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Congress of the United States
House of Representatives
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To: Republican Members of the Committee on Oversight and Government Reform

From: Republican Staff, Committee on Oversight and Government Reform

Subject: Full Committee Hearing: “Bank of America and Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout?” – Part III

Hearing Date: Thursday, July 16, 2009, 10:00 a.m.

On Thursday, July 16, 2009, at 10:00 a.m., in room 2154 of the Rayburn House Office Building, the Committee will hold a hearing entitled, “Bank of America and Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout?” This is the third in a series of hearings the Committee plans to hold on this subject.

The Majority Staff Memorandum lays out background information about the hearing, which will feature just one witness, Henry M. “Hank” Paulson, Jr., former Secretary of the Treasury under President George W. Bush. This memorandum lays out the key questions to be addressed at the hearing as well as the Minority’s views about the critical issues related to this matter.

Background

On September 15, 2008, Bank of America announced its intention to merge with Merrill Lynch. However, Merrill’s condition deteriorated rapidly as the financial crisis deepened. Shortly before Thanksgiving, Merrill’s after-tax losses for the 4th quarter of 2008 had increased to over \$9 billion. However, Bank of America decided to proceed with the deal and the two companies’ shareholders voted to approve it on December 5.¹ By mid-December, however, Merrill’s after-tax losses ballooned to about \$14 billion and, on December 17, Bank of America’s CEO, Ken Lewis, called Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke, informing them of his intention to exercise a Material Adverse Change clause (“the MAC clause”) in the contract to get out of the deal.² Ultimately, however, Bank of America went ahead with the merger, which was consummated on January 1, 2009. In the end, Merrill Lynch’s 4th quarter losses exceeded \$15 billion.³

¹ See Dan Fitzpatrick, Susanne Craig and Deborah Solomon, “In Merrill Deal, U.S. Played Hardball,” *The Wall Street Journal*, (February 5, 2009).

² See document, *Analysis of Bank of America & Merrill Lynch Merger*, (December 21, 2008), Bates BOG-BAC-ML-COGR-00036 to BOG-BAC-ML-COGR-00076.

³ See letter, Andrew Cuomo, Attorney General of the State of New York, (April 23, 2009).

On April 23, 2009, New York State Attorney General Andrew Cuomo sent a letter to Members of Congress in which he alleged that Ken Lewis, under duress from the Treasury and the Federal Reserve, may have violated his fiduciary responsibility to Bank of America's shareholders in the interest of the larger U.S. financial system. These allegations were based on testimony received by Cuomo from Ken Lewis in connection with an investigation into bonuses awarded at Merrill Lynch. According to Cuomo, Paulson threatened Lewis that the government would remove Lewis and the entire board of Bank of America if Bank of America sought to pursue the MAC clause and back out of the merger with Merrill Lynch.⁴ Cuomo told Congress that Paulson made this threat at the request of Chairman Bernanke and that Paulson specifically kept the Securities and Exchange Commission in the dark about these proceedings.⁵ According to Cuomo, Ken Lewis seemed to admit that, under government pressure, he acceded to a merger with Merrill Lynch that, in the short term, was not in the best interests of his shareholders.⁶

This hearing is significant, not only because the Bank of America-Merrill Lynch merger was an important transaction in its own right, but also because it speaks to the larger context of the unprecedented government intervention in the free market started in the Bush Administration and accelerated in the Obama Administration. Messrs. Paulson, Bernanke and Geithner consistently excuse their actions by resorting to dire predictions of the chaos and doom that would have ensued in the financial markets had they not taken the actions they did. These justifications serve those who make them well by virtue of the fact that they cannot be definitively disproven. What is certain, however, is that the Bush-Obama policies of bailout and nationalization are a threat to the free market and individual liberty and, as such, merit a thorough debate in the public square.

