http://www.foxbusiness.com/story/markets/economy/timeline-financial-crisis/

Saturday, September 27, 2008

The Financial Crisis: A Timeline

Erik Berte

FOXBusiness

The developments of the past few weeks are likely to change our financial markets as much as any short period in most of our lifetimes. Here's a rundown of recent major events.

Sept. 7: Government Seizes Fannie Mae, Freddie Mac
Government takes control of the mortgage giants, putting the liability of more than $5 trillion of mortgages onto the backs of U.S. taxpayers.
WATCH: Fannie and Freddie Rescue Plan

Sept. 11: Lehman Brothers Says it's Actively Looking to be Sold
Shares of the investment bank plunge 45% as traders feared it was having a difficult time finding a suitor.

Lehman Brothers employees

Sept. 14: Bank of America Says it Will Buy Merrill Lynch for $29 a Share
After walking away from Lehman Brothers, the bank said it would pay $50 billion for the brokerage house.
WATCH: Bank of America-Merrill Lynch Deal

Sept. 15: Lehman Brothers Files for Bankruptcy
This is the largest bankruptcy filing in the history of the United States, at $639 billion. After a weekend of feverish negotiations, potential buyers such as Bank of America (BAC: 36.70, +2.33, +6.77%) and Barclays (BCS: 29.82,

+0.82, +2.82%) walk away, leaving Lehman and its CEO, Dick Fuld, with basically no other options.
WATCH: Life After Lehman

American International Group

Sept. 16: Government Announces $85 Billion Emergency Loan to Rescue AIG
Feds say a failure of the company could be devastating to the financial markets as well as the economy. This is in exchange for a nearly 80% equity stake in the company.
WATCH: How Did AIG Get Into Trouble?
WATCH: How Does AIG Affect You?

Sept. 17: Barclays Makes Deal With Lehman to Buy North American Banking Division
The British bank, which had passed on buying Lehman before it filed for bankruptcy, picks up the failed firm's North American investment banking and trading operations for $250 million.
WATCH: Barclays-Lehman Deal

Sept. 19: Bush Administration Announces Bailout Plan to Confront Crisis
Congress is asked to give the administration new powers to execute a plan that could cost taxpayers billions to buy toxic debt and bad mortgages. Federal Reserve Chairman Ben Bernanke and Treasury Secretary Paulson hold meetings with lawmakers over weekend to convince them to approve the measures.
WATCH: Making Sense of Paulson’s Plan

Sept. 21: Goldman Sachs, Morgan Stanley to Become Bank Holding Companies
The Federal Reserve approves transformation of Morgan Stanley (MS: 24.75, -2.35, -8.67%) and Goldman Sachs (GS: 137.99, +2.49, +1.83%) into bank holding companies from investment banks in order to increase oversight and allow them to access the Fed's discount window.


Treasury Secretary Paulson

Sept. 23: Bernanke and Paulson Testify on Capital Hill on Bailout
The Fed Chairman says, “If financial conditions fail to improve for a protracted period, the implications for the broader economy could be quite adverse.”

President Bush meets with Congressional leaders

Sept. 24-27 and Maybe Beyond: Bush Works With Legislators on Bailout Plan
The President asks Barack Obama, John McCain, and Congressional leaders to meet and discuss rescue legislation. Congress works to hammer out legislation that's acceptable to enough interested parties to pass and, hopefully, be successful.
WATCH: How We Got to This Crisis
WATCH: What Happens Without a Bailout

Washington Mutual

Sept. 26: Washington Mutual Becomes Largest Thrift Failure With $307 Billion in Assets
JPMorgan (JPM: 48.24, +4.78, +10.99%) agrees to pay $1.9 billion for the banking operations, but doesn't take ownership of the holding company.
WATCH: WaMu's Collapse

Bailout protesters at Wall Street

http://www.foxbusiness.com/story/markets/industries/media/key-areas-bailout-hit-home-consumers/

Friday, September 26, 2008

The Five Key Areas Where The Bailout Will Hit Home For Consumers

Andrea Coombes

MarketWatch

SAN FRANCISCO -- The proposed $700 billion bailout package is aimed at Wall Street, but how will it affect U.S. homeowners, consumers and savers?

The good news is the expected injection of capital into Wall Street likely will help to prevent certain things, most notably the job market, from getting much worse, economists said. The bad news is it won't necessarily make the financial situation of most Americans much better.

And whether the package will do anything to resuscitate the ailing housing market is an open question.

Congress, which had been expected to act quickly on the relief effort, remained bogged down in negotiations Friday as lawmakers anticipated working throughout the weekend, at least, to hammer out the details of a final package.

No matter what its ultimate shape, the final bill isn't expected to turn the economy around -- plenty of economists see more economic sluggishness and job losses ahead even with a rescue plan in place -- but the credit freeze constricting the financial markets will likely start to thaw, helping more U.S. companies tap the funds they need.

That, in turn, will help prevent a major increase in job layoffs, experts said.

The housing market is another story. "We have a collapsing housing bubble," said Dean Baker, co-director of the Center for Economic and Policy Research. "This bailout won't do anything, as best I can tell, about the collapsing housing bubble, nor should it. The bubble has to collapse."

Meanwhile, the rescue plan may lead to a slight increase in credit available for consumers seeking auto loans, mortgages and credit cards. "There may be some improvement in [credit] availability in the sense that banks might be a little more willing to take risks with people that don't have perfect credit histories," Baker said.

