

3 Major Banks Offer Plan to Calm Debts in Housing

- [E-Mail](#)
- [Print](#)
- [Single Page](#)
- [Reprints](#)
- [Save](#)
- [Share](#)
 - [Del.icio.us](#)
 - [Digg](#)
 - [Facebook](#)
 - [Newsvine](#)
 - [Permalink](#)

ARTICLE TOOLS
SPONSORED BY



By [FLOYD NORRIS](#)

Published: October 16, 2007

The biggest banks in the United States, with active encouragement from the Treasury Department, unveiled a plan yesterday to keep the housing-related debt crisis from worsening.

[Skip to next paragraph](#)

Multimedia

[▶ Back Story With The Times's Vikas Bajaj \(mp3\)](#)

The plan calls for the banks to create a new financing vehicle to try to restore confidence and reduce the risk of a market meltdown by propping up an important part of the debt markets. But the banks hope to take minimal risk and avoid actually investing any of their own money.

Although credit markets have calmed in recent weeks, and the stock market remains near record highs, some securities are almost impossible to sell anywhere near their previous prices. There is fear that allowing those securities to plunge in price could disrupt credit markets, alarm investors in everything from hedge funds to money market funds, and perhaps make it harder to borrow money, making a recession more likely.

If the banks' initiative works as planned, many investors that helped to finance risky loans — including supposedly safe money market funds — will be spared distress. And the banks will collect fees for little more than promising to make loans if no one else will.

"The idea is to avoid a fire sale of assets," said one banker involved in the initiative, who asked not to be identified because negotiations on its terms are continuing.

The new entity, called a Master Liquidity Enhancement Conduit, or M-LEC, could raise as much as \$200 billion or more through the issuance of its own securities, and use the money to buy securities that otherwise might be dumped on the market.

The announcement by [Citigroup](#), [JPMorgan Chase](#) and [Bank of America](#) came on the same day that Citigroup reported a sharp fall in third-quarter profits, with write-offs on troubled securities that were substantially larger than it had forecast just two weeks ago. Other financial institutions, including [Merrill Lynch](#), have also had to take substantial write-offs.

Though yesterday's move was meant to reassure the markets, investors reacted with doubt. The Dow Jones industrial average fell 108 points, and financial stocks were among the worst hit.

"I don't really see that this is going to make a significant difference," said Jan Hatzius, chief United States economist at [Goldman Sachs](#). "It seems a little more like a P.R. move, frankly."

Mr. Hatzius said he wondered "why this is going on when previously the official word was that things were getting better."

The market upheaval that took hold in July arose from securities that were supposed to be safe — and were certified as such by bond rating agencies — even though they financed risky mortgages. Those securities would not default unless a large portion of the underlying loans went bad, and that was deemed unlikely. But in the wake of the subprime mortgage crisis, questions have arisen about whether the rating agencies were too optimistic.

The conduit could work brilliantly if it turns out that the collapse in the market value of the securities represents market panic rather than an accurate assessment of the likelihood of eventual default. If this is the case, then prices will eventually return to normal and this new creation will have bought time for that to happen.

In the meantime, it is hoped that what amount to bank guarantees of some debt — coupled with the fact the Federal Reserve is the lender of last resort for banks — will persuade investors like money market funds to buy securities issued by the new conduit.

If they will not buy, or if the securities really do not prove to be worth face value, however, little will have been changed.

Details remained in flux yesterday, but some were not persuaded that the new structure would really do much. Josh Rosner, an expert in mortgage-backed securities at [Graham Fisher](#), an independent research firm in New York, questioned why the banks needed to establish such a vehicle.

“If they really believe these are good assets being mispriced in the market,” he said, the banks could just buy them and wait for the asset values to recover. “This raises the question of whether the banks are doing this just to avoid taking their losses.”

But some hailed the move as a way of preventing a crisis without directly involving the government, and said it reduced the so-called moral hazard that comes when the government bails out those who made risky bets, thus encouraging more foolish bets in the future. In this case, the Treasury encouraged the talks, but neither offered to put up money nor dictated the agreement.

- [1](#)
- [2](#)

[Next Page »](#)

Gretchen Morgenson and Michael M. Grynbaum contributed reporting.

[Next Article in Business \(2 of 40\) »](#)

[Need to know more? 50% off home delivery of The Times.](#)

Ads by Google

[what's this?](#)

[Umbilical Cord Banking](#)

Learn the Benefits of Banking Your Baby's Cord Blood

[Viacord.com/Umbilical-Blood-Bank](#)

[Hedge Fund Jobs](#)

The leading recruitment site for the hedge fund industry

[jobs.hedgemediacom.com](#)

[Audit / Compliance tool](#)

Risk Assessment, GLBA, FFIEC rules Software for Banks & Credit Unions

[www.sourcesentry.com/fsb.htm](#)

Tips

To find reference information about the words used in this article, double-click on any word, phrase or name. A new window will open with a dictionary definition or encyclopedia entry.

Past Coverage

- [Banks to Start Fund to Protect Credit Market](#) (October 15, 2007)
- [Banks May Pool Billions to Avert Securities Sell-Off](#) (October 14, 2007)
- [YOUR MONEY; Rate Chasers Are Online and Moving Cash Quickly](#) (October 13, 2007)
- [Bank of England Eases Money Policy](#) (September 20, 2007)

Related Searches