Paulson Acknowledges Threatening Bank of America on the Fed's Behalf

In his written testimony, Mr. Paulson acknowledges that he threatened to remove the management of Bank of America if Mr. Lewis tried to back out of the merger with Merrill Lynch. While Paulson says that "Chairman Bernanke never asked me to indicate any specific action the Federal Reserve might take," he acknowledges he threatened to fire Bank of America's management at the behest of the Federal Reserve:

I was expressing what I am confident was the strong opinion of the Federal Reserve, namely, that exercise of the MAC clause was not a legally viable option...I had gained this understanding of the Federal Reserve's position over the course of meetings and several telephone calls in the preceding days. I note that what I said echoes sentiments expressed in internal Federal Reserve emails.⁷

Pursuant to the Oversight and Government Reform Committee's subpoena of internal Federal Reserve documents, staff uncovered emails which indicate that the Treasury and the Federal Reserve working together threatened to fire Lewis and the entire Bank of America board if they chose to exercise the MAC clause. For example, Jeffrey Lacker, President of the Richmond Federal Reserve, wrote this in an email to his colleagues:

Just had a long talk with Ben [Bernanke]. Says that they think the MAC threat is irrelevant because its not credible. Also intends to make it even more clear that if they play that card and they need assistance, management is gone.⁸

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ See testimony of Henry M. Paulson, (July 16, 2009).

⁸ See email, Jeffrey Lacker, Federal Reserve Bank of Richmond, (December 20, 2008), Bates BOG-BAC-ML-COGR-00020.

Bernanke's intention to convey this threat is confirmed by the minutes of Bank of America's Board meeting, which state that:

[T]he Treasury and Fed stated strongly that were the Corporation to invoke the material adverse change ("MAC") clause in the merger agreement with Merrill Lynch and fail to close the transaction, the Treasury and Fed would remove the Board and management of the Corporation.⁹

On June 11, 2009, the Committee received testimony from Lewis in which he admitted that the government's threat to fire him and his board "was a strong influence on [his] decision," not to exercise the MAC clause.¹⁰

However, when Bernanke testified before the Committee on June 25, 2009, he denied either making such a threat personally or directing someone else to do so:

TOWNS: [D]id you instruct Hank Paulson to tell Ken Lewis and [sic] he and his board would be fired if they backed out of...the Merrill deal?

BERNANKE: I did not.

BURTON: What did you tell him? You say you didn't tell him anything like that. What did you tell him?

BERNANKE: All I can say is I'm sure that I never told him to convey such a message to Ken Lewis.

JORDAN: [From] the letter that Mr. Cuomo...sent to Members of Congress, Secretary Paulson has informed us that he made the...threat dealing with the Merrill Lynch acquisition at the request of Chairman Bernanke.

BERNANKE: As I said, I did not tell Mr. Paulson to convey any threats.

BERNANKE: I did not instruct Mr. Paulson or anyone else to convey such a threat or message to Mr. Lewis.¹¹

Bernanke's testimony before the Committee contradicts what New York Attorney General Andrew Cuomo told Members of Congress in his letter, which said that "Secretary Paulson has informed us that he made the threat at the request of Chairman Bernanke."¹² After the public release of Cuomo's letter, Paulson issued two follow-up statements through a spokesman. The first said in part that "Chairman Bernanke did not instruct [me] to indicate any specific action the Fed might take."¹³ The second statement, issued hours after the first, stated: "To clarify the earlier statement, Secretary Paulson does not take exception with the Attorney General's characterization of his conversation with Ken Lewis. His prediction of what could happen to Lewis and the Board was his language, but based on what he knew to be the Fed's strong opposition to Bank of America attempting to renounce the deal."¹⁴

⁹ See minutes of the Special Meeting of Board of Directors, Bank of America Corporation, (December 22, 2008).

¹⁰ See transcript, *Bank of America and Merrill Lynch: How Did a Private Deal Turn into a Federal Bailout?* (June 11, 2009).

¹¹ See transcript, *Bank of America and Merrill Lynch: How Did a Private Deal Turn into a Federal Bailout? Part II*, (June 25, 2009).

¹² See note 3, *supra*.

¹³ See Heidi N. Moore, "Paulson: 'Creating More Questions Than It Answered,'" *The Wall Street Journal*, (April 24, 2009), available at <http://blogs.wsj.com/deals/2009/04/24/paulson-creating-more-questions-than-it-answered/>.

¹⁴ *Id.*

Ranking Member Darrell Issa sent letters requesting additional documents to both Attorney General Cuomo and the U.S. Treasury Department in an attempt to obtain more information about the statements and actions of various government officials.¹⁵ However, as of the writing of this memorandum, neither has responded. In addition, while staff for the Democrat Majority indicated it would seek additional documents from Treasury, no request has been forthcoming. It is important, therefore, for the Committee to take this opportunity to question Mr. Paulson about what exactly he said or was told to say to both Ken Lewis and Attorney General Cuomo.

Paulson's Dire Predictions: "A Little Over the Top?"

