

The Emergency Economic Stabilization Act of 2008:

The Troubled Asset Relief Program (TARP)

A Brief Summary of Significant Provisions

- Legislative Provisions re: the Troubled Asset Relief Program (TARP)
 - Who can participate?
 - Purchase and Insurance of Troubled Assets
 - Considerations in disbursing TARP funds
 - Minimizing costs and maximizing benefits
 - Executive Compensation and Governance
 - Truth In Lending Amendments
 - HOPE for Homeowners Amendments and Foreclosure Mitigation Efforts
 - Establishment of the Financial Stability Oversight Board (FSOB)
- Implementation of the TARP Program and Authorities
 - Designated Teams at Treasury to Implement TARP
 - Application process for receiving TARP funds
 - TARP Programs
 - Financial Agents and Contractors
 - Organizational Developments
 - Activity to Date

- Summary of the Emergency Economic Stabilization Act as it relates to TARP
 - Treasury is given the authority to purchase and insure certain types of troubled assets in order to provide stability to and prevent disruptions in the economy and financial system and protecting taxpayers.
 - The purposes of the act are to immediately provide authority and facilities that Treasury can use to restore liquidity and stability to the U.S. financial system and to ensure that these activities are consistent with protecting essential components of the financial system.
- Termination of Treasury's Authority
 - The authority of the Secretary with respect to purchases and guarantees of Troubled Assets under the Act terminates on December 31, 2009, but may be extended to up to 2 years from the enactment of the Act provided that the Secretary certifies to Congress a justification for the necessity of the extension and the expected costs to taxpayers.

- Who can participate?
 - Only “financial institutions” may participate in TARP.
 - Treasury given authority to determine the scope of “financial institution.”
 - Clearly excludes foreign central banks and any institution owned by a foreign government.
 - A financial institution must have “significant operations” in the United States.
 - Treasury must ensure that financial institutions are eligible to participate without discrimination based on their size, geographic location, organizational structure, or troubled assets held.
- Purchase of Troubled Assets
 - Treasury Secretary has authority to purchase or to make and fund commitments to purchase Troubled Assets up to \$700 billion outstanding at one time.
 - Initial authority is limited to \$250 billion; \$100 billion to be authorized by the President, in writing to Congress.
 - Remaining \$350 billion upon request of Treasury Secretary and approval of Congress.
- Insurance of Troubled Assets
 - Treasury Secretary has authority to establish a program to guarantee Troubled Assets originated or issued prior to March 14, 2008.

In disbursing TARP funds, the Treasury Secretary must take into consideration the following:

- (1) protecting the interests of the taxpayers by maximizing overall returns and minimizing the impact to the national debt;
- (2) providing stability or preventing disruption to the financial markets or banking system;
- (3) the need to help families keep their homes and to stabilize communities;
- (4) the long-term viability of Financial Institutions and efficient use of funds under the Act;
- (5) ensuring that all Financial Institutions are eligible to participate without discrimination based on size, geography, form of organization or the size, type, and number of Assets eligible for purchase;
- (6) providing assistance to Financial Institutions serving low and moderate income populations and smaller Financial Institutions that were adequately capitalized as of June 30, 2008 and that have dropped a capital level as a result of devaluation of preferred government-sponsored enterprises stock;
- (7) stability for United States public instrumentalities;
- (8) protecting retirement security by purchasing Troubled Assets held on behalf of certain eligible retirement plans; and
- (9) the utility of purchasing owned real estate and multi-family mortgage backed instruments.

Minimizing Costs and Maximizing Benefits

- Treasury Secretary will act to minimize long-term negative impact on taxpayers.
- Treasury will receive warrants for debt or equity of the institution.
- The Treasury Secretary is not permitted to purchase Assets from a Financial Institution unless the Secretary receives a warrant for non-voting common stock or preferred stock if the Financial Institution is publicly traded or a warrant for common or preferred stock or senior debt if the institution is not publicly traded and the terms and conditions relating to such warrants or senior debt will be set by the Secretary in the public interest according to provisions specified in the Act.

