Economic Stabilization Act Provisions You May Have Missed

On October 3, 2008, the President signed H.R. 1424, the Emergency Economic Stabilization Act of 2008 (the Act) into law. In addition to the bailout provisions, referred to as the Troubled Asset Relief Program (the TARP), the law also contains various tax provisions (extending alternative minimum tax relief, establishing tax credits for alternative energy and other areas, and extending many existing tax credits) as well as other Congressional matters.

The Act has several areas of particular significance:

Asset Purchases and Guarantees

- The U.S. Department of Treasury (Treasury) is authorized to (1) purchase up to $700 billion of mortgages, mortgage-based securities and other securities (including new equity in banks) and (2) provide guarantees of mortgages and mortgage-based securities. When Treasury purchases troubled assets, it generally must also acquire warrants or similar securities in the selling entity on terms favorable to Treasury. Treasury's authority to purchase troubled assets is graduated, with initial authority to purchase up to $250 billion in troubled assets. If the President provides written certification of need, Treasury may purchase up to an additional $100 billion in troubled assets. Treasury may purchase up to the remaining $350 billion only if the President transmits a written report to Congress and Congress does not enact a joint resolution of disapproval within 15 days.
- Treasury's authority to purchase and guarantee assets terminates on December 31, 2009, but Treasury may extend this authority until October 3, 2010.

Mark-to-Market Accounting

- The SEC is authorized to suspend mark-to-market accounting for any issuer or any class or category of transaction.

Oversight and Reporting

- The Act creates several layers of independent oversight over Treasury's authorized powers, including the creation of new oversight entities (Financial Stability Oversight Board, Congressional Oversight Panel, and Office of the Special Inspector General), new responsibilities for existing entities, and additional reporting obligations for Treasury and other agencies.

Temporary FDIC Insurance Limits Increase

- The law raises FDIC deposit insurance limits from $100,000 to $250,000 per account until December 31, 2009.

Troubled Assets. The Act defines "troubled assets" as (1) residential or commercial mortgages and any securities, obligations or other instruments that are based on or related to such mortgages, issued before March 14, 2008—the purchase of which Treasury determines promotes stability in the financial markets; and (2) any other financial instrument the Secretary (after consultation with the Chairman of the Federal Reserve) deems necessary to promote financial market stability, but only upon the submission of written notification of such a determination to Congress. Importantly, "troubled assets" is defined broadly enough to include common or preferred equity newly issued by banks or other financial institutions.

Asset Purchases and Guarantees. The Act authorizes Treasury to purchase and to make and fund commitments to purchase troubled assets. When Treasury purchases troubled assets from a financial institution listed on a national securities exchange, it must also acquire warrants for stock in the selling entity on terms favorable to Treasury. When Treasury purchases troubled assets from any other institution, it must also acquire warrants for stock or a senior debt instrument on terms favorable to Treasury. Treasury is directed to take steps to prevent unjust enrichment of participating financial institutions, including prevention of the sale of a troubled asset to Treasury at a price greater than the original price paid by the seller to purchase that asset.

The Act also authorizes Treasury to guarantee troubled assets originated or issued before March 14, 2008. Treasury will collect premiums from any financial institution participating in this guarantee program, and these premiums will be set at an amount necessary to meet the purposes of the Act and to provide sufficient reserves to meet anticipated claims under this insurance program.

The aggregate troubled assets held and obligations guaranteed by Treasury (net of guarantee premiums) are limited to an amount outstanding at any one time equal to (1) initially, $250 billion, (2) after the President submits to Congress a certification that Treasury requires additional funds, $350 billion, and (3) after the President submits to Congress a report detailing Treasury's plan to exercise further authority, $700 billion, unless within 15 days of such a submission Congress enacts into law a resolution disapproving Treasury's plan. Assuming a presidential veto, Congress would need a two-thirds majority to enact this type of resolution.

Guidelines for the TARP, including guidance on mechanisms for pricing, valuing, and purchasing troubled assets, procedures for selecting asset managers, and criteria for identifying troubled assets for purchase, must be published by the earlier of November 17, 2008 and two business days after the first purchase of troubled assets.

Purchases and guarantees of troubled assets may be made under TARP until December 31, 2009. Treasury may extend this authority to October 3, 2010 upon certification of need to Congress.

Oversight. The Act creates several layers of independent oversight of Treasury's authority under the TARP.

The Financial Stability Oversight Board (comprised of the Secretary, the Chairman of the Federal Reserve, the Director of the Federal Housing Finance Agency, the Chairman of the Securities and Exchange Commission, and the Secretary of Housing and Urban Development) is created to review the Secretary's exercise of authority under the Act, to make recommendations to the Secretary regarding the use of his authority, and to report suspected fraud or wrongdoing to the Attorney General or to the newly-created Office of the Special Inspector General for the TARP.

