

September 30, 2008

The following is a Dear Colleague sent by Representative DeFazio introducing his No BAILOUTS Act, which would Address the current financial crisis without putting the American taxpayer on the hook for billions of dollars.

Dear Democratic Colleague:

The House of Representatives rejected the \$700 bailout yesterday. Distinguished economists across the world have stated it would not have solved the problem at hand. However, we can potentially solve this liquidity problem at little cost to the taxpayer. I am proposing that Congress drop the Paulson Plan, and instead pass the **No BAILOUTS Act.**

□

The No BAILOUTS Act provides an alternative to the Paulson Proposal to address the current credit crunch.

□

Once Congress addresses the liquidity shortfalls in our financial markets, a Democratic Congress can turn to Democratic solutions to address the broader economic crises we face today.

□

Specifically, Congress can work to resolve the housing crisis across the country and pass effective job stimulus, which is the response Main Street America expects and deserves.

□

□ □ □

□

While Democrats and Republicans may disagree on the underlying solutions to solve the economic crises we face, the No BAILOUTS Act - a regulatory based proposal - has the potential for significant bipartisan support.

The Paulson Premise Flawed

Simon Johnson, a former chief economist at the International Monetary Fund, stated today in the *New York Times* of Paulson's plan, "**It's our view that this package, in a fundamental sense, will not solve the problem.**" □ Other economic analysts noted yesterday that the credit markets around the world were almost entirely dysfunctional even when political leaders and investors assumed that Congress had reached a deal and would easily approve the bailout.

There is no reason to believe Paulson's plan will work.

Alternatives

We have credible alternatives to the Paulson/Bush \$700 billion gamble. William Isaac, the chairman of the FDIC during the previous worst financial crisis in the United States during the 1980s, believes Congress can address the current crisis with simple changes to Securities and Exchange Commission (SEC) rules.

Mr. Isaac points out that while we face serious financial challenges today, many banks are still in good shape.

This allows Congress to take swift, uncomplicated steps to ensure the financial markets return to working order. After that, we can work to resolve the housing crisis and pass effective job stimulus.

Today I am offering an alternative to the Wall Street bailout that will correct the capital shortfalls experienced by many financial institutions and help protect the integrity and quality of the securities market. My plan could be implemented promptly meeting the demands of the Bush Administration to act immediately without putting the American taxpayer on the hook for billions of dollars.

No BAILOUTS Act

Bringing Accounting, Increased Liquidity, Oversight and Upholding Taxpayer Security

1) Require the Securities and Exchange Commission (SEC) to require an economic value standard to measure the capital of financial institutions.

This bill will require SEC to implement a rule to suspend the application of fair value accounting standards to financial institutions, which marks assets to the market value, no matter the conditions of the market. When no meaningful market exists, as is the current market for mortgage backed securities, this standard requires institutions to value assets at fire-sale prices. This creates a capital shortfall on paper. Using the economic value standard as bank

examiners have traditionally done will immediately correct the capital shortfalls experienced by many institutions.

2) Require the Securities and Exchange Commission to restricting naked short sells permanently

This bill will require SEC to implement a rule that blocks naked selling, selling a stock short without first borrowing the shares or ensuring the shares can be borrowed. Such practices many times harm the companies represented in the sales and hurt their efforts to raise capital. There is no economic value produced by naked short sales, but significant negative effects.

3) Require the Securities and Exchange Commission to restore the up-tick rule permanently.

This bill will require SEC to implement a rule that blocks short sales without an up-tick in the market. On September 19, 2008, the SEC approved a temporary pause of short selling in financial companies “to protect the integrity and quality of the securities market and strengthen investor confidence.” This rule prevents market crashes brought on by irrational short term market behavior.

4) “Net Worth Certificate Program”

This bill will require FDIC to implement a net worth certificate program. The FDIC would determine banks with short-term capital needs and the ability to financially recover in the foreseeable future. For those entities that qualify, the FDIC should purchase net worth certificates in these institutions. In exchange, these institutions issue promissory notes to repay the FDIC, counting the amount “borrowed” as capital on their balance sheets. This exchange provides short term capital, with not cash outlay.

Interest rates on the certificates and the FDIC notes should be identical so no subsidy is necessary.

Participating banks must be subject to strict oversight by the FDIC including oversight of top executive compensation and if necessary the removal of poor management. Financial records and business plans should be subject to scrutiny while participating in the program.

In 1982, Congress approved a program, known as the Net Worth Certificate Program, that allowed banks and thrifts to apply for immediate capital assistance. From 1982 to 1993, banks with total assets of \$40 billion participated in the program. The majority of these banks, 75%, required no further assistance beyond the certificate program.

5) Increase the FDIC Insurance limit from \$100,000 to \$250,000.

The bill will require the FDIC raise its limit to provide depositors confidence that their money is safe and help eliminate runs on banks which are destabilizing to the industry.

Sincerely

Peter DeFazio

Member of Congress