That doesn't mean a return to the no-holds-barred leaps of faith lenders took during the heyday of the housing market, but lenders might again take small risks that they are unwilling to take today, some say.

Consider a consumer who defaulted on a car loan five years ago, but who has since regained his footing and is otherwise a good credit risk, Baker said. "Banks are erring now on the side of not giving those people credit, whereas if this [bailout] goes through, things settle down, maybe they will be more like to give those people credit," he said. Still, lenders won't be opening their purse strings to borrowers who would stretch to afford loan payments, he said.

Importantly, small-business owners who today can't get a loan might see that change with the bailout. But this easing of the credit crunch could take months, or longer. "You're not talking about $700 billion coming into the marketplace tomorrow," said Greg McBride, senior financial analyst at Bankrate.com.

"If it's successful, [the bailout] would bring about greater availability of credit, particularly in the mortgage market," he said. "Lenders that today are on the sidelines because they're unable to sell mortgages to the secondary market and because they need to boost their capital base could come back into the lending marketplace," he said. But borrowers will "still need good credit, proof of income and money for a down payment."

And there are naysayers. Without serious executive-compensation reform, said Peter Morici, an economist at the University of Maryland, "this is not going to free up a lot of credit," Banks "cannot create enough value creating financial products when you pay 30-year old MBA's $10 million a year."

Here are the five key areas of concern to consumers where the bailout will likely have an impact:

1. Mortgage rates

If you're shopping for a mortgage, the bailout might make a loan more available -- but higher interest rates might make it less affordable. "The prospect of an additional $700 billion in Treasury issuance is suggestive of higher Treasury yields and consequently higher mortgage rates," McBride said.

Already, the prospect of a bailout has mortgage rates hopping higher, with the 30-year fixed-rate averaging 6.09% for the week ending Sept. 25, up from last week's 5.78% average. See full story.

Still, McBride expects mortgage-rate volatility for a while. "Longer term, there's a lot of concern about inflation, which would ultimately push mortgage rates higher. But in the short-term, concerns about the economy could lead to some dips along the way."

Meanwhile, savers should keep an eye on the Fed and its rate-cutting penchant, he said. Certificate of deposit yields "have been rising pretty consistently over the last five months," McBride said. "I'm not expecting a whole lot of movement as long as the Fed stays on the sidelines." See related story.

2. On the job

Thanks to the bailout, the job market should avoid a dramatic drop-off, many experts said.

Companies "will be able to fund their expansions and their inventories," said Jim Hardesty, president of Baltimore-based Hardesty Capital Management. Going forward, "we will see lower levels of economic activity than would be desired, but they'll be substantially higher than if this bill were to fail."

Without the bailout, the unemployment rate could hit as high as 12%, said Brad DeLong, a professor of economics at the University of California at Berkeley. "A successful bailout could help keep the unemployment rate below 8% for the next year," he said.

3. Outlook for taxpayers? Depends who you ask

A major worry is that the rescue plan, depending on how it's structured, will cause a big tax hit down the road. But economists differ widely on the likely effects of this potential $700 billion outlay.

"It would be a one-time deal, so it would have a different ... effect on the budget and would be less likely to require taxes to accomplish," said Milton Ezrati, senior economist with Lord Abbett & Co. in Jersey City, N.J.

Others agreed. "It is a big hit. It's not trivial. But it's not as though before this things were great, and now we have to start raising taxes in a big way," Baker said. "We don't have a great budget picture. And this makes it worse. But I wouldn't say it qualitatively changes the overall picture."

Still, the ballooning deficit will "crowd out other tax cuts or spending eventually," said Len Berman, director of the Tax Policy Center, a joint venture of Brookings Institution and Urban Institute. That means the next president will have to make choices, given that "the candidates are each proposing $4 trillion to $6 trillion in additional tax cuts, including their health plans," he said.

Berman and others worry, too, that foreign investors won't buy U.S. debt forever.

"Everybody is flooding to [Treasurys] for the security and safety of the federal government," said Mike Moebs, an economist and chief executive of Moebs Services, a Chicago-based independent economic research firm. "If you're European, you can say, well I am concerned about my money, but I'm not going to get a quarter of one percent from the Americans, I'll do something with somebody over here in Europe," Moebs said.

Meanwhile, U.S. taxpayers may foot another bill -- as bank customers, Moebs said. Banks facing financial difficulties may lob significantly higher bank fees as they've done in the past, he said.

4. Not helping homeowners?

Some say Washington's rescue plan does too little to help struggling homeowners -- a root cause of the economy's current problems. A proposal to change bankruptcy laws to enable judges to modify mortgages may not make it into the final package.

Instead, the rescue plan may offer additional foreclosure assistance from the government, and help for borrowers to obtain better mortgages. Also, some say the government will be able to use its influence as the new owner of mortgage-related assets to influence servicers to help borrowers.

But it's unclear such a plan will work, experts said.

"There has been a lot of talk that if the government buys this stuff, they can make modifications. But that's really based on a misunderstanding -- the government is buying mortgage-backed securities. And the holders of mortgage-backed securities don't have the right to decide that mortgages are going to be modified," said Henry Sommer, president of the National Association of Consumer Bankruptcy Attorneys.

Proposals from Congress thus far "encourage" and "request" servicers to modify loans. But servicers, who fear being sued, may not be persuaded by a gentle push from the government. Rather, the enactment of a safe-harbor law for servicers might work, perhaps as part of the rescue plan, said Carey Leahey, an economist with Decision Economics.

"Giving a lot of money to Wall Street is going to be helpful. But if you want to get to the root cause of the problem, you have to get in housing and mortgage relief," Leahey said.

