Bankrupt Funds' Bailout Push Bars Mortgage Crisis Solution

by Paul Gallagher

As the U.S. home foreclosures crisis deepens, and mortgage banks and lenders sit on the edge of bankruptcy in the United States and in Europe, Congressional sources say that efforts to act on the crisis are being distorted by tremendous pressure on Congress from the hedge funds, investment banks, and their lobbies—pressure for a huge bailout of the funds by government housing agencies. Such a bailout, under the guise of "helping homeowners avoid foreclosure," would do no such thing—the admitted failure of a $100 million Ohio state mortgage refinancing plan, since May, has shown that. But it would turn Fannie Mae, Freddie Mac, the Federal Housing Administration, into so many additional Federal Reserve Banks, injecting hundreds of billions—as the Fed has already been doing—into a bailout of the hedge funds and their partners, the Wall Street investment banks, which created the monstrous speculative bubbles based on housing mortgages.

This bailout policy is worse than doing nothing at all about the banking crisis, economist Lyndon LaRouche said on Sept. 14: "It is the precise equivalent of spraying cold gasoline on a burning building," spreading the fire into an international explosion of inflation and a dollar collapse.

Should Congress or the Federal Reserve have bailed out Enron, with its scores of "off-the-balance-sheet" loan scams, debt investment vehicles, derivatives-trading operations, and billions in hidden losses? Such an insanity is the repeated bailout of Countrywide Mortgage, which has now reached $23.5 billion in banks' new credit lines to Countrywide using Federal Reserve money-printing injections into those banks, plus a $2 billion stock purchase by Bank of America. What's Countrywide done with all that bailout credit? Shrunk its mortgage lending by 20%, laid off 13,000 employees, further *restricted* refinancing for distressed mortgage-holders—and bought back devalued mortgage-backed securities (MBS) from hedge funds, investment banks, etc. at full price!

Such an insanity, multiplied many times over, is what Wall Street's Financial Services Forum and the hedge funds' Managed Funds Association lobbies are demanding from Congress.

These funds are divided between bankrupt and going-bankrupt, because they came to dominate all the various speculative markets driven by the hyperinflated mortgage bubble: MBS and collateralized debt markets, commodities futures, currency and foreign exchange markets driven by the yen carry trade, and short-term commercial loan markets. When the huge mortgage bubble started to collapse, the hedge funds spread the debt collapse to financial markets worldwide, blowing crippling holes in the books of the banks which had supported them. Now that they are going bankrupt, they want Congress's actions to bail out the $6-7 trillion MBS and collateralized mortgage obligations markets of which the hedge funds held 15-20% before it began to collapse in July-August.

Congress should let the Queen—to whose offshore territories 90% of these hedge funds have gone and "registered" their activities—bail them out.

Desperation of the 'Non-Banks'

The hedge-fund sector—the crafty "agents of financial innovation and dispersal of risk," so lavishly praised over the years by Sir Alan Greenspan at the Federal Reserve, have congealed into a gang of only a couple of hundred Frankenstein monsters sustained by bank credit. Although 8,000, 9,000, even 10,000 hedge funds all over the world are sung of by the financial press, in fact nearly 20% of the assets of the entire sector—about $300 billion—were controlled by just nine hedge-fund managers as of mid-2007, according to Hedge Fund Research, Inc. The biggest funds feature "funds of funds" living off banks like Goldman Sachs and JP Morgan Chase; and several of these biggest have already admitted to their in-

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Lyndon LaRouche's Homeowners and Bank Protection Act would prevent foreclosures and save the chartered banks; the hedge funds will be put out of their misery. Here, a LaRouche Youth Movement organizer offers an ironic take on the crisis in the Seattle financial district.

vestment clients that they are losing money big time, including Goldman Sachs' Global Alpha fund and the misnamed Renaissance Technologies Capital Fund. Others among the biggest have gone bust, from Amaranth to the Bear Stearns' funds. Only about 250 hedge funds, each managing a billion dollars or more, controlled 85% of the assets of the hedge fund sector, and nearly a dozen of these have failed during 2007's mortgage-backed securities meltdown and ensuing credit panic.

The entire hedge-fund sector suffered a net drain of roughly $32 billion in July and at least that much during August 2007 (about 4% of the total assets they were managing), completely wiping out in those two months, the inflows of the first two quarters of the year. The losses hit the "hedge funds of funds," usually dependent on banks in the major cases, which had $55 billion in assets pulled out in July alone, a 5.5% shrinkage that month.

Then came Aug. 15, a date—arriving amidst a torrent of hedge fund losses and a credit panic—on which hedge fund investors were to notify the managers if they wanted their investments pulled out by Oct. 1. No one knows, in this unregulated and unregistered "industry," how many funds were given the effective equivalent of death notices at that time. But since then, the big funds shutting down, or blocking withdrawals preliminary to doing so, have accelerated: two of Wharton Asset Management's funds with big 2007 losses; Caliber Global Investment Ltd.; London-based Synapse Investment Management; Absolute Capital Management and two of Basis Capital Management's funds, based in Sydney, Australia, etc. As the head of one hedge-fund investor group, IGS, was quoted by Reuters, "Managers of asset-backed funds could be in a lot of pain over the next few months. There are no decent valuations on any of this stuff."

During July and August, the entire sector of hedge funds—which charge at least 2% off the top just to manage an investor's money—lost approximately 1.5% each month. And that is based on reporting by the incomplete surveys of research groups, which, for lack of information, "average up"; they do not include those hundreds of smaller funds which fold up completely on a monthly basis.

