



Immediate Action Taken to Stabilize the Global Financial System and Proposed Long Term Solutions

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I. Stopping the Bleeding: Actions Taken by the United States Government

1. The Original Plan: The Emergency Economic Stabilization Act of 2008

Enacted October 3, 2008, this legislation was a reaction to the turmoil in the U.S. economy arising from the subprime mortgage crisis.

Goals

Stabilize the economy by thawing the frozen credit markets, both for consumer lending and for lending between banks, avoid further failures of "too-big-to-fail" financial institutions, and restore investor confidence in the markets by creating a market for so-called "toxic" subprime mortgage-related assets.

Structure of the Legislation

The Troubled Asset Relief Program (TARP): The TARP allowed the government to purchase "troubled" or "toxic" assets—for example, securities based on subprime mortgages—from struggling financial institutions. The program had a spending limit of up to \$700 billion, with which it would purchase the assets and then sell them. The money earned from the sale would then have gone back into the pool, facilitating the purchase of more assets.

Note: The U.S. Treasury set aside the TARP plan in November of 2008 in favor of a capital purchase program in order to provide more immediate relief to financial institutions.

Equity Stakes: The Act requires financial institutions selling assets to TARP to issue equity warrants, or equity or senior debt securities (for non-publicly listed companies) to the Treasury.

Limits on Executive Compensation: The Act sets new limits on the compensation of the five highest-paid executives at companies that elect to participate significantly in TARP.

Recoupment: If TARP has not been able to recoup its outlays through the sale of the assets within five years after its operation, the Act requires the President to submit a plan to Congress to recoup the losses from the "financial industry."

Increase in FDIC deposit insurance: The Act increased the maximum amount of federal deposit insurance from \$100,000 to \$250,000 until December 31, 2008.

HOPE Act Amendments and foreclosure relief: The Act amends the HOPE Act provisions to expand eligibility.

Problems With TARP

Asset Pricing: The Treasury needed to find a way to price the troubled assets they would buy through TARP. A balance needed to be found to permit the participating institutions to sell at a price high enough to survive and the government to avoid paying more than the assets were worth.

Time Constraints: During the period after the EESA was enacted, the global financial system rapidly destabilized, necessitating immediate action by the government. TARP was not ready to be mobilized because of the pricing difficulties. Also, it would not have provided the quick liquidity that became imperative to the survival of many financial institutions.

2. Plan B: Quick Capital! TARP Capital Purchase Program

In lieu of the original TARP plan, the U.S. Treasury decided in late October to adopt the Capital Purchase Program (CPP) to recapitalize banks directly and quickly.

Goals

To increase the availability of lending for consumers and businesses by increasing banks' capital reserves and to stabilize the financial system to avoid further failures of financial institutions.

Structure

The CPP allows U.S. financial institutions to sell senior preferred shares to the Treasury, thereby augmenting their capital reserves and facilitating lending.

In addition to the non-voting senior preferred shares, the government will receive warrants to purchase common stock. The government's senior preferred shares will take priority over all other shares and will pay a 5 percent dividend rate per year for the first five years and 9 percent per year after the fifth year.

Participating institutions must also abide by the TARP restrictions on executive compensation and were admonished, though not required, to use the money for increased lending.

The Treasury committed \$250 billion to the program in which forty-three institutions have participated.

3. Bailout Version 2.0: The Financial Stability Plan "Deploying the Full Arsenal"

Problem

Even after the implementation of the Capital Purchase Program, bank lending remains hampered by large amounts of asset-backed securities that remain on banks' balance sheets.

On February 10, 2009, the Obama Administration released its preliminary plan for a bailout revamp to address this continuing problem—**The Financial Stability Plan**.

Structure

Financial Stability Trust: All banks with more than \$100 billion in assets are required to undergo a comprehensive "stress test" to evaluate their financial position and sustainability. Additionally, any institution that has undergone a stress test will be able to borrow from the capital assistance program, but all such funds will be held in the separate Financial Stability Trust.

