Where Things Stand in Quest to Fix the Financial Mess

BY DEBORAH SOLOMON

Treasury Secretary Henry Paulson is asking Congress for unprecedented authority to buy from financial firms the troubled assets at the "root" of the worst financial crisis since the 1930s. While many details remain unresolved, here's a rundown of how things stand.

Why is Treasury asking for authority to do this?

With credit markets frozen, the engines of the U.S. economy are essentially stuck. Companies are having trouble financing operations and lending for everything from homes to automobiles has slowed. Treasury argues the root of the problem is rotten assets sitting on the balance sheets of financial institutions. Buying these assets will help jump-start the economy by allowing financial institutions to raise more capital and begin lending and investing.

How much will it cost?

Treasury has asked Congress for $700 billion to buy assets but the cost could exceed that depending on how the assets are priced and how many assets are purchased.

Is it possible Congress won't approve this?

There seems to be broad agreement that something needs to be done to prevent the U.S. economy sliding into a deep and prolonged recession. With an election just eight weeks away, few expect Congress to let that happen.

Henry Paulson

Who is eligible to sell their assets to Treasury?

Treasury says any financial institution with "significant operations" in the U.S. will be eligible to participate in the program. Treasury is asking Congress for broad discretion here, saying that the Treasury secretary, in consultation with the chairman of the Federal Reserve, should have the authority to expand the eligibility if necessary "to effectively stabilize financial markets."

Who will manage the assets?

Treasury plans to hire "asset managers," financial intermediaries who will manage the assets, including buying and selling loans and securities. Treasury will use a competitive bidding process to hire the managers.

Will the government own my mortgage?

Possibly. Treasury has asked for authority to buy residential and commercial mortgages, along with mortgage-backed securities. So if a financial institution that holds your mortgage wants to dispose of it, it may sell it to Treasury.

Will this program help me refinance my loan or prevent foreclosure?

It could. If Treasury winds up owning mortgage-backed securities, as well as whole mortgages, it will have new leverage over the mortgage servicers and might be able to demand changes to certain loans. Congress is also looking to include additional provisions to help troubled borrowers stay out of foreclosure.

How long will the government hold the assets?

The government can hold the assets until maturity, meaning they could hold a 30-year mortgage for the entire 30 years or they can sell the assets at their discretion.

What will Treasury pay for the assets?

This is one of the biggest and thorniest questions. For the plan to succeed, financial institutions must be able to get these assets off their books at a high enough price so that their balance sheets aren't further pinched. But the market turmoil has complicated efforts to determine their "real" value. One reason financial institutions are in trouble is because they keep having to write-down the value of the assets as they fall in price. For the program to work, Treasury needs to pay enough that the institutions are able to record a price that doesn't exacerbate their woes.

The mechanics are expected to be worked out between the asset managers and Treasury. One option is a reverse auction. In that case, Treasury could determine a class of assets it wants to buy-such as all AAA-rated mortgage-backed securities-and would then purchase securities from financial institutions that offer to sell at the lowest price.

What will the government get in return?

This is another big open question. Some in Congress want the government to extract something from the companies that participate, such as restrictions on executive compensation or agreements that companies will modify loans on other mortgage assets. Treasury doesn't want the program to be punitive because it wants firms to participate.

Taxpayers will foot the bill to buy the assets.

What's the risk to taxpayers?

Taxpayers will ultimately foot the bill to buy the assets and could wind up on the hook if they continue to fall in price or can't be sold. Treasury has asked for authority to increase the debt ceiling, since it will have to borrow money to buy these assets. That's going to increase the federal deficit and increase interest payments on the federal debt. Treasury says the government could make money off the assets it buys if the housing market turns around and it's able to sell these at a profit.

How long will this program last?

Treasury has asked for authority to purchase assets for two years from the date the program begins.

How will this help homeowners?

In addition to potentially revising terms of some troubled mortgages, the plan could eventually make more mortgages available. If it helps revive firms, they should restart making loans for homes, small business and other matters. The aim is broader than helping just homeowners. Treasury says that without the program, the economy will stall, costing jobs, increasing costs for goods and services and sending the U.S. into a steep decline.