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Emergency Economic Stabilization Act of 2008

By now, you have heard about the $700 billion U.S. bailout plan to restore liquidity in the US credit market. This is an article to summarize the Emergency Economic Stabilization Act of 2008 (Emergency Act). As you can appreciate, each individual corporate decision is heavily dependent upon its financial institution's ability to function properly. Each corporation depends on its financial institutions for their support in the free economic trade and commercial activities. Without understanding the Emergency Act you may be missing a major component of understanding your U.S. financial institutions and their behaviors.

The Emergency Act, enacted on October 3, 2008, authorizes the U.S. Treasury Department ("Treasury") to actively participate in the direct purchase of securities and other mortgage driven financial instruments from U.S. financial institutions on a mark-to-market basis. This authority is well beyond that of the existing Federal Deposit Insurance Corporation (FDIC). The Treasury, through the Federal Reserve, may create an auction facility specifically to purchase these assets. Once a market for underperforming assets being held by various financial institutions has been created, the financial institutions will be able to resume leading to each other and to provide credit for commerce.

The heart of Emergency Act is built around the Troubled Assets Relief Program ("TARP"), which will expire on December 31, 2009 with a one year potential extension period. The Federal Reserve, the Securities and Exchange Commission, and the Department of Housing and Urban Development will participate, along with the U.S. Treasury, in a program to purchase, insure, hold and dispose of residential and/or commercial property mortgage portfolios originated prior to March 14, 2008, and their securitized securities portfolios.

There are three phases of authorized funding: an initial $250 billion to be made available immediately, the second $100 billion upon presidential request, and the final $350 billion upon presidential request, but subject to congressional approval. TARP can also be used to invest in the equity of financial entities currently listed on national security exchanges. This segment was heavily discussed in the U.S. media to assure that U.S. taxpayers will receive as good a deal as other financial institutional investors in a similar setting. The public sentiments are reflected in the Executive Compensation Limitation provision which applies to those firms who are receiving the TARP program benefits. The provision includes a return of executive bonus or incentives and a 20 percent exercise tax on exit or separation compensation.

TARP also calls for a plan to mitigate the home foreclosures, including a residential loan modification, and other foreclosure prevention programs. Any financial institutions who have suffered losses from holding Fannie Mae and Freddie Mac preferred stocks can offset those losses against ordinary income, assisting many local community institutions impacted by the failure of Fannie Mae and Freddie Mac. Further, FDIC will increase its depository insurance coverage limit to $250,000 per account from the current $100,000 limit which will have a positive impact on financial institutions' capacity to borrow more funds from the Treasury.

TARP will be implemented by a flexible discretionary management program. It will be created upon an initial transaction with criteria to identity the troubled assets and their value and price; a mechanism to purchase them; and, prevent any unjust enrichment to those financial institutions in the program. TARP will be monitored by various oversight programs including Financial Stability Oversight Board (composed of representatives from Treasury, Federal Reserve, HUD, FHFA and SEC), the Congressional Oversight Panel, the U.S. General Accounting Office annual audit, and the Special Inspector General for TARP.

TARP is designed to provide necessary liquidity to U.S. financial institutions. They, in turn, can provide capital to U.S. commerce. It is unlike any other investment program in its scope and size. Treasury has been promising that TARP should not cost anything to US taxpayers. However, in the event that TARP does result in a net loss, the president of United States is required to seek Congressional approval in recouping that net loss, five years after the enactment of Emergency Act. With the U.S. presidential election on November 4th, neither the current nor the next president, unless re-elected, will face this task.

Along with the concerted actions by the Central Banks in the European Union, the Emergency Act provided a solution to the lack of liquidity in the Global credit market, and aborted a credit crisis driven depression. The Emergency Act has also created an environment of opportunity for merger and acquisition among U.S. financial institutions as well as opportunities for them to restructure their operations and capital structures. Some of the changes will happen involuntarily and contrary to the desires or intentions of management. None are excluded from the potential changes in the current credit market. As the financial institutions evolve, the consumers of financial services must keep up with the changes in depository and non-depository banks and availability of credit facilities in the market.

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The article is not a legal advice or legal opinion on the subject.

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