:** Terminates the Secretary's authority to purchase and insure troubled assets on December 31, 2009, but allows for extensions until two years after the date of enactment.

**Mark to Market Accounting:** Restates current law that authorizes the SEC to suspend mark-to-market accounting with respect to any class or category of transactions. The law also requires the SEC to study the impact of mark-to-market regulations on the balance sheets of financial firms and the advisability and feasibility of potential modifications.

**Exchange Stabilization Fund:** Requires the Secretary to replenish the Exchange Stabilization Fund for any funds used to provide a temporary guarantee program for the money market fund industry and bars it from ever being used that way again.

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