In his written testimony, Mr. Paulson makes the following dire assertion:

An attempt by Bank of America to break its contract to acquire Merrill Lynch would have threatened the stability of our entire financial system and the viability of both Bank of America and Merrill Lynch.¹⁶

He goes on to say that:

There was not sufficient TARP capacity to respond to the financial chaos that would have been triggered by Bank of America's invocation of the MAC clause.¹⁷

And in retrospect, Mr. Paulson is "confident that our responses were substantially correct and...saved this nation from great peril."¹⁸

Despite Mr. Paulson's certainty of his own actions, and the grave consequences they averted, not everyone in the Treasury and Federal Reserve shared his morose outlook at the time. A Federal Reserve Bank of New York employee, for example, questioned the government's contention that a withdrawal from the Merrill Lynch merger would be disastrous for financial markets, Bank of America and its shareholders. In response to an email containing draft "talking points" for the government's discussions with Bank of America, the New York Fed's Adam Ashcraft expressed his view that the statement, "A collapse of the merger will have dire consequences for Merrill Lynch, and will likely have a severe adverse effect on Bank of America as well," was "a little over the top."¹⁹ He went on to say:

I think [sic] equally possible that the market looks at Merrill's 2008 [fourth quarter losses] and sees [Bank of America] making a smart move by walking away from a Black Hole into which large amounts of time, effort, and money would have been going. In other words, it is not clear that the market reaction to [Bank of America] is so clearly negative. It might be, but a little more balance here might be worthwhile.²⁰

¹⁵ See letter, Darrell E. Issa to Andrew M. Cuomo, (July 1, 2009). See also letter, Darrell E. Issa to Timothy Geithner, (July 2, 2009).

¹⁶ See note 7, *supra*.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ See email, Adam B. Ashcraft, Federal Reserve Bank of New York, (December 21, 2008), Bates BOG-BAC-ML-COGR-000120.

²⁰ *Id.*

Perhaps even more revealing is the fact that John Dugan, head of the Office of the Comptroller of the Currency and one of Bank of America's direct regulators, did not share the dim view of Messrs. Paulson and Bernanke with regard to Bank of America's supposedly dilapidated financial state. In an email, Arthur Angulo of the Federal Reserve Bank of New York wrote that:

Dugan pushed back re: our view of the severity of the problems facing [Bank of America] (not clear whether the push back was [Bank of America]-specific or w[ith] r[egard] t[o] the implications for other large firms...or both).²¹

It is worth asking Mr. Paulson to clarify his understanding of Mr. Dugan's reservations as it may shed further light on the accuracy of the appeals to catastrophe upon which Messrs. Paulson and Bernanke rely in attempting to justify their response to the financial crisis.

Mr. Paulson's contention that there was not enough TARP money to prop up Merrill Lynch in the event that Bank of America withdrew from the merger also bears scrutiny. While Mr. Paulson is correct that Congress appropriated a finite amount of TARP money, the Federal Reserve's off-balance sheet support to swathes of the financial system belies any compunction on the part of Messrs. Paulson and Bernanke to do what was needed to keep any institution from failing. This is made even clearer by internal Fed documents. In response to an inquiry from the United Kingdom's Financial Services Authority one day prior to the shareholder vote on the merger, a senior Federal Reserve Bank of Richmond employee wrote:

We have had recent discussions with [Bank of America] and [Merrill Lynch] management who contend that they have the required shareholder support and are confident that the transaction will be approved with tomorrow [sic] vote. If approval is withheld, [Merrill Lynch] would continue to have access to the various facilities and programs currently in place in the US. Additionally, it is reasonable to expect that [Merrill Lynch] would be provided support necessary to preclude significant systemic disruption.²²

The government's commitment to prop up Merrill Lynch even if Bank of America successfully backed out of the deal is revealed by the Fed's contingency planning to provide additional backing to the troubled investment bank once Lewis raised the prospect of a MAC. In a document entitled "Contingency Actions re MER Should BAC Refuse to Consummate Acquisition," the Federal Reserve said:

In the event that [Bank of America] were to abruptly announce that it does not intend to consummate its acquisition of [Merrill Lynch] on January 1, 2009, [Merrill Lynch] would face an immediate run. Emergency liquidity provision actions that could be taken to provide some time for the sale/disposition of [Merrill Lynch] businesses and assets include the following...²³

The document goes on to list options including an expansion of Merrill's access to Federal Reserve lending and an emergency conversion to a bank holding company, which would give Merrill access to additional federal backing, including FDIC deposit guarantees.²⁴

²¹ See email, Arthur Angulo, Federal Reserve Bank of New York, (December 29, 2008), Bates BOG-BAC-ML-COGR-000129.

