



## Can Washington – and a Reverse Auction – Save the Markets and Still Protect the Taxpayers?

By

*Ronald P. O'Hanley*  
Vice Chairman  
The Bank of New York Mellon

*Charles J. Jacklin, Ph.D.*  
President and CEO  
Mellon Capital Management Corporation

Critics of the government's financial rescue plan are rightly concerned about taxpayers getting stuck with a \$700 billion tab that benefits Wall Street bankers. No plan can be successful if it unduly enriches any of the participants at the expense of the taxpayer.

But does this rescue plan really need to be a 'bailout' in order to be successful? Not if it is structured properly and strikes the right balance between protecting taxpayers and encouraging participation by the financial industry. Remember how we got here: an increase in credit risk, a decrease in liquidity, and increased ambiguity of valuation. The Treasury plan will not eliminate credit risk, and taxpayers should not bail out companies that made bad decisions. However, Treasury can increase liquidity by increasing demand and can reduce ambiguity by providing transparency. The best way to do so is to put in place a reverse auction that can help lift the entire market.

Traditional auctions have one seller and many buyers competing on price. But in this situation, there is likely, at least at first, to be only one buyer (the U.S. Treasury) and many potential sellers (all the banks holding these toxic securities). Through such a reverse auction, these sellers would propose to the Treasury – and ultimately any other buyers willing to come into the market as co-investors – the lowest price they would accept for their eligible securities. This will help protect taxpayers from overpaying for these securities.

Several other fundamental principles of effective auctions can help ensure that Secretary Paulson's plan achieves its ultimate objectives:

- **The More Buyers, the Better:** In addition to the Treasury, pension funds, sovereign wealth funds, foundations, endowments, investment managers, distressed funds, private equity funds and others should be allowed to participate in the buying process. These players are on the sidelines in the current moribund market, but they are more likely to dive in once a series of reverse auctions helps establish liquidity and transparency.
- **The More Auctions, the Better:** Investors may be reluctant to participate in a new process they do not yet fully understand. So, a single, market-wide auction is not the answer. The Treasury should hold multiple auctions – which will help establish liquidity and transparency and ultimately increase the potential impact of the plan among an increased pool of buyers.
- **Allow Smaller Bidders to Participate By Pooling Funds:** Qualified high-net-worth individuals and smaller institutional investors may also wish to participate in the auction. The Treasury should consider providing seed capital to create pools of assets from which smaller investors could purchase pro-rata shares, and thus further broaden the pool of buyers.
- **Disclose Total Treasury 'Buy-in' Prior to the Initial Auction:** The Treasury needs to be clear upfront about the total size of its purchases and how it plans to allot them over time. This will allow sellers and buyers to gauge the ultimate price of the securities, encourage participation up front, and serve to lift prices, even in the first auction.

**The fate of the global financial market depends not just on Washington agreeing to a plan, but implementing one with the right design.**

- **Begin With the Larger, Widely-Held Issues:** This will make it easier for potential buyers to analyze fewer, larger issues – and thus encourage greater participation in the earlier auctions.
- **Provide Transparency:** The lack of information in the marketplace is one of the fundamental problems that led to the problems with these toxic securities. Simply having a large and willing buyer won't help restore the market unless it also restores a price-setting mechanism. All transaction prices should be disclosed and easily accessible to get this market functioning effectively again.

The original Resolution Trust Corporation was a positive force during the savings and loan crisis in the early 1990s in part because it succeeded in creating a mechanism for determining asset prices in a frozen market. It used auctions to define a market bottom, and from there to facilitate rising asset values, and bids. TARP (Troubled Asset Relief Program) is intrinsically more complex. Yet the primary goal is the same: stabilizing the financial system during a period of unprecedented stress. The fate of the global financial market depends not just on Washington agreeing to a plan, but implementing one with the right design that will actually achieve the desired goal.

