



SENATE REPUBLICAN

POLICY COMMITTEE

## Legislative Notice

No. 75

September 28, 2008

### **H.R. 3997 – Emergency Economic Stabilization Act**

*On September 29, 2008, the House is expected to amend and pass H.R. 3997.*

#### **Noteworthy**

- The House will use H.R. 3997 as the vehicle for consideration of the Emergency Economic Stabilization Act, and is expected to vote on the legislation this morning.
- In response to the turmoil in the financial sector of the United States' economy, Congress, the Department of Treasury, and the Federal Reserve have taken many different steps to restore confidence in the economy including financial markets.
- On September 19, 2008, the Secretary of the Treasury, Henry Paulson, announced the need for legislation allowing the federal government to purchase \$700 billion in distressed assets from institutional investors and submitted language to Congress to accomplish this purpose.
- It is anticipated that the Emergency Economic Stabilization Act will be introduced in the House of Representatives. At press time, it was unclear when the legislation would be considered on the House floor and what the timing would be for consideration in the Senate.
- The legislation provides the Secretary of the Treasury with \$700 billion in authority to purchase distressed assets with authority available in multiple tranches (an initial \$250 billion, a second exercise of \$100 billion, and a final \$350 billion unless disapproved by Congress).
- The legislation also provides for an insurance program for troubled assets, whereby, Treasury would guarantee troubled assets including any mortgage backed securities issued prior to March 18, 2008. Under the program, the Secretary of the Treasury would collect premiums from participating financial institutions which are both risk-based and actuarially-based.
- The legislative package includes provisions to address executive compensation, golden parachutes, and warrants to minimize risk for taxpayers. The package does not include language regarding bankruptcy "cram-down" or funding for groups such as ACORN.
- A Statement of Administration Policy (SAP) for the legislation was unavailable at press time.

## **Background**

The United States economy has experienced significant turmoil this year. In response, Congress, the Department of Treasury and the Federal Reserve have taken significant steps to try to manage this turmoil. These steps include:

- Passage of the Economic Stimulus Act of 2008 (H.R. 5140), which passed the Senate on February 7, 2008 and became law on February 13, 2008, provided stimulus checks to individual tax filers who filed returns in tax years 2007 and 2008 with a direct spending cost of \$152 billion.
- On March 14, 2008 JP Morgan Chase, in conjunction with the Federal Reserve System guarantee, provided a 28-day emergency loan to Bear Stearns in order to prevent Bear Stearns from becoming insolvent. Two days later, Bear Stearns merged with JP Morgan Chase.
- On July 26, 2008, the Housing and Economic Recovery Act of 2008 (H.R. 3221) passed the Senate and later became law on July 30, 2008. According to the Congressional Budget Office (CBO), the legislation included a new mortgage guarantee program and other provisions which cost a total of \$41.7 billion in direct spending. The legislation also included an increase in the public debt limit of \$800 billion (to \$10.615 trillion).
- The Housing and Economic Recovery Act of 2008 gave authority to the Secretary of the Treasury to exercise expanded regulatory authority over Fannie Mae and Freddie Mac (GSEs) through the newly established Federal Housing Finance Agency. In an exercise of that authority, on September 7, 2008, the Administration placed the GSEs under a conservatorship after concluding that the companies did not have enough capital to continue their operations and made arrangements to invest up to \$200 billion in the GSEs.
- On September 14, 2008, the New York Federal Reserve intervened when Lehman Brothers announced it would file for Chapter 11 bankruptcy protection. According to reports, a group of Wall Street firms agreed to provide financial assistance for Lehman's orderly liquidation and the Federal Reserve agreed to swap lower-quality assets in exchange for loans and other assistance from the government.
- On September 16, 2008, the American International Group, Inc. (AIG) suffered a liquidity crisis following the downgrade of its credit rating. The Federal Reserve extended \$85 billion in credit to AIG for a term of 24 months with AIG pledging assets as collateral and a warrant for 79.9 percent of AIG shares which were issued to the Federal Reserve.
- On September 19, 2008, the Secretary of the Treasury, Henry Paulson, announced the need for additional legislation allowing the federal government to purchase \$700 billion in distressed assets from institutional investors and submitted language to Congress to accomplish this purpose. At the same time, the Department of Treasury announced the establishment of a temporary guaranty program for the U.S. money market mutual fund industry for up to \$50 billion in guarantees.

