THE PUBLIC-PRIVATE INVESTMENT PROGRAM

Can the latest bank rescue plan help to repair troubled thrifts?

President Barack Obama, left, flanked by Treasury Secretary Timothy Geithner, and Federal Reserve Chairman Ben Bernanke, and Vice President Joseph Biden, right, receive an Economic Briefing, Monday, March 23, 2009, in the Roosevelt Room of the White House in Washington.

White House Photo by Chuck Kennedy, www.whitehouse.gov

March 23, 2009 Treasury Secretary Timothy Geithner announced details of a new Obama administration effort to get banks lending again – a "critical piece of our plan to increase the flow of credit and expand liquidity." The blandly-named Public-Private Investment Program depends on private investors to boldly step up and buy up troubled assets with a little encouragement from the federal government.

Keyword: Cooperation. The PPIP aims to marshal federal and private resources to remove as much as $1 trillion in illiquid real estate assets from the hands of banks. This way, the private sector can share some of the risk of the effort, the government can leverage taxpayer dollars, and competition can help to set market prices for the assets.

The program calls for a public-private partnership – the federal government will couple $75-100 billion of remaining TARP funds with private capital to generate $500 billion in purchasing power, complemented by financing from the Federal Reserve and debt guarantees from the Federal Deposit Insurance Corporation.[1,2]

By offering low-interest loans and TARP money, the plan hopes to attract private sector investors to buy about $500 billion in toxic assets in its first stage. The White House expects pension funds, insurance firms and other long-term investors to bid for the troubled assets.[3] Private asset managers will be selected by the federal government in May.[1]

Why doesn't the government just buy up the bad assets? Some economists have suggested that sweeping move, but Secretary Geithner feels this public-private partnership is the best option among three plausible choices. He doesn't want to leave the assets sitting on banks' balance sheets. "Simply hoping for banks to work these assets off over time risks prolonging the crisis in a repeat of the Japanese experience," he noted in the *Wall Street Journal.*[4]

Former Reagan-era Treasury Secretary James Baker and Nobel Prize-winning economist Paul Krugman both think that the government should just take over banks in trouble, fire their executives, and dispose of illiquid assets. Geithner disagrees: "We are the United States of America, we are not Sweden."[2]

Now let's look at the components of the PPIP.

The Legacy Loans Program. Roughly half of the TARP funds in the PPIP will be used to set up this program, which will be managed by the FDIC. Through this program, the Treasury Department and private fund managers will provide the capital to purchase a pool of loans from thrifts. (The FDIC will guarantee financing for investors up to six times the equity provided.) The FDIC will then auction off these pools of loans, which will be managed by the private-sector investment firms under FDIC supervision. Banks will indicate what assets they want to sell, and the FDIC will make a determination of how much funding it is willing to guarantee.[1,2]

The Legacy Securities Program. This effort will offer private-sector investors non-recourse loans so that they can buy up troubled mortgage-backed securities and asset-backed securities that were once highly rated. The Federal Reserve gets involved here. The Fed will broaden the scope of its Term Asset-Backed Securities Loan Facility (TALF) to take on assets such as residential mortgage-backed securities. (TALF has only received requests for $4.7 billion in loans, yet TALF has up to $200 billion to offer.)[1,3]

The Treasury will recruit multiple asset managers to buy up the illiquid securities, and they will be given time (to raise private capital), money (matching funds from the Treasury) and help (if they wish, they can call on the Treasury to request "senior debt" equivalent to 50-100% of the fund's capital level).[1]

Will it work? The partnership plan will certainly take weeks or months to have real impact. Noted economist Mark Zandi of MoodysEconomy.com thinks another $400 billion is needed to effectively attack the problem.[3] Vincent Reinhart, who used to direct the Fed's Monetary Affairs Division, told Bloomberg.com on March 23, 2009 that should the program prove a bust, the Obama administration "will have to use the machinery of resolution" – nationalization.

Dow gains 497.48. Investors are confident about the plan: the Dow Jones Industrial Average soared 6.8% on March 23,2009 finishing at 7,775.86. The S&P 500 rose 7.1% on the day to 822.92 and the S&P Financial Index climbed approximately 18% on the day. The rally capped the greatest two-week gain for the S&P 500 since 1938.[5]

Citations

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