**Take two on Geithner's toxic-mortgage plan**

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*The Treasury Secretary lobbies private equity and hedge fund executives as he rolls out a more detailed plan to save the banks.*

In a much-anticipated move to unfreeze credit markets, the Obama administration on Mar. 23 issued details of its "public-private investment program," to remove hundreds of billions of dollars in toxic mortgage assets from the balance sheets of financial institutions. The plan would deploy up to $100 billion in federal funds and capital from private investors to purchase up to $500 billion in troubled assets, and could be expanded to cover $1 trillion of the assets over time.

Financial markets cheered the plan, with the Dow Jones Industrial Average jumping more than 240 points, or 3.5%, in mid-morning trading. Other indexes also gained. "The actions that we're getting from a policy standpoint are very helpful in removing the sand from the gears," said Alan Gayle, senior investment strategist at RidgeWorth Investments. "That is going to be good for the financials."

Taking no chances on a tepid reception for the launch, Treasury Secretary Timothy Geithner and other Obama Administration officials worked late Sunday to line up support from private equity and hedge fund executives for their plan. The next day, the plan was formally announced with a fusillade of briefings and fact sheets  as well as an effort to rename what the financial industry has been referring to for months as "toxic assets" into the more benign sounding "legacy" assets.

Under the plan, private investors will put up as little as 6% in capital to purchase equity, a number which suprised some observers as quite low. But Geithner, discussing the plan on Monday morning , dismissed those worries by stressing that private investors would be on the hook before taxpayers. "Their entire capital will be at risk, that's the important thing," he said.

If there are gains, however, the government will benefit as well, Geithner said. "If there's a return over time, which we expect there will be, taxpayers will share in that return."

The Geithner plan has broadened somewhat since he first announced in early February that the Treasury intended to join with hedge funds, private equity firms, and other investors in public-private partnerships to buy up the bad assets weighing down banks. Following that speech, investors and others on Wall Street heavily criticized Geithner for providing only vague details as to how the partnerships would work. The stock market immediately tanked, with the Dow Jones industrial average finishing down 4.6% that day.

Wary of a repeat of that performance, Geithner and other officials issued a flurry of detail on Monday. Officials said the plan would rely on three principles: maximizing the impact of each taxpayer dollar, shared risks and profits with private-sector participants, and private sector price discovery for the "legacy" assets.

"This approach is superior to the alternatives of either hoping for banks to gradually work these assets off their books or of the government purchasing the assets directly," Treasury said in a briefing paper. "Simply hoping for banks to work legacy assets off over time risks prolonging a financial crisis, as in the case of the Japanese experience. But if the government acts alone in directly purchasing legacy assets, taxpayers will take on all the risk of such purchases—along with the additional risk that taxpayers will overpay if government employees are setting the price for those assets."

The program will leverage funds using a maximum six to one debt to equity ratio. Officials said by using $75 to $100 billion in capital from the Troubled Asset Relief Program (TARP) and capital from private investors, the plan will generate $500 billion in purchasing power to buy the troubled assets. The program could be expanded to purchase up to $1 trillion in troubled assets.

The size of the program has given some analysts pause. "We think the problem for Treasury is that given the size of problem, they may need additional funds from Congress and as of now, we do not think those funds are available," writes Brian Gardner of investment firm Keefe, Bruyette & Woods.

"An understandable backlash"

Estimates are that it will take anywhere from $1 trillion to $2 trillion to cleanse the banks' balance sheets of bad assets. But Treasury has nowhere near that amount of money available and Congress—particularly after the explosion of public outrage over AIG's bonuses—is in no mood to allocate more funds to save the banks. Treasury is hoping to leverage its dwindling resources by getting private money to invest in the assets, alongside Uncle Sam's resources.

"There's no question that some companies have appeared to move irresponsibly with those [government] funds. There is an understandable backlash," warns Melissa Bean (D-Ill.), a member of the House Financial Services Committee and a key player among moderate Democrats. "It makes it more difficult to get money out of Congress, no question about it."

So how would Geithner's plan work? The partnerships he proposes would be run by private sector investment managers. They would take an investment interest, but Treasury would commit government funds for as much as an 80% equity stake in the partnerships. The government would lend the partnerships additional funds to increase their ability to buy assets. Uncle Sam will also put a floor under losses, limiting the risks of buying into the toxic assets.

Will banks and investors perform?

In short, Geithner hopes that by heavily subsidizing the asset purchases—and limiting the downside risk—he will be able to entice private investors into jump-starting the frozen market for bad mortgage loans.

"We'll essentially have the government trying to drive the market by giving a subsidy to private investors to lower the spread" between what the banks are willing to sell for and what the buyers are willing to pay for the toxic assets, says Daniel Clifton, Washington policy analyst for institutional brokers Strategas Research Partners. "But it's too early to tell if investors will jump in, or how far down the banks will go in terms of selling the assets."

Government officials are counting on those players to participate in establishing market prices for the troubled assets. The difficulty of coming up with a price banks would accept—but which wouldn't leave taxpayers paying too much—has bedeviled previous federal efforts to buy up the assets. Under Geithner's new plan, banks looking to sell off bad loans and mortgage backed securities would put them up for auction and several partnerships would make competitive bids.

Talf expands to stir consumer credit

"The key is that private-equity and hedge-fund players will vie for the assets," says Scott Talbott, head of government affairs for the Financial Services Roundtable. "That's how you get a pricing mechanism going."

At the same time, Treasury also plans to announce an expansion of the effort it has been making with the Federal Reserve to unfreeze the stalled consumer credit markets. The program, known as the Term-Asset Backed Securities Loan Facility, or TALF, got started this past week in an effort to reinvigorate the securitization market for credit cards, auto loans, and small business loans. Previously, TALF financing from the Fed had only been available for newly originated loans. Now Treasury will expand the program to make eligible loans that originated as long ago as 2005. It is also expected to begin including mortgage assets, too.

In addition, Geithner will announce a new program under which the FDIC will also create an entity to buy up and hold mortgage loans. It is unclear how those purchases will differ in detail from the asset purchases made by the public-private partnerships, though the key may simply be that the FDIC can provide another source of funding to help stretch the limited money available to the Treasury for the bank rescue. Analysts estimate that of the original $750 billion allocated by Congress, no more than $100 billion remains uncommitted and available.

"It gives them another arrow in their quiver," says Clifton.

Congress could change the rules later

No matter how well the plan is now detailed on the page, the central question remains: Will private investors participate? Even before the debacle over the American International Group (AIG) bonuses, many expressed fear that if they joined in with the government, the rules might later change. That has happened repeatedly, as the government has revised the rules governing executive pay for banks that have already received Treasury funds. The furor over AIG's bonuses—which in only a week led to competing proposals to tax away most bonuses at virtually all major banks and Wall Street firms—has spread even more fear that the government is an unreliable investment partner.

While Treasury officials have tried to assure investors that there will be no restrictions on bonuses among participating firms, no one believes Treasury has the final say. As with AIG, Congress will step in if the furor continues, whatever Treasury now promises.

One fear, of course, is that if the bank rescue plan succeeds, private investors could be criticized for having made a lot of money investing in bad banking assets, using government funds. Many worry that they could end up being hauled before Congress to explain what might come to be seen as unreasonable gains if the public's ire doesn't diminish.

"The reactions to AIG last week could have a chilling effect on participation in the program," warns the Roundtable's Talbott. "If people are unwilling to participate, the whole rescue effort could tank."

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