A Congressional Oversight Panel is created to submit periodic reports to Congress on the Secretary's use of authority under the Act, the impact of Treasury's purchases on the financial marketplace and on market transparency, and the effectiveness of foreclosure mitigation efforts.

The Comptroller General is granted the authority to evaluate the performance of the TARP and to audit its annual financial statements.

Reporting Requirements. Treasury and other agencies will be subject to periodic reporting requirements under the TARP. Treasury is directed to submit detailed financial reports to Congress 60 days after the first exercise of power under the Act and every 30 days thereafter. Treasury is also directed to submit a report within seven days of each increment of $50 billion of purchase commitments made, including a description of all transactions made during the reporting period, the pricing mechanisms used in these transactions, and a justification of the prices paid in the transactions. The Comptroller General is directed to report to Congress every 60 days on the activities and performance of the TARP. The Special Inspector General is directed to report to Congress every 60 days with a detailed statement of all purchases, obligations, expenditures and revenues associated with the TARP. The Office of Management and Budget and the Congressional Budget Office are directed to provide semi-annual reports.

Regulatory Reviews and Recommendations. Several agencies are directed to perform studies of potential factors that may have contributed to the current state of the financial system and to report their findings to Congress.

The Securities and Exchange Commission is directed to study the effects of mark-to-market accounting from several perspectives, including potential effects on bank failures in 2008, the impact of such standards on the quality of information available to investors, and the advisability of modifications to such standards, and to submit recommendations to Congress by January 1, 2009.

The Congressional Oversight Panel is directed to study regulatory reform of the financial markets and related consumer protection issues and to submit to Congress by January 20, 2009 recommendations for improvement, including recommendations regarding whether any market participants that are outside the current regulatory system should become subject to regulation, and whether there are any gaps in existing consumer protections.

Treasury is directed to study the current state of the financial markets and the regulatory system and to submit a report analyzing the current regulatory system and its effectiveness, including the over-the-counter swaps market and government-sponsored enterprises, and to provide recommendations to Congress by April 30, 2009. Specifically, Treasury is to provide recommendations regarding whether any financial market participants that are outside the current regulatory system should become subject to future regulation, and recommendations for potential enhancement of the clearing and settlement of over-the-counter swaps.

The Comptroller General is directed to study the extent to which leveraging and sudden deleveraging of financial institutions contributed to the current financial climate, and to submit recommendations to Congress by June 1, 2009.

Executive Compensation. If Treasury purchases troubled assets directly from a financial institution and as a result Treasury receives a meaningful debt or equity position in such financial institution, such financial institution must, in a manner satisfactory to Treasury, (1) adopt limits on compensation that excludes incentives to take unnecessary and excessive risks during the period that Treasury owns an equity or debt position in such financial institution, (2) recover bonuses paid on earnings or other criteria later proven to be inaccurate and (3) prohibit golden parachute payments during the period that Treasury owns an equity or debt position in such financial institution.

Any financial institution selling troubled assets to Treasury in auctions, where such purchases in the aggregate exceed $300 million (including direct purchases), may not provide new golden parachutes to senior executives in the event of involuntary termination, bankruptcy filing, insolvency or receivership. Additionally, such financial institutions' tax deductions for compensation paid to the top five highest paid executives will be limited to $500,000 per person per year, and will be subject to the 280G "golden parachute" rules limiting deductions for severance compensation to three times annual compensation.

Fannie Mae and Freddie Mac Preferred Stock. Any gain or loss by a bank or other financial institution on the sale or exchange of Fannie Mae and Freddie Mac preferred stock held by the bank or other financial institution after January 1, 2008 and before September 7, 2008 will be treated as ordinary income or loss for tax purposes.

Foreclosure Minimization. Treasury, Fannie Mae and Freddie Mac are directed to implement a plan to minimize foreclosures by facilitating modification of mortgages through such means as a reduction in interest rates, reduction in principal, and other alternatives including the HOPE for Homeowners Program. Additionally, beginning December 2, 2008, Treasury, Fannie Mae and Freddie Mac are directed to make reports to Congress every 30 days containing specific information on the number and types of loan modifications made and the number of foreclosures occurring during the reporting period.

Mark-to-Market Accounting. The SEC is granted authority to suspend, by rule, regulation or order, mark-to-market accounting (the application of Statement Number 157 of the Financial Accounting Standards Board) for any issuer or with respect to any class or category of transaction if the SEC deems it necessary or appropriate, in the public interest, and is consistent with the protection of investors.

National Debt. The ceiling on public debt is raised from $10.615 trillion to $11.315 trillion, an increase of $700 billion.

Recoupment from Financial Industry. After five years, the Director of the Office of Management and Budget is directed to submit a report to Congress on the net amount in the TARP under this Act. In the event of a shortfall, the President is directed to submit to Congress a proposal to recoup from the financial industry any net cost to the government from the program to ensure that the TARP does not add to the deficit or national debt.

If you have questions, or would like more information please contact your regular Ropes & Gray attorney, or one of our Securities & Public Companies attorneys.