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U.S. Seals Bailout Deal

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WASHINGTON -- The White House and congressional leaders agreed on a deal to authorize the biggest banking rescue in U.S. history.

The $700 billion program would effectively nationalize an array of mortgages and securities backed by them -- instruments whose deteriorating value has clogged the nation's financial system.

Lawmakers finished writing the bill late Sunday, after which Speaker of the House Nancy Pelosi declared it "frozen," meaning no changes would be made. The bill leaves many mechanics of the operation up to the Treasury. Among these are the crucial issues of how the U.S. government would decide which assets it will buy and how it would decide what to pay for them. The legislation leaves the Treasury 45 days to issue guidelines on those procedures. The bill awaits votes in Congress starting on Monday.

From big Wall Street houses to small community banks, executives have expressed an interest in signing up for the bailout. But some have said the extent of their involvement will depend on critical details.

The political fallout from the bailout could be substantial, given the enormous expenditure of taxpayer money. Some polls show wide opposition. But the legislation includes provisions designed to guard against ultimate losses for the government. And it calls on the Treasury, as an owner of mortgage securities, to "encourage the servicers of the underlying mortgages" to minimize foreclosures.

The deal came after tension-filled weekend negotiations, where the specter of a faltering economy collided with the politics of a presidential election to create one of the biggest congressional dramas of recent years. Saturday included a high-decibel exchange between Treasury Secretary Henry Paulson and congressional Democrats, a ban on handheld email devices to forestall news leaks, and a battery of lobbying calls from the president and the presidential candidates.

"The key was to work through this and incorporate everybody's concerns but in a way that gave us the tools we needed," Mr. Paulson said in an interview. "We had to just insist that we can work on things. We can compromise, but at the end of the day it had to be something that was workable in the marketplace."

At the bill's core is Mr. Paulson's concept of buying impaired mortgage-related assets from financial firms -- giving them cash to replace the toxic debts that have put them in danger or dissuaded them from lending. The plan is to help the firms restore their capital bases as well as the trust that enables them to borrow and lend at reasonable terms. Without this, officials worry that the credit markets, the lifeblood of the economy, would grind to a halt.

Credit Unions

Sellers of assets could include a broad range of financial entities -- not just banks but also credit unions and pension funds. The assets offered to the government must have been originated or issued on or before March 14, 2008.

The Treasury wouldn't get the entire $700 billion for purchasing such assets upfront. Just $350 billion would be immediately available. But the other $350 billion would be available unless Congress specifically holds it back.

Mr. Paulson doesn't expect the funds to unclog the financial situation immediately. "I'm hoping that, in a very fragile system, this restores some confidence when it's announced. But it will take several weeks" before the asset purchases begin to work, he said.

The plan would impose some curbs on executive compensation at firms that sell assets to the government. These include a ban, for those that sell a large amount of securities to the U.S., on creating new "golden parachute" payments to departing top executives. Companies also would have to have provisions to "claw back" past bonuses found to have been based on misleading financial statements.

The Treasury would receive warrants giving it the right to acquire nonvoting common stock or preferred stock in firms benefiting from the bailout. The program would be subject to oversight that includes a bipartisan committee and the Government Accountability Office. The GAO would have an office located within the Treasury Department.

The Treasury plans to hire asset managers to determine the criteria for the purchase of securities and oversee the portfolio once the buying begins. While those details remain murky, the Treasury expects to buy up large chunks of assets at a single time. The asset managers would likely start buying the simplest assets first, such as mortgage-backed securities, and then move on to more complex ones, such as collateralized debt obligations.

One likely method of purchasing and pricing assets is a reverse auction. In this, firms would offer to sell securities at given prices, and the Treasury could buy the least expensive on offer. Institutions would presumably offer to sell at prices high enough to alleviate their woes but not so high they'd be passed over in favor of lower-priced offers.

The historic legislation is an attempt to stem a crisis that threatens to stall the U.S. economy. Treasury and Federal Reserve officials dubbed it their "break the glass" plan.

The agreement came together only after concessions on all sides. Democrats backed down from a proposal to let bankruptcy judges alter the terms of mortgages, and from another that would have steered government profits from the package to affordable-housing programs. The Bush administration, for its part, agreed to much broader executive-compensation limits than it originally envisioned, among other things.

Pivotal Point

At a pivotal point Saturday afternoon, Mr. Paulson met with lawmakers and argued over whether the funds would come in one tranche or in installments. "Damn it, if you think you need $700 billion right away you better tell us," Democratic Sen. Charles Schumer of New York told the Treasury secretary, according to two people familiar with the matter.

"I'm doing this for you as much as for me," Mr. Paulson shot back. "If we don't do this, it's coming down on all our heads."

The House plans to vote on the measure Monday, with the Senate likely to follow later in the week. Both parties have already started the process of pressuring and cajoling members to vote for the bill. Passage is seen as likely, despite the measure's unpopularity.

