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## Treasury Lacks Staff and Software To Run Toxic Asset Plan

By Ivy Schmerken

**T**he U.S. Treasury's unveiling of its toxic asset plan sent the stock market soaring yesterday as the government laid out its plan for selling off bad loans and other types of debt to unclog the credit markets.

But the real work of implementing the plan is going to involve putting in some infrastructure and hiring professionals with expertise in pricing bank debt and complex mortgages.

One source contends that the Treasury department doesn't have the personnel to manage the business of toxic assets. While U.S. Treasury Secretary Tim Geithner has been working 15-16 hour days at the Treasury Department, dealing with the various bank bailout plans and the bonus backlash over A.I.G, the department is lagging behind in nominating, let alone confirming, assistant secretaries that are needed to run the department. "The Treasury department doesn't have the staff," contends George Michaels, a principal at

G2 Systems, LLC, a boutique consultancy and software services integration company that provides programming, integration and customization services for hedge funds, brokers and fund administrators. "Even if they get the staff they have no idea how to run a portfolio of assets that are as complicated as what they are getting," said Michaels in an interview yesterday.

Michaels knows the score. Founded in 2006, Boston-based G2 Systems specializes in developing software systems to calculate P&L on bank debt and derivatives including interest rate swaps, credit default swaps and volatility swaptions. The firm has worked with several high-profile hedge funds to accurately calculate their P&L. For example, it worked with a Boston-based credit derivatives fund on a huge credit-default-swap project. The hedge fund had a dispute with its fund administrator, Mellon Derivative Products Management Group. G2 was brought in to provide advanced software and to calculate the P&L from

2005-2006. There were discrepancies of tens of millions of dollars of mark-to-market value on its CDS, explained Michaels. The hedge fund wasn't able to produce a K1 statement (given to investors) and so investors weren't able to file their taxes. "They went under because they couldn't give an answer to their investors," says Michaels.

Also, G2 assisted a fixed-income hedge fund spun out of a large Ivy League endowment fund. The hedge fund was launched with the endowment's portfolio to manage. In the cutover, there were about 1,100 different swap contracts and 20 different interest rate swaps. "We got in-depth with caps and floors and swaptions and how to properly track the cash flows on that one," said Michaels. G2 built custom software to help the hedge fund track what their counterparties thought was each individual piece of their cash flows, explained Michaels. "Watch their cash flows. It's a way of knowing what your profit and loss is," said Michaels.

Calculating P&L is going to be important for the U.S. Treasury too, because Geithner is saying that private investors (hedge funds and private equity firms) will participate on the upside, said Michaels.

Watching Geithner announce details on the Public-Private Partnership Program, Michaels sees an opportunity. "If they launch a new business entity to manage the toxic asset, we're going to line up and say this is our area," said Michaels, who feels the TARP 2 project is similar to what he's been working on.

Geithner wants to create a series of hedge funds owned by the taxpayers and parts owned by the private investors. He wants to buy the toxic assets at prices the banks want to sell them at, said Michaels. Geithner is now promising accountability and transparency into how taxpayer money is spent going for-

ward. "If they start such an entity, you're going to get immense taxpayer demand for what's my P&L," said Michaels.

It's probably fair to say that the government doesn't have the software let alone the derivatives expertise to price the instruments and track their cash flows. "It's a big data processing problem. You've got 50 different varieties of toxic assets, in which each one has its own pricing model. It's when you have a whole herd of them that it gets really messy," he said.

Michaels said his firm would go in and help the Treasury know on a day-to-day basis whether they are making money. "It's a derivatives market, that has one huge underlying which is the value of American real estate," says Michaels.

Presumably, the government would need a system to manage the distressed debt and

mortgages—unless this is being outsourced to the private investors. Since there is a waste factor of 10-to-1 with government contracts, if there are \$500 billion in toxic assets, he estimated the system will cost about \$60 million to build. That's only the first year. There will be recurring costs in the second year in the range of \$100,000 to \$200,000 range, Michaels estimated.

Of course it's a political question as to whether the Obama Administration will award business to small firms or go for the big accounting shops. If they pick the biggest firms, the accounting shops may need to subcontract to specialty firms like G2. "It's a huge budget. Getting even a small fraction of it would be terrific," said Michaels. The problem is these instruments are difficult to price, and the government will need firms that can do the work.