

What to do if recapitalization is priority 1

September 30, 2008

Stage 1: Recapitalization of the banks

Treasury Fund		Banking System	
Assets	Liabilities	Assets	Liabilities
+Equity shares	+Treasury bills	+Treasury bills	+Equity shares

Stage 2 (Paulson); Toxic Asset Sale

Treasury Fund		Banking System	
Assets	Liabilities	Assets	Liabilities
Equity shares +Toxic assets	Treasury bills +Treasury bills	Treasury bills -Toxic Assets +Treasury bills	Equity shares

Stage 2 (KM): Toxic Asset Insurance

Treasury Fund		Banking System	
Assets	Liabilities	Assets	Liabilities
Equity shares +Treasury bills	Treasury bills +BBB Insurance policy	Treasury bills -Treasury bills +BBB Insurance Policy	Equity shares

You can see how Stage 2 (KM) nets the Treasury bills issued in State 1, not so with Stage 2 (Paulson)

Stage 3 (KM): Continuing liquidity facility

Treasury Fund		Banking System	
Assets	Liabilities	Assets	Liabilities
Equity shares +Cash (or loan)	BBB Insurance policy +AAA Insurance policy	BBB Insurance Policy +AAA Insurance policy -Cash	Equity shares