5. Betting on bankruptcy

Proponents of the proposal to change the bankruptcy laws note that court-supervised modifications could help borrowers with "piggyback" loans, which are second mortgages. Financial institutions who hold those second liens often won't allow loans to be modified without first being paid.

"Bankruptcy is the only thing that would actually give homeowners the right to get their mortgage modified," Sommer said. And, Sommer said, the court infrastructure already exists, along with its expertise in handling difficult financial situations.

But some say the proposal to let bankruptcy judges modify mortgages would further dampen consumers' access to those loans.

"Put yourself in the shoes of the bank. You're the bank and now in the post-bailout world a bankruptcy judge can do anything they want to. You've loaned your money... and a judge can arbitrarily reduce the amount of money they owe you," said Steve Curnutte, president, InsBank Mortgage, in Nashville, Tenn. "Now you're going to demand a higher interest rate, you're going to be less willing to lend. In the long run, that's horrible for consumers. That means fewer people buying houses."

Another reason supporters call for the bankruptcy change: fairness.

"How can you possibly support giving banks that blew it the opportunity to renegotiate loans using taxpayer money and not give homeowner victims the right to renegotiate their loans," said Ed Mierzwinski, consumer program director with U.S. Public Interest Research Group. "It defies conscience as well as common sense."

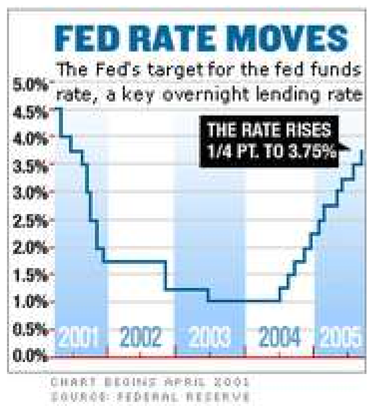
http://www.creditwritedowns.com/2008/09/dummys-guide-to-us-banking-crisis.html

Wednesday, September 24, 2008

The Dummy's Guide to the US Banking Crisis

Whenever I wade into a new topic like digital photography, gardening or what have you, I visit the local bookstore and get a "For Dummies" book to guide me. I figure that it's the best way to get up-to-speed quickly without actually looking like a dummy.

So, for those of you who want the 3-minute version of the present crisis, here it is in 20 short steps:



1. In 2001, following a massive stock market and capital spending bubble, Federal Reserve Chairman Alan Greenspan worried that the U.S. faced a severe recession. He began cutting interest rates down to 1% and kept them at that level until 2004, raising them slowly only 0.25% at a time thereafter.
2. With interest rates so low, the financial services industry sensed a lot of money could be made and went all in on real estate, seemingly unaware that low interest rates were masking large risks.
3. Meanwhile, Americans had been anticipating a nasty downturn after the bubble burst. But, they soon realized that money lost in the stock market was more than offset by rising home prices. So, Americans continued to spend freely.

4. 

The Economist's house-price indices
% change:

	on a year earlier		1997-2005
	Q1 2005*	Q1 2004	
South Africa	23.6	28.1	244
Hong Kong	19.0	17.4	-43
Spain	15.5	17.2	145
France	15.0	14.7	87
New Zealand	12.5	23.3	66
United States	12.5	8.4	73
Denmark	11.3	6.0	58
Sweden	10.0	7.7	84
China	9.8	7.7	na
Italy	9.7	10.8	69
Belgium	9.4	8.8	71
Ireland	6.5	13.2	192
Britain	5.5	16.9	154
Canada	5.2	5.7	47
Singapore	2.0	-1.5	na
Netherlands	1.9	5.5	76
Switzerland	1.0	3.4	12
Australia	0.4	17.9	114
Germany	-1.3†	-0.8‡	-0.2
Japan	-5.4	-6.4	-28

*Or latest †2004 average ‡2003 average
Sources: ABSA; Bulwien; ESRI; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quotable Value; Stadim; Swiss National Bank; government offices

As Americans spent freely, the U.S. went further into debt with the rest of the world. Foreigners, used their dollar IOUs from these debts to start their own bubbles too.

5. Eventually, things started to unravel in 2006 when those that could least afford to purchase homes -- so called subprime borrowers -- started to default in the U.S., prices having run well out of their range of affordability.

6. In February 2007, HSBC issued the first major warning, a harbinger of things to come, writing down tens of billions in losses from their ill-timed 2002 acquisition of U.S. subprime lender Household International. At first things looked fine and policy makers convinced themselves and the wider public that the problem was contained to subprime.

7. However, when two Bear Stearns hedge funds with exposure to the US housing market blew up in June 2007, people became worried that the risks had been underestimated.

8. It was in August 2007 when BNP Paribas, a large French bank, froze withdrawals in three investment funds that people began to panic. If a bank with zero obvious exposure to the U.S. mortgage sector could have this measure of difficulty, anyone could be hiding untold losses. This marked the official beginning of the credit crisis.

The result was mutual distrust amongst large banks operating in the global market for interbank loans which meant credit was hard to come by for many banks.

9. By September, liquidity in the interbank market was so bad that rumors were swirling about various institutions which received most of their funding in wholesale markets. One of these was Northern Rock, an aggressive British mortgage lender. The British public panicked and began lining up to pull their money out of the institution. The Bank of England was forced to bail out the company, subsequently nationalizing it altogether.

10. Meanwhile U.S. housing prices continued to decline. The result was massive losses in the alphabet soup of mortgage-related derivative assets held by large global banks.