Despite these actions, the Administration has indicated that additional action is necessary to spur the financial sector. At the root of the problems in the financial sector is the decline in housing prices which poses a continued risk for the economy. Billions of dollars of illiquid mortgage assets remain on the balance sheets of financial institutions. Because of this illiquidity, these assets are clogging U.S. credit markets. Until this issue is resolved, the financial system and economy remain at risk. The Administration has indicated that financial market turbulence also puts the housing market at greater risk. A lack of mortgage financing will put further pressure on home prices and result in more foreclosures as struggling homeowners would be unable to refinance mortgages.

The Secretary of the Treasury has warned that there is serious risk of a systemic financial collapse. Because of this concern, there is a wholesale flight to cash and U.S. Government securities. Fundamentally sound financial institutions and blue chip industrial companies are struggling to obtain critical financing. A systemic financial crisis would have serious negative impacts on Americans' everyday lives and economic well-being. When businesses and financial institutions are unable to finance their normal operations, the implications to the economy are severe. Families lose access to their savings and are unable to borrow to finance a home, a car, a college education, or other important investments. Businesses unable to access short and long-term financing cease operations and do not invest. New job creation slows significantly, credit becomes scarce, and current jobs are at risk.

Between September 5 and 17, the capitalization of stocks in U.S. markets fell by \$1.3 trillion. This put downward pressure on family savings at a time when consumers were already burdened by the slow labor market, declining home values, and high energy prices. Roughly 50 percent of American families hold stock either directly or indirectly, and roughly 50 percent have retirement accounts. Private pension plans, including defined benefit and defined contribution plans, hold over \$5.6 trillion in financial assets. More than \$4.2 trillion of these assets are in corporate stocks and mutual funds.

Capital markets matter for everyone—they affect everything from home loans, to student loans, retirement savings, and insurance. Businesses rely on capital markets to fund daily expenses and long-term investments. If financial markets collapse there will be an economic contraction affecting Americans jobs and livelihoods as consumers will be unable to finance essential purchases and businesses will not be able to operate and expand.

The Emergency Economic Stabilization Act is the result of bipartisan, bicameral negotiations with the Administration to provide the Secretary of the Treasury with the authority requested on September 19, 2008. Namely, to provide the Secretary with \$700 billion to purchase distressed assets to remove them from the balance sheets of financial institutions to stabilize their balance sheets with the hope that this will in turn stabilize and restore confidence to the financial sector as a whole. In addition to accomplishing the purposes requested by the Secretary of the Treasury, the legislation increases the statutory limit for the public debt an additional \$700 billion to \$11.315 trillion.

H.R. 3997, a bill providing tax relief for first responders and Peace Corps volunteers, was considered by the House and the Senate in 2007. In lieu of a conference, the bill was messaged

between the Houses several times, the last time on December 19, 2007 when the Senate amended the bill and sent it back to the House. With the addition of the economic stabilization legislation, the measure will come to the Senate as a House amendment to the Senate amendment to the House amendment to the Senate amendment to H.R. 3997. When this legislation returns to the Senate it cannot be further amended.

## **Bill Provision Highlights**

**Section 1 – Short Title.** “Emergency Economic Stabilization Act of 2008.”

**Section 2 – Purposes.** Provides authority to the Treasury Secretary to restore liquidity and stability to the U.S. financial system and to ensure that such authority (a) protects home values, college funds, retirement accounts and life savings; (b) preserves home ownership and promotes jobs and economic growth; (c) maximizes overall returns to the taxpayers of the United States; and (d) provides public accountability for the exercise of such authority.

