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Washington Hopes 'Vulture' Investors Will Buy Bad Assets

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Howard S. Marks is the sort of financier who Washington hopes will help fix the nation's tumbledown banks. Trouble is, he is not quite sure he wants the job.

Mr. Marks is a former banker who became a pioneer in the graveyard of Wall Street. He is one of the biggest players in distressed investing — putting money into risky investments that few others will touch.

But he and other potential investors are wary of the risk in this case.

With its plan to shore up banks that was announced on Tuesday, the Obama administration hopes to entice investors like Mr. Marks, who has $55 billion at his command, to buy troubled assets from the nation's banks and enable them to make the loans needed to jump-start the economy.

The administration hopes, in short, to counterbalance some of the fear gripping the financial world with a bit of old-fashioned greed.

To combat the bust, Washington wants to marshal some of the same financiers who grew rich during the boom: hedge fund managers and corporate buyout specialists.

But Mr. Marks and other investors like him said they were in no hurry to wade into this mess. Distressed investors — "vultures" is the Wall Street term for them — aim to buy investments on the cheap in hopes of reaping big returns.

Yet even for the vultures, the risks — political as well as financial — seem daunting. Some worry about being seen as profiteers who benefit at taxpayers' expense, even though the economy could get worse unless they swoop in.

"You have to ask whether this is an attractive deal," said Mr. Marks, the chairman of Oaktree Capital Management, a big money management firm in Los Angeles. It all depends on the price, the terms and the risks, he said. Wall Street, of course, wants what it always wants: a lot of potential profit on the upside, and not much risk of losses on the downside. But as Treasury Secretary Timothy F. Geithner outlined his sweeping rescue plan on Tuesday, the questions kept piling up.

What kind of assets would the banks sell, and at what price? What role would the government play? And, of course, the big one: what are these investments really worth? The banks themselves are struggling to place values on them.

Hundreds of billions of dollars of these assets are hanging over banks. Until there is a clear way to purge them, the industry, and the broader economy, are likely to languish.

That is where the vultures come in. Hedge funds and other institutions dominate the field of distressed investing, and they are known for driving hard bargains. In recent weeks, several prominent hedge fund managers met with Lawrence H. Summers, the head of the National Economic Council, to discuss their interest in the planned public-private partnership.

Few of these investors were willing to discuss their plans publicly on Tuesday. Some worried their own investors, which include large public pension funds, might view the potential investments as too risky. And some would not be allowed to buy such assets under their own investment guidelines.

But if the vultures do alight, their rewards could be enormous. Funds specializing in distressed investments earned annual returns of more than 30 percent in the early 1990s as the economy pulled out of recession.

“There are plenty of guys who are willing to take the risk, but they want the high returns,” said Chip MacDonald, a partner at the law firm Jones Day.

Some private investment firms, like Apollo Global Management, headed by Leon D. Black, first made their names and fortunes in the wake of the savings and loan crisis, when the government’s Resolution Trust Corporation sold off assets to other investors on the cheap.

Others, like the Blackstone Group, the large buyout firm run by Stephen A. Schwarzman, and Paulson & Company, whose chief, John Paulson, made billions betting against subprime mortgages, have told their investors they are hunting for the bargains in the ruins of the financial sector.

Still others, like the Pacific Investment Management Company, the big bond fund, and BlackRock, another money management firm, could also emerge as big buyers of the troubled assets.

Howard Newman, the chief executive of Pine Brook Road Partners, a private equity firm that invests in financial companies, said such investors drew a distinction between potentially valuable assets and those that are outright toxic. Some good assets simply cannot be sold right now given the turmoil in the markets.

“If the purpose of the partnership is to find a place to house the loss, I don’t think private equity will be willing to do that,” Mr. Newman said.

Some executives said they wanted the government to subsidize their purchases with low-cost loans. Others said the Treasury should put a floor under their potential losses.

One model might be the government-brokered sale of IndyMac Bancorp, the large California mortgage lender that failed last summer. IndyMac was bought by a group of private firms last month for $13.9 billion. As part of the deal, the investors agreed to assume the first 20 percent of the bank’s losses, while the government picked up the rest.

Another big issue is the price at which the troubled assets would be valued by the banks. While potential investors want to buy as cheaply as possible, the banks might have to take debilitating write-downs if they sold at fire-sale prices. Such an outcome might not be in the government’s — or taxpayers’ — interests.

But competing interests are bound to bedevil this kind of deal, said Campbell R. Harvey, a professor at the Fuqua School of Business at Duke University.

“Given the conflicting objectives, I’m not sure I’d be interested in this kind of altruistic investing,” he said.

And the potential political costs, money managers said, are real. Some managers said that if they did their job well, they could earn double-digit returns and, with them, public scorn.

“We can’t really win,” one private equity executive said. “When we made money, people criticized us. This year, we lost money, and people are criticizing us.”