

This memorandum briefly summarizes the key provisions of a discussion draft of the Emergency Economic Stabilization Act of 2008, a legislative proposal to “provide authority for the Federal Government to purchase certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers, and for other purposes” (the “Bill”). The discussion draft addressed in this memorandum began circulating on the afternoon of September 28, 2008 and contained numerous provisions still subject to negotiation. The descriptions of any such provisions are bracketed in the memorandum.

GENERAL PROVISIONS

[The Bill grants the Secretary of the Treasury (the “Secretary”) authority to establish a troubled asset relief program (the “program”) to purchase, and to make and fund commitments to purchase, “troubled assets” from any “financial institution.” Section 101(a)(1).] “Troubled assets” include “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,” [as well as any other financial instrument that the Secretary, in consultation with the Chairman of the Board of Governors of the Federal Reserve System, deems “necessary to promote financial market stability,” so long as such determination is transmitted in writing to certain congressional committees. Section 3(9).] [A “financial institution” is “any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, organized and regulated under the laws of the United States . . . and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.” Section 3(5).]

The Bill grants the Secretary authority to purchase up to \$700 billion of troubled assets under the program. The authority to spend \$250 billion goes into effect immediately. Section 115(a)(1). The President may increase the limit to \$350 billion at any time by submitting a written certification to Congress. Section 115(a)(2). Authority to spend the final \$350 billion goes into effect if the President submits to Congress a written report detailing the Secretary’s plan to spend it, unless Congress enacts a joint resolution disapproving of the plan within ten or fifteen days of such submission. Section 115(a)(3), (c)(1).¹

The Secretary’s authority under the program expires on December 31, 2009. Section 120(a). The Secretary may, however, extend the authority to no later than two years from the date of enactment by submitting a written certification to Congress. Section 120(b).

¹ The deadline is described as fifteen days in Section 115(a)(3) and ten days in Section 115(c)(1).

MECHANICS OF THE PROGRAM

The Secretary must implement the program through a newly created Office of Financial Stability (within the Treasury Department's Office of Domestic Finance), which will be headed by an Assistant Secretary of the Treasury appointed by the President with the advice and consent of the Senate. Section 101(a)(2)(A). The Secretary may take such actions as he deems necessary to carry out his authority under the program, including designating financial institutions as agents of the government and establishing vehicles authorized to purchase troubled assets and issue obligations. Section 101(c). The Secretary must, however, consult with the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and the Secretary of Housing and Urban Development. Section 101(b).

The Secretary must make purchases under the program at the lowest price that he determines to be consistent with the purposes of the statute. Section 113(b)(1). The Secretary must make purchases using, where appropriate, "market mechanisms, including auctions or reverse auctions." Section 113(b)(2). The Secretary may not purchase or make a commitment to purchase troubled assets from a financial institution unless he receives stock warrants or senior debt instruments in the financial institution. Section 113(d).

If the Secretary makes direct purchases of troubled assets from a financial institution in return for a "meaningful equity position," then the financial institution must satisfy "appropriate standards for executive compensation and corporate governance." Section 111(a)(1). Such standards include "limits on compensation that exclude incentives for executive officers of a financial institution to take unnecessary and excessive risks that threaten the value of the financial institution during the period that the Secretary holds an equity 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 Secretary holds an equity position in the financial institution." Section 111(a)(2). The bill also limits the income tax deductions participating financial institutions may take with respect to executive compensation. Section 111(d).

The Secretary has authority to exercise all rights with respect to the purchased assets. Section 106(a). The Secretary may hold the assets to maturity or until "such time as the Secretary determines that the market is optimal for selling such assets, in order to maximize the value for taxpayers." Section 113(a)(2)(A). The Secretary may sell the assets at a price that he determines will, based on "available financial analysis, . . . maximize return on investment for the Federal Government." Section 113(a)(2)(B). [At least twenty percent of any profits realized from the sale of purchased assets must be deposited into funds created by the Federal Housing

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Enterprises Regulatory Reform Act of 1992; all other proceeds must be paid into the general fund of the Treasury for reduction of the public debt. Section 106(d).]

