



In Defense of “The Plan”

The Financial Stability Plan was doomed before Tim Geithner opened his mouth on Tuesday at 11:00 am New York time. We live in a culture that wants immediate gratification, where most hardworking Americans won't save a dollar because the power of compound interest is less compelling than the power of owning the newest iPhone. Americans were primed for an all-encompassing strategy that would fix our economic ills and right the ship of state on a mid-single digit GDP growth trajectory, and all before year-end. That wasn't going to happen. And worse, this was an announcement that had been built up in the hearts, minds and wallets of America since Hank Paulson checked out. President Obama didn't help matters much by delaying it for a day and then cutting short any comprehensive discussion of economic issues during his maiden press conference because he didn't want to steal Geithner's thunder. CNBC had a running countdown to his speech, with expert commentators standing by. The Plan was a dead man walking.

Expectations were so high that it was bound to fall short of them. And it did: NBC's Brian Williams interviewed Geithner literally minutes after his speech concluded and informed him that CNBC's Larry Kudlow thought it was “a disaster.” Stocks fell and bonds rallied. “Market Pans Bank Rescue Plan,” was the lead headline in the next day's Wall Street Journal. “A Package With Lots of Loose Ends,” said the FT. The main criticism levied at the speech was how much of the Financial Stability Plan was left unexplained.

On the contrary, the Financial Stability Plan was very well-explained, but it is what it is. To use a football analogy, Geithner didn't give us—or the rest of the world either—his playbook (and what good coach would do that?), but he told us what players he would use and in what formations. Perhaps this was by design, perhaps it was unintentional, but the fact of the matter is that Secretary Geithner didn't lay out a detailed and comprehensive discussion of his tactics only to have it subjected to point by point instant analysis. (Let's face it; Kudlow would've hated anything Geithner said.) Instead, he provided the country with a focused and concise summary of the government's strategy for dealing with our current economic distress. Yes, there are a lot of devilish details that need to be fleshed out, and we have no doubt that we will hear them in the weeks ahead. But at least the markets know where he is going.

So let's follow his lead and focus on the main elements of the strategy. We think it is the right one for these times. First, it focuses on further stabilizing the banks, by promising to stand at the ready to make more capital injections while instituting a requirement for more transparency and stricter regulatory oversight, including frequent stress testing. The Treasury's investments in financial institutions will be managed in portfolio fashion. Second, it attempts to increase liquidity in markets that have been frozen by expanding the TALF's size and asset mix. Third, it recognizes the need to right-size bank balance sheets by purging them of the euphemistically phrased “legacy assets”, that is, assets that have collapsed in value and challenged investors, auditors and regulators over how to mark them.

What else is important about the Plan? It is huge—up to \$2 trillion—with potential to get larger, and it needs to be. It acknowledges that the private sector must be intimately involved to avoid



the worst ramifications of being crowded out by government intervention. It utilizes the resources of every branch of government that makes sense—the TARP, Treasury, the Federal Reserve and the FDIC. It emphasizes and builds on strategies that have worked so far. For example, the FDIC’s loan guarantee program has been a winner, the Fed’s commercial paper program has loosened up that market, and the expansion of Fed credit to the broker-dealer community has successfully kept the short-term liquidity markets functioning for Agencies and Treasuries.

Just as important is what the Plan doesn’t do. It doesn’t rush to nationalize banks or put them in conservatorship as a first resort. Bankers from institutions large and small (over 350 different banks have received TARP money at this point) are like deer stuck in headlights, not knowing if they should be thinking like lenders, government employees, or soon-to-be-fired workers. It’s no wonder that senior lending officers are wary of extending loans when they’re worried about their own job security.

We do have some quibbles with the Plan. We think some elements of the foreclosure prevention plan are misguided. The market should be left to set mortgage rates and house prices in order to cure itself. Foreclosure relief should not be focused on keeping people in houses they can’t afford, but on putting in a strong safety net under the folks who may lose their homes. Anything else just stalls the market clearing process. We think the salary caps for firms receiving capital will foster self-interested behavior in the wrong direction (bankers won’t take the cure knowing it will hurt them personally). Instead, let company boards set compensation. We were hoping to see more clarity on an approach to cramdown legislation (i.e., speaking out against it). The securitization market, which is absolutely critical to reviving the financial market and the flow of credit, will never come back if over-collateralization protections are obviated. We also believe that the Plan should contain an exit strategy for all this government intervention, or at least acknowledge the need for one.

The Plan as a speech, as an articulation of a strategy, was a down payment on a comprehensive program to fix our system. By not enumerating a lot of specifics, it affords Secretary Geithner the flexibility to change tactics and adapt to developments on the ground. We wish we didn’t need the Plan, but we are the first to embrace its urgency. For now, I’d rather worry about the unintended consequences of the Plan rather than the consequences of not having it.

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