

The Downfall of J.P. Morgan Chase

by John Hoefle

Has J.P. Morgan Chase & Co., the world's largest derivatives bank, gone bankrupt? The indications are growing that the bank has indeed failed, and that emergency operations are under way to wind down its huge derivatives portfolio and prepare the public for some sort of dramatic bailout or restructuring.

Because of its enormous derivatives holdings, any widespread problem in the derivatives market would almost certainly involve Morgan Chase, which as of Sept. 30, 2001, had \$24 trillion in notional value of derivatives on its books. That is a staggering amount, well beyond the toxic level, amounting to half of all U.S. commercial bank derivatives as reported by the Federal Deposit Insurance Corp., and nearly a quarter of the world derivatives total admitted by the Bank for International Settlements. A loss equivalent to just under 0.2% of its derivatives portfolio would be sufficient to wipe out every penny of the bank's \$41 billion in equity capital.

That such a loss will occur is certain; the only question is when.

EIR believes that such losses may have already occurred, in part due to certain intriguing changes on its balance sheet, and in part due to the extraordinary level of attention being given to the bank's problems in the financial press. If we are correct, the level of panic behind the scenes must be extraordinary.

Disappearing Assets

At the end of 2001, J.P. Morgan Chase & Co. was the nation's second-largest bank, with \$694 billion in assets, just ahead of number-three Bank of America's \$622 billion. Well

ahead of both was Citigroup, which became the first U.S. bank holding company to break the trillion-dollar barrier, with \$1.05 trillion in assets. These three easily outdistance the rest of the pack, reflecting the rapid consolidation taking place in the banking world. The number-four bank was Wachovia (née First Union) with \$330 billion, followed by Wells Fargo with \$308 billion. Rounding out the top ten were Bank One (\$269 billion), FleetBoston (\$204 billion), U.S. Bancorp (\$171 billion), National City Corp. (\$106 billion), and SunTrust (\$105 billion).

However, at the end of the third quarter of 2001, Morgan Chase reported \$799 billion in assets, a drop of \$105.7 billion in assets—the equivalent of a top-ten bank—in just three months. Morgan Chase's explanation for the perilous asset drop was that the "majority of the reduction . . . reflects the resolution of the industry-wide clearing and settlement problems experienced in September."

Since the existence of such industry-wide derivatives problems was denied after (and before) the Sept. 11 events, Morgan Chase's explanation raises far more questions than it answers.

The bank has also seen its market capitalization drop sharply. On the last day of 2000, when the acquisition of J.P. Morgan and Co. by Chase Manhattan Corp. was completed, the newly christened J.P. Morgan Chase & Co. had a market capitalization of \$86 billion, of which \$26.5 billion came from Morgan and \$59.5 billion came from Chase. As of Feb. 27, 2002, the bank had a market capitalization of \$57 billion, less than Chase alone at the time of the merger; the value of Morgan, and then some, has evaporated.

Going Down With Enron

Morgan Chase also seems to be at the scene of more disasters than an ambulance-chasing lawyer. The bank was a major lender to the bankrupt Kmart and Global Crossing, and the troubled Tyco, in addition to its losses on loans to Argentina.

Morgan Chase is also intimately entwined with the bankrupt Enron. The bank made loans to Enron, was an investor in some of the Enron partnerships, bought Enron stock for investment funds managed by the bank, and its analysts advised suckers—uh, investors—to buy the company's stock. The bank, a major player in the credit derivatives market, also sold credit derivatives which would pay off, were Enron to default on its bond payments. These multiple connections mean that the bank had a vested interest in keeping alive the illusion that Enron was a sound and profitable enterprise.

Morgan Chase was Enron's top lender, helping to arrange billions of dollars of loans for the Texas firm; as is typical in such cases, pieces of these loans were sold off to other banks. After Enron filed for bankruptcy, Morgan Chase put its loan exposure to the company at \$900 million, but a few weeks later revealed that it had also incurred \$1 billion in losses on deals it did with Enron through Mahonia, Ltd., an offshore Morgan affiliate in Jersey, one of the British Channel Islands off the French coast.