- Executive Compensation restrictions for institutions accepting TARP funds:
 - The institution must place limits on compensation to its executive officers that exclude incentives to take "unnecessary and excessive risks" that threaten the value of the institution;
 - The institution must provide for a "clawback" of any incentive compensation paid to its senior executives based on statements of earnings, gains or other criteria that are later proven to be false or inaccurate; and
 - The institution is prohibited from making any golden parachute payments to its senior executives.
- EESA contains a more limited set of compensation-related restrictions in cases involving use of TARP for auction purchases of assets.

- EESA amends the Truth in Lending Act (TILA) by expanding the loans subject to TILA's early disclosure requirements.
- The Act requires creditors to provide applicants for loans that relate to time share plans with a Good Faith Estimate ("GFE") of the required TILA disclosures either:
 - as prescribed by regulations before they extend the credit; or
 - by mail within three days of the date on which they receive a consumer's loan application, whichever is earlier.

- EESA amends the HOPE for Homeowners program by expanding eligibility for insurance under the HOPE for Homeowners Program by:
 - including borrowers who, when considering a post March 1, 2008 interest rate reset, are likely to have debt-to-income ratios greater than 31 percent; and
 - giving the Program Board the discretion to decide to insure loans that exceed 90 percent of the appraised value of the property to which the mortgage relates.

- **Legislative Considerations:**
 - To the extent that Treasury acquires mortgages, MBS and other assets secured by residential real estate, the Secretary will maximize the assistance to homeowners.
 - The Secretary may also use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures.
- **Other Strategies under development:**
 - Treasury's new Office of Financial Stability is currently reviewing strategies to guarantee loan modifications by private lenders.
 - The HOPE for Homeowners program at the Federal Housing Administration (FHA) is one such program. According to FHA, lenders benefit by turning failing mortgages into performing loans. Other loan modification programs include those announced by FHFA in partnership with Treasury, such as a streamlined loan modification program for at-risk borrowers, to prevent foreclosures and mitigate losses.
 - The Office of Financial Stability is also considering what policy actions might be taken under CPP to encourage participating institutions to modify mortgages that are at risk of or in default.
(Source GAO)

- EESA establishes the Financial Stability Oversight Board (the “FSOB”), to:
 - (1) review the exercise of authority under the Act, including, policies implemented by the Secretary and the Office of Financial Stability to effect the purchase and insurance programs and the effect of such actions in assisting American families in preserving home ownership, stabilizing financial markets, and protecting taxpayers;
 - (2) make recommendations to the Secretary regarding use of authority under the Act; and
 - (3) report any suspected fraud, misrepresentation or malfeasance to appropriate law enforcement agencies.

- The FSOB is composed of:
 - (1) the Chairperson of the Federal Reserve;
 - (2) the Secretary of the Treasury;
 - (3) the Director of the Federal Home Finance Agency;
 - (4) the Chairman of the SEC; and
 - (5) the Secretary of HUD.

