CCSB Bail-Out Bulletin No. 2

If at first you don't succeed . . . . The Emergency Economic Stabilization Act of 2008 finally passed Congress on the second try, and the President wasted nary a second before signing it into law. Last we looked, however, it appears that the federal government's decreeing "economic stabilization" doesn't make it so. For a comprehensive but concise summary of the new Act, and of its course through the legislative maze, see our Stabilization Act Summary. Meanwhile, as we all contemplate where the bottom may be, set out below are summaries of a number of other significant developments (with links, where available, to more detailed descriptions):

SEC Emergency Orders on Short Selling and Financial Stocks

http://www.sec.gov/news/press/2008/2008-235.htm

Emergency orders expired or expiring. The SEC announced that the following emergency orders have been extended, but did not indicate that it intended to make them permanent. (These orders cannot be extended any further.)

- Ban on short sales of financial sector stocks originally extended until the third business day after the enactment of "anticipated legislation," but in no event later than October 17, 2008. http://www.sec.gov/rules/other/2008/34-58723.pdf
  Later, the SEC announced that because of the passage of bail-out legislation, its ban on short-selling stocks of financial companies would expire at midnight on October 8. http://www.sec.gov/news/press/2008/2008-238.htm
- Easing of restrictions on issuer's ability to repurchase its own shares: Extended until October 17, 2008. http://www.sec.gov/rules/other/2008/34-58703.pdf

Continuing emergency orders. The SEC also announced that the following emergency orders have been extended until October 17, *and* will continue beyond that date without interruption in the form of interim final rules.

- Enhanced requirements for delivering securities pursuant to a short sale. http://www.sec.gov/rules/other/2008/34-58711.pdf
- Requirement that institutional money managers report short sales. http://www.sec.gov/rules/other/2008/34-58724.pdf

Final rules. Finally, the SEC reiterated that it had promulgated the following as final rules on September 18, 2008. http://www.sec.gov/news/press/2008/2008-235.htm

- Ban on naked short selling by options market makers.
- Naked short selling anti-fraud rule, which makes naked short selling a violation of Rule 10b5-1 if it is done deceptively.

Raising and Preserving Capital

Farmer Mac sells preferred shares to raise capital. The Federal Agricultural Mortgage Corp. (Farmer Mac), which suffered heavy losses on investments in Fannie Mae and Lehman Brothers, announced that it had raised an additional $65 million through the sale of preferred shares. According to *The Wall Street Journal*, the company stated in recent securities filings that it could not "give assurances that it [would] be in compliance with its statutory minimum capital requirements as of Sept. 30, 2008." A failure to raise capital could have resulted in a downgrade of Farmer Mac's credit rating, which would have limited its ability to lend funds.

- Press releases on Farmer Mac's preferred share sale are available at: http://www.farmermac.com/

AIG sells non-core operations to raise capital. According to *The Wall Street Journal*, AIG has released a list of companies it will sell to raise capital. The insurer plans to focus on its core businesses, namely "its U.S. and foreign commercial property-casualty insurance business and a majority stake in its foreign life insurance business."

- More information is available at: http://ir.aigcorporate.com/phoenix.zhtml?c=76115&p=irol-newsArticle&ID=1205337&highlight=

Bank of America announces dividend cut, intent to raise capital. Bank of America is attempting to sell $10 billion in common stock to raise capital. In addition, to preserve capital, according to *The Wall Street Journal*, "[t]he bank halved its dividend to 32 cents to add more than $1.4 billion to capital each quarter. Bank of America said it hopes to resume dividend increases as soon as its 'earnings performance warrants.' Net income fell 68%."

- http://newsroom.bankofamerica.com/index.php?s=press_releases

Government Investigations and Intervention

Justice Department ramps up auction-rate securities investigation. According to *The Wall Street Journal*, the Justice Department has intensified its investigation of the auction-rate securities market. Some investors, who allegedly believed that they were investing in short-term, liquid securities, have been unable to access their funds since the market froze earlier this year. The DOJ investigations include criminal probes of individuals at Lehman Brothers and UBS AG.

President's Working Group issues statement to calm investors. The President's Working Group on Financial Markets issued a statement Monday, October 6, that it "is working with market participants and regulators globally to address the current challenges and restore confidence and stability to financial markets around the world." The Working Group stated that the Treasury can address strained global financial conditions by "directly strengthen[ing] the balance sheet of individual institutions." According to *The Wall Street Journal*, although Treasury could "inject capital into a failing firm by taking a significant equity stake," this is unlikely to occur unless a firm crucial to the stability of the financial system nears collapse.

- The President's Working Group's statement is available at: http://www.ustreas.gov/press/releases/hp1177.htm

More aid for AIG. The Federal Reserve has announced that it will lend AIG an additional $37.8 billion to keep the insurer above water. AIG already has received an $85 billion loan, which the government made available in exchange for an 80% ownership interest in the company. According to *The Wall Street Journal*, the Fed is "effectively loaning money to itself to keep its own insurance company afloat."

- More information is available at: http://www.federalreserve.gov/newsevents/press/other/20081008a.htm

Federal government may buy stake in banks. According to CNN, the Bush administration is considering injecting capital into U.S. banks in return for an equity stake in the institutions, one option available to it under the $700 billion bail-out plan. The Treasury's purchase of an ownership interest in banks would resemble a package announced by Britain, which empowers the government to purchase up to $87.9 billion in banks' preference shares.

