Obama's Latest No Banker Left Behind Scheme

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On Wall Street, that is. So hyped by advance fanfare, Timothy Geithner unveiled his Public-Private Investment Program (PPIP) on March 23, the latest in a growing alphabet soup of handouts topping $12.5 trillion and counting – so much in so many forms, in "gov-speak" language, with so many changing and moving parts, it's hard for experts to keep up let alone the public, except to sense something is very wrong. They're being fleeced by a finance Ponzi scheme, sheer flimflam, and here's how from what we know:

— $400 billion in taking over Fannie and Freddie;

— $42 billion for the auto giants; billions more coming for their suppliers;

— approaching $200 billion for AIG with more coming on request;

— $350 billion to Citigroup in handouts and loan guarantees;

— tens of billions to other banks, including $87 billion to JP Morgan Chase for bad Lehman Brothers trades;

— $700 billion for TARP I; half the money released under TARP II;

— over $200 billion and counting for the Term Asset-Backed Securities Loan Facility (TALF) to extend government-guaranteed loans for investors to buy "certain AAA-rated asset-backed securities (as a) component" of the Consumer and Business Lending Initiative (CBLI), established under the Emergency Economic Stabilization Act (EESA) of 2008;

— the $787 billion stimulus under the American Recovery and Relief Act of 2009 (ARRA);

— around $300 billion under the Homeowner Affordability and Stability Plan (HASP) – the so-called mortgage bailout plan;

— $50 billion backing for short-term corporate IOUs held by money market funds – from the Exchange Stabilization Fund (ESF), a vehicle established by a provision in the 1934 Gold Reserve Act for foreign exchange intervention to stabilize the value of the dollar;

— $500 billion for various credit market rescues;

— $620 billion for industrial nations' currency swaps;

— $120 billion for emerging economies' currency swaps;

— $1.25 trillion for Fannie and Freddie mortgage backed securities;

— $200 billion for Fannie, Freddie, and Federal Home Loan Bank bonds;

— way more than the announced $300 billion for longer-term Treasuries (mostly with 7 – 10 year maturities); the Fed's been buying billions of them since last year;

— Fed-expanded overnight lending to $2.4 trillion – free money at 0% interest;

— a reported $750 billion for banks in the FY 2010 budget – yet to be voted on and appropriated;

— a proposed $470 billion increase for the FDIC to borrow from the Treasury;

— perhaps hundreds of billions more in unannounced or hidden handouts in amounts and to whom the Fed and Treasury won't say; on March 14, AIG named its big counterparties for the first time with firms like Goldman Sachs, Societe Generale, Deutsche Bank, and Barclays showing up prominently; and now

— PPIP – the latest gift to Wall Street courtesy of taxpayers getting none of the gain and all the pain.

A Treasury Fact Sheet explains it on its web site. In "gov-speak," it cites the "challenge of legacy assets" comprised of (distressed commercial and household) "loans"/mortgages and (toxic) "securities" (mortgage-backed and others) with a new Public-Private Investment Program (PPIP) in conjunction with the FDIC and Fed to finance and guarantee it. The idea is to "repair balance sheets," encourage banks to lend, and "help drive us toward recovery." It expands TALF "to bring private investors back into the market" by offering deals too sweet to pass up:

— a public-private (open-ended) trillion dollar partnership with Washington contributing up to 95-97% of the cash and investors the other 3-5%;

— the Fed and FDIC (through low-cost loans and guarantees) acting as middlemen to transfer "legacy asset" losses to the public while buyers get government financing and guarantees (for no-risk investments) to purchase them on the cheap for themselves and well above fair value for the banks;

— PPIP particulars are for $100 billion in mostly TARP and some private capital with Fed and FDIC $500 billion in leverage financing to expand it to $1 trillion or more in purchasing power.

In a March 23 Wall Street Journal op-ed, Geithner called it "My Plan for Bad Bank Assets (to) increase the flow of credit and expand liquidity (and do it by) shar(ing) risk with the private sector (to) rid banks of legacy assets." These "policies will work," says Geithner, even though everything tried to date failed, and the only achievement is what they planned – the greatest ever wealth transfer in the shortest span of time, now increased by another trillion or more through PPIP and whatever else the masters of the universe have in mind.

