A Beginner’s Guide to ... The Great Bailout of 2008
Or, A Beginner’s Guide to . . .

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The Great Bailout of 2008
Or, would it be

The Great Bailout of 2008
Why did we see such dramatic actions?

Economic train wreck is in process
Financial markets have seized up
Liquidity at banks is drying up
Likely the worst economic quarter in 25 years.
Will likely last to at least 1\textsuperscript{st} and 2\textsuperscript{nd} quarter 2009.
Recovery may be delayed due to deleveraging.
Why did we see such dramatic actions?

Loan losses are increasing in all loan categories
The failure of Lehman will be seen by historians as “when the bottom fell out”
Some forecast reaching 9% unemployment
ALL leading indicators suggest a recession is now underway
House prices are falling and will continue to fall
Why did we see such dramatic actions?

Stock market won’t stabilize until credit markets stabilize and credit markets won’t stabilize until house prices stabilize.

Possible $1 Trillion budget deficit next year.

• Source: Federal Reserve of St. Louis
What was passed?

On October 3, 2008, the House passed the

*Emergency Economic Stabilization Act of 2008*
The Great Bailout

What was passed?

• A plan that began with 2 ½ pages until
• It became 140 pages and
• Then 300 pages which failed to pass until it
• Finally passed with 450 pages.
What did it do?

The Bill authorized the Treasury Secretary to purchase and fund commitments to purchase $750 billion in troubled assets from any eligible financial institutions without unjustly enriching anyone.
The Great Bailout

What did it do?

• On the date of enactment, the Secretary of the Treasury would be authorized to purchase troubled assets up to $250 billion.

• That amount may be increased by $100 billion if President submits written notification to Congress.

• The Secretary would be prohibited from exercising authority to make purchases exceeding $350 billion if, within 15 days after the receipt of the report submitted to Congress, Congress enacts a joint resolution disapproving the plan.
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What happened between October 3 and 10?

The market dropped 1,874.19 points

It was time for Plan B
Why was Plan B needed?

- The plan as presented by Treasury was too complex and uncertain.
- The world understood that we were all in this together and recognized that they would have to act to bail out their own banks and economies.
- The G-7 Nations were meeting on the weekend to go forward together.
What was Plan B?

- Treasury would take approximately $250 billion in equity stakes in potentially thousands of banks.
- FDIC is expected to temporarily extend its backstop from bank deposits to new senior preferred debt issued by banks and thrifts for three years and expand DDA coverage.
What was Plan B?

• The debt would be fully protected in the event the issuing institution subsequently fails, or its holding company files for bankruptcy.

• This includes promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt.

• Coverage would be limited to June 30, 2012, even if the maturity exceeds that date

• The cost – 75 basis point fee to protect new debt issues
What was Plan B?

- Participating institutions can provide full deposit insurance coverage for non-interest bearing deposit transaction accounts, regardless of dollar amount.
- These are mainly payment-processing accounts, such as payroll accounts used by businesses. Frequently, these exceed the current maximum limit of $250,000.
- The temporary guarantee expires at the end of 2009.
- The cost –10 basis point surcharge for the deposit insurance on excess deposits.
- Both Plans are Opt Out Plans – 30 days
The Great Bailout

What are implications of all this?

- General fear of world events and the economy
- Specific fear of losing money
- Tremendous losses in 401k’s and cash flows from investments
- An almost irrational fear caused by uncertainty and unprecedented changes and upheaval
- A general lack of trust in
  - Politicians and the Political Process
  - Wall Street
  - Financial Institutions
In short, we are seeing the *redefinition* of the . . .

**American Dream**

- Home Ownership
- Small Business Ownership
- Discretionary Spending
- A Comfortable (Early) Retirement
What does your business need?

- A safe instrument for transaction accounts
- A reliable and available source of short term credit
- A reliable and reasonable source of long term credit
- Good advice when you are considering expanding or restructuring your business
- Confidential treatment of your corporate information
- A healthy economy so you can continue to do business
How does the Great Bailout of 2008 help?

- It provides unlimited insurance for transaction accounts like operating and payroll accounts
  - Non interest bearing only
  - Sweep accounts will need to be restructured
  - Verify that your financial institution has not opted out of insurance program after first 30 days (November 14)
- Provides security for interbank lending (i.e. Fed Funds) which provides money for banks to loan on a short term basis
How does the Great Bailout of 2008 help?

- The investment in banks provides capital for banks to shore up their balance sheets and allows them to continue lending without increasing their risk profile.

*Most business borrowers in communities across our state have not experienced any problems with getting credit*
How does the Great Bailout of 2008 help?

- Provides capital for stronger banks to acquire weaker banks without a cost to the FDIC

This is generally not a problem in Arkansas as our banks are in much better condition than their peers in other states
How does the Great Bailout of 2008 help?

- Provides taxpayers a very good return on the investment in the banks
  
  \[
  5\% \text{ non deductible cost} = 8\% \text{ return to Gov't}
  \]
  
  \text{Plus the opportunity to benefit from warrants}

- Provides accountability for safety and soundness of participating banks

\text{Healthy banks help build strong healthy communities}
How should I respond?

- Operate conservatively
- Understand your company’s cash flow needs
- Prepare a reasonable business plan taking into account your capital and cash-flow needs for the next year
- Establish a first name relationship with your local banker if you don’t already have one
- Explain your business plan to him and be sure he can meet your needs in good times and hard times
How should I respond?

- Make sure your banker is comfortable with your line of business and that he has lenders that are familiar with how it operates.
- Expect your banker to carefully review your financials and assumptions and help you understand how much you can safely borrow.
- Don’t borrow money just because you can....
For additional information...

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