These instruments are called derivatives because their value is **derived** from the value in underlying assets like mortgages. The first wave of mortgage-related losses were concentrated in these instruments and investing vehicles: RMBSs (Residential Mortgage Backed Securities) CDOs (Collateralized Debt Obligations), and SIVs (Structured Investment Vehicles) and CDOs of CDOs. Merrill Lynch was the first to report a large loss, at $5.5 billion on 5 Oct 2007. Only to come back less than three weeks later on 24 Oct 2007 to say that the losses were now over $8 billion. Eventually, losses reached $500 billion a year into the crisis for all global institutions.

11. The Merrill losses were followed by losses at most of the large global financial institutions. Many CEOs lost their jobs and the companies were forced to raise capital. By August 2008, the amount raised was to reach $350 billion.

12. The situation seemed to quiet down in early 2008. However, in March the failures of hedge funds Peloton and Carlyle Capital put the credit crisis back in full view. Another 2nd period of panic resulted in the sudden collapse of Bear Stearns, America's 5th largest investment bank. The Fed organized a takeover by JP Morgan Chase that was a catastrophic 90% loss for Bear's shareholders.

13. Eventually the collapse of Bear Stearns faded and, for the third time, we were lulled into a false sense of security that the worst was over. Nevertheless, writedowns continued unabated as did capital raising. When Lehman Brothers announced a massive $3 billion loss 0n 9 Jun 2008, the crisis came into full view yet again -- much as it had when Bear Stearns' hedge funds collapsed the previous June.

14. This time, market fears did not recede and the financial markets remained in a constant state of stress. Things started to unravel very quickly. IndyMac, an aggressive mortgage lender, an American version of Northern Rock, was taken over by the FDIC. And a panic was on for the third time.

15. Next were the GSEs. The end result of the market panic was a questioning of the viability of Fannie Mae and Freddie Mac, the two largest mortgage lenders in the United States and at the core of the residential property market. Eventually the U.S. Government was forced to take the two companies into conservatorship.

16. Afterwards, all financial shares generally came under assault. The ones considered the weakest came under the heaviest selling pressure, resulting in the collapse of Lehman Brothers. Without government support and unable to close a merger in around-the-clock negotiations at the weekend, the company filed for bankruptcy on Sep. 15.

17. Merrill Lynch, the venerated US investment bank, sensing trouble, sought and received cover in a takeover by Bank of America that very same weekend.

18. Financial markets smelled blood after Lehman collapsed. Apparently no company was too big to fail. So, the assault on financial service companies continued. Eventually, AIG, the largest insurance company in the world, succumbed to this pressure. The Federal Reserve, citing special considerations, bailed out the non-depositary institution.

19. At this stage, we were in free fall and the entire banking system was on the verge of collapse in the United States. Global shocks had not ended either, as UK institutions

were increasingly under attack as well, having been damaged by their own property bubble. At the urging of the British Prime Minister and the UK regulatory authorities, Lloyds TSB bought Britain's largest mortgage lender HBOS, which was in jeopardy of failing.

20. By this time, the Feds had had enough. The time for ad hoc crisis management was at an end. Hank Paulson moved decisively and put forward his $700 billion bailout plan. It awaits congressional approval.

Timeline

2001: *Beginning of housing bubble*. The Federal Reserve (Fed) lowers interest rates 11 times on the back of the dot.com bust and 9/11.

Interactive Timeline by NY Times

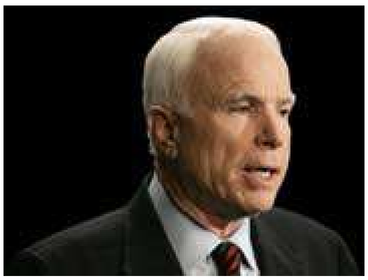
http://www.nytimes.com/interactive/2008/09/15/business/20080915_TURMOIL_TIMELINE.html

Timeline: Freddie and Fannie's financial fiasco

Posted: Sep 26, 2008 01:40 PM EDT

Barney Frank (Photo: AP)

Charles Schumer (Photo: AP)



John McCain (Photo: AP)

Ted Malave Reporting

WASHINGTON -- The Bush Administration, in April of 2001 warned congress of a potential financial crisis. In their 2002 budget requests they declared the size of Fannie Mae and Freddie Mac "A potential problem... and can cause strong repercussions in the financial markets."

In 2003, the White House upgraded the warning on real estate mortgage loans. Their experts said that the way loans were being handled could spread beyond the housing sector. In fall of 2003 the Bush Administration was pushing congress hard to create a new federal agency that would monitor and supervise Fannie Mae and Freddie Mac; both are Government Sponsored Enterprises (GSE).

John Snow, Treasury Secretary at the time called for regulations and supervision of GSEs. He said in September 2003 "We need a strong world-class regulatory agency to oversee the prudential operations of the GSEs and the safety and the soundness of their financial activities."

Snow was pushed back from this position, by then ranking member, but the eventual Chairman of the Senate Banking Committee, Barney Frank (D) from Massachusetts.

Frank denied there was any problem and was quoted as saying, "Fannie Mae and Freddie Mac are not in crisis."

In fact, Barney Frank was encouraging the government to do more to get low income families into homes.

"The more people, in my judgment, exaggerate the threat of safety and soundness, the more people conjure up the potential for serious financial losses.... [a problem] I do not see. We see entities that are fundamentally sound financially and would stand some of the disastrous scenarios. But, even if there were a problem the government wont bails them out. The more pressure we see there then there is less, I think, we see in terms of affordable housing," Barney Frank said in September of 2003.

