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Aug 11 • 28 tweets • SalomonCrypto/status/1557759375837499392

(1/27) The Fall of Bear Stearns

In 2008, one American capitalism's favorite sons suddenly collapsed. Bear Stearns was the canary in the coal mine, the harbinger of the Global Financial Crisis.

Read on to learn the absurd and chaotic ending to this storied institution.

(2/27) Bear Stearns was founded as an equity trading house on May 1, 1923.

By November 2006, the company employed more than 15,500 people, had $67 billion of capital and total assets of $350 billion. It was the seventh-largest securities firm.

(3/27) For many, summer 2007 marks the beginning of the Global Financial Crisis.

On June 22, Bear Stearns interceded to save 2 of its hedge funds who were invested in collateralized debt obligations (CDOs).

Bear Stearns had invested $25MM - the first bailout was a $3.2B loan.

(4/27) The second bailout gave Merrill Lynch $850 million worth of the underlying collateral to liquidate. Merrill Lynch was able to auction only $100 million.

The fear of forced liquidation began building; similar assets in other portfolios were promptly marked-down.

(5/27) On July 16, less than a month after this 10-figure bailout, Bear Stearns disclosed that the two subprime hedge funds had lost nearly all of their value amid a rapid decline in the market for subprime mortgages.

(6/27) On September 21st, a report in The New York Times reported that Bear Searns posted a 61 percent drop in net profits due to their hedge fund losses.

On November 15th, CFO Samuel Molinaro announced a further $1.2B write-down from mortgage-related losses.

(7/27) By this point, Bear Stearns had $395 billion in assets supported by a net equity position of $11 billion for a leverage ratio of 35.6 to 1.

By the end of 2007, its clear Bear Stearns is at serious risk of collapse. By March, it's no longer a risk... it's a certainty.

(8/27) At this point, the cat is out of the bag. As everyone follows the drama at Bear Stearns, it's becoming increasingly obvious that they are just the canary in the coal mine.

Bear Stearns wasn't doing anything particularly risky... everyone was doing it!

(9/27) In early March 2008 the repurchase agreement markets (short-term lending markets that financial institutions rely on for day-to-day operations) were freezing up.

As collateral quality requirements increased, the system grew closer and closer to insolvent.

(10/27) As liquidity dries up, those with leverage are most at risk... and Bear Stearns was very levered.

Bear Stearns' problems escalated when rumors spread about its liquidity crisis; its liquidity pool started at $18.1B on March 10 and then plummeted to $2B on March 13.

(11/27) At this point, the Federal Reserve Board cited "unusual and exigent circumstances" and sprung into action

These aren't the first actions the Federal Reserve took during the Global Financial Crisis, but they mark the beginning of the deus-ex machina chapter of the story

(12/27) The Board of Governors of the Federal Reserve implemented 4 actions:

- Term Securities Lending Facility (Mar 11)
- A bridge loan to Bear Stearns (Mar 14)
- A loan $30 billion to facilitate the sale of Bear Steans (Mar 16)
- Primary Dealer Credit Facility (Mar 17)

(13/27) Term Securities Lending Facility (TSLF) & Primary Dealer Credit Facility (PDCF) were two programs created to create liquidity to support the remaining institutions.

Both gave key players huge amounts of liquidity at good terms (low rates, high LTV, poor collateral, etc).

(14/27) Although TSLF was announced to address market tensions impacting many firms, many concluded that it was created because of specific concerns about Bear Stearns.

TSLF and PDCF were about avoiding the next Bear Stearns... but we still have our bear to worry about.

(15/27) Late on Thursday, March 13, 2008, Bear Stearns notified the NY Fed that it would likely have to file for bankruptcy the next day unless the Fed provided the firm with an emergency loan.

The fear: Bear Stearns' collapse would threaten the entire financial system.

(16/27) The next morning, the Fed voted to provide a weekend-long $12.9B loan to Bear Stearns through JP Morgan Chase (JMPC). This emergency loan enabled Bear Stearns to avoid bankruptcy, providing time for potential acquirers to asses Bear Stearns' financial condition.

(17/27) That weekend, vultures circled around a dying Bear Stearns. Very quickly, it became obvious that JMPC was the only realistic potential buyer.

On Sunday, March 16, JPMC made their ultimatum: the merger would only happen if they could exclude the mortgage-backed securities

> Bear approached several major financial institutions, beginning on March 13. Those discussions intensified on Friday and Saturday. Bear's management provided us with periodic progress reports about a possible merger. Although several different institutions expressed interest in acquiring all or part of Bear, it was clear that the size of Bear, the apparent risk in its balance sheet, and the limited amount of time available for a possible acquirer to conduct due diligence compounded the difficulty. Ultimately, only JPMorgan Chase was willing to consider an offer of a binding commitment to acquire the firm and to stand behind Bear's substantial short-term obligations.[32]

(18/27) By Sunday, the fate of the country and the global economy rested on the negotiations between JP Morgan Chase and The New York branch of the Federal Reserve.

The deal: the Fed would eat the $30B of mortgage backed securities. JPMC would acquire Bear Stearns for $2/share

(19/27) $2/share is a a mere 7% of what the stock was worth on Friday, just 2 days before.

For reference, it was worth $93/share the month before, $172/share the year before.

Bear Stearns board members and shareholders were outraged and threatened to kill the merger.

(20/27) It wasn't just the price, the deal was a mess.

There were questions around who held the bag if the merger was rejected. There was no certainty if JMPC would honor Bear Stearns obligations; counterparties stopped trading. The Fed had offered to take all the toxic stuff.

(21/27) During the following week, the terms of this agreement were renegotiated.

On March 24, 2008, a class action was filed on behalf of shareholders, challenging the merger. That same day, a new agreement was reached that the offer to $10 a share.

(22/27) On May 29, Bear Stearns shareholders approved the sale to JPMorgan Chase at the $10-per-share price.

And just like that, Bear Stearns, the nation's 5th largest investment bank, survivor of the Great Depression, cornerstone of the financial system, was gone.

(23/27) Now everyone reading in 2022 knows that this is not the end of the Global Financial Crisis. Bear Stearns was not the bad apple rotting the bunch, it was the first major crack in an increasingly brittle system.

But, at least for now, the catastrophe had been averted.

(24/27) Over the next year the dominos kept falling, bigger and faster than anyone thought possible.

Lehman Brothers. Washington Mutual. Mutual Merrill Lynch. Countrywide. AIG. Fannie Mae & Freddie Mac.

ABN AMRO. UBS. HBOS. Royal Bank of Scotland. Fortis.

And sooo many more.

(25/27) As the financial crisis rage on, @federalreserve, @ecb and the rest of the central banks raged from fire to fire. Sometimes saving, sometimes destroying for the greater good.

Always trying to save the financial system from collapse. Protecting the system, whatever it too

(26/27) The Global Financial Crisis is the result of hundreds of years of capital concentration, consolidation and collusion with the state. The only way to fix it was with powers equal to the task.

"Thankfully," we had the Federal Reserve.

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(1/28) The History of Modern Finance: From 1492 to 2022

In the 16th century, Europe catapulted from the backwater of Eurasia into the forefront of global dominance. The secret? The invention of modern finance.

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(27/27) But I wonder... maybe we only needed the Fed because of the situation we found ourselves. Was it even possible to get there without that kind of centralization in the first place?

And who the hell is going to be in charge next time?

WSJ

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https://www.wsj.com/articles/BL-REB-1312

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