



Analysis of Oversight and Accountability Provisions in the 2008 Emergency Economic Stabilization Act

The 2008 Emergency Economic Stabilization Act contains stronger oversight protections than the three-page bill Treasury Secretary Henry Paulson offered a few days ago. Watchdog entities are established, reports requested, and some information is supposed to be made available to the public electronically. But just how much power do the oversight mechanisms established by the bill have to check the substantial powers afforded the Treasury? Here's a TCS breakdown of the sections of the bill that deal with oversight and the strengths and weaknesses of these provisions.

Section 101: Purchases of Troubled Assets

Summary: The legislation gives the Treasury Secretary wide discretion in administering the vehicle for buying and selling toxic investments, the Troubled Assets Relief Program (TARP). This authority includes hiring asset managers, consultants and other employees as well as entering into contracts. The section also directs the Secretary to “prevent unjust enrichment of financial institutions...by preventing the sale of a troubled asset at a higher price than what the seller paid to purchase the asset.”

Analysis: Preventing such enrichment will depend on how TARP values the assets it purchases. TARP cannot pay less than the financial institution paid but may pay much more than the asset is currently worth, thereby making taxpayers absorb some of the banks' losses. The suspension of mark-to-market accounting (which requires institutions to value assets based on daily prices rather than potential future value) in Section 132 has the potential to undermine many of the taxpayer protections. Suspending these accounting rules does nothing to change the actual value of the assets; essentially it would allow institutions to value their assets based on a best or better case scenario than the actual market would deliver. This could lead to overvaluing the assets that the government purchases and mean that the taxpayers absorb even more loss than we bargained for.

Section 104: Financial Stability Oversight Board

Summary: A Financial Stability Oversight Board will be established to review the Secretary's policies, including purchasing assets and hiring. The Secretary himself will sit on the board, flanked by the Chairman of the Board of Governors of the Federal Reserve System, the Director of the Federal Home Finance Agency and secretaries of the Securities Exchange Commission and Housing and Urban Development. The Board will provide semiannual reports to Congress.

Analysis: This looks like a working group, not an oversight board. And we can't help but point out that these are the very same people who failed to monitor the downward spiral of the economy. The board can report any malfeasance to not only the Special Inspector General but the Attorney General, an authority not afforded other financial oversight entities in the bill. There is no direction to make the reports public. Moreover, nothing in current law prevents anyone of these people from reporting malfeasance to the Attorney General. This is window dressing.

Section 105: Reports

Summary: The Secretary must provide Congress a detailed financial statement each month covering all transactions including insurance contracts, assets purchased and operating expenses. The statement must also describe “the valuation or pricing method used for each transaction.” The Secretary must also release a written report within a week of committing to purchase a \$50 billion “tranche” of assets: The report should include “a justification of the price paid for and other financial terms associated with the transactions.” Treasury also must submit a report by April 30, 2009, recommending improvements to the current regulatory system. The language on the regulatory report requires:

- (1) recommendations regarding—
 - (A) whether any participants in the financial markets that are currently outside the regulatory system should become subject to the regulatory system; and
 - (B) enhancement of the clearing and settlement of over-the-counter swaps; and
- (2) the rationale underlying such recommendations.

Analysis: As a starting point, it should be explicit that all of the reports filed under this section should be made public in a timely way on the internet. That said, one of the core weaknesses of the bill is revealed by the content required in the reports: that the valuation of each transaction must be identified belies the fact that there are no overarching standards for valuation. In addition, this is where we should be given some idea of the extent to which past de-regulation helped fuel the use and abuse of exotic mortgages and other financial instruments.

Section 107: Contracting Procedures

Summary: The legislation allows the Treasury Secretary to waive “specific provisions” of the Federal Acquisition Regulation (FAR) if he determines that “urgent and compelling circumstances make compliance with such provisions contrary to the public interest.” The Secretary has to explain waivers to Congress within seven days and come up with a plan to include minority and women-owned businesses if he waives related provisions.

Analysis: Current law already allows for bypassing certain FAR provisions in emergency or exigent circumstances, so this provision may be altogether superfluous. Moreover, the legislation does not identify the “specific provisions” in the FAR that could be waived, nor does it give examples of the kind of “urgent and compelling” circumstances that could prompt a waiver. Finally, waiving the FAR has caused problems in the past: The Resolution Trust Corporation, an independent agency created in 1989 to dispose of assets from the Savings and Loan bailout, had similar waiver authority but few standards for adequate competition and compensation for contractors. The result was untrammled payouts to the private sector and reprimands from Congress and the Government Accountability Office.

Section 109: Foreclosure Mitigation Efforts

Summary: Under this section, “the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures.”

