

INTERNATIONAL  
**Herald Tribune**

## Fed moves in to avert meltdown

By Edmund L. Andrews

Monday, March 17, 2008

**WASHINGTON:** Hoping to avoid a systemic meltdown in financial markets, the U.S. Federal Reserve on Sunday approved a \$30 billion loan to engineer the takeover of Bear Stearns and announced an open-ended lending program for the biggest investment firms on Wall Street.

In a third move aimed at helping banks and institutions such as savings and loan associations and credit unions, the Fed also lowered the rate for borrowing from its so-called discount window by one-quarter percentage point, to 3.25 percent.

The moves amounted to a sweeping and apparently unprecedented attempt by the Federal Reserve to rescue the nation's financial markets from what officials feared could be a chain reaction of defaults.

After a weekend of intense negotiations, the Federal Reserve approved a \$30 billion loan to help JPMorgan Chase acquire Bear Stearns, one of the biggest firms on Wall Street, which had been teetering near collapse because of its deepening losses in the mortgage market.

In a highly unusual maneuver, Fed officials said they would minimize the central bank's own risk by taking direct control over Bear Stearns's huge portfolio of financial assets.

The Fed, working closely with bank regulators and the Treasury Department, raced to complete the deal Sunday night in order to prevent investors from panicking on Monday about Bear Stearns's ability to make good on billions of dollars in trading commitments.

In a potentially even bigger move, the Federal Reserve also announced its biggest commitment yet to lend money to cash-strapped investment banks.

The central bank said its new lending program would make money available to the 20 large investment banks that serve as "primary dealers" and trade Treasury securities directly with the Fed.

Much like a \$200 billion loan program the Fed announced last Tuesday, this program will essentially agree to hold as collateral a wide variety of securities that include hard-to-sell securities backed by mortgages.

But Fed officials told reporters on Sunday night that the new program would have no limit on the amount of money that can be borrowed.

It was unclear just how much risk the Federal Reserve was taking on, especially in the bailout of Bear Stearns.

Fed officials said they would take control of Bear Stearns's investment holdings in order to maximize their value and minimize disruptions as a result of a cash squeeze.

Without providing details, Fed officials insisted that the \$30 billion in loans was "over-collateralized" and thus secure.

Fed and Treasury officials worked through the weekend to engineer the Bear Stearns deal.

The Federal Reserve was in charge, because it had the money to lend, and senior officials at the Federal Reserve Bank of New York led most of the discussions.

The Federal Reserve chairman, Ben Bernanke, who spent much of the weekend in his office in Washington, set the overall parameters for how much risk the central bank was willing to shoulder in order to facilitate a deal.

But Bernanke had already been worrying for some time about the collapse of a major Wall Street bank, and Bear Stearns had been high on its watch list.

Last Tuesday, the central bank announced a \$200 billion loan program that would allow the nation's biggest banks to borrow Treasury securities and post mortgage-backed securities as collateral. The financing gave 20 top investment banks 28-day loans at what amounted to wholesale rates — at or slightly below the Fed's benchmark rate on overnight loans between banks.

But the program did little to rejuvenate the credit markets, which have been paralyzed by fears about even conservative short-term debt securities. On Wall Street, rumors about a possible collapse at Bear Stearns, which had been a leader in packaging mortgage-backed securities, gained gale-force strength.

"For those who have already taken on too much debt or who are not creditworthy, making available funds to borrow does not get at the critical issue," said Lawrence Summers, who was a Treasury secretary under President Bill Clinton. "There is a fundamental issue, which is that the financial system is short of capital and is under pressure to contract."

Henry Paulson Jr., the Treasury secretary, vigorously endorsed the Fed's rescue efforts on Sunday and made it clear he was much less worried about the "moral hazard" of bailing out a Wall Street firm than he was about a chain reaction of defaults if Bear Stearns were to abruptly collapse.

"The right decision here, I am convinced, was the decision that the Fed made, which was to do things, work with market participants to minimize the disruptions," Paulson said on "This Week With George Stephanopoulos" on ABC.

Paulson and two top deputies, Robert Steel and Anthony Ryan, stayed in Washington rather than participate in person with the talks under way in New York. But Treasury officials said they stayed in constant telephone contact with the New York Fed and with Wall Street executives.

The New York Fed, which runs the Fed's daily market operation and has long been the Federal Reserve's primary channel for dealing with Wall Street, led the negotiations with JPMorgan Chase.

The principal issue, according to officials, was how much insurance the Fed was willing to provide to JPMorgan Chase in exchange for taking over Bear Stearns and its hard-to-quantify assets.

Fed officials were racing to announce an agreement of some sort before financial markets opened in Asia, which meant reaching a deal on Sunday night. But even as they worked to engineer a takeover of Bear Stearns, Fed officials were also canvassing executives at other Wall Street firms that might be in trouble as well.

Timothy Geithner, president of the New York Fed, had already worked intensively with Wall Street institutions in his efforts to reduce risks tied to the explosive growth of largely unregulated hedge funds and trading in complex financial instruments.

A Treasury official said on Friday that the department had been aware of the problems at Bear Stearns since last summer. They said Paulson, a former chairman of Goldman Sachs, had made an effort to get to know Alan Schwartz, who took over as chief executive of Bear Stearns in January.

But as rumors about problems at Bear Stearns swept across Wall Street last week, Fed and Treasury officials became convinced that they needed more weapons to help out cash-strapped investment banks. On Tuesday, the Fed announced the \$200 billion lending program.

But while stock investors initially cheered the announcement, the credit markets showed little reaction — an indication that investors were still dubious about the mountain of mortgage-backed securities that companies like Bear Stearns were holding.

As conditions worsened in the middle of the week, senior officials at the Fed, in Washington and New

York, held a series of conference calls with the Treasury and the Securities and Exchange Commission to assess conditions and sort through their options.

---

Notes:



Copyright © 2008 The International Herald Tribune | [www.iht.com](http://www.iht.com)