'Lehman Weekend': the biggest bankruptcy in American history

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Lehman Brothers's bankruptcy was the biggest in American history

It was "Lehman Weekend." The moment in September 2008 when the 150-year-old investment bank Lehman Brothers collapsed, precipitating the worst global economic crisis since the 1930s.

After failing to find buyers for the troubled financial giant, that was weighed down by risky debt holdings made up of at subprime mortgages, US authorities declined to offer a bailout and allowed the institution to fail.

Monday, September 15, 2008, at 1:45 am, Lehman Brothers filed for bankruptcy, taking the world by surprise leaving well over $600 billion in debt, as well as 25,000 employees in shock.

It was the biggest bankruptcy in American history. On Wall Street, the Dow Jones plunged 500 points, the largest drop since the attacks of September 11, 2001. Stunned traders streaming out of the building carrying boxes of their belongings became a symbol of the crisis.

Some were caught by surprise. But others, like Lawrence McDonald, a former trader and co-author of a 2009 book on the collapse—"A Colossal Failure of Common Sense: The Incredible Inside Story of the Collapse of Lehman Brothers"—said management had long been alerted to the excessive risks they took to increase short term profits.

The top Lehman leadership, housed on the bank's 31st floor, "drove us 162 miles (261 kilometers) an hour...right into the biggest subprime iceberg ever seen," he told AFP in 2009.

"It was 24,992 people making money and eight guys losing it," he said, lamenting that the management "bet the ranch" on toxic assets.

From 2005 to 2007, at the height of the real estate bubble, when mortgages were given to many homebuyers who could not afford them, and then packaged into securities and sold off, Lehman Brothers bought several mortgage brokerages and posted record profits.

But in mid-2007, the losses began to build. The knockout punch came nine months later, March 16, 2008, with the near bankruptcy of another investment bank, Bear Stearns.

Between a rock and a hard place

Bear Stearns was on the verge of bankruptcy also because of its massive bets on subprime mortgage securities, and was bought for a pittance by JPMorgan, in a sale brokered by the Federal Reserve. The deal shakes markets, which are now betting on Lehman's demise.

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The Fed and Treasury tried to find a buyer, negotiating in vain with a South Korean bank, then with Bank of America and Barclays.

But while the government just a week earlier took over mortgage giants Fannie Mae and Freddie Mac—government-sponsored private enterprises that guarantee more than $5 trillion in home loans—in the end officials choose to abandon Lehman.

A few days later, Uncle Sam would rescue insurance giant AIG for $180 billion, before providing another $700 billion dollars in a controversial recapitalization plan to prop up banks: the Troubled Asset Relief Program (TARP) to try to shore up the teetering financial system.

Authorities found themselves between a rock and a hard place and have been widely criticized for sacrificing Lehman Brothers but saving other banks, such as Goldman Sachs.

"The thing we get the most criticism for is letting Lehman go down," said Henry Paulson, who served as Treasury secretary under then President George W. Bush and was at the helm at the start of the crisis.

"Many people say well they were able to save Bear Stearns, they were able to save AIG, why couldn't they save Lehman? We answer it and most people don't believe us," he complained to National Public Radio.

Officials concluded that Lehman was so weak, and had so little collateral, that a bailout would be simply unworkable.

Timothy Geithner, who lead the New York Fed during that time and late became Treasury secretary under President Barack Obama, said officials had very few options.

"Lehman was terribly weak even relative to the other weaker institutions in this context. The world was terrifically fragile," he told NPR.

"It was very hard to find someone strong enough in that moment of peril that was going to be capable of taking on the vast bulk of that risk."

But others, including Laurence Ball, head of the economics department at Johns Hopkins University, said in a 2016 report on Lehman that the reasons given do not add up and it was more likely there was political pressure on the Fed to allow the bank to fail.

"Another factor is that both Paulson and Fed officials, although worried about the effects of a Lehman failure, did not fully anticipate the damage that it would cause," Ball argued.

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