²² See email, Jennifer Burns, Federal Reserve Bank of Richmond, (December 4, 2008), Bates BOG-BAC-ML-COGR-000116.

²³ See document, "Contingency Actions re MER Should BAC Refuse to Consummate Acquisition," attached to an email, Arthur Angulo, Federal Reserve Bank of New York, (December 21, 2008), Bates BOG-BAC-ML-COGR-000123.

²⁴ *Id.*

The Fed and Treasury Seek to Control the Disclosure of Merrill's Losses

Bernanke, Paulson and Lewis have all taken great pains to deny that the government pressured Bank of America or Merrill Lynch to violate federal securities laws by not disclosing material information to their shareholders. While none of the documents reviewed by Committee staff at the Federal Reserve show that government officials explicitly instructed Bank of America employees to not disclose the dramatically accelerating losses at Merrill Lynch, internal emails reveal at least the intent to influence disclosure decisions.

Although both Bernanke and Paulson gave verbal assurances to Ken Lewis and Bank of America of additional taxpayer capital injections and asset guarantees, the government refused to put this verbal guarantee into writing in an effort to manage public disclosure. In an email, Jeffrey Lacker of the Federal Reserve Bank of Richmond said:

Spoke with [Bernanke] and he confirmed [Lewis's] appeal for a letter committing to future support, which was denied. His sense is that [Lewis] is just generally anxious about the merger, not trying to shake anyone down."²⁵

In an email to David McCormick of the Treasury Department, Federal Reserve Governor Kevin Warsh said:

[I] told [Joe [Price, Bank of America's Chief Financial Officer]] that we were not yet in a position to proffer a package [of additional taxpayer support], but we were working towards something that works for them and us – not in anyone's interest to leave [Bank of America] out there in the eyes of [the] market weaker than possible.²⁶

Bernanke and Paulson insisted that Lewis rely solely on their verbal assurance of more support because, as Paulson told Lewis, a written pledge “would be a disclosable event and we do not want a disclosable event.”²⁷

Bernanke and Paulson were concerned that disclosure of the government's commitment to provide additional support to Bank of America would expose Merrill's mounting losses and prompt a run on both banks. Therefore, while the government never instructed Ken Lewis to violate the law by not disclosing Merrill's losses to his shareholders, the government also went to great lengths to avoid creating a “disclosable event” in the first place. Thus the government's actions helped to ensure that information about Merrill's mounting losses was not revealed to Bank of America's shareholders or the American people.

Nevertheless, some Fed employees naturally expected that, given the severity of the losses at Merrill Lynch, Bank of America's management may be required to report those losses to its shareholders. In an email, Kevin Stiroh of the New York Fed asked:

How confident are we that we have until [the Bank of America earnings announcement on] 1/20? Given the increase in [Merrill Lynch's] losses and [the] difference from expectations, there might be pressure for a pre-announcement to investors and analysts. Has this been discussed and ruled out by the companies? The concern about drawing attention to [Bank of America] is fair, but the upside is for the [U.S. Government] to be ahead of the curve and not appear so reactive.²⁸

²⁵ See email, Jeffrey Lacker, Federal Reserve Bank of Richmond, (December 23, 2008), Bates BOG-BAC-ML-COGR-000128.

²⁶ See email, Kevin Warsh, Federal Reserve Board of Governors, (December 30, 2008).

²⁷ See testimony to the New York State Attorney General, Kenneth Lewis, (February 26, 2009).

Another email from Federal Reserve Bank of New York employee Arthur Angulo to New York Fed General Counsel Thomas Baxter also demonstrates the government's concern to control the flow of information to the public. In this email, Mr. Angulo says he will call Merrill Lynch's Chief Financial Officer Nelson Chai:

I'll ask about: [Merrill Lynch's] current estimate of [4th Quarter] loss[es] v[ersus] market expectations and whether and when [Merrill Lynch] intends to file an 8-K. **If I get a sense that [Merrill Lynch] is leaning toward an early January filing, I'll try to steer him toward a later filing. If I get a sense that [Merrill Lynch] is committed to an early January filing, I'll ask for a follow-up discussion with appropriate securities counsel at [Merrill Lynch] to gain a better sense as to the amount of flexibility [Merrill Lynch] has in this regard** [emphasis added].²⁹

