

Bernanke Defends Use of Public Money to Rescue of Bear Stearns

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The government's rescue of investment bank Bear Stearns last month was necessary to protect the financial system as a whole from breaking down, the officials involved said today, in their most extensive defense of the unprecedented intervention in the workings of Wall Street.

In testimony to the Senate Banking Committee, top officials of the Federal Reserve system, the Treasury Department and the Securities and Exchange Commission described the series of actions that led to the Fed making an emergency loan to Bear Stearns on March 14 and backing its acquisition by [J.P. Morgan Chase](#) on March 16.

The top officials of J.P. Morgan Chase and of Bear Stearns, scheduled to testify later, stressed in prepared remarks that their actions were driven by extenuating and unique circumstances.

Both the government officials and executives said the plan they implemented was meant to prevent a much bigger problem than the dissolution of a single investment bank. Some \$29 billion in public money is on the line to back assets of Bear Stearns, a concession the Fed made to get J.P. Morgan to agree to acquire Bear Stearns.

"In short, we judged that a sudden, disorderly failure of Bear would have brought with it unpredictable but severe consequences for the functioning of the broader financial system and the broader economy," said Timothy F. Geithner, president of the Federal Reserve [Bank of New York](#), "with lower equity prices, further downward pressure on home values, and less access to credit for companies and households."

The recent turmoil over Bear Stearns reflects broader concerns over the state of U.S. and global financial markets, and comes at a time when many feel the economy has slipped into or is heading toward a recession. Data over the next two days will add to the debate: Statistics released today showed that new claims for unemployment benefits spiked to more than 405,000 last week -- the highest level in several years. Tomorrow, the unemployment report for March will show whether the economy is continuing to shed jobs.

U.S. markets were down in morning trading, with the [Dow Jones industrial average](#) dropping about half of a percentage point. But they edged up in the afternoon, and the Dow closed with a gain of nearly 20 points at 12,625. The Standard & Poor's 500-stock index rose nearly 2 points to 1,369. The Nasdaq composite index also was up 2 points at 2,363.

Fed officials recognized they were taking extreme action by intervening, Geithner and Fed Chairman Ben S. Bernanke said, but viewed it as the best possible action. Geithner offered an extensive timeline of the actions.

On March 13, Bear Stearns notified its regulators that it would have to file for bankruptcy the next morning short of some new action. The officials involved concluded that given the fragile state of financial markets and the extensive network of institutions that did business with Bear, such a move could have serious repercussions, they argued.

"The idea that the Bear Stearns fallout would have been limited to a few Wall Street firms just isn't so," Jamie Dimon, chief executive of J.P. Morgan Chase, said in prepared testimony to be delivered later today. "People all over America -- union members, retirees, small business owners, and our parents and children -- are now invested in the financial system through pensions, 401(k)s, mutual funds and the like."

Dimon's firm was able to acquire Bear for a deep discount in what Wall Street analysts viewed as a big financial win, and its stock soared the day the transaction was announced.

Alan Schwartz, chief executive of Bear Stearns, characterized the series of events that caused massive losses to his shareholders -- and to Bear executives and employees -- as the result of a run on the bank, as rumors and speculation led lenders to refuse to roll over short-term loans.

Senators questioning the officials expressed only modest reservations about the actions of the Fed and other government officials that weekend.

"As a bottom line, I happen to think this was the right decision," said Sen. Christopher J. Dodd (D-Conn.). "The alternative could have been devastating. So I don't question that decision. But I want to know about the rationale leading up to it."

Geithner also laid out principles for how the regulatory system should change to prevent such events. He said there needs to be a stronger set of "shock absorbers" in the amount of cash and other liquid investments held by large investment banks and other financial institutions, with stronger supervision of those companies.

Geithner argued for a simpler regulatory system in the financial world, and for stronger regulation of the markets for arcane financial instruments called derivatives and the "repo market," a market for short-term debt.

Finally, Geithner urged a reconsideration of the tools that the government uses to ensure the financial system has adequate cash, and that the Fed have proper authority and responsibility to respond quickly to threats.

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