Hunton & Williams

Client Alert

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Breaking News: Current State of the Paulson Proposal

The Current Situation

On Monday evening, leaders in Congress emerged from a briefing by some of the nation's leading economists convinced that the United States faces economic peril grave enough to justify an unprecedented intervention in the nation's financial system, which is consistent with the position advanced by the Administration over the weekend. At the same time, many in Congress stand opposed to any such intervention. At this time a wide gap remains between Treasury Secretary Henry Paulson's plan and a competing proposal based upon a draft circulated Monday morning by Senator Christopher Dodd. Below is a brief summary of the current key features of each proposal. Additional Client Alerts will follow as the proposals evolve and consensus emerges.

Coming Days

Today at 9:30am, Treasury Secretary Paulson and Federal Reserve Chairman Ben Bernanke appear before the Senate Banking Committee. Wednesday at 2:30pm, the two will appear before the House Committee on Financial Services.

At present, despite the speed urged by Treasury, it is unclear whether a bill will pass this week. Some in Congressional leadership have indicated they recognize the need to move as quickly as possible without sacrificing due diligence. The situation on Capitol Hill is extremely fluid and dependent on financial market conditions; consequently, no reliable forecast of Congressional action can be made at this time.

The Competing Approaches

The Paulson Proposal

The Treasury Secretary would be granted virtually unfettered authority to borrow and spend up to $700 billion to purchase mortgage-related assets (in reverse auctions and through other market mechanisms) from financial institutions that do significant business in the United States. Purchased assets would be held by Treasury or resold in future transactions. Those assets would be managed, and the underlying loans potentially modified, by "private asset managers" with an eye toward eventual resale. The proposal allows for immediate purchase of the most volatile assets from financial institutions, permitting those institutions to raise more capital and resume their credit and capital market activities.

Despite Treasury's desire for prompt passage, many Democrats and Republicans have voiced concerns over the program's cost and lack of oversight. The ranking member of the Senate Banking panel, Republican Richard Shelby, has made particularly critical remarks.

The Dodd Proposal

Like the Paulson proposal, the Dodd plan would authorize the Treasury Secretary to borrow and spend up to $700 billion to purchase mortgage-related assets from financial institutions. Beyond that, the features of each proposal differ markedly. The Dodd proposal contemplates a government intervention even greater than the Paulson proposal. Under the Dodd proposal, the government would take a contingent equity stake in any financial institution participating in the Treasury Department's asset purchase plan, would place a cap on executive compensation at participating institutions, and perhaps even permit bankruptcy judges to alter the terms of home mortgages in the course of foreclosure proceedings. The Dodd proposal would not grant unfettered authority but rather would impose restraints upon the Treasury Secretary, including an Oversight Board, an Inspector General, and monthly reports to Congress.

The Dodd proposal was greeted with approval by many in Congress and with trepidation by some. Nevertheless, as negotiations proceeded Monday evening, the Dodd proposal appeared to be the template from which Congressional proponents of an intervention were working.

How We Can Help

Hunton & Williams is helping clients today address the challenges presented by these proposals. We are providing interested clients with regular, exclusive updates on the progress of legislative deliberations and advising on the practical implementation of Treasury's troubled asset purchase program. For over 25 years, our firm has been a market leader on mortgage trading, servicing and securitization matters. Our firm was heavily involved in representing financial institutions and the RTC on RTC-related matters in the early 1990's, as well as the establishment of the only full faith and credit REMIC programs for the Federal government. In the historical and challenging times facing the capital markets, we stand ready to partner with our clients in pursuit of the opportunities that the new federal purchase program may present.

If you have any questions relating to the developments in Congress or in the markets today, please contact us.