**Section 3 – Definitions.** Contains various definitions used under this Act.

### **Title I. Troubled Assets Relief Program.**

**Section 101 – Purchase of Troubled Assets.** The legislation authorizes the Secretary of the Treasury (Secretary) to establish a “troubled asset relief program” (TARP) to purchase and make commitments to purchase troubled assets from financial institutions (troubled assets are not limited to mortgage related assets but could include auto loans, credit card debt, student loans or any other paper related to commercial loans). Section 101(a)(1). In exercising the authority, the Secretary is required to consult with the Federal Reserve Board (Fed), the Federal Deposit Insurance Corporation (FDIC), the Comptroller of the Currency, the Director of the Office of Thrift Supervision (OTS) and the Secretary of Housing and Urban Development (HUD). Section 101(b). The Secretary is required to take steps to ensure that the financial institutions participating in the TARP program are not unjustly enriched. Section 101(e).

**Section 102 – Insurance of Troubled Assets.** If the Secretary exercises authority to create the TARP program, the Secretary is required to also establish an insurance program to guarantee troubled assets including any mortgage backed securities issued prior to March 18, 2008. Section 102(a)(1). Upon the request of a financial institution, the Secretary may guarantee the timely payment of principal and interest to the financial institution up to 100 percent of such payments. Section 102(a)(3). In order to cover the claims, the Secretary is required to collect premiums from participating financial institutions which are both risk-based and actuarially-based. Section 102(c)(2) and (3).

**Section 103 – Considerations.** In using authority under this Act, the Treasury Secretary is required to take a number of considerations into account, including the interests of taxpayers,

minimizing the impact on the national debt, providing stability to the financial markets, preserving homeownership, the needs of all financial institutions regardless of size or other characteristics, and the needs of local communities. It requires the Secretary to examine the long-term viability of an institution in determining whether to directly purchase assets under the TARP.

**Section 104 – Financial Stability Oversight Board.** The legislation creates a Financial Stability Oversight Board (Board) which will meet monthly to oversee the TARP program. Section 104(a) and (d). The Board will be comprised of the Chairman of the Fed, the Treasury Secretary, the Director of the Federal Home Finance Agency, the Chairman of the Securities and Exchange Commission (SEC), and the Secretary of Housing and Urban Development (HUD).

**Section 105 – Reports.** Within 60 days of the first exercise of TARP authority or the guarantee authority, and every 30 days thereafter, the Secretary is required to report to Congress the actions the Secretary has taken together with a detailed financial statement regarding the TARP program. Section 105(a). An additional report to Congress is required within seven days after the Secretary makes each \$50 billion commitment to purchase troubled assets; the report shall detail each of the agreements made, insurance contracts entered into, and the nature of the asset purchased and projected costs and liabilities. An additional report is also required from the Secretary with an analysis of the current financial regulatory framework and making recommendations for improvements. Section 105(c).

**Section 106 – Rights; Management; Sale of Troubled Assets; Revenues and Sale Proceeds.** Establishes the right of the Secretary to exercise authorities under this Act at any time and provides the Secretary with the authority to manage troubled assets, including the ability to determine the terms and conditions associated with the disposition of troubled assets. Requires profits from the sale of troubled assets to be used to pay down the national debt.

**Section 107 – Contracting Procedures.** Allows the Secretary to waive provisions of the Federal Acquisition Regulation where compelling circumstances make compliance contrary to the public interest. Such waivers must be reported to Congress within seven days. If provisions related to minority contracting are waived, the Secretary must develop alternate procedures to ensure the inclusion of minority contractors. Allows the FDIC to be selected as an asset manager for residential mortgage loans and mortgage-backed securities (MBS).

**Section 108 – Conflicts of Interest.** Requires the Secretary to issue regulations and guidelines to address, manage or prohibit conflicts of interest arising pursuant to authorities exercised under this bill.

**Section 109 – Foreclosure Mitigation Efforts.** Requires the Secretary to implement a plan to maximize assistance for homeowners and to encourage mortgage servicers to work with homeowners under various homeowner assistance programs. Section 109(a).

**Section 110 – Assistance to Homeowners and Localities.** To the extent that the Federal Property Manager (FPM)(which is defined collectively as the Federal Housing Finance Agency as conservator for Fannie and Freddie, the FDIC and the Board) holds, owns or controls

mortgages, MBS, and other assets secured by residential real estate, the FPM is required to implement a program to help distressed homeowners by reducing interest rates, loan principal, or similar modifications.