Analysis: We have written extensively in the past on the potential for loan guarantees to be very costly, particularly when they are used as a means to mask the true budgetary implications of a particular outlay. While it may be important to include safeguards to curtail additional home foreclosures, the mechanisms for doing so must be carefully constructed to both help prevent mass foreclosures, and to also minimize the risk to all taxpayers.

Section 114: Market Transparency

Summary: The Secretary will “make available to the public, in electronic form,” a description, including amount and pricing, of assets obtained by the government. It will also determine whether the required public disclosure is adequate to give the public “sufficient information” to learn the “true financial position” of the institution: If not, the Secretary can impose additional disclosure requirements.

Analysis: Our only concern here is that the information be made available in a timely and easy to digest format that lay people can understand

Section 115: Graduated Authorization to Purchase

Summary: This section lays out the amount and terms regarding how much money the Secretary will have available for the bailout. \$250 billion is made available immediately; with an additional \$100 billion available if the President certifies such action is necessary. After these steps, the President may request the remaining \$300 billion by sending to Congress a report detailing how the Secretary will use the additional money. This may be denied if, within 15 days of the report being sent, the Congress passes a joint resolution disapproving of the request. The joint resolution would proceed on a fast track basis. In the House all points of order are waived

and a motion to reconsider is not in order. In the Senate: the motion to proceed is not debatable; a motion to reconsider is not in order; 10 hours of debate equally divided

Analysis: This is an improvement over the previous bill, which would have handed the entire \$700 billion to the Treasury with very little strings attached. It's still a lot of money with no guarantees it will fix things.

Section 116: Oversight and Audits

Summary: Language at the end of the section directs TARP to establish internal controls that provide "reasonable assurance of" reliable financial reporting, compliance with laws and regulations, and efficient use of resources. Earlier language addresses the agency presumably dispatched to make sure this happens: the Government Accountability Office (GAO). Treasury must make space for a dedicated office for the GAO to set up its TARP-watching operation, in addition to giving the agency full access to all TARP books, records and employees (the Congressional Budget Office and Joint Committee on Taxation are afforded the same access in section 201). The GAO will audit TARP annual financial statements and report at least every 60 days to Congress and the Special Inspector General on TARP activities, including:

- progress toward its objectives, such as stabilizing financial markets, mitigating foreclosures, and protecting taxpayers
- internal controls
- price, value and terms of asset purchases and other transactions
- efficiency in using funds
- progress in preventing conflicts of interest
- contracting practices

Analysis: This actually looks very strong as far as oversight in terms of monitoring, but it is unclear whether this provision will be the mechanism by which any failures are remedied. As with all GAO action, determining consequences of failure is up to Congress. In response to the GAO reports, corrective actions include that the Secretary may "(B) certify to appropriate committees of Congress that no action is necessary or appropriate." Sounds like the Secretary can simply say, "They're wrong."

Section 117: Study and Report on Margin Authority

Summary: "The Comptroller General shall undertake a study to determine the extent to which leverage and sudden deleveraging of financial institutions was a factor behind the current financial crisis." This includes determining the extent of involvement the Board, Secretary, SEC and other federal agencies should have in monitoring and preventing excessive leveraging. GAO will make recommendations to Congress on the need for more oversight.

Analysis: We heartily concur with the need for a forensic audit of the crises' origins, but as always, change depends on the incorporation of recommendations by Congress. Language requiring some follow-up legislation would strengthen this provision, and by not specifying remedies could avoid tying Congresses' hands.

Section 121: Special Inspector General for the Troubled Asset Relief Program

Summary: This section directs the President to appoint a Special Inspector General to monitor TARP activities in the same institutional accountability vein as other inspector generals. This entails detailed descriptions and listings of TARP employees, vendor financial institutions, assets purchased, insurance contracts issued, and an estimate of profits and losses incurred. This SIGTARP (acronym ours) will report to Congress on a quarterly basis on the Treasury's "purchases, obligations, expenditures and revenues." The bill authorizes \$50 million to get the office started.

Analysis: Establishing the office is a good move, though information collected by the IG should be made electronically available to the public, with appropriate caveats for privacy, legal proceedings, etc.

Section 125: Congressional Oversight Panel

Summary: This section establishes a panel of five members appointed by Congressional leadership to "review the current state of the financial markets." The panel will report every 30 days to Congress on the Secretary's use of contracting authority, impact of activities on financial markets and institutions, and the program's effectiveness "from the standpoint of minimizing long-term costs" and "maximizing benefit" to taxpayers. The panel will also submit a report on regulatory reform by January 20, 2009, assessing the current regulatory system's ability to oversee financial institutions and "protect consumers."

Analysis: Again, the more insight into the roots of this crisis the better, though the progress of the Act has shown the difficulty Congress has overcoming ideology in this area.