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Melanie L. Fein

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THE EMERGENCY ECONOMIC STABILIZATION ACT
OF 2008

AND RELATED GOVERNMENT ACTIONS
IN SUPPORT OF THE U.S. FINANCIAL SYSTEM

BY

MELANIE L. FEIN

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THE ECONOMIC STABILIZATION ACT OF 2008

AND RELATED GOVERNMENT ACTIONS

IN SUPPORT OF THE U.S. FINANCIAL SYSTEM

I. INTRODUCTION

The Emergency Economic Stabilization Act of 2008 (“EESA”) was enacted on October 3, 2008, in a bold move by Congress and the Administration to provide liquidity to the U.S. financial system and forestall a looming economic collapse. The Act came as the U.S. housing market deteriorated, large financial institutions faltered at home and abroad, and global credit markets seized up.

The EESA empowered the U.S. Treasury with a \$700 billion budget and broad authority to purchase troubled financial assets, inject capital in financial institutions, and take other actions to protect the financial system. The Act also included provisions to expand federal deposit insurance, mitigate home foreclosures, and restrain executive compensation.

The Treasury began implementing the Act immediately upon its enactment. Even before then, the Treasury, Federal Reserve Board and other government agencies had commenced an aggressive program of coordinated emergency measures designed to stabilize the financial system and ease worsening economic conditions. Indeed, many, if not most, of the government’s emergency measures were taken pursuant to the agencies’ existing authority independent of EESA.

This paper analyzes the EESA and related actions by the government. It discusses events leading to enactment of EESA, key elements of the government’s rescue plan, and the legal authority under which the government acted. It offers a viewpoint on whether EESA really was necessary in light of the other broad authorities at the disposal of the financial regulators which they used in fashioning the rescue plan.

The government’s various responses to the ongoing financial crisis are continuing to evolve. This paper covers developments as of November 4, 2008.

A. **Events Leading to Enactment of EESA**

The Emergency Economic Stabilization Act of 2008 was enacted two weeks after Treasury Secretary Paulson and Federal Reserve Chairman Bernanke met with Congressional leaders and warned that “if we don’t do this, we may not have an

economy on Monday.”¹ The two agency heads sought Congressional backing for a sweeping rescue plan as events in the U.S. financial marketplace cascaded out of control and threatened catastrophic economic consequences in the United States and abroad. These events included:

- the near-default by Fannie Mae and Freddie Mac (GSEs) and their takeover by the federal government,
- the bankruptcy of one of the nation’s premier investment banks (Lehman Brothers),
- failure of the nation’s largest insurance company (AIG) and its rescue by the Federal Reserve,
- emergency FDIC-assisted takeovers of some of the nation’s largest banks (IndyMac, Washington Mutual and Wachovia),
- extinction of Wall Street’s remaining investment banks through mergers with bank holding companies (Merrill Lynch, Goldman Sachs, and Morgan Stanley),
- “breaking the buck” by the Reserve Primary Fund,
- a run on the \$11 trillion money market mutual fund industry,
- accelerating housing foreclosures across the country,
- record stock market volatility,
- freezing of worldwide credit markets, and
- paralysis of the U.S. commercial paper market.

All of these events occurred in September of 2008. They were preceded by a series of earlier shocks and tremors in the financial markets, highlighted by the failure of Bear Stearns in March of 2008 and the enactment of legislation to prop up the GSEs in July of 2008. But the concatenation of events in September seemed beyond the ability of U.S. financial regulators to handle without a mandate from Congress.

The Treasury Secretary and Federal Reserve Chairman asked to meet with Congressional leaders on the night of September 18. They painted a dire picture of

¹ This statement is attributed to Chairman Bernanke during a meeting with Congressional leaders on October 18, 2008. *See* New York Times’ account of events leading to enactment of EESA, “The Reckoning: As Credit Crisis Spiraled, Alarm Led to Action,” New York Times, Oct. 1, 2008.

financial chaos and collapse and asked for massive funding and Congressional support for an initiative to deal with the crisis.² The leaders of the Democratically controlled Congress pledged to act in a non-partisan manner to give the regulators broad emergency powers and funds.

The next day, Treasury Secretary Paulson sent up a three-page bill outlining in basic terms a \$700 billion rescue package that would allow the Treasury to purchase troubled assets from financial institutions. Surprised at the sparseness of the bill, members of Congress added provisions providing for comprehensive Congressional oversight of the program and limiting excessive executive compensation at financial institutions—a sore spot with many of their constituents. The length of the bill grew as additional provisions were tacked on to flesh out the terms and conditions of the rescue package and add new programs, such as expanded federal deposit insurance coverage and provisions calling for various studies of financial regulatory trouble spots.

The bill initially failed to pass in the House of Representatives on September 29 by a vote of 228-205, causing record losses in the stock market.³ Although the bill had the support of Democratic leaders, conservative Republicans balked at the size of the package and the prospect of a government “bailout of Wall Street.” The bill was revised to make it more palatable to the Republican minority and put to a vote again the following week.⁴ This time, both the Senate and the House of Representative passed the bill. President Bush immediately signed it into law and the Treasury went to work implementing it.

B. The Causes of the Crisis

The causes of the crisis that led to the enactment of EESA are manifold but stem primarily from the origination of subprime residential mortgages by unregulated and sometimes unscrupulous mortgage brokers who sold billions of dollars worth of shaky loans to banks, the GSEs, and other institutions in exchange for hefty origination fees. These institutions then securitized the loans and created elaborate structures—such as collateralized debt obligations (“CDOs”) and structured investment vehicles (“SIVs”)—through which they sold interests in the

² See “Congressional Leaders Stunned by Warnings,” *New York Times*, Sept. 19, 2008 (Congressional leaders were told “we’re literally maybe days away from a complete meltdown of our financial system, with all the implications here at home and globally.”).

³ The Dow Jones Industrial Average lost 778 points, more than any one day drop in its history. A total of \$1.2 trillion in equity value was wiped out in one day, attributable to the rejection of the bill by the House of Representatives.

⁴ In the interim, the bill was amended to include billions of dollars of tax relief extensions and other “pork”, including a \$2 million tax benefit for makers of wooden arrows for children; a \$100 million tax break to benefit auto racetrack owners; \$192 million in rebates on excise taxes for the Puerto Rican and Virgin Islands rum industry; \$148 million in tax relief for U.S. wool fabric producers; and a \$49 million tax benefit for fishermen and other plaintiffs who sued over the 1989 tanker Exxon Valdez spill.

loans to U.S. and foreign investors, earning lucrative servicing fees in the process. In a low interest rate environment, these investors were hungry for higher yielding investments and comforted by the high credit ratings assigned to the instruments by erstwhile reputable credit rating agencies. The federal government's support for the housing market—by providing mortgage funds for low and moderate-income families through Fannie Mae and Freddie Mac—created an abundance of home loans to be securitized and sold to investors. The perceived backing of the GSEs by the government created a huge market for their debt obligations, allowing them to generate a steady flow of funds into an increasingly bloated housing market.

Lax credit underwriting standards and unrealistic assumptions about ever-increasing home values meant that large numbers of the subprime loans were destined to fail, particularly in the event of an economic downturn. Financial institutions developed credit default swaps (“CDSs”) to hedge against these risks, but the CDS market was unregulated and opaque, making it impossible for investors to know where the exposure to liability on the CDSs lay and creating distrust among counterparties.⁵

After the inflated housing market peaked and borrowers began to default on subprime mortgages in 2007, the financial house of cards that had built up around the mortgages came tumbling down. Mark-to-market accounting principles that took effect in 2007 required banks and other financial institutions to declare losses not only on defaulted loans but loans in danger of defaulting and related asset-backed securities. Billions of dollars of assets were written off, causing a loss of shareholder confidence that sent the stock market reeling off record highs reached in October of 2007.⁶

The failure of Bear Stearns in March of 2008 sent shock waves through the financial system. The firm was adequately capitalized in accordance with regulatory requirements but highly leveraged.⁷ The immediate cause of its failure was a lack of confidence by its clients and counterparties, due to rumors and short-selling of its stock which set off a liquidity crisis. The firm lacked access to sufficient liquidity to meet its short-term obligations when its counterparties fled.

The Federal Reserve intervened to arrange a takeover of Bear Stearns by JPMorgan/Chase & Co., arranging \$29 billion in loans from its own coffers.

⁵ Congress had determined not to regulate swaps in the Commodity Modernization Act of 2000, which specifically forbade the states from regulating swaps. The swap market ballooned into an unregulated industry with a notional value of over \$60 trillion, much of it backstopped by AIG.

⁶ By September of 2008, the Dow Jones Industrial Average had plunged by some 4,000 points and stock indices worldwide lost 30 percent or more of their value. By mid-October, even after enactment of the EESA, the Dow had lost 6,000 points and 40 percent of its value from one year earlier.

⁷ The SEC in 2004 changed the net capital rules applicable to the largest investment banks, allowing Bear Stearns and other broker-dealers in its class to leverage 30:1 and higher.

Within days, the Federal Reserve opened a liquidity facility for primary securities dealers. This action, which might have saved Bear Stearns had it been available earlier, signaled both the depth of the impending financial crisis and the scope of the central bank's legal authority and determination to contain it.

C. The Crisis Unfolds

Meanwhile, home values kept falling, growing numbers of homeowners defaulted on their mortgages, consumer spending stalled, the price of oil skyrocketed, overall economic conditions deteriorated, and the jobless rate rose.

Rumors persisted about the financial health of other brokerage houses, banks, the GSEs, and insurance companies. Lehman Brothers and American International Group (AIG) were sources of particular concern, along with IndyMac Bank and Washington Mutual.

On July 11, 2008, IndyMac, a federal savings association in precarious condition due to its holdings of subprime mortgages, failed and was taken into receivership by the government.⁸

A short time later, concerns about the health of Fannie Mae and Freddie Mac prompted the Treasury Secretary to ask Congress for broad authority to reform the regulation of the GSEs and purchase their debt. On July 30, 2008, Congress passed the Housing and Economic Recovery Act, creating a new federal regulator for the GSEs and giving the Treasury Secretary unlimited authority to purchase their equity and debt obligations until December 31, 2009.

As losses at the GSEs mounted, the Treasury on September 7, 2008, placed the two giant companies into conservatorship with the new Federal Housing Finance Agency serving as conservator. The Treasury injected \$1 billion of capital into each company in exchange for preferred stock, took warrants to acquire up to 79 percent of the common stock of each company, and agreed to provide up to \$100 billion each to keep the companies afloat.

While the Treasury protected the GSEs' debt holders, the conservatorship wiped out preferred stockholders and caused a sell-off in shares of other financial institutions perceived as weak and susceptible to government takeover.

Lehman Brothers was the next to fall, with more profound consequences for the financial markets. On September 12, Lehman advised regulators that it would

⁸ A run on the bank was attributed to ill-advised public comments made by Senator Charles Schumer. See "Regulators Seize Mortgage Lender," *New York Times*, July 12, 2008 ("The run on the bank came after a critical letter about the bank from Senator Charles E. Schumer, Democrat of New York. Federal regulators said on Friday that Mr. Schumer's letter had prompted the collapse by causing the run and scaring away potential acquirers.").

need to file for bankruptcy unless the government arranged a buyer or otherwise rescued the company. The regulators worked on potential solutions over the weekend but found no buyers and decided to let the firm fail.⁹

That same weekend, Merrill Lynch sold itself to Bank of America Corporation, a move that astonished the market and heightened fears about the magnitude of the crisis. Morgan Stanley reported that it was in negotiations to sell a 20 percent interest in itself to the Mitsubishi Bank group.

Lehman filed for bankruptcy on September 15. The next day, the Reserve Primary Fund, a large money market mutual fund, announced that it held \$785 million of now worthless Lehman debt and would not be able to redeem its shares at the \$1 net asset value required under SEC regulations—i.e., it “broke the buck”, something no other major money fund had ever done before.¹⁰ The Reserve Fund’s announcement triggered a run on other money market mutual funds. Over the next two days, money funds saw net outflows of over \$300 billion.

The run on money funds caused the commercial paper market to seize up. The funds—major commercial paper holders—could not renew their holdings because of massive redemptions by fund shareholders. Major corporations, which rely on commercial paper proceeds to meet short-term operating expenses, faced the prospect of being unable to meet their payrolls or pay contractors and other creditors.

The Federal Reserve Board had been prepared to let AIG fail along with Lehman. But, seeing the run on money funds and other consequences of the Lehman bankruptcy, the Board on September 17 announced that it would loan the insurance giant \$85 billion in exchange for a 79 percent equity interest in the company.¹¹

The Federal Reserve’s balance sheet was ballooning fast and would double to \$1.5 trillion by the end of October and \$2 trillion by mid-November as a result of the expansion of its liquidity facilities for banks and other financial institutions.

⁹ Federal Reserve Chairman Bernanke later stated that Lehman had insufficient collateral to justify a loan from the central bank and that the Federal Reserve’s authority did not permit it to make uncollateralized loans. That reason is unpersuasive in light of the Board’s broad authority under section 13(3) of the Federal Reserve Act, which the Board later used to purchase unsecured commercial paper from corporate issuers.

¹⁰ One small money market mutual fund broke the buck in 1994. On the same day, Bank of New York’s Institutional Cash Reserves—not technically a money fund—also broke the buck due to Lehman holdings. Putnam’s Prime Money Market Fund announced that it was liquidating due to redemptions.

¹¹ This loan would prove inadequate. AIG asked for an additional \$35 billion and ultimately gained access to \$150 billion of federal money. AIG, the largest insurance company in the world, also was a major underwriter of credit default swaps.

The Federal Reserve also commenced dollar swap arrangements with foreign central banks to ease the growing demand for dollars abroad.

On September 18, Treasury Secretary Paulson and Federal Reserve Board Chairman Bernanke met with Congressional leaders to outline the dire consequences of the mounting crisis and request a Congressional mandate for broad action to avert an utter collapse of the financial system. In the meantime, the regulators set to work on a variety of rescue plans using their existing legal authorities as the financial crisis worsened.

On September 19, the Treasury announced that it would insure money market mutual funds—a major step to quell the run on money funds.

On September 22, Goldman Sachs and Morgan Stanley, both under pressure in the markets, announced that they would become bank holding companies under the regulation of the Federal Reserve Board. Morgan also agreed to sell a 20 percent stake in itself to Mitsubishi Bank Group. The exodus of these firms marked the end of an era on Wall Street—all of the big independent investment banking firms were gone.

On September 24, the government took receivership of Washington Mutual, the nation's largest savings and loan association, the sixth largest bank in the country, and a big originator of home loans. It was the biggest bank failure in U.S. history. The FDIC sold the closed bank to JPMorgan/Chase & Co., again wiping out shareholders, many of whom were employees and retirees who held their shares through pension funds and deferred compensation plans. The FDIC said it had to close the bank hastily because a run on deposits had developed.

A similar run on deposits caused the FDIC on September 28 to arrange a sale of Wachovia to Citigroup with \$12 billion of FDIC assistance and a cap on losses. This transaction unraveled a few days later when Wachovia instead agreed to be acquired by Wells Fargo in a deal that required no government assistance.

Finally, on October 3, Congress enacted the Economic Stabilization Act.

The Act did not immediately stabilize the financial markets. The credit markets by this time were in knots. Banks were refusing to lend to one another, let alone to issuers of commercial paper or other borrowers. The problem existed not only in the United States, but globally. The G-7 financial ministers met in Washington, D.C. on October 10 and pledged comprehensive coordinated action to deal with the global crisis.

Meanwhile, global stock markets plunged precipitously worldwide. The Dow touched below 7,000 during intraday trading. In a flight to safety, foreign investors sought refuge in U.S. Treasury securities, causing the value of the dollar to rise against foreign currencies and creating new pressures, particularly on

emerging market economies. The only bright news was a dramatic fall in the price of oil.

Using every legal authority at their disposal (and then some), the Treasury, Federal Reserve and other U.S. regulators commenced a variety of programs to unfreeze the markets and alleviate the mounting financial turmoil:

The Treasury activated its program to partially guarantee money market mutual funds.¹²

The Treasury announced that it would use \$250 billion of the \$700 billion appropriated by Congress to make direct capital injections in banks and other financial institutions.

The Federal Reserve created new liquidity facilities allowing money market mutual funds to off-load asset-backed commercial paper and short-term debt obligations.

The Federal Reserve began purchasing commercial paper directly from corporate issuers, including General Electric and General Motors.

The FDIC guaranteed bank debt obligations and business checking accounts at banks.

The SEC provided greater flexibility for the valuation of assets under the mark-to market accounting rules.

By the end of October, with the worldwide financial situation nearing critical condition, the effects of the EESA and related programs began to take hold and the credit markets eased. By this time, however, the financial crisis had turned into an economic crisis with major U.S. corporations (such as General Motors) on the verge of bankruptcy, joblessness on the rise, and more homeowners losing their homes.

II. OVERVIEW OF EESA

A. Purpose

The stated purpose of the EESA is simply to “provide authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and

¹² The Treasury scaled down the guaranty program after banks complained it would cause an outflow of deposits and create a competitive imbalance.

financial system and protecting taxpayers.”¹³ The Treasury is directed to use such authority and facilities in a manner designed to further several potentially conflicting public policies:

To protect home values, college funds, retirement accounts, and life savings;

To preserve homeownership and promote jobs and economic growth; and

To maximize overall returns to the taxpayers of the United States.¹⁴

In addition, the Treasury must use its authority in such a way as to provide “public accountability for the exercise of such authority.”¹⁵ In exercising the authorities granted under the Act, the Treasury Secretary is required to take into consideration the following nine factors:

- (1) protecting the interests of taxpayers by maximizing overall returns and minimizing the impact on the national debt;
- (2) providing stability and preventing disruption to financial markets in order to limit the impact on the economy and protect American jobs, savings, and retirement security;
- (3) the need to help families keep their homes and to stabilize communities;
- (4) in determining whether to engage in a direct purchase from an individual financial institution, the long-term viability of the financial institution in determining whether the purchase represents the most efficient use of funds under this Act;
- (5) ensuring that all financial institutions are eligible to participate in the program, without discrimination based on size, geography, form of organization, or the size, type, and number of assets eligible for purchase under this Act;
- (6) providing financial assistance to financial institutions, including those serving low- and moderate-income populations and other underserved communities, and that have assets less than \$1,000,000,000, that were well or adequately capitalized as

¹³ Pub. L. No. 343, 110th Cong. 2d Sess. (2008), § 2 (referred to herein as “EESA”).

¹⁴ *Id.*

¹⁵ *Id.*

of June 30, 2008, and that as a result of the devaluation of the preferred government-sponsored enterprises stock will drop one or more capital levels, in a manner sufficient to restore the financial institutions to at least an adequately capitalized level;

(7) the need to ensure stability for United States public instrumentalities, such as counties and cities, that may have suffered significant increased costs or losses in the current market turmoil;

(8) protecting the retirement security of Americans by purchasing troubled assets held by or on behalf of an eligible retirement plan described in clause (iii), (iv), (v), or (vi) of section 402(c)(8)(B) of the Internal Revenue Code of 1986, except that such authority shall not extend to any compensation arrangements subject to section 409A of such Code; and

(9) the utility of purchasing other real estate owned and instruments backed by mortgages on multifamily properties.¹⁶

B. Troubled Assets Relief Program (“TARP”)

The centerpiece of the EESA is the Troubled Asset Relief Program or “TARP” under which the Secretary of the Treasury is authorized to purchase troubled assets from any financial institution:

The Secretary is authorized to establish the Troubled Asset Relief Program (or “TARP”) to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures developed and published by the Secretary.¹⁷

As noted below, the definition of “financial institution” is broad and includes institutions that do not necessarily perform financial functions.

The Act authorizes the Secretary to take such actions as he deems necessary to carry out the TARP program, including hiring outside service providers (such as asset managers and custodians) and designating financial institutions as financial agents of the federal government.¹⁸ The Secretary also may establish vehicles to purchase, hold, and sell troubled assets and to issue obligations.¹⁹ Such vehicles

¹⁶ EESA § 103.

¹⁷ EESA § 101(a)(1).

¹⁸ EESA § 101(c)(2) and (3)..

¹⁹ EESA § 101(c)(4).

presumably would be trusts or other structured investment vehicles to facilitate the securitization of troubled assets.

1. Definition of “Troubled Assets”

The Act broadly defines the term “troubled assets” to include almost any financial asset issued or originated before March 14, 2008, the purchase of which by the Treasury would promote financial market stability. The statutory definition is as follows:

The term “troubled assets” means:

(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 [whenever issued] 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.²⁰

This definition appears broad enough to allow the Treasury to purchase equity interests in both healthy and troubled financial institutions as long as the Treasury Secretary determines that the equity purchase promotes financial market stability.

2. Definition of “Financial Institution”

The TARP program provides for the purchase of troubled assets from any “financial institution.” The term “financial institution” is broadly defined and includes institutions that do not necessarily perform financial functions:

The term “financial institution” means *any institution*, including, but 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, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa, or the United States Virgin Islands, and having significant operations in

²⁰ EESA § 3(9).

the United States, but excluding any central bank of, or institution owned by, a foreign government. (emphasis added)

The definition does not exclude U.S. branches and agencies of foreign banks unless they are government-owned. The definition specifically excludes any central bank of, or institution owned by, a foreign government.²¹

The definition also does not exclude auto makers or other non-financial companies. Thus, the Treasury Secretary would not necessarily be precluded from using TARP funds to assist such companies, as members of Congress requested him to do subsequent to the enactment of EESA.²² In its implementation of the TARP program, however, the Treasury has limited eligible institutions to banks, bank holding companies, and certain savings and loan holding companies.

