Bernanke’s Witness Protection Program

Welcome to the TALF

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Fed chief Ben Bernanke’s new funding facility is a real doozy. In fact, if the Term Asset-Backed Loan Facility or TALF, which is set to launch on Thursday, doesn’t convince the American people that it’s time to take a wrecking ball to the Central Bank and start over, than nothing will. Bernanke and his co-conspirator at Treasury, Timothy Geithner, are planning to revive the shadow banking system by dumping $2 trillion into the same over-leveraged, derivatives-based garbage that blew up the financial system in the first place. All the blabbering about a “good bank-bad bank” remedy appears to have been a diversion. This is how Bloomberg sums it up:

> “Geithner’s program has three main elements: Injecting fresh government capital into some of the country’s biggest financial institutions; establishing a public-private partnership to handle as much as $1 trillion of banks’ bad assets; and starting a credit facility with the Federal Reserve of as much as $1 trillion to promote lending to consumers and businesses.
>
> The Treasury hopes to unfreeze credit markets by providing new incentives to banks and investors to resume trading in mortgage securities and other troubled assets. U.S. regulators are conducting a new series of examinations to make sure banks have enough capital to accept losses when selling these assets, while also planning to provide government financing to the investors who might buy them.” (Bloomberg News)

That’s right; $1 trillion for Bernanke’s TALF and another trillion for Geithner’s so called “Public-Private Partnership”. That’s $2 trillion down a derivatives sinkhole just to preserve the illusion that the banks are still solvent. Bernanke has decided to shrug off the advice of nearly every reputable economist in the country, most of whom are pushing for a government takeover of the failing banks (nationalization), just to toss his shifty banking buddies a lifeline. It doesn’t bother him that the public till has already been looted and that his action will leave the next generation of Americans bobbing in a pool of red ink.

Last week, investors backed away from Bernanke’s TALF, even though the Fed promised to provide up to 95 percent of the funding (through low interest loans) to investors willing to buy distressed assets backed by student loans, car loans and credit card debt. The potential investors “objected to the level of scrutiny that dealers would have over their books, arguing that the dealers’ rules attached too many strings. Dealers were saying they take plenty of risk to facilitate the program and need to be protected in situations where the collateral or the client made mistakes or wound up ineligible.” (Wall Street Journal”)

This is how crazy it’s gotten. Why shouldn’t the Fed have the right to look at the books and see if these financial institutions are solvent or not? Should they just take their word for it?

But that's only half the story. When the WSJ says that dealers need to "be protected in situations where the collateral or the client made mistakes or wound up ineligible", what they mean to say is that they expect the Fed to make up for any losses on securities which are explicitly banned from the program. This is no small matter, since the Fed cannot legally buy any asset that is less than triple A, and yet, everyone knows the TALF will end up being a dumping ground for all kinds of toxic waste.

So who will pay when financial institutions sell double A or lower securities that they KNOW are ineligible for the program? As it stands now, the taxpayer, because the Fed caved in to industry pressure. In other words, the interests of the people who put up a measly 5 percent of the original investment will take precedent over those who put up 95 percent. This is the kind of sleazy dealmaking that is going on behind the scenes of this bailout fiasco. The Fed is so desperate to launch its facility and keep these Wall Street scamsters and bank extortionists in business, they're willing to underwrite the fraudulent sale of rotten securities. It's outrageous!

But there's even more to this swindle than that–much more. According to the Wall Street Journal:

> "Wall Street dealers, including J P Morgan Chase & Co. and Barclays PLC's Barclays Capital, have created vehicles to participate in the TALF that would allow investors in the program to circumvent many of the restrictions laid out by the Fed. The vehicles resemble collateralized debt obligations, or CDOs, and use some of the financial engineering that was partially responsible for the collapse of the credit markets. The Fed, eager to get what it hopes will be a $1 trillion program up and running, has blessed the vehicles because they open the TALF up to a much larger group of investors." (TALF is reworked after investors balk, Liz Rappaport, Wall Street Journal)

Great. More CDOs. Just what we need.

