washingtonpost.com

Treasury Weighs Investing In Banks

Ownership Stake Details Discussed

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Friday, October 10, 2008; D01

The Bush administration is hammering out the final details of a plan that would allow the government to inject cash into banks in exchange for ownership stakes in an effort to shore up confidence in the faltering financial system, according to officials and sources who have been in contact with the Treasury Department.

Senior Treasury officials think they have the authority to take ownership stakes in banks under the $700 billion rescue package that was passed by Congress and signed into law last week, the sources said. But the administration has yet to work out several critical issues, such as how many banks should be included and when the plan should be put into effect.

The Treasury is expected to announce the plan by the end of the month or even sooner, the sources said, speaking on condition of anonymity because their conversations with the agency were private. Congressional leaders could be briefed as early as today.

The proposal already is generating controversy on Capitol Hill and among private-sector firms concerned that a broad intervention of this kind would represent a vote of no-confidence in the entire banking industry, not just troubled institutions.

White House press secretary Dana Perino suggested yesterday that President Bush would support a government move to buy shares in troubled U.S. banks if Treasury Secretary Henry M. Paulson Jr. decided to do so.

"It was a part of the rescue package that the president supported, and it gives the Treasury secretary a range of possibilities, and investing in banks directly was one of those authorities," Perino said. "Secretary Paulson can use that authority as he sees fit."

Unlike in the case of American International Group, which had to surrender an 80 percent stake in order to secure a massive government loan, Treasury officials are considering taking non-controlling equity stakes in banks that accept the cash infusions, probably in the range of 10 or 15 percent, the sources said.

What is less clear is what strings would be attached, particularly regarding the compensation of top executives at participating banks.

Under the law, any financial institution that accepts taxpayer money would be required to place limits on executive paychecks. But companies that receive a direct infusion of funds and do not participate in auctions would be subject to far more severe restrictions.

In those cases, the law says the Treasury must establish "appropriate standards" for corporate governance and compensation of the top five executives that would be in effect for as long as the Treasury holds the firm's assets or stocks. Those standards must include a ban on incentives for taking "excessive risks," a method to revoke bonuses paid for profits that never materialize and a ban on "golden parachute" payments for departing executives.

These provisions were among the last to be settled during negotiations between lawmakers and Paulson, who was resistant to placing limits on executive pay.

Because the Treasury has yet to finalize details, it's difficult to say which standard would apply. Treasury officials think banks that participate could avoid the strictest limits on executive pay.

But key Congressional aides said yesterday that providing direct infusions of cash would probably trigger the stricter standard.

"My sense is that Treasury would be playing with fire if they think for a second they can skirt the restrictions in the bill," one aide said, speaking on condition of anonymity because the details of the plan are not final.

Until now, Treasury officials had indicated that much of the $700 billion would be used to purchase troubled assets through auctions that force financial institutions to offer the Treasury the lowest possible price. But the Emergency Economic Stabilization Act gives Paulson expansive powers to purchase other kinds of securities, as well.

The law defines troubled assets as mortgages or securities backed by mortgages in a plummeting housing market, or "any other financial instrument that the Secretary . . . determines the purchase of which is necessary to promote financial market stability," including stocks. If Paulson chooses to apply the more creative definition, he must consult with Federal Reserve Chairman Ben S. Bernanke and notify Congress.

Moments before the House voted last week to approve the measure, lawmakers discussed their explicit intention to permit Paulson to fund a "capital infusion."

"This was always intended to be an option. The only question is, when, how and to what extent," Sen. Charles E. Schumer (D-N.Y.) said in a statement yesterday.

Many academics and economists have pushed for the government to make direct capital investments in banks, arguing such a program would be a much more effective vehicle to encourage new lending than buying up troubled assets.

But the Treasury faces significant difficulties in designing an effective plan. Experts say recapitalization would only serve to encourage new lending if the government focuses its investment on healthy banks instead of troubled ones.

"If it just focuses on troubled institutions, then it's not going to have the intended effect of reenergizing the credit market," said Campbell Harvey, a Duke University finance professor. "Troubled institutions don't deserve the capital. You're throwing good money at bad, helping an institution that might go under anyway."

The banking industry strongly opposes government investment in a large number of banks. The American Bankers Association, a trade group, yesterday cautioned the government against a broad plan that might carry the implication that a large number of American banks need help.

The administration could take a middle road by creating a voluntary program open to all banks. But experts said that might amount to a public relations gesture, with few banks stepping forward to participate.

Staff writer Dan Eggen contributed to this report.

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