The creation of a regulatory agency to oversee GSEs was ultimately blocked.

In February of 2005, Alan Greenspan spoke about the dangers of Fannie Mae and Freddie Mac after Fannie leaders admitted to accounting screw-ups.

Greenspan said, "Enabling these institutions to increase in size, and they will, once the crisis in their judgment passes. We are placing the total financial system of [in] the future at a substantial risk."

Later that year Greenspan warned, "If we fail to place GSE regulation, we increase the possibility of insolvency and crisis."

Fannie Mae and Freddie Mac had some strong defenders. One of them was democrat New York Senator Charles Schumer.

In April 2005 Schumer said, "I think Fannie and Freddie have done an incredibly good job, and are an intrinsic part of making America the best housed people in the world. If you look over the last 20 or whatever years, they've done a very, very good job."

Senator John McCain co-sponsored legislation pushing for regulation of GSEs like Freddie and Fannie.

In a speech on the senate floor, McCain said, "For years I have been concerned about the regulatory structure that governs Fannie Mae and Freddie Mac.... and the sheer magnitude of these companies and the role they play in the housing market... the GSEs need to be reformed without delay."

In 2006, Barney Frank took over the chairmanship of the Senate Banking Committee and on his first day declared that he was going to work on making housing more affordable for low-income owners and that loans would be easier to get by relaxing loan regulations.

That bill (THE FEDERAL HOUSING ENTERPRISE REGULATORY REFORM ACT) made it out of the senate banking committee with a party line vote. All the democrats voted against it. By then there had been an election and democrats had won back control of the Senate.

Republicans, knowing they did not have the numbers to get the bill passed, did not even bring it up for a vote that 2006 session.

Timeline Last Week

http://www.washingtonpost.com/wp-srv/business/creditcrisis/timeline/timeline.html

http://cbs2.com/business/credit.crisis.timeline.2.818699.html

Six things you need to know to understand the financial crisis

By Kimberly Blanton

Globe Staff / September 28, 2008

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Financial calamities have come in waves during the past two weeks, each one sending another jolt through the US economy.

These daily - sometimes hourly - developments have included continued declines in the housing market, government bailouts of troubled financial giants, and the disappearance of venerable Wall Street firms. Suddenly, Americans have had to become more familiar with financial terms and learn to navigate complex details about the inner workings of a US - and global - financial system that is in crisis.

Why mortgage-backed securities are a problem
During the housing boom earlier in the decade, many lenders relaxed standards and made subprime loans to homebuyers. These loans were risky and had interest rates that rose over the life of the loans, driving up payments. Wall Street bought up these subprime loans, put them into pools, repackaged them, and sold them.

Investors poured at least $1 trillion into these securities backed by subprime mortgages. Then the housing market slowed and home buyers defaulted in record numbers because they couldn't keep up with mortgage payments. The value of mortgage-backed securities plummeted.

These losses are at the root of today's crisis. As the housing market continues to decline and the economy slumps, losses are spreading to the traditional mortgage market and threaten to deepen the economic downturn. Investors - pension funds, hedge funds, mutual funds, and banks - have so far lost about $600 billion on securities backed by prime and subprime mortgages, according to Global Insight.

Credit default swaps: a time bomb like mortgage-backed securities
"Financial weapons of mass destruction" is what billionaire investor Warren Buffett called credit default swaps. These arcane financial products brought down the nation's largest insurer, American International Group.

Credit default swaps are insurance contracts purchased by investors to protect them against losses on their debt-backed securities - AIG lost $18 billion because it had to pay up on policies on mortgage-backed securities.

Swaps became popular among speculators and hedge funds that did not own the underlying securities but used them to turn quick profits. Swaps are also backed by credit cards, car loans, business, and other loans, and a long chain of swap transactions links investors in this $62 trillion market. Many of these bets were made with borrowed money.

"It's why we're in this mess," said Lance Pa, research director for Capital Advisors Group, a Newton money manager. "We understand how it works," Pa said about the market, but "don't know where the exposure could lie. That's the problem."

The financial market crisis leads to a credit crunch

As losses mounted, panic swept through the financial system. Loans - to businesses, banks, and consumers - become scarce and expensive, creating a credit crunch. Without loans, there is less spending, which causes the economy to slow.

Page 2 of 2 --

Corporations are having difficulty tapping the credit market to fund daily expenses, from payrolls to truck leases. American Express reduced credit card limits for more cardholders. And one of the country's largest auto dealers, Bill Heard Enterprises Inc., went out of business, because it couldn't arrange financing for car buyers.

Discuss
COMMENTS (4)

- QUIZ Test your knowledge of the crisis on Wall Street

The credit crunch is the primary reason that Treasury Secretary Henry Paulson and Federal Reserve chairman Ben Bernanke crafted a bailout plan, which Bernanke said was urgent to ease the credit crunch. A bailout allows the federal government to buy mortgages from financial companies. That in turn frees up capital in financial companies so that they can lend to businesses for investments and to consumers for purchases using credit cards and other loans.

"In light of fast-moving developments, it is essential to deal with the crisis at hand," Bernanke told the Senate Banking Committee last week.

Bailouts could ease the credit crunch
The Bush administration devised a plan to spend $700 billion plan to buy back bad mortgages from faltering financial companies and investors. Add to that the $85 billion federal takeover of American International Group, the nation's largest insurer, and another $200 billion will be injected into Fannie Mae and Freddie Mac, mortgage companies that support the US housing market.