**Section 111 – Executive Compensation and Corporate Governance.** Provides that Treasury will promulgate executive compensation rules governing financial institutions that sell its troubled assets. Where Treasury buys assets directly (but not by auction or other means), the selling institution must observe standards limiting incentives, allowing claw-back and prohibiting golden parachutes for as long as Treasury holds the equity position in the institution. When Treasury buys assets at auction, an institution that has sold more than \$300 million in assets is subject to additional taxes, including a 20 percent excise tax on golden parachute payments triggered by events other than retirement, and tax deduction limits for compensation limits above \$500,000 (current law provides deductibility up to \$1,000,000).

**Section 112 – Coordination with Foreign Authorities and Central Banks.** Provides that troubled assets held by foreign financial authorities and banks are eligible for the TARP program if the banks hold such assets as a result of having extended financing to financial institutions that have failed or defaulted.

**Section 113 – Minimization of Long Term Costs and Maximization of Benefits for Taxpayers.** Requires the Secretary to make purchases of troubled assets at the lowest price consistent with the purposes of the Act and to hold until maturity or sell such assets at the highest price. The Secretary is required to take warrants giving the Secretary the right to receive non-voting common stock or preferred stock in such financial institution as a condition to purchasing or making a commitment to purchase troubled assets.

**Section 114 – Market Transparency.** The Secretary is required, within two business days of exercising authority under this Act, to publicly disclose the details of any transaction.

**Section 115 – Graduated Authorization to Purchase.** Authorizes an initial \$250 billion in authority for the TARP program. An additional \$100 billion can be made available following a presidential certification to Congress. Thereafter, additional authority can be accessed up to \$700 billion following presidential certification unless a joint resolution is passed by Congress, with a veto-proof majority, within 15 days which disapproves of the additional certifications.

**Section 116 – Oversight and Audits.** Requires the Comptroller General of the United States to conduct ongoing oversight of the activities and performance of TARP, and to report every 60 days to Congress. The Comptroller General is required to conduct an annual audit of TARP. In addition, TARP is required to establish and maintain an effective system of internal controls.

**Section 117 – Study and Report on Margin Authority.** Directs the Comptroller General to conduct a study and report back to Congress on the role in which leverage and sudden deleveraging of financial institutions was a factor behind the current financial crisis.

**Section 118 – Funding.** Provides for the authorization and appropriation of funds consistent with Section 115.

**Section 119 – Judicial Review and Related Matters.** Provides that acts of the Secretary are reviewable pursuant to chapter 7 of Title 5 of the United States Code (Judicial Review of agency action).

**Section 120 – Termination of Authority.** The TARP and insurance authorities under Sections 101 and 101 sunset on December 31, 2009 unless the Secretary submits a certification to Congress to extend the authorities for an additional two years.

**Section 121 – Special Inspector General for the Troubled Asset Relief Program.** Establishes the Office of the Special Inspector General for the TARP program to conduct, supervise, and coordinate audits and investigations of the actions undertaken by the Secretary under this Act. The Special Inspector General is required to submit a quarterly report to Congress summarizing its activities and the activities of the Secretary under this Act.

**Section 122 – Increase in Statutory Limit on the Public Debt.** Increases the public debt limit by an additional \$700 billion to \$11.315 trillion. This Congress approved a debt limit increase of \$800 billion earlier this year with the enactment of the Housing and Economic Recovery Act of 2008 (Section 3083 of P.L. 110-289, which became law on July 30, 2008).

**Section 123 – Credit Reform.** Details the manner in which the legislation will be treated for budgetary purposes under the Federal Credit Reform Act.

**Section 124 – Hope for Homeowners Amendments.** Strengthens the Hope for Homeowners program to increase eligibility and improve the tools available to prevent foreclosures.

**Section 125 – Congressional Oversight Panel.** Creates a new five person panel whose members are appointed by Congress to review the current state of financial markets and the current regulatory system. This panel will also be responsible for reporting to Congress their review of the Secretary's actions under the TARP program and the effectiveness of foreclosure mitigation efforts. Such reports are required to be issued within 30 days after the Secretary first exercises TARP authority and each 30 days thereafter.

