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Fed Officials Say Ailing Banks Require More U.S. Funds

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Top Federal Reserve officials said Tuesday that the incoming Obama administration must pump more money into ailing financial institutions and might need to take bad assets off the hands of banks, a stance that injected the central bank into a tense political debate.

President-elect Barack Obama visited Capitol Hill Tuesday to lobby Senate Democrats for the remaining funds in the financial-rescue plan passed in October, amid deep concerns among lawmakers about the program's effectiveness. Lawmakers are pushing for new conditions as well as substantial new spending to prevent foreclosures, while some would like to scrap the program altogether.

On Monday, President George W. Bush requested, on Mr. Obama's behalf, the second half of the \$700 billion approved by lawmakers for the Troubled Asset Relief Program. The request comes as banks show new hints of strain. Bank stocks are down more than 15% so far this year.

Fed Chairman Ben Bernanke made a push Tuesday for a new effort to help banks get bad loans off their balance sheets, the TARP's original purpose. In a speech at the London School of Economics, he warned that while TARP funds helped prevent a global financial meltdown last year, bad assets continue to clog the balance sheets of financial institutions. Fixing that problem, he said, is paramount.

"The public in many countries is understandably concerned by the commitment of substantial government resources to aid the financial industry when other industries receive little or no assistance," Mr. Bernanke said. "This disparate treatment, unappealing as it is, appears unavoidable." Mr. Bernanke said repairing financial institutions is critical because the economy is dependent on the credit they provide.

The debate about the financial-rescue funds comes alongside efforts to craft Mr. Obama's proposed stimulus package. Pressure is mounting among lawmakers,

especially in the House, to drop an Obama-backed proposal to let businesses carry back losses to prior tax years, which would lead to windfalls in refunds from the government. Some House members are instead pushing a plan to hold middle-income families harmless from the alternative minimum tax, which was designed to ensure the wealthy don't avoid tax liability but now hits millions of working Americans.

Plans to stimulate the economy with tax cuts and government spending "are unlikely to promote a lasting recovery unless they are accompanied by strong measures to further stabilize and strengthen the financial system," Mr. Bernanke said.

Donald Kohn, the Fed's vice chairman, delivered a similar message in testimony before the House Financial Services Committee Tuesday. Both men also talked about the need to aid homeowners, but their emphasis was on securing the workings of the banking system.

Lawmakers have been highly critical of the TARP, arguing that taxpayer funds haven't led to more bank lending as planned and that the Bush administration failed to use the funds as it promised it would, such as to advance programs to prevent mortgage foreclosures.

During Tuesday's meeting, Mr. Obama's pitch for release of the bailout funds framed the issue as something that could help define "our ability to govern together," said Connecticut Sen. Joseph Lieberman, an independent who caucuses with the Democrats.

The request for the remaining TARP money has set in motion action on a resolution of disapproval, which could block the funds' release. The Obama team and top Democratic congressional leaders have little hope of defeating the resolution in the House, where wariness of the program runs high. But they hope to derail it in the Senate. A vote on the issue could come by week's end.

The Bush administration has used half of the TARP funds, almost entirely to pump capital into banks and to finance bank rescues. Several senators said the president-elect and his aides need to detail their plans for the remainder and how they would improve accountability in the program.

New York Democratic Sen. Charles Schumer said one proposal would require banks to demonstrate that they have begun lending before they can use certain tax breaks in the stimulus package being developed on Capitol Hill.

Banks' lending has been constrained because many are sitting on large losses and others are fearful that new losses could emerge. A Goldman Sachs study updated late Tuesday estimates that investors and financial institutions could lose \$2.1

trillion on bad loans, but that only half of those losses have been realized.

The presence of bad loans on banks' balance sheets "may inhibit both private investment and new lending," Mr. Bernanke said. He laid out three approaches to get bad assets off banks' books. One is to buy them outright. Another is to provide guarantees under which the government would agree, for a fee, to absorb losses if these assets fall further. A third is to help set up "bad banks," which would purchase bad assets from financial institutions in exchange for cash or equity in the bad bank.

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