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Some Seek Agency to Buy Bad Debt as Long-Term Answer

By STEPHEN LABATON

WASHINGTON — As the Bush administration has lurched from pillar to post in the financial crisis, some lawmakers and experts were considering a longer-term legislative solution that would create a new agency to dispose of the mortgage-related assets at the core of Wall Street's woes.

Proponents of a more systematic government role to help relieve financial institutions of their toxic securities range from Lawrence H. Summers, the former Treasury secretary under President Clinton, to former Federal Reserve chairmen Paul A. Volcker and Alan Greenspan.

In Congress, the idea that is gaining traction centers on the creation of a new agency that would buy troubled assets from hobbled companies. The idea was floated on Tuesday by Barney Frank, Democrat of Massachusetts, who heads the House Financial Services Committee. Among those signaling that it merited serious consideration were Senate Majority Leader Harry Reid and the House speaker, Nancy Pelosi.

With seven weeks until the presidential elections, no one expects Congress or the White House to move quickly to create a new federal agency that puts taxpayers at risk for hundreds of billions of dollars in bad assets. Steny H. Hoyer, the House majority leader, said there was no time to consider any new proposals in the two weeks before Congress adjourns.

But in its ad hoc approach to the crisis, the Treasury Department and the Federal Reserve have, in effect, already embarked on a course similar to the proposals in Congress.

In the case of Bear Stearns, the Fed took $29 billion of the investment bank's mortgage-related assets as collateral for a Fed loan to JPMorgan Chase, which then agreed to acquire Bear Stearns.

In the case of Fannie Mae and Freddie Mac, the Treasury Department placed the companies in a conservatorship and explicitly backed the $5.3 trillion of mortgages they own or guarantee.

Treasury also agreed to buy an unspecified amount of Fannie's and Freddie's mortgage-backed securities on the open market, starting with a $5 billion purchase this month. Those securities are to be managed and ultimately sold for the government by an investment house on Wall Street.

But federal officials remain concerned about the plight of other institutions, including Washington Mutual, the nation's largest savings association. Experts estimate that a government bailout of Washington Mutual could cut in half the size of the federal deposit insurance fund, which protects bank depositors at thousands of banks and savings and loan institutions.

Mr. Frank was among the House and Senate leaders who were hastily called to a meeting Tuesday with the

Federal Reserve chairman, Ben S. Bernanke, and Treasury Secretary Henry M. Paulson Jr. to hear about the Fed's latest rescue plan, this time of the American International Group.

Mr. Frank said that one of the issues discussed in the meeting was a potential need for broader, longer-term federal action in the marketplace.

"We have had a series of ad hoc interventions; this is one more ad hoc intervention," he said. "I do think, because you can't be sure this is the last one, the question of a broader more systemic action in which the government tries to help resolve these things is very important."

In concept, the proposal would resemble the Resolution Trust Corporation, which disposed of bad assets held by hundreds of crippled savings institutions. Created in 1989, Resolution Trust closed or reorganized 747 institutions holding assets of nearly $400 billion. It did so by seizing the assets of troubled savings and loans and then reselling them to bargain-seeking investors.

By 1995, the S.& L. crisis abated and the agency was folded into the Federal Deposit Insurance Corporation, which Congress created during the Great Depression to regulate banks and protect the accounts of customers when they fail.

But the parallels to Resolution Trust are inexact. The federal government, unlike now, had no choice but to acquire the assets from savings associations because they were backed by federal deposit insurance. The mortgages now at the heart of Wall Street's woes are not backed by federally insured deposits.

Moreover, the mission of the corporation was to dispose of the assets as quickly as possible for maximum value. Its goal was to reduce taxpayer exposure.

In the current crisis, the goal is more debatable. Should the government be helping homeowners, housing or financial markets, or large companies in trouble? Moreover, policy makers already have been seeking ways to reduce the impact of hard-to-sell assets on the books of companies by encouraging healthier institutions to acquire troubled ones.

The issue is whether Congress, after the election, should create a more formal and accountable mechanism, such as a federal agency, that would provide a relief valve for the troubled assets now causing havoc on Wall Street.

"The question is, and it's just a question, is, 'Are we at the point where the private market has made so many bad decisions and is so depressed that it can't get out from under?' " said Mr. Frank, who is planning to hold a hearing next week to explore whether Congress should create an agency to help the markets dispose of hard-to-sell assets.

"The question we have to address is, 'Is it the case that market psychology has so depressed assets that no entity has capacity to buy and hold these assets except for the government?' "

Mr. Frank said it would be more appropriate for a new agency, rather than the central bank, to be relieving the markets of the troubled assets.

“It is not appropriate for the Federal Reserve either in a financial sense or in a democratic sense to take on this role,” Mr. Frank said in an interview.

But Senator Christopher J. Dodd of Connecticut, the chairman of the Senate banking committee, said at a news conference announcing hearings later this week on the crisis that he wondered whether such an agency was necessary if Treasury and the Fed were already performing such a function and had the authority to continue to do it.

“I’m not opposed to it,” he said of Mr. Frank’s proposal. “I’m anxious to hear what the administration would have to say about this.”

Administration officials said they had no plans to make such a proposal, and that they would leave it to the next administration.

Mr. Frank emphasized that any legislation creating a new agency would have to be accompanied by “tough new regulations” to discourage companies from making more risky investments. He acknowledged that the decision about such an agency would be in the hands of the next Congress and the next president.

In recent days, aides to the presidential campaigns of John McCain and Barack Obama have said it would be premature to consider creating a new agency. But after the election, the political imperatives could significantly change, particularly if the housing markets remain depressed and Wall Street continues to choke on the billions of dollars in mortgage-backed assets.