

OPINION

LETTERS TO THE EDITOR

The Complex Interconnections of the 2008 Meltdown

Holman W. Jenkins, Jr. concludes in "The Fannie and Freddie Hate Storm" (Business World, Dec. 28) that these two federal agencies played a minor role in the housing bubble and therefore should not be pegged as the leading culprits in the resulting economic collapse. Rather, he believes the panic of 2008 was caused because "a handful of giant financial institutions in the U.S. and Europe had leveraged up with short-term and even overnight borrowings in order to hold complex mortgage derivatives."

Mr. Jenkins, however, misses a major point. The bulk of these mortgage derivatives would not have existed if many of the underlying subprime mortgages that comprised the complex mortgage derivatives were not "insured" by Fannie and Freddie. The implicit government guarantees on these mortgages gave mortgage-backed securities and their derivatives a luster they didn't deserve.

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Mr. Jenkins wisely expands the financial-crisis argument: A confluence of complex

events led to the financial-system meltdown. Increasing government-mandated quotas and the attendant deterioration in lending standards may have been the root of the problem, but other factors contributed mightily. Gaming risk-adjusted capital, opaque derivative markets and expanded holding of difficult-to-mark assets among financial institutions (Lehman Brothers being the poster child) provided fertile soil. Repealing Glass-Steagall, lax rating agencies, mark-to-market accounting and allowing mortgage interest as the sole consumer debt deduction provided ample fertilizer for the kudzu to choke the financial system.

I'd argue that the prudent approach is for risk managers to put in place a structure that establishes secure capital levels among risk units to ensure each has its own source of liquidity in a crisis, one that seeks the collective wisdom of interested parties, aligns personal wealth with risk and provides a credible mechanism to intervene.

If Lehman's commercial real-estate division, as a vivid example, had had its own capital structure, leverage might have been restrained. If a major portion of the net

worth of the group's employees had been retained in its division's capital, the calls for a dispersion of risk might have occurred sooner and with greater resolve.

Yet more important, if Lehman's management had continued to ignore the risk, its failure would have been more orderly. The vicious cycle that had the potential to cascade until the toxic assets clogged the financial irrigation system could have been held in check.

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It really matters little who is more right, Peter J. Wallison ("The Financial Crisis on Trial," op-ed, Dec. 21) or Mr. Jenkins. The only certainty is that everyone who was invited to Barney Frank's crap game knew one thing for certain—regardless if they loaded up or unloaded, or if they believed Fannie and Freddie a little or a lot, or if they pocketed a nice piece of change—all the players invited to roll the dice knew for absolutely certain that the taxpaying public would cover all their losses.

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