

# Bail-out leads to conflict of interest claims as Wall Street Financiers Cash in on Crisis

New questions have been raised about the \$700 billion economic bail-out of the US economy as President George W. Bush warned that the world may have to wait weeks for the benefits of the rescue package to be felt.

**By Tim Shipman**

**05/10/09 "The Telegraph"** -- - In a radio address to the nation, Mr Bush hailed the historic deal, the largest in US history, for providing "the necessary tools to address the underlying problem in our financial system" and "put our economy on the road to recovery".

But he warned: "While these efforts will be effective, they will also take time to implement. The benefits of this package will not all be felt immediately."

Doubts about the package were fuelled when financial experts warned that conflicts of interest could arise because Wall Street financiers, many of whom have been blamed for causing the financial meltdown in the first place, will have a hand in spending the \$700 billion of taxpayers' money.

The bail out plan, finally passed by the US House of Representatives and signed into law by Mr Bush on Friday afternoon, will enable the Bush administration to buy up the bad debts of failing banks to kick start the flow of credit through the economy.

But the US Treasury does not have the staff to make the decisions about which banks and which debts to buy up and will instead spend the next few weeks hiring Wall Street experts to do the buying for them.

It is a move reminiscent of the US government's controversial use of private military contractors to fight the war in Iraq.

Experts warned the approach is laden with financial pitfalls, since it may be impossible to find independent contractors who do not have a vested interest in which debts to buy and the price at which they buy them.

The companies hired to identify and buy the bad debts will have to make decisions that affect the same firms whose shares they own. In some cases they might effectively be buying up their own bad debts.

The warning flag was raised yesterday by Alan Blinder, a former vice chairman of the Federal Reserve. In a reference to the respected former chairman of the Fed, he told the New York Times: "With anyone short of the stature and honesty of a Paul Volcker running it, you need to worry a lot about conflicts of interest."

"Unfortunately, there just aren't many people with the expertise you need but without any possible conflicts."

Between five and 10 asset management companies will also be paid a commission on the work they do. While Treasury sources say it will be less than the one percent surcharge companies usually charge on transactions, they can still expect to make several billion dollars in profits between them.

The revelations will fuel anger among US taxpayers who blame Wall Street greed for the economic downturn and had heavily pressured their congressmen to reject the bail out bill.

Mr Paulson has revealed that it will be several weeks before the first bad debts are bought up, almost certainly after the presidential and congressional elections on November 4. That means furious voters will have no chance to see the benefits of the deal before they pass judgment on those who approved it.

The Treasury plans to run a system of reverse auctions, where firms hoping to offload their bad debts to the government compete to "sell" them at the lowest price.

The companies which will do the buying on the government's behalf have not yet been selected but Mr Paulson has been in talks with Legg Mason, Pimco, Blackrock and MKP Capital Management. He has already hired several former colleagues from his days as chief executive of Goldman Sachs to advise him.

A Treasury spokesman said the department plans to publish guidance on "how to manage any conflicts" and will formally request the services of private firms tomorrow. Mr Paulson also wants to hire a senior executive to oversee the whole programme.

The accusations of conflicts of interest are not Mr Paulson's only problem. Market watchers are already warning that the Treasury may soon need to provide short-term loans to companies other than banks which are having trouble obtaining credit.

In addition, between 10 and 12 American states may need their own bailouts because they cannot borrow the money they need to pay government workers. California Governor Arnold Schwarzenegger last week asked Mr Paulson for \$7bn in short term loans to allay a financial crisis in America's largest state.

This week the House Committee on Government Oversight will open hearings into the bankruptcy of banking giant Lehman Brothers and into the previous government bail out of the insurance giant AIG.

Democrats vowed that on their return in January, after the elections, they would seek to introduce new regulations to rein in excessive risk taking by hedge funds, private-equity funds and investment banks.

House Speaker Nancy Pelosi said the bail out was "only the beginning". Barney Frank, chairman of the House Financial Services Committee said: "We will be back next year to do some serious surgery to the financial structure. It would be highly irresponsible, a betrayal of our oath, if we were to stop now."