3. Management of Troubled Assets

The Treasury Secretary is authorized to manage troubled assets acquired under the TARP program, including managing revenues and portfolio risks.²³ The Treasury may sell troubled assets and enter into securities loans, repurchase transactions, or other financial transactions in regard to any troubled asset purchased under the program. Any revenues generated from the troubled assets must be paid into the general fund of the Treasury to reduce the public debt.

The Secretary may exercise any rights received in connection with troubled assets purchased under TARP (such as warrants to purchase stock of a financial institution). The Secretary may hold any troubled asset purchased under the Act beyond the termination of the TARP program.²⁴

The Act authorizes the Secretary to use the proceeds from the sale of government securities to fund the TARP and its administration costs.²⁵

4. TARP Guidelines

The Act requires the Secretary to publish TARP program guidelines, including the following:

- Mechanisms for purchasing troubled assets

²¹ EESA § 3(5).

²² See “Strains Mount on Bailout Plans,” Wall St. J., Nov. 11, 2008 (“On Monday, members of the Michigan congressional delegation sent a letter to Mr. Paulson asking him to “immediately” use his authority to help the auto industry. House Speaker Nancy Pelosi (D., Calif.) and Senate Majority Leader Harry Reid (D., Nev.) made a similar request of Mr. Paulson over the weekend.”).

²³ EESA § 106.

²⁴ It appears that the authority to hold TARP assets is indefinite.

²⁵ EESA § 118.

- Methods for pricing and valuing troubled assets
- Procedures for selecting asset managers
- Criteria for identifying troubled assets for purchase.²⁶

In making purchases under the TARP program, the Act requires the Secretary to take “such steps as may be necessary to prevent unjust enrichment of financial institutions participating” in the program, including by preventing the sale of a troubled asset to the Secretary at a higher price than what the seller paid to purchase the asset. This requirement does not apply to troubled assets acquired in a merger or acquisition, or a purchase of assets from a financial institution in conservatorship, receivership or bankruptcy proceedings.

5. Office of Financial Stability

The Act requires the TARP program to be administered by a new Office of Financial Stability (“OFS”) within the Office of Domestic Finance inside the Treasury Department, to be headed by an Assistant Secretary appointed by the President with the advice and consent of the Senate. Until a presidential appointment is made, the Act authorizes the Treasury Secretary to appoint an interim Assistant Secretary.²⁷

6. Contracting Procedures

The Act authorizes the Secretary of the Treasury, in contracting with agents to assist in the implementation of the TARP, to waive specific provisions of the Federal Acquisition Regulation. The Secretary must determine that “urgent and compelling circumstances make compliance with such provisions contrary to the public interest” and provide a justification to Congress within seven days.²⁸

If the Secretary waives any provisions of the Federal Acquisition Regulation pertaining to minority contracting, the Secretary must develop and implement standards and procedures to ensure, to the maximum extent practicable, the inclusion and utilization of minorities and women, and minority- and women-owned in its contracts.

The Treasury is specifically directed to consider the Federal Deposit Insurance Corporation in the selection of asset managers for residential mortgage loans and residential mortgage-backed securities.

7. Conflicts of Interest

²⁶ EESA § 101(d).

²⁷ EESA § 101(a)(3).

²⁸ EESA § 107.

The Secretary is required to issue regulations or guidelines necessary to manage or prohibit conflicts of interest that may arise in connection with the administration of the TARP program, including the following:

- conflicts arising in the selection or hiring of contractors or advisors, including asset managers;
- the purchase of troubled assets;
- the management of the troubled assets held;
- post-employment restrictions on employees; and
- any other potential conflict of interest, as the Secretary deems necessary or appropriate in the public interest.²⁹

8. Troubled Assets Guarantee Program

The EESA requires the Treasury Secretary to establish a program to guarantee troubled assets.³⁰ The guarantee program comes into effect only if the Treasury establishes the TARP program. It applies only to assets originated or issued prior to March 14, 2008, including mortgage-backed securities.

a. Type of Guarantee

The Secretary has discretion on how to develop the program for guaranteeing troubled assets and the associated premiums for such guarantees, which may be determined by category or class of assets. The guarantee may cover the timely payment of principal and interest on troubled assets in amounts not to exceed 100 percent of such payments.

The guarantee is available on a voluntary basis to financial institutions that request guarantees on terms and conditions determined by the Secretary to be consistent with the purposes of this Act. Within 90 days after the date of enactment of EESA, the Treasury Secretary must report to Congress on the guarantee program.

b. Premiums

The Secretary is required to collect premiums from any financial institution participating in the program in an amount the Secretary determines is necessary to meet the purposes of the Act and to provide reserves sufficient to meet anticipated claims, based on an actuarial analysis, and to ensure that taxpayers are fully protected.

²⁹ EESA § 108.

³⁰ EESA § 102.

The Secretary may base premiums on product risk by providing for variations in premium rates according to the credit risk associated with the particular troubled asset that is being guaranteed. The Secretary must publish the methodology for setting the premium for a class of troubled assets, together with an explanation of the appropriateness of the class of assets for participation in the program.

Premiums must be invested in a Troubled Assets Insurance Financing Fund, which will be invested in U.S. Treasury securities or cash and used to pay guarantees.

9. \$700 Billion Authority

The EESA appropriated \$700 billion “outstanding at any one time” for the TARP program, which the Treasury Secretary can access in phases.³¹ The Secretary’s authority to use these funds is limited to \$250 billion as of the date of enactment. The limit increases to \$350 billion upon the President’s submission to Congress of a written certification that the Secretary needs the additional funds for the TARP program.

Thereafter, the limit on the Secretary’s spending authority increases to the full \$700 billion if the President transmits to the Congress a written report detailing the Secretary’s plan to utilize the funds, unless within 15 calendar days Congress enacts a joint resolution disapproving the Secretary’s plan. The Act includes extensive procedures for Congressional consideration of the joint resolution.³²

The amount of troubled assets purchased by the Secretary “outstanding at any one time” is determined by aggregating the purchase prices of all troubled assets held by the Secretary.³³ The limit is applied on a portfolio basis, and the size of the portfolio may be reduced by sales of equity interests or other assets acquired by the Treasury to make room for new purchases.

In light of the Treasury’s decision to utilize his TARP authority to purchase equity interests in healthy banks as well as troubled ones, the Treasury appears to be interpreting the aggregate limit as pertaining to any exercise of the Secretary’s purchase authority under the TARP program. As noted above, the definition of a “troubled asset” is broad and provides the Treasury Secretary with wide discretion.

³¹ EESA § 115. The \$700 billion purchase authority limit is reduced by an amount equal to the difference between the total of the outstanding guaranteed obligations and the balance in the Troubled Assets Insurance Financing Fund required by the Act, described above.

³² EESA § 115(c) and (d).

³³ EESA § 115(b).

To accommodate the \$700 billion and other expenses under the Act, the EESA increased the statutory public debt ceiling to \$1.315 trillion.³⁴

10. Minimization and Recouping of Costs

The Treasury is required to use its authority under the Act in a manner that will minimize the long-term impact on taxpayers:

The Secretary shall use the authority under this Act in a manner that will minimize any potential long-term negative impact on the taxpayer, taking into account the direct outlays, potential long-term returns on assets purchased, and the overall economic benefits of the program, including economic benefits due to improvements in economic activity and the availability of credit, the impact on the savings and pensions of individuals, and reductions in losses to the Federal Government.³⁵

In this regard, the Treasury is required to hold assets it acquires to maturity or for resale “for and until such time as the Secretary determines that the market is optimal for selling such assets” in order to maximize the value for taxpayers. The Treasury must sell the assets at a price it determines, based on available financial analysis, will “maximize return on investment for the Federal Government.”³⁶

The Act calls for the Director of the Office of Management and Budget to submit a report to Congress after five years on the net amount with the TARP program. If the report shows a shortfall, the President is required to submit a legislative proposal that “recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt.”³⁷

The recouping provision is vague and irrational. It does not define “financial industry,” for example. Does that term include banks that had nothing to do with the current problems affecting the financial system? Does it include insurance companies and mutual funds that benefit from various government relief programs? Does it include issuers of commercial paper who benefit from Federal Reserve Board’s commercial paper facility, like General Electric? Won’t financial institutions merely pass on to their customers (i.e., taxpayers) the cost of any recoupment charge? The measure appears to be a hyperbolic expression of Congressional discontent and most likely will be ignored or otherwise come to naught.

³⁴ EESA § 122.

³⁵ EESA 113(a).

³⁶ *Id.*

³⁷ EESA §134.

11. Private Sector and Market Mechanisms

The Act requires the Treasury to “encourage” the private sector to participate in purchases of troubled assets and to invest in financial institutions, consistent with the provisions of the Act.

The Treasury is required to make asset purchases “at the lowest price” consistent with the purposes of the Act and to “maximize the efficiency of the use of taxpayer resources” by using market mechanisms, including auctions or reverse auctions, where appropriate.³⁸ The Treasury may make direct purchases of troubled assets if the Secretary determines that the use of a market mechanism “is not feasible or appropriate” and the purposes of the Act would be best met through direct purchases from an individual financial institution.³⁹ The Treasury must pursue additional measures to ensure that prices paid for assets are reasonable and reflect the underlying value of the asset.

12. Warrants for Stock

The Treasury may not purchase any troubled asset from a financial institution under the authority of EESA unless it receives stock warrants from the institution.⁴⁰

In the case of a financial institution with publicly traded securities, the Secretary must receive a warrant for nonvoting common stock or preferred stock in the institution, or may receive voting stock with respect to which the Secretary agrees not to exercise voting power, as the Secretary deems appropriate. In the case of a financial institution without publicly traded securities, the Secretary may receive a warrant for common or preferred stock, or a senior debt instrument from the financial institution. No amount of stock is specified in the Act.

The warrants or senior debt instruments must include terms and conditions designed, at a minimum, to provide for reasonable participation by the Secretary, for the benefit of taxpayers, in equity appreciation in the case of a warrant or other equity security, or a reasonable interest rate premium in the case of a debt instrument.⁴¹ The instruments also must provide “additional protection for the taxpayer against losses from sale of assets” by the Secretary under EESA and cover the administrative expenses of the TARP.

The Secretary may sell, exercise, or surrender a warrant or any senior debt instrument received under the Act. The exercise price for any warrant will be set by the Secretary “in the interest of taxpayers.”

³⁸ EESA §113(a)(3) and (b).

³⁹ EESA § 113(c).

⁴⁰ EESA § 113(d).

⁴¹ EESA § 113(d).

Each warrant must have conversion features such that that if, after the warrant is received by the Secretary, the issuing financial institution is no longer listed or traded on a national securities exchange or securities association, the warrant will convert to senior debt. Or, the warrant may contain appropriate protections to ensure that the Treasury is appropriately compensated for the value of the warrant, in an amount determined by the Secretary.⁴²

Any warrant representing securities to be received by the Secretary must contain anti-dilution provisions “of the type employed in capital market transactions,” as determined by the Secretary. Such provisions must protect the value of the securities from market transactions such as stock splits, stock distributions, dividends, and other distributions, mergers, and other forms of reorganization or recapitalization.⁴³

The Treasury is required to establish de minimis exceptions to the warrant requirements for transactions of not more than \$100 million.

13. Public Disclosure

The Treasury is required to make publicly available reports of its asset purchases “to facilitate market transparency.”⁴⁴ The reports must include a description, amounts, and pricing of assets acquired under the Act and must be made available in electronic form within two business days of purchase, trade, or other disposition.

In addition, for each type of financial institution that sells troubled assets to the Treasury, the Secretary must determine whether the public disclosures required for institutions of that type with respect to off-balance sheet transactions, derivatives instruments, contingent liabilities, and similar sources of potential exposure is adequate to provide sufficient information to the public as to the true financial position of the institution. If such disclosures are not adequate for that purpose, the Secretary is required to make recommendations for additional disclosure requirements to the relevant regulators.⁴⁵

14. Termination of Authority

⁴² EESA §113(d)(2)(C). If a financial institution lacks sufficient nonvoting stock to fulfill its obligations under a warrant, the Secretary may, to the extent necessary, accept a senior debt note in an amount, and on such terms as will compensate the Secretary with equivalent value, in the event that a sufficient shareholder vote to authorize the necessary additional shares cannot be obtained.

⁴³ EESA §113(d)(2)(D).

⁴⁴ EESA § 114.

⁴⁵ *Id.*

The authority for the TARP and TARP Guarantee program expires on December 31, 2009. The Treasury’s authority to hold troubled assets acquired under the program, however, has no expiration date.⁴⁶

The Secretary may extend the expiration of TARP until October 3, 2010 upon certification to Congress that the extension is “necessary to assist American families and stabilize financial markets, as well as the expected cost to the taxpayers for such an extension.”⁴⁷ The Secretary must explain why this is so.

15. Oversight and Audits

The EESA provides numerous mechanisms for oversight and auditing of the Treasury’s implementation of the TARP program, as described below.⁴⁸

a. Consultation with Other Regulators

In exercising authority under the TARP program, the Secretary is required to consult with the Federal Reserve Board, Federal Deposit Insurance Corporation, Comptroller of the Currency, Director of the Office of Thrift Supervision, Chairman of the National Credit Union Administration Board, and Secretary of Housing and Urban Development.

b. Financial Stability Oversight Board

The Act creates a Financial Stability Oversight Board consisting of the Secretary of the Treasury, Chairman of the Federal Reserve Board, Director of the Federal Housing Finance Agency, Chairman of the Securities and Exchange Commission, and Secretary of Housing and Urban Development.⁴⁹ The Oversight Board is responsible for meeting monthly and:

(1) reviewing the exercise of authority under the TARP program, including—

(A) policies implemented by the Secretary and the Office of Financial Stability, including the appointment of financial agents, designation of asset classes to be purchased, and plans for the structure of vehicles used to purchase troubled assets; and

(B) the effect of such actions in assisting American families in preserving home ownership, stabilizing financial markets, and protecting taxpayers;

⁴⁶ EESA § 106(e).

⁴⁷ EESA § 120.

⁴⁸ EESA § 116.

⁴⁹ EESA § 104.

(2) making recommendations, as appropriate, to the Secretary regarding use of the authority under this Act; and

(3) reporting any suspected fraud, misrepresentation, or malfeasance to the Special Inspector General for the Troubled Assets Relief Program or the Attorney General of the United States.

In addition, the Oversight Board is authorized to ensure that the policies implemented by the Secretary are in accordance with the purposes of EESA, in the economic interests of the United States, and consistent with protecting taxpayers. The Oversight Board may appoint a credit review committee to evaluate the exercise of the purchase authority under TARP and the assets acquired the program.

The Oversight Board is required to report to Congress at least quarterly on the matters within its purview.

c. Reports to Congress

The Secretary of the Treasury is required to report to Congress within 60 days of exercising authority to purchase assets under the TARP program and every month thereafter.⁵⁰ The report must provide:

(1) an overview of actions taken by the Secretary, including the Secretary's consideration of the factors required to be considered in exercising authority under the TARP program;

(2) the actual obligation and expenditure of funds provided for administrative expenses; and

(3) a detailed financial statement with respect to the exercise of authority under this Act, including—

- all agreements made or renewed;
- all insurance contracts entered into under the TARP Guarantee program;
- all transactions occurring during such period, including the types of parties involved;
- the nature of the assets purchased;
- all projected costs and liabilities;

⁵⁰ EESA § 105.

- operating expenses, including compensation for financial agents;
- the valuation or pricing method used for each transaction; and
- a description of the vehicles established to exercise such authority.

The Treasury Secretary also is required to provide Congress with a written report including the following:

- a description of all of the transactions made during the reporting period;
- a description of the pricing mechanism for the transactions;
- a justification of the price paid for and other financial terms associated with the transactions;
- a description of the impact of the exercise of such authority on the financial system, supported, to the extent possible, by specific data;
- a description of challenges that remain in the financial system, including any benchmarks yet to be achieved; and
- an estimate of additional actions under the authority provided under this Act that may be necessary to address such challenges.

The report must be provided not later than seven days after the date on which commitments to purchase troubled assets first reach an aggregate of \$50 billion and not later than seven days after each additional \$50 billion.

d. Comptroller General Audits

The Comptroller General of the United States is required to oversee the activities and performance of the TARP and of any agents and representatives of the TARP, including any vehicles for holding TARP assets. The Comptroller General's oversight must cover the following:

- (A) The performance of the TARP in meeting the purposes of the Act, particularly those involving—
 - (i) foreclosure mitigation;
 - (ii) cost reduction;

(iii) whether it has provided stability or prevented disruption to the financial markets or the banking system; and

(iv) whether it has protected taxpayers.

(B) The financial condition and internal controls of the TARP, its representatives and agents.

(C) Characteristics of transactions and commitments entered into, including transaction type, frequency, size, prices paid, and all other relevant terms and conditions, and the timing, duration and terms of any future commitments to purchase assets.

(D) Characteristics and disposition of acquired assets, including type, acquisition price, current market value, sale prices and terms, and use of proceeds from sales.

(E) Efficiency of the operations of the TARP in the use of appropriated funds.

(F) Compliance with all applicable laws and regulations by the TARP, its agents and representatives.

(G) The efforts of the TARP to prevent, identify, and minimize conflicts of interest involving any agent or representative performing activities on behalf of or under the authority of the TARP.

(H) The efficacy of contracting procedures in evaluating proposals for inclusion and contracting to the maximum extent possible of minorities, women, and minority- and women-owned businesses, including ascertaining and reporting the total amount of fees paid and other value delivered by the TARP to all of its agents and representatives, and such amounts paid or delivered to such firms that are minority- and women-owned businesses.⁵¹

The Secretary is required to provide appropriate space and facilities to the Comptroller General within the Treasury Department as necessary to facilitate oversight of the TARP until the program. The Comptroller General is required to submit to Congress reports on the TARP program every 60 days

The Act requires the TARP to provide to Congress and the public financial statements in accordance with generally accepted accounting principles, and requires the Comptroller General to audit the TARP's financial statements. The

⁵¹ EESA § 116(a).

Secretary must take action to address any deficiencies identified by the Comptroller General or certify to Congress that no action is necessary or appropriate.

As a further check, the EESA requires the TARP to establish and maintain its own system of internal control to provide reasonable assurance of:

- the effectiveness and efficiency of operations, including the use of the resources of the TARP;
- the reliability of financial reporting, including financial statements and other reports for internal and external use; and
- compliance with applicable laws and regulations.

The Act also requires the TARP, in its annual financial statement, to:

- state the responsibility of management for establishing and maintaining adequate internal control over financial reporting; and
- state its assessment, as of the end of the most recent year covered by such financial statement of the TARP, of the effectiveness of the internal control over financial reporting.⁵²

e. Congressional Oversight Panel

In addition to the panoply of other oversight mechanisms in the Act, Congress authorized the creation of a five-member Congressional Oversight Panel to review the Treasury's implementation of the programs authorized under the Act.⁵³ The Oversight Panel may hold hearings and is directed to provide regular reports to Congress on the following:

- The use by the Secretary of authority under the Act, including the use of contracting authority and administration of the TARP program;
- The impact of purchases made under the Act on the financial markets and financial institutions;
- The extent to which the information made available on transactions under the program has contributed to market transparency; and

⁵² EESA § 116(c).

⁵³ EESA § 125. The five members of the Panel are named by Congressional leaders in the majority and minority in the House and Senate. The Speaker of the House and Majority Leader of the Senate name the fifth member in consultation with minority leaders.

- The effectiveness of foreclosure mitigation efforts, and the effectiveness of the program from the standpoint of minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers.

The Oversight Panel is directed to submit reports to Congress not later than 30 days after the first exercise by the Secretary of authority under the TARP program, and every 30 days thereafter.

16. Judicial Review

Actions by the Treasury under EESA are subject to judicial review and any final actions shall be held unlawful and set aside if found to be arbitrary, capricious, an abuse of discretion, or not in accordance with law.⁵⁴ No injunction or other form of equitable relief may be issued against the Secretary for actions under the TARP program other than to remedy a violation of the Constitution.

Any request for a temporary restraining order against the Secretary for actions pursuant to the Act must be considered and granted or denied by the appropriate court within three days of the date of the request. Any request for a permanent injunction against the Secretary must be considered and granted or denied by the court on an expedited basis.

No action or claims may be brought against the Secretary by any person that divests its assets with respect to its participation in a program under the Act, other than as expressly provided in a written contract with the Secretary or if the Secretary acts arbitrarily and capriciously or not in accordance with law.

Any injunction or other form of equitable relief issued against the Secretary shall be automatically stayed pending appeal by the Secretary within three days.

The terms of any residential mortgage loan that is part of any purchase by the Secretary under the TARP program will remain subject to all claims and defenses that otherwise would apply notwithstanding the purchase.

