



Geithner Relies on Investors for \$1 Trillion Plan (Update6)

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By Rebecca Christie and Robert Schmidt

March 23 (Bloomberg) -- The Obama administration unveiled its plan to remove toxic assets from the books of the nation's banks, betting that it can revive the U.S. financial system without resorting to outright nationalization.

The plan is aimed at financing as much as \$1 trillion in purchases of illiquid real-estate assets, using \$75 billion to \$100 billion of the Treasury's remaining bank-rescue funds. The Public-Private Investment Program will also rely on Federal Reserve financing and Federal Deposit Insurance Corp. debt guarantees, the Treasury said in a statement in Washington.

Barely two months after President **Barack Obama** took office, he and Treasury Secretary **Timothy Geithner** are staking much of the new administration's economic credibility on the theory that removing the devalued loans and securities from banks' balance sheets will help them start lending again and resuscitate the economy.

U.S. stocks rallied, capping the market's steepest two-week gain since 1938, as investors bet the plan will rekindle growth. The Standard & Poor's 500 Stock Index rose 7.1 percent to 822.92, its biggest increase since Oct. 28. Yields on benchmark 10-year Treasury notes rose 2 basis points to 2.65 percent.

Because the program depends on private investors stepping up, it may be weeks or months before it's clear whether the approach will work. "You will start to see this buying up the assets" shortly after private asset managers are chosen by May, **Austan Goolsbee**, a member of the White House Council of Economic Advisers, said in an interview with Bloomberg Television.

Investor 'Eagerness'

"Some of the major firms have suggested a willingness, and perhaps even an eagerness, to take part," White House National Economic Council Director **Lawrence Summers** said in an interview with Bloomberg Television. "There's considerable investor interest from a number of different quarters."

Obama said he is "very confident" the plan will unlock credit markets. "This is one more element that is going to be absolutely critical in getting credit flowing again," the president said at the White House after a meeting with Geithner, Summers, Federal Reserve Chairman Ben S. Bernanke and FDIC Chairman Sheila Bair.

Today's announcement is the latest in a series of government attempts to end the worst financial crisis in seven decades; the Bush administration abandoned an earlier plan to buy the toxic securities in November. Obama officials still have to pick private asset managers and banks have yet to commit to selling their illiquid investments.

The Big Question

"The big question is what is the incentive for the banks to sell?" said **Dino Kos**, managing director at Portales Partners LLC in New York and former executive vice president at the New York Fed. "What is the incentive for a hedge fund to pay a price close to where the banks have it marked at?"

The announcement provides details on an initial strategy laid out by Geithner last month, which caused a slump in stocks because he didn't offer an explanation of how the effort would work. The S&P 500 index is still down about 5 percent since just before Geithner's Feb. 10 outline.

"This will allow banks to clean up their balance sheets," Geithner told reporters at a news briefing in Washington. "There is no doubt the government is taking risk," he added. "You cannot solve a financial crisis without the government assuming risk."

Critics including **Paul Krugman**, a winner of the Nobel Prize for economics, have said the government should take over banks loaded with devalued assets, remove their top management, and dispose of the toxic securities. **James Baker**, who served as Treasury secretary under **Ronald Reagan**, endorsed the idea earlier this month.

Swedish Model

Sweden adopted the temporary nationalization approach in the 1990s. Krugman said in a New York Times opinion piece today that Geithner's strategy won't work because it "assumes that banks are fundamentally sound and that bankers know what they're doing."

Geithner said that his plan was the best of a limited number of options, including leaving the illiquid assets on banks' balance sheets or having the government itself buy them all, shouldering all the risk.

"We are the United States of America, we are not Sweden," the Treasury chief said. Summers said that he was "surprised" at Krugman's article.

Other options considered by the administration included outright purchases of the distressed assets. Former Treasury Secretary **Henry Paulson** initially adopted that strategy before deciding to use most of the first half of the \$700 billion financial-bailout fund approved in October for buying stakes in banks.

Takeover Option

Former Fed official **Vincent Reinhart** predicted that any failure of the new approach would lead to government takeovers of major banks.

"If they don't get the private capital, or toxic securities put up for sale, they will have to use the machinery of resolution," said Reinhart, a resident scholar at the American Enterprise Institute in Washington, and the former director of the Monetary Affairs Division at the Fed.

As part of a separate goal of overhauling financial regulation, the administration plans to ask Congress for legislation setting up a process for handling large, complex financial institutions that are on the verge of failure. The FDIC already has that power for deposit-taking banks.

About half of the Treasury's funds will go to a "Legacy Loans Program" that will be overseen by the FDIC. The Treasury would provide at least half of the capital going to buy a pool of loans from banks, with private fund managers putting up the rest. The FDIC will then guarantee financing for the investors, up to a maximum of six times the capital, or equity, provided.

FDIC Role

The FDIC, which has extensive experience disposing of devalued loans from taking over failed banks, will hold auctions for the pools of loans, which will be controlled and managed by the private investors with oversight by the FDIC.

A "broad array of investors are expected to participate in the Legacy Loans Program," the Treasury said, encouraging insurance companies, pension funds and even individual investors to join in.

The second half of the Treasury's contribution will go to the "Legacy Securities Program." The objective of the initiative is to generate new prices for securities backed by mortgages that are thinly traded because investors have little confidence about the underlying value of the home loans.

Under this program, the Fed will expand an existing facility that provides financing for investor purchases of asset-backed securities. The Term Asset-Backed Securities Loan Program will be

broadened to take on assets such as residential mortgage-backed securities that were originally rated AAA and sold by private banks.

Five Managers

The Treasury will also approve as many as five asset managers “with a demonstrated track record of purchasing legacy assets” to buy the securities.

The managers will be given time to raise private capital and receive matching funds from the Treasury. They will also be able to get “senior debt” from the Treasury of 50 percent to as much as 100 percent of the fund’s capital.

Adding to the pressure on the administration is an unprecedented wave of populist anger over the rescue thus far, following the revelation that employees of **American International Group Inc.** got \$165 million in bonuses after the insurer received taxpayer funds.

Tax on Bonuses

On March 19, the House voted 328-93 to impose a 90 percent tax on employee bonuses paid by companies such as AIG and Fannie Mae that received more than \$5 billion in taxpayer assistance. The Senate is considering similar legislation.

The backlash on Capitol Hill means private firms may think twice about taking part in Geithner’s public-private partnership, even though government financing will limit their risk and increase the potential of earning profits, **David Kotok**, chairman and chief investment officer of Cumberland Advisors Inc., in Vineland, New Jersey, said before today’s release.

Summers said that executive-compensation restrictions won’t apply to investors in the Treasury’s plan.

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Last Updated: March 23, 2009 17:46 EDT