**Section 126 – FDIC Enforcement Enhancement.** Prohibits the misuse of the FDIC logo and name to falsely represent that deposits are insured. Strengthens enforcement by appropriate federal banking agencies, and allows the FDIC to take enforcement action against any person or institution where the banking agency has not acted.

**Section 127 – Cooperation with the FBI.** Requires any federal financial regulatory agency to cooperate with the FBI and other law enforcement agencies investigating fraud, misrepresentation, and malfeasance with respect to development, advertising, and sale of financial products.

**Section 128 – Acceleration of Effective Date.** Provides the Federal Reserve with the ability to pay interest on reserves.

**Section 129 – Disclosures on Exercise of Loan Authority.** Requires the Federal Reserve to provide a detailed report to Congress, in an expedited manner, upon the use of its emergency lending authority under Section 13(3) of the Federal Reserve Act.

**Section 130 – Technical Corrections.** Makes technical corrections to the Truth in Lending Act.

**Section 131 – Exchange Stabilization Fund Reimbursement.** Protects the Exchange Stabilization Fund from incurring any losses due to the temporary money market mutual fund guarantee by requiring the program created in this Act to reimburse the Fund. Prohibits any future use of the Fund for any guarantee program for the money market mutual fund industry.

**Section 132 – Suspension of Mark-to-Market Accounting.** Gives the SEC the authority under securities laws to suspend by rule, regulation or order the Statement Number 157 of the Financial Accounting Standards Board (FASB) if determined necessary or appropriate.

**Section 133 – Study on Mark-to-Market Accounting.** Requires the SEC, in consultation with the Federal Reserve and the Treasury, to conduct a study on mark-to-market accounting standards as provided in Financial Accounting Standard (FAS) 157, including its effects on balance sheets, impact on the quality of financial information, and other matters. The SEC is required to report to Congress within 90 days on its findings.

**Section 134 – Recoupment.** Requires that in five years, the President submit to Congress a proposal that recoups from the financial industry any projected losses to the taxpayer.

**Section 135 – Preservation of Authority.** Clarifies that nothing in this Act shall limit the authority of the Secretary or the Federal Reserve under any other provision of law.

## **Title II—Budget-Related Provisions**

**Section 201 – Information for Congressional Support Agencies.** Requires that information used by the Treasury Secretary in connection with activities under this Act be made available to CBO and the Joint Committee on Taxation.

**Section 202 – Reports by the Office of Management and Budget and the Congressional Budget Office.** Requires that CBO and OMB report cost estimates and related information to Congress and the President regarding the authorities that the Secretary of the Treasury has exercised under the Act.

**Section 203 – Analysis in President’s Budget.** Requires that the President include in his annual budget submission to the Congress certain analyses and estimates relating to costs incurred as a result of the Act.

**Section 204 – Emergency Treatment.** Specifies scoring of the Act for purposes of budget enforcement.



### **Title III—Tax Provisions**

**Section 301 – Gain or Loss from Sale or Exchange of Certain Preferred Stock.** Details certain changes in the tax treatment of losses on the preferred stock of certain GSEs for financial institutions. The section treats any losses on sales of Fannie Mae and Freddie Mac preferred stock by financial institutions or financial institution holding companies as ordinary losses. The provision applies to any preferred stock that was owned on September 6, 2008 or sold between January 1, 2008 and September 6, 2008.

**Section 302 – Special Rules for Tax Treatment of Executive Compensation of Employers Participating in the Troubled Assets Relief Program.** Applies limits on executive compensation and golden parachutes for certain executives of employers who participate in the auction program. Executive compensation in excess of \$500,000 is not deductible, and the definition of executive compensation is expanded to include performance pay and stock options. Golden parachutes will be prohibited prospectively for the top five executives in the case of termination, bankruptcy, insolvency, or receivership of the financial institution.

**Section 303 – Extension of Exclusion of Income from Discharge of Qualified Principal Residence Indebtedness.** Extends current law tax forgiveness on the cancellation of mortgage debt. Proposal extends for three years, through 2012, the provision enacted in the housing bill that forgives income from the cancellation of indebtedness. It does not extend the relief to home equity loans.

### **Administration Position**

A Statement of Administration Policy (SAP) for the legislation was not available at press time.