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Wall Street superfund: Not so super

A group of big banks has a plan to invest in mortgage debt, but doubts are growing over whether it will calm the markets.

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LONDON (CNNMoney.com) -- A week after a Wall Street consortium said it would form a fund to buy mortgage-backed debt, doubts are growing over whether the plan will offer any swift relief to the beleaguered credit markets.

Few details about the planned "superfund," which could buy as much as $100 billion in debt, have emerged since it was announced Oct. 15. In the interim, renewed concerns about the credit crisis have rattled financial markets worldwide. Investors, analysts and market participants are divided over whether the plan led by Citigroup Inc. (Charts, Fortune 500) will help revive segments of the credit market that have been battered in recent months.

Deutsche Bank Chief Executive Josef Ackermann, speaking on behalf of the Institute of International Finance, said on Sunday the group of financial institutions welcomes market-based initiatives but it was "premature to make a firm judgment" about the fund. Even if the plan garners more support among other banks and gets off the ground, many agree the dislocation in the credit markets is likely to persist well into next year.

"It's going to take some time to restructure all these questionable loans and for those that can't be restructured to go into foreclosure," said Peter Morici, professor of business at the University of Maryland.

The superfund - known as the master liquidity enhancement conduit, or M-LEC - will issue short-term notes and use the proceeds to buy mortgage-linked assets from structured investment vehicles, or SIVs. SIVs issue short-term debt to invest in longer-term securities. A lack of confidence in what these vehicles hold has put them under pressure to sell their assets. The fund is designed to hold these shaky assets until investors can better evaluate the default rates for the mortgages backing these bonds and other securities - which could take a year or two, Morici said.

While it isn't a quick fix, supporters say the superfund is an important first step in wooing debt investors back into the market. Since the summer, uncertainty over the value of bonds and other securities backed by home loans has unhinged investors in the credit market. The fear over poor-quality mortgages has spread to better-quality assets, which some believe are trading below their true value.

The new fund, created by Wall Street banks and backed by the Treasury Department, aims to ameliorate this problem by establishing a market for these assets. The idea is that the fund, by adding liquidity to the market, will help establish a price at which buyers and sellers are willing to trade.

But many critics, including former Federal Reserve chairman Alan Greenspan, are worried that by propping up the market, the fund could do more harm than good.

Some investors are skeptical of the superfund, saying it is essentially just another SIV and amounts to a bailout for banks.

"[Those behind the plan] may think this is going to bolster confidence, but in truth, this is just a restructuring of previously financed transactions," said Daniel Alpert, a partner at Westwood Capital, a boutique investment bank in New York that specializes in mortgage and related securities.

Many banks, most notably Citi, have set up SIVs or agreed to backstop these vehicles. Citi's exposure to SIVs alone is estimated at $80 billion. The banks behind the plan and Treasury Secretary Henry Paulson have refuted claims that the superfund is a bailout.

Much of the growing doubt over the fund has to do with the lack of details that has been released so far. The banks said they expect to launch the fund before the end of the year, but it's still unclear how it will operate and how much support it has garnered.

Since the plan was announced on Monday, Wachovia Corp. (Charts, Fortune 500) has been the only major bank to announce that it's joining Citi, Bank of America Corp. (Charts, Fortune 500) and J.P. Morgan Chase & Co (Charts, Fortune 500).

Until more clarity is offered, it will be hard to determine just how "super" the superfund will prove to be. Behind the Citi rescue Think the credit crunch is over? Think again. Even 'safe' funds play with fire