Bush Adminstration helping Wall Street investment houses rather than people on Main Street America.

By Global Research
Global Research, April 03, 2008
AP 3 April 2008

Region: USA
Theme: Global Economy

Bear Stearns Rescue Backed Amid Concerns
Thursday April 3, 10:21 pm ET
By Martin Crutsinger, AP Economics Writer

Bernanke, Bush Admin. Defend Decision to Rescue Bear Stearns Amid Questions by Lawmakers

WASHINGTON (AP) — Federal Reserve Chairman Ben Bernanke and the Bush administration on Thursday defended the decision to rescue Bear Stearns amid questions by lawmakers about why the government was helping Wall Street investment houses but not people on Main Street.

Bernanke and Treasury Department Undersecretary Robert Steel said that the consequences to the U.S. economy and financial system would have been far more serious had the government allowed the nation's fifth largest investment house to go bankrupt.

"Given the exceptional pressures on the global economy and financial system, the damage caused by a default by Bear Stearns could have been severe and extremely difficult to contain," Bernanke told the Senate Banking Committee.

The panel conducted a five-hour hearing as lawmakers sought to understand the decisions made during the hectic weekend of March 14-15 after Bear Stearns informed the Fed that it was on the verge of having to file for bankruptcy protection because nervous creditors were demanding to be repaid.

The investment house was purchased by JP Morgan Chase & Co. with assistance from the Fed in the form of a loan backed by $30 billion of Bear Stearns assets. JP Morgan has agreed to absorb the first $1 billion of losses if the value of the assets declines, but taxpayers are at risk for the remaining $29 billion.

Bear Stearns, with a stock price around $150 per share a year ago, was sold for $10 a share, becoming the biggest victim of a severe credit crisis that hit financial markets in August.

That crisis, which was triggered by a prolonged housing slump and cascading mortgage defaults, has made it harder for consumers and businesses to get loans and helped to push the country to the brink of a recession.

Democrats on the Senate Banking Committee questioned why the Fed was willing to put such a large amount of money at risk to protect Wall Street while as many as 3 million homeowners are facing the risk of defaulting on their mortgages with the administration balking at greater efforts to help them.

“Was this a justified rescue to prevent a systemic collapse of financial markets or a $30 billion taxpayer bailout for a Wall Street firm while people on Main Street struggle to pay their mortgages?” Senate Banking Committee Chairman Christopher Dodd asked Bernanke and the other witnesses.

Bernanke said that government’s effort was not a bailout for Bear Stearns shareholders, who will suffer big losses, but an effort to protect the financial system and ultimately the entire economy, which could have faced severe consequences from a Bear Stearns bankruptcy.

“The adverse impact of a default would not have been confined to the financial system but would have been felt broadly in the real economy through its effect on asset values and credit availability,” said Bernanke. On Wednesday, Bernanke had for the first time raised the possibility that the current economic troubles could push the country into a recession.

Steel said that Treasury Secretary Henry Paulson was actively monitoring four days of marathon negotiations that began after Bear Stearns notified the Fed on March 13 that it was one day away from having to file for bankruptcy protection. Steel said the administration supported the Fed’s decisions.

Most of the questions on the deal centered on the value of the assets the Fed is now holding as collateral for the loan.

Bernanke and Timothy Geithner, president of the Fed’s New York regional bank, said they believed $30 billion was a valid price for those assets and Bernanke said the central bank could end up making money on the deal as the assets are sold along with interest on the loan.

But some lawmakers questioned whether the Fed had done enough to properly value the Bear Stearns assets and wondered whether the entire episode had set a dangerous precedent for future risky behavior by other investment houses.

“How big do you have to be to be too big to fail?” asked Sen. Jim Bunning, R-Ky. “Who let our entire financial system become so fragile that one failure jeopardizes the health of the entire system?”

Also appearing before the committee were Alan Schwartz, the head of Bear Stearns, and Jamie Dimon, the head of JP Morgan, who described grueling marathon sessions over the weekend as executives searched for the best way out of the crisis.

Schwartz told the panel that Bear Stearns was brought down by “unfounded” market rumors that led to what was essentially a “run on the bank” as Bear Stearns creditors began demanding payment out of fears the company was about to collapse.

“Facing the dire choice of bankruptcy or a forced sale under exigent circumstances, we salvaged what we could to avoid wiping out our shareholders, bondholders and 14,000 employees,” Schwartz told the panel.

Dimon took issue with reports that the Fed had taken Bear Stearns' riskiest securities as collateral for the $30 billion loan the central bank made to facilitate the sale, saying that JP Morgan did not "cherry pick" the assets it would keep on its books and that it was critical that the sale be arranged.

"A Bear Stearns bankruptcy could well have touched off a chain reaction at other major financial institutions that would have shaken confidence in credit markets that already have been battered," Dimon told the committee.

Sen. Charles Schumer, D-N.Y., said entire episode pointed out the need to overhaul the government's regulatory system. On Monday, Treasury Secretary Henry Paulson put forward a plan that would scrap the current system of overlapping agencies for three super regulators, giving the Fed greater powers to monitor the safety of the entire financial system.

Dodd said his panel would examine the need for an overhaul of financial regulations but that this exercise, because of its complexity, would have to wait until next year when a new administration is in place.

The original source of this article is AP

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