

**BANK OF AMERICA AND MERRILL LYNCH: HOW  
DID A PRIVATE DEAL TURN INTO A FEDERAL  
BAILOUT? PART III**

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**JOINT HEARING**

BEFORE THE

**COMMITTEE ON OVERSIGHT  
AND GOVERNMENT REFORM**

AND THE

**SUBCOMMITTEE ON DOMESTIC POLICY  
OF THE**

**COMMITTEE ON OVERSIGHT  
AND GOVERNMENT REFORM**

**HOUSE OF REPRESENTATIVES**

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## **BANK OF AMERICA AND MERRILL LYNCH: HOW DID A PRIVATE DEAL TURN INTO A FEDERAL BAILOUT? PART III**

THURSDAY, JULY 16, 2009

HOUSE OF REPRESENTATIVES, COMMITTEE ON OVERSIGHT  
AND GOVERNMENT REFORM, JOINT WITH THE SUB-  
COMMITTEE ON DOMESTIC POLICY,

*Washington, DC.*

The committee and subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the full committee) presiding.

Present: Representatives Towns, Kanjorski, Cummings, Kucinich, Tierney, Clay, Watson, Lynch, Connolly, Quigley, Kaptur, Kennedy, Cuellar, Hodes, Welch, Foster, Speier, Issa, Burton, McHugh, Mica, Souder, Turner, McHenry, Bilbray, Jordan, Flake, Fortenberry, Chaffetz, and Schock.

Also present: Representatives Stearns and Garrett.

Staff present: John Arlington, chief counsel—investigations; Jaron R. Bourke, subcommittee staff director; Brian Eiler, investigative counsel; Linda Good, deputy chief clerk; Jean Gosa, clerk; Adam Hodge, deputy press secretary; Carla Hultberg, chief clerk; Marc Johnson and Ophelia Rivas, assistant clerks; Mike McCarthy, deputy staff director; Jesse McCollum, senior advisor; Jenny Rosenberg, director of communications; Joanne Royce and Christopher Staszak, senior investigative counsels; Christopher Sanders, professional staff member; Shrita Sterlin, deputy director of communications; Ron Stroman, staff director; Charisma Williams, staff assistant; Alex Wolf, professional staff; Lawrence Brady, minority staff director; John Cuaderes, minority deputy staff director; Jennifer Safavian, minority chief counsel for oversight and investigations; Frederick Hill, minority director of communications; Dan Blankenburg, minority director of outreach and senior advisor; Adam Fromm, minority chief clerk and Member liaison; Kurt Bardella, minority press secretary; Seamus Kraft and Benjamin Cole, minority deputy press secretaries; Christopher Hixon, minority senior counsel; Brien Beattie and Mark Marin, minority professional staff members; Katy Rother, minority staff assistant; and Sharon Casey, minority executive assistant.

Chairman TOWNS. The committee will come to order. Good morning and thank you all for being here.

Today we are continuing our investigation of Bank of America's acquisition of Merrill Lynch. When we held our first hearing on this merger, I called it a shotgun wedding. Now it looks like a mar-

riage of convenience. Ken Lewis got what he wanted, and the Treasury and the Fed got what they wanted. All of this happened against the backdrop of unchecked government power, with no transparency or accountability.

Ken Lewis appears to have manipulated the unaccountable system to his benefit. He started this all in motion when he made the first phone call to Mr. Paulson. He got the government involved. He got the Treasury to cough up \$20 billion of taxpayers' money to help finance his merger. He never had to disclose \$12 billion in Merrill Lynch losses to investors until it was over. He never had to ask the shareholders to reconsider the transaction.

In the end, Mr. Lewis got everything he wanted. Mr. Paulson and Mr. Bernanke also got what they wanted out of this marriage. They got an uninterrupted merger that they believed helped to stabilize the market. The problem was, while all of this was going on, the American people, investors, and the Congress were kept in the dark. There was no oversight to determine whether this arrangement made sense. In my view, this is unacceptable and must be prevented from happening in the future.

That being said, significant issues need to be resolved today.

Was Bank of America really forced to go through with the deal, or was this just an old-fashioned Brooklyn shakedown? Did Lewis threaten to back out of the deal in order to squeeze more money out of Federal Government? If Mr. Paulson believed that Ken Lewis had demonstrated a colossal lack of judgment, why did he and Mr. Bernanke leave Lewis in charge of Bank of America?

Did government officials tell Ken Lewis to keep quiet about the escalating losses at Merrill Lynch and the government's commitment to provide billions in Federal funding?

Did Congress make a mistake in conferring broad authority on the Fed and Treasury in October 2008, when the TARP fund program was created?

Should Congress have required more accountability, transparency, and checks and balances in the operation of the TARP funds?

Perhaps Mr. Paulson will help us shed some further light on this transaction and help us to answer these questions. I look forward to his testimony this morning.

I now yield 5 minutes to our ranking member of the full committee, Mr. Darrell Issa, for his opening statement.

[The prepared statement of Hon. Edolphus Towns follows:]

**HOUSE COMMITTEE ON  
OVERSIGHT & GOVERNMENT REFORM**

**OPENING STATEMENT OF  
CHAIRMAN EDOLPHUS TOWNS**

**Hearing: "Bank of America and Merrill Lynch: How Did  
a Private Deal Turn Into a Federal Bailout?" (Part 3)**

**July 16, 2009**

Good morning and thank you for being here.

Today we are continuing our investigation of Bank of America's acquisition of Merrill Lynch.

When we held our first hearing on this merger, I called it a shotgun wedding. Now, it looks like a marriage of convenience. Ken Lewis got what he wanted, and the Treasury and Fed got what they wanted. All of this happened against a backdrop of unchecked government power, with no transparency or accountability.

Ken Lewis appears to have manipulated this unaccountable system to his benefit.

He started this bailout in motion when he made the first phone call to Mr. Paulson that got the government involved. He got the Treasury to cough up 20 billion dollars of taxpayer money to help finance his merger. He never had to disclose \$12 billion in Merrill Lynch losses to investors until it was over. He never had to ask the shareholders to reconsider the transaction. In the end, Mr. Lewis got everything he wanted.

Mr. Paulson and Mr. Bernanke also got what they wanted out of this marriage. They got an uninterrupted merger that they believed helped to stabilize the market.

The problem is that while all of this was going on, the American people, investors, and the Congress were kept in the dark. There was no oversight to determine whether this arrangement made sense. In my view, this is unacceptable and must be prevented from happening again.

That being said, significant issues need to be resolved today.

Was Bank of America really forced to go through with the deal, or was this just an old fashioned shakedown?

Did Ken Lewis threaten to back out of the deal in order to squeeze more money out of the Federal government?

If Mr. Paulson believed that Ken Lewis had demonstrated a "colossal lack of judgment", why did he and Mr. Bernanke leave Lewis in charge of Bank of America?

Did government officials tell Ken Lewis to keep quiet about the escalating losses at Merrill Lynch and the government's commitment to provide billions in Federal funding?

Did Congress make a mistake in conferring broad authority on the Fed and Treasury in October 2008 when the TARP fund program was created?

Should Congress have required more accountability, transparency, and checks and balances in the operation of the TARP fund?

Perhaps Mr. Paulson will help us shed some further light on this transaction and these questions.

I look forward to his testimony this morning.

**###**

Mr. ISSA. Thank you, Mr. Chairman, and thank you for being a full partner in this process.

Mr. Chairman, I would ask unanimous consent that the gentleman from Florida, Mr. Stearns, and the gentleman from New Jersey, Mr. Garrett, be allowed to sit in on the panel pursuant to our rules and ask questions at the end of all other questioners.

Mr. Chairman, after reading former Secretary Paulson's testimony, it is clear that most of the basic facts related to this event in December of last year are no longer in question. Secretary Paulson has confirmed that he did tell Bank of America CEO Ken Lewis that if the Bank of America exercised the MAC clause and later needed assistance, then management would or could, depending on how you look at it, be fired. This is not in debate. As a matter of fact, the candor and clarity that the Secretary is bringing to us today is refreshing and helpful.

The fact that the Secretary does not believe it is inappropriate perhaps we should look at in light of the times. Just as revisionists have rewritten what we were doing after 2001 to protect the homeland, we are already beginning to question whether in fact means used at the disposal of the Fed and the Treasury and the FDIC were inappropriate or appropriate now that, of course, a global financial meltdown has been averted.

I think in fairness, just like in the cold war, had the Soviets come over the Czech border, we would have had to come as we are and bring what we had. What we had at the beginning of this crisis was in fact a Secretary of the Treasury relatively new on the job, a Fed chairman relatively new on the job, all of whom were being told, "here is what is happening on a daily basis, do something about it."

They came to us with a plan, a plan that I voted against, a plan to buy toxic assets for some \$700 billion. But when they went back and started looking at how to execute after receiving it, it became clear that it was more complex, it was more nuanced, that the needs were not necessarily for toxic asset purchases and it might not be in the taxpayers' best interests.

So although there will be some things that I approve of and some things I disapprove of, I think today, Mr. Chairman, we have to consider with this last witness the situation that existed at that time, one in which the President had lobbied heavily for moneys but without anyone having a book written on how you get through these times.

Wall Street perhaps would say that the end justifies the means; we have in fact been saved. Here in Washington we are Monday morning quarterbacks. Monday morning quarterbacks say, in fact, if we have to play again next Sunday, how do we do better? What can we learn from what happened on the gridiron on Sunday?

Mr. Chairman, that is our job here today. We have to ask some serious questions and use an expert witness as part of the process. We have to ask what would he do differently if he had it to do over again. He may or may not be able to answer it.

What should we do in order to glean the causes, the events, the solutions, and in fact what regulatory changes will be necessary or at least considered if we are to be prepared to either not have it happen again or, as the chairman said, provide the transparency,

accountability, predictability, and rule of law the next time that may have been lacking in this once-in-a-century event?

So, Mr. Chairman, on a bipartisan basis, I am thrilled that we are bringing to a close this three-part hearing process, because I believe it is helpful and will continue to be helpful not just as oversight but as a partner in the necessary reform.

Mr. Chairman, I might take note that just yesterday, on the House side at least, all of the commissioners for the 9/11-style financial commission that you and I worked on together were named. That is a beginning of what could be up to an 18-month process in which I believe both of us and all the members of our committee will be working together to ensure that our reforms fit future possible challenges.

I thank the chairman and yield back.

[The prepared statement of Hon. Darrell E. Issa follows:]

EDOLPHUS TOWNS, NEW YORK  
CHAIRMAN

DARRELL E. ISSA, CALIFORNIA  
RANKING MINORITY MEMBER

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**Opening Statement of Ranking Member Darrell Issa**  
**Joint Full Committee and Domestic Policy Subcommittee hearing on “Bank of America and**  
**Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout? Part III.”**  
**July 16, 2009**

Mr. Chairman, thank you for calling today’s hearing.

I appreciate Mr. Paulson’s appearance before the Committee today at our third hearing on the role of the federal government in the Bank of America – Merrill Lynch transaction.

Through the Committee’s investigation, we have learned that the federal government, led by Mr. Bernanke and Mr. Paulson, threatened to fire Ken Lewis and Bank of America’s Board of Directors if they exercised their legal right to attempt to back out of their agreement to acquire Merrill Lynch. It is clear from Mr. Lewis’s testimony before the Committee that he felt he was threatened, and this sentiment is confirmed by the minutes of Bank of America’s board meetings.

In his written testimony, Mr. Paulson confirms Mr. Lewis’s accounts of their conversations. While Mr. Paulson says that Chairman Bernanke never explicitly directed him to convey the threat, Mr. Paulson points to a consensus between Treasury and Federal Reserve officials that the government would simply not allow Bank of America to attempt to back out of the agreement. Mr. Paulson specifically cites an email from Jeffrey Lacker, President of the Richmond Fed, which shows that Mr. Bernanke intended to convey the threat to Mr. Lewis, as evidence of the Federal Reserve’s agreement with Paulson’s approach.

It is incredible that while Mr. Paulson cites this e-mail as indicative of the government’s consensus, when Mr. Bernanke was asked about it before this Committee he claimed, “I don’t recall what exactly was said,” and “I don’t know if I did or not.”

The inappropriate behavior of government officials did not start or end with the threat to fire Ken Lewis and Bank of America’s board of directors.

We have also learned that, subsequent to the transaction, the federal government refused to provide a written statement committing to provide Bank of America taxpayer money, despite private assurances that taxpayer dollars were coming. As Mr. Paulson told Mr. Lewis, a written pledge “would be a disclosable event and we do not want a disclosable event.” The government’s attempt to manipulate disclosure did not stop there. Government officials tried to “steer” the timing of Merrill Lynch’s disclosure as well. These efforts were all in an attempt to hide information about the financial condition of both banks from the public.

Internal e-mails and documents obtained by the Committee also indicate that Treasury and the Federal Reserve deliberately kept other regulators, including the SEC and the OCC, in the dark regarding Treasury and Fed negotiations with Bank of America over the MAC and additional taxpayer assistance. In addition, Mr. Paulson and Mr. Bernanke failed to raise these issues at two consecutive meetings of the Financial Stability Oversight Board, which Congress established to bring oversight to TARP. It is telling that despite Mr. 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*.

Mr. Paulson claims that an attempt by Bank of America to back out of the deal would have "threatened the stability of our entire financial system." Similar talking points for the government's discussions with Bank of America at the time of the discussions were dismissed by one New York Fed official as "a little over the top."

Mr. Bernanke also attempted to justify his actions with the convenient but unsupported assertion that forcing the deal to go through averted financial Armageddon. In fact, internal Federal Reserve documents show that the government had a backup plan to bail out Merrill Lynch directly in the event that the deal fell through. Instead, by forcing the deal to go through, Treasury and the Federal Reserve spread any systemic risk to Bank of America, its shareholders, and its depositors, which required a taxpayer bailout later anyway.

The Obama Administration has also used the excuse of a financial crisis to wholeheartedly endorse and accelerate the Bush Administration's economic interventions. President Obama has fully nationalized GM and Chrysler, secured 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. The slope of the Bush Administration's abandonment of free market principles has proven to be slippery indeed.

Mr. Chairman, these hearings are not only important to ascertain the facts, hold government officials accountable, and understand if Congress has been told the truth about what has transpired, but also because we must understand the limits of government's power in the next crisis. As the Congress examines the Obama Administration's plans and proposals to expand government regulatory power and bureaucracy across the financial sector, it is important that the debate is informed by the lessons we are learning about the federal government's abuses of power in response to the current crisis.

