

## **Emergency Economic Stabilization Act of 2008 and Related Developments – an Employee Benefits Update**

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The Emergency Economic Stabilization Act of 2008 (“EESA”) became law on October 3, 2008. Since then, there have been a number of unfolding stories connected with EESA and the broader set of initiatives undertaken by the U.S. Treasury, the Board of Governors of the Federal Reserve and the Federal Deposit Insurance Corporation to restore and stabilize the U.S. credit and financial markets. While the focus of these initiatives is on rescuing the financial markets, a number of these developments affect employee benefit plans.

The EESA authorizes the Secretary of Treasury to establish a new "troubled asset relief program" (or "TARP") to buy "troubled assets" from any "financial institution," subject to various conditions, limits and requirements. EESA would impose executive compensation limits and corporate governance requirements on any financial institution from which assets are purchased. In addition, it would generally require the Treasury to obtain from financial institutions, as part of the purchase transaction, warrants or a long-term note to help provide potential "upside" for taxpayers.

EESA seems to leave open the possibility that pension plans may be able to take advantage of the TARP to sell troubled assets to the Treasury, but this point is far from clear at this time. In addition to interest in the possibility of participating in TARP, pension plans are major investors and clients of financial institutions. As recipients of trustee, investment management, custody and securities lending services, pension plans are keenly interested in how the measures taken under EESA may affect services provided to plans.

In addition to learning about EESA, plan fiduciaries have spent time over the past two weeks watching the equity markets slide, keeping an eye on difficult credit conditions, and monitoring counterparty risk like never before. Among the challenges facing benefit plans are new concerns regarding securities lending programs, and questions about the health of a variety of financial institutions, especially in connection with money market funds and stable value funds.

Below is a very brief description of the major EESA and non-EESA developments announced in the last two weeks, and commentary on their meaning for the employee benefits community.

### **1. EESA Events and Initiatives**

On October 13, Treasury announced a “Capital Purchase Program” under TARP. Under this program, Treasury will invest up to \$250 billion of the \$700 billion available under EESA to purchase equity interests in U.S. financial institutions. Nine large banks, including: Citigroup, JP Morgan Chase, Bank of America, Wells Fargo, Goldman Sachs,

Morgan Stanley, BNY Mellon, and State Street are the initial participants in the program. In describing the Capital Purchase Program, Treasury indicated that these participating banks are “healthy.” For employee benefit plans with bank service providers, Treasury’s assessment of the health of financial institutions participating (or not participating) in the Capital Purchase Program could prove to be useful information. Until fairly recently, major financial institutions providing retirement services were assumed to be healthy. Now, however, plan fiduciaries tasked with selecting and monitoring these institutions are increasingly seeking information as to their financial health.

On October 14, 2008, Treasury issued guidelines governing executive compensation restrictions applicable to financial institutions participating in various aspects of TARP, including the Capital Purchase Program described above, and the troubled asset auction program. These guidelines are very detailed and deserve a comprehensive treatment that is outside of the scope of this summary. It is useful to note, however, that EESA also amended code section 457A. The new 457A greatly restricts the use of certain offshore deferred compensation arrangements, including the type used by many hedge fund managers. It is possible that these new rules may encourage restructuring of certain offshore hedge funds in which plans invest. Plan fiduciaries should keep an eye out for signs of such restructuring. In addition, while not entirely clear yet, new section 457A could potentially apply more broadly to U.S. employees of multinational employers.

Also, on October 14, 2008, Treasury called for public comment on the development of a program to guarantee principal and interest payments on “troubled assets” under EESA. Comments are due on October 28, 2008. Specific questions asked include:

- Should the insurance program cover mortgage-backed securities?
- Should the insurance program cover financial instruments other than mortgage related assets issued before March 14, 2008, and how would doing so be important for promoting financial market stability?
- What is the appropriate value for the guaranteed payout under the insurance program?
- What legal, accounting or regulatory issues would be posed by an insurance program?
- What types of financial institutions should be eligible for the guarantee program (and should different institutions be included in the guarantee program vs. the troubled asset purchase program)?

The request for comments does not specifically address issues associated with participation by employee benefit plans in the guarantee program, including whether plans or investment funds in which plans participate could be eligible. However, the questions noted above indicate that, at the very least, Treasury is thinking about the types of assets and types of financial institutions that will be covered, and fiduciaries may wish to consider whether employee benefit plans should be eligible to participate.