The Act provides that, except as established in any contract, a servicer of pooled residential mortgages owes any duty to determine whether the net present value of the payments on the loan, as modified, is likely to be greater than the anticipated net recovery that would result from foreclosure to all investors and holders of beneficial interests in such investment, but not to any individual or groups of investors or beneficial interest holders, and shall be deemed to act in the

⁵⁴ EESA § 119. The Treasury's original legislative proposal for the TARP would have provided for no judicial review of the Treasury's actions: "Decisions by the Secretary pursuant to the authority of this Act are non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency."

best interests of all such investors or holders of beneficial interests if the servicer agrees to or implements a modification or workout plan when the servicer takes reasonable loss mitigation actions, including partial payments.

C. Other Provisions

1. Federal Deposit Insurance

In order to help stabilize the banking system, the Act temporarily boosted the level of FDIC insurance for bank deposits.⁵⁵ Until December 31, 2009, the insured amount will increase to \$250,000 from \$100,000.⁵⁶ The Act provides that the temporary increase will not affect the amount of assessments on banks. In order to meet any claims under the new limit, the FDIC is authorized to borrow from the Treasury.

The Act also amended the Federal Deposit Insurance Act to make it unlawful for any person to represent or imply that any deposit liability, obligation, certificate, or share is insured or guaranteed by the FDIC, when it is not, by using the terms “Federal Deposit”, “Federal Deposit Insurance”, “Federal Deposit Insurance Corporation”, any combination of such terms, or the abbreviation “FDIC” as part of the business name or firm name of any person, including any corporation, partnership, business trust, association, or other business entity. The same prohibition applies to the use of such terms or any other terms, sign, or symbol as part of an advertisement, solicitation, or other document.⁵⁷ The Act also prohibits a person from otherwise knowingly misrepresenting that any deposit liability, obligation, certificate, or share is insured under the Federal Deposit Insurance Act if such is not so insured.

2. Certain Agreements “Contrary to Public Policy”

In a provision affecting mergers between insured depository institutions, the EESA amended the Federal Deposit Insurance Act to make certain agreements unenforceable. The amendment specifically declares the following contract provisions to be “contrary to public policy” and unenforceable to impose any liability:

Any provision contained in any existing or future standstill, confidentiality, or other agreement that, directly or indirectly—
(A) affects, restricts, or limits the ability of any person to offer to acquire or acquire, (B) prohibits any person from offering to acquire or acquiring, or (C) prohibits any person from using any previously disclosed information in connection with any such

⁵⁵ EESA § 136.

⁵⁶ A similar increase was authorized for credit unions.

⁵⁷ EESA § 126.

offer to acquire or acquisition of, all or part of any insured depository institution, including any liabilities, assets, or interest therein, in connection with any transaction in which the [FDIC] exercises its authority under section 11 or 13.⁵⁸

This provision was cited by Wells Fargo & Company when it entered into an agreement to acquire Wachovia Corporation several days after Citigroup entered into an agreement in principle to acquire Wachovia in an FDIC-assisted transactions. Wells Fargo argued that this provision effectively voided Citigroup's agreement in principle.⁵⁹ The matter resulted in litigation between the parties.

3. Help for Homeowners and Tenants

In addition to the TARP program, which is aimed at financial institutions, the EESA includes provisions designed to help homeowners more directly. The Act requires the Secretary, when acquiring mortgages, mortgage-backed securities, and other assets secured by residential real estate, including multifamily housing, to implement a plan that seeks to “maximize assistance for homeowners” and to encourage the servicers of the underlying mortgages, “considering net present value to the taxpayer,” to take advantage of the HOPE for Homeowners Program or other available programs to minimize foreclosures.⁶⁰ In addition, the Secretary is authorized to use loan guarantees and credit enhancements to facilitate loan modifications to prevent “avoidable foreclosures.”

The Secretary is directed to coordinate with other federal agencies to “identify opportunities for the acquisition of classes of troubled assets that will improve the ability of the Secretary to improve the loan modification and restructuring process and, where permissible, to permit bona fide tenants who are current on their rent to remain in their homes under the terms of the lease.” In the case of a mortgage on a residential rental property, the plan must include provisions for “protecting Federal, State, and local rental subsidies and protections, and ensuring that any modification takes into account the need for operating funds to maintain decent and safe conditions at the property.”⁶¹

The Act further provides that, “upon any request arising under existing investment contracts,” the Secretary shall consent “where appropriate, and

⁵⁸ EESA § 126(c).

⁵⁹ See “Wells Fargo Asks Court to Void Citi’s Wachovia Deal,” New York Times, Oct. 15, 2008 (“In a complaint filed Tuesday with the U.S. district court in Manhattan, Wells Fargo said the earlier agreement is unenforceable under the government’s \$700 billion banking industry bailout because it is ‘contrary to public policy.’ Wells Fargo asked for a ruling that the Citigroup agreement is unenforceable to the extent it may have prohibited Wachovia from considering another merger offer, and to bar damages premised on the idea that the agreement could be enforced.”).

⁶⁰ EESA § 109.

⁶¹ EESA § 109(b).

considering net present value to the taxpayer” to reasonable requests for loss mitigation measures, including term extensions, rate reductions, principal write downs, increases in the proportion of loans within a trust or other structure allowed to be modified, or removal of other limitation on modifications.

The Act also requires each federal agency that holds, owns, or controls mortgages, mortgage-backed securities, or other assets secured by residential real estate (for example, as acquired by the FDIC in a bank failure) to implement a plan that seeks to “maximize assistance for homeowners.” Each agency also must use its authority to encourage the servicers of the underlying mortgages “considering net present value to the taxpayer” to take advantage of the HOPE for Homeowners Program or other available programs to minimize foreclosures.⁶² Modifications to residential mortgage loans may include the following:

- reduction in interest rates;
- reduction of loan principal; and
- other similar modifications.⁶³

The federal agency plans must begin within 60 days after the date of enactment the Act and each agency must report to Congress on a monthly basis specific information on the number and types of loan modifications made and the number of actual foreclosures occurring during the reporting period.

If a federal agency is not the owner of a residential mortgage loan, but holds an interest in obligations or pools of obligations secured by residential mortgage loans, the agency must encourage implementation by the loan servicers of loan modifications and assist in facilitating any such modifications to the extent possible.

4. Executive Compensation

Limiting executive compensation at financial institutions was a major goal of many members of Congress who voted for the TARP and the Act includes provisions for this purpose. Under the Act, any financial institution that sells troubled assets to the Treasury is subject to limitations on executive compensation.⁶⁴

When the Treasury makes direct purchases of troubled assets from an individual financial institution where no bidding process or market prices are

⁶² EESA § 110.

⁶³ In the case of mortgages on residential rental properties, modifications must ensure the continuation of any existing Federal, State, and local rental subsidies and protections and ensure that modifications take into account the need for operating funds to maintain “decent and safe conditions at the property.”

⁶⁴ EESA § 111.

available, and the Secretary receives a meaningful equity or debt position in the financial institution as a result, the Secretary must require the institution to meet “appropriate standards” for executive compensation and corporate governance that will be effective as long as the Treasury holds an equity or debt position in the financial institution. The appropriate standards include:

- Limits on compensation that exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of the financial institution during the period that the Treasury holds an equity or debt position in the financial institution;
- A provision for the recovery by the financial institution of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate; and
- A prohibition on the financial institution making any golden parachute payment to its senior executive officers during the period that the Treasury holds an equity or debt position in the financial institution.

Other restrictions apply if the Treasury purchases troubled assets by auction and such purchases per financial institution in the aggregate exceed \$300,000,000 (including direct purchases). Then the Treasury must prohibit the financial institution from entering into any new employment contract with a senior executive officer that provides a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership. The Treasury is required to issue guidance to carry out this provision.

The term “senior executive” means an individual who is one of the top five highly paid executives of a public company, whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934, and any regulations issued thereunder, and non-public company counterparts.

The limitations on executive compensation lapse after the TARP program ends.

5. Coordination with Foreign Authorities

The Act directs the Treasury Secretary to coordinate with foreign financial authorities and central banks, as appropriate, to work toward the establishment of programs similar to the TARP by such authorities and central banks.

To the extent that foreign financial authorities or banks hold troubled assets as a result of extending financing to U.S. financial institutions that have failed or

defaulted on such financing, the Act provides that such troubled assets qualify for purchase under the TARP program.

6. Disclosure of Federal Reserve Board Loans

The Act requires the Federal Reserve Board to report to Congress on the use of the Board's emergency lending authority under section 13 of the Federal Reserve Act (i.e. the authority relied on by the Board to make loans to Bear Stearns and AIG).⁶⁵

Within seven days after exercising such authority, the Board is required to report to the House Financial Services Committee, the Senate Committee on Banking, Housing, and Urban Affairs, and the Congressional Oversight Panel. The report must include the justification for exercising the authority and the specific terms of the Board's actions, including the size and duration of any loans, the value of collateral held with respect to any such loan, the recipient of warrants or any other potential equity in exchange for the loan, and any expected cost to the taxpayers for such exercise. The must provide updates at least once every 60 days for the duration of any loan, including the status of the loan, the value of the collateral held, and the projected cost to the taxpayers of the loan. The Board may request that this information be kept confidential, in which case it is available only to the committee chairmen.

This provision applies to loans made by the Board beginning on March 1, 2008, including the loans to Bear Stearns and AIG.

7. Tax Relief on GSE Investment Losses

The Act provides tax relief for banks that suffered losses on certain holdings of Fannie Mae and Freddie Mac perpetual preferred stock. The Act changed the character of these losses from capital to ordinary losses for federal income tax purposes.⁶⁶ Prior to enactment of EESA, losses on sales of Fannie Mae and Freddie Mac preferred stock by banks generally were considered capital gains and losses for federal income tax purposes.

In order to maximize the benefit of this tax relief, the federal banking agencies allowed banking organizations to recognize the effect of the tax change in their third quarter 2008 regulatory capital calculations on their Call Reports, even though the relief was enacted after the close of the third quarter (i.e., on EESA's date of enactment, October 3, 2008).⁶⁷ Absent such relief, under generally accepted accounting principles, banks could not have recorded the effect of this tax change

⁶⁵ EESA § 129.

⁶⁶ EESA § 301.

⁶⁷ See Federal Deposit Insurance Corporation, FIL-112-2008 (Oct. 29, 2008).

until the fourth quarter of 2008. This relief applies only for regulatory capital purposes and not for balance sheet and income statement purposes.

8. Reports on the Financial System

The EESA mandates several studies and reports addressing various issues involving regulation of the financial services industry, as described below.

a. Regulatory Reform

The Oversight Panel appointed by Congress under the Act is required to review the current state of the financial markets and the regulatory system and to submit a special report on regulatory reform no later than January 20, 2009.⁶⁸ The special report must “analyze the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers” and must provide recommendations for improvement. Specifically, the recommendations must address, among other things, “whether any participants in the financial markets that are currently outside the regulatory system should become subject to the regulatory system, the rationale underlying such recommendation, and whether there are any gaps in existing consumer protections.” This provision appears to be aimed at hedge funds and issuers of credit default swaps.

The Treasury similarly is required to review the current state of the financial markets and the regulatory system and to submit a written report to Congress no later than April 30, 2009.⁶⁹ The Treasury’s report must analyze “the current state of the regulatory system and its effectiveness at overseeing the participants in the financial markets, including the over-the-counter swaps market and government-sponsored enterprises.” The report must include recommendations, and the rationale for such recommendations, addressing “whether any participants in the financial markets that are currently outside the regulatory system should become subject to the regulatory system” and “enhancement of the clearing and settlement of over-the-counter swaps.”

b. Financial Institution Leveraging

The Act directs the Comptroller General to undertake a study to determine “the extent to which leverage and sudden deleveraging of financial institutions was a factor behind the current financial crisis.”⁷⁰ The study must include an analysis of the roles and responsibilities of the Federal Reserve Board, Securities and Exchange Commission, the Secretary of the Treasury, and other federal banking agencies with respect to “monitoring leverage and acting to curtail excessive leveraging.”

⁶⁸ EESA § 125(b).

⁶⁹ EESA § 105(c).

⁷⁰ EESA § 117.

The Comptroller General is specifically directed to report on the authority of the Federal Reserve Board to “regulate leverage, including by setting margin requirements.” The study must discuss “what process the Board used to decide whether or not to use its authority” and “any usage of the margin authority by the Board.” The Comptroller General is directed to make recommendations to the Board and appropriate committees of Congress with respect to the Board’s existing authority. The study is due to Congress no later than June 1, 2009.

c. Mark-to-Market Accounting

The Act calls for a study on mark-to-market accounting standards by the SEC in consultation with the Federal Reserve Board and Treasury.⁷¹ The study must cover mark-to-market accounting standards as provided in Statement Number 157 of the Financial Accounting Standards Board, as such standards are applicable to financial institutions, including depository institutions. The study at a minimum must consider the following:

- the effects of such accounting standards on a financial institution's balance sheet;
- the impacts of such accounting on bank failures in 2008;
- the impact of such standards on the quality of financial information available to investors;
- the process used by the Financial Accounting Standards Board in developing accounting standards;
- the advisability and feasibility of modifications to such standards; and
- alternative accounting standards to those provided in FASB 157.

The report must be submitted to Congress within 90 days of enactment of EESA and must include such findings and recommendations as the SEC deems appropriate.

The Act also authorizes the SEC to suspend the application of FASB 157 for any issuer or with respect to any class or category of transaction if the SEC determines that such action is necessary or appropriate in the public interest and is

⁷¹ EESA §133.

consistent with the protection of investors. This provision is not intended to limit the SEC's otherwise existing authority to do so.⁷²

9. Guarantee of Money Market Mutual Funds

Prior to enactment of EESA, the Treasury established a temporary guarantee program for money market mutual funds using monies available in the Exchange Stabilization Fund.⁷³ EESA requires the Treasury to reimburse the Fund for any monies used under that program from the \$700 billion authorized under EESA and prohibits the Treasury from using the Fund for the establishment of any future guaranty programs for the money market mutual fund industry.⁷⁴

The effect of this provision in EESA appears to be to acquiesce in the existing guarantee program but to force Treasury to rely on its authority under TARP to fund any future guarantee program for the money fund industry.

III. IMPLEMENTATION OF EESA

The Treasury and other government agencies commenced steps to implement the EESA immediately upon its enactment.

A. Administration of TARP Program

1. Office of Financial Stability

On October 6, 2008, the Treasury named Neel Kashkari as interim head of the Office of Financial Stability to oversee the TARP program.⁷⁵ In a speech the following week, Mr. Kashkari stated that Treasury would be implementing its new authorities with “one simple goal—to restore capital flows to the consumers and businesses that form the core of our economy.”⁷⁶ Achieving this goal, he said, “will require multiple tools to help financial institutions remove illiquid assets from their balance sheets, and attract both private and public capital.”

Based on the broad authority provided by EESA, Mr. Kashkari stated that Treasury was “working very closely with both domestic and international regulators to understand how best to design tools that will be most effective in dealing with the challenges in our financial system.” The toolkit was being designed to help financial institutions of all sizes, he said.

⁷² Prior to enactment of EESA, on September 30, 2008, the SEC issued guidance on FASB 157 emphasizing its flexibility in its application to financial institutions.

⁷³ See Treasury Announces Guaranty Program for Money Market Funds, Treasury Press Release HP-1147 (Sept. 19, 2008).

⁷⁴ EESA § 131.

⁷⁵ Treasury Press Release HP-1184 (Oct. 6, 2008).

⁷⁶ Treasury Press Release HP-1199 (Oct. 13, 2008).

Mr. Kashkari emphasized that the EESA gave Treasury broad and flexible powers, including the authority to purchase equity interests in banks:

The law gives the Treasury Secretary broad and flexible authority to purchase and insure mortgage assets, and to purchase any other financial instrument that the Secretary, in consultation with the Federal Reserve Chairman, deems necessary to stabilize our financial markets—including equity securities. Treasury worked hard with Congress to build in this flexibility because the one constant throughout the credit crisis has been its unpredictability.

The law empowers Treasury to design and deploy numerous tools to attack the root cause of the current turmoil: the capital hole created by illiquid troubled assets. Addressing this problem should enable our banks to begin lending again.⁷⁷

Mr. Kashkari outlined seven areas where the Treasury had established policy teams to develop tools and program elements required under the TARP and described them as follows:

1. Mortgage-backed securities purchase program: This team is identifying which troubled assets to purchase, from whom to buy them and which purchase mechanism will best meet our policy objectives. Here, we are designing the detailed auction protocols and will work with vendors to implement the program.

2. Whole loan purchase program: Regional banks are particularly clogged with whole residential mortgage loans. This team is working with bank regulators to identify which types of loans to purchase first, how to value them, and which purchase mechanism will best meet our policy objectives.

3. Insurance program: We are establishing a program to insure troubled assets. We have several innovative ideas on how to structure this program, including how to insure mortgage-backed securities as well as whole loans. At the same time, we recognize that there are likely other good ideas out there that we could benefit from. Accordingly, on Friday we submitted to the Federal Register a public Request for Comment to solicit the best ideas on structuring options. We are requiring responses within fourteen days so we can consider them quickly, and begin designing the program.

⁷⁷ *Id.*

4. Equity purchase program: We are designing a standardized program to purchase equity in a broad array of financial institutions. As with the other programs, the equity purchase program will be voluntary and designed with attractive terms to encourage participation from healthy institutions. It will also encourage firms to raise new private capital to complement public capital.

5. Homeownership preservation: When we purchase mortgages and mortgage-backed securities, we will look for every opportunity possible to help homeowners. This goal is consistent with other programs - such as HOPE NOW - aimed at working with borrowers, counselors and servicers to keep people in their homes. In this case, we are working with the Department of Housing and Urban Development to maximize these opportunities to help as many homeowners as possible, while also protecting taxpayers.

6. Executive compensation: The law sets out important requirements regarding executive compensation for firms that participate in the TARP. This team is working hard to define the requirements for financial institutions to participate in three possible scenarios: One, an auction purchase of troubled assets; two, a broad equity or direct purchase program; and three, a case of an intervention to prevent the impending failure of a systemically significant institution.

7. Compliance: The law establishes important oversight and compliance structures, including establishing an Oversight Board, on-site participation of the General Accounting Office and the creation of a Special Inspector General, with thorough reporting requirements. We welcome this oversight and have a team focused on making sure we get it right.⁷⁸

2. Capital Purchase Plan

On October 14, 2008, Treasury Secretary Paulson announced the first major deployment of funds under the \$700 billion budget provided by Congress. Instead of a program to purchase troubled assets from financial institutions as had been anticipated, he announced a plan to inject capital into healthy as well as troubled banks. The Treasury Secretary apparently concluded that a direct injection of capital into the banking industry would be a more immediate and effective way to

⁷⁸ *Id.*

utilize the EESA funding, although he did not rule out a program to purchase troubled assets.⁷⁹

Under the Capital Purchase Plan announced by Mr. Paulson, the Treasury will utilize \$250 billion of funds under EESA to purchase equity securities of financial institutions.⁸⁰ Secretary Paulson announced that, as a first step, nine of the largest financial institutions had agreed to participate in the program on a voluntary basis:

Today I am announcing that the Treasury will purchase equity stakes in a wide array of banks and thrifts. Government owning a stake in any private U.S. company is objectionable to most Americans – me included. Yet the alternative of leaving businesses and consumers without access to financing is totally unacceptable. When financing isn't available, consumers and businesses shrink their spending, which leads to businesses cutting jobs and even closing up shop.

To avoid that outcome, we must restore confidence in our financial system. The first step in that effort is a plan to make capital available on attractive terms to a broad array of banks and thrifts, so they can provide credit to our economy. From the \$700 billion financial rescue package, Treasury will make \$250 billion in capital available to U.S. financial institutions in the form of preferred stock. Institutions that sell shares to the government will accept restrictions on executive compensation, including a clawback provision and a ban on golden parachutes during the period that Treasury holds equity issued through this program. In addition, taxpayers will not only own shares that should be paid back with a reasonable return, but also will receive warrants for common shares in participating institutions. We expect all participating banks to continue and to strengthen their efforts to help struggling homeowners who can afford their homes avoid foreclosure. Foreclosures not only hurt the families who lose their homes, they hurt neighborhoods, communities and our economy as a whole.

While many banks have suffered significant losses during this period of market turmoil, many others have plenty of capital to get through this period, but are not positioned to lend as widely

⁷⁹ The Treasury's decision to take this action undoubtedly was influenced by the actions of European financial regulators that had begun to make direct capital injections into European banks.

⁸⁰ Treasury Press Releases HP-2305 and HP-1207 (Oct. 14, 2008). As a point of information, the FDIC is prohibited from using its powers under the Federal Deposit Insurance Act to purchase common stock of any insured financial institution. *See* 12 U.S.C. § 1823(c)(5).

as is necessary to support our economy. Our goal is to see a wide array of healthy institutions sell preferred shares to the Treasury, and raise additional private capital, so that they can make more loans to businesses and consumers across the nation. At a time when events naturally make even the most daring investors more risk-averse, the needs of our economy require that our financial institutions not take this new capital to hoard it, but to deploy it.

Nine large financial institutions have already agreed to participate in this program. They have agreed to sell preferred shares to the US government, on the same terms that will be available to a broad array of small and medium-sized banks and thrifts across the nation. These are healthy institutions, and they have taken this step for the good of the U.S. economy. As these healthy institutions increase their capital base, they will be able to increase their funding to U.S. consumers and businesses.⁸¹

The nine large financial institutions that initially agreed to participate in the program are JPMorgan/Chase & Co., Citigroup, Bank of America, Wells Fargo, State Street, Merrill Lynch, Morgan Stanley, and Goldman Sachs. While the program is “voluntary,” it was generally assumed that the Treasury strong armed healthy banks to participate in the program in order to avoid creating a stigma for problem banks that participate in the program.