- More information is available at: http://money.cnn.com/2008/10/09/news/economy/bc.apfn.meltdown.paulson.ap/index.htm?cnn=yes

Global Action and Reaction

Financial turmoil in Europe. Financial troubles in Europe and elsewhere, and the efforts to address them, include:

- **Iceland**: The government drafted emergency legislation to help avoid a national bankruptcy, announced that it would guarantee all savings, and passed measures to allow banks to sell some foreign assets. According to the BBC, the Icelandic krona, which "plummeted against the dollar after the government nationalized the country's third-largest bank, Glitnir, last week" had lost one-fifth of its value by Friday, October 3. **Russia** has reportedly agreed to give Iceland a $5.5 billion loan. **Iceland** has nationalized the country's largest bank, Kaupthing. Kaupthing is Iceland's third nationalization of a large financial institution in the past week. The Icelandic government has stated that Kaupthing's domestic deposits are guaranteed and that the bank will remain open. The nationalization of Kaupthing is only the most recent turmoil in Iceland. An excellent article on Iceland's financial troubles is available at:
  http://www.nytimes.com/2008/10/09/business/worldbusiness/09icebank.html?_r=1&ref=business&oref=slogin
- **Spain** has announced that it will provide up to $40.7 billion to purchase banks' illiquid assets. In addition, the government has raised the guarantee on deposits to $136,000.
- **Germany**: The government arranged a new $68 billion "bail-out" after its first attempt failed, and announced unlimited guarantees of private savings. In addition, one of the country's major lenders neared collapse due to the amount of bad debt on its balance sheet.
- **Belgium**: French bank BNP Paribas agreed to purchase 75% of the Belgium and Luxembourg operations of Fortis, in the wake of earlier efforts to rescue the bank. The government has raised its guarantee of depositors' savings to $136,000.
- **Ireland**: The government guaranteed all savings at its major banks.
- **Britain**: The government raised its guarantee of savings from £35,000 to £50,000.
- **Greece**: The government stated that it will guarantee all savings.
- **Denmark**: The government removed the maximum amount of its savings guarantees.
- **Mexico:** President Felipe Calderon has proposed an approximately $5 billion rescue plan and the country's central bank has announced a $2.5 billion auction designed to help stabilize the peso.

- **Japan:** The government has approved an $18 billion spending program.
- **Australia:** The government has guaranteed all personal savings.
- **Italy:** The country's prime minister has said that Italy may purchase an interest in floundering banks in order to stabilize the institutions.
- **Russia:** President Dmitry Medvedev has announced a $36.4 billion aid package for banks and called for "urgent joint action" to stabilize the financial system.

  http://news.bbc.co.uk/2/hi/business/7654647.stm

- **EU**: The European Union has issued a statement guaranteeing support of the European banking system.

  Excerpts from the statement are available at:
  http://www.forbes.com/reuters/feeds/reuters/2008/10/07/2008-10-07T131410Z_01_BAT002408_RTRIDST_0_ECOFIN-STATEMENT.html

International Monetary Fund urges response to crisis. The International Monetary Fund (IMF) has forecast that losses on U.S. loans and securities will reach $1.4 trillion. It has called for a global response to the financial crisis.

- The IMF's report is available at:
  http://www.imf.org/external/pubs/ft/survey/so/2008/NEW100708A.htm

Central banks slash interest rates. Six central banks, including the Federal Reserve, cut key interest rates October 8 in an effort to prevent further economic turmoil. The half-point rate decrease was adopted by the Bank of Canada, the Bank of England, the European Central Bank, Sveriges Riksbank, and the Swiss National Bank, as well as the Fed. Banks in China, Hong Kong, and Australia have already cut rates, and the Bank of Japan expressed its support for the action. In a joint statement, the central banks said: "Incoming economic data suggest that the pace of economic activity has slowed markedly in recent months. Moreover, the intensification of financial market turmoil is likely to exert additional restraint on spending, partly by further reducing the ability of households and businesses to obtain credit. Inflation has been high, but the Committee believes that the decline in energy and other commodity prices and the weaker prospects for economic activity have reduced the upside risks to inflation."

- The banks' statement is available at:
  http://www.federalreserve.gov/newsevents/press/monetary/20081008a.htm

British government bails out banks and depositors. Britain's treasury has announced a plan to invest in the country's financial institutions in order to promote lending and assuage concerns about banks' viability. According to *The Wall Street Journal*, the U.K. will (1) buy up to £50 billion ($87.9 billion) in banks' preference shares, (2) guarantee approximately £250 billion of bank-issued bonds, and (3) provide about £200 billion of additional liquidity through a program that permits banks to trade illiquid assets for Treasury bills. In addition, Britain announced that it will guarantee all British savings in an Icelandic internet bank whose parent company, Landsbanki, was placed in government receivership on October 7. Britain has stated that it will seek a legal remedy against Iceland for failing to guarantee depositors' savings. On a related note, ING Direct UK announced that it will acquire $4.4 billion of deposits at the British division of Kaupthing and $934 million of deposits at a subsidiary of Landsbanki.

- More information is available at:
  http://news.bbc.co.uk/2/hi/business/7658277.stm

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