In total, nearly $1 trillion could be the price tag on the taxpayer-funded bailout - that's more than $3,000 for every man, woman, and child in the United States.

Nariman Behravesh, chief economist for Global Insight, a Waltham consulting firm, said the final cost will be lower, because the government will sell off many of the assets it is taking over. But even if the mortgage bailout costs $700 billion, that would be equal to just 4.5 percent of US gross domestic product, he said. By comparison, Japan's bank bailout in the 1980s and President Franklin Roosevelt's bailout of the US banking system amounted to 20 percent of each country's GDP at the time.

Banking system remains a problem

The strength of the nation's banking system - the foundation of the US economy - also is a chief concern for Paulson and Bernanke. Banks have been under severe strain as borrowers have defaulted on their mortgage payments, leaving lenders with portfolios of repossessed homes and rising losses.

While numerous lenders that made subprime mortgages began to fail in 2007, the problems accelerated in recent weeks as major banking companies failed.

IndyMac Bank in Pasadena, Calif., was seized by federal regulators in July. Last week, regulators seized the nation's largest thrift, Washington Mutual Inc. in Seattle, which was teetering from its portfolio of subprime loans. JPMorgan Chase purchased the thrift for $1.9 billion. It was the biggest such failure in US bank history. Bank of America Corp., the nation's largest banking company, also acquired Merrill Lynch & Co., the nation's largest broker.

Going forward, there will be more market share in the hands of fewer financial institutions and less competition.

How bad is the economy: Recession vs. Great Depression?

While the events of the past two weeks were dramatic, they do not rival the Great Depression. Then, 1,500 banks went under, factories closed, and one in four Americans was out of work. The current crisis hit Wall Street hard but has not devastated the US economy. Unemployment in August was 6.1 percent, a historically low rate, and the United States is technically not in a recession, which is defined by two consecutive quarters of negative economic growth - the economy grew 2.8 percent in the second quarter, the latest data available.

However, many economists believe the country entered recession in the third quarter, and if the financial system does not stabilize the economy may enter a long, deep downturn. Next year, Global Insight predicted, the US economy would grow less than 1 percent, and the jobless rate could reach 7 percent - or higher. Things could be worse without an injection of federal bailout money into the system, which would offset some of the negative impact of the credit crunch, Behravesh, the economist, said.

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are you kidding? You blame the banks and lenders! They were not forced to throw sub prime mortgages to everyone, they did it because it was quick money for them. And you don't see the trend here neocon? Enron? Tyco? Now the financial and insurance industries. The one thing to blame here is greed... You can't expect republicans to ever look in the mirror. They're like vampires, they can't see their reflection.

A conservative is fiscally responsible and the chickens have come home to roost for the Republican party. They have spent their way along and created the department of Homeland Security and used it as a patronage tool. As an independent and a conservative, our government betrayed us. I include, Republicans first, and Democrats second. The neocons betrayed us in the war against terror when they invaded a country that we supported against our enemy, the Iranians.

The six things seems to leave out the most important and that is this crisis started when Democrats decided to play social engineers and lower the standards for getting a loan. Poor people, people with bad credit, etc. got loans they could not afford. This is not Wall Streets fault, certainly not the GOP - President Bush tried to stop the easy loan rules the Democrats created. Blame the Democrats. Blame the Liberals. Blame the Community Organizers.

Talk about THEFT of OUR TAXPAYER MONEY. Let's do the MATH:

$700,000,000,000 / 50 states = 14 billion taxpayer dollars from every state!!!

That means that the government could give 14,000 people in EVERY state a million dollars each or 140,000 people could get $100,000 each. Think about that!!!!

So why are we bailing out these firms again? This bail out will KILL the US economy. We are being sold out by the Republicans (and also Democrats)

http://www.amnation.com/vfr/archives/011459.html

EXPLAINING THE SUBPRIME FINANCIAL CRISIS, IN THREE LESSONS

Here is a readable and understandable short course in the subprime crisis, by a person who identifies himself as "Informed Trades." I have copied the text of the three lessons below. On the Web, the lessons are available in video as well as text, and there are also readers' comments with further answers by the author. Yesterday I had a long conversation with a friend who had already listened to the course, and we began to piece together this amazingly complex and strange picture so that it started to make sense.

How to Explain the Subprime Financial Crisis Part 1

There is lots of news out about sub prime loans and the issues they are causing for the consumer, the economy, and in the financial markets in general. While I have seen a lot of coverage of recent events with subprime I have not found through my research many good resources for leaning about how exactly this all happened.

So in this three lesson series we are going to examine exactly how all this came about by looking at things from the borrowers side of the equation in this lesson, and then the lenders side of the equation in lesson 2. Then we are going to tie everything together in lesson 3 by bringing our newfound understanding of both sides together to understand exactly what caused the problem, what we are experiencing now, and what we are likely to see going forward.

A subprime loan is a loan given to borrowers that are considered more risky, or less likely to be able to make their loan payments, in relation to high quality borrowers because of problems with their credit history. When you go to get a loan you need to get a credit check, and what results from this credit check is something that is known as your FICO score. A FICO score is a number which represents how credit worthy you are considered which is based on factors such as the amount of money that you earn, your record of paying back past debts, and how much debt you currently hold. The higher the score the better your credit is considered, and the more likely you are to get a loan.

