

# The Secret Bailout of J. P. Morgan: How Insider Trading Looted Bear Stearns and the American Taxpayer

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Global Research, December 30, 2012  
[webofdebt.com](http://webofdebt.com) 14 May 2008

Region: [USA](#)

Theme: [Global Economy](#)

*The mother of all insider trades was pulled off in 1815, when London financier Nathan Rothschild led British investors to believe that the Duke of Wellington had lost to Napoleon at the Battle of Waterloo. In a matter of hours, British government bond prices plummeted. Rothschild, who had advance information, then swiftly bought up the entire market in government bonds, acquiring a dominant holding in England's debt for pennies on the pound. Over the course of the nineteenth century, N. M. Rothschild would become the biggest bank in the world, and the five brothers would come to control most of the foreign-loan business of Europe. "Let me issue and control a nation's money," Rothschild boasted in 1838, "and I care not who writes its laws."*

In the United States a century later, John Pierpont Morgan again used rumor and innuendo to create a panic that would change the course of history. The panic of 1907 was triggered by rumors that two major banks were about to become insolvent. Later evidence pointed to the House of Morgan as the source of the rumors.

The public, believing the rumors, proceeded to make them come true by staging a run on the banks. Morgan then nobly stepped in to avert the panic by importing \$100 million in gold from his European sources. The public thus became convinced that the country needed a central banking system to stop future panics, overcoming strong congressional opposition to any bill allowing the nation's money to be issued by a private central bank controlled by Wall Street; and the Federal Reserve Act was passed in 1913. Morgan created the conditions for the Act's passage, but it was Paul Warburg who pulled it off. An immigrant from Germany, Warburg was a partner of Kuhn, Loeb, the Rothschilds' main American banking operation since the Civil War. Elisha Garrison, an agent of Brown Brothers bankers, wrote in his 1931 book *Roosevelt, Wilson and the Federal Reserve Law* that "Paul Warburg is the man who got the Federal Reserve Act together after the Aldrich Plan aroused such nationwide resentment and opposition. The mastermind of both plans was Baron Alfred Rothschild of London." Morgan, too, is now widely believed to have been Rothschild's agent in the United States. <sup>1</sup>

Robert Owens, a co-author of the Federal Reserve Act, later testified before Congress that the banking industry had conspired to create a series of financial panics in order to rouse the people to demand "reforms" that served the interests of the financiers. A century later, JPMorgan Chase & Co. (now one of the two largest banks in the United States) may have pulled this ruse off again, again changing the course of history. "Remember Friday March 14, 2008," wrote Martin Wolf in *The Financial Times*; "it was the day the dream of global

free-market capitalism died.”

## The Rumors that Sank Bear Stearns

Mergers, buyouts and leveraged acquisitions have been the *modus operandi* of the Morgan empire ever since John Pierpont Morgan took over Carnegie’s steel mills to form U.S. Steel in 1901. The elder Morgan is said to have hated competition, the hallmark of “free-market capitalism.” He did not compete, he bought; and he bought with money created by his own bank, using the leveraged system perfected by the Rothschild bankers known as “fractional reserve” lending. On March 16, 2008, this long tradition of takeovers and acquisitions culminated in JPMorgan’s buyout of rival investment bank Bear Stearns with a \$55 billion loan from the Federal Reserve. Although called “federal,” the U.S. central bank is privately owned by a consortium of banks, and it was set up to protect their interests.<sup>2</sup> The secret weekend purchase of Bear Stearns with a Federal Reserve loan was precipitated by a run on Bear’s stock allegedly triggered by rumors of its insolvency. An article in The Wall Street Journal on March 15, 2008 cast JPMorgan as Bear’s “rescuer”:

“The role of rescuer has long been part of J.P. Morgan’s history. In what’s known as the Panic of 1907, a semi-retired J. Pierpont Morgan helped stave off a national financial crisis when he helped to shore up a number of banks that had seen a run on their deposits.”