"Toxic-Asset Plan Lifts Stocks," headlined the Wall Street Journal, after surging around 7% on March 23 with banks and other financials in the lead, buoyed by the prospect of more free money, hundreds of billions for the taking, and plenty more where that came from.

If It Works, A Win-Win for the Money Trust

Here’s how economist Jeffrey Sachs explains it:

Geithner’s plan will have the Fed and FDIC “subsidize investors to buy toxic assets from the banks at inflated prices.” If done, it will be another in a series of massive wealth transfers in the hundreds of billions of dollars “to bank shareholders from taxpayers.” If investors incur losses, the Fed and FDIC will absorb them, meaning heads or tails they win.

“The investment funds will have the following balance sheet. For every $1 of toxic assets (bought), the FDIC will lend up to 85.7 cents, and the Treasury and private investors (only) 7.15 cents in equity to cover the remaining balance. FDIC loans will be non-recourse, meaning that if the toxic assets (bought) fall in value below the amount of FDIC loans, the investment funds will default on the loans and the FDIC will end up holding the toxic assets….”

In other words, “The FDIC is giving a ‘heads you win, tails the taxpayer loses’ offer to private investors.’ ” Economist Paul Krugman agrees calling it a one-way bet, “a disguised way to subsidize purchases of bad assets.”

Economist James Galbraith calls it another massive “ineffective” giveaway to banks with taxpayers getting hosed from a repackaged trash removal scheme that’s been around since last fall when Geithner, as New York Fed president, planned it with Wall Street CEOs. They see it as a temporary liquidity problem (which it’s not) so the idea is to clean up the system and get banks lending again. But here’s the rub:

“If Geithner’s plan to fix the banks would also fix the economy,” maybe the idea makes sense. “But no smart economist we know thinks that it will.” It’s a giant swindle, but that aside, Geithner has “five fundamental misconceptions:”

(1) The trouble with the economy is that banks aren’t lending, he says.

In fact, it’s because businesses and mainly households are way over-extended and “are now collapsing under the weight of it. As consumers retrench (of necessity), companies that sell to them (must also), thus exacerbating the problem. The banks, meanwhile, are lending,” just not as much as they used to.

“Also, the shadow banking system (securitization markets), which actually provided more funding to the economy than the banks, has collapsed.”

(2) The banks aren’t lending because their balance sheets are loaded with ‘bad assets.’

In fact, “banks aren’t lending (enough) because they have decided to stop making loans to people and companies who can’t pay them back” or don’t want more loans in the first place. They’re also scared that new debt will cause more write-offs, greater losses, and the threat they’ll be wiped out entirely. So their strategy is hunker down and wait for a better time to do business.

(3) Bad assets are “bad” because the market doesn’t understand how much they’re really worth.

In fact, they’re bad because “they are worth (lots) less than banks say they are.” A major factor is the near-30% drop in house prices wiping out over $5 trillion in valuations. Lenders want households to take losses because if they do it themselves they'll be wiped out. So PPIP arranges it for them.

(4) Once "bad assets" are off balance sheets, banks will start lending again.

In fact, banks will stay cautious until the housing market and economy improve. So far, that's nowhere in sight.

(5) Once banks start lending, the economy will recover.

In fact, house prices are falling, savings have been wiped out, huge job losses are continuing, and "consumers will have debt coming out of their ears" that will take years to work off.

Geithner's plan just shifts debt from lenders to taxpayers "where it will sit until the government finally admits that a major portion will never be paid back." Galbraith's conclusion: Geithner's plan is "extremely dangerous" besides being a scam to cheat the public. Why does Wall Street love it? Because it wrote it in the first place, so the whole scheme is arranged for its benefit – if it works.

It's a big "if" as investors want the lowest possible prices and banks the highest. The question is will they compromise and for what – the better quality junk investors want or the most toxic stuff banks want to offload for whatever they can get.

Even a Wall Street Journal editorial raised doubts about "Geithner's Asset Play. At least it's an attempt to clean up bank balance sheets," it said, but hold the cheers. "The best news (is that Geithner has) a strategy. The uncertainty was almost as toxic as those securities. Now all (he) has to do is find private investors willing to 'partner' with the feds to bid for those rotten assets, coax the banks to sell them at a loss, and hope the economy doesn't keep falling…."

"Other than that, general, how (did) the siege of Moscow" go?