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 the Congress to take the long view and ask, what are the limits a free people demand on their government in a time of crisis?

Thank you again, Mr. Chairman, for calling this hearing.

Chairman TOWNS. Thank you very much, Congressman Issa from California.

This hearing is being conducted jointly with the Domestic Policy Subcommittee. I now yield 5 minutes for an opening statement to the chairman of that subcommittee, Congressman Kucinich from Ohio.

Mr. KUCINICH. Thank you very much, Mr. Chairman.

I don't think the question facing us today, with all due respect to my friend from California, is whether or not this is a moment for Monday morning quarterbacks. The question is whether taxpayers should have purchased the Bank of America franchise.

With Mr. Paulson's testimony today, it is an undisputed fact that then Secretary Paulson told Bank of America's Ken Lewis that the government might remove him and his board of directors if Bank of America abandoned its deal to acquire Merrill Lynch. It requires a judgment call to decide if Secretary Paulson was being justifiably tough in response to Bank of America's consideration of invoking the material adverse change clause in its merger contract, an arguably unwise but lawful action which he viewed as a potential threat to the financial system at a moment of crisis.

But nothing in Secretary Paulson's testimony today justifies the government's decision to ignore evidence that Bank of America withheld information from its shareholders about mounting losses at Merrill Lynch before the crucial shareholder vote on December 5th, a potentially illegal act. I have seen no justification for the government to override recommendations of professional staff at the Fed and the president of a regional Federal Reserve Bank for greater accountability of Bank of America's top executives. Yet, sadly, that is precisely what Mr. Paulson and Mr. Bernanke did.

This committee's investigation and two previous hearings have revealed that the government had concluded that Mr. Lewis's management of Bank of America was seriously deficient and possibly in legal jeopardy. Top staff at the Fed and Treasury had determined that Mr. Lewis knew about accelerating losses at Merrill Lynch before the shareholder vote to ratify the merger, but he did not provide that information to shareholders.

The top lawyer at the Fed had determined that Mr. Lewis and his management team were possibly in violation of securities laws for withholding material information from shareholders.

Top professional staff at the Fed had determined that Mr. Lewis and his management team had failed to do due diligence in acquiring Merrill Lynch and were not up to the task of identifying and solving the problems in which they found themselves in late 2008.

Top staff at the Fed and even the president of a regional Federal Reserve Bank were pressing for a number of new requirements on Bank of America as conditions of any Federal bailout in order to remedy the deficient management they perceived.

If you will look at the screen, you will see the supporting documents our investigation has revealed. In an e-mail from a senior adviser at the Federal Reserve to Chairman Bernanke, "There are clear signs in the data we have that the deterioration at Merrill Lynch has been observably under way over the entire quarter, albeit picking up significantly around mid-November."

The next slide, please.

From a restricted Federal Reserve analysis of Bank of America-Merrill Lynch merger, “BAC management’s contention that the severity of MER’s losses only came to light is problematic and implies substantial deficiency in the diligence carried out in advance of and subsequent to the acquisition. These were clearly shown in Merrill Lynch’s internal risk management reports that BAC reviewed during their due diligence.”

Next slide, please.

“The potential for losses and other risk exposures cited by management, including those coming from leveraged loans and the trading and complex structured credit derivatives products, that is called correlation trading, should also have been reasonably well understood, particularly as BAC itself is also active in both these products.”

Next slide, please.

From an e-mail from the Fed’s general counsel to Chairman Bernanke: “Lewis should have been aware of the problems at ML”—Merrill Lynch—“earlier, as early as mid-November and not caught by surprise. That could cause other problems for him around the disclosures Bank of America made for the shareholder vote.”

Next slide, please.

From another e-mail from the Fed’s general counsel to Chairman Bernanke: “A different question that doesn’t seem to be the one Lewis is focused on is related to disclosure. Management may be exposed if it doesn’t properly disclose information that is material to investors. His potential liability here will be whether he knew or reasonably should have known the magnitude of the Merrill Lynch losses when Bank of America made its disclosures to get the shareholder vote on a Merrill Lynch deal in early December.”

Next slide, please.

From talking points prepared by top staff at the Fed Reserve: “Bank of America should expect to be required to more intrusive review and involvement by the U.S. Government in the selection of management of Bank of America, including the board of directors.”

And the final slide.

From an e-mail from Eric Rosengren, president of the Boston Federal Reserve Bank, to Chairman Bernanke: “Going forward, I am concerned if we too quickly move to a ring-fenced strategy, particularly if we believe that existing management is a significant source of the problem and they do not have a good grasp of the extent of their problems and appropriate strategies to resolve them. I think it is instructive to look at the example of the Royal Bank of Scotland. The U.K. replaced senior management. I would not want to discard this option prematurely.”

In spite of the evidence and recommendations from top staff, Secretary Paulson and Chairman Bernanke bailed out the merger of Bank of America and Merrill Lynch without requiring replacement of Bank of America’s top management or board of directors or imposing any meaningful new requirements on Bank of America’s management.

Not every national government, faced with troubled, systemically significant banks, behaved the same way. The U.K. dismissed top corporate management at Royal Bank of Scotland upon rescuing

the company, without impairing the bank's ability to operate. Even in the United States, General Motors' top executive was pushed aside as a condition of Federal support. But in the United States, the management of systemically significant banks, such as Bank of America, not only kept their jobs, they received billions in taxpayer dollars to help plug the holes in their balance sheets.

Secretary Paulson regards the government's intervention in financial markets as successful. Certainly TARP and the Fed's many new lending facilities aid systemically significant banks and have bought time for those banks. But the lasting contribution—

Chairman TOWNS. Will the gentleman summarize?

Mr. KUCINICH. I will summarize right now.

The lasting contribution of this committee's investigation will be exposing Treasury and the Fed's failure to require meaningful accountability from systemically significant banks in exchange for Federal bailout. Not a single CEO of a systemically significant bank was removed from his job by government action for a misdeed or mistake. Nor has a single CEO of a systemically significant bank fully explained his role in creating the circumstances of the financial crisis. The biggest, most powerful bankers have essentially received a free ride at taxpayers' expense.

In conclusion, in choosing to bail out Bank of America without also removing its top management for their failure to do due diligence and for withholding potentially material information from shareholders prior to the merger ratification vote, the government sent a signal to the management of all systemically significant banks that their mistakes and misdeeds will be treated differently and more gently by regulators than those committed by managers of mid-sized and small-sized banks. Over the coming months and years, it will prove to be a dangerously destabilizing signal that we will deeply regret.

I yield back.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

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**Opening Statement**

**Dennis J. Kucinich**

**Chairman, Domestic Policy Subcommittee**

**Joint Full Committee-Subcommittee Hearing on the  
Government's rescue of the  
Bank of America-Merrill Lynch merger**

**July 16, 2009**

With Mr. Paulson's testimony today, it is an undisputed fact that then-Secretary Paulson told Bank of America's Ken Lewis that the Government might remove him and his Board of Directors if Bank of America abandoned its deal to acquire Merrill Lynch. It requires a judgment call to decide if Mr. Paulson was being justifiably tough in response to Bank of America's consideration of invoking the material adverse change clause in its merger contract,

an arguably unwise but lawful action, which he viewed as a potential threat to the financial system at a moment of crisis.

But nothing in Mr. Paulson's testimony today justifies the Government's decision to ignore evidence that Bank of America withheld information from its shareholders about mounting losses at Merrill Lynch before the crucial shareholder vote on December 5 -- a potentially illegal act. I have seen no justification for the Government to override recommendations of professional staff at the Fed and the President of a regional Federal Reserve Bank for greater accountability of Bank of America's top executives.

Yet that is precisely what Mr. Paulson and Mr. Bernanke did.

This Committee's investigation and two previous hearings have revealed that the Government had concluded that Mr. Lewis's management of Bank of America was seriously deficient and possibly in legal jeopardy. Top staff at the

Fed and Treasury had determined that Mr. Lewis knew about accelerating losses at Merrill Lynch before the shareholder vote to ratify the merger, but he did not provide that information to shareholders. The top lawyer at the Fed had determined that Mr. Lewis and his management team were possibly in violation of securities laws for withholding material information from shareholders. Top professional staff at the Fed had determined that Mr. Lewis and his management team had failed to do due diligence in acquiring Merrill Lynch and were not up to the task of identifying and solving the problems in which they found themselves in late 2008. Top staff at the Fed and even the President of a regional Federal Reserve Bank were pressing for a number of new requirements on Bank of America as conditions of any federal bailout in order to remedy the deficient management they perceived. Nevertheless, Mr. Paulson and Chairman Bernanke bailed out the merger of Bank of America and Merrill Lynch without requiring replacement of Bank of America's top management or Board of Directors or imposing any meaningful new requirements on Bank of America's management.

Not every national government, faced with troubled systemically significant banks, behaved the same way. The UK dismissed top corporate management at Royal Bank of Scotland upon rescuing the company, without impairing the bank's ability to operate. Even in the U.S., General Motors's top executive was pushed aside as a condition of federal support. But, in the United States, the management of systemically significant banks such as Bank of America not only kept their jobs, they received billions in taxpayer dollars to help plug the holes in their balance sheets.

Mr. Paulson regards the Government's interventions in financial markets as successful. Certainly, TARP and the Fed's many new lending facilities aid systemically significant banks and have bought time for those banks. But the lasting contribution of this Committee's investigation will be exposing Treasury's and the Fed's failure to require meaningful accountability from systemically significant banks in exchange for federal bailout. Not a single CEO of a systemically significant

bank was removed from his job by government action for a misdeed or mistake. Nor has a single CEO of a systematically significant bank fully explained his role in creating the circumstances of financial crisis. The biggest, most powerful bankers have essentially received a free ride at taxpayers' expense.

In choosing to bailout Bank of America without also removing its top management for their failure to do due diligence and for withholding potentially material information from shareholders prior to the merger ratification vote, the government sent a signal to the management of all systemically significant banks that their mistakes and misdeeds will be treated differently and more gently by regulators than those committed by managers of mid-sized and small banks. Over the coming months and years it will prove to be a dangerously destabilizing signal that we will deeply regret.

Mr. ISSA. Mr. Chairman, as a point of order, on this side at least we have not received any of the documents that were displayed. Could we get copies of each of those put on the board, please?

Chairman TOWNS. I will be delighted to do so, without objection.

I now yield to the gentleman from Ohio, who is the ranking member of the Domestic Policy Subcommittee, Mr. Jordan.

Mr. JORDAN. Thank you, Mr. Chairman.

Let me thank you, Chairman Kucinich, Ranking Member Issa, for working with me and others to get this series of hearings here in front of the committee.

I would also like to thank Secretary Paulson for coming before the committee today, and I think we all look forward to his testimony in the few hours we are going to get to spend here with him.

The fall of 2008 was a watershed time for our economy. Our economic challenges were felt the most by the millions of Americans who lost jobs, saw savings shrink and their credit tightened. Unfortunately, the approach taken by the Federal Government I believe is dangerous and I think many Americans would argue has not helped.

Federal bailouts and Federal stimulus packages are transforming our free market economy into a political economy. The Federal Government now selects the winners and the losers. The current issue before this committee is merely a symptom of the ever-increasing reach of the Federal Government into the everyday affairs of American businesses and American families.

Should anyone be surprised by the way the Federal Government has administered the bailout program? With a trillion dollars at their disposal, little guidance and oversight, we have seen Treasury and the Federal Reserve behave in a way that can only be described as unprecedented.

The evidence is clear. The Federal Government has used threats, intimidation, and I believe deception to impose growing command and control over our economy, with the increasing nationalization of everything from banks to car companies, runaway Federal spending and deficits, higher taxes, government takeovers of energy and, potentially, health care, all while the economy is deteriorating even further and more American jobs are being lost.

The American people are saying, enough is enough; and the American people want answers.

I look forward to hearing from Mr. Paulson about his role in these dealings and would yield back the balance of my time, Mr. Chairman.

Chairman TOWNS. Thank you very much for your statement.

We turn now to our witness, Henry M. Paulson. Mr. Paulson served as the Secretary of the Treasury from 2006 to 2009, January 2009. He previously served as the chairman and CEO of Goldman Sachs.

It is committee policy, Mr. Paulson, that we swear our witnesses in. Will you please stand and raise your right hand.

[Witness sworn.]

Chairman TOWNS. Let the record reflect he answered in the affirmative. You may be seated.

So, Mr. Paulson, you may begin.

**STATEMENT OF HENRY M. PAULSON, FORMER SECRETARY OF  
THE TREASURY**

Mr. PAULSON. OK. Chairman Towns, Ranking Member Issa and distinguished members of the committee, I served as Secretary of the Treasury from July 2006, to January 2009. During my tenure, the world experienced a financial crisis unprecedented in our lifetimes. The crisis presented a relentless series of novel challenges that required swift, innovative, and dramatic responses.

Had the crisis of 2008 been left to unfold without strong Federal reaction and intervention, the world of 2009 would look very different from the world we live in today. Many more Americans would be without their homes, their jobs, their businesses, their savings, their way of life.

The crisis of confidence last fall threatened to disrupt our entire financial system, not just the institutions that had high credit losses on their mortgage investments but all financial firms, whether weak or solvent. As liquidity dried up, the continued collapse of financial institutions that provide credit and handle payments would have meant in short order that firms across industries, not just Wall Street but every street, would have seen a massive curtailment of access to financing needed to purchase supplies and pay employees.

Missed payrolls would have quickly turned into even more millions of layoffs, and this in turn would have meant an even greater retreat of consumer spending. It would have been extremely difficult to break the momentum of this downward spiral.

Now that the financial system is stabilized, we can and should take the time to learn the lessons of the past. In the midst of a rapidly changing crisis, our responses were not perfect, but I am confident that they were substantially correct and that they saved this Nation from great peril.

This hearing is about Bank of America, and in my prepared testimony I lay out the series of events surrounding its acquisition of Merrill Lynch. There are three issues that are appropriate to address at the outset of this hearing.

First, some have opined that I and other government officials allowed concerns about systemic risk to outweigh concerns about potential harm to Bank of America and its shareholders. That simply did not happen. In my view and the view of numerous government officials working on the matter, the interests of the Nation and Bank of America were aligned with respect to a closing of the Merrill Lynch transaction.

Second, some have suggested that there was something inappropriate about my conversation of December 21st with Mr. Lewis in which I mentioned the possibility that the Federal Reserve could remove management and the board of Bank of America if the bank invoked the MAC clause. I believe it was appropriate for me to explain to Mr. Lewis that the government was supportive of Bank of America and that it felt very strongly that if Bank of America exercised the MAC clause that would show a colossal loss of judgment and would jeopardize Bank of America, Merrill Lynch, and the financial system.