This attempt to manage the disclosure situation was mooted when it became clear that Merrill Lynch had intended all along to defer responsibility to publicly disclose its mounting losses to Bank of America, as demonstrated in the following email from Merrill's Chief Financial Officer to Merrill CEO John Thain:

Had a call with art angelo [sic] at fed, had a quick discussion on where we are quarter to date. His hope is that there is no disclosure prior to [Bank of America] quarterly announcement. We told him this was the current plan. He asked [sic] this course changes [sic] and we planned on issuing an 8k on [Merrill Lynch] stand alone to alert him.³⁰

While Merrill's existing public disclosure plan happened to conform to the government's wishes, this does not alter the fact that some within the Federal Reserve clearly intended to control the timing of public disclosure.

The Fed and Treasury Keep Other Regulators in the Dark

The Federal Reserve and the Treasury apparently sought to control the disclosure of information about the Bank of America-Merrill Lynch merger to other government regulators as well, including the Securities and Exchange Commission ("SEC") and the Office of the Comptroller of the Currency.

In his letter to Congress, New York Attorney General Andrew Cuomo said:

Notably, during Bank of America's important communications with federal banking officials in late December 2008, the lone federal agency charged with protecting investor interests, the Securities and Exchange Commission, appears to have been kept in the dark. Indeed, **Secretary Paulson informed this Office that he did not keep the SEC Chairman in the loop during the discussions and negotiations with Bank of America in December 2008** [emphasis added].³¹

The Federal Reserve joined Treasury in keeping the SEC in the dark. This has been confirmed by internal Fed emails subpoenaed by the Committee. It was not until January 11, 2009, three weeks after Ken Lewis was forced to abandon the notion of pulling a MAC clause, that the SEC finally got wind of what had

²⁸ See email, Kevin Stiroh, Federal Reserve Bank of New York, (December 28, 2008), Bates BOG-BAC-ML-COGR000217.

²⁹ See email, Arthur Angulo, Federal Reserve Bank of New York, (December 22, 2008), Bates BOG-BAC-ML-COGR-000127.

³⁰ See email, Nelson Chai, Merrill Lynch, (December 22, 2008), Bates HOC-DPS-00002097.

³¹ See note 3, *supra*.

transpired and the following exchange took place between an employee of the Federal Reserve Bank of New York and Scott Alvarez, General Counsel of the Federal Reserve Board in Washington:

Have we conveyed anything to the SEC re the [Bank of America] situation? I [received] an e-mail and follow up [voicemail] from [an SEC employee] on Friday evening...Based on his [voicemail], he knows something is up...I intend to give him the broad outlines, but before doing so I wanted to check to [see] how much (if anything) has been shared with the SEC...³²

The reply came about 30 minutes later:

I have not discussed this with the SEC. [Bank of America] has complained that someone did talk to the SEC, with the result that the SEC called late last week to say they heard [Bank of America] was negotiation [sic] a Citi type deal with the [U.S. Government] and to ask [Bank of America] to explain the unexpectedly high losses at [Merrill Lynch]...So I agree you should give him the broad and tentative outlines.³³

Even the Office of the Comptroller of the Currency (“OCC”), Bank of America’s direct regulator, was kept in the dark by Federal Reserve employees when it came to the Fed’s negotiations with Ken Lewis over the MAC clause. In one exchange, Fed employees refer to an upcoming conference call in which they express their interest in withholding Bank of America’s negotiations with the government over the MAC:

Given the presence of the OCC on the call, I think we should not discuss or reference the call with Ken Lewis and Paulson.³⁴

The reply came:

Agree. Also not the MAC discussion.³⁵

Not only did Paulson and Bernanke deliberately keep the SEC and OCC in the dark about events at Bank of America and Merrill Lynch, they also failed to raise the issue at two consecutive meetings of the Financial Stability Oversight Board (“FSOB”), which Congress established to bring oversight to TARP. According to minutes of the FSOB meetings, it was not until January 15, 2009, that Paulson and Bernanke informed the FSOB of the government’s plans for additional bailouts of Bank of America in connection with the Merrill Lynch merger.³⁶ It is telling that despite Paulson’s claim that failing to force the merger would have had a catastrophic effect on *financial stability*, he decided it wasn’t worth revealing to the *Financial Stability Oversight Board*.

