Obama's Toxic Asset Plan

The Plan will leave the same Amount of Toxic Assets In the System, but with Taxpayers now liable for most of the Losses

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The most succinct description of what is wrong with Geithner's PPIP toxic asset plan comes from the Financial Times:

> Critics say that would leave the same amount of toxic assets in the system as before, but with the government now liable for most of the losses through its provision of non-recourse loans.

That's exactly right. American banks that have received billions in bailout funds, including Citigroup Inc, Goldman Sachs, Morgan Stanley and JPMorgan Chase & Co, are considering buying toxic assets to be sold by rivals under the Treasury's trillion dollar plan (and Bank of America – another big bailout recipient – is buying toxic assets as well).

The amount of toxic assets isn't going to be meaningfully reduced – the assets will just be shuffled from one bailout buddy to another.

But the government is guaranteeing 85% of the value of the toxic assets.

So the taxpayers (who anteed up for the bailout funds which the banks are now using to purchase the assets) will again pick up the tab when the assets turn out to not be worth as much as the banks are paying for them.

But why would the banks overpay for the other guy's toxic assets?

Some financial writers have speculated that these banks are giving each other kickbacks under the table. But we don't even have to go there.

If all of the big banks holding the lion's share of toxic assets (about 5 banks, as discussed below) have a gentleman's agreement to overpay for the other guy's toxic assets, then they will end up in the same position as if they had all paid fair market value. You overpay for mine, I'll overpay for yours . . .

But since they can then say that they naively overvalued the assets, the government will pay them back for their "losses".

Get it?

It is well-known that JP Morgan, B of A, Citigroup, HSBC and Wells Fargo have by far the largest derivatives holdings (and see this). Their derivatives exposure – especially credit default swaps – are the core type of toxic asset (and one of the main causes of the financial crisis). These are really the players which would need to agree to play this game for it to work.

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