It was also appropriate for me to remind him that, under such circumstances, the Federal Reserve could invoke its authority to re-

move management and the board of Bank of America. I intended my message to reinforce the strong view that had been expressed by the Fed and which was shared by the Treasury that it would be unthinkable that Bank of America take this destructive action.

Third, the suggestion has been made that I discouraged Mr. Lewis from making required disclosures to the public markets about losses at Merrill Lynch. That simply did not happen, and Mr. Lewis has denied it unambiguously in testimony before this committee.

I would like to conclude with what is most prominent in my recollection of the events of last fall. What I recall most vividly is a Nation faced with a threat of an unparalleled economic crisis and the efforts of the men and women from both the public and private sectors who worked hard to steer our Nation away from that precipice. It was my privilege to work with them, and I am proud of what we have accomplished.

Thank you, Mr. Chairman. I would be very happy to answer your questions.

[The prepared statement of Mr. Paulson follows:]

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**10:00 a.m.**  
**July 16, 2009**

**Testimony by Henry M. Paulson**  
**Before the House Committee on**  
**Oversight and Government Reform**  
**July 16, 2009, 10:00 a.m.**

Chairman Towns, Ranking Member Issa, and distinguished Members of the Committee.

I served as Secretary of the Treasury from July 2006 to January 2009. During my tenure, the world experienced a financial crisis unprecedented in our lifetimes. The crisis presented a relentless series of novel challenges that required swift, innovative, and dramatic responses. I am proud to have been among the many public servants—in the Congress and at Treasury, the Federal Reserve, the FDIC, the OCC, and other agencies of the government—who came together to confront these challenges and to prevent a far more damaging meltdown of our financial system.

Had the crisis of 2008 been left to unfold without strong federal reaction and intervention, the world of 2009 would look very different from the world we live in today. Many more Americans would be without their homes, their jobs, their businesses, their savings, and their way of life. Although commentary on the crisis often focuses on events at financial institutions, the human suffering of the crisis has been staggering in ways that are beyond measure. Unemployment reached historic levels. Savings were depleted. Americans lost trillions of dollars in home value, and many lost their homes. Yet without the actions taken in 2008, that suffering would have been far more profound and disturbing.

Our financial system underpins our modern economy; commerce today requires a string of payments, whether that string of payments is for delivering a gallon of milk from farm to consumer or for delivering a new product from idea to production. And that string of payments depends on trust. Our financial system works because consumers and investors have confidence in the strength of financial institutions.

Last fall, that confidence was largely gone, especially among those who lend to financial institutions by purchasing their debt. The crisis of confidence threatened to disrupt our entire financial system—not just the institutions that had high credit losses on their mortgage investments, but all financial firms, whether weak or solvent, would have suffered as widespread fear prevented investors from lending to any financial institution. As liquidity dried up, the continued collapse of financial institutions that provide credit and handle payments for our economy would have meant that firms across industries—not just Wall Street, but every street—would have seen a massive curtailment of their access to liquidity and thus their ability to purchase supplies and pay employees. Missed payrolls would quickly have turned into even more millions of layoffs, and this in turn would have meant an even greater retreat of consumer spending than we have witnessed since last September. It would have been extremely difficult to break the momentum of this downward spiral.

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Fortunately, the most dire of consequences were averted. I am proud that, along with many others, I brought what experience, talent, and efforts I could to right our nation's course.

Now that the financial system has stabilized, many, including this Committee, have begun to look back to analyze the efficacy of our responses to the crisis as it unfolded. Learning the lessons of the past is a necessary and important step as we forge our way forward. The complexity of the crisis and the multifaceted character of the solutions, coupled with the short time in which decisions had to be made, will all require careful consideration and analysis to help the current Administration and future generations understand and confront issues of economic crisis. Our responses were not perfect, and, even when our actions proved effective, Congress and many in the private sector played a significant role. But, having had the benefit of some time to reflect, and to consider views expressed by others, I am confident that our responses were substantially correct and that they saved this nation from great peril.

One component of our response, which I have been invited to discuss today, was the assistance that the Federal Government provided to Bank of America in January of this year in a transaction that surely prevented destabilization of our financial system.

\* \* \*

During his testimony before this Committee, Ken Lewis, the CEO of Bank of America, set forth the relevant events, which I will reiterate briefly. On September 15, 2008, Bank of America entered into an agreement to acquire Merrill Lynch. On November 26, 2008, the Board of Governors of the Federal Reserve approved the merger. The shareholders of both firms ratified the merger agreement on December 5, 2008.

On December 17, 2008, Mr. Lewis called me and told me that Bank of America was considering exercising the "material adverse change"—or MAC—clause to terminate the Merrill Lynch acquisition. I recognized the danger that the potential dispute arising from invocation of the MAC clause would pose for Bank of America, for Merrill Lynch, and for the economy as a whole, and that evening, at my request, Mr. Lewis met with Chairman Bernanke, me, and other Federal Reserve and Treasury officials to discuss the matter. Mr. Lewis explained that Bank of America's concerns related to Merrill Lynch's accelerating fourth quarter loss projections and the effect they would have on the combined entity.

Late December of 2008 was a period of great vulnerability for our markets and our economy. In December our economy hit a low point. Bank earnings were particularly weak and our financial markets and institutions were fragile. 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.

In the few days following Mr. Lewis's call to me, officials from the Federal Reserve and Treasury conferred among themselves and with Bank of America representatives

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regarding these issues. My participation in that process consisted of conversations with people from the Federal Reserve, including several with Chairman Bernanke, and with Treasury personnel. During this period, the clear conclusion of Federal Reserve lawyers was that exercise of the MAC clause was not a legally reasonable option and, accordingly, that the merger contract was binding. Moreover, all public officials involved, including Mr. Bernanke and me, believed that the failure to consummate the merger would likely create immediate financial market instability, would threaten the viability of both firms, and would call into serious question the judgment of Bank of America's leadership.

On December 21, 2008, I relayed the substance of those conclusions to Mr. Lewis. My conversation with Mr. Lewis, which has been the subject of much subsequent commentary, was accurately recounted in Mr. Lewis's testimony before this Committee, and I will discuss it again in a moment.

On December 22, 2008, we learned that Bank of America's board had determined not to exercise the MAC clause, and that Bank of America intended to work with the Federal Reserve and Treasury to obtain government financial support for the combined entity once the merger was closed. Although Bank of America did not, at that time, have any firm agreement with the government, its decision was reached against the backdrop of a clear public commitment undertaken by Chairman Bernanke and me, dating back at least to October 14, 2008, that the government would act to prevent the failure of any systemically important financial institution. I had reiterated that commitment often in the months preceding Bank of America's decision to forgo any attempt to invoke the MAC clause. Given that commitment, it was clear that if the merger proceeded and the combined Bank of America Merrill Lynch entity needed financial support, the government would work to provide such appropriate and necessary support.

On January 1, 2009, the Bank of America Merrill Lynch merger was completed as planned. Over the following weeks, representatives of Bank of America worked closely with officials from the Federal Reserve, Treasury, and the FDIC to arrange an appropriate support package. On January 16, 2009, Treasury, the Federal Reserve, and the FDIC announced an agreement to provide Bank of America with \$20 billion in TARP funds, as well as FDIC protection against losses on certain assets, in exchange for preferred stock, restrictions on executive compensation, and other covenants.

\* \* \*

Subsequent analysis of these events has raised three issues that should be addressed at the outset of this hearing.

First, some have opined that government officials involved in examining the Bank of America Merrill Lynch merger—myself included—allowed concerns about systemic risk to our nation's financial system to outweigh concerns about potential harm to Bank of America and its shareholders. That simply did not happen. In my view, and the view of the numerous government officials working on the matter, the interests of the nation and

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Bank of America were aligned with respect to the closing of the Merrill Lynch transaction. 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. Those who participated in the discussions concerning this matter recognize this point. For example, as Mr. Lewis explained to this Committee last month, “I think they thought that by us—by all of this happening [i.e., the potential failure of the merger], and the uncertainty coming back into the financial system, that, in fact, that would hurt the system and us.”<sup>1</sup>

I agree with that general sentiment. Also, although I did not see the document at the time, I agree with the detailed analysis conducted by Bank of America’s regulator, the Federal Reserve, which concluded that the failure of the merger would have caused significant disruption to the interbank and credit markets which would have rippled out to financial institutions broadly and Bank of America specifically.<sup>2</sup> In his testimony on June 25th before this Committee, Chairman Bernanke said it succinctly: “. . . I expressed concern that invoking the MAC would entail significant risks not only for the financial system as a whole, but also for Bank of America itself.”<sup>3</sup>

Moreover, based on my own experience working in financial markets, I knew that the attempt to revoke the merger contract would have caused great uncertainty and fear in the market, would likely have caused the markets to question Bank of America’s financial strength and managerial competence, and would have led to rating downgrades, weakened liquidity, possible failure and, of course, regulatory action. In short, Bank of America’s completion of the merger, and the subsequent assistance from the government, not only protected our country’s financial system, but also was in the best interest of the shareholders, customers, employees, and creditors of Bank of America and Merrill Lynch. Or, as Mr. Lewis put it, “there was serious risk to declaring a material adverse change and . . . proceeding with the transaction with governmental support was the better course. This course made sense for Bank of America and its shareholders, and it made sense for the stability of the markets.”<sup>4</sup>

Second, some have suggested that there was something inappropriate about my conversation of December 21st with Mr. Lewis in which I mentioned the possibility that the Federal Reserve could remove management and the board of Bank of America if the bank invoked the MAC clause. I believe my remarks to Mr. Lewis were appropriate. I explained to him that the government was supportive of Bank of America, but that it felt very strongly that if Bank of America exercised the MAC clause, such an action would show a colossal lack of judgment and would jeopardize Bank of America, Merrill Lynch, and the financial system. I further explained to him that, under such circumstances, the

<sup>1</sup> Testimony of Kenneth Lewis, Committee on Oversight and Governance Reform, June 11, 2009 (“Lewis Testimony”).

<sup>2</sup> Analysis of Bank of America & Merrill Lynch Merger, December 21, 2008, at BOG-BAC-ML-COGR-00039.

<sup>3</sup> Testimony of Ben Bernanke, Committee on Oversight and Governance Reform, June 25, 2009 (“Bernanke Testimony”).

<sup>4</sup> Lewis Testimony.

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Federal Reserve could exercise its authority to remove management and the board of Bank of America. By referring to the Federal Reserve's supervisory powers, I intended to deliver a strong message reinforcing the view that had been consistently expressed by the Federal Reserve, as Bank of America's regulator, and shared by the Treasury, that it would be unthinkable for Bank of America to take this destructive action for which there was no reasonable legal basis and which would show a lack of judgment.

I want to make clear that my words in speaking to Mr. Lewis were my own. Chairman Bernanke never asked me to indicate any specific action the Federal Reserve might take. I also want to make clear, however, that 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; that it threatened significant harm to Bank of America and to the financial system; and that it would raise serious questions about the competence and judgment of Bank of America's management and board. 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, including the sentiment attributed to Chairman Bernanke in a December 20, 2008 email from Jeffrey Lacker, in which Chairman Bernanke is said to have remarked the he "intend[ed] to make it even more clear that if [Bank of America] plays that card [invokes the MAC clause] and then need[s] assistance, management is gone."<sup>5</sup> Chairman Bernanke, when he appeared before this committee in June, put it this way: ". . . I don't think it's unreasonable if someone makes a decision that endangers his company, that he'd be accountable for that."<sup>6</sup>

The sentiment makes sense to me. The management and board of a regulated entity that triggered such destabilization within their own institution could be subject to removal by the Federal Reserve under federal statute,<sup>7</sup> and should be. Mr. Lewis, in his testimony, acknowledged this authority held by the Federal Reserve. And, Chairman Bernanke also recognized this in his June 25th testimony before this Committee when he said, "the supervisors at the Federal Reserve can make changes or recommend changes in management . . ."<sup>8</sup> I hasten to add that I do not believe the circumstances ever brought us close to that eventuality, and Bank of America, after its own detailed consideration, acted appropriately in deciding not to invoke the MAC clause.

Third, the suggestion has been made that I discouraged Mr. Lewis from making required disclosures to the public markets about losses at Merrill Lynch. That simply did not happen—and Mr. Lewis has accordingly denied it unequivocally in testimony before this Committee. Mr. Lewis said, "[n]either Secretary Paulson nor the chairman of the Federal Reserve, Mr. Bernanke, ever told me not to disclose something that we publicly—that we felt should be publicly disclosed."<sup>9</sup> And, he further stated that, "[d]uring all of that time

<sup>5</sup> E-mail from J. Lacker, Dec. 20, 2008, BOG-BAC-ML-COGR-00020.

<sup>6</sup> Bernanke Testimony.

<sup>7</sup> See, e.g., 12 U.S.C. § 1818(e).

<sup>8</sup> Bernanke Testimony.

<sup>9</sup> Lewis Testimony.

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there was never, ever a time that the Federal Reserve or the Treasury Department told me that we should not disclose something that we thought would be a disclosable event.”<sup>10</sup>

As Mr. Lewis recounted, he did request a letter from me confirming government support, and I declined to provide it. In doing so, I told him that a letter would be vague and unsatisfactory because no program had yet been developed. For example, we had not determined the size of the potential program, the type of equity it would use, or which assets it would involve. I also told him that if Treasury provided a letter, then Treasury would publicly disclose it. I did not—nor to my knowledge did anyone at the Federal Reserve or Treasury—tell Mr. Lewis not to disclose any information to the public markets, including Merrill Lynch losses, that Bank of America believed it was legally required to disclose.

\* \* \*

Although attention has recently focused on brief moments of stress during the events of December 2008, those moments are not foremost in my recollection. What I recall most vividly is a nation faced with the threat of an unparalleled economic crisis and the efforts of the men and women from both the public and private sectors who worked hard to steer our country away from that precipice. It was my privilege to work with them, and I am proud of what we accomplished.

The programs we put in place at the height of the turmoil continue to provide critical support to our financial markets. As the markets stabilize and begin to recover, we are now entering a critical phase of reforming our regulatory system so a crisis like this never happens again. There are many parts of our fragmented regulatory system that must be reformed, reshaped, and reconstituted, so that lines of authority are clear, regulators can make decisions, and no institution can exploit seams in the system. Among the most important steps we must take is the creation of a resolution authority so that large, interconnected institutions can fail without a systemic impact. I began calling for such authority last summer, and I applaud the recent proposal to that effect put forward by President Obama. Had the government had such authority in early 2008, three of the important events that rattled markets—Bear Stearns, Lehman Brothers, and AIG—could have been handled very differently, with far less impact on the stability of our financial system and our economy.