Public-Private Investment Fund: The Fund will use TARP funds to leverage private sector investment in banks' asset-backed and mortgage-backed security holdings.

Consumer and Business Lending Initiative: This initiative will expand the Term Asset-Backed Securities Loan Facility (TALF), which will provide up to \$1 trillion in financing from the Treasury and the Federal Reserve to investors wishing to purchase AAA-rated asset-backed securities.

Transparency and Accountability Agenda: Participation in the Financial Stability Plan will now require extensive disclosures about how public funds are used and will subject the participating institution to new restrictions on investments, executive compensation (including the newly announced \$500k salary cap), and lobbying activity.

Affordable Housing Support and Foreclosure Prevention Plan: This plan will commit \$50 billion in TARP funds to foreclosure prevention and will continue the efforts of the Federal Reserve to drive down mortgage rates through the purchase of up to \$600 billion in GSE mortgage-backed securities. The plan also requires recipients of public funds from the Trust to participate in foreclosure mitigation plans.

Small Business and Community Lending Initiative: This initiative will provide financing for AAA-rated small business loans to loosen the secondary markets for such loans and increase lending.

4. Fiscal Stimulus: Keynes Lives!

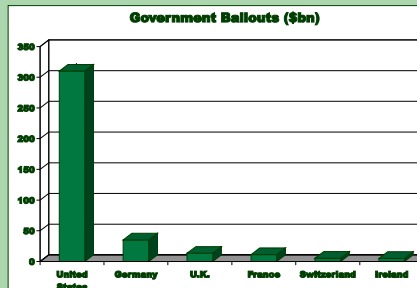
1. Fiscal stimulus plan of February 2008

In early 2008, as the financial crisis was brewing, the Bush administration passed a fiscal stimulus bill in an effort to avert recession and improve the U.S. economic outlook.

The Bush plan principally involved tax rebates to lower and middle class taxpayers, as well as additional tax incentives for business investment. The plan also increased the maximum amount of loans available from the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac.

2. President Obama's stimulus plan

A compromise was reached on February 11, 2009 between the Obama administration and Congressional Democrats and Republicans on a \$789 billion stimulus plan that would provide \$507 billion in new spending on things like renewable energy, infrastructure, education, health care, and fiscal relief measures to prevent state budget cuts. Another \$282 billion would be spent on tax relief to individuals and businesses. The House of Representatives will vote on the bill Friday, February 13, 2009, with the Senate vote to come soon thereafter.



II. Stopping the Bleeding: Actions Taken by Foreign Governments

1. The European Union

In October 2008, the European Union member states agreed to an intergovernmental effort to rescue European financial institutions from the crisis. These countries agreed to coordinated, but very little common, action. The Commission did, however, agree to a proposal to increase the minimum protection for bank deposits in Europe to €100,000 from €20,000.

2. The United Kingdom

The UK originally put together a bailout plan worth \$740 billion that injected capital directly into three of its largest banks (RBS, HBOS, and Lloyds TSB Group) and guaranteed bank-issued debt. Now, UK officials have a new plan to further guarantee banks against losses from toxic assets on their balance sheets. In addition, the government plans to guarantee up to roughly \$147 billion in newly issued mortgage- and asset-backed securities in an attempt to jumpstart the market for such securities, which has been a major source of funding for bank lending.

3. France

France enacted a €360 billion bailout plan under which €40 billion would be available to recapitalize fragile banks and the government would guarantee up to €320 billion in inter-bank loans.

4. Germany

In October 2008, Germany put together a rescue package to guarantee up to €500 billion in inter-bank debt. Germany will also inject up to €85 billion into banks in return for equity stakes in the institutions and changes in executive compensation and business strategies. Germany is currently considering its own "second phase" under which each troubled bank would be required to set up its own "good" bank and "bad" bank. The "bad" bank would get government guarantees against losses from the original €500 billion, while the "good" bank would receive new injections of capital.