That was one interpretation of events, but a later paragraph was probably closer to the facts:

“J.P. Morgan has been on the prowl for acquisitions. . . . Bear’s assets could be too good, and too cheap, to turn down.”<sup>3</sup>

The “rescuer” was not actually JPMorgan but was the Federal Reserve, the “bankers’ bank” set up by J. Pierpont Morgan to backstop bank runs; and the party “rescued” was not Bear Stearns, which wound up being eaten alive. The Federal Reserve (or “Fed”) lent \$25 billion to Bear Stearns and another \$30 billion to JPMorgan, a total of \$55 billion that all found its way into JPMorgan’s coffers. It was a very good deal for JPMorgan and a very bad deal for Bear’s shareholders, who saw their stock drop from a high of \$156 to a low of \$2 a share. Thirty percent of the company’s stock was held by the employees, and another big chunk was held by the pension funds of teachers and other public servants. The share price was later raised to \$10 a share in response to shareholder outrage and threats of lawsuits, but it was still a very “hostile” takeover, one in which the shareholders had no vote.

The deal was also a very bad one for U.S. taxpayers, who are on the hook for the loan. Although the Fed is privately owned, the money it lends is taxpayer money, and it is the taxpayers who are taking the risk that the loan won’t be repaid. The loan for the buyout was backed by Bear Stearns assets valued at \$55 billion; and of this sum, \$29 billion was non-recourse to JPMorgan, meaning that if the assets weren’t worth their stated valuation, the Fed could not go after JPMorgan for the balance. The Fed could at best get its money back with interest; and at worst, it could lose between \$25 billion and \$40 billion.<sup>4</sup> In other words, JPMorgan got the money (\$55 billion) and the taxpayers got the risk (up to \$40 billion), a ruse called the privatization of profit and socialization of risk. Why did the Fed not just make the \$55 billion loan to Bear Stearns directly? The bank would have been saved, and the Fed

and the taxpayers would have gotten a much better deal, since Bear Stearns could have been required to guaranty the full loan.

### The Highly Suspicious Out-of-the-Money Puts

That was one of many questions raised by John Olagues, an authority on stock options, in a March 23 article boldly titled “Bear Stearns Buy-out . . . 100% Fraud.” Olagues maintains that the Bear Stearns collapse was artificially created to allow JPMorgan to be paid \$55 billion of taxpayer money to cover its own insolvency and acquire its rival Bear Stearns, while at the same time allowing insiders to take large “short” positions in Bear Stearns stock and collect massive profits. For evidence, Olagues points to a very suspicious series of events, which will be detailed here after some definitions for anyone not familiar with stock options:

A *put* is an option to sell a stock at an agreed-upon price, called the *strike price or exercise price*, at any time up to an agreed-upon date. The option is priced and bought that day based upon the current stock price, on the presumption that the stock will decline in value. If the stock’s price falls below the strike price, the option is “in the money” and the trader has made a profit. Now here’s the evidence:

On March 10, 2008, Bear Stearns stock dropped to \$70 a share — a recent low, but not the first time the stock had reached that level in 2008, having also traded there eight weeks earlier. On or before March 10, 2008, requests were made to the Options Exchanges to open a new April series of puts with exercise prices of 20 and 22.5 and a new March series with an exercise price of 25. The March series had only eight days left to expiration, meaning the stock would have to drop by an unlikely \$45 a share in eight days for the put-buyers to score. It was a very risky bet, unless the traders knew something the market didn’t; and they evidently thought they did, because after the series opened on March 11, 2008, *purchases were made of massive volumes of puts controlling millions of shares.*

On or before March 13, 2008, another request was made of the Options Exchanges to open additional March and April put series with very low exercise prices, although the March put options would have *just five days of trading* to expiration. Again the exchanges accommodated the requests and massive amounts of puts were bought. Olagues contends that there is only one plausible explanation for “anyone in his right mind to buy puts with five days of life remaining with strike prices far below the market price”: the deal must have already been arranged by March 10 or before.

