

Friday, February 6, 2009



## Industry Readies for 'Bad Bank' Plan

By [Erika Morphy](#)

WASHINGTON, DC--On Monday the Treasury Department is expected to roll out an ambitious plan to address the trillion dollar-plus toxic debt that has thrown the lending and credit markets into near paralysis, according to several news agencies, including the *Washington Post*.

In this latest iteration of a financial system bailout, the Treasury Department under President Barack Obama will be taking both a more nuanced and aggressive approach in dealing with toxic debt, compared to earlier proposals put forth by Treasury under the Bush Administration: namely, that Treasury will create a so-called 'Bad Bank', which will decide what to do with each asset or pool of assets. It will buy those loans that are most burdensome to banks right now-- such as assets whose prices have dropped like stones. With more stable--but still troubled--assets, the banks will keep the assets on their books, but receive a government guarantee to limit losses. The government will also be injecting more capital into banks to shore up their balance sheets.

The plan will provide a psychological boost to the CRE industry, which has found it difficult to strategize with the government changing course every few months in its approach. Distressed asset trades have all but ceased in the last few months because no one knows where the market would head, Sue Allon, co-founder and CEO of mortgage due diligence provider Allonhill, tells GlobeSt.com. "On the buy side nobody wants to buy these assets at what they would have to pay today, because they are afraid they could get it for cheaper tomorrow. Sellers don't want to sell for the same reason--they could get a better price tomorrow. Ironically the source for this uncertainty is the same for both parties: the Treasury department and its plans." Separate from the news accounts, Allon says she has heard of a 'Bad Bank' plan that the government will announce from her own industry contacts.

Since the start of the crisis--defined by many to be Lehman Bros.' collapse in September--there has been formal and informal talk of the government taking on this problem of toxic debt. The case to be made for this aggressive and unprecedented government interference in the economy and financial system is basic: Banks had ceased lending because they could not move these toxic assets off of their balance sheets. The case against the government's move is multi-tiered, centering around fears of dangerous tinkering in the private markets, a huge burden that would be imposed on taxpayers, the possibility that the measure might not work, and finally, the difficulty in executing it.

These reasons, presumably, were behind the back-and-forth on the subject when Treasury was under the helm of Secretary Henry Paulson in the Bush Administration. The Obama Administration appears to have decided that inaction would be more dangerous to the financial system, even despite the many uncertainties.

With the decision, apparently, made to go forward, the big questions will center around execution. From the beginning it was recognized that deciding which assets to bring onto the government's balance sheet--and more importantly, how to value them--would be messy.

Earlier this week, in fact, a Congressional panel overseeing the bailout reported that the government overpaid \$78 billion last year for stakes in troubled banks as part of the \$700 billion Troubled Asset Relief Program. The panel found that Treasury paid \$254 billion in 2008 for shares in banks including Citigroup, but got only \$176 billion in value.

The CRE industry, meanwhile, has its own concerns. Certainly the majority of players want to see the government intervene. But there could be unforeseen repercussions depending on the details of the plan, John Annaloro, president and CEO of the Washington Credit Union League, tells GlobeSt.com. "I think a lot of people expect the government to buy these assets at their original prices. But the government will have to adhere to their own policy mandates so that

is not likely to happen." If the assets are not purchased at their original prices, mark-to-market rules will lead to a haircut for many financial institutions that own these assets, he says.

Meanwhile there is a wild card in all of this: the Federal Reserve Bank, which, thanks to its charter and mandate, is not as transparent an operation as Treasury. In at least one case made public, the Fed has [purchased toxic assets](#). No doubt there are other plans and strategies the Federal Reserve is hatching as well and how these will dovetail with Treasury's approach is anyone's guess at this point.

The Federal Reserve Bank has taken on a greater regulator role since the crisis began last Fall--and will likely continue, Edward Kramer, EVP of Regulatory Programs for Wolters Kluwer Financial Services and a former deputy superintendent of Banks with the New York State Banking Department, tells GlobeSt.com. Much of what the Fed has done thus far has been in a triage capacity, he says. "But I believe they are also looking at creating better ways to systematically guard against undue risk."