I urge all of you to move quickly and thoughtfully to build a regulatory framework that gives government the appropriate authorities to intervene and facilitate the orderly wind down of a systemically important institution, and to make the other reforms necessary to create a coherent, flexible regulatory structure. I urge you to build a structure where regulators have clear accountability for market stability, institutional safety and soundness, and consumer and investor protection. And I urge you to build a structure that can meet those objectives even as innovation constantly brings new products and new business models into the market. Dynamic markets, and a flexible regulatory

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<sup>10</sup> *Id.*

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framework that provides clear guidance to all participants, are vital to our economic recovery and to the restoration of American prosperity.

Thank you, and I would be happy to answer any questions.

Chairman TOWNS. Thank you very much, Mr. Paulson.

We will begin with the question period. Each Member in turn will have 5 minutes, of course; and I will begin.

As you can see with the document up on the screen, Mr. Lewis of Bank of America claimed under oath to Attorney General Cuomo's office that he would have renegotiated the deal if you didn't tell him he could not do so. A lawyer says to Mr. Lewis, "you can always renegotiate." Mr. Lewis says, "not when you are told you cannot do it." Mr. Lewis is asked, "would you have tried to renegotiate the price if you weren't told not to do it by Mr. Paulson?" Mr. Lewis's answer to that is "yes."

Is it true then, Mr. Paulson, that you told Mr. Lewis he could not renegotiate the Merrill deal?

Mr. PAULSON. It wasn't quite that direct or specific, but I can be very clear that we viewed the invocation of a MAC clause, whether it was to renegotiate or just get out of the merger, as being very risky. The markets were driven by fear and uncertainty, and invocation of a MAC clause, whether it was ultimately going to be resolved by the courts or be resolved by renegotiation in a shareholder vote, would lead to an extended and difficult process, and the fact still remained that we viewed the MAC clause as being an illegally binding contract.

Chairman TOWNS. Was that a yes?

Mr. PAULSON. That is what I said. I said that we viewed—I viewed and I know the Fed viewed—that the invocation of a MAC clause would be a serious mistake. It would be a colossal lack of judgment if he invoked the MAC clause, whether it was to renegotiate or whether to go through the courts.

Chairman TOWNS. I am still trying to find out whether that was a yes or a no?

Mr. PAULSON. Well—

Chairman TOWNS. "Maybe" is not allowed.

Mr. PAULSON. Did I order him directly? It wasn't that direct. But I did say I thought invoking the MAC clause would be a colossal lack of judgment. There was no sound legal basis for it, and the distinction between invoking the MAC clause to renegotiate or go to the courts was one that for all practical purposes was not a significant one.

Chairman TOWNS. Let me say, if he had invoked the MAC clause, wouldn't that be a colossal lack of judgment on his part, and wouldn't this have jeopardized his own bank and the American economy if he had exercised the MAC?

Mr. PAULSON. Yes. Yes, Mr. Chairman. It was the view of very experienced Federal Reserve lawyers that there wasn't a sound legal basis, and it is my understanding that there is no instance where a Delaware court has let a company use a MAC clause to get out of a merger.

This particular MAC clause even had a carve-out which carved out changes due to market conditions.

Chairman TOWNS. My concern is, if you had those concerns, why didn't you just fire him?

Mr. PAULSON. Well, I would say this. Remember, Mr. Lewis did not invoke the MAC clause. He did not do something that showed a colossal lack of judgment. Mr. Lewis was considering this and his

board was considering this and they decided to fulfill their contract and acquire Merrill Lynch.

Chairman TOWNS. You know, it seems to me that if he had this lack of judgment, how could you give him \$20 billion? It seemed to me you would have just forced his hand at that point in time and pushed him out.

Mr. PAULSON. Mr. Chairman, I am making a distinction between an action that he might have taken which he didn't take. If he had taken an action that showed a lack of judgment, I think then the regulator would have been irresponsible if the regulator didn't push him out. But he did not take that action, and they fulfilled their contract, and they acquired Merrill Lynch.

Chairman TOWNS. I am running out of time here. Did you call Mr. Lewis or did he call you in reference to this deal?

Mr. PAULSON. In which of these calls?

Chairman TOWNS. Is it true that Mr. Lewis called you in December 2008, and asked the government to get involved in the Merrill Lynch deal, or did you call him?

Mr. PAULSON. No, the first time we heard of this was a call from Lewis. So on December 17th, I heard from a member of my staff that he would be calling, and then I got a call from him, and he said that he and his board were concerned to learn of the extent of Merrill losses which he had become aware of very recently.

Chairman TOWNS. My time has expired, but let me just ask you this before we go on. Is it true that Bank of America first brought up the bailout? Did they bring up the bailout to you, or did you bring up the bailout to them?

Mr. PAULSON. Bank of America came to us with their concerns about their losses and their concerns about going ahead with the acquisition. And in terms of the bailout, I am not—I prefer to use the word “rescue.” But whatever word we use, that this came out of discussions, because we had very much—at least I think we had—an alignment of interests. Because my concern was the American people, and I took a look at the losses that I heard coming—

Chairman TOWNS. Pull the mic a little closer to you.

Mr. PAULSON. I am sorry.

So, as I said, the rescue came out of discussions; and I believe it was the view of the government that the Fed and Treasury—that when these announcements were announced, that they would truly shake the market were it not for some form of government support being in place. So we felt that we needed that in place in order to keep the system intact.

Chairman TOWNS. Let me just say we will continue to go on a second round.

I yield to the Congressman from California, the ranking member, Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman.

Mr. Paulson, with our previous two testimony witnesses, obviously, Chairman Bernanke found himself in an odd situation of saying, although Mr. Cuomo had said that the threat that you had said—and I will quote it as best I can from his letter—Secretary Paulson has informed us that he made the threat at the request of Chairman Bernanke.

That came from Cuomo's office. I apologize that his work was a little sloppy. We get a letter, but there is no transcript, there is no written records, so we have to take his interpretation of your statements, and that is one of the reasons you are here today.

We also dealt with Ken Lewis, who came here with a situation in which he had received a threat by your own statements and yet he had to say that the threat was not the reason that he went through with the bad deal. For if he had said that, then the Ohio pension funds and others that have sued saying that the merger diminished their asset value in Bank of America would have in fact had their lawsuit go forward much more readily.

So each of you before you have been in an odd situation. You are uniquely positioned to help us. One, you have told us, yes, you did issue the threat. Two, you believed that it was reasonable.

I want to put it in perspective just for a moment, perhaps for historical purposes, and go back to the first Gulf war in 1990 in which Margaret Thatcher said to President George Herbert Walker Bush, "don't go wobbling on me, George," when she felt that he was not prepared to pursue a war against Saddam after he invaded and brutally treated the people of Kuwait.

This was not a war, but this was an emergency situation. Your threat is admitted. Your threat was because you felt that there was clearly disaster if they didn't go forward with it. After one more thing I would like to ask you to elaborate on that and how Mr. Cuomo came to give us the line he did.

My understanding is, had the MAC clause been completely valid, had Ken Lewis renegotiated, had they agreed to a new term or to a breakup, isn't it true that in fact we would have had a long period of time while statutory notice for stockholders and a stockholder vote occurred?

Mr. PAULSON. Yes. If there had been a renegotiation period, there would have been an extended period and there would have been a revote, is my understanding.

Mr. ISSA. Isn't it that which is at the center of why you issued the threat and why Ken Lewis ultimately decided that the damage from that period, even if he got a better price or broke it, either way could be disastrous to both firms?

Mr. PAULSON. Well, the reasoning again, I don't—Ken Lewis didn't characterize it as a threat, and I—

Mr. ISSA. Actually, he did characterize it as a threat. He managed to say that he didn't feel threatened while receiving a threat.

Mr. PAULSON. I prefer to characterize it as me explaining the Fed's supervisory authorities to him. In any event—

Mr. ISSA. I like Margaret Thatcher's way of doing it.

Mr. PAULSON. However we characterize it, the concern that I had was that the MAC clause wasn't a legally viable option. There is no precedent for it. There is no basis for it. So doing that would have just—would have then—it would have shown a lack of judgment, and I think it would have really undermined the viability of B of A and Merrill Lynch and the financial system.

Mr. ISSA. Going back to Mr. Cuomo's characterization of what you had to say, if you can help us, if you will, thread the needle between these two; and before my time is up I want to ask one other question, sort of an easy one. Would you say that effectively,

no matter what the reason, the viability of the MAC, you were saying the equivalent of what Margaret Thatcher said to George W. Bush, which is, “stay the course; get this done; it is better to do it right now than not.”

Mr. PAULSON. Let me go to explaining the confusion with Secretary Cuomo’s office. It is really quite simple, because the Fed had invoked a privilege that kept me from recounting my conversation with Ben Bernanke to Cuomo’s office. So if it hadn’t been for that Fed privilege, I would have told and would have said to Attorney General Cuomo’s office exactly what I am saying here today. So I think it is really quite understandable, you know, this discrepancy in light of the Fed privilege.

And right after Attorney General Cuomo’s letter came out, I made a public statement where I said that my prediction of what could happen to Lewis and the board, that was for me, those were my words, but it was based upon what I understood to be the Fed’s very strong opposition to B of A renouncing the deal.

Now, to your last question, I was attempting to send a very strong message to Ken Lewis in terms of how strongly the Fed and Treasury viewed this matter. And it wasn’t just the words about the Fed’s supervisory power and the other language which I presented at that time, again, a very strong message on the lack of the MAC being a legally viable option, a very strong message on it being a lack of judgment, and a very strong message on what I believed and what the Fed believed this would do to Bank of America and Merrill Lynch and the financial markets.

Mr. ISSA. Thank you.

Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much.

I now yield 5 minutes to the gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. Secretary Paulson, in your testimony you justified telling Mr. Lewis that the government might remove Bank of America management if they terminated the deal to acquire Merrill Lynch. You state, “Such an action would show a colossal lack of judgment and would jeopardize Bank of America, Merrill Lynch and the financial system.”

Mr. Secretary, if a lack of management judgment merits decisive governmental action, what about potential violations of the law?

Mr. Paulson, were you aware of concerns felt at the Fed and Treasury that Ken Lewis’s management team failed to do due diligence in acquiring Merrill Lynch and possibly violated securities laws by withholding material information from his shareholders to get the vote for the merger with Merrill?

Mr. PAULSON. I have become aware from some of the e-mails that this committee has released and other documents.

Mr. KUCINICH. Did you know at that time?

Mr. PAULSON. That there were concerns. And I know there were some concerns—

Mr. KUCINICH. At that time, did you know, Mr. Secretary?

Mr. PAULSON. By staff members, some concerns at that time along the lines of what you expressed on due diligence. I had not heard concerns at that time about securities laws.

Mr. KUCINICH. Now, Chairman Bernanke testified here that he shared those concerns about Bank of America's management. Did you share the concerns with anyone?

Mr. PAULSON. In terms of concerns about Bank of America's management? Here is what I would say about management. Congressman, I have been involved and was involved in at least three situations when I was at Treasury where CEOs were replaced: Fannie, Freddie, AIG.

Mr. KUCINICH. Let me ask you this on that point. In 2008, did you ever inform the management of any systemically significant bank that they would be forced out for any reason?

Mr. PAULSON. Well, I would say this. Here is the calculus. You have to ask yourself, is this management capable of running the firm and is there someone else there or someone else you know of that can do a better job? And I would say that these large, complex financial institutions are not easy to run, and it is not easy to find strong people to run them during a financial crisis.

Mr. KUCINICH. I just want to say this, Mr. Paulson—and we have limited time here, so I appreciate you answering these questions. The investigators of this committee have reviewed tens of thousands of pages, including notes of conversations you participated in, where the Federal Reserve response to Bank of America's problems was crafted. These documents clearly show that you were an advocate of aggressive fiscal responsibility. You advocated for a large cash injection, a very large asset protection plan. But nowhere in these documents did we find evidence that you advocated for holding Bank of America's management accountable for failing to do due diligence and for withholding potentially material information from shareholders.

So, Mr. Secretary, did you in fact advocate for requiring such accountability as a condition of the bailout you were developing?

Mr. PAULSON. I advocated the accountability we put in place which was we treated Bank of America like Citigroup. We treated them differently than those that went to the TARP the first time. So we had tougher restrictions on executive comp, and we had provisions on foreclosure mitigation.

But in terms of replacing the CEO, in this situation it was my judgment and it was the judgment of the regulator that it was appropriate to keep Mr. Lewis—that this is a decision that is made by the board of directors and for regulators to come in and decide to replace him, we didn't think that was appropriate.

Mr. KUCINICH. Mr. Paulson, as you know, invoking the MAC, however ill-considered it would have been, was not against the law. Meanwhile, Bank of America's decision to withhold material information about a merger from shareholders and their failure to do due diligence are potential violations of law. Perhaps you can explain to this committee how a Secretary of the Treasury can justify punishing an unwise but lawful act, while ignoring potentially illegal ones?

Mr. PAULSON. Well, in terms of legality—

Mr. KUCINICH. Could you speak closer to the mic?

Mr. PAULSON. I would say, in terms of legality, I certainly don't feel qualified to sit here and opine on whether there was an illegal action, and I certainly have not seen evidence of an illegal action,

and that is in terms of the relationship between B of A and the capital markets and the relationship between B of A and the SEC. I think that is a matter for others to opine on.

Chairman TOWNS. The gentleman's time has expired.

I now yield to the ranking member, Mr. Jordan.

Mr. JORDAN. Thank you, Mr. Chairman.

I think as I look at this and as most people look at this, they see a clear pattern of deception and intimidation. I don't think there is anyone in this room who doesn't believe that you guys intimidated Mr. Lewis.

I think it starts at the October 13th meeting when you called the nine biggest banks to Washington. They didn't know what the meeting was about. The whole meeting took 45 minutes. You slide a piece of paper across. They have to sign it and write in the amount of TARP money they are going to take. And I think it continues.

But my biggest concern is this—again, what I have said is a pattern of deception. Because, I mean—and this is the concern. I think the American people need to see this situation, because it sheds light on where we are headed.

We have a car czar, pay czar, 21 other czars. We have an auto task force. We have unprecedented involvement by the government in the private sector. And coming soon to families across America we have this comparative effectiveness board that is going to decide what kind of health care you are going to get. So it is important we see what happens when you give this kind of involvement to the Federal Government.

