

THE BAILOUT BILL AND YOU

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On October 3, 2008 President Bush signed the Emergency Economic Stabilization Act of 2008. The media colloquially refers to the new law as the “bailout bill.” Yet, if one thing is clear, it is that passage of the law itself will not bail the United States out of its current liquidity crisis. Perhaps history will show that passage of the law was a critical step in moving the economy forward. In the meanwhile, as the economy continues to sputter, middle market businesses need to assess the impacts of the changes on their business. This article briefly summarizes the most significant aspects of the new law for companies operating in these uncertain times.

The law has the stated intent of restoring liquidity to the financial system while protecting home values and savings, promoting job growth and homeownership, maximizing returns to taxpayers, and providing public accountability. The most discussed aspect of the new law is the Troubled Assets Relief Program (“TARP”). Under TARP, the Secretary of the Treasury (“Secretary”) is authorized to purchase, insure, hold, and sell troubled financial instruments. The TARP program will operate from the Treasury as part of a newly minted Office of Financial Stability.

Eligible Participants in TARP

Financial institutions eligible to participate in TARP include but are not limited to any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, and having significant operations in the United States. Any central bank of a foreign government or institution owned by a foreign government is not an eligible institution. Financial institutions participating in TARP are required to abide by certain restrictions, including grants of equity to the Secretary, limits on executive compensation and prohibitions on golden parachutes for the senior executive officer of the participating institution.

Eligible Troubled Assets

Financial assets may be acquired by the Secretary under TARP if they satisfy the following definition of “troubled assets”: (a) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and (b) any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress.

Funding Authority

As of October 3, 2007, the day the law was enacted, the Secretary was vested with the authority to hold up to \$250 billion of troubled assets at any one time. Upon a written certification from the President to Congress, a further \$100 billion will be authorized. A final \$350 billion will be authorized following a report and request from the President unless Congress passes a joint resolution of disapproval within fifteen days of the President's report.

Within two weeks of the creation of TARP, the Secretary announced a voluntary capital purchase program available to U.S. financial institutions pursuant to which the Treasury would purchase up to \$250 billion of senior preferred shares on standardized terms. Interested financial institutions have until November 14 to express interest to the Secretary who will then determine eligibility and allocation. It seems quite clear that Treasury will have no trouble exhausting the initial \$250 billion in short order.

Pricing and Management of Troubled Assets

The Secretary has broad authority to manage troubled assets once purchased. This authority includes the right to hold the assets to maturity or to sell once the Secretary determines that the market is optimal for a sale. Any sale must be at a price that the Secretary determines, based on available financial analysis, will maximize the return on investment for the Federal Government. This may entail the use of market mechanisms, including auctions or reverse auctions, where appropriate. Most likely, the Secretary will contract with private parties for the provision of asset management services. Further, to the extent that the Secretary acquires residential mortgages and/or assets secured by residential real estate the Secretary must implement a plan to maximize assistance to homeowners and encourage mortgage servicers to take steps to minimize foreclosures.

Insurance of Troubled Assets

The new law also requires the Secretary to establish a program to guarantee troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities. Under this provision, the Secretary is authorized to develop guarantees of troubled asset and develop programs to collect premiums for the guarantees from participating financial institutions sufficient to cover anticipated claims. The law establishes a Troubled Assets Insurance Fund, which consists of the premiums paid by participating institutions, and will be used to fulfill obligations of guarantees provided to financial institutions. The authority to purchase troubled assets under TARP will be reduced by an amount equal to the difference between the total of the outstanding guaranteed obligations minus the balance of funds in the Insurance Fund.

Oversight of TARP

The TARP program will be subject to significant oversight and reporting obligations. The law establishes the Financial Stability Oversight Board, which will review the exercise of authority granted under the law and make recommendations to the Secretary. The Board will be comprised of the Federal Reserve Chair, the Secretary, the Director of the Federal Home Finance Agency, the Securities and Exchange

Commission Chair, and the Secretary of Housing and Urban Development. Additional oversight and accountability will be fostered by congressional oversight panels and a Special Inspector General for TARP who will conduct, supervise, and coordinate audits and investigations for the purchase, management, and sale of assets by the Secretary. In addition the Secretary must make regular reports to Congress and the relevant committees thereof.

Non-Tarp Provisions

The new law contains many provisions not directly related to TARP, two of which are highlighted here. Until December 31, 2009, the amount of deposit and share insurance coverage offered under the Federal Deposit Insurance Act and the Federal Credit Union Act is increased from \$100,000 to \$250,000. Another number raised by the act is the level of public debt. In just one sentence, Congress authorized an increase in the public debt to \$11.3 trillion dollars.

In sum, the Emergency Economic Stabilization Act of 2008 represents a massive effort by the federal government to combat the economic catastrophe caused by toxic financial instruments that have clogged the nation's access to capital. Financial institutions will be afforded substantial opportunities to participate in the recovery effort as sellers, servicers, advisors or as beneficiaries of government investment. Businesses function best with fully functioning credit markets and a stabilized economic environment. The enormity of the current crisis requires careful consideration of government initiatives, such as TARP, in restoring liquidity and stability to the markets.