

The Credit Crisis and the Economic Stabilization Act of 2008, What it Means for You and I.

On October 3rd, The House of Representatives voted to pass the Economic Emergency Stabilization Act of 2008, which gives the Treasury Department, which includes the Internal Revenue Service among other departments, the ability to purchase assets, mainly mortgages, from banks across the nation. Most of the assets are "troubled" or "risky" loans that financial institutes have been underwriting since the early 1990's such as stated income loans, loans that reset at significantly higher rates of interest after 5 years, and reverse mortgage loans. Although these types of loans fueled the housing boom of the 1990's and the first five years of the 21st century, once the US began seeing a slowdown in economic activity beginning in 2006, these loans began to sour. Hence, Congress has felt it had to pass two significant bills this year to save our economy from disaster, this bill being the latest.

Of course, if you are like me, giving the Treasury Department the right to spend 700 billion dollars of taxpayer's money on bailing out companies that have gone unregulated and circumventing the regulations established to prevent such a disaster since the early 1990s is not right, however, without it, this economy would freeze and go into serious recession. Let me explain, large companies like IBM or Coca Cola, periodically borrow money overnight or short-term in order to pay operating cost, such as payroll. These funds come from financial institutions, such as banks or large brokerage houses. Financial institutions, in the ordinary course of their business, make loans to individuals like you and I and either service those loans themselves or sell those loans. If they service the loans themselves, they have less lending power because their cash is tied up in a mortgage. In order to be able to lend more money, the financial institutions have the option of selling some or all of their mortgages in order to bring more money into their reserves, thus increasing their ability to loan money. What has happened in the past 18 months is that a major portion of the loans underwritten by financial institutions over the past decade have become uncollectible and therefore, no one wants to purchase them, which in turn, severely hinders the financial institutions ability to lend. This is the "credit crisis" you have been continually hearing about through the media over the past year. No one has money to lend, even if they want to.

Another factor that has contributed to the current credit crisis of the United States is the failure of two institutions originally created to inject lending power back into the economy, Fannie Mae and Freddie Mac. These institutions were originally created by the Congress of the United States to either purchase mortgages from lending institutions in order to keep their ability to lend at a constant, or either insure mortgages and other types of credit in the event of default. These institutions had very strict and regimented underwriting requirements before they would purchase or insure credit from lenders up until the 1990s, when these companies were privatized and allowed to really go un-regulated. Underwriting requirements became very lax, which lead to Congress having to bail them out just two months ago before this enormous bailout.

As you can see, this situation has been stewing for a long time and with due respect to all of the Presidential administrations involved and without pointing the finger at any political party, the Wall Street giants and the banking industry have not been regulated properly and now we are where we are.....bailing out the financial institutions of this Country in order to stabilize our economy. This is not the first time this has occurred either. Many of you should remember the savings and loan crisis of the 1980s and for some, the great depression of the 1930s. OK, enough of my venting. Here is the short and sweet summary of the legislation.

This bill, in summary, gives the power to the Treasury Department, currently head by Henry Paulson Jr. (Which is scary to me because he is the former CEO of Goldman Sachs, one of the Wall Street Firms at the core of this situation), the ability to purchase "bad loans" from financial institutions so they can in turn inject credit into the economy and also keep the marginal institutions from failing. This power does not come without consequences for those firms partaking in the bailout and also adding insurance to the purchase of these "toxic assets" in order to protect the taxpayers. Here are the highlights in summary:

- The core of the legislation is to allow the Treasury Department to purchase financing instruments, mostly mortgages or mortgage backed securities, in order to alleviate the current credit crisis. The 700 billion dollars that have been approved for this part of the legislation will come in stages, with 250 billion available immediately.
- The taxpayer protection part of the bill includes directing the President to propose legislation which would require the financial industry to reimburse taxpayers for any losses from the program after a five year period and gives the Treasury Department to take ownership in participating companies. It also stipulates that the Treasury Department establish an insurance program funded by premiums paid by the financial industry which will help guarantee troubled financial assets purchased or issued before March 14, 2008
- The legislation also includes curbs on compensation of the executives of those firms who participate in the legislation. This is aimed at limiting the lavish bonuses that are a normal part of executive pay in America today.
- In order to gain more support from members of the House of Representatives, the legislation also included extending numerous tax breaks and credits that were set to expire, including relief for one more year from the Alternative Minimum Tax, which is to me one of the major inequities in the current tax code.
- The legislation also increases the FDIC insurance levels from \$ 100,000 to \$ 250,000 per depositor.

Although we as taxpayers should not have to institute this historical legislation, it is evident that the economy needed this shot in the arm. It also brings into the forefront that we as citizens of this Nation need to pay more attention to what our representatives are doing in Washington. We as a Nation should not have to continue to bail out those who circumvent the system for personal gain nor should we be subject to "damned if we do or damned if we don't legislation". I encourage all of our clients to take more incentive in making sure your representatives in Washington are doing what you want, not what the special interests and lobbyist want. Please, no matter what your political views are, we all need to accept that we as citizens can make a difference in how this great County is run and to vote.