Timothy Geithner’s Role in Government Intervention Remains Non-Transparent

While Paulson and Bernanke appear to have been the principal actors in interventionist government policies during the waning days of the Bush Administration, the seamless transition from the Bush Administration to

³² See email, Arthur Angulo, Federal Reserve Bank of New York, (January 11, 2009), Bates BOG-BAC-ML-COGR000254.

³³ See email, Scott Alvarez, Federal Reserve Board of Governors, (January 11, 2009), Bates BOG-BAC-ML-COGR000254.

³⁴ See email, Brian Peters, Federal Reserve Bank of New York, (December 19, 2008), Bates BOG-BAC-ML-COGR000308.

³⁵ See email, Jennifer Burns, Federal Reserve Bank of Richmond, (December 19, 2008), Bates BOG-BAC-ML-COGR000308.

³⁶ See Minutes of the Financial Stability Oversight Board Meeting, (December 19, 2008; January 8, 2009; January 15, 2009), available at <http://www.financialstability.gov/about/oversight.html>.

the Obama Administration leads one to question the role that Treasury Secretary Timothy Geithner played as well.

We know that Geithner was in the room at the infamous October 13 meeting at which Paulson forced nine banks to take \$125 billion in TARP money, according to the “talking points” obtained by Judicial Watch, Inc. under a Freedom of Information Act (“FOIA”) request.³⁷ However, the Treasury Department redacted multiple versions of Paulson’s “talking points” in draft. Among the redacted drafts that remain hidden from public disclosure is a version containing Geithner’s “suggested changes.”³⁸ Ranking Member Darrell Issa sent a letter to the Treasury Department requesting these documents but, as of the drafting of this memorandum, Treasury has not responded.³⁹

Geithner was also fully briefed and involved in the Bank of America-Merrill Lynch discussions in mid-December. According to Secretary Paulson’s personal schedule obtained by the Committee, after his conversation with Ken Lewis about the MAC on December 19, 2008, the first person Paulson called was Geithner.⁴⁰

10:25 AM	10:30 AM	Call to FED Chairman Bernanke
10:30 AM	10:35 AM	Call from FED Chairman Bernanke
10:35 AM	11:20 AM	
11:40 AM	11:55 AM	NR
1:25 PM	1:30 PM	Call from FED Chairman Bernanke
1:30 PM	1:35 PM	NR
1:35 PM	1:40 PM	Call to John Thain, Merrill Lynch, left word
1:40 PM	2:00 PM	Call to FED Chairman Bernanke
2:00 PM	2:40 PM	
2:40 PM	2:55 PM	Call to Ken Lewis, Bank of America
2:55 PM	3:05 PM	Call to Tim Geithner
3:10 PM	3:15 PM	Meeting with Jeremiah Norton, Bob Hoyt, Jim Lambright, Kevin, Michele, Dave McCormick, Secretary's Office
3:15 PM	3:30 PM	Call from FED Chairman Bernanke
3:30 PM	4:05 PM	Conference Call, Secretary's Office
4:05 PM	4:10 PM	Call to John Thain, Merrill Lynch
4:10 PM	4:15 PM	Call to Ken Lewis, Bank of America

An email Geithner sent the following day – December 20 – appears to chronicle this conversation with Paulson. It reads in part:

BofA/ML [i.e., Bank of America/Merrill Lynch]. Can't MAC. Have to close.⁴¹

On that same day, Geithner emailed Federal Reserve Governor Kevin Warsh to ask him:

Are you all over [Bank of America/Merrill Lynch] and are you getting what you need from the troops?⁴²

Warsh responded that, in his opinion:

[the] [b]igger issue is Treas[ury] – who is undermanned and less than crisp in their views.⁴³

³⁷ See <http://www.judicialwatch.org/news/2009/may/judicial-watch-forces-release-bank-bailout-documents>.

³⁸ See <http://www.judicialwatch.org/files/documents/2009/TreasuryDocsPart3.pdf> at 36.

³⁹ See note 15, *supra*.

⁴⁰ See document provided to the Committee.

⁴¹ See email, Timothy Geithner, Federal Reserve Bank of New York, (December 20, 2008), Bates BOG-BAC-ML-COGR000309.

⁴² See email, Timothy Geithner, Federal Reserve Bank of New York, (December 20, 2008), Bates BOG-BAC-ML-COGR000310.

