Taxpayers risked trillions at height of crisis

Gov't risked taxpayer trillions to save banks, and the subsidies continue, watchdog says

- By Daniel Wagner, AP Business Writer
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WASHINGTON (AP) -- Government officials put trillions of taxpayer dollars on the line to guarantee risky bank assets -- a strategy that could cause permanent and costly market distortions, a government watchdog says.

At the peak of the financial crisis, taxpayer money guaranteed assets worth $4.3 trillion to help banks ride out the panic. The programs, which essentially provided insurance against losses, helped stabilize financial markets but put far more taxpayer dollars at risk than Congress intended, according to the Congressional Oversight Panel.

The report, released Friday, says the guarantee programs became the single largest part of the government's effort to calm the markets. And even though many of the programs have now expired, the guarantees still provide invisible government subsidies even to healthy banks, according to the report.

The panel makes periodic assessments of how Treasury is managing the $700 billion financial bailout Congress approved last year.

Guarantees "put more power in the hands" of Treasury and the Federal Deposit Insurance Corp. because "they're not limited by the number of dollars Congress will authorize," panel chairwoman Elizabeth Warren said in a call with reporters.

The Treasury Department leveraged limited bailout money to insure assets worth many times more. That allowed officials to risk far more taxpayer money than Congress intended, Warren said.

"It's a very dangerous tool," she said. "It did well this time but we might not always be so lucky."

She worried in particular about the low upfront cost of offering the guarantees, which she said makes the approach "tempting -- perhaps too tempting -- as a way to subsidize troubled financial institutions."

Insuring bank deposits did not attract the same scrutiny as the higher-profile capital injections that came directly from the $700 billion fund. That meant there was relatively little discussion about their unintended negative consequences: invisible, permanent subsidies to banks and price distortion in many parts of the market.

For example, when a major money market mutual fund threatened to "break the buck" last year, the Treasury Department temporarily guaranteed its assets to reassure investors that their money was safe. The actions spared investors the downside of their risk while allowing them to earn better returns than they would have in a normal deposit account.

Investors now assume that the government will step in if the funds teeter again, said Warren, also a Harvard Law School professor. She called that "an example of a free government subsidy in the marketplace."

Taken together, these "implied guarantees" could lead banks to take excessive risk because they assume the government will be there to break their fall, the report says.

Analysts say the report shows that banks still rely on the potential for government support, even as the Obama administration trumpets repayments from banks as evidence that the government is withdrawing from the private sector.

"The fact is, all these guarantees are producing positive benefits for all the banks that took advantage of them," including apparently healthy banks like Goldman Sachs Group Inc. and JPMorgan Chase & Co., said Daniel Alpert, managing director at the New York investment bank Westwood Capital LLC. "Why should the U.S. taxpayer be helping these institutions become more profitable?"

The panel took a warmer view of Treasury's efforts than it has in past reports, some of which accused the government of going too easy on banks at taxpayers' expense. Friday's report says the deals reflect "a trend towards a more aggressive and commercial stance on the part of Treasury in safeguarding the taxpayers' money."

But it said "in light of these guarantees' extraordinary scale and their risk to taxpayers," Treasury should provide "extraordinary transparency," disclosing more details about how and why the guarantees were offered.

Treasury spokesman Meg Reilly said the department is pleased with the report's conclusion that the insurance programs stabilized financial markets and have produced some returns for taxpayers -- including $1.2 billion from the now-expired guarantees on money market mutual funds.

She said in a statement that Treasury has "worked continuously with the oversight bodies to improve transparency and implement constructive recommendations" around the financial stabilization programs.

However, panel member Rep. Jeb Hensarling, R-Tex., who voted to approve the report, warned in a separate statement that the subsidies "should not serve as a template for future bailouts."

He said he was not convinced Treasury was within its rights to use bailout dollars to guarantee assets worth many times more, and said it is too early to say whether Treasury charged banks high enough fees to offset the risk borne by taxpayers.

The panel is one of three oversight mechanisms Congress built into the financial bailout legislation. The law also created a Special Inspector General for the programs and authorized regular audits by the Government Accountability Office.

Warren gained prominence as an early voice questioning whether Treasury was providing enough transparency as it doled out the bailout money. She also was the first to propose creating a new agency to protect consumers against abuse by lenders and other financial enterprises. Mortgage brokers, payday lenders and other companies offering high-risk loans faced little regulation in the run-up to the mortgage and financial crises.

Legislation to create a consumer financial protection agency is working its way through Congress.

In an interview with the Huffington Post last month, House Financial Services Committee Chairman Barney Frank, D-Mass., endorsed Warren to head the agency.