Legal Authority

The Treasury’s capital purchase plan appears to be grounded on solid legal authority under the EESA. Although the principal purpose of EESA had been perceived as authorizing the Treasury to purchase toxic assets from financial institutions, the Act also gives the Treasury broad discretion to purchase equity interests in financial institutions. As noted above, the definition of a “troubled asset” includes, in addition to mortgages and mortgage-related securities:

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.⁸²

Preferred stock and other equity interests of financial institutions would fall within this definition. Assuming that the consultation and Congressional

⁸¹ Statement of Treasury Secretary Henry Paulson, October 14, 2008. *Id.*

⁸² EESA § 3(9)(b).

notification provisions were satisfied, there does not appear to be any question that the Treasury's capital purchase plan is consistent with its authority under EESA.

Ironically, under the draft legislative proposal originally submitted to Congress by the Treasury, the Treasury would not have had such authority.

Uses of Capital

The Treasury initially did not impose any limitation on the uses of the capital injections by banks participating in the program. After some banks indicated that they would use the capital to acquire other institutions,⁸³ the Chairman of the House Financial Services Committee issued the following statement stating that the funds must be used for lending and "no other purpose":

I am deeply disappointed that a number of financial institutions are distorting the legislation that Congress passed at the President's request to respond to the credit crisis by making funds available for increased lending. Any use of these funds for any purpose other than lending—for bonuses, for severance pay, for dividends, for acquisitions of other institutions, etc.-- is a violation of the terms of the Act.

I appreciate the fact that the Secretary of the Treasury has reemphasized that increased lending activity is the only legitimate purpose for taxpayer funding of these institutions. He must make it absolutely clear to any participating entity that the federal government will insist on compliance.

On November 12th and November 18th the House Financial Services Committee will hold oversight hearings on legislation Congress has passed to cope with the financial crisis. It is very important if Congressional and public support for this program is to continue that we receive assurances at those hearings that the money being advanced will be used only for relending and for no other purpose.⁸⁴

Amount of Investment

The Treasury said it would purchase up to an aggregate of \$250 billion of senior preferred shares on standardized terms.⁸⁵ The term sheet provided for a

⁸³ Shortly after receiving its capital injection, PNC Financial Corporation announced that it would acquire National City Corporation. The CEO of JPMorgan/Chase was reported to have said that he also intended to use the capital injection to acquire other banks.

⁸⁴ Statement by Barney Frank, Chairman, House Financial Services Committee, Oct. 31, 2008.

⁸⁵ See Treasury Press Release HP-1207 (Oct. 14, 2008) and Term Sheet attached thereto.

minimum subscription amount to each participating institution of one percent of the institution's risk-weighted assets. The initial maximum subscription amount was the lesser of \$25 billion or 3 percent of risk-weighted assets. The Treasury said it would fund the senior preferred shares purchased under the program by year-end 2008.

Eligible Institutions

The program is available only to bank holding companies, financial holding companies, insured depository institutions, and savings and loan holding companies that engage solely or predominately in activities that are permissible for financial holding companies. To qualify, an applicant must be established and operating in the United States and may not be controlled by a foreign bank or company.⁸⁶ Institutions must consult with their appropriate federal banking regulator prior to submitting this application.

In order to qualify, a financial institution was required to elect to participate before 5:00 pm (EDT) on November 14, 2008. Treasury said it would determine eligibility and allocations for each financial institution after consultation with the appropriate federal banking agency.

Tier 1 Capital Paying Dividends

The senior preferred shares qualify as Tier 1 capital and rank senior to common stock and *pari passu* (which is at an equal level in the capital structure) with existing preferred shares, other than preferred shares which by their terms rank junior to any other existing preferred shares.

The senior preferred shares pay a cumulative dividend rate of five percent per annum for the first five years. The dividend resets to a rate of nine percent per annum after year five—an inducement to institutions to redeem the shares after year five.

Nonvoting Shares

The senior preferred shares are non-voting, but have voting rights on matters that could adversely affect the shares. The shares are callable at par after three years from the date of the investment.

Redemption and Transferability

The Treasury can transfer the senior preferred shares to a third party at any time. Prior to the end of three years, the senior preferred may be redeemed with the

⁸⁶ The omission of foreign-owned institutions may have been in recognition that such institutions are covered by similar capital injection plans by their home countries.

proceeds from a qualifying equity offering of any Tier 1 perpetual preferred or common stock.

The Treasury's consent is required for any share repurchases (other than repurchases of the senior preferred or junior preferred shares or common shares in connection with any benefit plan in the ordinary course of business) until the third anniversary of the date of the Treasury's investment, unless prior to such third anniversary the senior preferred is redeemed in whole or the Treasury has transferred all of the senior preferred to third parties. In general, no share repurchases are allowed of junior preferred shares, preferred shares ranking *pari passu* with the senior preferred, or common shares.

Warrants

In conjunction with the purchase of senior preferred shares, Treasury receives warrants to purchase common stock with an aggregate market price equal to 15 percent of the senior preferred investment. The initial exercise price for the warrants, and the market price for determining the number of shares of common stock subject to the warrants, is the market price for the common stock on the date of the Treasury's investment (calculated on a 20-trading day trailing average), subject to customary anti-dilution adjustments. The exercise price is reduced by 15 percent of the original exercise price on each six-month anniversary of the issue date of the warrants if the consent of the institution's shareholders is not received, subject to a maximum reduction of 45 percent of the original exercise price.

The term of the warrants is ten years, and they are immediately exercisable, in whole or in part. The Treasury agrees, however, not to exercise voting power with respect to any shares of common stock it receives upon exercise of the warrants.

The warrants are not subject to any contractual restrictions on transfer, provided that the Treasury may transfer or exercise an aggregate of one half of the warrants prior to the earlier of December 31, 2009 or the date on which the institution has received aggregate gross proceeds of not less than 100 percent of the issue price of the senior preferred from one or more qualified equity offerings.⁸⁷

⁸⁷ "Qualified equity offering" means the sale by the financial institution after the date of the investment of Tier 1 qualifying perpetual preferred stock or common stock for cash. The institution must file a shelf registration statement covering the warrants and the common stock underlying the warrants as promptly as practicable after the date of this investment and, if necessary, must take all action required to cause such shelf registration statement to be declared effective as soon as possible. The institution also is required to grant to the Treasury piggyback registration rights for the warrants and the common stock underlying the warrants and take such other steps as may be reasonably requested to facilitate the transfer of the warrants and the common stock underlying the warrants. The institution must will apply for the listing on the national exchange on which the institution's

The amount of warrants issued to the Treasury will be reduced as follows. If the institution receives aggregate gross proceeds of 100 percent of the issue price of the senior preferred from one or more qualified equity offerings on or prior to December 31, 2009, the number of shares of common stock underlying the warrants then held by the Treasury will be reduced by a number of shares equal to the product of (i) the number of shares originally underlying the warrants (taking into account all adjustments) and (ii) one-half of one percent (0.5).

Restrictions on Dividends

For as long as any senior preferred shares are outstanding, a financial institution may not declare or pay dividends on junior preferred shares, preferred shares ranking pari passu with the senior preferred, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the senior preferred), nor may the institution repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the senior preferred or common shares, unless (i) in the case of cumulative senior preferred all accrued and unpaid dividends for all past dividend periods on the senior preferred are fully paid or (ii) in the case of non-cumulative senior preferred the full dividend for the latest completed dividend period has been declared and paid in full.

The Treasury's consent is required for any increase in common dividends per share until the third anniversary of the date of the investment unless prior thereto the senior preferred is redeemed in whole or the Treasury has transferred all of the senior preferred to third parties.

Executive Compensation Limitations

Companies participating in the program are required to adopt the Treasury Department's standards for executive compensation and corporate governance for the period during which Treasury holds equity issued under the program. These standards generally apply to the chief executive officer, chief financial officer, and the next three most highly compensated executive officers. In this regard, each institution is required to modify or terminate all benefit plans, arrangements and agreements (including golden parachute agreements) to the extent necessary to comply with the executive compensation limitations applicable under EESA for the duration of the Treasury's equity investment.⁸⁸ Each institution must meet the following standards:

common stock is traded of the common stock underlying the warrants and take such other steps as may be reasonably requested to facilitate the transfer of the warrants or the common stock.

⁸⁸ Each institution and its senior executive officers also must grant to the Treasury a waiver releasing it from any claims that the institution and such officers may otherwise have as a result of the issuance of any regulations which modify the terms of benefits plans, arrangements and

ensure that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution;

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;

prohibit on the financial institution from making any golden parachute payment to a senior executive based on the Internal Revenue Code provision; and

agree not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive.

Treasury issued interim final rules for these executive compensation standards, as described below.

On October 20, 2008, the Treasury Department published interim final regulations to provide guidance on the executive compensation and corporate governance provisions of EESA with respect to the capital purchase plan.⁸⁹ The regulations are complex and include references to specific provisions of the securities laws and the Internal Revenue Code.

The regulations clarify that the executive compensation requirements apply not only to the financial institution that participates in the program, but also to any other entity in its controlled group (i.e., parent and subsidiary companies based on an 80-percent ownership test; but not sister organizations).

The compensation limitations generally apply to the chief executive officer, the chief financial officer, and the three mostly highly compensated executive officers. The latter are determined according by reference to total compensation for the last completed fiscal year. Until the compensation data for the current fiscal year are available, a financial institution is expected make its best efforts to identify the three most highly compensated executive officers for the current fiscal year.

For purposes of participation in the capital purchase program, the regulations require a financial institution's compensation committee to identify any features in the institution's senior executive officer incentive compensation arrangements that could lead senior executives to take "unnecessary and excessive

agreements to eliminate any provisions that would not be in compliance with the executive compensation and corporate governance requirements of the EESA.

⁸⁹ 73 Fed. Reg. 62,205 (Oct. 20, 2008); 31 C.F.R. Pt. 30.

risks that could threaten the value of the financial institution.” The regulations require that the compensation committee review the compensation arrangements with the institution’s senior risk officers to ensure that senior executives are not encouraged to take such risks. Such review must occur promptly, and in no case more than 90 days, after participation in the capital purchase program.

The regulations also require that the compensation committee meet at least annually with the financial institution’s senior risk officers to discuss and review the relationship between the financial institution’s risk management policies and practices and the senior executive incentive compensation arrangements. In addition, the compensation committee is required to certify that it has completed the reviews of the compensation arrangements as outlined above. Financial institutions with securities registered with the SEC must disclose the certifications in filings under the federal securities laws. Financial institutions that do not have securities registered with the SEC are required to provide the certifications to their primary regulatory agency.

The regulations provide that bonus and incentive compensation paid to senior executives during the period that the Treasury holds an equity or debt position under the capital purchase program must be subject to recovery or “clawback” by the financial institution if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.

The regulations also prohibit a financial institution from making any golden parachute payment to a senior executive officer during the period the Treasury holds an equity or debt position in the institution pursuant to the capital purchase plan. A “golden parachute” is defined to mean any payment in the nature of compensation to (or for the benefit of) a senior executive officer “made on account of an applicable severance from employment to the extent the aggregate present value of such payments equals or exceeds an amount equal to three times the [officer’s] base amount.”

The regulations include a special rule for cases in which a financial institution that has sold troubled assets to the Treasury through the capital purchase program is acquired by an entity in an acquisition of any form. Under this rule, the acquirer does not become subject to the executive compensation requirements merely as a result of the acquisition.

The regulations set forth an additional standard on the tax deductibility of senior executive compensation, as required by EESA.

3. Asset Guarantee Program

On October 16, 2008, the Treasury Department published a notice in the *Federal Register* soliciting comments to assist it in developing the asset guarantee

program required by EESA. Treasury specifically requested comment by October 28, 2008, on the following questions:

What are the key issues Treasury should address in establishing the guarantee program for troubled assets?

Should the program offer insurance against losses for both individual whole loans and individual mortgage backed securities (MBS)?

What is the appropriate structure for such a program?

How should the program accommodate various classes of troubled assets?

Should the program differ by the degree to which an asset is troubled?

What are the key issues to consider with respect to guaranteeing whole first mortgages?

What are the key issues to consider with respect to guaranteeing HELOCs and other junior liens?

What are the key issues to consider with respect to guaranteeing MBS?

What are the key issues associated with guaranteeing financial instruments other than mortgage related assets originated or issued before March 14, 2008 that could be important for promoting financial market stability?

What are the key issues to consider with respect to setting the payout of the guarantee?

Should the payout be equal to principal and interest at the time the asset was originated or to some other value? What should that value be? What would be the impact of offering guarantees of less than 100 percent of original principal and interest?

Should payout vary by asset class? If so, please describe using the same asset classes as enumerated above.

What event should trigger the payout under the guarantee?

Should the holder be able to present the claim at will or should there be a set date? Should this date differ by asset class?

Should this date differ by the degree to which the asset is troubled?

Should the holder be permitted to sell the troubled asset with the program guarantee? If appropriate, should asset sales be restricted to eligible financial institutions or should there be no restrictions to promote liquidity in the marketplace?

What are the key issues the Treasury should consider in determining the possible losses to which the government would be exposed in offering the guarantee?

What methodology should be used to determine possible losses?

Does it differ by asset class? If so, please describe using the same asset classes as enumerated above.

Does it differ by the degree to which the asset is troubled?

What are the key elements the Treasury should consider in setting premiums for this program?

Is it feasible or appropriate to set premiums reflecting the prices of similar assets purchased under Section 101 of the EESA?

If use of prices of similar assets purchased under Section 101 of the EESA are not feasible or appropriate, should premiums be set by use of market mechanisms similar to (but separate from) those contemplated for the troubled assets purchase program? How would this be implemented?

If not feasible or appropriate, what methodologies should be used to set premiums?

Do these considerations of feasibility or appropriateness vary by asset class? If so, please describe using the same asset classes as enumerated under 1.21-1.24.

Should the premiums vary by the degree to which the asset is troubled?

How and in what form should payment of premiums be scheduled?

How should a guarantee program be designed to minimize adverse selection, given that the program must be voluntary? Is

there a way to limit adverse selection that avoids individually analyzing assets?

What legal, accounting, or regulatory issues would such a guarantee program raise?

What administrative and/or operational challenges would such a guarantee program create?

What expertise would Treasury need to operate such a guarantee program? Please describe for all facets of the program.

What are the key issues to be considered in determining the eligibility of a given type of financial institution to participate in this program? Should these eligibility provisions differ from those of the troubled asset purchase program?

What are the key issues to be considered in determining the eligibility of a given asset to be guaranteed by this program?

Should eligibility provisions of assets to be guaranteed under this program differ from those of the troubled asset purchase program?

Assuming the guarantee is priced to cover expected claims, are there situations (perhaps created by regulatory or accounting considerations) in which financial institutions would prefer this program to the troubled asset purchase program? Please describe.

Does this preference differ by type and condition of the asset? For what troubled assets might financial institutions choose to participate in the guarantee program rather than sell under the troubled asset purchase program?

Is accommodating this choice likely to best promote the goals of the EESA?

Does it adequately protect the taxpayer?

If not, what design feature should be included to assure these goals are met?⁹⁰

4. Solicitation of Service Providers

⁹⁰ 73 Fed. Reg. 61452 (Oct. 16, 2008).

On October 5, 2008, Treasury solicited proposals from financial institutions to provide various services for the TARP program and requested the proposals to be submitted two days later, by October 8.⁹¹ The Treasury said that each selected contractor must be prepared to provide services immediately and noted that, as a financial agent, the contractor would have a fiduciary responsibility to perform all services in the best interests of the United States.

Financial Agents

The Treasury sought proposals for a single financial agent to provide infrastructure services for the entire TARP portfolio of troubled assets.⁹² As described by the Treasury, the selected agent would perform custody, asset tagging, asset pricing and valuation, cash management, accounting, management reporting, federal government financial reporting, and auction management services for reverse auctions and for other asset acquisition mechanisms (collectively “infrastructure services”).

The financial agent would provide the accounting of record for the portfolio, hold all cash and assets in the portfolio, produce reports to support Federal Credit Reform accounting, produce reports for the Treasury’s general ledger accounting system, manage cash balances generated by the portfolio, and provide for pricing and asset valuation services. The financial agent also would track unique asset attributes as required by the Act, such as linkages to executive compensation limits and to warrants received from selling institutions. In addition, the financial agent would support the acquisition of securitized assets by serving as auction manager and conducting reverse auctions designed to allow efficient and effective purchases.

Securities Asset Managers

The Treasury also solicited proposals from asset managers and submanagers to handle different asset classes acquired for the TARP securities portfolio.⁹³ The Treasury said the portfolio could reach several hundred billion dollars and would include Prime, Alt-A, and Subprime residential mortgage backed securities (MBS), commercial MBS, and MBS collateralized debt obligations. In addition, the Treasury said it might include other types of securities in the portfolio as necessary to promote market stability.

The portfolio would need to be managed according to the policy objectives in the EESA rather than the pursuit of yield or diversification, the Treasury said:

Consistent with the purposes of the Act, the Treasury’s policy goals for the portfolio of troubled mortgage-related securities are

⁹¹ Treasury Press Release HP-1185 (Oct. 6, 2008).

⁹² *Id.*

⁹³ *Id.*

to (1) provide stability and prevent further disruption to the financial markets and banking system, (2) ensure mortgage availability, and (3) protect the interests of taxpayers. The Treasury noted that the portfolio mandate and specific investment strategies could change over time but would always be consistent with these policy goals. Nevertheless, to the maximum extent practicable, the Treasury said the portfolio's credit and market risks would be managed to limit the potential for capital losses.

The Treasury indicated that the portfolio assets likely would be acquired through reverse auctions and other market mechanisms designed to "support efficient and effective price discovery and generate observable market-based valuations, to the maximum extent practicable." Consistent with the policy goals, Treasury said the portfolio was expected to hold assets "until market conditions improve and stabilize" but the specific holding period of particular assets could vary from months to years. The Treasury said that, over time, it would provide guidance on re-balancing assets. Accordingly, the Treasury noted, portfolio management is expected to be relatively passive, but may be relatively active at certain times depending on market conditions.

The Treasury also said it would provide on-going guidance on how positions may be liquidated or remonetized: "The portfolio may be benchmarked to established indices, but more likely will be measured by a dashboard of custom metrics linked to the Treasury's policy goals." In addition, the Treasury said it would establish guidelines on managing the risks of the portfolio, on eligible trading counterparties and counterparty risk management, on the disposition of cash flows, and on managing temporary cash holdings generated by the portfolio. The Treasury noted that it "may decide to hedge convexity and other risks within the portfolio" and would establish parameters for any such hedging activity.

The Treasury said that financial institutions selected to provide securities asset management services would be required to:

Act as the Treasury's appointed asset manager with authority to control assets, consistent with the Treasury's investment policy and guidelines.

Manage assets (i) acquired by the Treasury and segregated to the Financial Institution, and/or (ii) acquired by the Financial Institution in accordance with the Treasury's instructions.

Devise, document, and execute strategies to meet the Treasury's investment policy and guidelines.

Adhere to, measure, and report on standards for best execution with brokers, dealers, and other counterparties in compliance with the Treasury's investment policy and guidelines.

Execute trades as agent for a disclosed or undisclosed principal, as determined by the Treasury, at market prices or another pricing basis, as determined by the Treasury.

Execute large trades, potentially of multi-billions of dollars as required, on a single day using approved counterparties.

Provide a dedicated team of individuals (full or part-time) to undertake the services required in this notice.

Confirm all trades with approved counterparties promptly.

Maintain records of (i) trades executed, including all pertinent financial and settlement information, (ii) principal and interest (P&I) payments, and (iii) cash flow projections of new trades and principal and interest payments.

Track, maintain records of, and promptly resolve notification and settlement fails.

Maintain settlement tolerance thresholds consistent with best practices.

Interface with an independent custodian, selected by the Treasury, that will have possession and safekeeping of all cash and assets, process transactions, collect P&I distributions, disburse cash and remit funds to the Treasury as required, and provide GAAP accounting of record.

Interface with the Treasury's management and accounting systems and provide data feeds.

Reconcile, on a daily basis, its own books and records with the custodian's cash and custody accounts and with the Treasury's accounting systems.

Provide for all necessary operational and analytical hardware and software to support the services in this notice.

Identify, document, and enforce internal controls on an on-going basis.

Permit the Treasury's internal and external auditors, or other governmental oversight entities, to audit books and records related to the services in this notice.

Report portfolio performance and status against the Treasury's benchmarks and/or success metrics.

Report on (i) securities holdings, (ii) positions in assets and asset classes, (iii) securities characteristics, such as maturity distributions, and (iv) transactions.

Forecast expected P&I payments given a range of interest rate scenarios using industry standard prepayment models.

Produce portfolio valuation reports, incorporating pricing and relative value measures from external sources and models, as appropriate.

Produce risk management reports to monitor and assess the portfolio against risk constraints and metrics to be established by the Treasury.

Assist with the preparation of reports to oversight bodies.

Provide a SAS No. 70 Service Organization Type II report, on an annual basis, for the services required in this notice.