The measure of the hedge funds' desperation was signalled by the London *Financial Times* on Sept. 13, when it "reported" plans by the Federal Reserve to start lending out funds to "non-banks"—read, hedge funds and certain large and nearly bankrupt mortgage lenders—for the first time in its history. The *Financial Times*, clearly pushing the Fed on behalf of City of London financial managers, conjured onto the agenda of the Fed's Sept. 18 meeting, "unorthodox measures" which "reach beyond banks to the stressed non-bank financial sector and the distressed markets for asset-backed commercial paper and non-agency mortgage-backed securities," including setting up a facility to lend directly to non-banks against their collateral—that is, the illiquid and massively devalued debt securities and derivatives, in the hedge funds' case.

Such a step by the Fed, which must be prevented by Congressional action, would effectively promise to monetize any debts and bets, based on other bets and debts, dumped on the Fed by the desperate financial funds, including frozen 30-day commercial loans, mortgage-backed securities and their derivatives, etc. It would be, in LaRouche's warning words, simply hyperinflationary in the terms of reference of Weimar Germany in the Fall of 1923.

The private-equity and hedge fund "corruption drive" to buy Congress away from any regulation or fair taxation of the funds, received a blow at a Sept. 6 Senate Finance Committee hearing. The pension managers of the National Conference of Public Employee Retirement Systems managers released a statement *rescinding* a previous claim by one of its officials, that if Congress taxed private equity and hedge funds at a higher rate, pension fund investments into those pirate funds would be hurt. The pension funds asserted, instead, that they had no objection to the legislation, which would make the pri-

vate equity and hedge fund managers pay fair taxes on their compensation, and that higher taxes for the pirates would have no effect on the pension plans.

But it will have an effect on the dying hedge-fund sector, which at this point, could not survive even government regulation, let alone significantly greater taxation. The Blackstone Group, *EIR* has learned, has paid out the largest lobbying fee recorded—$3.75 million for just the first six months of 2007—to the Ogilvy Government Relations lobbying firm, to push Congress against any such moves. The Ogilvy firm is headed by one of former Rep. Tom DeLay's "kitchen cabinet," Wayne Berman, a close friend of Dick and Lynne Cheney. This occurs while the individual hedge funds have thrown large amounts of money into the 2008 campaign cycle, predominantly to Democrats, putting pressure on Congress to block any fair tax changes and to go with the Federal bailout approach to the mortgage bubble collapse.

The ghost of Alan Greenspan now haunts the financial markets, as the "wall of money" he built out of hedge funds crumbles to dust.

FDR's Principles

The only action proposed to Congress which would actually protect homeowners, chartered banks, and the U.S. economy, by a "firewall," from the global debt conflagration under way, is action on LaRouche's proposed principles of a Homeowner and Bank Protection Act of 2007.

The three simple principles proposed for this Act (see *Resolutions*) revive the successful legacy of President Franklin Roosevelt in a similar crisis—including a massive wave of farm and home foreclosures—as he entered the Presidency. These principles effectively combine the result of FDR's actions of March 1933, in reorganizing, protecting, and saving the U.S. banking system, then chaotically shutting down; and in April of the same year, in the Home Owners Loan Act. That Act created the Federal Housing Administration, and gave or insured millions of new, affordable mortgages, but at values at least 20% and typically 50% below the bubble mortgages coming from the 1920s speculation—and it provided the banks protection and a means to participate in the new mortgages.

And LaRouche's legislative principles, while protecting Federal and state chartered banks, would *cut off* the bankrupt hedge funds, the securitizing investment banks, the other "alternative players" in the mortgage bubble, from any bailout.

The mass foreclosure wave now under way looks even worse than the alarming forecasts of a couple of months ago. MoodysEconomy.com on Sept. 13 reported the highest estimate yet, of 4.5 million adjustable-rate mortgages (ARM) or "teaser" mortgages of 2004-06 whose monthly payments will jump to unaffordable levels *during the next 12 months*, as the homes' market values drop another 9-10% even in the conservative estimates of the National Homebuilders. The National Association of Realtors said that 60% of homeowners who tried to refinance their ARM mortgages in August, couldn't do so, due to the credit collapse. An astonishing one-third of all U.S. home purchase closings in August failed "at the altar" because the mortgage lender didn't show up with the—pre-approved—loan.

Even assuming that half of these 4.5 million mortgages go into foreclosure, 200,000 or more households would be losing their homes *every month* in 2008, compared to the 50,000 or so a month losing them in 2007. This would mean social, as well as economic chaos.

The mobilization for LaRouche's Homeowners and Bank Protection Act proposal is strongest at the state level, where the mass-foreclosure "tsunami" is a stark reality, and where a growing number of legislatures are in, or facing special sessions because of the disappearance of real estate-based tax revenue. The LaRouche Youth Movement's interventions with those state legislatures and city governments has begun to produce resolutions of endorsement of LaRouche's proposal, and growing pressure on Congress for it.

But that action must be taken now, by early October, before the financial crisis triggers widespread bank failures like those already seen in Britain and Germany.

Members of Congress, in recent hearings of key economic committees in the House, have acknowledged that the mortgage collapse has "gone systemic," turning into a global financial crisis hitting all markets and the underlying economies as well. They have professed surprise over this alarming spread of a bank panic. But they are really just affirming that they refused to listen to LaRouche's warnings on this debt crisis going back to the auto industry collapse beginning early 2005, or to take the clear actions LaRouche's movement proposed to them. The purpose of these actions was to create "firewalls" between the unstoppable onrushing collapse of this colossal debt bubble, and the real economic factors of employment, industrial and technological capabilities, homeownership, etc., which need government protection from that collapse.

Now, they know LaRouche was right. The failure in Congress is a moral failure. They are not fooled, but are threatening to act like fools for the hedge funds, and for the investment bank circles of Felix Rohatyn's "Democratic" influence.