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Tracker impact analysis: The crazy 2008s — the great digression

Nov 24 2008 Nancy Lininger

The phrase originally uttered by Flip Wilson as the cross-dressing Geraldine, "What you see, is what you get," is not valid in today's economic circles. The current mantra is, "Here today, gone this afternoon." Stocks are sinking, considerable companies are combusting, and Paulson's promises go "poof."

Act I

President Bush signed into law the Emergency Economic Stabilization Act of 2008 ("EESA") on October 3, 2008. This granted new authorities to the Treasury, Federal Reserve, and the FDIC. EESA is designed to restore market confidence by strengthening the balance sheets of financial intermediaries and improving overall market functioning. EESA is one of three statutes under the "bailout bill." (The other two are the Energy Improvement and Extension Act of 2008 and Tax Extenders and Alternative Minimum Tax Relief Act of 2008.)

EESA intends to: 1) stabilize the economy; 2) preserve home ownership; 3) protect taxpayers; 4) limit windfalls ("golden parachutes") for executives; and, 5) provide oversight to the Treasury.

The crux of EESA is the troubled asset relief program.

- TARP authorized the Treasury to purchase troubled assets from financial institutions.
- The Secretary is required to establish a program to guarantee troubled assets of financial institutions.
- The Secretary has the authority to manage and dispose of troubled assets.
- Profits from the sale of troubled assets are to be used to pay down the national debt.
- The Secretary must implement a plan to mitigate foreclosures and to encourage servicers of mortgages to modify loans through Hope for Homeowners and other programs.
- The Treasury will promulgate executive compensation rules governing financial institutions that sell its troubled assets.
- TARP gives authority to the SEC to suspend mark-to-market accounting (FAS Statement No. 157, which establishes a framework for measuring fair value in GAAP) and requires the SEC to conduct a study on mark-to-market accounting standards.
- In five years, the President must submit to Congress a proposal that recoups from the financial industry any projected losses to the taxpayer.
- TARP temporarily raises the FDIC and national credit union share insurance fund deposit limits from $100,000 per account to $250,000 until December 31, 2009.
- TARP establishes the financial stability oversight board to review and make recommendations regarding the exercise of authority under the Act.

Act II

In a seemingly about-face, the Treasury shook out the TARP and rolled in the new capital purchase program. Under the voluntary program, the Treasury will purchase up to $250bn of senior preferred shares of US banks and savings institutions. The program is to encourage US financial institutions to build capital to increase the flow of financing to US businesses and consumers and to support the US economy.

Stay tuned for the exciting conclusion

"Round and round she goes, where she stops, nobody knows." This phrase came from *The Original Amateur Hour* (a TV show from 1948 – 1970). But it will take more than amateurs to fix what is amiss with our economy.

Will we adopt Paulson's (aka Treasury's) blueprint, a new regulatory structure with three regulators (Market Stability, Prudential, and Business Conduct)? Do we let free-markets reign or rein in with more regulation?

Some economists predict a shallow recession lasting five months. Those forecasting a free-fall don't see ends meeting for five years. However long it takes, one thing is for sure. To paraphrase then-movie-actor Arnold Schwarzenegger, "We'll be back!" What we are experiencing is simply a detour, or a digression from business as usual. I call this the Great Digression.

Compliance tips and next steps

In the meantime, what can you do as financial services professionals to protect yourself and survive the Crazy 2008's? Here are some insights and tips:

- What should we invest in today... gold, real estate, movie deals, or stocks? We will look back in a few years and say that hindsight is 20/20. For now, we must make educated choices. Remember a couple of adages – "buy low/sell high" and "diversify."
- Financial advisors need to return all phone calls promptly. This means the same business day (or next at the latest). Have your staff ready, willing, and able to touch base with clients in your absence.
- Be proactive – contact clients before they call you. Don't assume that a client is doing well if they aren't calling you. They may be scared and hiding.
- Compliance officers might confirm that financial advisors are reaching out to clients now. Registered investment advisers have an annual responsibility to contact clients – broker/dealers only have an obligation once every three years to update suitability. Don't wait for the deadline – do it now; do it often.
- Financial advisors and compliance officers should take customer "inquiries" about shrinking portfolios more seriously – and treat them all as potential complaints. (Some firms already treat these the same, but others try to differentiate to minimize complaints on the books.) Understandably, this results in a massive increase in focus on this issue as nearly all customers may be making "inquiries" at this time. But investors are likely to be in a litigious mode – and firms need to try to head this off as early as possible.
- Compliance staff should watch for undisclosed outside business activities ("selling away") as financial advisors attempt to supplant dropping incomes.
- Will fees based on assets under management ("AUM") remain as king after financial advisors see the effects of falling incomes with dropping stock prices? Advisors are working harder and getting paid less. Will "retainer" fees become more popular as a method of ensuring a steady income?
- Services must focus away from managing a portfolio and start shining on managing perspectives.

Nancy Lininger *(www.liftburden.com) is founder/consultant of The Consortium, a Camarillo, California-based consulting company providing compliance and marketing consulting to investment advisers and broker-dealers, and publisher of the ComplianceE-News. The Consortium provides compliance resources, including a Self-Audit Kit. Ms. Lininger is often quoted in the trade journals and speaks at industry conventions on Success Strategies, Marketing and Compliance.*

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