Retain all documentation and reports related to the services in this notice.

Respond to the Treasury's reasonable verbal inquiries on trading activity and market conditions during the business day, and provide end of day commentary on trading decisions and activity as requested the Treasury.

Whole Loan Asset Managers

The Treasury also sought proposals by financial institutions to act as asset managers for different types of mortgage whole loans that might be acquired for the portfolio, such as residential and commercial loans. The asset managers would be required to provide a variety of services, from pre-transactional diligence on loans offered for sale, such as determination of fundamental loan values and loan

acquisition, loan servicing and foreclosure mitigation, and liquidation of physical assets and underlying property, if necessary.

The Treasury said it expected asset managers to acquire loans through market-based or other competitive mechanisms and noted that the acquisition process might entail the review of individual loans for valuation purposes. As with the portfolio of securities assets, the Treasury said that the asset manager of whole loans would be expected to hold the loans until market conditions improve and stabilize, and that the specific holding period of particular loan types might vary from months to years. Given current market conditions, the Treasury said, an asset manager's initial activities might focus on risk management versus more active portfolio management.

Treasury said that whole loan managers would be expected to provide the fundamental real estate judgments and loan level analysis to support management, servicing, modifications, restructurings, re-sales, and loss mitigation over time. The Treasury said it likely would establish central servicing and loss mitigation guidelines, as well as standard risk management parameters, across all asset managers. In addition, the Treasury said it might decide to hedge interest rate and convexity risks and would establish parameters for any such hedging activity.

The performance of individual asset managers would be measured by a "dashboard of custom metrics" linked to the Treasury's policy goals. The Treasury stated that it would require asset managers to direct servicers to maximize assistance for homeowners, considering net present value to the taxpayer, and to facilitate re-financings under the HOPE for Homeowners Program.

The financial institution selected to provide whole loan asset management would be required to do the following:

- Conduct preliminary pre-transaction diligence on loans and portfolios of loans, and report on actual and represented loan characteristics and exceptions to transaction guidelines.

- Conduct deeper post-transaction reviews of purchased loans and portfolios of loans.

- Receive and process data files with descriptions of loans and portfolios of loans from potentially hundreds or thousands of Financial Institutions offering loans.

- Ensure that smaller Financial Institutions, including but not limited to community banks and credit unions, have access to the infrastructure and can proffer loans for sale to the Treasury.

Analyze, standardize, and convey the data into systems and reports as necessary.

Execute the whole loan acquisition transactions.

Value loans and portfolios of loans offered for sale according to product and performance characteristics.

Act as the Treasury's appointed asset manager with authority to control loans, consistent with the Treasury's policies and guidelines.

Provide integrated asset management services for loans and portfolios of loans including acquisition, management, reporting, risk management, and asset disposition capabilities.

Devise, document, and execute loan strategies to meet the Treasury's policies and guidelines.

Work in good faith with the Treasury's central loan custodian and trustee to execute and settle loan and portfolio transactions.

Work in good faith with the Treasury's central loan custodian and trustee for loan and portfolio cash management, reporting, warehousing of title and legal documents, and other central administrative services.

Work in good faith to help the central monitoring of servicer compliance with the Treasury's servicing and loss mitigation guidelines across the entire portfolio.

Service loans and portfolios of loans in accordance with the Treasury's servicing and loss mitigation guidelines.

Monitor the ongoing performance of purchased loans and portfolios of loans, and provide detailed reporting to Treasury.

Manage liquidation of physical assets and underlying property, as necessary.

Interface with the custodian's and the Treasury's management and accounting systems and provide data feeds as necessary.

Reconcile books and records with the custodian and the Treasury.

Maintain records of all loans acquired and cash flow projections of principal and interest.

Provide for all necessary operational and analytical hardware and software to support the services in this notice.

Identify, document, and enforce internal controls on an on-going basis.

Permit the Treasury's internal and external auditors, or other governmental oversight entities, to audit books and records related to the services in this notice.

Report on loan and portfolio holdings, valuations, and characteristics

Report on loan and portfolio performance against the Treasury's benchmarks or success metrics.

Assist with the preparation of reports to oversight bodies.

Retain all documentation and reports related to the services in this notice.

The Treasury said the selected financial institutions might provide all services directly or in combination with third party subcontractors identified by the financial institution, and that it reserved the right to hire other contractors as necessary to support the full suite of services needed to manage the portfolio of mortgage whole loans efficiently and effectively.

Other Agents and Staff

The Treasury on October 13, 2008, announced that it had hired a number of individuals to serve in key staff positions in the TARP program. It also announced that it had engaged the New York law firm of Simpson Thatcher to assist in structuring the equity purchase program.⁹⁴

Investment Adviser

⁹⁴ Treasury Press Release HP-1199 (Oct. 13, 2008).

On October 13, 2008, the Treasury announced that it had hired the Chicago-based firm of EnnisKnupp and Associates to serve as its investment adviser for the implementation of the TARP program.⁹⁵ Treasury said that EnnisKnupp began work immediately to help the Department administer the portfolio of troubled assets it will purchase and to assist in the Treasury's evaluation of potential asset managers and other vendors. The firm's duties also include developing and maintaining investment policies and guidelines and assisting with the oversight of the portfolio's multiple asset managers. The Treasury said this oversight will include helping Treasury to determine asset allocations for each manager, evaluating the performance and costs, identifying conflicts of interest and identifying strategic investment and market issues impacting the overall portfolio.

The investment adviser also will conduct research on mortgage whole loan asset managers and on servicing organizations. Additionally, the firm will identify qualified minority- and women-owned businesses to provide services for the portfolio.

B. Guidance on Tax Relief

The EESA provided banks and other financial institutions ordinary treatment for gains and losses on direct investments in preferred stock of Fannie Mae and Freddie Mac. The Act directed the Treasury Department to issue guidance with respect to the treatment of such gains or losses on indirect investments through adjustable rate preferred programs, partnerships, and other investment vehicles.

The Treasury and the Internal Revenue Service provided guidance on October 29, 2008, giving banks and other financial institutions the benefit of ordinary treatment on indirect gains and losses.⁹⁶

IV. OTHER GOVERNMENT ACTIONS

In addition to programs initiated under EESA, the government has acted under other legal authority to develop programs designed to stabilize the financial system, including the following.

A. Liquidity for Money Market Mutual Funds

The stability of the money market mutual fund industry became fragile after Lehman Brothers declared bankruptcy on September 15, 2008, and the Reserve Primary Fund money market mutual fund which held over \$700 million of Lehman's worthless paper, announced the next day that it could no longer redeem

⁹⁵ Treasury Press Release HP 1201 (Oct. 13, 2008). Treasury said it hired EnnisKnupp using a procurement contract under the Federal Acquisition Regulation.

⁹⁶ See Treasury Press Release HP-1242 (Oct. 29, 2008); IRS Revenue Procedure 2008-64 (Rev. Proc. 2008-64).

shares at a net asset value of \$1.00 (i.e., it “broke the buck”). A run on money market mutual funds began.

Because of the importance of the \$3.5 trillion money market mutual fund industry in the credit markets, the government took immediate action to staunch the run and provide liquidity.

1. Money Market Mutual Fund Guarantee Program

On September 19, 2008, the Treasury Department announced the creation of a temporary guaranty program to insure money market mutual funds.⁹⁷ Treasury Secretary Paul said, “for the next year, the U.S. Treasury will insure the holdings of any publicly offered eligible money market mutual fund – both retail and institutional – that pays a fee to participate in the program.”⁹⁸

President Bush approved the use of the Treasury’s Exchange Stabilization Fund to provide up to \$50 billion to fund the money market mutual fund insurance program.⁹⁹ In authorizing the program, the Treasury Secretary emphasized the importance of money market mutual funds in the financial system:

Money market funds play an important role as a savings and investment vehicle for many Americans; they are also a fundamental source of financing for our capital markets and financial institutions. Maintaining confidence in the money market fund industry is critical to protecting the integrity and stability of the global financial system.

Concerns about the net asset value of money market funds falling below \$1 have exacerbated global financial market turmoil and caused severe liquidity strains in world markets. In turn, these pressures have caused a spike in some short term interest and funding rates, and significantly heightened volatility in exchange markets. Absent the provision of such financing, there is a substantial risk of further heightened global instability.

Maintenance of the standard \$1 net asset value for money market mutual funds is important to investors. If the net asset value for a fund falls below \$1, this undermines investor confidence. The

⁹⁷ Treasury Press Release HP-1147 (Sept. 19, 2008).

⁹⁸ *Id.*

⁹⁹ The Exchange Stabilization Fund was established by the Gold Reserve Act of 1934. The Act authorizes the Secretary of the Treasury, with the approval of the President, “to deal in gold, foreign exchange, and other instruments of credit and securities” consistent with the obligations of the U.S. government in the International Monetary Fund to promote international financial stability.

program provides support to investors in funds that participate in the program and those funds will not “break the buck”.

The actual insurance program that emerged several days later proved to be not as sweeping as the Secretary Paulson’s initial statement had indicated, largely due to objections from the banking industry which complained that an unlimited guarantee of money market mutual funds could cause a destabilizing shift of money out of bank deposits. The American Bankers Association wrote to Secretary Paulson and Federal Reserve Chairman Bernanke:

While we understand that we are in an extreme financial emergency, the program announced this morning runs the risk in the long run of profoundly changing the nature of our financial system and, specifically, undermining the nation’s banking system. The debt instruments in a money market mutual fund will pay a higher interest rate, and therefore the fund will pay a higher interest rate, than a bank deposit or short-term CD. It also appears there will be no limit on how much an individual or institution can invest in these funds. Therefore, such funds will be in a significantly superior market position to FDIC-insured bank deposits. . . .

Today’s action will undermine the role of banks during the current crisis and has the potential to have an extremely negative impact in the future. Simply put, the ability of banks to attract and keep deposits is being compromised in a profound fashion.¹⁰⁰

The ABA posed a list of questions it said needed to be answered “immediately, before the program is finalized and any further harm is done to our banking industry and the economy”:

- While the action is temporary, how will you address the perception by the market that money market mutual funds now have a permanent implicit government guaranty – much like Fannie Mae and Freddie Mac did?
- Banks face a wide range of regulation and examination because of their FDIC insurance to ensure their safety and soundness. What equivalent regulation and examination will be placed on guaranteed money market funds? How will the government ensure the safety of its guaranty without equivalent regulation?

¹⁰⁰ Letter dated Sept. 19, 2008, from Edward L. Yingling, Executive Director, American Bankers Association, to Treasury Secretary Paulson and Federal Reserve Board Chairman Bernanke. See American Bankers Association Press Release, “ABA Deeply Concerned, Raises Questions on Treasury Money Market Program,” Sept. 19, 2008.

- How will you keep corporations from taking unreasonable advantage of the lower cost of funding provided by the guaranty by moving more and more of their financing to commercial paper in these funds?
- Will there be any limit on the amount an individual or institution can put in a guaranteed fund and still be covered by the guaranty, or will an individual or institution be able to have millions of dollars guaranteed by the government in a single fund?
- The guaranteed funds will generally contain commercial paper of large, AAA-rated companies. Those companies will now have a funding advantage because of the guaranty. Funds will be moved from bank deposits to the guaranteed funds driving down interest rates large companies will need to pay. Since banks are the traditional lenders to smaller businesses, less credit will be available for small businesses. How will this impact on small business lending be addressed?
- The FDIC fund consists of tens of billions of dollars paid by banks over the years, plus the interest the fund has earned. While the announcement says that fees will be charged for the guaranty, those fees will not fund the guaranty program in any material way. Unlike the FDIC fund, which is pre-funded by banks and then backed in the first instance by the almost \$1.5 trillion in bank capital, this new guaranty program is in the first instance a direct tax-payer funded program. How is that fair to the banking industry and what precedents are being set?
- What is the exit strategy? How do you remove the guaranty at the end of the temporary period without causing severe market disruptions?
- Will the guaranteed funds have some type of obligation to serve their communities, equivalent to the Community Reinvestment Act, which applies to banks?¹⁰¹

Ten days later, the Treasury announced the details of a much reduced insurance program. Under the revised program, the Treasury said it would guarantee only amounts invested in money market mutual funds as of September 19, 2008 and only for an initial three month period, which could be extended no later than September 18, 2009. Investors in the Reserve Fund that “broke a dollar”

¹⁰¹ *Id.*

before September 19 were not covered. There was no limit on the insured amount per investor.

Eligible funds had to be regulated under Rule 2a-7 of the Investment Company Act of 1940 and maintain a stable share price of \$1.00. Both taxable and non-taxable funds were eligible for the program.

To participate in the program, eligible funds had to pay a fee and complete a Guarantee Agreement and corresponding documents. Individual investors could not sign-up for the program.

The program covers the shares of any shareholder of record on September 19, 2008. The number of shares covered will be the lesser of: (a) the number of shares owned on September 19, 2008; or (b) the number of shares owned on the date on which a guarantee event occurs. A guarantee event occurs when the NAV of a fund falls below \$0.995, unless promptly cured.

Covered shareholders will receive \$1.00 per covered share upon liquidation of a fund, subject to adjustment and the overall amount available to all funds under the program.

The Treasury posted questions and answers concerning how the guarantee program would be affected when a fund shareholder moves money in and out of a fund after September 19, and other issues:

What happens if the number of shares an investor holds in a specific fund increases above the level at the close of business on September 19, 2008?

The program provides a guarantee based on the number of shares held in a specific fund at the close of business on September 19, 2008. Any increase in the number of shares held in a specific fund after the close of business on September 19, 2008 will not be guaranteed.

Examples Include:

If an investor owned 100 shares in a specific money market fund as of close of business September 19, 2008, but owns 150 shares in the same fund on the day a Guarantee Event occurs, then that investor will be guaranteed only for 100 shares. The fund, upon liquidation, will distribute proceeds from the assets to the extent available to the shareholder for the additional 50 shares, at net asset value.

If an investor owned no shares in a specific fund as of close of business September 19, 2008, but owns 100 shares in a fund on

the day a Guarantee Event occurs, none of the investor's shares are guaranteed by the program and the investor will receive the net asset value directly from the fund.

What happens if the number of shares an investor holds in a specific fund decreases below the level held at the close of business on September 19, 2008?

The program provides a guarantee based on the number of shares held in a specific fund at the close of business on September 19, 2008. If a Guarantee Event occurs and an investor holds less than the level of shares originally held in the specific fund on September 19, 2008, only the amount of shares held when the Guarantee Event occurs will be covered.

Examples Include:

For example, if an investor owned 100 shares in a specific money market fund as of close of business September 19, 2008, but owns 50 shares in the same fund on the day a Guarantee Event occurs, then that investor will be guaranteed for 50 shares.

Assume an investor owns shares at the close of business on September 19, 2008 in a specific fund that is participating in the Program. What happens if the investor transfers funds from the specific fund held on September 19, 2008 to another fund that is also participating in the Program?

The program provides a guarantee based on the number of shares held in a specific fund at the close of business on September 19, 2008. Any contribution after the close on September 19, 2008 to another fund that is participating in the program – even one that is in the same fund family – will not be covered.

Assume an investor owns shares at the close of business on September 19, 2008 in a specific fund that is participating in the Program. Assume that after the close on September 19, 2008 the investor transfers funds from the specific fund held on September 19, 2008 to another fund. Can the investor now transfer funds back to the original fund held on September 19, 2008 and still be covered? What happens if the investor transfers all of his funds and the balance goes to zero?

The program provides a guarantee based on the number of shares held in a specific fund at the close of business on September 19, 2008. The number of shares held by the investor in a specific fund may fluctuate – including reaching a zero balance –

provided that at all times the investor maintains his account with the same fund family, broker, or other intermediary where the shares were originally held. If the account is closed and the investor reopens a new account, even if it is with the same institution where the shares were originally held, it will not be covered.

Examples Include

If an investor owned 100 shares in a specific fund as of close of business September 19, 2008, subsequently sold the 100 shares, and then repurchased 100 shares in the same specific fund prior to a Guarantee Event, the investor would be covered for 100 shares.

If an investor owned 100 shares in a specific fund as of close of business September 19, 2008, subsequently sold the 100 shares, and then repurchased 125 shares in the same specific fund prior to a Guarantee Event, the investor would be covered for only 100 shares.

If an investor owned 100 shares in a specific fund as of close of business September 19, 2008, subsequently sold the 100 shares, and then repurchased 100 shares in another fund that is participating in the program, the investor would not be covered.

Assume an investor owns shares in a participating fund at the close of business on September 19, 2008 in one ownership structure (e.g. directly, through a broker or other intermediary, or through another vehicle like a 401(k) or IRA). Can the investor transfer his shares in the same specific fund and hold them through a different ownership structure (i.e. to a new direct ownership structure, a new broker or other intermediary, or a new vehicle like a 401(k) or IRA) and still be covered?

No. Transferring shares from one ownership structure to another would be deemed to be a new investment made after September 19, 2008 and would not be eligible for coverage.

What if another fund in an investor's fund family breaks the buck before this program starts? Is the investor covered?

The program provides a guarantee on a fund-by-fund basis up to the amount of shares held as of the close of business on September 19, 2008. The performance of a different fund, even one in the same fund family of the investor's fund, doesn't affect

the investor's fund's eligibility. Investors should contact their fund to determine if their fund participates in the program.

When does the program terminate?

The program is designed to address temporary dislocations in credit markets. The program will be in effect for an initial three month term, after which the Secretary of the Treasury will review the need and terms for the program and the costs to provide the coverage. The Secretary has the option to extend the program up to the close of business on September 18, 2009. In order to maintain coverage, funds would have to renew their participation in the program after each extension. If the Secretary chooses not to extend the program at the end of the initial three month period, the program will terminate.

Who provides this guarantee? Are investors able to get all of their money back whenever they want?

The U.S. Treasury Department, through the Exchange Stabilization Fund, is providing this guarantee. In the event that a participating fund breaks the buck and liquidates, a guarantee payment should be made to investors through their fund within approximately 30 days, subject to possible extensions at the discretion of the Treasury.¹⁰²

2. ABCP Funding for Money Market Mutual Funds

On September 19, 2008, the Federal Reserve Board announced the creation of a temporary Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility to provide liquidity for money market mutual funds.¹⁰³ Using this Facility, the Board said it would 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 asset-backed commercial paper (“ABCP”) from money market mutual funds.¹⁰⁴ The Board said this initiative would assist money funds

¹⁰² Treasury Press Release HP-1163, Frequently Asked Questions About Treasury’s Temporary Guarantee Program for Money Market Funds (Media Advisory October 16, 2008). *See also* Technical Questions Regarding Treasury’s Temporary Guarantee Program for Money Market Funds, posted on the Treasury’s web site.

¹⁰³ Federal Reserve Board Press Release dated Sept. 19, 2008.

¹⁰⁴ To be eligible, the fund must qualify as a money market mutual fund under Rule 2a-7 of the Securities and Exchange Commission pursuant to the Investment Company Act of 1940.

that hold such paper in meeting demands for redemptions by investors and foster liquidity in the ABCP markets and broader money markets.¹⁰⁵

The Facility is being administered by the Federal Reserve Bank of Boston.¹⁰⁶ There are no special fees associated with the facility.

Eligible borrowers may secure advances from the facility by completing an ABCP Liquidity Facility Document Package obtained from the Federal Reserve Discount Window website. All U.S. depository institutions, bank holding companies (parent companies or U.S. broker-dealer affiliates), or U.S. branches and agencies of foreign banks are eligible to borrow under the facility in the Reserve Bank's discretion.

Presumably, banks will purchase ABCP from their own affiliated money market mutual funds. Banks have an incentive to participate in the program because they can earn a spread equal to the difference on the low interest rate charged on the Reserve Bank loan and the return on the commercial paper.

ABCP Collateral

The maturity date of an advance under the facility will equal the maturity date of the eligible ABCP pledged to secure the advance. ABCP collateral is eligible for pledge under the Facility if it:

was purchased by the borrower on or after September 19, 2008 from a registered investment company that holds itself out as a money market mutual fund;

was purchased by the borrower at the fund's acquisition cost as adjusted for amortization of premium or accretion of discount on the ABCP through the date of its purchase by the borrower;

is rated at the time pledged to Federal Reserve Bank, not lower than A1, F1, or P1 by at least two major rating agencies or, if rated by only one major rating agency, the ABCP must have been rated within the top rating category by that agency;

¹⁰⁵ To further support market functioning, the Federal Reserve said it also planned to purchase from primary dealers federal agency discount notes, which are short-term debt obligations issued by Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. These purchases would be similar to the Federal Reserve's secondary market purchases of Treasury securities and would be conducted with the primary dealers through a series of competitive auctions via the Open Market Trading Desk's FedTrade system. A series of purchase operations were planned over the ensuing weeks.

¹⁰⁶ Federal Reserve Bank of Boston, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility Term Sheet, Sept. 19, 2008.

was issued by an entity organized under the laws of the United States or a political subdivision thereof under a program that was in existence on September 18, 2008; and

has a stated maturity that does not exceed 120 days if the borrower is a bank or 270 days for non-bank borrowers.

Advances made under the facility will be made at a rate equal to the primary credit rate in effect at the Federal Reserve Bank of Boston offered to depository institutions at the time the advance is made.