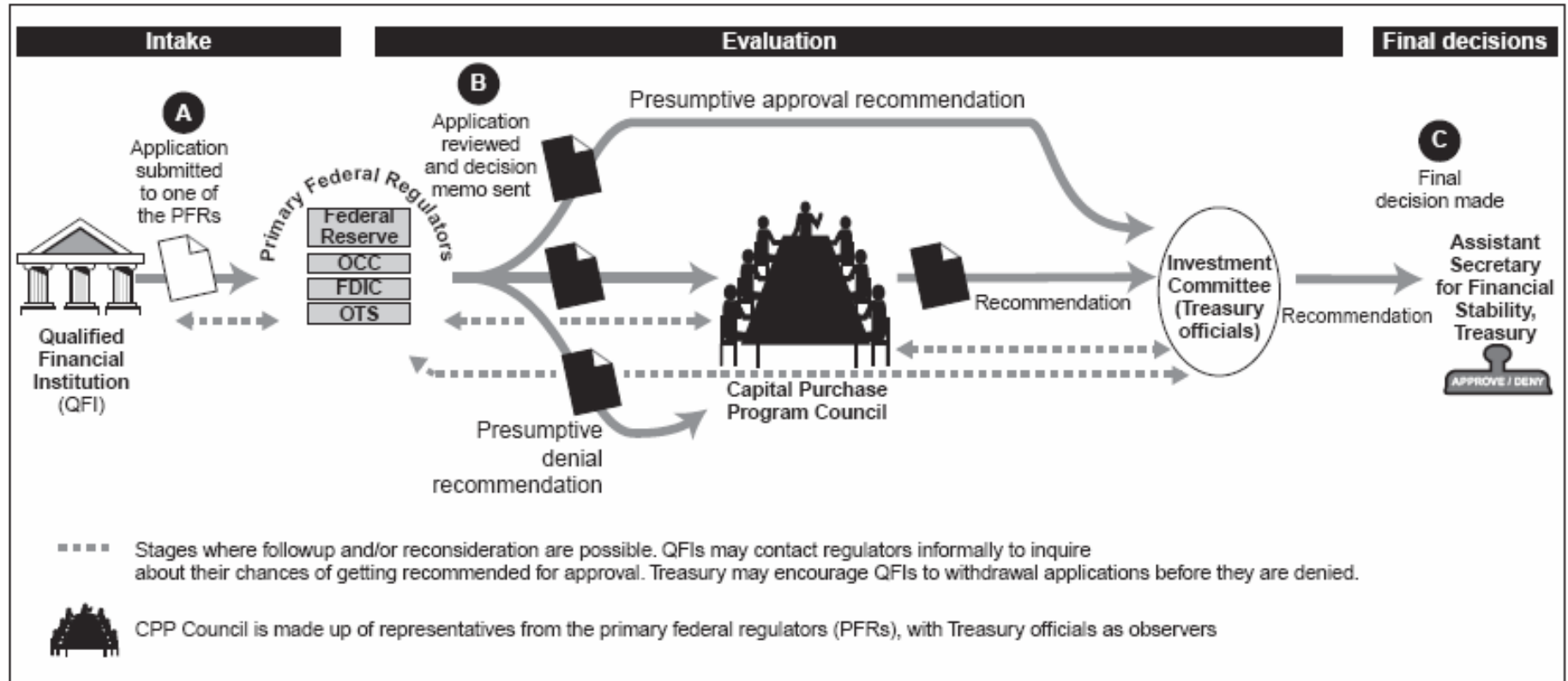
- Application process to receive TARP funds
- Where have Program efforts been focused?
 - What programs have been authorized AND utilized?
 - Troubled Asset Auction Program
 - Capital Purchase Program (CPP)
 - Programs for Systemically Significant Failing Institutions (SSFI)
- Program Activity
- Who has Treasury hired to advise and implement TARP?
 - Investment Advisers
 - Legal Advisers
 - Law Firms
 - Accounting firms
 - Custodian
 - Chief Investment Officer
- Organizational Developments

- 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.
- 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.

(Source: Asst. Secretary Kashkari Remarks October 13, 2008 before the Institute of International Bankers)

Application Process for TARP Funds

Figure 1: Process for Accepting and Approving CPP Applications, as of November 21, 2008



Sources: GAO analysis; Treasury; Art Explosion (images).

Authorized Programs under TARP Legislation

- Authorized Programs not yet in use:
 - Troubled Asset Auction Program
 - Programs for Systemically Significant Failing Institutions (SSFI)
- Authorized Programs utilized to date:
 - Capital Purchase Program (CPP)
 - The Capital Purchase Program was initiated and designed to stabilize the financial system as quickly as possible by bolstering bank capital levels, then to restore confidence to the market thereby unlocking the flow of credit.
 - Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms as described in the program's term sheet. The program will be available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities that elect to participate before 5:00 pm (EDT) on November 14, 2008. Treasury will determine eligibility and allocations for interested parties after consultation with the appropriate federal banking agency.
 - The minimum subscription amount available to a participating institution is 1 percent of risk-weighted assets. The maximum subscription amount is the lesser of \$25 billion or 3 percent of risk-weighted assets. Treasury will fund the senior preferred shares purchased under the program by year-end 2008.