In a front of the paper article, a trio of Journal writers said "visions of vilification of Wall Street executives on Capitol Hill remain fresh in the minds of potential (bad asset) buyers….numerous (ones) express(ing) concern that they, too, might be hauled before Congress for a grilling, or be subjected to new taxes if they profit from partnerships with the federal government."

They quoted Washington lobbyist, Lendall Porterfield, whose clients include hedge funds and banks, saying: "There are still some very serious reservations about doing business with the government, because you don't know what the rules may be tomorrow, next week or next month."

Economist Nouriel Roubini wants two firmly in place:

— force banks to sell toxic assets at true value and take the losses; and

— shut down the insolvent ones.

For his part, Financial Times writer Martin Wolf expressed deep concerns about PPIP in his March 25 column headlined: "Successful bank rescue still far away." He's "ever more worried” and says why:

— he expected a “popular new president to be decisive;”

— he fears a “Congress indulging in a populist frenzy” and an administration “hoping for the best;”

— instead of letting businesses succeed or fail on their own, “bailouts have poured staggering sums into the failed institutions that brought the economy down;”

— PPIP is a “vulture (investor) relief scheme,” cash for trash, with Washington putting up most of the money, bearing nearly all the risk, while private parties get all the gain – if the plan works;

— PPIP masks a “more fundamental problem” of “chronic under-capitalization of US finance” and it may make achieving it harder – given growing public anger, a “timid” president, Congress on the “warpath,” and being less likely to put up the kind of money needed to do it;

— enriching vulture investors may “convince ordinary Americans that their government is a racket run for the benefit of Wall Street;” and

— when all is said and done, PPIP may not work.

As a result, “Nobody can be confident that the US yet has a workable solution to its banking disaster….If this is not frightening, I do not know what is.”

Economist Jack Rasmus calls PPIP a “win they win vs. lose they win proposition — i.e. free money with which to leverage to make even more money” with government taking nearly all the risk. It’s “an offer that no capitalist speculator could ever refuse” with nothing for the public except the bill.

It’s why Dean Baker, co-director of the Center for Economic and Policy Research, called it “another Rube Goldberg contraption intended to funnel taxpayer dollars to bankrupt banks….” However, the process plays out, “much of the toxic waste (will) stay on the banks’ books (since it’s) likely that the gap between the asking price and the offer (won’t) be closed for a large portion of these assets, even with the government subsidy.”

So what’s next? “The Obama administration will be forced to go to Congress with yet another bailout proposal. (It’s) hard to understand this plan as anything other than a last ditch effort to save Wall Street banks. (Obama) seems prepared to risk his presidency on their behalf” and odds are he’ll lose.

Whatever happens going forward, the uncertainties and dangers are enormous:

— Eurointelligence refers to “Geithner’s trillion dollar gamble” despite the positive market reaction;

— will taxpayers stand for it, how long, and at what cost;

— will enough buyers settle for the best deals they can get, and/or will banks compromise enough to matter; put another way – will government “grease” attract enough buyers willing to invest at valuations banks will accept; so far, they've stubbornly refused to take losses, preferring instead to keep junk on their books at fictitious values hoping eventually they'll be real or close enough; another disincentive is talk that the Financial Accounting Standards Board (FASB) will ease mark-to-market accounting rules to legitimize fake values;

— whatever they do, can banks offload enough to matter or are they so over-indebted that nothing can work;

— how much in the way of deficits, money printing and dollar debasing can the nation stand, and how long will sovereign and private debt buyers put up with it;

— going forward, how many banks are too weak to survive no matter what's done to save them – that is, ones big enough to matter (like Citigroup), not others targeted to be bought up or closed down – and globally that's what's behind this scheme in the first place;

— what about the CEOs that caused the global crisis and left their banks insolvent; issues of fraud and bailouts aside, why weren't they fired long ago; why are they still in charge drawing big salaries and bonuses; why wasn't the main demand to fire these guys and replace them with responsible managers; and

— skeptics call Geithner's plan much like Paulson's, except for some differences in details.

On March 24, Dan Roberts in the London Guardian headlined: "US follows UK – on the wrong road." Geithner's plan "aims to achieve roughly the same as the British government's (bad loans) insurance for the Royal Bank of Scotland and Lloyds. So how do the two schemes compare?"