The ABCP must be transferred to the Reserve Bank's restricted account at the Depository Trust Company (DTC) before an advance, collateralized by that ABCP, will be approved. The collateral valuation will be the amortized cost of the eligible ABCP pledged to secure an advance. This amount will not be margin adjusted.

Each advance will be in a principal amount equal to the amortized cost of the ABCP pledged to secure the advance. Advances made under the facility are made without recourse. Consequently, once an eligible borrower has borrowed under the facility, it is at no risk of loss on the eligible ABCP, unless the ABCP is deemed to be non-conforming. The risk of loss is absorbed by the Reserve Bank.

No new credit extensions will be made after January 30, 2009, unless the facility is extended by Federal Reserve Board.

Bank Capital and Accounting

The Federal Reserve stated that, because bank holding companies and banks would bear no credit or market risk in their holdings of ABCP under the facility, the holdings will not be assessed any regulatory capital charge. Thus, the holdings will receive a 0 percent risk weight for risk-based capital purposes and would be excluded from average total consolidated assets for leverage capital purposes.¹⁰⁷

Consistent with GAAP, the Federal Reserve said it expected banks and bank holding companies purchasing ABCP under the facility to report the purchased ABCP as an investment security (i.e., held-to-maturity or available-for-sale) on their balance sheets. The assets would be reflected at the time of purchase at the organization's best estimate of fair value. The non-recourse nature of the transaction would impact the valuation of the liability to the Federal Reserve. After reflecting any appropriate discounts on the assets and associated liabilities, the Federal Reserve said, organizations would be expected to report any material net gains or losses (if any) at the time of purchase. Any discounts generally would be

¹⁰⁷ Federal Reserve Board, Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Frequently Asked Questions (Oct. 23, 2008).

accreted over time into income and expense. The Federal Reserve noted that its staff, in connection with providing the above guidance, had consulted with staff of the SEC's Office of the Chief Accountant.

Legal Authority

The Federal Reserve stated that the legal authority for this Facility is section 13(3) of the Federal Reserve Act which permits the Board, in unusual and exigent circumstances, to authorize Reserve Banks to extend credit to individuals, partnerships, and corporations that are unable to obtain adequate credit accommodations.¹⁰⁸ The Board stated that the Facility also is authorized under section 10B of the Act, which authorizes Reserve Banks to make advances to depository institutions.

3. Money Market Investor Funding Facility

The Federal Reserve Board on October 21, 2008, took further action to provide liquidity to money market mutual funds, announcing the creation of the Money Market Investor Funding Facility (MMIFF).¹⁰⁹ Under the MMIFF, the Federal Reserve Bank of New York will provide senior secured funding to a series of private sector special purpose vehicles or conduits ("PSPVs") to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from money market mutual funds. Eligible assets include bank CDs and short-term debt obligations.

JPMorgan Chase will be the sponsor and manager of the PSPVs. The Board said it was chosen for this role by representatives of the money market mutual fund industry. A wide variety of banks and financial institutions will provide custodial, private placement and administrative services to the PSPVs.¹¹⁰

The program does not limit how much a single fund may sell to a PSPV, but the Federal Reserve noted that SEC Rule 2a-7 under the Investment Company Act placed quantitative limits on the ability of money market mutual funds to sell assets to the PSPVs.

The MMIFF initially will be authorized to lend to five PSPVs. The PSPVs will be authorized, in turn, to purchase a maximum amount of \$600 billion in eligible assets. Since the Federal Reserve Bank of New York will provide 90 percent of the financing to the PSPVs, Federal Reserve lending could total \$540 billion.

¹⁰⁸ 12 U.S.C. § 343.

¹⁰⁹ Federal Reserve Board Press Release dated Oct. 21, 2008.

¹¹⁰ Federal Reserve Bank of New York, Money Market Investor Funding Facility: Questions and Answers (Oct. 23, 2008).

In announcing this initiative, the Federal Reserve Board noted that the short-term debt markets had been under considerable strain in recent weeks as money market mutual funds and other investors had experienced difficulty selling assets to satisfy redemption requests and meet portfolio rebalancing needs. By facilitating the sales of money market instruments in the secondary market, the Board said, the MMIFF would improve the liquidity position of money market investors, thus increasing their ability to meet any further redemption requests and their willingness to invest in money market instruments. “Improved money market conditions will enhance the ability of banks and other financial intermediaries to accommodate the credit needs of businesses and households,” the Board said.

The asset-backed commercial paper liquidity facility for money market mutual funds similarly improves liquidity by financing purchases of ABCP by banking organizations with loans from the Federal Reserve Bank of Boston at the primary credit rate. The loans are collateralized by the ABCP but are without recourse to the borrowing banking organization. Under the MMIFF, the New York Reserve Bank’s loans are collateralized by a different set of money market instruments and are with recourse to the borrowing PSPV. Both programs are intended to facilitate the sale of assets by money market mutual funds in the secondary market to increase their liquidity and encourage them to lend at longer maturities, but the MMIFF facilitates the sale of a different set of assets than the ABCP program.

The MMIFF program became effective on October 22, 2008.¹¹¹

Eligible Assets

The assets eligible for purchase by a PSPV include U.S. dollar-denominated certificates of deposit, bank notes and commercial paper with a remaining maturity of 90 days or less. These assets will be purchased at amortized cost.

Each of the five PSPVs will purchase debt instruments issued by ten financial institutions designated in its operational documents, for a total of fifty institutions. Each of these institutions will have a short-term debt rating of at least A-1/P-1/F1 from two or more major nationally recognized statistical rating organizations (NRSROs). The fifty institutions were chosen by representatives of the U.S. money market mutual fund industry, according to the Federal Reserve, primarily because they are among the largest issuers of highly rated short-term liabilities held by money market mutual funds, but also with an objective of achieving geographical diversification in each PSPV. The financial institutions include most of the largest global North American and European financial institutions.

¹¹¹ Federal Reserve Bank of New York, Money Market Investor Funding Facility Term Sheet, Oct. 22, 2008.

PSPV Concentration Limit

At the time of a PSPV's purchase of a debt instrument issued by a financial institution, the debt instruments of that financial institution may not constitute more than 15 percent of the assets of the PSPV.

Liabilities of a PSPV

Each PSPV will finance its purchase of an eligible money market mutual fund asset by selling ABCP and by borrowing under the MMIFF. The PSPV will issue to the seller of the eligible asset ABCP equal to 10 percent of the asset's purchase price. The ABCP will have a maturity equal to the maturity of the asset and will be rated at least A-1/P-1/F1 by two or more major NRSROs. The Federal Reserve Bank of New York will commit to lend to each PSPV 90 percent of the purchase price of each eligible asset until the maturity of the asset. The New York Fed loans will be on an overnight basis and at the primary credit rate, currently 1.75 percent. The loans will be senior to the ABCP, with recourse to the PSPV, and secured by all the assets of the PSPV.

Downgrade or Default of an Eligible Asset

If the debt instruments of a financial institution held by a PSPV are no longer eligible assets due to a short-term debt rating downgrade, the PSPV must cease all asset purchases until all of the PSPV's assets issued by that financial institution have matured.

Upon a default of any asset held by a PSPV, the PSPV must cease all asset purchases and repayments on outstanding ABCP. Proceeds from maturation of the PSPV's assets will be used to repay the Federal Reserve Bank of New York and, upon maturation of all assets in the PSPV, any remaining available cash will then be used to repay principal and interest on the ABCP. Any excess spread will be allocated as described below.

Termination and Wind-down Process

A PSPV will cease purchasing assets and will enter a wind-down process on April 30, 2009, unless the Board extends the MMIFF. During the wind-down process, proceeds from the maturation of the assets of a PSPV on a given day will be used first to repay principal and interest on the Federal Reserve Bank of New York loans and then to repay principal and interest on the ABCP that matures on that day. A small fixed amount of any excess spread remaining in the PSPV after completion of the wind-down process will be allocated proportionally among investors in its ABCP; the Reserve Bank will receive any remaining excess spread.

Legal Basis

The Federal Reserve cited as the basis for the program section 13(3) of the Federal Reserve Act, which permits the Board, in unusual and exigent circumstances, to authorize Reserve Banks to extend credit to individuals, partnerships, and corporations that are unable to obtain adequate credit accommodations.

B. Commercial Paper Funding Facility

The Federal Reserve Board on October 7, 2008, announced that it would use its broad authority to lend to corporations in “unusual and exigent circumstances” in order to stabilize the commercial paper market. The Board created a new Commercial Paper Funding Facility (“CPFF”) to provide a liquidity backstop to U.S. corporations and other issuers of commercial paper through a special purpose vehicle (“SPV”) that will purchase three-month unsecured and asset-backed commercial paper directly from eligible issuers.¹¹²

This extraordinary action marked the first use of the Board’s authority to assist non-financial institutions, authority the board has not used for decades.

Under the Facility, the Federal Reserve of New York will provide financing on a recourse basis to the SPV and will be secured by all of the assets of the SPV. In the case of commercial paper that is not asset-backed, by the retention of up-front fees paid by the issuers or by other forms of security acceptable to the Federal Reserve Bank in consultation with market participants.

The Federal Reserve Board stated that the Treasury would make a special deposit at the Federal Reserve Bank of New York in support of this facility. The Board stated “Treasury believes this facility is necessary to prevent substantial disruptions to the financial markets and the economy.”¹¹³

In announcing this new Facility, the Board stated:

The commercial paper market has been under considerable strain in recent weeks as money market mutual funds and other investors, themselves often facing liquidity pressures, have become increasingly reluctant to purchase commercial paper, especially at longer-dated maturities. As a result, the volume of outstanding commercial paper has shrunk, interest rates on longer-term commercial paper have increased significantly, and an increasingly high percentage of outstanding paper must now be refinanced each day. A large share of outstanding commercial paper is issued or sponsored by financial intermediaries, and their difficulties placing commercial paper have made it more difficult

¹¹² Federal Reserve Board Press Release dated Oct. 7, 2008.

¹¹³ *Id.*

for those intermediaries to play their vital role in meeting the credit needs of businesses and households.

By eliminating much of the risk that eligible issuers will not be able to repay investors by rolling over their maturing commercial paper obligations, this facility should encourage investors to once again engage in term lending in the commercial paper market. Added investor demand should lower commercial paper rates from their current elevated levels and foster issuance of longer-term commercial paper. An improved commercial paper market will enhance the ability of financial intermediaries to accommodate the credit needs of businesses and households.¹¹⁴

The SPV will purchase from eligible issuers three-month U.S. dollar-denominated commercial paper through primary dealers. Eligible issuers are U.S. issuers of commercial paper, including U.S. issuers with a foreign parent company. The SPV will purchase only U.S. dollar-denominated commercial paper (including asset-backed commercial paper (ABCP)) that is rated at least A-1/P-1/F1 by a major nationally recognized statistical rating organization (NRSRO) and, if rated by multiple major NRSROs, is rated at least A-1/P-1/F1 by two or more major NRSROs.

Limits per issuer

The maximum amount of a single issuer's commercial paper the SPV may own at any time will be the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between January 1 and August 31, 2008. The SPV will not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the SPV) equals or exceeds the issuer's limit.

Pricing

Pricing will be based on the then-current 3-month overnight index swap rate plus fixed spreads. At the time of its registration to use the facility, each issuer must pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the SPV may own.

Termination date

The SPV will cease purchasing commercial paper on April 30, 2009, unless the Board extends the facility. The Federal Reserve Bank of New York will continue to fund the SPV after such date until the SPV's underlying assets mature.

¹¹⁴ *Id.*

Legal Authority

The Federal Reserve Board relied on section 13(3) of the Federal Reserve Act as authority for its action. That section provides as follows:

3. Discounts for Individuals, Partnerships, and Corporations. In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank: *Provided*, That before discounting any such note, draft, or bill of exchange for an individual, partnership, or corporation the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.¹¹⁵

The Board has used this authority rarely in the past. The Board used it for limited periods during 1932 through 1936 when it made loans to 123 businesses in an aggregate amount of \$1.5 million with the highest loan being \$300,000. The Board used the authority again in 1966 and 1969 to meet the credit needs of savings and loan associations, mutual savings banks, and nonmember commercial banks.¹¹⁶

As noted earlier, EESA requires the Board to report to Congress on its uses of the section 13(3) authority.

C. FDIC Temporary Liquidity Guarantee Program

On October 14, 2008, the FDIC announced a Temporary Liquidity Guarantee Program for banks.¹¹⁷ The program consists of two components: a temporary guarantee of newly-issued senior unsecured debt by depository institutions (the Debt Guarantee Program) and a temporary unlimited guarantee of funds in noninterest-bearing transaction accounts at FDIC-insured institutions (the

¹¹⁵ 12 U.S.C. § 343.

¹¹⁶ Howard H. Hackley, *Lending Functions of the Federal Reserve Banks: A History* (May 1973).

¹¹⁷ FDIC Press Release 100-2008 (Oct. 14, 2008).

Transaction Account Guarantee Program). Both programs became effective automatically for all eligible institutions for a 30-day period beginning on October 14, 2000, and were available on a voluntary participation basis thereafter.

The Debt Guarantee Program guarantees new, senior unsecured debt issued by any bank, thrift or holding company and is intended to help those institutions fund their operations. The FDIC noted that both term and overnight funding of banks had come under extreme pressure, with the costs of funding ballooning to several hundred basis points.

The Debt Guarantee Program will allow banks and their holding companies to roll maturing senior debt into new issues fully backed by the FDIC. The ability to tap into the program expires at the end of June 2009, and guaranteed maturities cannot extend beyond three years.

The Transaction Account Guarantee Program gives unlimited insurance coverage for non-interest bearing deposit transaction accounts. The FDIC noted that these are mainly payment processing accounts such as payroll accounts used by businesses which frequently exceed the maximum insurance limit. The FDIC noted that many smaller, healthy banks have been losing these accounts to their much larger competitors because of uncertainties in the financial system. The program is intended to help to stabilize these accounts and “avoid having to close otherwise viable banks because of deposit withdrawals.” The program runs through the end of 2009.

Both programs are to be funded through user fees paid by participating institutions without reliance on taxpayer funding and without depleting the Deposit Insurance Fund. At the expiration of the programs, if funds remain after the FDIC has satisfied all eligible claims, the surplus funds will remain in the Deposit Insurance Fund and be included in the future calculation of the Fund’s reserve ratio.

Coverage for both programs was automatic for the first 30 days without charge. After that, the FDIC began assessing premiums for coverage on institutions that elected to continue the coverage.

The FDIC said the programs “will address the systemic risk recognized by the FDIC and the other agencies” and are designed “to preserve confidence and encourage liquidity in the banking system in order to ease lending to creditworthy businesses and consumers.”¹¹⁸ The programs were necessitated notwithstanding enactment of the EESA, the FDIC said, because:

[M]any insured depository institutions have responded to the market turmoil by retaining cash and severely tightening their lending standards. Disruptions in money markets have

¹¹⁸ 73 Fed. Reg. 64,179, 64,180 (Oct. 29, 2008).

significantly impaired the ability of creditworthy companies to issue commercial paper, particularly at longer maturities. Interest rates on commercial paper continue to be extremely high. Issuances of residential and commercial mortgage-backed securities in the first half of 2008 have fallen by more than 90 percent from levels one year ago, and issuances of asset-backed securities have fallen 68 percent over the same period. As a result of this market volatility, economic concern has intensified, and short-term funding markets have slowed significantly.

FDIC analysis suggests that a five percent reduction in uninsured deposits would reduce Gross Domestic Product growth by 1.2 percent per year in a normal economy and 2.0 percent per year in a stressed economy. With U.S. economic growth currently stressed, a run of this magnitude could result in, or deepen and prolong, recession. FDIC data indicate rapid and substantial outflows of uninsured deposits from institutions that are perceived to be stressed. The systemic nature of this threat is further evidenced by the increasing number of bank failures.¹¹⁹

The FDIC issued an interim rule to implement both programs on October 14, 2008.¹²⁰

Voluntary Participation

The Temporary Liquidity Guarantee Program became effective on October 14, 2008. For the first 30 days of the program, all eligible entities were automatically covered under the Program and the Program guarantees were offered at no cost. On or before November 12, 2008, however, eligible entities were required to inform the FDIC whether or not they intended to participate in the Program or opt out. The opt-out later was extended to December 5, 2008. If an eligible entity opted out of the TLG Program, the FDIC's guarantee of its newly-issued senior unsecured debt and noninterest-bearing transaction deposit accounts would expire.

An eligible entity could elect to opt out of either the Debt Guarantee Program or the Transaction Account Guarantee Program or of both components of the program. All eligible entities within a U.S. bank holding company or savings and loan holding company structure had to make the same decision regarding participation in each component or none of the members of the holding company structure would be eligible to participate in that component of the program.

¹¹⁹ *Id.*

¹²⁰ 12 C.F.R. Pt. 370; 73 Fed. Reg. 64,179 (Oct. 29, 2008).

The FDIC said it would post on its website a list of institutions that opt in and institutions that opt out of the program. Eligible institutions are be required to make clear to the public whether or not they have elected to participate in either or both components of the program.

Eligible Entities

The Program is limited to “eligible entities” financial institutions, subject to any restrictions imposed by the FDIC in consultation with the primary regulator. The term “eligible entity” is defined to mean any of the following:

- (1) an insured depository institution;
- (2) a U.S. bank holding company, provided that it has at least one chartered and operating insured depository institution within its holding company structure;
- (3) a U.S. savings and loan holding company,¹²¹ provided that it has at least one chartered and operating insured depository institution within its holding company structure; or
- (4) Other affiliates of insured depository institutions that the FDIC after consultation with the appropriate Federal banking agency, designates as eligible entities which affiliates, by seeking and obtaining such designation, will have opted in to the debt guarantee program.¹²²

1. Bank Debt Guarantee Program

The Debt Guarantee Program is intended to provide liquidity to the inter-bank lending market and promote stability in the unsecured funding market for banks. The program temporarily guarantees all newly-issued senior unsecured debt (up to prescribed limits) issued by participating financial institutions on or after October 14, 2008, through and including June 30, 2009. The unpaid balance of the newly-issued senior unsecured debt will be paid by the FDIC upon the failure of the issuing institution or the filing of a bankruptcy petition with respect to the issuing holding company.

The FDIC defines “senior unsecured debt” as follows:

¹²¹ To be an eligible entity, a savings and loan holding company must either engage only in activities that are permissible for financial holding companies to conduct under section (4)(k) of the Bank Holding Company Act of 1956 (BHCA) or have at least one insured depository institution subsidiary that is the subject of an application that was pending on October 13, 2008, pursuant to section 4(c)(8) of the BHCA, or any affiliate of these entities approved by the FDIC after a written request made by, and the positive recommendation of, the appropriate federal banking agency.

¹²² 12 C.F.R. § 370.2(a).

The term “senior unsecured debt” means unsecured borrowing that: (a) is evidenced by a written agreement; (b) has a specified and fixed principal amount to be paid in full on demand or on a date certain; (c) is noncontingent; and (d) is not, by its terms, subordinated to any other liability.

(1) Senior unsecured debt includes, for example, federal funds purchased, promissory notes, commercial paper, unsubordinated unsecured notes, certificates of deposit standing to the credit of a bank, bank deposits in an international banking facility (IBF) of an insured depository institution, and Eurodollar deposits standing to the credit of a bank. For purposes of this paragraph, the term “bank” means an insured depository institution or a depository institution regulated by a foreign bank supervisory agency.

(2) Senior unsecured debt may be denominated in foreign currency.

(3) Senior unsecured debt excludes, for example, obligations from guarantees or other contingent liabilities, derivatives, derivative-linked products, debt paired with any other security, convertible debt, capital notes, the unsecured portion of otherwise secured debt, negotiable certificates of deposit, and deposits in foreign currency and Eurodollar deposits that represent funds swept from individual, partnership or corporate accounts held at insured depository institutions. Also excluded are loans to affiliates, including parents and subsidiaries, and institution affiliated parties.¹²³

The exclusions from the definition are intended to avoid encouraging innovative, exotic or complex funding structures or to protect lenders who make high-risk loans in hopes of high returns.

Eligible debt must be issued on or before June 30, 2009. For eligible debt issued by that date, the FDIC will provide the guarantee coverage for such debt until the earlier of the maturity date of the debt or until June 30, 2012. This final effective date for coverage is absolute; coverage will expire at 11:59 pm EST on June 30, 2012, regardless of whether the liability has matured at that time.

If an eligible entity chooses to opt out of the Debt Guarantee Program, the FDIC’s debt guarantee will terminate on the earlier of 11:59 pm EST on November 12, 2008, or at the time of the eligible entity’s opt-out decision.

¹²³ 12 C.F.R. § 370.2(e).

In order for newly-issued senior unsecured debt to be guaranteed, the debt instrument must be clearly identified in writing in a commercially reasonable manner on the face of any documentation as “guaranteed by the FDIC” and this fact must be properly disclosed to the creditors. The Debt Guarantee Program does not apply to debt that is contractually subordinated to other debt of the entity.

The guarantee applies to newly issued unsubordinated debt in a total amount up to 125 percent of the par or face value of an institution’s senior unsecured debt outstanding, excluding debt extended to affiliates, as of September 30, 2008, that is scheduled to mature before June 30, 2009. This maximum guaranteed amount is calculated for each individual participating entity within a holding company structure. The FDIC said it would publish procedures to require each participating entity to calculate its outstanding senior unsecured debt as of September 30, 2008, and provide that information (even if the amount of the senior unsecured debt is zero) to the FDIC.