According to the *Wall Street Journal*, the Federal Reserve Bank of New York is investigating these Mahonia transactions, in which what were effectively loans to Enron were disguised as energy trades, allowing Enron to get the money, while keeping the debt off its books.

To protect itself against a possible Enron default on the Mahonia transactions, Morgan Chase bought credit protection from a number of insurance companies. When Enron filed for bankruptcy, Morgan tried to collect, but the insurance companies refused to pay, claiming the deals were shams, not legitimate transactions. The case is now headed for the courts.

Meanwhile, holders of Morgan Chase debt are scrambling to protect themselves from a potential Morgan default. The price of a credit derivative which would pay off, in the event of a default on a \$10 million Morgan bond, went from \$35,000 at the end of January, to \$80,000 in late February, according to Morgan Stanley, a clear sign that the institutional investors are growing increasingly concerned about Morgan's survival.

Preparing the Public

The extent to which the *Wall Street Journal*, *New York Times*, *Financial Times*, and other major financial mouthpieces are reporting the problems at Morgan Chase, is another indication that the troubles at Morgan are serious.

Serious problems at major banks are rarely reported in the press; just the opposite, troubled banks are usually protected by a veneer of positive statements designed to prevent runs by depositors and investors. Thus the constant reporting on the problems at Morgan Chase, mainly revolving around its

Enron involvement, suggest that a campaign is under way to prepare the public for some very bad news.

An example of how this works is the 1994 failure of Bankers Trust. Bankers Trust, which politically was a spinoff of J.P. Morgan, was at the bleeding edge of the derivatives market in the early 1990s, touting its expertise, its state-of-the-art computer systems, and its daring as the model for the brave new financial world. Bankers Trust's derivatives holdings exploded during the 1989-93 period, thanks to a series of Federal Reserve interest rate cuts and a determination by the financial and political elite to hide the bankruptcy of the U.S. banking system.

In February 1994, afraid that their bubble was ballooning out of control, the Federal Reserve began to slowly raise interest rates. The result was chaos in the general derivatives markets and the mortgage-backed securities market. In March, rumors that Bankers Trust was insolvent began to sweep the market. That same month, David Askin's Granite hedge fund collapsed, and by April, the top dog in the mortgage-backed securities market, General Electric-owned Kidder Peabody, was on the ropes. Kidder failed, and attempted to blame the failure on one of its traders, Joseph Jett.

After several months of behind-the-scenes work on its \$2 trillion derivatives portfolio, the takedown of Bankers Trust began in earnest in September, when Gibson Greetings filed suit against Bankers Trust, accusing the bank of fraud. Investigations by the Securities and Exchange Commission and Commodities Futures Trading Commission revealed that derivatives traders at Bankers Trust had deliberately lied to Gibson about the value of derivatives the bank had sold the greeting card company. Using this fraud as a pretext, the Fed and Treasury effectively took control of the bank and completed cleaning up its derivatives mess.

This pattern of finding scapegoats to hide the damage done by systemic problems in the derivatives markets, is the way the game is played. Just as Nick Leeson was blamed for the failure of Barings in 1995, so a handful of Enron executives are now being set up to take the blame for the biggest derivatives blowout in history. The fact that they appear to be guilty of massive fraud, makes them perfect candidates to take the fall for much larger, systemic problems.

In a Feb. 25 discussion with the author, Lyndon LaRouche said that the oligarchs were "going to sink" Morgan Chase, adding that the nature of those creatures is "to eat their own children." It remains to be seen whether a bailout or restructuring of Morgan Chase is in the works, or if the damage is so great that it will simply collapse. The plan of the oligarchs is to shove as much of the losses in the ongoing crash onto publicly owned institutions as possible, in an attempt to protect themselves. However it plays out, the collapse of Morgan Chase represents a nasty turn in this dark and deadly drama. Morgan Chase may continue to walk the Earth a little longer, but it, like the system it represents, is already dead.