So I want to walk you through a series of things that took place in this acquisition and then ask you a question at the end.

First of all, I want to start with what some people would describe as an exaggeration. You said the world was going to end, everything was going to be terrible if in fact this deal didn't get completed. Yet there are people at the Fed like Mr. Ashcraft, who said the doomsday predictions were "a little over the top."

You timed the release of information so you kept the American public in the dark. You only gave verbal assurances to Mr. Lewis. You wouldn't put anything in writing. You didn't want that out. You made sure that Ken Lewis' testimony to Attorney General Cuomo, he said Mr. Paulson said we don't want a disclosable event. We have the Angulo e-mail that says, if Merrill decides to file early, we want to steer Merrill to a later filing.

So you controlled when the American people could get this information, even though you are using \$700 billion of their money. You deceived the regulators.

We have the Attorney General's letter to Congress, "Secretary Paulson did not keep the SEC chairman in the loop during discussions and negotiations with the Bank of America."

The Office of the Comptroller of the Currency was also kept in the dark. We have e-mail from Brian Peters from the New York Fed where he is talking about an upcoming conference call: "Given the presence of the OCC on the call, I think we should not discuss or reference the call with Ken Lewis and Secretary Paulson."

Maybe most importantly, and I just want to read from—our staff did good work—I want to read from the memo they put together.

You kept the Financial Stability Oversight Board in the dark as well. Let me just read this: “Not only did Mr. Paulson and Mr. Bernanke deliberately keep the SEC and OCC in the dark about events at Bank of America and Merrill Lynch,” you also failed to raise the issue at two consecutive meetings of the Financial Stability Oversight Board which Congress established to bring oversight to TARP. According to the minutes of these FSOB meetings, it was not until the January 15th meeting that you and Mr. Bernanke informed the board of the government’s plans for additional bailouts of Bank of America in connection with the Merrill Lynch merger.

So, again, you claim that failing to force the merger would have had catastrophic effect on financial stability, yet it wasn’t worth revealing to the Financial Stability Oversight Board. So financial instability is going to happen, but you are not going to reveal what is going on to the Financial Stability Oversight Board.

Then the last example I would point to is one I started with. Go back to the October 13th meeting. You deceived the banks involved with this. I mean, this is based on Ken Lewis’ testimony, and I have asked this question, talked about this with Ken and Fed Chairman Bernanke.

You called the nine biggest banks to Washington. They don’t know what the meeting is about. The whole meeting takes 45 minutes. He described the meeting. They sat on one side. You and Mr. Geithner and Mr. Bernanke and Ms. Bair sat on the other side, and you basically tell them they are going to take TARP money, like it or not.

So I have one question, and I think this is critical. That was on October 13th, that meeting. I want to go back to October 3rd, because that is when this whole thing started.

When we started down this bailout road, this bailout fever that has grabbed Washington, it, frankly, started on October 3rd when the Congress of the United States decided to give you \$700 billion of taxpayer money; and the whole premise of that action was that you were going to take that money and you were going to go buy the troubled and toxic assets. You were going to clean things up, and things were going to get back on the right track. And yet, to date, the Treasury has not purchased those assets.

So I want to know, when did you know that you could not be able to do what you told Congress? I remember sitting in on the conference calls with you and Mr. Bernanke. I remember when you came in front of lawmakers and you talked about we are going to buy these troubled assets. And yet less than—actually, 10 days later, you had changed direction completely and instead just injected capital into the institutions.

So did you deceive the Congress before the October 3rd vote, Mr. Paulson?

And, again, it is a pretty clear pattern of what has taken place.

Mr. PAULSON. Well, unfortunately, I don’t think I have time to respond to every question you asked or every statement you made, many of which I disagree with. But let me get to the TARP, because I think that is critical.

We went to Congress and asked for authority to buy liquid assets. We also recognized we needed flexibility, and we worked with Congress to make sure that we had the flexibility to deal with

whatever we had coming at us. Congress, I believe, knew they were giving us this flexibility, and thank goodness they did give us that flexibility.

Now, what happened in the last few days before we got the TARP legislation which passed on October 3rd and in the week after we got the TARP legislation, the markets continued to freeze up. We had a whole series of bank failures overseas. Five or six different countries had to intervene to rescue their banks.

Market participants were clamoring for us to do something quickly. We needed to do something quickly. And the way we were able to do something quickly and make a difference and make a dramatic difference and prevent something very dire from happening was to make the change and inject capital.

I would say one other thing. I think subsequent events have proven unequivocally that there is not an easy, quick way to purchase illiquid assets. So when did I come to the conclusion that we would—we needed to move and do something? It was sometime—

Mr. JORDAN. Sometime between October 3rd and October 13th, obviously. My question is, was it before October 3rd?

Mr. PAULSON. It wasn't—I would say—

Mr. JORDAN. Would you disagree—wouldn't you say that the main point that you and Mr. Bernanke sold—and I didn't go along with this. I thought it was a crazy thing. The main thing you sold to the Congress of the United States was we were going to go in and buy these toxic, troubled assets? Would you agree? That was the main point, and it changed in 10 days.

Mr. PAULSON. Well, let me say this. That was the main thrust, and that is what we talked about. But we, from the beginning, wanted flexibility. Congress wanted to give us flexibility. It was very good that Congress gave us flexibility.

Chairman TOWNS. The gentleman's time has expired.

I now yield to the gentleman from Pennsylvania, Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Secretary, I am not sure that the committee here isn't having this examination to find out whether we could promote the shareholders' interests at Bank of America. That seems to be what you potentially violated. But I am going to give you an opportunity, since this is your first testimony before the Congress, to be a little more explicit and descriptive of the situation that happened from September 15th to the 18th and then on October 3rd by act of Congress and processes that were taken.

You heard my colleagues on the other side seem to suggest that you overreacted, that there was an exaggeration of difficulty, and that in some way abuse of power occurred on behalf of yourself and the President and this Congress in acting precipitously in the fall of 2008 in this disaster.

Now we have had the occasion to have Chairman Bernanke before this committee and before the Financial Services Committee three or four times, and I always ask the question of him to make sure we restate that picture and that the American people have a chance to understand what happened. I daresay for criticism, I think both yourself and Chairman Bernanke and the new Secretary of Treasury have failed to inform adequately the American people as to what meltdown meant. I remember those vital days and some

of those meetings and telephone conference calls that we all participated in and some of the descriptions.

I don't want to provide that testimony, but I am hoping that maybe you may remember whether questions of law and order were asked, whether questions of the capacity to feed the American people for what period of time were asked. I am not going to say what I remember the answer to be, but I think when you give the description now, something dire had to be stopped from happening. That is great for you to understand that and those of us that were there, but that doesn't mean a damn thing to the American people. And as we move through this, you can see that committee members here don't quite understand what the situation of September, October, November, and December 2008 was like.

Please take moments now to describe as fully in detail as you can what were the projections that could happen to not only the United States but the world in a period of 24 hours, 48 hours, 72 hours, and how that would comport to what life would be like if no action were taken.

Mr. PAULSON. Congressman, thank you for the question.

One of the issues we dealt with at the time was the more explicit we were and more graphic we were the more this would terrify the American people and lead to an even greater economic problem. So as we were attempting to explain this, there was this conflict. We didn't want to overly scare people and make it worse.

Mr. KANJORSKI. Now—scare people. Tell them the truth. We have to deal with the American people now and some of our fellow members who think that this was a facade of some sort, that it didn't really happen, that we weren't in jeopardy.

Mr. PAULSON. Well, if you have a situation where the banking system is frozen and money can't move between financial institutions, what ultimately happens is that every business, even businesses that seem to be solid and small businesses across America, will not be able to fund their inventory. They won't be able to meet their payroll. You will have—when a financial system breaks down, the kinds of numbers that we were looking at in terms of unemployment was much greater than the numbers we are looking at now, people in the streets.

And, of course, around the world it is very significant. Because I remember talking with, for instance, German leaders who were explaining to me that people in the old east were unhappy with the big discrepancies in wealth but they at least believed in the system and believed in some form of market-driven capitalism, but that if we had a meltdown of the system it just could lead to chaos or people even questioning the basic system.

So there was—

Mr. KANJORSKI. Let me put it a little more succinctly, because we are running out of time.

Mr. Paulson, I was in New York the other day and had this very discussion with a lot of your former colleagues on Wall Street; and we talked about what would happen if the President, yourself, and the Congress did not take action. The one member I remember sitting at the panel described it—he said that the people that talked about we would have gone back to the 16th century were being optimistic.

Mr. PAULSON. Well, I try not to use hyperbole and explain something that is impossible to ever prove now that it didn't happen. But at least I believe, when we had this debate, I had some people say, listen, look at everything that has been in place since the Great Depression. We certainly couldn't go through that again.

I looked at it the opposite. When I looked at a world where information can flow, money can move with the speed of light electronically, looked how fast this liquidity went, looked at the ripple effect and looked at how when a financial system fails a whole country's economic system can fail, I believe we could have been gone back to the sorts of situations we saw in the depression.

I remember asking Ben Bernanke what he thought the world would look like.

And he said, well, just take a look at what happened in the Depression.

But I didn't spend a whole lot of time thinking about that, because I knew it was going to be very bad, and I never wanted to experience very bad. I didn't want to ever get to the point where we could, where we could really understand it.

Chairman TOWNS. Your time has long expired.

Mr. KANJORSKI. Thank you, sir.

Chairman TOWNS. Let me move to Mr. Burton of Indiana.

Mr. BURTON. Mr. Paulson, there are those of us that don't agree with your analysis that going about solving this problem was the correct way. You know, you talk about a meltdown, we have 9.5 percent unemployment right now. If you take into consideration those who are working part-time or who are getting unemployment compensation, it's closer to 16.5 percent. There was an article in the Wall Street Journal.

So you are talking about you guys saved the economy and saving the world. We do have a meltdown going right now. And if you don't believe it go out to Indiana and look at some of the parts of my district.

Let me ask you a couple of questions. First of all, I asked Mr. Bernanke if he talked to you about telling Lewis if they used the MAC clause, that they were going to be fired, and he said he didn't give you any instruction or say anything to you about that. And yet when you spoke, you said that, in your testimony, you said you were confident that was a strong opinion of the Federal Reserve.

How did you know that? I mean, there must have been some communication. How did you know that you were confident that was their position?

Mr. PAULSON. I would say two things here. First of all, you are right that I do not remember Ben Bernanke ever suggesting to me that the Fed—

Mr. BURTON. You don't remember? You know, Mr. Bernanke said the same thing. He said he didn't remember.

Mr. PAULSON. But what I do, so you asked where I came away with that view.

Mr. BURTON. Yes.

Mr. PAULSON. And I participated in a number of meetings and calls where Chairman Bernanke participated, there were lawyers from the Fed, staff members from the Fed, people from Treasury. And I came away from that, those calls with that understanding.

Mr. BURTON. Well, who—wait a minute. Wait. Well, if you came away from that from those phone calls—

Mr. PAULSON. Let me just, let me just—

Mr. BURTON. No, listen. Just a second. If you came away from that from those phone calls, somebody must have said, “hey, we can’t let them do this.” And I would suggest that it might have been Mr. Bernanke.

Mr. PAULSON. Well, what I would say to you, I do not know whether someone in those conversations or calls expressly said it or if my understanding came from just the tone and the forcefulness of—

Mr. BURTON. You know, you are a very smart man. I don’t think anybody is buying what you are saying right now. I mean you guys were on a phone call, there was a number of conversations and e-mails, and you are saying that you didn’t get any suggestion from Mr. Bernanke that he wanted you to let them know they were going to be fired if they didn’t do what you said?

Mr. PAULSON. I said I clearly came away with the understanding that this committee has, which was substantiated by the e-mails that have been released and some of the other things, that was the view of the Fed.

But I also don’t remember Ben Bernanke ever talking about that possibility with me.

Mr. BURTON. It’s interesting that both and you Mr. Bernanke can’t remember.

Let me just read something here that really concerns me. First of all, they expected a \$9 billion liability, and a few days later they found it wasn’t \$9 billion but \$12 billion. And so they were very concerned that they weren’t going to be able to swallow all of that, and that’s why they said they wanted to change and wanted to use the MAC provision. And you didn’t want to make that public.

You didn’t want to make any of this public. Why not?

Mr. PAULSON. Well, let me say to you that is not a fact. The only—this came up in connection with Ken Lewis asking me for a letter from Treasury. And what I said to him about a letter from Treasury, I said, “Ken, we do not have any kind of a specific agreement here. We haven’t decided on the size of the program, the dollar amount. We haven’t decided on how many assets.” And so if I gave a letter, all I would be saying is what I have already said publicly, which is that BofA is systemically important and that we are committed to not having a failure.

So—let me just finish here.

Mr. BURTON. Don’t use up all my time.

Mr. PAULSON. So what I said was just the opposite. I said if I give you a letter of disclosure—

Chairman TOWNS. Mr. Paulson, please pull the mic closer to you.

Mr. PAULSON. Oh, sorry. If we give you a letter we disclose it is what I said to him.

Mr. BURTON. Here is what was said in testimony. Bernanke and Paulson insisted that Lewis relied solely on their verbal assurance of more support because, as Paulson told Lewis in a written pledge, “would be a disclosable event, and we did not want a disclosable event.”

And he goes into more detail than that.

Mr. PAULSON. Well, let me say Lewis has testified clearly before this committee that I never, ever suggested to him that he delay any disclosure. What I said to him was something I would expect you all would agree with, which is if we are going to issue a letter from the Treasury, I am not going to issue a letter without disclosing that letter, and I don't see the point of a letter because we have no specific agreement. There's nothing to write down. We don't have the size of the program, we don't have the dollar amount, and we have already publicly said—

Mr. BURTON. You gave him verbal assurance, but you wouldn't put it in writing?

Mr. PAULSON. I gave him verbal assurance that we were committed to working to get something done.

Mr. BURTON. Why didn't you want to put it in writing? I mean, there are several places where he says that you would not allow it to be put in writing. You didn't want people to know, you didn't want public disclosure. Why not?

Mr. PAULSON. I attempted to answer. I will answer it one more time for you, sir—

Mr. SOUDER. Mr. Chairman, may we ask the witness again to speak in the mic again? I can't hear Mr. Paulson.

Mr. PAULSON. I am sorry. I had already said publicly, as had the Fed, that we were committed to working to prevent the failure of any systemically important institution, and Bank of America was one.

