

+-----+
Paulson, Bernanke Push New Proposal to Cleanse Balance Sheets
2008-09-19 04:12:18.490 GMT

By Alison Vekshin and Dawn Kopecki

Sept. 19 (Bloomberg) -- U.S. Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben S. Bernanke proposed moving troubled assets from the balance sheets of American financial companies into a new institution.

Congressional leaders who met with Paulson and Bernanke late yesterday in Washington said they aim to pass legislation soon.

The initiative, which may also insure money-market funds, is aimed at removing the devalued mortgage-linked assets at the root of the worst credit crisis since the Great Depression.

The effort is a recognition that Paulson's and Bernanke's steps have so far failed to revive financial and housing markets.

The government took over American International Group Inc., Fannie Mae and Freddie Mac in the past 12 days, a period when Lehman Brothers Holdings Inc. filed for bankruptcy and Americans pulled a record \$89 billion from money-market funds.

"They were just worn out and weary from the one-off situations they had to deal with, and finally came to the realization that it's a much more pervasive problem," said Marilyn Cohen, who manages \$185 million in bonds as president and chief executive of Envision Capital Management in Los Angeles.

"Hopefully, this will give the trading desks the confidence to start making markets again."

Securities and Exchange Commission Chairman Christopher Cox, who attended the gathering with lawmakers, said the SEC planned to consider more rules to guarantee market liquidity. The commission is weighing a ban on short-sales of the shares of Wall Street brokerages after Morgan Stanley fell 39 percent this week, said a person familiar with the matter.

Stocks Rally

U.S. stock index futures gained more than 1.6 percent, the dollar rose versus the yen and Japan's Nikkei 225 Stock Average climbed 3.1 percent on optimism that Congress and policy makers will enact a comprehensive plan for the crisis.

Options under consideration include establishing an \$800 billion fund to purchase so-called failed assets and a separate \$400 billion pool at the Federal Deposit Insurance Corp. to insure investors in money-market funds, said two people briefed by congressional staff who spoke on condition of anonymity because the plans may change.

Another possibility is using Fannie and Freddie, the federally chartered mortgage-finance companies seized by the government last week, to buy assets, one of the people said.

"We will try to put a bill together and do it fairly quickly," House Financial Services Committee Chairman Barney Frank, a Massachusetts Democrat, said after the meeting. "We are not in a position to give you any specifics right now" on the proposals, he said when asked about the potential cost.

Debt Concern

The likelihood of the government taking on yet more devalued assets, after the seizures of Fannie, Freddie and AIG and the earlier assumption by the Fed of \$29 billion of Bear Stearns Cos.

investments, may spur concern about its own balance sheet.

The Treasury has pledged to buy up to \$200 billion of Fannie and Freddie stock to keep them solvent, while the Fed agreed Sept.

16 to an \$85 billion bridge loan to AIG. The Treasury also plans to buy \$5 billion of mortgage-backed debt this month under an emergency program.

“It sounds like there's going to be a giant dumpster for illiquid assets,” said Mirko Mikelic, senior portfolio manager at Fifth Third Asset Management in Grand Rapids, Michigan, which oversees \$22 billion in assets. “It brings up the more troubling question of whether the U.S. government is big enough to take on this whole problem, relative” to the size of the American economy, he said.

Senator Richard Shelby of Alabama and some other Republicans have criticized the takeovers of AIG, Fannie and Freddie for imposing a potentially high cost on taxpayers.

Shelby Skeptical

“We cannot protect all risk in the market, and we shouldn't do it at the risk of the taxpayer,” Shelby, the ranking Republican on the Senate Banking Committee, said in an interview with Bloomberg Television this week.

Still, Representative John Boehner, the head of the Republicans in the House, told reporters after the meeting with Paulson and Bernanke that he was “hopeful that in the coming days we'll have a proposal that will pass this Congress.”

Senator Charles Schumer of New York, a Democrat who chairs the congressional Joint Economic Committee, warned yesterday against leaving the Fed with an expanding role for addressing the credit crisis.

“It's hard for them to do monetary policy, which is their primary task, and then run all these businesses,” Schumer said yesterday in Washington.

Record Lending

The Treasury the past two days announced \$200 billion in special bill sales to help the Fed expand its balance sheet. The U.S. central bank extended a record \$59.8 billion in loans to investment banks and \$33.4 billion to commercial banks as of Sept.

17. The Fed yesterday also joined its counterparts from around the world to pump \$180 billion into global money markets.

An increasing number of lawmakers are advocating a stronger response to the crisis sparked by record homeowner defaults.

Schumer proposed an agency to inject capital into troubled financial companies in exchange for rewriting mortgages to make them more affordable. It would be modeled on the Great Depression-era Reconstruction Finance Corp., he said. Others have floated a type of Resolution Trust Corp., which was a 1990s fund to manage devalued assets from failed savings and loans.

Citigroup Inc., JPMorgan, Bank of America Corp., Goldman Sachs Group Inc., Merrill Lynch & Co. and Lehman Brothers alone had more than \$500 billion of so-called Level 3 assets as of June 30, according to data in a Sept. 15 report from New York-based bond research firm CreditSights Inc. The holders of these assets say their values can only be determined through internal models because of illiquid markets.

Senator Christopher Dodd, who chairs the Senate Banking Committee, said it was a “sober” gathering. The plan would likely come from the Treasury and Fed this weekend and “nothing is more important than this,” Dodd said.

For Related News:

For news on the credit crisis: [NI CRUNCH BN <GO>](#) For finance news: [NI FIN <GO>](#) Most-read stories on the U.S. Treasury: [TNI MOSTREAD TRE <GO>](#)

--With reporting by James Rowley, Brian Faler, Jesse Westbrook, John Brinsley and Rebecca Christie in Washington, Christine Harper in New York and Vivien Lou Chen in San Francisco.
Editors: Chris Anstey

To contact the reporter on this story:

Alison Vekshin in Washington at +1-202-654-4307 or avekshin@bloomberg.net; Dawn Kopecki in Washington at +1-202-624-1915 or dkopecki@bloomberg.net

To contact the editor responsible for this story:
Chris Anstey at +1-202-624-19472 or canstey@bloomberg.net.