The 125 percent limit may be adjusted for certain participating entities if the FDIC, in consultation with any appropriate Federal banking agency, determines that an adjustment is necessary. The FDIC may grant a participating entity authority to temporarily exceed the 125 percent limitation or limit a participating entity to less than 125 percent. These decisions will be made on a case-by-case basis.

Upon request and with a positive recommendation by the appropriate federal banking agency, the FDIC, in its sole discretion and on a case-by-case basis, may allow an affiliate of a participating entity to take part in the Debt Guarantee Program.

A participating entity may not represent that its debt is guaranteed by the FDIC if it does not comply with the rules governing the Debt Guarantee Program. If the issuing entity has opted out of the Debt Guarantee Program, it may no longer represent that its newly-issued debt is guaranteed by the FDIC. Similarly, once an entity has reached its 125 percent limit, it may not represent that any additional debt is guaranteed by the FDIC, and must specifically disclose that such debt is not guaranteed.

After consulting with a participating entity’s federal banking regulator, the FDIC may determine to bar an entity from participation in the Temporary Liquidity Guarantee Program. Termination of participation will be effective prospectively, and the entity will be required to notify its customers and creditors that it is no longer issuing guaranteed debt.

Entities that choose to participate in the Debt Guarantee Program and that issue guaranteed debt must agree to supply information requested by the FDIC, as well as to be subject to on-site reviews by FDIC examiners as needed after

consultation with the appropriate Federal banking agency.¹²⁴ The purpose of such reviews is to determine compliance with the terms and requirements of the Debt Guarantee Program. Participating entities also must agree that they will be bound by the FDIC's decisions, in consultation with the appropriate federal banking agency, regarding the management of the Temporary Liquidity Guarantee Program.

The FDIC's guarantee arising from the Debt Guarantee Program does not exempt any participating entity from complying with federal and state securities laws and with any other applicable laws.

Eligible entities that do not opt out of the Debt Guarantee Program on or before November 12, 2008, will be unable to select which newly issued senior unsecured debt is guaranteed debt as they issue such debt. All senior unsecured debt issued during the initial 30-day period by the participating entity will become guaranteed debt as and when issued.

If an eligible entity remains in the Debt Guarantee Program, it must clearly disclose to interested lenders and creditors, in writing and in a commercially reasonable manner, what debt it is offering and whether the debt is guaranteed under the program. Debt guaranteed by the FDIC must be clearly identified as "guaranteed by the FDIC" and properly disclosed to creditors.

Fees

For all newly issued senior unsecured debt, an annualized fee equal to 75 basis points multiplied by the amount of debt issued under the program will be charged to the participating institution.

2. Transaction Account Guarantee Program

The Transaction Account Guarantee Program provides a temporary full guarantee for funds held at FDIC-insured depository institutions in noninterest-bearing transaction accounts above the existing deposit insurance limit. The FDIC's Interim Rule provides that all insured depository institutions are automatically enrolled in the Transaction Account Guarantee Program for an initial thirty-day period (from October 14, 2008, through November 12, 2008). Insured depository institutions are not required to pay any assessments for participating in the Transaction Account Guarantee Program for this initial 30-day period. Coverage continues through December 31, 2009, for those institutions that do not opt out of the program.

The Rule requires each participating entity to prominently disclose in writing at its main office and at all branches at which deposits are taken its decision to participate in or opt-out of the Transaction Account Guarantee Program. These

¹²⁴ 12 C.F.R. § 370.10.

disclosures must be provided in simple, readily understandable text indicating the institution's participation or nonparticipation in the Transaction Account Guarantee Program. The disclosure must clearly state whether or not covered noninterest-bearing transaction accounts are fully insured by the FDIC. If the institution uses sweep arrangements or takes other actions that result in funds in a noninterest-bearing transaction account being transferred to or reclassified as an interest-bearing account or a non-transaction account, the institution also must disclose those actions to affected customers and clearly advise them in writing that such actions will void the transaction account guarantee.

A "noninterest-bearing transaction account" is defined in the Interim Rule as a transaction account with respect to which interest is neither accrued nor paid and on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal. The definition encompasses traditional demand deposit checking accounts that allow for an unlimited number of deposits and withdrawals at any time as well as official checks issued by an insured depository institution. The definition, however, does not encompass negotiable order of withdrawal (NOW) accounts or money market deposit accounts (MMDAs).

The FDIC noted that depository institutions sometimes waive fees or provide fee-reducing credits for customers with checking accounts and stated that such account features do not prevent an account from qualifying under the Transaction Account Guarantee Program as a noninterest-bearing transaction account, as long as the account otherwise satisfies the definition.

The guarantee provided for noninterest-bearing transaction accounts is in addition to and separate from the coverage provided under the FDIC's general deposit insurance regulations. Although the unlimited coverage for noninterest-bearing transaction accounts is intended primarily to apply to transaction accounts held by businesses, the FDIC said it applies to all such accounts held by any depositor. Thus, for example, if a consumer has a \$250,000 certificate of deposit and a noninterest-bearing checking account for \$50,000, he or she would be fully insured for \$300,000 (assuming the depositor has no other funds at the same institution). Coverage up to \$250,000 would be provided for the certificate of deposit under the FDIC's general rules for deposit insurance coverage.¹²⁵ Full coverage of the \$50,000 checking account would be provided under the Transaction Account Guarantee Program.

With respect to sweep accounts, the FDIC's Interim Rule treats funds in sweep accounts in accordance with the usual rules and procedures for determining sweep balances at a failed depository institution. Under these procedures, funds

¹²⁵ See 12 CFR 330.1(n) (providing that the standard maximum deposit insurance amount is \$250,000 through December 31, 2009).

may be transferred from a noninterest-bearing transaction account to another type of deposit or nondeposit account. Under the Interim Rule, the funds are treated as being in the account to which the funds were transferred. An exception exists, however, for funds swept from a noninterest-bearing transaction account to a noninterest-bearing savings account. Such swept funds are treated as being in a noninterest-bearing transaction account. As a result, funds swept into a noninterest-bearing savings account are guaranteed by the Transaction Account Guarantee Program.

Fees

Beginning on November 13, 2008, insured depository institutions that have not opted out of the Transaction Account Guarantee Program will be assessed on a quarterly basis an annualized 10 basis point assessment on balances in noninterest-bearing transaction accounts that exceed the existing deposit insurance limit of \$250,000. Under the Interim Rule, the FDIC will collect such assessments at the same time and in the same manner as it collects an institution's normal quarterly deposit insurance assessments. Assessments associated with the Transaction Account Guarantee Program will be in addition to an institution's risk-based assessment.

The Interim Rule requires the FDIC to impose an emergency systemic risk assessment on insured depository institutions if the fees and assessments collected under the Temporary Liquidity Guarantee Program are insufficient to cover any loss incurred as a result of the TLG Program. In addition, if at the conclusion of these programs there are any excess funds collected from the fees associated with the Temporary Liquidity Guarantee Program, the funds will remain as part of the Deposit Insurance Fund.

Payment of Claims

The Interim Rule sets forth the process for payment and recovery of FDIC guarantees of noninterest-bearing transaction accounts. Under the rule, the FDIC's obligation to make payment arises upon the failure of a participating federally insured depository institution. The payment and claims process generally follows the usual procedures for deposit insurance claims.

The FDIC will make payment to the depositor for the guaranteed amount or will make such guaranteed amount available in an account at another insured depository institution at the same time it fulfills its general deposit insurance obligation. The payment made pursuant to the Transaction Account Guarantee Program will be made as soon as possible after the FDIC, in its sole discretion, determines whether the deposit is eligible and what amount is ultimately guaranteed. In most cases, the FDIC said it will make the entire amount of a qualifying transaction account available to the depositor on the next business day following the institution's failure. If there is no acquiring institution for a

transaction account guaranteed by the program, the FDIC will mail a check to the depositor for the full amount of the guaranteed account within days of the insured depository institution's failure.

As it does in satisfying claims for insured deposits, the FDIC will rely on the books and records of the insured depository institution to establish ownership and coverage for payment of deposits subject to the Transaction Account Guarantee Program. In making its determination about what amounts are guaranteed, the FDIC may require the depositor to file a proof of claim, although the FDIC anticipates that such proofs generally would not be required in the normal course.

The FDIC's determination of the guaranteed amount will be final and will be considered a final administrative determination subject to judicial review in accordance with Chapter 7 of Title 5, similar to that provided for insured deposit claims.

Legal Authority

The FDIC relied on its emergency powers under section 13(c)(4)(G) of the Federal Deposit Insurance Act as legal authority for both prongs of the Temporary Liquidity Guarantee Program.¹²⁶ A reading of that section, however, indicates that the FDIC stretched to find authority for the Program.

Section 13(c)(4)(G) provides, in pertinent part, as follows:

(G) Systemic risk.—(i) Emergency determination by secretary of the treasury.— Notwithstanding subparagraphs (A) [requiring least cost resolution of a financial institution] and (E) [disallowing protection of uninsured depositors and creditors], if, upon the written recommendation of the [FDIC] Board of Directors (upon a vote of not less than two-thirds of the members of the Board of Directors) and the Board of Governors of the Federal Reserve System (upon a vote of not less than two-thirds of the members of such Board), the Secretary of the Treasury (in consultation with the President) determines that—

(I) the Corporation's compliance with subparagraphs (A) and (E) with respect to an insured depository institution would have serious adverse effects on economic conditions or financial stability; and

(II) any action or assistance under this subparagraph would avoid or mitigate such adverse effects,

¹²⁶ 12 U.S.C. § 1823(c)(4)(G).

the Corporation may take other action or provide assistance under this section as necessary to avoid or mitigate such effects.¹²⁷

The above systemic risk exception allows the FDIC to act “notwithstanding subparagraphs (A) and (E)” of section 13(c)(4). Subparagraph (A) requires the FDIC, before providing assistance to any insured depository institution, to determine that such assistance is necessary to meet the FDIC’s obligation to provide insurance coverage “for the insured deposits in such institution” and that the total amount of the FDIC’s expenditures and obligations in connection with insurance coverage for such institution “is the least costly to the deposit insurance fund of all possible methods” for meeting for providing deposit insurance coverage. Subparagraph (E) prohibits the FDIC from taking “any action, directly or indirectly, with respect to any insured depository institution that would have the effect of increasing losses to any insurance fund by protecting (I) depositors for more than the insured portion of deposits . . . or (II) creditors other than depositors.”

Both of these subparagraphs relate to the FDIC’s determinations with respect to a specific financial institution. Nevertheless, the FDIC interpreted section 13(c)(4)(G) to permit both prongs of the Temporary Liquidity Guarantee Program. The FDIC said that section 13(c)(4)(G) “provides a blueprint that authorizes action by the Federal government in circumstances involving . . . systemic risk.”¹²⁸ The FDIC noted that the Secretary of the Treasury, after consultation with the President, made a determination of systemic risk following receipt of written recommendations by the FDIC and Federal Reserve Board. The FDIC said that the determination of systemic risk “allowed the FDIC to take certain actions to avoid or mitigate serious adverse effects on economic conditions and financial stability.”¹²⁹

In making its written recommendation regarding systemic risk, the FDIC said it reviewed a number of factors, including “unduly tightened lending standards and terms, decreased borrowing, rapid outflows of deposits, reduced issuances of commercial paper and asset- and mortgage-backed securities, decreased and costly alternative funding mechanisms, and a lack of confidence in financial institutions based on embedded and uncertain balance sheet losses.”¹³⁰

D. Conservatorship of Fannie Mae and Freddie Mac

Congress enacted legislation in July of 2008 to reform the regulation of the GSEs and provide the Treasury with authority to purchase their obligations.¹³¹ The legislation had been requested by the Treasury to address a precipitous drop in the market value of GSE equity securities and concern that rumors about the financial

¹²⁷ 12 U.S.C. § 1823(c)(4)(G).

¹²⁸ 73 Fed. Reg. 64,179 (Oct. 29, 2008).

¹²⁹ 73 Fed. Reg. at 64,180.

¹³⁰ *Id.*

condition of these entities could have a negative impact on their borrowing capacity.¹³² In light of the GSE's central role in the U.S. housing finance system, the Treasury determined that these entities should not be allowed to fail.¹³³

In conjunction with the Treasury's proposal, the Federal Reserve Board authorized the Federal Reserve Bank of New York to lend to the GSEs should such lending prove necessary.¹³⁴

The GSE legislation authorized the Treasury, until December 31, 2009, to purchase an unlimited amount of equity securities and/or debt obligations issued by the GSEs.¹³⁵ As a condition to the exercise its expanded authority, the Secretary of the Treasury was required to conclude that such action was necessary to provide stability to the financial markets, prevent disruptions in the availability of mortgage finance, and protect the taxpayer. The Treasury could establish the terms and conditions for such purchases, but had to take into account, among other factors "the need to maintain the [GSE's] status as a private shareholder-owned company."¹³⁶

The legislation also created a new regulatory agency with significantly enhanced authority over the GSEs. The new Federal Housing Finance Agency ("FHFA") was given broad powers to establish capital requirements, prudential operating standards, and similar rules for the GSE. The FHFA also was granted a wide range of enforcement powers similar to those of the federal banking agencies, and the authority to place the GSEs into conservatorship or receivership.¹³⁷

¹³¹ Federal Housing Finance Regulatory Reform Act, Title I of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289 (2008).

¹³² See "Bets on Fannie, Freddie Prove Costly," Wall St. J., July 15, 2008 C.13 (reporting that shares of the Associations had declined more than 80 percent in the past year).

¹³³ See Treasury Department Press Release dated July 13, 2008, HP-1079, "Paulson Announces GSE Initiatives."

¹³⁴ Federal Reserve Board Press Release dated July 13, 2008. Any such lending would be at the primary credit rate and collateralized by U.S. government and federal agency securities. The Board stated that this authorization "is intended to supplement the Treasury's existing lending authority and to help ensure the ability of Fannie Mae and Freddie Mac to promote the availability of home mortgage credit during a period of stress in financial markets."

¹³⁵ 12 U.S.C. § 1719(g) and 12 U.S.C. § 1455(l), as added by the Housing Finance Act. Previously, the Treasury was authorized to purchase debt obligations issued by the GSEs up to \$2.25 billion. 12 U.S.C. § 1719(c).

¹³⁶ *Id.* at § 1719(c) (v). In order to maintain the GSEs as private shareholder-owned companies, the Treasury was required to honor the rights of GSE debt holders, since defaulting on debt obligations is a mandatory ground for receivership. Under the new law, mandatory grounds for receivership include not generally paying debt obligations as they become due for a period of 60 calendar days.

¹³⁷ The Act also eliminated the prior exemption from federal securities registration for equity securities issued by the GSEs, thereby requiring them to file public documents concerning their financial condition. This provision was intended to foster greater transparency, accountability, and public availability of information concerning the GSEs. In actuality, FNMA began voluntarily

Notwithstanding the Congressional intent to maintain the GSEs as private shareholder owned companies, on September 7, 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship. As the conservator for the GSEs, the FHFA assumed all of the legal authority of the shareholders, directors and officers of these companies.

In an explanatory statement, the FHFA's director did not point to any one single critical event that prompted this action, but noted that the GSEs were facing a number of challenges, including current market conditions and an inability to fund themselves according to normal practices and prices. He stated that conservatorship was necessary to "help restore confidence in Fannie Mae and Freddie Mac, enhance their capacity to fulfill their mission, and mitigate the systemic risk that has contributed directly to the instability in the current markets."¹³⁸ He noted that a lack of market confidence in these companies had resulted in a continuing widening of the spread between Treasury and GSE securities, which meant that the drop in interest rates generally had not been fully reflected in mortgage rates. The director reiterated that the objective of the conservatorships was to return the entities to normal business operations.¹³⁹

The boards of both Fannie Mae and Freddie Mac consented to the appointment of a conservator for their respective institutions. The conservatorships are not subject to any time limitation and will end when FHFA determines they are no longer necessary.

In conjunction with the conservatorships, the Treasury on September 7, 2008, announced that, pursuant to its authority under the Federal Housing Finance Regulatory Reform Act enacted in July, it had entered into agreements with Fannie Mae and Freddie Mac to provide both capital and liquidity support to these companies. In consideration for these commitments, the Treasury received one million shares of "Variable Liquidation Preference Senior Preferred Stock" of each company, with an initial liquidation preference of \$1,000 per share, for a total value of \$1 billion per company. The Treasury also received warrants for the purchase of common stock of each GSE representing 79.9% of the common stock of each GSE on a fully-diluted basis at a nominal price.

In return, the Treasury became contractually committed to provide up to \$100 billion of additional equity funding to each company, upon the call of either company, if certain financial triggering events occur.

registering its common stock with the Securities and Exchange Commission in 2003, and FHLMC did so in 2008.

¹³⁸ Federal Housing Finance Agency, Statement of FHFA Director James B. Lockhart (Sept. 7, 2008).

¹³⁹ *Id.*

The Treasury also entered into Senior Preferred Stock Purchase Agreements with the FHFA, as conservator for the GSEs. Each agreement specifies that the Treasury will provide funds to the GSE to the extent that the liabilities of the GSE exceed its assets as determined under GAAP. If a GSE is placed into receivership or becomes subject to any other liquidation process or proceeding, the draw on the Treasury is equal to the amount that total allowed claims (other than those equal to or subordinate to the senior preferred shares) exceeds total assets. These commitments are subject to a \$100 billion limit for each GSE, are of “indefinite duration”, and will terminate with respect to either GSE at the earlier of:

- (i) liquidation of the GSE’s assets and the payment of the Treasury’s obligations to make up capital deficiency;
- (ii) the payment in full of all of the GSE’s obligations (or defeasance of such obligations) and provision for unmatured liabilities; or
- (iii) the purchase of \$100 billion of senior preferred securities.

In other words, the Treasury is obligated, up to \$100 billion for each GSE, to ensure that the GSE’s assets exceed its liabilities. If a GSE nevertheless is placed into receivership, the Treasury is obligated, again up to \$100 billion for each company, to ensure that the amount of the GSE’s assets equals the amount of allowed claims (other than claims equal to or subordinate to the senior preferred shares). There is no discretion under the agreements for the Treasury to refuse to provide such equity funding if the conditions in the agreements are satisfied (e.g., a determination consistent with GAAP that liabilities exceed assets; the receipt of a written notice from the FHFA).¹⁴⁰

The Agreements provide rights to GSE debt holders to enforce the terms of the Agreements against either the Treasury or FHFA if there is a default on a debt obligation or payment on a guarantee.

As part of the justification for governmental assistance to the GSEs, the Treasury stated that due to “ambiguities” in the statutes establishing Fannie Mae and Freddie Mac, a perception had been created of Government backing, and that there was therefore a governmental responsibility to protect debt holders:

¹⁴⁰ Each Agreement states that the Treasury commits to provide “immediately available funds.” However, the procedures for the FHFA director to request a draw state that the request must be made within 15 business days after the end of a fiscal quarter. Following receipt of the request, the Treasury has up to 60 days to provide the funds. If the Director determines that he or she will be required, by law, to place a GSE into conservatorship, the Treasury is required to provide the funds in a shorter time period as may be necessary to avoid a mandatory receivership if “reasonably practicable taking into consideration [Treasury’s] access to funds.”

To address our responsibility to support GSE debt and mortgage-backed securities holders, Treasury entered into a Senior Preferred Stock Purchase Agreement with each GSE which ensures that each enterprise maintains a positive net worth. This measure adds to market stability by providing security to GSE debt holders – senior and subordinated – and adds to mortgage affordability by providing additional confidence to investors in GSE mortgage-backed securities.

Nevertheless, each agreement also states that it is not intended to and shall not be deemed to constitute a guarantee by the Treasury for the payment or performance of any liability of a GSE.

In addition to the equity support, the Treasury established a credit facility to provide backstop liquidity to the GSEs. The credit facility will make advances to either GSE as needed through December 31, 2009. Fannie Mae and Freddie Mac guaranteed mortgage-backed securities will be eligible collateral. The Treasury said that it would provide additional support for the GSEs by purchasing GSE issued mortgage-backed securities in the open market.

E. Other Regulatory Actions

In addition to the measures described above, federal government agencies took a number of other actions addressing various aspects of the financial crisis.

1. Regulation of Subprime Lending

In July of 2008, the Federal Reserve Board issued rules to regulate the subprime mortgage market. Congress directed the Board to issue such rules in 1994 in the Home Owner Equity Protection Act of 1994 (“HOEPA”) but the Board failed to do so until this year.¹⁴¹

The new rules provide four key protections for “higher-priced mortgage loans” secured by a consumer’s principal dwelling. The Board said the definition of “higher-priced mortgage loans” capture virtually all loans in the subprime market, but generally exclude loans in the prime market.¹⁴² For loans in this category, the rules:

¹⁴¹ HOEPA provides as follows: “The Board, by regulation or order, shall prohibit acts or practices in connection with— (A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and (B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.” 15 U.S.C. § 1639(I).