These facts were in sharp contrast to the story told by officials who testified at congressional hearings on April 4. All witnesses agreed that false rumors had undermined confidence in Bear Stearns, making the company crash despite adequate liquidity just days before. On March 10, 2008, Reuters was citing Bear Stearns sources saying there was no liquidity crisis and no truth to the speculation of liquidity problems. On March 11, the Chairman of the Securities and Exchange Commission himself expressed confidence in its “capital cushion.” Even “mad” TV investment guru Jim Cramer was proclaiming that all was well and the viewers should hold on. On March 12, official assurances continued. Olagues writes:

“The fact that the requests were made on March 10 or earlier that those new series be opened and those requests were accommodated together with the subsequent massive open positions in those newly opened series is conclusive

proof that there were some who knew about the collapse in advance . . . This was no case of a sudden development on the 13 or 14th, where things changed dramatically making it such that they needed a bail-out immediately. The collapse was anticipated and prepared for. . .

“Apparently it is claimed that some people have the ability to start false rumors about Bear Stearns’ and other banks’ liquidity, which then starts a ‘run on the bank.’ These rumor mongers allegedly were able to influence companies like Goldman Sachs to terminate doing business with Bear Stearns, notwithstanding that Goldman et al. believed that Bear Stearns balance sheet was in good shape. . . . The idea that rumors caused a ‘run on the bank’ at Bear Stearns is 100% ridiculous. Perhaps that’s the reason why every witness was so guarded and hesitant and looked so mighty strained in answering questions . . .

“To prove the case of illegal insider trading, all the Feds have to do is ask a few questions of the persons who bought puts on Bear Stearns or shorted stock during the week before March 17, 2008 and before. All the records are easily available. If they bought puts or shorted stock, just ask them why.”<sup>5</sup>

## Suspicious Mount

Other commentators point to other issues that might be probed by investigators. Chris Cook, a British consultant and the former Compliance Director for the International Petroleum Exchange, wrote in an April 24 blog:

“As a former regulator myself, I would be crawling all over these trades. . . . One question that occurs to me is who actually sold these Put Options? And why aren’t they creating merry hell about the losses? Where is Spitzer when we need him?”<sup>6</sup>

In an April 23 article in LeMetropoleCafe.com, Rob Kirby agreed with Olagues that it was not Bear Stearns but JPMorgan that was bankrupt and needed to be “recapitalized” with massive loans from the Federal Reserve. Kirby pointed to the huge losses from derivatives (bets on the future price of assets) carried on JPMorgan’s books:

“. . . J.P. Morgan’s derivatives book is 2-3 times bigger than Citibank’s – and it was derivatives that caused losses of more than 30 billion at Citibank . . . . So, it only made common sense that J.P. Morgan had to be a little more than ‘knee deep’ in the same stuff that Citibank was – but how do you tell the market that a bank – any bank – needs to be recapitalized to the tune of 50 – 80 billion?”<sup>7</sup>

Kirby wrote in an April 30 article:

“According to the NYSE there are only 240 million shares of Bear outstanding . . . [Yet] 188 million traded on Mar. 14 alone? Doesn’t this strike you as being odd? . . . What percentage of the firm was owned by insiders that categorically did not sell their shares? . . . Bear Stearns employees held 30 % of the company’s stock . . . 30 % of 240 million is 72 million. If you subtract 72 from 240 you end up with approximately 170 million. Don’t you think it’s a stretch to believe that 186+ million real shares traded on Friday Mar. 14? Or do you believe that rank-and-file Bear employees, worried about their jobs, were pitching their stocks on the Friday before the company collapsed knowing their

company was toast? But that would be insider trading – wouldn't it? No bloody wonder the SEC does not want to probe J.P. Morgan's 'rescue' of Bear Stearns . . ."8

If *real* shares weren't trading, someone must have been engaging in "naked" short selling – selling stock short without first borrowing the shares or ensuring that the shares could be borrowed. Short selling, a technique used by investors to try to profit from the falling price of a stock, involves borrowing a stock from a broker and selling it, with the understanding that the stock must later be bought back and returned to the broker. *Naked* short selling is normally illegal; but in the interest of "liquid markets," a truck-sized loophole exists for "market makers" (those people who match buyers with sellers, set the price, and follow through with the trade). Even market makers, however, are supposed to cover within three days by actually coming up with the stock; and where would they have gotten enough Bear Stearns stock to cover 75% of the company's outstanding shares? In any case, naked short selling is *illegal* if the intent is to drive down a stock's share price; and that was certainly the result here.<sup>9</sup>

