

**Report Pursuant to Section 129 of the
Emergency Economic Stabilization Act of 2008:
Bridge Loan to The Bear Stearns Companies Inc.
Through JPMorgan Chase Bank, N.A.**

Overview

On Friday, March 14, 2008, the Board of Governors of the Federal Reserve System (Board), by the unanimous vote of all available members, authorized under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343) the Federal Reserve Bank of New York (FRBNY) to extend credit to The Bear Stearns Companies, Inc. (Bear Stearns) through JPMorgan Chase Bank, N.A. (JPMC Bank).¹ The extension of credit was designed to provide funding to Bear Stearns to meet its immediate liquidity needs for that day and to give the company and policymakers additional time to develop a more permanent solution to the company's severe liquidity pressures that threatened to cause its sudden default and bankruptcy.

Background and Details on the Extension of Credit to Bear Stearns Through JPMC Bank

In March 2008, Bear Stearns was one of the largest securities firms in the country. As of February 29, 2008, Bear Stearns reported total consolidated assets of approximately \$399 billion. Bear Stearns engaged in a broad range of activities, including investment banking, securities and derivatives trading and clearing, brokerage services, and originating and securitizing commercial and residential mortgage loans. As a result of these

¹ Section 13(3), which relates to discounts to individuals, partnerships, and corporations, generally requires an affirmative vote of at least five members of the Board to approve an extension of credit under that provision. One member of the Board was unavailable at the time of the Board vote because he was enroute to the Board from Helsinki, Finland. As permitted under section 11(r)(2) of the Federal Reserve Act (12 U.S.C. § 248(r)(2)), however, the Board's action approving the March 14 extension of credit to Bear Stearns was adopted by the unanimous vote of all available Board members. The approval of the credit by less than five Board members complied with all of the requirements of section 11(r)(2) for taking such action. The available members of the Board then in office unanimously approved the action and, among other things, determined that action on the extension of credit was required before the other member of the Board required to vote on the matter could be available to participate by any available means. As required by section 11(r)(2), the Board submitted a record of its action approving the credit extension to the Chairmen of the appropriate Congressional committees.

activities, Bear Stearns maintained a large portfolio of mortgage-related securities and other debt instruments. Like most large securities firms, the company heavily financed itself in the short-term securities repurchase market.

Financial conditions deteriorated markedly between mid-January and mid-March 2008. Volatility was steadily increasing and liquidity was quickly declining in many credit markets – including in particular the market for residential mortgage-backed securities, but also in the markets for other asset-backed securities, corporate securities, and municipal securities. Moreover, many market participants were financing a large portion of their holdings of these long-term securities in short-term collateralized funding markets.

The senior management of Bear Stearns notified the Federal Reserve on the evening of Thursday, March 13, that it anticipated that many of its counterparties would on Friday not agree to roll over their repurchase agreements and, therefore, that Bear Stearns would be required on Friday to repay a significant portion of its repurchase agreement liabilities. Bear Stearns expected that it would not have sufficient funds or liquid assets to repay these obligations as they came due and would not be able during the short period before the markets opened on Friday to find a private-sector source of alternative financing. Bear Stearns reported that it would likely have to file for bankruptcy protection on Friday unless the Federal Reserve were willing to provide Bear Stearns with liquidity.

The sudden imminence of insolvency for Bear Stearns, the large presence of Bear Stearns in several important financial markets (including in particular the markets for repo-style transactions, over-the-counter derivative and foreign exchange transactions, mortgage-backed securities, and securities clearing services), and the potential for contagion to similarly situated firms raised significant concern that financial markets would be seriously disrupted if Bear Stearns were suddenly unable to meet its obligations to counterparties. Most crucially, the consequences of an unexpected and disorderly default or insolvency by Bear Stearns – a major borrower and lender in the repurchase agreement market – could have seriously disrupted this very large, important, and increasingly strained market for short-term secured financing. Market participants were likely to respond to the failure of Bear Stearns by withdrawing generally from short-term collateralized funding markets, resulting in a dramatic drop in the

overall availability of short-term financing, and threats to the liquidity and possibly the solvency of other large and highly leveraged financial institutions.

To address the imminent liquidity needs of Bear Stearns and forestall the potential systemic disruptions a default or bankruptcy of the company would cause in the already stressed credit markets, on Friday, March 14, 2008, the Board determined that unusual and exigent circumstances existed and authorized the FRBNY to extend credit to Bear Stearns through JPMC Bank. The purpose of the loan was to ensure that Bear Stearns would meet its obligations as they came due on Friday. This would allow for time during the weekend for Bear Stearns to explore options with other financial institutions that might enable it to avoid bankruptcy and for policy makers to continue to seek ways to contain the risk to financial markets in the event no private-sector solution proved possible.

On March 14, the FRBNY made an overnight discount window loan of \$12.9 billion to JPMC Bank on a non-recourse basis and took as collateral assets of Bear Stearns with a value of \$13.8 billion. The rate of interest on this loan was the rate for primary credit extended by the Reserve Banks, or 2.25 percent.² In a simultaneous back-to-back transaction, JPMC Bank provided secured financing to Bear Stearns and took as collateral the same assets that JPMC Bank used to secure its loan from the FRBNY. The FRBNY received no warrants or any other potential equity of either JPMC Bank or Bear Stearns in exchange for the loan.

On Monday morning, March 17, the \$12.9 billion back-to-back loan through JPMC Bank to Bear Stearns was repaid in full to the FRBNY with interest of nearly \$4 million. Thus, the loan resulted in a profit to the Federal Reserve and the taxpayers, and not in any loss to either.³

² Section 10B of the Federal Reserve Act (12 U.S.C. § 347b) authorizes a Reserve Bank to make advances to depository institutions under certain conditions.

³ On Sunday, March 16, 2008, in connection with the proposed acquisition of Bear Stearns by JPMorgan Chase & Co., the Board authorized the FRBNY under section 13(3) to extend credit to a limited liability company that would acquire assets from Bear Stearns where the credit would be secured exclusively by those assets. This extension of credit is the subject of a separate report being submitted under section 129 of the Emergency Economic Stabilization Act of 2008.