Keep in mind that the Fed's funding is in the form of "non recourse loans" already, which means that if the dealers decide to walk away, the losses are transferred to the taxpayers balance sheet, no questions asked. But even that is not good enough for the Wall Street crooksters. They want to create a whole new security buffer-zone for themselves by dredging up the Frankenstein of structured debt-instruments–the notorious CDO–so they can "circumvent" the rules and plead innocent when B grade garbage is sold through the TALF. This isn't a financial rescue plan, it's a witness protection program for self acknowledged con artists and snake oil salesmen.

Again, the Wall Street Journal:

> "Under the new proposal, a bank such as Barclays or J.P. Morgan would set up a trust to buy securities with money borrowed from the Fed. The trust would then sell investors securities in the trust. Those securities would give returns similar to the TALF loan, but without the strings attached….The dealers say they could create markets for these derivative securities to trade."

The Fed's culpability in this boondoggle is undeniable. Bernanke and his wily friend at Treasury have given their full support to a plan that does nothing but move trillions of dollars of toxic waste from one balance sheet to another while foisting the liability onto the American taxpayer. And don't be misled by the term "trust" in the Journal's report. In this instance, "trust" refers to an Enron-type, off-balance sheets Structured Investment Vehicle (SIV) which is designed to keep investors in the dark about the real condition of the financial institutions that run them. SIV's are the banks sausage-making units which hold hundreds of billions of dollars of undercapitalized complex securities, like mortgage-backed securities (MBS) and collateralized debt obligations (CDO). These are the same debt-instruments which greased the skids for the current downward death-spiral.

Wall Street Journal:

> "The vehicles also would make it easier for investors that aren't eligible for TALF loans to buy into the program, like investors that are restricted by their investment guidelines from using borrowed money to buy securities. Smaller hedge funds that can't vie for large allocations of deals could also buy in through these vehicles."

Sure, what the heck. Why worry about "eligibility" or "restrictions"?

We don't need a financial rescue plan that isolates the toxic waste and writes down the losses. We don't need to protect the taxpayer or the depositor. We'll just keep asset prices in the stratoshpere for a while longer by adding a little more helium and pretending that private institutions really want this mortgage-backed sludge. That way, we can keep the public from knowing what's really going on." This seems to be the general line of reasoning at the Fed and Treasury.

Wall Street Journal:

> "Some investors have raised concerns, however, noting that the structure puts these dealers at an advantage in bidding and influencing the price of new offerings. They also say the derivative securities present old and familiar problems, such as keeping the end holder of the risk of the TALF securities several steps away from the pricing of that risk."

The economy is sliding headlong into another Great Depression because of the mispricing of risk, the sale of complex and unregulated derivatives, the vast and unsustainable use of leverage, and shadowy and fraudulent off-balance sheets operations. When the TALF is launched on Thursday, all of these same activities will be reignited with the explicit blessing of the Central Bank. It is a reckless, wacky plan to keep the banks in private hands and to keep asset prices inflated beyond their true market value.

Bernanke and Geithner are moving ahead with their plan despite the clearly articulated guidelines set out by the world's finance ministers and central bankers who convened over the weekend in Sussex, England. Number 7 of the G-20's Communiqué reads:

> "We have also agreed to: regulatory oversight, including registration, of all Credit Rating Agencies whose ratings are used for regulatory purposes, and compliance with the International Organization of Securities Commissions

> (IOSCO) code; full transparency of exposures to off-balance sheet vehicles; the need for improvements in accounting standards, including for provisioning and valuation uncertainty; greater standardization and resilience of credit derivatives markets; the FSF's sound practice principles for compensation; and the relevant international bodies identify non-cooperative jurisdictions and to develop a tool box of effective counter measure."

It couldn't be much clearer than that. But don't expect "compliance" from Geithner or Bernanke. They have no intention of reworking their plans to meet the demands of the G-20. No way. Multilateralism and cooperation might sound great in speeches, but it's not what drives policy.

The TALF and the "Public-Private Partnership" are another slap in the face of the international community. They violate the spirit and the letter of the G-20 communique. It will be interesting to see if foreign holders of US Treasurys endure this latest insult in silence or if there's a sudden stampede for the exits. There's a sense that the world is getting fed up with the Fed's financial chicanery and would like to chart a different course. Enough is enough.

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