END GAME The Federal Reserve is now bailing out the world

Thursday, Dec. 10, 2010
Bloomberg News

Federal Reserve data showing UBS AG and Barclays Plc ranked among the top users of $3.3 trillion from emergency programs is stoking debate on whether U.S. regulators bear responsibility for aiding other nations' banks.

UBS was the biggest borrower under the Commercial Paper Funding Facility, with $74.5 billion overall, more than twice as much as Citigroup Inc., the top U.S. bank recipient, according to the data released yesterday. London-based Barclays Plc took the biggest single amount under another program that made overnight loans, when it got $47.9 billion on Sept. 18, 2008.

"We're talking about huge sums of money going to bail out large foreign banks," said Senator Bernard Sanders, the Vermont independent who wrote the provision in the Dodd-Frank Act that required the Fed disclosures. "Has the Federal Reserve become the central bank of the world? I think that is a question that needs to be examined."

The first detailed accounting of U.S. efforts to spare European banks may add to scrutiny of the central bank, already at its most intense in three decades. The Fed, which released data on 21,000 transactions, said in a statement that its 11 emergency programs helped stabilize markets and support economic recovery. The Fed said there have been no credit losses on rescue programs that have been closed.

The growth of the U.S. mortgage-backed securities market and the dollar's status as the world's reserve currency enticed overseas banks such as Zurich-based UBS to buy assets in the country before 2008. They paid for the holdings with U.S. dollars, and when funding seized up, the Federal Reserve refused to take the risk that European firms would unload the assets and further depress markets for housing-related investments.

'Much Worse'

"Things would have been worse if they hadn't lent to foreigners," said Perry Mehrling, senior fellow at the Morin Center for Banking and Financial Law at Boston University and author of "The New Lombard Street: How the Fed became the Dealer of Last Resort." "We're finally getting to understand the role of the Fed in the world."

Fed spreadsheets showed the central bank became the world's lender of last resort as dollars flowed to European banks as well as Bank of America Corp. and Wells Fargo & Co, among top borrowers from the Term Auction Facility at $45 billion each.

Goldman Sachs Group Inc., which posted record profit last year, borrowed more than $24 billion from another program. Milwaukee-based Harley-Davidson Inc. and Fairfield, Connecticut-based General Electric Co. sold commercial paper, a form of short-term debt, to the Fed under a program that lent as much as $348.2 billion at its peak.

Sanders, the Vermont senator, said yesterday he plans to investigate whether banks profited by borrowing from the Fed and investing the funds in Treasurys, benefiting from the difference in interest rates.

'Bailout Protection Act'

U.S. Representative Mike Pence, an Indiana Republican, said he planned to introduce a "European Bailout Protection Act" to restrict the flow of International Monetary Fund loans to European countries. He said he was responding to reports that U.S. officials might bolster a European fund designed to deal with this year's debt crisis, which has spread from Greece to Ireland.

Edwin Truman, a former Fed official who is a senior fellow at the Peterson Institute for International Economics in Washington, said any push to confine the Fed's role to U.S. banks would create a "massive exercise in financial protectionism."

"It would lead to retaliation, so U.S. banks in London or Tokyo would expect the same kind of treatment," Truman said. William Poole, senior economic adviser to Merk Investments LLC and a former Federal Reserve Bank of St. Louis president, said he was surprised by the extent of non-U.S. bank borrowing.

Commercial Paper

"I was under the impression that each country bore the responsibility for supervising the banks headquartered in their borders," Poole said in an interview.

The $74.5 billion received by UBS through the CPFF, which bought short-term debt, represents total borrowings by UBS over the life of the program. The total outstanding at any point in time never exceeded about half that sum, said Karina Byrne, a UBS spokeswoman.

Byrne said the bank's tapping the Fed fund "should be seen in the context of our overall desire to maintain flexibility and diversification in our funding sources."

The loan to a Barclays unit came from the Primary Dealer Credit Facility, created to make sure U.S. securities firms and foreign firms' U.S. affiliates had cash to satisfy clients' financing demands.

Barclays took the loan the week in September 2008 that it acquired the U.S. operations of Lehman Brothers Holdings Inc. Mark Lane, a spokesman for Barclays, declined to comment.

'A Big Operation'

Paris-based Natixis borrowed $27 billion under the commercial paper program. "We've got a big operation in the U.S.A.," Victoria Eideliman, a spokeswoman for the bank said. "It was, for us, natural that we participate in this program like all the banks. When we participated, the liquidity situation was very tense."

The $182.3 billion rescue of American International Group Inc. spared European banks that traded with the New York-based insurer from having to raise as much as $16 billion in capital, according to a June report from the Congressional Oversight Panel, which reviews bailout spending.

Fed Chairman Ben S. Bernanke addressed questions in a 2009 Congressional hearing about why non-U.S. banks benefited from the AIG rescue.

'The Obligation'

"I would point out that the Europeans have also saved a number of major financial institutions, and the issue of whether those institutions owed American companies money has not come up," Bernanke said. "So I think that there is a sense that we all have the obligation to address the problems of companies in our own jurisdictions."

Three of the top seven borrowers under the CPFF program were private firms. New York-based Hudson Castle received $53.3 billion in aggregate, BSN Holdings took $42.8 billion, and Liberty Hampshire Co., a unit of Guggenheim Partners LLC, drew $41.4 billion, Fed data show.

Hudson's website says it develops "customized debt products." A person who answered its phone said no one was available to comment. A Guggenheim spokesman didn't return phone calls.

BSN Capital Partners Ltd., which was associated with BSN Holdings according to a 2006 Standard & Poor's note, was founded by John Burgess, a former Deutsche Bank AG managing director. Burgess declined to comment.

To contact the reporters on this story: Bradley Keoun in New York at bkeoun@bloomberg.net; Hugh Son in New York at hson1@bloomberg.net.

To contact the editor responsible for this story: David Scheer at dscheer@bloomberg.net.