⁴³ See email, Kevin Warsh, Federal Reserve Board of Governors, (December 20, 2008), Bates BOG-BAC-ML-COGR000310.

Not only do these exchanges make it clear that Geithner was fully briefed and engaged in the Bank of America-Merrill Lynch merger issue, they also speak to the Federal Reserve's view of itself as in the driver's seat when it came to the government's response to Ken Lewis's desire to pull the MAC clause. Furthermore, this adds credence to the theory that Bernanke led the effort to threaten to fire Lewis.

Documents previously released by Bank of America also attest to Geithner's involvement in the government's efforts to pressure Bank of America to go through with the Merrill Lynch merger. In handwritten notes, Bank of America's Chief Financial Officer, Joe Price, chronicled a conversation between Ken Lewis and Henry Paulson regarding Lewis's desire to pull the MAC clause. The notes include the comments: "**Fire BOD if you do it – irresp[onsible] for country. Tim G. agrees [emphasis added].**"⁴⁴

Hank Paulson's Bait-and-Switch Approach to TARP

Many economists argue that the Federal Reserve under the leadership of Alan Greenspan and Ben Bernanke kept interest rates too low for too long after the recession of 2001, fueling a massive asset bubble in housing.⁴⁵ Added to this were government "affordable housing" policies which pushed the government-sponsored enterprises, Fannie Mae and Freddie Mac, to support a boom in risky and unsustainable subprime mortgages.⁴⁶ The collapse of this bubble was the catalyst for the financial crisis. Given the role of government policies in creating the conditions for the housing bubble which caused the financial crisis, it is remarkable that the prescription of the Bush Administration and now the Obama Administration and the Democratic Congress has been more government intervention in the economy.

According to one of Mr. Paulson's top aides at the Bush Treasury, Paulson "truly meant" to use the \$700 billion Troubled Asset Relief Program ("TARP") the way he had told Congress he would – to purchase "troubled" assets from financial institutions.⁴⁷ Having convinced Congress of the urgency of buying up "troubled" assets from banks, however, Paulson came to believe the TARP funds provided by Congress were insufficient to buy enough "troubled" assets to make a difference. As a result, Paulson decided to take equity stakes in financial institutions instead.⁴⁸

Paulson's bait-and-switch approach was met with approval by House Democrats such as Nancy Pelosi and Barney Frank, who convened a group of economists and advisors on October 13, 2008, to endorse the Bush Administration's new approach. According to liberal economist Jared Bernstein, now Vice President Biden's chief economic adviser, the meeting's "consensus was so strong towards direct equity injections that there was literally no dissension on the point...[t]he only head-scratching is why did it take us so long to get here?"⁴⁹ In so doing, Paulson partially nationalized the U.S. banking system, despite his own misgivings that having "the government involved in ownership of banks," was a "fundamentally bad idea."⁵⁰

⁴⁴ See notes, Joe Price, Bank of America, (December 21, 2008), Bates HOC-DPS-00002107.

⁴⁵ See John B. Taylor, *Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*, Stanford, CA: Hoover Institution Press, (2009).

⁴⁶ See staff report, Committee on Oversight and Government Republicans, (forthcoming).

⁴⁷ See David Wessel, "Paulson Expected Criticism for Changing Course on TARP," *The Wall Street Journal*, (April 2, 2009), available at <http://online.wsj.com/article/SB123867380519382149.html>.

⁴⁸ *Id.*

⁴⁹ See Deborah Solomon, Damian Paletta, Michael M. Phillips, and Jon Hilsenrath, "U.S. to Buy Stakes in Nation's Largest Banks," *The Wall Street Journal*, (October 14, 2008), available at <http://online.wsj.com/article/SB122390023840728367.html>.

⁵⁰ See note 47, *supra*.

October 13, 2008: Force-feeding Taxpayer Money to Banks

On October 13, 2008, Paulson summoned the top executives of the nation's nine largest banks to a meeting at the Treasury Department.⁵¹ Bernanke was present at the meeting along with Federal Reserve Bank of New York President Timothy Geithner and Federal Deposit Insurance Corporation Chairman Sheila Bair. According to government documents obtained by the group Judicial Watch, media reports, and Ken Lewis' testimony at the June 11 hearing, these government officials forced the nine banks to take TARP money appropriated by Congress whether they wanted it or not.⁵² In exchange, the Treasury received preferred shares and warrants in the banks, giving the government substantial ownership stakes.