Now going beyond that, we had made it clear that we were going to be working with him to develop a support program. But we didn't have a size, we didn't have the amount of assets that would be covered, we didn't know what form of equity and how much. We had nothing definitive to say.

And so I said I don't see how a letter is going to be meaningful or helpful. But if I give you a letter, we are going to disclose it. And then that got twisted around to say I didn't want a disclosure.

Mr. BURTON. I know my time is up. Let me just read one thing real quick, Mr. Chairman. Here is what he said.

I was instructed that, "We do not want a public disclosure." That is what he said flat out.

Mr. PAULSON. Well, he has testified something different before this committee.

Mr. SOUDER. Mr. Chairman.

Chairman TOWNS. I am sorry, his time is expired.

Mr. SOUDER. Well, I have a procedural question, that Mr. Paulson clearly is moving back and forth. Is there enough slack in the mic so that the mic could be pulled more to the edge of the table? If you could pull it back in that direction. Thanks.

Chairman TOWNS. Thank you very, very much.

Mr. Paulson, we are having problems hearing you.

Mr. PAULSON. Yes. OK.

Chairman TOWNS. The gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

Mr. Secretary, I want to go back to the line of questioning suggested by Mr. Jordan of Ohio. I also sit on the Financial Services

Committee. You testified at least a half a dozen times before that committee prior to the TARP vote.

You did indeed, in all of your testimony, along with Mr. Bernanke, express the intent, the central intent of this TARP Program was to buy toxic assets to get the economy moving again and to get folks lending again, and you pounded away at that central theme.

And what Mr. Jordan was saying that a matter of days went by and you changed completely the focus of that program. Now, in my opinion, you misled Congress. When you were asked by Mr. Bachus in the Financial Services Committee, he said, wouldn't it be more impactful, I am paraphrasing, to just inject the money directly in the banks?

And what was your response?

Mr. PAULSON. I believe I said right there—

Mr. LYNCH. You said that wouldn't work. You dismissed that. You dismissed that in open committee.

Mr. PAULSON. Right.

Mr. LYNCH. Which led Members of Congress to believe that you weren't going to do that. Now hear me out. If you had come up with here with Mr. Bernanke and said, "I have a plan, I want to take \$800 billion in taxpayer money and I want to give it to my pals in the nine biggest banks in America," how many votes do you think you would have up here?

And that's why. That's why I believe you have misled Congress.

Let me ask you something else. This conversation that you had, you had a conversation December 26th—22nd, I believe it was, with Mr. Lewis. According to his testimony, you were on a bike ride, and he says that you spoke to him, you were on a bicycle, he was able to catch up to you.

Mr. PAULSON. Which date was this?

Mr. LYNCH. I am sorry?

Mr. PAULSON. What date was this?

Mr. LYNCH. December 21st or 22nd. I actually have it in my notes here.

Mr. PAULSON. I happened to be out skiing. It would have been an interesting bike ride.

Mr. LYNCH. Well, he is saying you are on a bike. Well, whether you were on skis or on a bicycle, that's not important. I want to know what you said. What did you say to him directly? Give me the gist of this conversation, paraphrase it if you must, but tell me what you said to him.

Mr. PAULSON. Which conversation on the 21st because I had two conversations with him on the 21st?

Mr. LYNCH. Well, the one in which he says that you stated that there was a real threat, the real possibility, I won't use the word "threat," that he could be removed and the board could be removed under the emergency Fed power, not by Treasury. That conversation.

Mr. PAULSON. OK. This conversation was one where I said to him, No. 1, that the Treasury and the Fed have communicated publicly that we are committed to prevent the failure of systemically important institutions and Bank of America definitely is one, No. 1.

Second, that we believed that the exercise of a MAC clause would show a lack of judgment and, if he did so—

Mr. LYNCH. This is what you said to him.

Mr. PAULSON. Yes. And if he did so, it could destabilize both—destabilize Bank of America, Merrill Lynch, and the financial system. And under those circumstances, the Federal Reserve could replace management and board.

Mr. LYNCH. Did you have a conversation with Mr. Bernanke prior to this that you were going to have this conversation and put it on the line like this?

Mr. PAULSON. I had—the conversation I had with Ben Bernanke, I did have a conversation before this with Ben Bernanke.

I had received a call from Ken Lewis, telling me that he had been giving more thought to the situation, and he and his board were increasingly concerned and were considering exercising the MAC clause.

And I had a conversation with Ben Bernanke beforehand. But I will say to you, I had had so many conversations with Ben Bernanke, I have trouble distinguishing one call from another. And the call I had with him was not one where we were saying, “now let’s get our script down.” I had a conversation with Ben Bernanke, told him that I had heard from Lewis. And then afterwards I got back to Lewis with the conversation I just gave to you.

Mr. LYNCH. Let me ask you, either on skis or on bicycle, was anybody with you when you made this call?

Mr. PAULSON. I made the call from—no. I made the call from my living room in a ski cabin in Colorado.

Mr. LYNCH. And there was nobody else in the room at the time?

Mr. PAULSON. I—unless one of the kids were running through—or one of the grandchildren. But other than that, I think I was by myself.

Mr. LYNCH. All right. My time has expired. I yield back.

Chairman TOWNS. Thank you very much. I now yield to the gentleman from Florida, Mr. Mica.

Mr. MICA. Thank you, Mr. Chairman.

Mr. Paulson, you just spoke about some conversations with Mr. Lewis, and if I could just clarify, I guess Mr. Lewis claims that he first learned of the \$12 billion financial loss at Merrill Lynch on December 14th, which was 9 days after the shareholder vote.

Now, you just testified that he called you at that point and told you he was strongly considering backing out. Is that what you were referring to just a moment ago, or was it a conversation later on December 21st when Lewis informed you that he was considering backing out because of financial losses at Merrill Lynch?

Mr. PAULSON. Well, we had—

Mr. MICA. There’s two conversations, one earlier, which is shortly after their board meeting, when he first indicated, and a second time. Do you recall?

Mr. PAULSON. Yes, there were multiple conversations. The first call was the first time I had any inkling of the problem, was on December 17th. And that’s when he called and—

Mr. MICA. Well, he said on the 14th that he called you, and that’s what we have information. Then there’s another conversation on the 21st that he was, again, very seriously moving toward get-

ting out of the deal because of what he had learned. And he said that is when you threatened to remove him and the Board of Directors at Bank of America.

Do you recall threatening him in one of those conversations?

Mr. PAULSON. Well, I don't characterize it as a threat. I clearly recall on the December 21st, explaining to him that—

Mr. MICA. So you did not threaten him, either to remove him or the Board of Directors?

Mr. PAULSON. No. What I have testified here today is that I sure explained to him that the Fed could remove management and the Board of Directors.

Mr. MICA. You told folks that all hell would break loose if they backed out of the deal; is that correct?

Mr. PAULSON. I didn't use those words, but I sure told him it would be a very serious problem and it would be creating financial havoc.

Mr. MICA. But there were backup plans. Were you aware of those backup plans? Did you disclose those backup plans or ever mention that you had any alternative to Lewis?

Mr. PAULSON. I don't know what you are speaking of in terms of backup plans.

Mr. MICA. Well, it's my understanding that you had information relating to a possible backup plan by a British regulatory authority, and that there were backup plans if, in fact, they didn't go through with the deal.

You are not aware of any backup plans? That was the only option?

Mr. PAULSON. I don't know what the—you know, we certainly had—we had our TARP, and we were low on the capacity in the TARP. But I don't know anything about British—

Mr. MICA. Well, I have the information here we will put in the record, that we have had recent discussions with BAC and ML Management who contend that they have the required shareholder support and are confident that a transaction will be approved with tomorrow's vote. If approval is withheld, ML will continue to have access to the various facilities and programs currently in place in the United States. Additionally, it is reasonable to expect that ML would be provided necessary support to preclude sufficient systemic disruption.

Are you aware of that?

Mr. PAULSON. I assume people are just—that you are just talking about a board report where they are talking about access to Fed lines or the fact—

Mr. MICA. From the Richmond Fed to the U.K.?

Mr. PAULSON. Yes, I am not aware of that.

Mr. MICA. You are not aware. And you were never aware of any backup plan. The only thing—and you never threatened Lewis to remove him or his board?

Mr. PAULSON. You keep putting words in my mouth. I have now told you three times and told the committee repeatedly that, of course, I told Lewis that we would—the Fed had the authority and could replace Lewis and the board.

Mr. MICA. So you did tell him that you had the authority to remove him and the board?

Mr. PAULSON. I told him that the Federal Reserve could replace him and the board if he pursued the course of invoking the MAC.

Mr. MICA. And, again, for the record, you were not aware, you are telling this committee that you are not aware of any contingency or backup plans other than your holding Mr. Lewis and the board to the deal that you wanted to impose?

Mr. PAULSON. I am saying that our—my plan and my preparedness was to get ready with the support package when the company announced the earnings. In terms of—

Mr. MICA. Mr. Chairman, I have information contrary to what the witness is testifying, and I would like to ask unanimous consent that be made part of the record.

Chairman TOWNS. Without objection, so ordered.

[The information referred to follows:]

Posted: 4:11 pm EDT June 11, 2009 Updated: 6:27 pm EDT June 11, 2009

WASHINGTON, D.C. -- In congressional hearings today, more evidence surfaced that [Bank of America](#) was pressured into its takeover of Merrill Lynch.

The controversial multibillion-dollar deal transformed the Charlotte-area banking industry and endangered a huge local employer.

Eyewitness News reporter Scott MacFarlane said it appears government regulators leaned on Bank of America harder than previously thought to pull the trigger on the deal.

Members of Congress were angered at testimony indicating that government financial regulators threatened to fire BoFA's management if they didn't take over Merrill Lynch. CEO Ken Lewis was the only one in the hearing who said he didn't feel pressured into making arguably the largest deal in company history.

The congressional committee displayed revealing e-mails on a projection screen, some indicating the Federal Reserve Board was going to toss Lewis and his team if they didn't agree to take over Merrill Lynch.

Lewis was diplomatic. "They strongly advised, and in strong terms, with the best of intentions," he said.

In other e-mails, government regulators suggested Lewis knew how roughed-up Merrill Lynch was when he agreed to the deal. One e-mail said, "Lewis knows they did not do a good job. And he's worried about his own job after cutting loose lots of good people."

Lewis again Thursday defended the takeover, saying it's already producing substantial profits. But when MacFarlane asked whether layoffs were looming at the company, Lewis was ushered away.

U.S. Rep. Patrick McHenry, R-Hickory, said the deal is still a huge question mark. "With the financial crisis we're facing, we're all concerned about jobs. We're all concerned about the health and safety of our [financial institutions](#) and small businesses across North Carolina."

The congressional committee is expected to call the Federal Reserve Board chairman and possibly treasury officials to testify in the coming months.

McHenry said if regulators did lean hard on Bank of America and its management, they might have overstepped their bounds.

To see the e-mails from today's hearing, [click here](#)

To read Ken Lewis' testimony, [click here](#)

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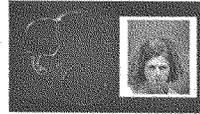
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Mr. MICA. Thank you. I yield back.

Chairman TOWNS. I yield to the gentleman from Illinois, Mr. Quigley. Congressman Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Mr. Paulson, I guess I want to put this in context with what didn't happen with Lehman, and I believe the expression you used was "moral hazard," which is the notion of bailing out institutions, inviting more risk taking. Is that a concept, is that a term you do not use any more?

Mr. PAULSON. No, I think moral hazard is a very important concept. And I do think where we have a regulatory system that's in balance, and you have the wind down powers that the administration is requesting, and hopefully Congress will pass, that lets a nonbank institution fail without disrupting the system, that it will be—that moral hazard will have more teeth in it.

Mr. QUIGLEY. So why was Lehman a moral hazard and not Bear Stearns, Fannie Mae, Freddie Mac, AIG?

Mr. PAULSON. OK, I would actually thank you for the question.

That we, I believe quite strongly, that if we—if Tim Geithner, Ben Bernanke and Hank Paulson had found something legal we could have done to save Lehman, we would have.

And let me explain the difference. In Lehman Brothers, there was a liquidity problem and a capital problem. And we were unable to find any buyer to come in and make the acquisition on an assisted basis or an unassisted basis.

And so although the Fed was able to loan against Lehman collateral and did loan to help facilitate liquidation and bankruptcy, a Fed loan would not have saved Lehman Brothers.

In the case of Bear Stearns, we had a buyer, JPMorgan, and JPMorgan then—the Fed was able to make a loan to assist that acquisition. Bear Stearns, there was a liquidity problem and a capital problem, and JPMorgan took care of the capital problem. They were able to guarantee the trading book while the merger was being voted on.

AIG was a different situation because in AIG the perception at the time was this is a liquidity problem only, because we had—they had a number of stable, regulated insurance companies that were perceived to be well capitalized and were collateral for the loan.

So we faced a situation in Lehman Brothers where we did not have—the government didn't have wind down powers, the government didn't have powers to inject capital. That came after we got the TARP, and we didn't have a buyer. And so there was no power that we could find to solve both the liquidity and the capital problem.

Mr. QUIGLEY. Did Bank of America request your assistance to purchase Lehman?

Mr. PAULSON. Did Bank of America?

Mr. QUIGLEY. Yes.

Mr. PAULSON. We went to Bank of America repeatedly and Bank of America asked each time for more assistance, and we had the—we had the private sector ready to fill the gap, but Bank of America, in my judgment, was never serious about it because each time they showed less interest, and it turns out they were—that they were interested in Merrill Lynch.

We had another buyer, Barclays, that we thought was going to do the deal right up until Sunday morning.

Mr. QUIGLEY. Well, let me ask just one more question, given the short timeframe.

Most of these other groups that were saved, AIG, Fannie Mae, Freddie Mac, their management was replaced. Lewis wasn't replaced.

Was his situation different? In short, did you promise him he could keep his job if he did it this way?

Mr. PAULSON. Absolutely not. These are—these decisions, for the government to come in and take the responsibility away from the board and replace the board, there's got to be a very good reason.

And Fannie, Freddie, AIG, there was good reasons, but I also looked at this very pragmatically and said these are big, difficult institutions to run.

Is the current CEO, is he capable of running this institution, and then you have to say who else is suitable to come in and run these institutions?

Mr. QUIGLEY. I appreciate it, and my time is up. I guess you could see how that appears to be splitting hairs of who you fire and who you don't fire, and it could very easily be construed to those who are making these decisions in these financial institutions that their first course, their first thought must be that they have to listen to whatever you say. They have to play ball, or because you have such discretion, you know, those who play ball keep their jobs and those who don't get fired.