On May 10, 2008, in weekly market commentary on FinancialSense.com, Jim Puplava observed that naked short selling has become so pervasive that the number of shares sold "short" far exceeds the shares actually issued by the underlying companies. Yet regulators are turning a blind eye, perhaps because the situation has now gotten so far out of hand that it can't be corrected without major stock upheaval. He noted that naked short selling is basically the counterfeiting of stock, and that it has reached epidemic proportions since the "uptick" rule was revoked last summer to help the floundering hedge funds. The uptick rule allowed short selling only if the stock price were going up, preventing a cascade of short sales that would take the stock price much lower. But that brake on manipulation has been eliminated by the Securities Exchange Commission (SEC), leaving the market in unregulated chaos.

Eliot Spitzer has also been eliminated from the scene, and it may be for similar reasons. Greg Palast suggested in a March 14 article that the "sin" of the former New York governor may have been something more serious than prostitution. Spitzer made the mistake of getting in the way of a \$200 billion windfall from the Federal Reserve to the banks, guaranteeing the mortgage-backed junk bonds of the same banking predators responsible for the subprime debacle. While the Federal Reserve was trying to bail the banks out, Spitzer was trying to regulate them, bringing suit on behalf of consumers.<sup>10</sup> But he was swiftly exposed and deposed; and the Treasury has now broached a new plan that would prevent such disruptions in the future. Like the Panic of 1907 that justified a "bankers' bank" to prevent future runs, the collapse of Bear Stearns has been used to justify a proposal giving vast new powers to the Federal Reserve to promote "financial market stability." The plan was unveiled by Treasury Secretary Henry Paulson, former head of Goldman Sachs, two weeks after Bear Stearns fell. It would "consolidate" the state regulators (who work for the fifty states) and the SEC (which works for the U.S. government) under the Federal Reserve (which works for the banks). Paulson conceded that the result would not be to *increase* regulation but to actually *take away* authority from state regulators and the SEC. All regulation would be subsumed under the Federal Reserve, the bank-owned entity set up by J. Pierpont Morgan in 1913 specifically to preserve the banks' own interests.

On April 29, a former top Federal Reserve official told The Wall Street Journal that by offering \$30 billion in financing to JPMorgan for Bear's assets, the Fed had "eliminated

forever the possibility [that it] could serve as an honest broker.” Vincent Reinhart, formerly the Fed’s director of monetary affairs and the secretary of its policy-making panel, said the Fed’s bailout of Bear Stearns would come to be viewed as the “worst policy mistake in a generation.” He noted that there were other viable options, such as looking for other suitors or removing some assets from Bear’s portfolio, which had not been pursued by the Federal Reserve.<sup>11</sup>

Jim Puplava maintains that naked short selling has now become so pervasive that if the hedge funds were pressed to come in and cover their naked short positions, “they would actually trigger another financial crisis.” The Fed and the SEC may be looking the other way on this widespread stock counterfeiting scheme because “if they did unravel it, everything really would unravel.” Evidently “promoting market stability” means that whistle-blowers and the SEC must be silenced so that a grossly illegal situation can continue, since the crime is so pervasive that to expose it and prosecute the criminals would unravel the whole financial system. As Nathan Rothschild observed in 1838, when the issuance and control of a nation’s money are in private hands, the laws and the people who make them become irrelevant.

This article was first published in May 2008

## Notes

1

For many references, see E. Brown, *Web of Debt* (2008); and E. Brown, “Dollar Deception: How Banks Secretly Create Money,” [webofdebt.com/articles](http://webofdebt.com/articles) (July 3, 2007).

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Kate Kelly, et al., “Fed Races to Rescue Bear Stearns in Bid to Steady Financial System,” *The Wall Street Journal* (March 15, 2008).

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Greg Palast, "Eliot's Mess" [gregpalast.com](http://gregpalast.com) (March 14, 2008).

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Reuters, "Ex-Fed Official Criticizes Bear Stearns Rescue," citing Wall Street Journal (April 29, 2008).

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