In order to understand how these sub prime loans have caused so many problems, we must first understand what happened in the years leading up to the recent problems. In the years leading up to the sub prime crisis interest rates (or the cost of borrowing money) had been at historical lows as the fed had aggressively cut interest rates to avoid going into recession after the tech bubble burst in 2000. While you don't need to understand all the details of the effects that low interest rates had you do need to understand two things:

1. When interest rates are low in general it causes the economy to expand because businesses and individuals can borrow money easily which causes them to spend more freely and thus increases the growth of the economy.

2. What drives interest rates lower is the fact that there is an increase in the supply of money, meaning that there is more money to go around.

Before the Fed lowered interest rates substantially after the bursting of the NASDAQ bubble in 2000, if you wanted to get a loan for a house you had to have a relatively good credit score. Buyers with a FICO score below 620 (generally considered sub-prime) where in most cases considered too risky to lend to and therefore could not get a loan.

After the fed lowered interest rates to historical lows however there was so much money (also referred to as liquidity) available that financial institutions started offering loans to buyers with FICO score's below 620. Because these borrowers were considered less likely to be able to pay the loan back than borrowers with higher credit scores, these sub prime borrowers were charged a higher interest rate.

Things initially went very well for the financial institutions that made these loans because in the years that followed interest rates stayed low, the economy continued to grow, and the real estate market continued to expand causing the value of most people's houses (including the sub-prime borrower's houses) to go up in value pretty dramatically. This made it relatively easy for these borrowers to make payments on their loans as if they ran into financial trouble they in more cases than not could tap the equity in their home (which came from the increase in the house price) to refinance at more favorable terms or to make their mortgage payment.

Because a relatively few of these sub prime borrowers were defaulting on their loans, the financial institutions which held these loans were enjoying the additional profits earned by charging these borrowers a higher interest rate, without many problems.

After the initial success and profitability for those offering sub prime mortgages the practice expanded dramatically and the terms which borrowers were given in order to allow them to obtain loans became all the more creative.

There are now many different types of sub prime loans such as:

Interest Only Mortgages: These loans require the borrower to pay only the interest portion of the loan for the first few years thus keeping the payment relatively low for the first few years before the interest only component expires and the borrower must pay the principle and interest component of the mortgage payment (of course a much higher amount)

Adjustable Rate Mortgages: Unlike traditional mortgages have a fixed interest rate so your payment is the same each month, with an adjustable rate mortgage if interest rates rise (as they have been recently) your monthly mortgage payment goes up as well.

Low Initial Fixed Rate Mortgages: Mortgages that initially have very low fixed rates and then quickly convert to adjustable rate mortgages. .

Because house prices had increased so rapidly in the last few years many of these sub prime borrowers took out loans that they could not afford in the anticipation that, when the mortgage reset to the higher payment, they would be able to refinance at more favorable rates using the increased value of their home and the equity that they now had as a result of that.

So now that we have a background on what was happening on the borrower's side of the equation the next thing that we will look at is what was happening on the lender side of the equation. Once we have a background there then we will tie everything together in the third and final article so you have a good understanding of all the factors at play here in the sub prime crisis.

As always if you have any questions or comments please feel free to leave them in the comments section below, and have a great day!

How to Explain the Sub Prime Crisis In Simple Terms Part 2

So now that we understand things from the borrowers side of the equation lets look at things from the lender side.

One of the reasons why this is such a big problem is because so many different types of financial firms and investors have exposure to these subprime loans. To understand how we must understand something which is known as securitization. Securitization in simple terms means taking a bunch of assets, pooling them together, and offering them out as collateral for third party investment. Securitization happens with many different types of assets but for the purposes of this article we will focus on how they apply to mortgages.

Up until relatively recently when you went to get a loan for a house from a bank, they would lend you the money and then hold your loan, earning money from the fees they charge you to give you the loan and the interest that you pay the bank on that loan. As the money the bank was lending out was the money that people were depositing in the bank, the bank was limited on how many loans it could do by how much money it had on deposit. As the bank was holding all of the loans on its books so to speak it also held all the risk for those loans.

As a way of diversifying risk and allowing the banks to make more loans (thus earn more fees) investment bankers came up with a process for securitizing mortgages so they could be sold off to other financial institutions and investors in a secondary market. So very basically instead of holding all the loans they make to homebuyers on their books, lending institutions will now pool a bunch of these loans together and sell them in the secondary market to another financial institution or investor.

The pools that the loans are put into are referred to as Mortgage Backed Securities (MBS for short), Collateralized Debt Obligations (CDO for short) or Asset Backed Securities (ABS for short). For the purposes of this article you do not need to understand all the details of each as they are very similar in the fact that they all act as a way of taking individual loans and bundling them up so they can be sold in the secondary market. This frees up capital for the bank and reduces their risk, so they can make more loans and earn more fees. What you do need to understand however is the following:

1. A large portion of the financial institutions that are potential purchasers of these mortgage pools will not buy or are restricted from buying sub prime debt because it is considered too risky.

2. To get around this what investment bankers did was take a pool which contained subprime mortgages and divided it up into different levels (also referred to as traunches). Each level was then defined by who would take the first losses if and when any of the subprime borrowers in the pool stopped making their mortgage payments. The lower levels were the first take these losses and the higher levels were the last.

3. Next they got the companies who assign credit ratings to different types of debt instruments which are referred to as ratings agencies to come in and assign different credit ratings to each level. The higher levels which were the last to take losses if and when mortgages defaulted were given high credit ratings and the lower levels that were the first to take losses were given the sub prime ratings.