Chairman TOWNS. The gentleman's time has expired.

Mr. Chaffetz from Utah.

Mr. CHAFFETZ. Thank you, and thank you, Secretary Paulson for being here. I appreciate it.

When this country experienced Enron, there was outrage from coast-to-coast, people who were not informed about the material things that were happening and not happening within that company, because the shareholders were left in the dark.

My concern is the lack of transparency to the shareholders and to the public at large, not only as investors, but as investors, as shareholders, if you will, as being taxpayers in this country.

So the question that I have, I want to followup on Mr. Jordan's question, a little deeper into why you did not share this information with other regulatory agencies, for instance, the SEC. Why didn't you feel compelled to share information with them?

Mr. PAULSON. First of all, we were working with the regulators that were involved with putting the financial assistance together. That was the effort.

Mr. CHAFFETZ. But—

Mr. PAULSON. But the responsibility, it is not a Treasury Secretary's job to get between a company and the SEC, for instance, once you get disclosure.

Mr. CHAFFETZ. My understanding—

Mr. PAULSON. I have been around long enough to know these are critically important decisions and that's the responsibilities of a CEO working with his general counsel and with the regulator.

Mr. CHAFFETZ. But you were a participant on the Financial Stability Oversight Board. I mean, one of the requirements with TARP

was that the Financial Stability Oversight Board, which you had two meetings and you did not inform the SEC nor did you inform the Office of the Comptroller of the Currency. Why is that?

Mr. PAULSON. Well, let me be—because I take exception with that.

After a January 8th meeting of the Financial Stability Board, I sat down with Chairman Chris Cox, and I explained to him, it was still early, we didn't have the package together, but we were working on it. And I gave him the details to the extent that we knew them at that time.

Mr. CHAFFETZ. I mean, this thing was fully baked at this point. That was pretty late in the game. Let me go back to what—pardon me. Let me go back to what Attorney General Andrew Cuomo said. He told Congress in his April 23rd letter that Hank Paulson informed this office that he did not keep the SEC chairman in the loop during the discussions and negotiations with the Bank of America in December 2008.

Is that true or not true?

Mr. PAULSON. Well, what Attorney General Cuomo's office was talking about was that—the question was in December. I also explained to the Attorney General in January—

Mr. CHAFFETZ. Again, is the Attorney General's statement true or not true? I will read it to you again, Informed this office that he did not keep the SEC chairman in the loop during the discussions, the negotiations with the Bank of America in December 2008.

Mr. PAULSON. In December I did not. That's absolutely correct.

Mr. CHAFFETZ. And you feel no obligation, the one agency that is out there as an advocate for the shareholders, you didn't think that was an important effort on your part, or you didn't feel any obligation to share with the SEC or other regulatory agencies, even the one within your own agency, the Office of Comptroller of the Currency?

Mr. PAULSON. I would again, let me say two things, separate it, because you have blurred two things.

First of all, with regard to the relationship of Bank of America to the SEC, that is something that is not my responsibility. It's not the responsibility of the Fed. That's the role of Bank of America to work with the SEC.

Mr. CHAFFETZ. But the Congress—

Mr. PAULSON. But the Financial Stability Oversight Board, because this has come up now several times—

Mr. CHAFFETZ. Right.

Mr. PAULSON. We did not begin to have this together until we brought it to the Financial Stability Board and there was a full and thorough airing there.

Mr. CHAFFETZ. But that was so far after these deals were already cut.

Mr. PAULSON. These deals were not cut. These deals were not cut. That's where there is a misunderstanding. There's an understanding that we are going to work to get something done, but we had nothing specific to bring forward.

And the other point I made was on January 8th, in his role as a member of the Financial Stability Oversight Board, I gave Chris Cox a briefing.

Mr. CHAFFETZ. I think, Mr. Chairman, what needs to be explored further is that—I wasn't here. I am a freshman. You wouldn't have wanted me here because I would have voted against this TARP. I think it's an absolute disaster.

But I have to tell you that I think this Congress or the Congress before this did set up this Financial Stability Oversight Board to precisely make sure there wasn't this audacity of arrogance that would be held in just one or two persons' hands and that there would be more involvement from other agencies that are very relevant.

And to exclude the one agency that is shared, that is tasked with taking care of shareholders I think is inexcusable and I think we need to delve into further.

I see my time has expired. Thank you, Mr. Paulson, and thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much. I now yield 5 minutes to the gentleman from Vermont, Mr. Welch, Congressman Welch.

Mr. WELCH. Thank you very much, Mr. Chairman. Thank you, Mr. Paulson.

Mr. Paulson, I was on that call, I think, in September or October when you informed Congress, you and Mr. Bernanke, of the dire condition in the financial markets.

My understanding of what your goals were at that time were to do basically three things: One, stabilize the financial system; No. 2, eventually reform the system; and No. 3, repay the taxpayer. Is that more or less a fair summary?

Mr. PAULSON. Yes.

Mr. WELCH. I want to go into this—and I share that concern about repaying the taxpayer.

When the deal with Bank of America went through, the Federal Government—and you were very much a part of this—did two things to help in the stability effort. One was the TARP payment of \$20 billion and, No. 2, was the asset backing of these mortgage-backed securities of \$118 billion.

Mr. PAULSON. Yes.

Mr. WELCH. And the intention was that the taxpayer would get repaid on that \$20 billion TARP payment. Some firms have repaid, Goldman Sachs, JPMorgan. And there was going to be an 8 percent interest rate paid to the taxpayer on preferred stock; correct?

Mr. PAULSON. Well, yes. On the second round is 8 percent.

Mr. WELCH. And then there was a \$118 billion backing by the U.S. Government and a nonrecourse loan that provided assurance to the Bank of America shareholders and the owners of these securities that the Federal Government would make good on them in the event that there was a collapse; correct?

Mr. PAULSON. Yes.

Mr. WELCH. And my understanding is that it was the intention of the Treasury Department that the taxpayers be compensated for providing this guarantee; correct?

Mr. PAULSON. Yes.

Mr. WELCH. And that guarantee was going to be, as I understand it, in the form of a fee of about \$4 billion; correct?

Mr. PAULSON. I have forgotten the precise number, but that sounds about right.

Mr. WELCH. That sounds about right. And that fee would be arrived at in the ordinary course of what was the customary fee for such a guaranteed program, correct?

Mr. PAULSON. Yes.

Mr. WELCH. Mr. Lewis is now—and you understood, in your capacity as Treasury Secretary, that, in fact, the American taxpayer was on the hook to backstop those loans if they went sour; correct?

Mr. PAULSON. Well, I clearly understood that we had a term sheet, and that the deal wasn't finalized yet, but we were—and then I left office before it was finalized.

Mr. WELCH. I understand that, but a deal is a deal and you shake hands and that's all you need. Frankly, I think that's the way most Americans would be, right?

Mr. PAULSON. I would say on this one, and I know where you are leading, I just was not—I don't have the details because—

Mr. WELCH. I am not asking the details. You, as the Treasury Secretary of the U.S. Government, a person filling the shoes of Alexander Hamilton, would agree that when you give your word, you are going to keep your word?

Mr. PAULSON. I would expect we would keep the word.

Mr. WELCH. And I think you would, and I give you credit for that. My question is this; Mr. Lewis is apparently now saying that there is no deal, he didn't sign it. Even though he benefited by it, he doesn't want to pay back the American taxpayer for the benefit that the Treasury and the U.S. taxpayer provided.

Is that the right thing for Mr. Lewis to do?

Mr. PAULSON. Well, I don't know what the circumstances are. So I don't know why—

Mr. WELCH. I think there are a lot of things you did well, and I understand you were trying to stabilize the situation.

But this, frankly, I think, is a simple yes or no. We put, "we" being the Treasury Department and the U.S. taxpayers, \$118 billion of our money at risk. Bank of America took great advantage of that because it provided stability and confidence.

And now Mr. Lewis says he doesn't have to pay for it because somebody forgot to have the term sheet signed. Is that acceptable to you?

Mr. PAULSON. Well, can I just explain why I am hedging on this, because I was part of doing a similar deal for Citigroup.

And we had a term sheet, and then it was very difficult to get it done. And Citigroup wanted to get it done at least as much as the U.S. Government, and it was hard to get it done.

So what I don't know, if the circumstance was, as you presented it, OK, then there would be one answer. But I do not know why, because I wasn't there. All I know is we had a term sheet. I left government, and the deal didn't close.

Mr. WELCH. Well, here is the bottom line on that, and this is one of the frustrations. A lot of us voted for that program.

Mr. PAULSON. Right.

Mr. WELCH. Because we felt it was the lesser of evils. We didn't want to. And I remember you on the phone call.

Mr. PAULSON. Right.

Mr. WELCH. You actually were quite candid in saying the last thing in the world you wanted to do was come to the American taxpayer and ask for this bailout, but it was your honest judgment that if we didn't do it there would be a calamity that would ripple across all America.

Mr. PAULSON. Right.

Mr. WELCH. So you went ahead.

We did the same thing, in effect, with Bank of America. Now Mr. Lewis wants the benefit from the taxpayer commitment, the Treasury commitment, and he doesn't want to pay. Most Americans think a deal is a deal and they should pay.

Mr. PAULSON. I would say that if it was a deal, I would think he should pay. And no one was tougher than I was in trying to protect the American taxpayer. And no one is looking at these programs more with hindsight more than I am in wanting to get the money back.

Mr. WELCH. Well, see, this isn't hindsight. I mean, this is like a deal with a wink. You know, the taxpayer made a handshake, we are going to cover it. Mr. Lewis kind of had a wink or had his fingers crossed.

Mr. PAULSON. I don't want to take the other side of your argument. I am just simply being honest and saying I don't know why the deal didn't get done. A deal could not get done for two reasons—three reasons. It could not get done because it was so complex, people couldn't figure out how to get it done because it was so complex or he wanted out or the government wanted out, and I don't know the answer.

Chairman TOWNS. The gentleman's time has expired.

Mr. WELCH. All right, thank you very much. Thank you, Mr. Paulson.

Chairman TOWNS. I now yield time to the gentleman from Ohio, Congressman Turner.

Mr. TURNER. Thank you, Mr. Chairman. Thank you, Mr. Paulson, for being here and your description of the environment in which you were in and your actions.

You know, it's interesting. When we have hearings, we basically try to do two things in hearings, find out what happened and find out should it have happened, why did it happen. Is this the appropriation action? That's the oversight. Why it happened is a factual issue.

Now on the factual side, what we hear from you is that you don't deny that you told Mr. Lewis don't renegotiate and don't back out.

You disagree as to whether or not it was an actual threat for his removal being the consequences, but you told him, don't renegotiate, don't back out.

And the why you say is because for the American people you believe it was irresponsible, that the interest of the shareholders of the Bank of America were the interests of the Nation, which the financial markets were at risk, and apparently \$12 billion is not material for you to believe that a material change had occurred, and you cite your vast experience.

Now, you also say that you have taken actions that there has been removal before. You cite the actions of Fannie, Freddie, and AIG on removal.

Those were so different, you had failures of organizations. You didn't have just merely a business deal that was going forward. So they are really not comparable.

I mean, I don't think you have an instance where you can provide us that's comparable where there's a threat from the Treasury Secretary for the purposes of removal of a CEO for a business transaction to go forward, unless there are other threats that you put forward that we are not yet aware of.

Now, the thing about your vast experience that just really strikes me is that you really have no exact science with your vast experience. You cite the impact on the markets, your view of these deals, your impressions of how the markets might have an impression, which is not a science. There is no accounting problem from which you made your decision. There is no data point from which you made your decision.

And with all the responsibilities that you had, which apparently somewhere around that time include skiing, there was no way that you could have been up to speed on the economics, the due diligence, the specifics of the details of this deal to the extent of someone to intervene enough to say do not renegotiate this deal and do not back out.

Now, I agree with Representative Lynch. I absolutely believe that you misled Congress.

And I want to take you back to a meeting that you had with Cheney, yourself, Mr. Paulson, and Bernanke where you came before the Republican Conference to explain your \$700 billion bailout deal, which I voted against.

You came forward and told us that you were going to buy toxic assets, illiquid assets, and that if these were not removed from the market that we were going to have calamity and that the crisis was those toxic assets were causing, again, the markets to have instability because the markets had the impression that these toxic assets, having no value, raised questions as to the value of the institutions.

I thought it was a crock then, and I voted against it. And then you turned completely away from the toxic assets, and I believe that you were misrepresenting Congress. I don't think it was an issue of just asking for flexibility.

I also voted against it because the deal was, you didn't tell us who was going to get the money, you didn't tell us what the money was going to be used for, you didn't tell us how much. And the part that was crucial to me is that you didn't step forward and say these are the changes that need to be made in our regulatory systems and the laws to make certain that this never happened again.

Now the other thing that was important to me is that I believe we were about to participate in the largest theft in history.

I come from Ohio, ground zero for the mortgage foreclosure crisis. So when you were standing in front of us asking for \$700 billion of taxpayers' money to bail out what you called toxic assets for these mortgage-backed securities as a result of the mortgage foreclosure crisis and the credit default swaps, I realized that you were

asking me to give taxpayers' money to bail out these people who I believe were systematically defrauding my community and the people who were buying houses and refinancing their houses with overvaluations.

And I had a great concern, as did my community, that the underlying collateral for these mortgage-backed securities was not there. And that's ultimately what took down the valuation of those mortgage-backed securities.

So my question to you is, Mr. Paulson, in your vast amount of experience, since you were in this position in July 2006 while the mortgage foreclosure crisis was raging throughout the country, and your description of people losing their homes was happening then, not just in 2008, when you stepped in with your TARP Program, there were record foreclosures, mortgage-backed securities were being traded with significant questions, I believe, in the market of the underlying value of the collateral. Subprime mortgage lending was spiraling. Refinances were increasing based on inflated and escalating property values.

Where was your vast experience then and what do you believe we should have done in 2006 to have stopped this?

Mr. PAULSON. Well, first of all, if you are making the comment that I did not see this crisis coming to the extent it came, you are absolutely right, OK. I, like many others, underestimated this then, No. 1.

But what I did do, very shortly on arriving, was begin preparing for a financial crisis. I began meetings with the President's working group on preparations, No. 1.

And No. 2, although I would take exception with a lot of the things you said, I began working on a plan, which we had announced in March, well before I went to Congress, to overhaul this outdated, inadequate regulatory system. And so we came out with that in March, came out with recommendations that we needed the authorities to wind down these nonbanking institutions if they get in trouble, so they don't have to be bailed out.

