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Treasury Draws Fire for Shift in Rescue

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WASHINGTON -- Lawmakers sharply criticized the Treasury Department on Thursday for saying in recent weeks it intended to buy distressed assets despite having already decided to move away from the concept.

The complaints from Capitol Hill came a day after Treasury announced it was abandoning the plan to buy illiquid assets to unfreeze credit markets. Instead, Treasury Secretary Henry Paulson said he intends to focus on investing Treasury funds directly into banks and other financial institutions, and on unclogging markets that fund consumer debt.

The move renders moot the plan to purchase troubled assets, which was conceived during two weeks of negotiations between Congress and Treasury in September. Treasury initially hoped that lifting bad debt off the books of financial firms would encourage them to start lending again.

Mr. Paulson "has his hand on the tiller and has to do what he think is right, but it would've been good to communicate to the markets and Congress his thinking," said Sen. Mel Martinez (R., Fla.), adding that he was "honestly surprised" by the way the government's $700 billion rescue plan has evolved.

Sen. Robert Casey Jr. (D., Pa.), who sits on the Banking Committee along with Mr. Martinez, said lawmakers were frustrated "on a number of levels" because Treasury wasn't clear about its intent and hasn't used its authority to help slow record numbers of foreclosures.

Three Senate Republicans -- Sens. Tom Coburn (Okla.), Richard Burr (N.C.) and David Vitter (La.) -- said in a letter to Mr. Paulson on Thursday that such a "rapid reversal" raised questions about the department's future plans for the rescue funds.

"Congress gave us authority that was broad to use as necessary to promote financial market stability," said a Treasury spokeswoman. "Congress has been briefed and advised about programs and decisions" made since the bill's passage.

In recent weeks, both in speeches and in congressional testimony, Treasury officials said the asset-purchase program was on its way to being implemented. Assistant Secretary Neel Kashkari, appearing before the Senate Banking Committee on Oct. 23, said teams of Treasury staff were making "rapid progress" on a number of areas, including the programs to purchase mortgage-backed securities and whole loans. Treasury planned to hire asset managers for both programs in the near future, Mr. Kashkari testified.

Treasury officials also continued extensive discussions with people on Wall Street about how to structure, price and manage the mortgage-asset and whole-loan purchases, according to people familiar with the matter.

Behind the scenes, Mr. Paulson had already moved away from the idea. On Sept. 29, he watched as markets swooned in reaction to the House's initial rejection of the $700 billion bailout bill. Mr. Paulson began to realize then that asset purchases wouldn't be enough to turn markets around, according to a person familiar with his thinking.

The day after the vote, Mr. Paulson ordered his staff to start figuring out how an equity-investment program might work instead.

Over the next weeks, Treasury staff worked on two tracks: a plan to take equity stakes and a plan to purchase assets. On Oct. 7, Treasury solicited bids for managers to run the asset-purchase program and gave firms just two days to apply. Some officials thought they might hire firms within a matter of days.

But Treasury ran into complications hiring managers, and market conditions continued to deteriorate. Treasury needed asset managers in place but struggled to figure out what fees to pay and how to resolve the conflicts of interest in hiring Wall Street firms to oversee government money. A lack of manpower also hampered its ability to move quickly.

Another problem: If the government purchased securities from banks, they would likely have to record further losses on the markdown price, which many could ill afford.

Firms that applied to be asset managers were confused by the process. Contracts hadn't been signed with all the players and the winners hadn't been publicly disclosed. Suddenly, the firms were greeted with silence from Treasury for several weeks before Mr. Paulson's announcement.

The switch could hamper Mr. Paulson's ability to draw on the second installment of the $700 billion fund, which has to be approved by Congress. Lawmakers, even before the latest shift, have talked about adding extra conditions, such as a requirement that banks loan funds they receive to consumers and businesses, instead of sitting on the cash or using it to pay dividends. Treasury has only $60 billion remaining from its first tranche.

—Deborah Solomon and Diya Gullapalli contributed to this article.