---

The statements and opinions expressed in this article are those of the author as of the date of the article, and do not necessarily represent the view of BNY Mellon Asset Management or any of its affiliates. This article does not constitute investment advice, and should not be construed as an offer to sell or a solicitation to buy any security. Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. Securities are offered in the U.S. through MBSC Securities Corporation, a registered broker-dealer, FINRA member, and a wholly owned subsidiary of The Bank of New York Mellon Corporation.

BNY Mellon Asset Management is the umbrella organization for The Bank of New York Mellon Corporation's affiliated investment management firms and global distribution companies. Effective January 1, 2008, Mellon Equity Associates has merged into Mellon Capital Management Corporation. Effective February 19, 2008, the Quantitative Equity Management Group of The Bank of New York has integrated into Mellon Capital. BNY Mellon ARX and Mellon Global Alternative Investments do not currently offer services in the U.S. This presentation does not constitute an offer to sell, or a solicitation of an offer to purchase, any of the firm's services or funds to any U.S. investor or otherwise unlawful. BNY Mellon ARX is the brand used to represent the Brazilian investment capabilities of BNY Mellon ARX Investimentos Ltda. and BNY Mellon Gestão de Patrimônio Ltda. The investment company dedicated to the management of any particular investment will depend on the strategy and domicile of the investment. Hamon's services are offered in the U.S. by Hamon U.S. Investment Advisors Limited. The Bank of New York Mellon Corporation holds a 19.9% interest in Hamon Investment Group Pte Limited which is the parent of Hamon U.S. Investment Advisors Limited. The Newton Group refers to the following group of companies: Newton Investment Management Limited, Newton Capital Management Limited, Newton International Investment Management Limited, Newton Capital Management LLC, and Newton Fund Managers (CI) Limited. Except for Newton Capital Management LLC and Newton Capital Management Limited, none of the other Newton companies offers services in the U.S. WestLB Mellon Asset Management Holdings is a joint 50:50 venture between The Bank of New York Mellon Corporation and WestLB AG. WestLB Mellon Asset Management LLC, a wholly owned subsidiary of this joint venture, offers securities in the U.S. The Bank of New York Mellon Corporation holds 80% of the parent holding company of Alcentra Inc., which offers services in the U.S. Franklin Portfolio Associates has no affiliation to Franklin Templeton Group of Funds or Franklin Resources, Inc.

**Additional Disclosure for Distribution outside the United States:**

This publication is not a financial promotion. Issued in Germany by WestLB Mellon Asset Management Kapitalanlagegesellschaft mbH, which is regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht. Issued in Hong Kong by Mellon Global Investments Asia Limited, whose address in Hong Kong is Unit 1501-1503, 15/F Vicwood Plaza, 199 Des Voex Road, Central, Hong Kong. Mellon Global Investments Asia Limited is regulated by the Hong Kong Securities and Futures Commission and its registered office is at BNP House, Anley Street, St Helier, Jersey, Channel Islands JE4 8WJ. Issued in the UK and in mainland Europe (excluding Germany) by BNY Mellon Asset Management International Limited whose address is The Bank of New York Mellon Centre, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No. 1118580. Authorised and regulated by the Financial Services Authority. Issued in Dubai, United Arab Emirates, by the Dubai branch of The Bank of New York Mellon, which is regulated by the Dubai Financial Services Authority.

**BNY Mellon Asset Management**

Alcentra, Inc.  
BNY Mellon ARX  
The Boston Company Asset Management, LLC  
The Dreyfus Corporation  
EACM Advisors LLC  
Franklin Portfolio Associates, LLC  
Hamon Investment Group  
Ivy Asset Management Corp.  
Mellon Capital Management Corporation  
Mellon Global Alternative Investments  
The Newton Group  
Pareto Investment Management Limited  
Standish Mellon Asset Management Company LLC  
Urdang Capital Management, Inc.  
Urdang Securities Management, Inc.  
Walter Scott & Partners Limited  
WestLB Mellon Asset Management LLC