Implementation of TARP: Program Activity

10/14: Treasury announces that it will purchase up to \$250 billion in financial firms' preferred stock under TARP via the Capital Purchase Program (CPP)

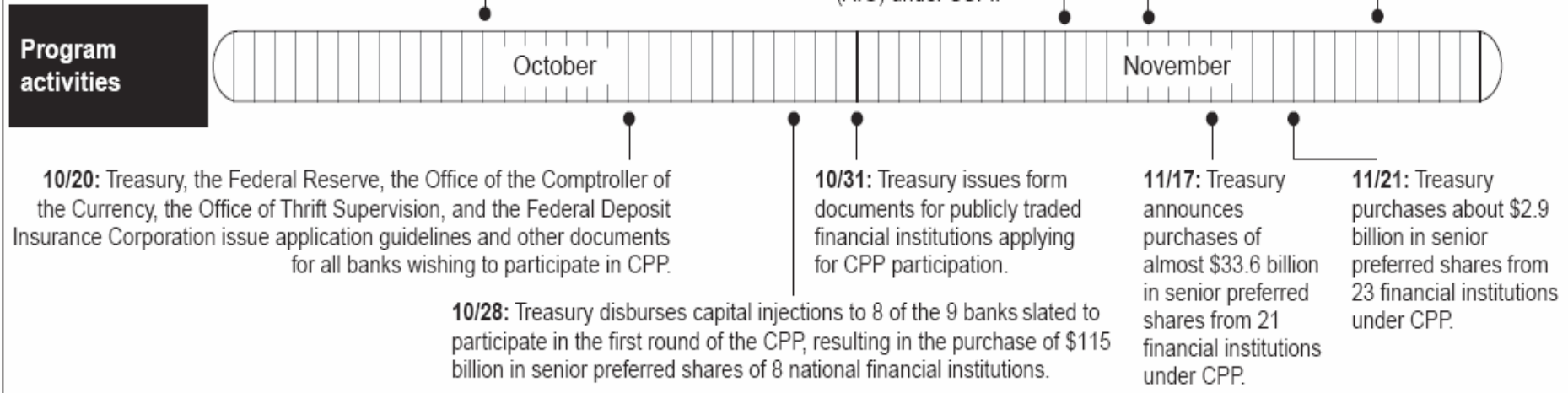
Nine major financial institutions agree to participate in CPP.

Treasury issued executive compensation guidelines on Tuesday, October 14, for three TARP areas: CPP, Troubled Asset Auction Program, and Systemically Significant Failing Institutions (SSFI).

11/10: Treasury announces that it will purchase \$40 billion in senior preferred stock from the American International Group (AIG) under SSFI.

