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Obama Team Pushes to Complete Rescue as Stocks Plunge (Update1)

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By Rich Miller and Robert Schmidt



Jan. 21 (Bloomberg) -- President **Barack Obama**'s economic team is pushing to complete a bank-rescue plan that can be twinned with the \$825 billion stimulus package being negotiated with Congress to alleviate the rapidly deepening financial crisis.

While full details of the rescue haven't been settled yet, people familiar with the deliberations said the package is likely to include a \$50 billion-plus program to stem foreclosures, fresh injections of capital into the banks and steps to deal with toxic assets clogging lenders' balance sheets.

Officials "feel like they need to move quickly to provide some sense of calmness and assurance to the market that the government isn't going to let this problem get out of hand," said **John Douglas**, a partner at the Paul, Hastings, Janofsky & Walker law firm and a former general counsel at the Federal Deposit Insurance Corp.

In his inaugural address yesterday, Obama called for "bold and swift" action to resolve the crisis that's cost the economy almost 2.6 million jobs last year, the most since 1945. Bank stocks sank yesterday, driving the **Dow Jones Industrial Average** to its worst-ever inauguration-day decline.

The president meets with his economic advisers today. One option that may be gaining ground: coupling the establishment of a so-called bad bank to buy some toxic assets with government guarantees to limit losses on those that remain on banks' balance sheets.

Market Meltdown

State Street Corp., the largest money manager for institutions, tumbled 59 percent yesterday after unrealized bond losses almost doubled. The **Standard & Poor's 500 Financials Index** plunged 22 percent, partly on concern some firms are in such bad shape they may have to be nationalized.

The U.K. unveiled a 100 billion pound (\$140 billion) bailout on Jan. 19 that included guaranteeing banks on losses from toxic assets. While Prime Minister **Gordon Brown**'s plan didn't specifically call for a bad bank, it gave the Bank of England unprecedented power to buy securities in an effort to encourage lending.

In the U.S., the Federal Reserve and Federal Deposit Insurance Corp. are advocating a government-backed bad or "aggregator bank" to acquire hundreds of billions of dollars of troubled securities now held by lenders.

Contributing Money

FDIC Chairman **Sheila Bair** has said that cash from the Troubled Asset Relief Program may help capitalize the bad bank and that commercial banks may kick in some money of their own. One possibility that's been discussed is issuing lenders some kind of stock in the new organization in return

for their impaired assets.

American banks are reluctant or unable to lend after suffering more than \$700 billion in writedowns and credit losses since the collapse of the market for subprime U.S. mortgages 18 months ago. The slump in lending, even after the government has pumped billions into the nation's banks, is exacerbating the worst recession since the 1980s.

U.S. financial losses may reach \$3.6 trillion, suggesting the banking system is "effectively insolvent," New York University Professor Nouriel Roubini, told a conference in Dubai on Jan. 20. Obama will have to use as much as \$1 trillion of public funds to bolster the capitalization of the industry, he estimates.

Top advisers to Obama have signaled they will emphasize getting credit to consumers and businesses rather than helping banks in deploying the remaining TARP cash.

Fundamental Reform

"We have to fundamentally reform this program to ensure that there is enough credit available to support recovery," Treasury Secretary-nominee **Timothy Geithner** said in prepared testimony for a Senate Finance Committee hearing scheduled for today that was obtained by Bloomberg News.

So far, the U.S. has poured more than \$200 billion into banks through the TARP, a \$700 billion fund approved by Congress in October. Obama's aides were forced to pledge changes to the program before Congress released the second \$350 billion tranche of that money.

In any new rescue efforts, the Treasury is likely to continue to require banks to hand over ownership stakes to the government as a condition of receiving aid, though it will want to avoid outright nationalization. Programs so far have sought preferred shares and warrants, which can be converted into common stock and cashed out on the government's request.

Taxpayer Benefits

Under now departed Secretary **Henry Paulson**, Treasury went out of its way to avoid taking a controlling interest in the banks it has supported, preferring instead to use the warrants as a way to make sure taxpayers reap benefits of any stock-price recovery. However, regulators have taken stronger measures on occasion, such as the 79.9 percent stakes demanded last year of American International Group Inc. and mortgage companies Fannie Mae and **Freddie Mac**.

Parts of the discussion taking place within the government revolve around ways to leverage the remaining money in the TARP. The Fed already plans to use \$20 billion from the TARP to set up a \$200 billion program to support consumer and small business loans. Adoption of a similar strategy for financing any bad bank would involve larger amounts and the Fed taking on riskier assets.

"Very quickly, we are going to be moving to some kind of" solution to clear the toxic assets and get credit flowing again, **Laura Tyson**, a professor at the University of California, Berkeley, said in a Bloomberg Television interview on Jan. 19.

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