5. Ireland

The Irish government guaranteed €400 billion in debt for the six largest Irish-owned lenders and for foreign-owned banks with "significant" operations in Ireland. In December 2008, the Irish government injected an additional €.5 billion into its three largest banks.

6. Switzerland

The Swiss government announced a \$60 billion bailout of UBS, one of its two largest banks, in October 2008. The plan will create a state-funded vehicle to buy UBS's "bad" debt. Switzerland will also inject \$3.9 billion into the bank directly, thereby taking a 10 percent stake in the bank.

III. Proposed Long Term Solutions: No Global Financial Regulator

1. The G20 Communiqué: Washington and London

On November 15, 2008, the members of the G20 economies met in Washington to plan a coordinated response to the financial crisis.

The nations agreed to seven principles for reform:

- Strengthening Transparency and Accountability
- Enhancing Sound Regulation
- Prudential Oversight
- Risk Management
- Promoting Integrity in Financial Markets
- Reinforcing International Cooperation
- Reforming International Financial Institutions

The G20 also agreed on an Action Plan for immediate and medium-term implementation of these principles.

On April 20, 2009, the leaders of the G20 nations met in London for the second G20 summit addressing the global financial crisis. The summit produced a communiqué that laid out the group's agreements toward the achievement of five goals:

- Restoring growth and jobs
- Continuing to support economic growth through fiscal expansion.
- Restoring lending and capital flows through whatever means necessary.
- Supporting increased IMF surveillance of economies and financial sectors.
- Strengthening financial supervision and regulation
- Will increase global consistency and raise international standards for financial regulation. In particular, the nations agree to:
 - Establish a new Financial Stability Board including all the G20 members.
 - Create an early warning system for macroeconomic and financial risks through collaboration between the IMF and FSB.
 - Extend regulation to all systemically important firms, including hedge funds.
 - Improve regulation of capital in the banking system.
 - Take action against tax havens.
 - Extend regulation to Credit Rating Agencies.
- Strengthening our global financial institutions
 - Will commit \$750 billion to the IMF and \$100 billion to the MDBs, as well as authorizing a \$250 billion increase in SDRs into the global economy.
- Resisting protectionism and promoting global trade and investment
- Ensuring a fair and sustainable recovery for all

2. U.S. Framework for Regulatory Reform

On March 26, 2009, the U.S. Treasury announced its framework for reform of financial regulation. The framework has four main goals:

1. Addressing systemic risk to ensure stability
2. Protecting consumers and investors through strengthened enforcement
3. Eliminating gaps in the regulatory structure
4. Fostering international coordination to work towards high standards worldwide

The details of each of the four goals are to be released in the coming weeks, but the Treasury has released its initial plans for the first prong—addressing systemic risk.

The Treasury proposes to:

1. Create a single independent regulator for systemically important firms.
2. Impose higher standards on capital and risk management for systemically important firms.
3. Require registration of some hedge fund advisors.
4. Increase oversight, protection, and disclosure for the OTC derivatives market.
5. Impose new rules for money market funds to reduce risk of rapid withdrawals.

3. Larosière Report on EU Financial Reform

In October 2008, the European Commission ordered the High Level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, to investigate the causes of, and possible solutions to, the financial crisis. The results of their report, which are not necessarily the views of the EU itself but are expected to be influential, were published on February 25, 2009. The report made thirty-one recommendations, including:

1. Extending regulation to all systemically important financial firms.
2. Creating a registration and disclosure system for hedge funds.
3. Requiring the creation of a central clearing house for credit default swaps in the EU.
4. Changing the structure of remuneration in the financial sector to reward long-term profitability rather than short-term risk taking.
5. Creating a coherent regulatory framework for crisis management in the EU.
6. Creating a European Systemic Risk Council in order to gather and analyze information about macroeconomic conditions and relevant changes in the financial sector, as well as a risk warning system to alert authorities about systemic risks.
7. Working towards the creation of a European System of Financial Supervision including Colleges of Supervisors for all major cross-border institutions.