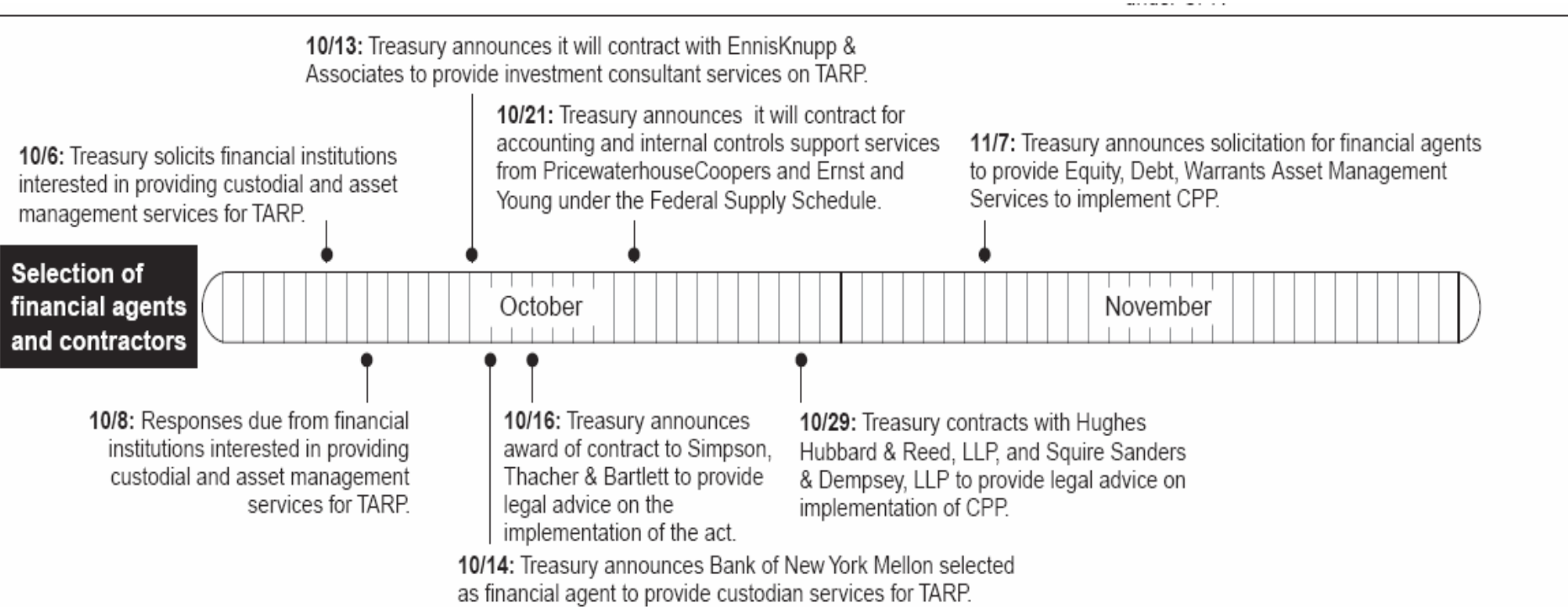
11/14: Deadline for financial institutions to apply for participation in CPP.

11/25: Treasury purchases \$40 billion in senior preferred shares from AIG under the SSFI program.



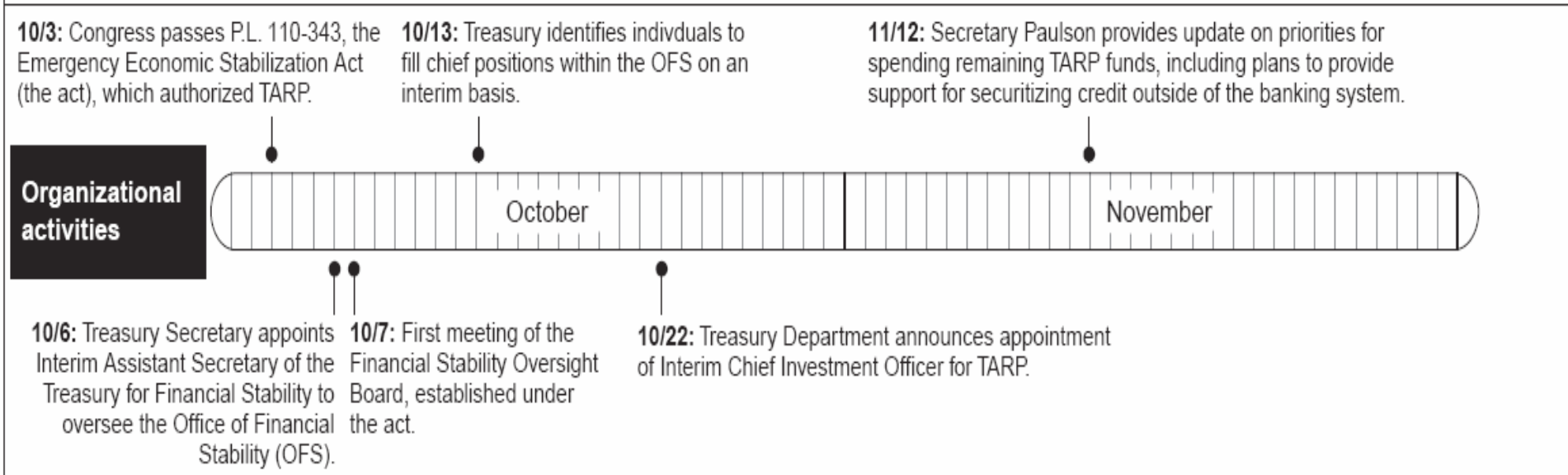
(Source: GAO)

