The Aggregator Bank
What would a storehouse for toxic assets do for the economy?
February 3, 2009

Could a "bad bank" rescue the credit markets? Imagine a government-run bank that would buy up assets from private banks in order to ease the credit crunch. That's the vision circulating through Washington D.C. right now, and it looks like this plan may be announced in the first few days of February.[1]

The pros and cons. The aggregator bank would attack a core problem, and in the best-case scenario, help to heal the broad economy. If the government purchases bad loans from banks and takes them off their hands, investors should feel more confident about placing their money with banks. That translates to more capital at banks, and that would let these thrifts lend more freely. (Isn't this what Henry Paulson wanted to do back in September? Basically, yes. In October, the Treasury decided that buying preferred stock in private banks was the best option.)

What is the possible downside? Well, some economists think the aggregator bank would be too costly to taxpayers. The risk is that the government might pay too much for the toxic assets. Skeptical economists think that just seizing insolvent banks (like in the S&L crisis of the late Eighties) might cost taxpayers less in the long term.

In front of the Senate Finance Committee on January 21, now-Treasury Secretary Tim Geithner presented three options for how the government might value the bad assets. It could use a model-pricing mechanism – that is, turn to independent firms and their computer-model estimates. Or, it could simply gauge how the market is pricing similar assets. Optionally it could do both, with additional input from bank supervisors. FDIC-guaranteed bonds could help to finance the effort.[2]

Who would run the aggregator bank? Probably the FDIC. Its chairman, Shelia Bair, has pushed for that role. Bair has indicated that the bank could be capitalized through a mix of TARP money and money from commercial lenders. Another option: the FDIC or the Treasury could give firms stock in the "bad bank" as partial payment for the troubled assets.[2] It seems likely that the government would take further ownership stakes in banks as a condition of the federal aid.

What about your money? If it works, the aggregator bank could really make a dent in the credit crisis, and things could look up for the markets and even the housing sector. A recovery seems two or three quarters away, but the stock market could improve before then. It might be a good time to chat with me.

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Citations.

[1] cnbc.com/id/28879872 [1/27/09]

[2] bloomberg.com/apps/news?pid=20601068&sid=adCZHbu_es4E&refer=home [1/28/09]