The Bill also establishes a Troubled Assets Insurance Fund and authorizes the Secretary to establish a program to guarantee troubled assets. Section 102(a)(1), (d)(2). Under this program, the Secretary will collect premiums from financial institutions seeking such guarantees; these funds will then be used to fulfill obligations of the guarantees. Section 102(c), (d)(1), (3).

OVERSIGHT AND REPORTING

The Bill sets out several oversight mechanisms to monitor the Secretary's activities under the program.

First, the Bill vests principal oversight responsibility in the Comptroller General. *See* Section 116(a)(1). The Secretary must "provide the Comptroller General with appropriate space and facilities in the Department of the Treasury as necessary to facilitate oversight," and the Comptroller General must be given access to all of the program's "information, data, schedules, books, accounts, financial records, reports, files, electronic communications, or other papers, things, or property." Section 116(a)(2)(A)-(B). The Comptroller General must submit reports on the program at least every two months to certain congressional committees and the Special Inspector General (see below). Section 116(a)(3).

Second, the Bill establishes several new entities with oversight responsibilities:

- The Financial Stability Oversight Board ("FSOB") is responsible for, among other things, reviewing and making recommendations regarding the Secretary's exercise of authority under the program. Section 104(a). The FSOB, which must meet monthly, is to be comprised of five members: the Secretary, the Chairman of the Board of Governors of the Federal Reserve System, the Director of the Federal Home Finance Agency, the chairman of the Securities and Exchange Commission, and the Secretary of Housing and Urban Development. Section 104(b), (d). The FSOB has the authority to "ensure" that the program is consistent with the purposes of the Act, the economic interests of the United States, and the protection of taxpayers. Section 104(e)(2).
- The Congressional Oversight Panel ("COP") is responsible for "review[ing] the current state of the financial markets and the regulatory system." Section 125(a), (b). The COP must submit to Congress monthly reports on the program and, by January 20, 2009, a special report on regulatory reform of the financial system. Section 125(b). The COP is to be comprised of five members appointed by the Speaker and minority leader of the House of Representatives and the majority and minority leaders of the Senate. Section 125(c).

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- The Office of the Special Inspector General for the Troubled Asset Program is responsible for, among other things, conducting “audits and investigations” of the program. Section 121(a), (b), (e). The Special Inspector General is appointed by the President. Section 121(c). Starting no later than October 31, 2008, the Special Inspector General must submit quarterly reports of his activities to several congressional committees. Section 121(h)(1).

Third, the Bill directs the Secretary to make various reports to Congress and the public (in addition to those already described above):

- The Secretary must submit to several congressional committees monthly reports, including detailed financial statements, explaining the actions taken pursuant to the program. Section 105(a). Also, for every \$50 billion of troubled assets the Secretary purchases under the program, he must submit a report detailing the transactions constituting that tranche. Section 105(b). Finally the Secretary must submit by April 30, 2009 a report on regulatory reform of the financial system. Section 105(c).
- The Secretary must make available to the public a description, including amounts and pricing, of the assets acquired under the program. Section 114(a). The Secretary may also require financial institutions participating in the program to make certain disclosures to regulators. Section 114(b).
- The Secretary must prepare and submit to Congress annual financial statements audited by the Comptroller General. Section 116(b).

Finally, the Bill provides for judicial review of the Secretary’s actions under the program pursuant to the Administrative Procedure Act. Section 119(a)(1). Accordingly, the Secretary’s actions will be held unlawful if “arbitrary, capricious, an abuse of discretion, or not in accordance with the law.” *Id.* The Bill imposes, however, limitations on equitable relief. Section 119(a)(2), (4).

HOMEOWNER PROTECTION

The Bill contains several provisions designed to protect homeowners. For example, with respect to any mortgages, mortgage-backed securities, and other assets secured by residential real estate purchased under the program, the Secretary must “implement a plan that seeks to maximize assistance for homeowners and use the authority of the Secretary to encourage the servicers of the underlying mortgages . . . to take advantage of . . . available programs to minimize foreclosures.” Section 109(a). The Secretary must also “consent, where appropriate, and considering net present value to the taxpayer, to reasonable requests for loss mitigation measures,” *i.e.*, loan modification requests. Section 109(c). The Bill does not, however, grant

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bankruptcy judges the authority to modify the terms of mortgages; such a provision had been included in discussion drafts circulated last week.