Implementation of TARP: Selection of Financial Agents and Contractors



(Source: GAO)

Implementation of TARP: Organizational Activities



(Source: GAO)

Note: The update from Treasury Secretary Paulson on November 12 explained that TARP funds will NOT be used to purchase troubled assets from financial institutions.

- Treasury has stated that it intends to use CPP to encourage U.S. financial institutions to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy.
- Treasury has also indicated that it intends to use CPP to encourage financial institutions to work to modify the terms of existing residential mortgages.
- Institutions participating in CPP have agreed to comply with certain requirements, such as limitations on executive compensation, dividend payments, and repurchases of stock.
- Treasury has not yet determined how it will ensure compliance with these requirements.
- The extent to which Treasury will pursue other approaches to strengthening financial markets, including insuring troubled assets, to meet the purposes of the act also remains uncertain.

- Swift activity by Treasury:
 - On October 14, 2008, in conjunction with similar actions by foreign governments and coordinated actions by the Federal Reserve and FDIC, Treasury announced that it planned to use \$250 billion to purchase senior preferred shares in a broad array of qualifying financial institutions.
 - Treasury approved \$125 billion in capital purchases for nine of the largest public financial institutions considered by the federal banking regulators and Treasury to be systemically significant to the operation of the financial system.
 - Overall, Treasury has purchased preferred shares in 52 institutions, putting \$151 billion in additional capital into the financial system. (Source: Asst. Secretary Kashkari Remarks 12/5/2008)

- Citigroup

- On November 23, Treasury announced that it would invest an additional \$20 billion in Citigroup from TARP in exchange for preferred stock, with an 8 percent dividend to Treasury.
- Citigroup must comply with executive compensation restrictions and must implement the FDIC's mortgage modification program.
- Treasury and FDIC will provide protection against unusually large losses on a pool of loans and securities on Citigroup's books.
- The Federal Reserve will backstop residual risk in the asset pool through a nonrecourse loan.

- Federal Reserve Consumer Asset Backed Securities (ABS) Facility

- This Term Asset Backed Securities Loan Facility is intended to assist the credit markets in accommodating the credit needs of consumers and small businesses by facilitating the issuance of ABS and improving ABS market conditions.
- On November 25, Treasury allocated \$20 billion of TARP resources to back the lending facility for the consumer ABS market established by the Federal Reserve Bank of New York.

- Future Activity and Use of TARP Funds:
 - Treasury has stated that both banks and non-banks may need more capital given their troubled asset holdings, continued high rates of foreclosures, and stagnant global economic conditions. (Kashkari comments to Senate Appropriations Committee 12/4/08)
 - In addition to the Capital Purchase Program, the insurance program, and potential foreclosure mitigation programs, Treasury is considering additional strategies under TARP.
 - On December 1, Secretary Paulson underscored the critical priorities for the most effective deployment of remaining TARP funds, foremost of which is to ensure our banking sector has the necessary capital base to continue lending to consumers and businesses and support economic growth, and to help homeowners avoid preventable foreclosures. (Kashkari comments to Senate Appropriations Committee 12/4/08)
 - The Treasury Secretary has noted that Treasury is evaluating a program to leverage TARP funds with matching capital from private investors; this could address the needs of nonbank financial institutions that are not eligible to participate in CPP.

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