The Bush Administration ultimately used TARP money to buy stakes in over 500 U.S. banks. It did not stop with a partial nationalization of the banking sector, however. The Bush Administration also committed to spend up to \$200 billion to bail out Fannie Mae and Freddie Mac and used TARP money to purchase an 80% stake in AIG for \$40 billion and began the process of nationalizing GM and Chrysler with a \$20 billion down payment.⁵³

President Obama Accelerates the Bush Administration's Statist Policies

The Obama Administration has not missed a stride. Indeed, it has wholeheartedly endorsed and accelerated the Bush Administration's interventions in the economy. President Obama has fully nationalized GM and Chrysler with an additional \$48 billion in taxpayer assistance, passed a \$787 billion "stimulus" bill based on outdated and discredited Keynesian economic theory, doubled taxpayers' exposure to Fannie and Freddie to \$400 billion, and proposed a \$3.6 trillion federal budget including a nationalized health care system and a national energy tax on carbon emissions.⁵⁴

A letter obtained by *The New York Times* makes it clear that the Obama Administration even plans to take a page out of Mr. Paulson's playbook in continuing the government's heavy-handed manipulation of the private sector. Treasury Secretary Geithner demanded that the top 25 mortgage servicing companies appear in Washington for a meeting on July 28.⁵⁵ The purpose of this meeting is to pressure mortgage servicers to "devote substantially more resources" to the Administration's "Making Home Affordable" program, under which the government subsidizes servicers to modify mortgages, despite the fact that doing so may not be in the financial interests of the companies.⁵⁶ According to the letter, the Obama Administration plans to "begin publicly reporting results under the program," presumably to use the threat of public shaming to force recalcitrant companies to comply with the Administration's wishes.⁵⁷ In other words, the Administration seeks to use its power to compel behavior in private sector actors which may not otherwise be in their economic interest.

Facilitating the modification of mortgages in an attempt to stem the tide of foreclosures may in fact be a worthwhile policy objective. However, the Obama Administration has yet to show that it sees any limit to its ability to exercise government power to coerce private individuals and companies into pursuing the

⁵¹ The banks were: Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Merrill Lynch, Morgan Stanley, State Street, and Wells Fargo.

⁵² See note 37, *supra*.

⁵³ See U.S. Treasury Department Office of Financial Stability, "Troubled Asset Relief Program Transaction Report," (July 6, 2009), available at http://www.financialstability.gov/docs/transaction-reports/transactions-report_070609.pdf.

⁵⁴ *Id.*

⁵⁵ See Joe Nocera, "From Treasury to Banks, an Ultimatum on Mortgage Relief," *The New York Times*, (July 10, 2009), available at <http://www.nytimes.com/2009/07/11/business/11nocera.html>.

⁵⁶ See letter from Timothy F. Geithner and Shaun Donovan to unknown recipient [name redacted], (date unknown), available at <http://graphics8.nytimes.com/packages/pdf/serviceletter.pdf>.

⁵⁷ *Id.*

Administration's priorities. This is a troubling trend begun in the Bush Administration and now continued and accelerated in the Obama Administration. This lack of respect for the rule of law and limited government bodes ill for free markets and individual liberty in the United States. It is an approach perhaps best summed up by *The New York Times*' description of the Obama Administration's strong-arm approach to the mortgage servicing companies: "a good swift kick in the rear."⁵⁸

Some have questioned the need for using these hearings on the Bank of America-Merrill Lynch merger to reopen an inquiry into the government's actions in intervening strongly in the U.S. economy. It is tempting to join those who are content to revel in the passing of the darkest days of the financial crisis, to live in the moment and not worry too much about tomorrow. This perspective, however, is short-sighted. Economic freedom is a necessary condition for political freedom, and a government circumscribed in what actions it may take in the name of averting the crisis of the moment is essential to the maintenance of a free market and a free people. It is a threat to the foundations of our free society when government officials, acting in the midst of a crisis, use dire predictions of imminent disaster to justify their encroachment on our individual liberty and the rule of law. It is essential, therefore, for the American people and their elected representatives to use the opportunity of these hearings to take the long view and ask, what are the limits a free people demand on their government officials in a time of crisis? As the Obama Administration and the Congress consider sweeping changes to the financial regulatory system which touches the lives of every American, we must take care that the final outcome respects the rule of law and the principle that ends do not justify the means, even in a crisis.

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⁵⁸ See note 55, *supra*.