Details aside, they "work on the same principle: that banks will (behave) normally again and (benefit) the economy (once) they're protected from past mistakes. But these responses underestimate the scale of the crisis." Geithner's plan covers not just toxic assets but many ordinary bank loans as well.

"Similarly, the assets put forward by Lloyds in the UK insurance scheme include every buy-to-let mortgage issued by HBOS, not just the ones already in default. Judge the banks on their actions (not just their words), and you would conclude this crisis has some way to go. Yet both governments assume banks (suffer) from a crisis of confidence (simply cured) by removing (toxic debt) uncertainty. What neither seems willing to acknowledge is the likelihood that much of their lending has gone for good; that this is not a liquidity crisis, but a solvency (one)." Britain's plan didn't work and neither will Washington's.

No comment from the Journal except to say: "Whatever the Geithner plan's pitfalls, we sincerely hope it works. The feds so thoroughly botched the TARP and (other) bailouts that Treasury has few options left."

Indeed so. No accounting magic can erase losses, inspire investors, and turn a sick economy around. Especially since all Washington schemes make it sicker, and now Geithner's thrown more fuel on the fire. Problem one is reducing the huge debt overhang and helping beleaguered households. His solutions:

— help Wall Street, not people and

— pile on more debt but hope bank "operating" results improve enough to create an illusion of recovery.

It won't work, and at the same time, the latest Fed Flow of Funds data show trillions in vanished household wealth – $12.9 trillion from real estate, savings, investments, and other personal losses. So while insolvent banks are partying, the crisis is deepening. It's far from being resolved, at best has a long way to run, so Bank of America's Richard Bernstein advised clients to sell bank stocks after their rally because PPIP won't stop their profits from falling.

Worse still, according to financial expert and investor safety advocate Martin Weiss, Washington greatly underestimates the "magnitude of the debt crisis." He cites the following:

— the current FDIC "Problem List" includes 252 banks with $159 billion in assets;

— from his analysis, he lists 1568 troubled banks and thrifts by name with $2.32 trillion "at risk of failure" – because of "weak capital, asset quality, earnings, and other factors;"

Last year when TARP was announced, Treasury officials thought it would stabilize the economy and improve the health of recipients like Citigroup. However, it quickly learned that Citi and other major banks needed emergency capital to keep from collapsing – for their credit default swap (CDS) problems alone.

AIG's $2 trillion CDS portfolio triggered a government takeover, but it's not alone. Citi has $2.9 trillion, JP Morgan Chase $9.2 trillion, and the Bank of International Settlements reports a global $57 trillion burden, much of it toxic and plenty to sink holders of enough of it.

The problem in America is so great that "the money available to the government is too small for a crisis of these dimensions." Forced mergers, buyouts and handouts have done "little more than shift toxic assets like DDT up the food chain." Further, Washington's "promises to buy up the toxic paper have done little more than encourage banks to hold on, piling up even bigger losses."

Another CDS is also worrisome, one no one talks about but should, on US sovereign debt – Treasury bills, notes and bonds. "A small but growing number of investors are not only thinking the unthinkable, they're actually spending money on it, bidding up the premiums on Treasury bond (CDSs) to 14 times their 2007 level" because they're worried about the Treasury's credibility and borrowing power.

Their message is clear and important – "there's no free lunch; the government (can't) bail out every failing giant with no consequences; and contrary to popular belief, even Uncle Sam must face his day of reckoning with creditors."

Also, "the public knows intuitively that (too much debt) got us into trouble. Yet the solution being offered is to encourage banks to lend more and people to (save less and) borrow (and spend) more." The only way forward is to change course because there's "no other choice….We have to bite the bullet, pay the penalty for our past mistakes," and make hard sacrifices for a sound recovery.

That includes shuttering insolvent banks and other companies (even big ones), not bail them out. Even Kansas City Fed president Thomas Hoenig recommends that:

"public authorities….declare any financial institution insolvent whenever its capital level falls too low to support its ongoing operations and claims against it, or whenever the market loses confidence in the firm and refuses to provide funding and capital."

The wrong choices are trillions more in handouts, reckless money creation, dollar debasing, and an eventual inflation destroying the purchasing power for millions. So far, that's where Congress and Obama's money managers are heading us, and already the bill for their actions is past due.

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