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# Economic Stabilization Act: Overview of Transactions Involving Troubled Assets

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Congress passed legislation for the Emergency Economic Stabilization Act of 2008 (the "Act"), and the President promptly signed the bill into law. The Act is designed to restore liquidity and stability to the credit markets and includes a wide range of measures, including temporarily increasing the limit on FDIC deposit insurance to $250,000. But key measures of the Act must be implemented by the Department of the Treasury ("Treasury"). The actual mechanisms for transactions in troubled assets will remain undefined until Treasury implements rules and guidelines for the particular programs.

**Overview of Transactions Involving Troubled Assets**

The Act permits Treasury to establish programs both to buy and to insure "troubled assets" relating to residential and commercial mortgages held by "financial institutions." The Act authorizes Treasury to establish a Troubled Asset Relief Program ("TARP") to purchase assets and a program to guarantee the troubled assets of financial institutions ("Insurance Program").

***Who Can Participate?***

- Institutions "established and regulated" under U.S. laws and having "significant operations" in the U.S., other than foreign central banks or institutions "owned by" foreign governments, can sell assets and obtain insurance.
- The Act also authorizes Treasury to purchase assets from "foreign financial authorities" or foreign central banks to the extent that such entities "hold troubled assets as a result of extending financing to financial institutions that have failed or defaulted on such financing."

***What Assets Will Be Covered?***

- The types of assets that will be classified as *troubled assets* for either the asset-purchase or guaranty programs remain to be determined by Treasury.

***How Will the Programs Work?***

**TARP**

- Treasury may purchase troubled assets from any financial institution on terms and conditions to be determined by Treasury. In order to participate, financial institutions must provide an equity kicker or debt premium to Treasury—in the form of a nonvoting, convertible warrant or senior debt security—to protect the downside risk to the taxpayer *and* pay for the administrative expenses of TARP itself.
- The Act directs Treasury to prevent "unjust enrichment" of the participating financial institutions, "including by preventing the sale of a troubled asset to the [Treasury] at a higher price than what the seller paid to purchase the asset." However, methods to price and value the troubled assets are yet to be established.
- Treasury is required to establish procedures to be used for making purchases and managing

assets under TARP, including loan modifications for homeowners whose mortgages are placed in one of Treasury's trust vehicles.
- Treasury is separately granted broad authority to subsequently enter into sales, loans, or repurchase transactions in connection with the disposition of those assets.
- Financial institutions selling troubled assets to Treasury will be subject to limitations on executive compensation.

**Insurance Program**

- Treasury must establish an Insurance Program, which would operate principally through a specially designated "Troubled Assets Insurance Financing Fund" ("Fund"), for managing guarantees for categories or classes of troubled assets.
- In exchange for paying premiums, financial institutions would be able to obtain guarantees on the timely payment of principal, and interest on, the troubled assets, not to exceed 100 percent of the payments of the underlying instruments.
- The Act authorizes Treasury to provide variable premium rates, depending on the credit risks of the classes of troubled assets, but Treasury must publish the methodology for setting those premiums.
- Moreover, Treasury must set the premiums at rates "necessary to create reserves sufficient to meet anticipated claims, based on actuarial analysis, and to ensure that taxpayers are fully protected."