¹⁴² The Board said it would publish an index based on the “average prime offer rate” which is based on a survey currently published by Freddie Mac. A loan is higher-priced for purposes of the

- Prohibit creditors from extending credit without regard to a consumer's ability to repay from sources other than the collateral itself;
- Require creditors to verify income and assets they rely upon to determine repayment ability;
- Prohibit prepayment penalties except under certain conditions; and
- Require creditors to establish escrow accounts for taxes and insurance, but permit creditors to allow borrowers to cancel escrows 12 months after loan consummation.¹⁴³

These rules promote sounder credit underwriting practices as well as protect borrowers. In addition, the rules adopt the following protections for loans secured by a consumer's principal dwelling, regardless of whether the loan is higher-priced:

- Creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home's value.
- Companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers' loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.
- Creditors must provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer's principal dwelling, such as a home improvement loan or a loan to refinance an existing loan.¹⁴⁴

The rules also require that advertisements for mortgage loans provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features. The rules also prohibit specific practices deemed to be deceptive or misleading.

rule if it is a first-lien mortgage and has an annual percentage rate that is 1.5 percentage points or more above this index, or 3.5 percentage points if it is a subordinate-lien mortgage.

¹⁴³ 12 C.F.R. Pt. 226; 73 Fed. Reg. 44,521 (July 30, 2008).

¹⁴⁴ Currently, early cost estimates are only required for home-purchase loans. Consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

2. Payment of Interest on Bank Reserves

On October 6, 2008, the Federal Reserve Board announced that it would begin paying interest on reserve requirements maintained by depository institutions at the Federal Reserve Banks. The Board stated that the payment of interest on reserve balances would give it “greater scope to use its lending programs to address conditions in credit markets while also maintaining the federal funds rate close to the target established by the Federal Open Market Committee.”¹⁴⁵

Congress had authorized the Board to begin paying interest on reserve requirements as of October 1, 2011 in the Financial Services Regulatory Relief Act of 2006.¹⁴⁶ The EESA moved this date forward to October 1, 2008.¹⁴⁷

Reserve requirements assist in monetary policy by providing a predictable demand for the total reserves that the Federal Reserve needs to supply through open market operations in order to achieve a given federal funds rate target. As explained by the Board’s vice chairman:

In order for the Federal Open Market Committee (FOMC) to conduct monetary policy effectively, it is important that a sufficient and predictable demand for balances at the Reserve Banks exist so that the Federal Reserve knows the volume of reserves to supply (or remove) through open market operations to achieve the FOMC’s target federal funds rate.

Having the authority to pay interest on excess reserves also could help mitigate potential volatility in overnight interest rates. If the Federal Reserve was authorized to pay interest on excess reserves, and did so, the rate paid would act as a minimum for overnight interest rates, because banks generally would not lend to other banks at a lower rate than they could earn by keeping their excess funds at a Reserve Bank.¹⁴⁸

Initially, the rate on required reserve balances was set at the average target federal funds rate established by the Federal Open Market Committee (FOMC) over a reserves maintenance period minus 10 basis points. The rate on excess balances was set as the lowest federal funds rate target in effect during a reserve maintenance period minus 35 basis points. The Federal Reserve Board changed these formulas on November 5, 2008, so that the rate on required reserve balances will be equal to the average target federal funds rate over the reserve maintenance period and the

¹⁴⁵ Board Press Release dated Oct. 6, 2008.

¹⁴⁶ 12 U.S.C. 461 note.

¹⁴⁷ EESA § 128.

¹⁴⁸ Testimony of Federal Reserve Board Vice Chairman Donald L. Kohn before the Senate Committee on Banking, Housing, and Urban Affairs (March 1, 2006).

rate on excess balances will be set equal to the lowest FOMC target rate in effect during the reserve maintenance period.

3. Clarification of Mark-to-Market Standards

The SEC on September 30, 2008, issued clarifications and guidance on FASB Statement No. 157, Fair Value Measurements, to provide greater flexibility for institutions to exercise judgment in measuring the fair value of assets during unstable market conditions. The clarifications were issued jointly with staff of the Financial Accounting Standards Board (FASB) pending FASB's preparation of additional interpretative guidance.¹⁴⁹

The fair value (or mark-to-market) accounting standards were thought to have exacerbated the financial crisis by requiring financial institutions to mark down assets to unreasonably low levels.

The guidance allows financial statements to reflect management's judgment and internal assumptions (such as expected cash flow from an asset) to be used in measuring fair value when relevant market evidence does not exist:

When an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, and include appropriate risk premiums, is acceptable. Statement 157 discusses a range of information and valuation techniques that a reasonable preparer might use to estimate fair value when relevant market data may be unavailable, which may be the case during this period of market uncertainty. This can, in appropriate circumstances, include expected cash flows from an asset. . . .

The guidance noted that "the determination of fair value often requires significant judgment" and that, in some cases, "multiple inputs from different sources may collectively provide the best evidence of fair value."

The guidance also addressed the use of market quotes by brokers in assessing the mix of information available to measure fair value and factors that may be considered in determining whether an investment is other-than-temporarily impaired. The guidance stated that disorderly transactions are not determinative in measuring fair value and that the fact that a transaction is distressed or forced is relevant in making fair value judgments. Transactions in an inactive market also may affect fair value measurements:

The SEC said that, because fair value measurements and the assessment of impairment may require significant judgments, clear and transparent disclosures

¹⁴⁹ SEC Press Release 2008-234 (Sept. 30, 2008).

must be provided to investors so they can understand the judgments made by management.

As noted above, the EESA required the SEC to conduct a study on mark-to-market accounting standards within 90 days after enactment.

4. Easing of Section 23A Restrictions

The Board adopted an exemption from the prohibitions on bank transactions with affiliates in sections 23A and 23B of the Federal Reserve Act to allow securities broker-dealers to obtain financing from affiliated banks for securities or other assets that the affiliate ordinarily would finance through the U.S. tri-party repurchase agreement market.¹⁵⁰ The rule was effective as of September 14, 2008, on an interim basis. The Board said the exemption would expire on January 30, 2009, unless extended by the Board.

The Board also granted an exemption from Sections 23A and 23B to increase the capacity of banks to purchase asset-backed commercial paper from affiliated money market mutual funds in connection with the asset-backed commercial paper lending facility. As described above, the Board on September 19, 2008, created a special lending facility allowing banks and bank holding companies to borrow from the Federal Reserve Bank of Boston on a non-recourse basis if they use the proceeds of the loan to purchase asset-backed commercial paper from money market mutual funds. Without the Section 23A exemption, banks would have been constrained in their purchases from affiliated funds. This exemption also expires on January 30, 2009, unless extended by the Board.

5. Easing of Bank Capital Requirements

The federal banking agencies on October 27, 2008, requested public comment on a proposed rule to modify the agencies' risk-based capital rules to give more favorable capital treatment to bank investments in debt and securities guaranteed by Fannie Mae and Freddie Mac.¹⁵¹ The proposal would free up bank capital to support other bank assets, such as new loans.

Ordinarily, claims on, and the portion of claims guaranteed by, U.S. government-sponsored agencies receive a 20 percent risk weight. The agencies proposed to assign a 10 percent risk weight to such claims in light of the \$100 billion of additional financial support the Treasury committed to provide to each of

¹⁵⁰ 73 Fed. Reg. 54,307 (Sept. 19, 2008); 12 C.F.R. § 223.42. Section 23A of the Federal Reserve Act limit a bank's loans and other "covered transactions" with affiliates to no more than 10 percent of the bank's capital in the case of a single affiliate and no more than 20 percent in the case of all affiliates. Section 23A requires all affiliate transactions to be conducted on an arms' length basis. 12 U.S.C. §§ 371c and 371c-1.

¹⁵¹ 73 Fed. Reg. 63,656 (October 27, 2008).

the GSEs after they were placed into conservatorship on September 7, 2008. The reduced risk weight reflects the reduced risk of the GSEs' obligations.

Under the proposal, claims would include all credit exposures, such as senior and subordinated debt and counterparty credit risk exposures, but not preferred or common stock. The 10 percent risk weight would be applied to credit exposures created on, before, or after September 7, 2008. The required leverage ratio under the capital rules would not be changed.

V. WAS EESA NECESSARY?

The U.S. financial crisis has been met with a barrage of actions by various federal government agencies as well as Congress. It is difficult to say which actions have had the greatest impact in containing the crisis and restoring financial stability. Arguably the most dramatic action was the enactment of the EESA. Ironically, the Act appears to be the least necessary of the government actions taken to date, other than as a political necessity.

With the exception of the Treasury's capital injection plan, all of the major actions taken by the government in response to the financial crisis thus far were adopted pursuant to the agencies' legal authority independent of EESA. And even the capital injection plan was possible under pre-existing authority.

The Treasury's program to partially guarantee money market mutual funds was initiated prior to enactment of EESA under the Gold Reserve Act of 1934 which created the Economic Stabilization Fund and which the Treasury is using to fund the guarantee program.¹⁵² The EESA did not alter this authority, or the Treasury's money market mutual fund guarantee program, other than to require the Treasury to reimburse the Fund and to prohibit Treasury from using the Fund for any future guaranty programs for the money market mutual fund industry.

The Federal Reserve Board relied on its existing authority under section 13(3) of the Federal Reserve Act to create new liquidity facilities for money market mutual funds to off-load asset-backed commercial paper and short-term debt obligations. The Board similarly relied on section 13(3) for its direct purchases of commercial paper from private sector corporate issuers.¹⁵³

¹⁵² The Gold Reserve Act authorizes the Secretary of the Treasury, with the approval of the President, "to deal in gold, foreign exchange, and other instruments of credit and securities" consistent with the obligations of the U.S. government in the International Monetary Fund to promote international financial stability.

¹⁵³ As noted above, that section permits the Board, in unusual and exigent circumstances, to authorize the Reserve Banks to extend credit to individuals, partnerships, and corporations that are unable to obtain adequate credit accommodations.

The FDIC relied on the systemic risk provisions in section 13(c)(4)(G) of the Federal Deposit Insurance Act in guaranteeing bank debt obligations and business checking accounts at banks. Under the FDIC's expansive interpretation of its powers under the Federal Deposit Insurance Act, the enactment of EESA was not necessary to increase the deposit insurance limit to \$250,000—the FDIC could have done that on its own without EESA.

The SEC acted prior to enactment of EESA to provide greater clarity in the valuation of troubled assets under mark-to market accounting rules, relying on its existing authority.

The conservatorships of Fannie Mae and Freddie Mac, and the Treasury's commitment to provide financial backing to the GSEs, were taken pursuant to legislation enacted prior to EESA.

The only emergency relief program directly emanating from EESA to date appears to be the Treasury's capital injection plan. Yet, even this program could have been implemented by the Federal Reserve Board using its powers under the Federal Reserve Act, much as the Board did in the case of AIG and in lending to corporate issuers of commercial paper.¹⁵⁴ The Board's balance sheet is unlimited, and its powers under section 13(3) and 10B of the Federal Reserve Act appear sufficiently broad to enable it to make capital injections in a form similar to that under the Treasury's capital injection program.¹⁵⁵

Why, then, did the Treasury and Federal Reserve Board request Congressional approval for new authority to deal with the financial crisis when their existing authority seemed ample? Sensitivity to Congressional criticism is a likely reason, along with a desire to share accountability with legislators for the massive expenditures of federal funds.

An article appearing in the *Washington Post* on September 18, 2008, highlighted Congressional agitation at the unilateral actions of the Federal Reserve and Treasury:

¹⁵⁴ The criticality of the capital injection plan in stabilizing the financial markets is questionable in any event to the extent that it aids healthy banks.

¹⁵⁵ Section 10B provides: "Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. Notwithstanding the foregoing, any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time notes having such maturities as the Board may prescribe and which are secured by mortgage loans covering a one-to-four family residence. Such advances shall bear interest at a rate equal to the lowest discount rate in effect at such Federal Reserve bank on the date of such note." Limitations apply on the duration of advances to undercapitalized banks. 12 U.S.C. § 347b.

Lawmakers on both sides of the aisle expressed concern yesterday that they have had no control over when and how federal money has been used to curb the panic on Wall Street. . . .

House Speaker Nancy Pelosi (D-Calif.) said she has dispatched Rep. Barney Frank (D-Mass.), chairman of the House Financial Services Committee, to determine whether Federal Reserve Chairman Ben S. Bernanke should retain authority to unilaterally bail out failing firms, as he did Tuesday with a loan of \$85 billion to insurance giant American International Group. * * * *

Republicans in the House have scheduled a news conference for today to protest the string of bailouts that began in March with Wall Street investment bank Bear Stearns and extended in recent weeks to mortgage-finance giants Fannie Mae and Freddie Mac, as well as AIG. * * * *

. . . . Frank said he was troubled to learn in the meeting Tuesday that Bernanke has legal authority to use the central bank's reserves, which total \$888 billion, to make loans to any entity under any terms he deems economically justified.

"No one in this democracy -- unelected -- should have \$800 billion to dispense as he sees fit," Frank said. "It may be that there is so much bad debt out there clogging our system that we may have to have some intervention. But it shouldn't be the unilateral decision of the chairman of the Federal Reserve with the backing of the secretary of the Treasury."

. . . ."These massive amounts, it is deeply troubling," said Sen. Christopher J. Dodd (D-Conn.), chairman of the Senate Banking Committee."¹⁵⁶

The Treasury and Federal Reserve undoubtedly concluded that it would be prudent to consult with Congressional leaders before undertaking even greater expenditures to prop up the financial system. Had they not asked for and received Congressional endorsement of their plans, it is likely that Congress would have

¹⁵⁶ "Lawmakers Left On the Sidelines As Fed, Treasury Take Swift Action," Wash. Post, Sept. 18, 2008, A1 (House Speaker Nancy Pelosi reportedly "dispatched" Rep. Barney Frank, chairman of the House Financial Services Committee, to determine whether Federal Reserve Chairman Bernanke should retain authority to unilaterally bail out failing firms, as he did with an \$85 billion loan to AIG. "Frank said he was troubled to learn . . . that Bernanke has legal authority to use the central bank's reserves, which total \$888 billion, to make loans to any entity under any terms he deems economically justified." Majority Leader Harry Reid publicly criticized the Treasury and Federal Reserve for not letting Congress know ahead of time about the AIG bailout.

complained more loudly. It is unlikely that Congress would have acted to forestall their actions, however, especially since the legislature was about to adjourn for the 2008 elections.

It is unknown precisely what authority Secretary Paulson and Chairman Bernanke asked for when they met with Congressional leaders on the night of September 18, 2008. But it seems clear that the two leaders concluded it would be advisable to have some form of Congressional imprimatur on the major actions they were about to take. The Treasury and Federal Reserve Board understandably were hesitant to announce a sweeping \$700 billion plan on their own, and undoubtedly hoped that Congressional endorsement of a massive rescue package would have a salutary effect on the markets.

Their calculus was risky. The possibility that the debate in Congress would be contentious no doubt entered their minds, but they perhaps did not anticipate the extent to which ill-considered remarks on the floor of the House of Representatives would disturb the markets. Nor is it likely that they anticipated that the bill would be defeated on its initial vote, causing a record one-day drop in the stock markets.

More significantly, the Treasury Secretary and Federal Reserve Chairman risked the likelihood that Congress would load up the bill with strings and whistles that could impede the rescue effort. Indeed, the legislation that ultimately became EESA includes numerous extraneous provisions—apart from the offensive “pork” provisions—that complicate the regulators’ job. The directives in the bill are self-contradictory in places. The layers of oversight are excessive. The language requiring the government to recoup from the “financial industry” any losses resulting from TARP after five years is irrational. The provisions on executive compensation are counterproductive.

It would have been simpler in many respects for the Treasury and Federal Reserve to have proceeded with their various rescue plans without the involvement of the legislative body, particularly one that was about to face angry voters. Congress would not have been deprived of its oversight role—the oversight process would have occurred regardless through hearings, GAO studies, formal and informal reporting, and ultimately through legislative reform of the financial regulatory system which is likely to occur in the next Congress.¹⁵⁷

Nevertheless, it would have been politically risky, if not irresponsible, for the federal agencies to have acted without some form of direct Congressional involvement. The Federal Reserve Board particularly is beholden to Congress for its status as an independent agency and is necessarily sensitive to Congressional

¹⁵⁷ The regulators also might have had greater flexibility to rescue other sectors of the economy, such as the auto industry. The TARP program, as enacted in EESA, is limited to financial institutions. The Federal Reserve Board nevertheless has broad powers under the Federal Reserve Act that might be used to lend to the auto makers.

criticism and concerns. Given the staggering sums of federal money at stake, Congressional concerns as to how it should be used seem legitimate.

The enactment of EESA appears to have given the Treasury and other government agencies, in addition to \$700 billion of statutory spending power, implicit Congressional approval for the entire rescue effort underway, including programs not expressly authorized by EESA. By enacting EESA, Congress became complicit in the “bailout” of the financial system. It, along with the government agencies, will share responsibility for the ultimate outcome.

APPENDIX A—TEXT OF THE EMERGENCY ECONOMIC STABILIZATION ACT
OF 2008

See <http://thomas.loc.gov/cgi-bin/query/z?c110:H.R.1424.enr>:

APPENDIX B—TREASURY’S INITIAL THREE-PAGE VERSION OF EESA

LEGISLATIVE PROPOSAL FOR TREASURY AUTHORITY TO PURCHASE MORTGAGE-RELATED ASSETS

Section 1. Short Title.

This Act may be cited as _____.

Sec. 2. Purchases of Mortgage-Related Assets.

(a) Authority to Purchase.--The Secretary is authorized to purchase, and to make and fund commitments to purchase, on such terms and conditions as determined by the Secretary, mortgage-related assets from any financial institution having its headquarters in the United States.

(b) Necessary Actions.--The Secretary is authorized to take such actions as the Secretary deems necessary to carry out the authorities in this Act, including, without limitation:

- (1) appointing such employees as may be required to carry out the authorities in this Act and defining their duties;
- (2) entering into contracts, including contracts for services authorized by section 3109 of title 5, United States Code, without regard to any other provision of law regarding public contracts;
- (3) designating financial institutions as financial agents of the Government, and they shall perform all such reasonable duties related to this Act as financial agents of the Government as may be required of them;
- (4) establishing vehicles that are authorized, subject to supervision by the Secretary, to purchase mortgage-related assets and issue obligations; and
- (5) issuing such regulations and other guidance as may be necessary or appropriate to define terms or carry out the authorities of this Act.

Sec. 3. Considerations.

In exercising the authorities granted in this Act, the Secretary shall take into consideration means for--

- (1) providing stability or preventing disruption to the financial markets or banking system; and
- (2) protecting the taxpayer.

Sec. 4. Reports to Congress.

Within three months of the first exercise of the authority granted in section 2(a), and semiannually thereafter, the Secretary shall report to the Committees on the Budget, Financial Services, and Ways and Means of the House of Representatives and the Committees on the Budget, Finance, and Banking, Housing, and Urban Affairs of the Senate with respect to the authorities exercised under this Act and the considerations required by section 3.

Sec. 5. Rights; Management; Sale of Mortgage-Related Assets.

(a) Exercise of Rights.--The Secretary may, at any time, exercise any rights received in connection with mortgage-related assets purchased under this Act.

(b) Management of Mortgage-Related Assets.--The Secretary shall have authority to manage mortgage-related assets purchased under this Act, including revenues and portfolio risks therefrom.

(c) Sale of Mortgage-Related Assets.--The Secretary may, at any time, upon terms and conditions and at prices determined by the Secretary, sell, or enter into securities loans, repurchase transactions or other financial transactions in regard to, any mortgage-related asset purchased under this Act.

(d) Application of Sunset to Mortgage-Related Assets.--The authority of the Secretary to hold any mortgage-related asset purchased under this Act before the termination date in section 9, or to purchase or fund the purchase of a mortgage-related asset under a commitment entered into before the termination date in section 9, is not subject to the provisions of section 9.

Sec. 6. Maximum Amount of Authorized Purchases.

The Secretary's authority to purchase mortgage-related assets under this Act shall be limited to \$700,000,000,000 outstanding at any one time

Sec. 7. Funding.

For the purpose of the authorities granted in this Act, and for the costs of administering those authorities, the Secretary may use the proceeds of the sale of any securities issued under chapter 31 of title 31, United States Code, and the purposes for which securities may be issued under chapter 31 of title 31, United States Code, are extended to include actions authorized by this Act, including the payment of administrative expenses. Any funds expended for actions authorized by this Act, including the payment of administrative expenses, shall be deemed appropriated at the time of such expenditure.

Sec. 8. Review.

Decisions by the Secretary pursuant to the authority of this Act are non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency.

Sec. 9. Termination of Authority.

The authorities under this Act, with the exception of authorities granted in sections 2(b)(5), 5 and 7, shall terminate two years from the date of enactment of this Act.

Sec. 10. Increase in Statutory Limit on the Public Debt.

Subsection (b) of section 3101 of title 31, United States Code, is amended by striking out the dollar limitation contained in such subsection and inserting in lieu thereof \$11,315,000,000,000.

Sec. 11. Credit Reform.

The costs of purchases of mortgage-related assets made under section 2(a) of this Act shall be determined as provided under the Federal Credit Reform Act of 1990, as applicable.

Sec. 12. Definitions.

For purposes of this section, the following definitions shall apply:

(1) Mortgage-Related Assets.--The term "mortgage-related assets" means 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 September 17, 2008.

(2) Secretary.--The term "Secretary" means the Secretary of the Treasury.

(3) United States.--The term "United States" means the States, territories, and possessions of the United States and the District of Columbia.