Treasury has also hired two service providers to help administer TARP. EnnisKnupp and Associates will act as a consultant assisting with, among other things, the selection and monitoring of financial agents hired by Treasury to manage assets under TARP. The services contract provides that EnnisKnupp has a fiduciary duty to the government in performance of its services. Of course, EnnisKnupp's fiduciary responsibilities are contractual and do not implicate ERISA's fiduciary provisions.

Treasury hired Bank of New York Mellon as custodian of TARP assets. BNY Mellon's contractual responsibilities include: holding portfolio assets, asset valuing and pricing services, and tracking linkages to executive compensation limits and to warrants received from selling institutions. The contract provides that in its custodial role, BNY Mellon owes a fiduciary duty of loyalty and fair dealing to the United States, and that BNY will perform its obligations with care, competence and diligence, and will use any information or assets of the United States "solely for the purposes of fulfilling its duties to the Treasury and not for its own commercial purposes or those of a third party."

Both EnnisKnupp and BNY Mellon were required to provide Treasury with detailed conflict avoidance procedures addressing potential conflicts that might arise in connection with clients of either entity (including pension plans) that may consider participating in TARP. As TARP adds more service providers, including investment managers who also provide services to plans, plan fiduciaries may need to be aware of the conflict procedures and discuss them with service providers.

## **2. Non-EESA Developments**

On October 7, 2008, the Federal Reserve has announced a Commercial Paper Funding Facility through which it will purchase commercial paper from issuers. While it will not purchase paper from investors, such as plans, it is hoped that the CPFF will stabilize the commercial paper market, which could be helpful for plans in a number of ways. Plans are major investors in money market funds and stable value funds, both of which purchase significant amounts of commercial paper. Addressing the strain on the commercial paper market will hopefully help stabilize these types of funds. In addition, plan fiduciaries considering options with respect to plan securities lending programs may determine that a stable commercial paper market will be useful in returning securities lending collateral investment funds to pre-Lehman bankruptcy levels of performance.

Two other developments may also interest fiduciaries monitoring securities lending programs:

- On October 10, 2008, the SEC issued a no-action letter providing that money market funds may comply with Investment Company Act Rule 2a-7 by "shadow-pricing" certain portfolio securities using amortized cost value rather than using available market quotations. In the letter, the SEC concluded that current market conditions warranted a decision not to recommend enforcement actions against money market funds under Investment Company Act rules regarding valuing and pricing of redeemable securities if the funds

use amortized cost for valuing certain short term securities. The SEC noted, however, that amortized cost may not be appropriate where the creditworthiness of the issuer of the short term security is impaired. This letter will likely affect the way that certain money market funds, including those used as vehicles for collateral investment value and price securities.

- On September 24, 2008, the University of Washington filed a state law complaint against The Northern Trust Company alleging losses of up to \$7.5 million on \$750 million in loaned securities. The parties have reportedly settled the dispute.

Participation in the U.S. Treasury's Temporary Guarantee Program for Money Market Funds appears to be robust. The Program, which is voluntary, and open to registered money market funds, guarantees that shareholders will receive \$1 for each fund share held as of the close of business on September 19, 2008. Knowing whether a plan's money market fund is participating in the program could be useful to plan fiduciaries in communicating with participants who may be worried about their accounts. Similarly, plan fiduciaries may be interested in determining whether a money market fund that is an investment vehicle for securities lending collateral is covered under the program.

Where a money market fund suspends redemptions (as has happened with two funds, the Reserve Primary Fund and the Putnam Prime Money Market Fund) including redemptions initiated by participants in plans, plan administrators have been faced with difficulties in administering loans, hardship withdrawals and other distribution requests.

As the financial crisis subsides into what may be a lengthy economic slow down, the investments and administration of employee benefit plans seem likely to continue to garner attention from Congress and from the administration of the next President. We are already seeing evidence of this. On October 7, 2009, the House Education and Labor Committee held a hearing addressing the impact on 401(k) plans of the recent market turmoil. Among the topics discussed were defined contribution plan fees and DB plan funding issues. Chairman Miller indicated his continued interest in passing H.R. 3185, his bill addressing disclosure of fees charged to individual account plans. In addition, both presidential candidates have proposed changes to plan withdrawal and distribution rules. Thus, it appears that plan sponsors and fiduciaries will have a lot to keep up with in the coming weeks and months.