Support from House Republicans, who staged an 11th-hour revolt on Thursday, is still uncertain. Asked about the outcome of the House vote, Rep. Christopher Shays, a Connecticut Republican, said, "I think it's up in the air. This is what we call a legacy vote."

An exhausted Sen. Chris Dodd, a central player in the negotiations, expressed Congress's split emotions Sunday morning. "I'm pleased that we've come to a result," the Connecticut Democrat said. "I think it's dreadful that we had to come to this result."

Several days ago, it wasn't clear any kind of deal would be reachable, amid divisions between Democrats and Republicans in Congress and between Democratic negotiators and the Bush administration. The tensions of election-year politics ratcheted the pressure further.

On Thursday, talks broke down after a showdown at the White House featuring congressional leaders and the presidential candidates. House Republicans, emboldened by the emergence of Sen. John McCain on the scene, demanded wholesale revisions, including an insurance plan through which banks would pay into a fund to protect against further declines in asset values.

Mr. Paulson didn't believe this would be as effective as buying assets outright. Fearing the defection of House Republicans, he agreed to consider it. Inside the Treasury, there was deep concern that divisions between the White House and House Republicans could blow up the deal.

Mr. Paulson's negotiators arrived on the Hill Friday with a basic message: We can compromise on certain things, but we can't agree to anything that will limit participation in the program. Treasury staff members and congressional staffers separated the legislation into piles, one for bipartisan agreement and another pile for contentious items. At least 10 issues remained unresolved.

At 3:15 p.m. Saturday, a group of lawmakers met in a conference room outside the office of Rep. Pelosi. Republican aides complained as they saw eight Democratic lawmakers arrive for the meeting, but only two Republicans.

Mr. Paulson, who looked exhausted, reiterated his warnings about the consequences of a failure to act. "The crisis is ongoing," he said. "You saw what happened earlier this week with Washington Mutual" -- which on Thursday became the largest lending institution to fail in U.S. history. "There are other companies," Mr. Paulson said, "including large companies, which are under stress as well. I can't emphasize enough the importance of this."

The meeting grew contentious. Senate Democrats, many of whom had felt let down by the Bush administration when the plan nearly derailed at the White House, were more assertive. For over two hours the group argued, with several members yelling at Mr. Paulson. The Treasury secretary, growing agitated at times, continually told members they needed to design a program that would work and that it made no sense to create a program if financial firms didn't want to participate in it. "The situation is fragile," he said repeatedly.

Democratic Sen. Max Baucus of Montana, chairman of the Senate Finance Committee, became frustrated that Mr. Paulson appeared to be arguing for softer language on the executive-pay rules, arguing loudly that executives at these companies shouldn't be handsomely paid. "Let's not get emotional," Mr. Paulson responded, according to someone who was in the room.

Mr. Paulson objected to language that would give a new oversight board power to control how the new program would be run. "All we're talking about is having Groucho, Harpo, and Chico watching over Zeppo," said Rep. Frank, before Democrats backed off.

The meeting ended around 5:30 p.m., and lawmakers broke into smaller working groups. Sandwiches and pizza were delivered later. Many lawmakers grazed on a big bowl of pistachios in Rep. Pelosi's office.

The House speaker's office was furious about leaks coming out of Saturday's afternoon meeting. In order for Capitol Hill aides to stay in the meeting, they had to hand over their BlackBerrys, said one participant. A Pelosi staffer walked through the meeting with a trashcan. The devices were later put on a table with Post-it notes identifying each owner.

On the tough issue of limiting severance pay for executives, Sen. Schumer wanted a one-size-fits-all approach. Mr. Paulson said this would make the program impossible to implement quickly, by requiring every company to redo its employment contracts. They agreed to a compromise under which any firm that sells more than $300 million of assets to Treasury wouldn't be able to create new golden-parachute provisions for executives for the duration of the program.

The final hangup was a move to see that taxpayers were reimbursed if the plan lost money. Democrats earlier wanted a fee or tax levied on financial firms to cover losses.

By 11:30 p.m., there was a breakthrough. The administration would be required to submit a plan to Congress "to recoup those losses from the entities that benefited from this program," according to a summary circulated among House Republicans.

Lawmakers and the administration also struggled with details of the Republicans' insurance plan, which ultimately survived in limited form as an option for the Treasury. An official familiar with the conversations said Sen. McCain also tried to encourage reluctant House Republicans. "He would say, 'You are absolutely right -- the first round was a bad deal,'" and then go on to explain the urgency of acting on something else, this person said.

From 1 a.m. until 4 a.m. Sunday, three Treasury staffers -- General Counsel Robert Hoyt, head of legislative affairs Kevin Fromer and Neel Kashkari, assistant secretary for international affairs -- worked with congressional staff to continue drafting the legislation.

Early Sunday, Mr. Paulson, Rep. Pelosi, Sen. Reid and other lawmakers emerged to say an agreement was in hand. "I think we're there," Mr. Paulson said.

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