4. What this allowed investment bankers to do was to sell off a large portion of the sub prime loans as debt instruments with above prime credit ratings thus expanding the number of potential buyers of that debt.

The types of firms that invested in these instruments varied widely from other banks, to hedge funds, to pension funds, to insurance companies not only here in the United States but all over the world.

The last thing that it is important to understand in this lesson is that many of the financial institutions which held large amounts of these instruments held them in what is known as a Conduits, Special Investment Vehicle (SIV) for short, or Special Purpose Vehicles (all basically the same thing). These are semi separate off balance sheet entities which allow banks and other financial institutions more flexibility from an accounting and regulatory standpoint in their operation. Again here the details are not important but what is important to understand is that:

1. These entities hold large amounts of mortgage "pools" as one large "pool of pools". So instead of holding say $50 Million in mortgages they will hold a bunch of those smaller pools as one pool of $1 Billion or more.

2. They finance or fund their operations by issuing short term debt to buy this longer term debt essentially having to pay a lower interest rate on the short term debt that they issue to raise money than they earn on the mortgages that they are investing in.

3. Because these loans are short term they have to be "rolled over" or redone fairly frequently to continue the financing of the Special Investment Vehicle.

For the first few years as interest rates stayed low, the economy continued to expand, and real estate prices continued to rise, everything went smoothly and pretty much everyone was doing well. As we will learn in our next lesson however this all started to change when these trends started to slow.

So that wraps up our second lesson in this three part series on the subprime crisis. You should now have a good understanding of both the borrower and lender sides of the equation so we can now take a look at where it all went wrong in the third and final lesson of this series.

How to Explain the Subprime Crisis in simple terms part 3

So now that we understand what sub prime loans are and how they are packaged up into pools and resold, we can now look at how the sub prime crisis happened. By late 2004 the US economy was growing fast enough that the federal reserve decided to start raising interest rates, which it has continued to do until fed funds rate stood at 5.25% in January of 2007 (up from 1%). Several things happened as a result of this.

1. It became much more expensive to borrow money so less people could afford to buy a house and those that could, could not afford as large a mortgage as they could when rates where at 1%.

2. As there were not as many buyers, the real estate market began to cool and house prices which had been increasing rapidly in the years leading up to this began falling moderately.

3. If you remember correctly from our first article many of the sub prime borrowers took out adjustable rate mortgages where payments rose if interest rates rose and low initially fixed rate mortgages that quickly converted to adjustable rate mortgages. Their plan was to refinance these loans using the expected increase in value of their house to help them qualify for a better loan. As the housing market stalled however and their houses were no longer increasing in value, they could not refinance and therefore were stuck having to pay a much larger mortgage payment as the harsher terms of the loans they agreed to kicked in. This caused many of these borrowers to not be able to make their house payment and therefore their house was foreclosed on.

So the issue now is that there are billions of dollars in losses relating to rising defaults mostly related to sub prime borrowers.

From the financial institution side of the equation, the problem would be bad if everyone knew where all these loans were, which financial institutions and investors were going to lose money as a result of this, and how much money they could potentially lose.

If you remember from our second lesson however, these loans were for the most part no longer with the financial institutions that made the loans but had been sold off and traded among different financial institutions from around the world. As the subprime portion of these mortgage pools were defaulting at a much faster rate than expected, the institutions that held them stood to lose a lot of money as a result.

This has caused what is known as a liquidity crisis where no one trusts anyone else enough to lend them money at reasonable rates, even the largest banks in the world. This is a real problem for these banks, who basically are the financial system, because they rely on large short term loans from one another to cover their short term expenses.

Because these institutions are normally considered very credit worthy, and because these loans are short term, they normally come with a very low interest rate. As no one knows who has been left holding the bag with the subprime debt, the interest rates that are charged on these loans have gone through the roof.

This is why you read about the different central banks around the world having to step in and add liquidity to the market by basically injecting billions of dollars into the financial system to try and keep things from locking up.

If you also remember in our second lesson we learned about these huge pools of pools which are known as Structured Investment Vehicles. If you remember from that lesson these entities rely on this short term borrowing to buy the longer term debt and have to periodically roll the loans they are issuing over. The problem now is that they can no longer borrow short term to cover their obligations and are therefore in danger of having to sell off huge chunks of these mortgage backed securities to avoid running into financial difficulty. This is why you read about banks like Northern Rock having to be bailed out by the Bank of England and Citigroup having to raise billions of dollars from the Abu Dhabi Investment Authority.

As there are so many problems with the mortgage market right now however the market for many types of these pools has dried up as no one wants to buy them. This means that if these institutions are forced to sell they are going to have to do so at very low values in relation to how much the pools they own are probably still worth even with the problems. What this has caused is a situation where everyone that can is holding on hoping that the market will return to normal so they can exit their positions at a reasonable price.

Lastly and perhaps most importantly because the market for many of these pools has dried up, it is very difficult to tell how much they are worth. This has brought a lot of suspicion to even those who have come clean about how much subprime exposure they have, and how much the losses are they plan to take as a result, because there is really no way to know for sure if they have valued that loss correctly until the market returns to normal.

Currently there is still a lot of uncertainty as to when this will end and how bad it is going to end up being for the economy. All I can say here is that time is the key factor. If the banks and other financial institutions that are holding this bad debt come to a consensus on how much of it they are going to have to write down and how they are going to value the losses quickly, then things will be a bit painful in the short term but better over the long term. If there is no consensus on where and how much the losses are after the first quarter of next year, then we are probably in for lots of trouble and markets will head lower as a result.