The only other thing I would say to you was I am not disputing the fact that when Ben Bernanke and I came to Congress we understood the illiquid assets, because illiquid assets were at the heart of the problem in the financial institutions. That was at the heart of the problem. That was a major cause for the losses, for the illiquidity, and so our approach was to buy those illiquid assets. That was our primary approach.

And we learned, and as the situation began to crumble all around the world and it was so clear we had to move quickly, we needed to change gears. And I made the decision that when the facts change, you need to move quickly and change. And I am just saying the only point I was trying to make wasn't to say we didn't come to Congress and ask for illiquid assets, but, thank goodness, when we came to Congress we also asked to have flexibility and Congress gave us the flexibility.

And so the last point I would make is the people I care about are the same ones you care about, the American people, the people that are going to lose their jobs. And the tragedy is they didn't create the problem. It was the big banks that created the problem. It's a whole lot of—the problem was not created by them. But they

would be the ones that would pay the greatest penalty if there was a collapse. And so that is what I was working for.

Chairman TOWNS. The gentleman's time has expired.

I now yield 5 minutes to the gentlewoman from California, Congresswoman Speier.

Ms. SPEIER. Thank you, Mr. Chairman.

If the people of America didn't create the problem, who created the problem?

Mr. PAULSON. If the people of America didn't create the problem?

Ms. SPEIER. You said the people of America didn't create the problem. So tell us who created it. Were the banks involved?

Mr. PAULSON. Well, I would say this, this problem, there is so much blame to go around, it is hardly—

Ms. SPEIER. Well, give us a few people, few institutions.

Mr. PAULSON. OK, well you look at—excesses had been building up for a very long time.

Ms. SPEIER. I just want you to give me some names. I have a limited amount of time. Would we include the banks, would we include Goldman, would we include AIG? Would we include anyone who got TARP funds?

Mr. PAULSON. You could say financial institutions, regulators, investors, so that there is plenty of mistakes by a vast multitude of—

Ms. SPEIER. You would be interested in knowing that in the Financial Services Committee yesterday all the banks were represented and they, almost to a person, indicated that had they weren't responsible for this. But let me move on.

Do you use e-mail?

Mr. PAULSON. Do I use e-mail? No, I don't use it personally.

Ms. SPEIER. You don't use it personally or professionally?

Mr. PAULSON. Yes, I just don't. I have never used it for any business communications, just never use it.

Ms. SPEIER. So while you were Secretary of the Treasury you never used e-mail?

Mr. PAULSON. No.

Ms. SPEIER. How did you communicate with people?

Mr. PAULSON. Telephone.

Ms. SPEIER. All right. Did you know Mr. Lewis before you were Secretary of the Treasury?

Mr. PAULSON. Yes.

Ms. SPEIER. For how long?

Mr. PAULSON. I, you know, 4 or 5 years.

Ms. SPEIER. Did you know him socially?

Mr. PAULSON. No.

Ms. SPEIER. But professionally you knew him?

Mr. PAULSON. Professionally I knew him, yes.

Ms. SPEIER. OK. When you gave BofA and Mr. Lewis \$15 billion in October, he didn't want it, we were told. So why did you give it to him?

Mr. PAULSON. Well, that is certainly not my recollection. But let me tell you why we gave it to them.

Ms. SPEIER. Very briefly, because I have a second question I want to ask you.

Mr. PAULSON. OK. Then very briefly, after we got the TARP authorities, and when the system was on the edge and we needed to move quickly, we decided that the only way to do something that was going to be dramatic and make a difference was going to be put capital, get capital out quickly and get it out into nine systemically important major institutions.

So we called them together, the regulators, let them know what the recommendation was for each institution. And Mr. Lewis, like the other CEOs there, very willingly agreed to take that capital because they recognized that they had as much to gain as anyone from stability of the system.

Ms. SPEIER. All right, so you gave him \$15 billion in October and then another \$10 billion on January 9th and then \$20 billion on January 20th.

It's interesting that amount of money equals about \$45 billion. They paid \$50 billion for Merrill Lynch.

In many respects, I feel like the taxpayers bought Merrill Lynch for the Bank of America.

Mr. PAULSON. Well, I would say this to you. The taxpayer has benefited in two ways. First of all, I would be very optimistic that the taxpayer will get all of that money back with a profit, No. 1. And, second, what the taxpayer got was an averted calamity. Because if we had had the financial system collapse, the taxpayers would be the people who would be hurt.

Ms. SPEIER. All right. Let me ask you this. This press release went out from your office, as Secretary of the Treasury, on January 16th. And this press release talks about the package to the BofA and specifically says that the Treasury and the FDIC will provide protection against the possibility of unusually large losses on an asset pool of approximately \$118 billion of loans.

So this ring fence was a done deal on January 16th?

Mr. PAULSON. What—

Ms. SPEIER. When you were Secretary of the Treasury.

Mr. PAULSON. We worked out the details and put out a term sheet, but this deal was not closed then. And I left Treasury—

Ms. SPEIER. How could you possibly say this publicly if it wasn't closed then? It wasn't a deal. So were you giving him something or giving BofA something that they didn't actually have to agree to but give the appearance that they had something and then they could renege on it?

Mr. PAULSON. Congresswoman, I have no idea what happened after I left. So—

Ms. SPEIER. But how professional is it to put out a statement in a press release that something has been consummated when it hadn't been consummated. I mean, that's kind of like Contracts 101.

Mr. PAULSON. No—I am getting it from both angles here, people wanting me to put out letters when there's nothing to disclose. Here we had, what we did is we communicated to the market that we had a term sheet. The market knew that this deal wasn't closed yet. We were announcing a deal with the intent of closing it.

And why it didn't close, you will have to ask people that are at Treasury today.

Ms. SPEIER. Mr. Chairman, I certainly would hope that we would question further who was responsible at that point in time for these negotiations so we could have them come before this committee.

I yield back.

Chairman TOWNS. Good point. Thank you very much.

I now yield 5 minutes to the gentleman from Indiana, Mr. Souder.

Mr. SOUDER. Mr. Paulson, had Mr. Geithner signed off on that memo, the terms of the deal?

Mr. PAULSON. What did you say?

Mr. SOUDER. In other words, you were just about to transition between Treasury Secretaries. Had Mr. Geithner or the incoming administration signed off on the tentative terms?

Mr. PAULSON. The—Mr. Geithner, as you know, was the Treasury Secretary designate, and we wanted there to be a very smooth transition. And so I posted him generally on a number of matters, including that matter. But I never viewed him as a decisionmaker, and I certainly didn't go to him to sign off on the details of that term sheet.

Mr. SOUDER. I have a larger question I want to pursue off of Mr. Lewis.

But I want to correct the record that on some things that I think have been misstated. As somebody who voted for all three versions of TARP, took incredible political heat in the middle of a tough targeted race, I believe it was the right thing to do, and I would do it again with some additional caveats.

But there has been a lot said today about the restrictions that were put on you. In fact, you came, in my opinion, not very tactfully, and told us that you wanted, basically, a blank sheet of paper with whatever you wanted to do. Initially, they didn't need any Republican votes. Paul Ryan and others in our caucus negotiated some 20 pages of additional things. But the bottom line is that we left there, or the Secretary of Treasury and those responsible can do whatever they think they need to do.

Now, we can try to pass blame. We can try to say whatever we want. And in the future we probably need to tie it down more. But at the end of the day, our conference, after hours of internal debate, knew that given the nature of the crisis, we had signed a blank check, for good or bad, that we were going into an election season. We were about to leave town. It was getting highly politicalized. Things were changing. I am not defending the decisions that you made. I am just saying it's a little bit much for Members of Congress to claim that there were all these guidelines in place because we knew full well you had an opt-out clause.

Now, that said, clearly you misled us, and we probably wouldn't have had the votes, even though we underneath knew that was there, because we understood it was toxic assets. We didn't believe you were going to take over in the way this was going to evolve.

Had we known that, the bill would have never have passed or we would have put tighter restrictions in. Because what I would say is it was a verbal misleading. Even though if anybody read the document, it actually gave you a total blank check.

Now I would also say I don't understand where people were saying that we weren't in a crisis. Every 40 hours for 3 months someone was calling me telling me a bank was either calling their revolving loan, the mark-to-market was tightening up their assets, so the banks were having their assets dropped. People who were never late in their history, people who didn't know how to get their payroll dollars, major corporations in this country were having to borrow overseas from Third World countries in order to meet their payroll, and I don't know where it would have gone.

I represent a district that has the highest unemployment in the United States. Elkhart County has been first in unemployment all the way through. But they are 57 percent manufacturing. They are 17.6 percent right now unemployment.

We were headed to a lot more than we are right now. I am not necessarily happy with everything that's happening, but it could have been a lot worse. I don't know how catastrophic, but in fact it's relatively stabilized, in that I think we can have differences of opinion of how to do it.

Now, here is my concern about what I saw in the Lewis thing and where it has evolved.

When you intimidated, at the very least, Mr. Lewis into saying the government is going to do it, somewhere in here we went from toxic assets and loans, and your stated goal to us was we didn't want the government micro managing and directing. That was the next step, the Lewis process.

Then when you say when you handed it over, you thought you had a process, but you don't really know what happened after that. Since then, we now have common stock in banks. We are telling them we want bonuses, we are micromanaging. Tomorrow, we have a proposal, now that we have taken over stock in GM, to tell GM that they can't close dealerships.

Now, this is the problem when government starts to taking over.

If you were Treasury Secretary now, where would you have started to draw the line here? You started to walk into it with Mr. Lewis when you realized that it kind of unscrambled. Would you have moved to common stock? Do you believe this has gone too far? What lessons can we learn from what we have seen here, because right now the government is in so deep that getting out is going to be very difficult and we are micromanaging, and Congress is going to tell people what kind of tie they can buy if we are not careful.

Mr. PAULSON. To me, that's the right question. And one of the things that was most difficult for me is I came to the job, believing, totally, and I still do, in markets and free enterprise, and not wanting to see government overly involved.

And so I was forced to make some decisions, which were very objectionable, but they were better than the alternative. And I thought the decisions we made were going to ultimately help to preserve the markets.

So I think the key question is not only how do you get into these programs, but what's the right exit strategy? What is the right exit strategy? When is the system stable and when do we get out?

And I don't think that it is appropriate for me, as a former Secretary of Treasury, 5 months out of the job, to be not any closer

to it than I am now to be saying more than that, other than because I think everyone here understands that government has been forced to do things, I think forced to do things by not only an unprecedented crisis, but forced to do things because we didn't have the tools we needed.

There were not wind down authorities. There was nothing to deal with a failure of a large, nonbanking institution other than the bankruptcy process. And so we had a really outmoded, outdated regulatory system.

Mr. SOUDER. But it's fair to say that even under great pressure, you didn't take common stock?

Mr. PAULSON. Yes. I did not under—

Chairman TOWNS. The gentleman's time has expired. Let me just do a little housekeeping here. We have seven votes on the floor. So the committee will recess until 1:30. We will return back at 1:30.

[Whereupon, at 11:58 a.m., the committee was recessed, to reconvene at 1:30 p.m., this same day.]

Chairman TOWNS. The committee will reconvene. Let me remind the witness that he is still under oath.

I yield 5 minutes at this time to Congressman Foster of Illinois.

Mr. FOSTER. Thank you, Chairman, and Mr. Paulson for your time here.

Before I get into my main line of questioning, I was wondering if you could be of help in clearing up something that is actually a public statement on the minority side Web site from this committee having to do with the CPP program and its origins.

It contains, among other things, the statement that "under pressure from the House Democrats, such as Nancy Pelosi and Barney Frank, Bush Treasury Secretary Paulson partially nationalized the U.S. banking sector despite his own misgivings about the inevitable perverse consequences to follow."

I was wondering if that is a reasonable characterization of the origins, as you saw it?

Mr. PAULSON. No, it is categorically untrue.

The facts are, we went to Congress to get the TARP legislation. Our primary thrust was the purchase of illiquid assets. That was really the source of the problem, and that was our strong intent. We got additional flexibility.

After the legislation, it was clear that the problem was continuing to get worse. The facts were changing, banks were failing around the world, and there was quite a problem. We needed to move quickly to really put out the fire, and by far, the best idea and the only way we could think of doing it was with this program.

It was not a nationalization of the banks. As a matter of fact, the program that we implemented when I was here had preferred stocks, preferred stocks which—they were minority positions. And I have always said that this is something that is abhorrent to me, nationalization. But we did some things. And any kind of government intervention was not something I came to Washington to do, but it was better than the alternative.

But we switched gears, and, fortunately, Congress gave us the flexibility to do what we needed to do, which was prevent the American people from really having a very serious problem.

Mr. FOSTER. Well, thank you for clearing that up. I also voted for the TARP authority and recognized at the time this was a very important feature of it, that if things continued to get worse, that the only thing you could do fast was a rapid capital injection, and this was an important element of it. So thank you for clearing that up.

Now, I am interested in exploring the principle that you seem to be bringing forth in terms of that, in times of systemic risk, there are conditions under which shareholders of a systemically important firm might be expected to take a bullet, so-to-speak, for the good of the overall financial system, on the grounds that the firm, like everyone else, has much to lose if the financial system collapses, and that, moreover, threats from Federal regulators are an appropriate means of encouraging them to take that bullet.

Is this a reasonable, though a little bit perhaps stilted, characterization of your position on this?

Mr. PAULSON. Yes, that is not my characterization at all, because we were very fortunate in this situation to have an alignment of interests here, because I have no doubt what was in the best interests of the public, which was to not have Bank of America collapse, not have Merrill Lynch collapse, not have the financial system collapse.

I happen to believe, and I believe Ken Lewis testified he believes, that was—and also an alignment of interest with Bank of America and Merrill Lynch. I believe if Bank of America had invoked a MAC, tried to evoke a MAC, which was a legally binding contract, that was not legally valid, I think the merger contract was—

Mr. FOSTER. You asked them to not pursue—they certainly had the legal right to try to invoke it, and you had used what could basically be characterized as an indirect threat to encourage them not to attempt to exercise that legal right. I was wondering if you see that there is need for additional legal clarity in this area?

Mr. PAULSON. Well, I can say I think the more legal clarity we have, the better, on everything. But on this, I just want to come back to the MAC, because I heard people discuss this a lot. No one has ever dealt with, as far as I have heard on the other side, the basic issue. Show me a Delaware court that, after shareholders have voted, has let a company get out of a merger by invoking a MAC. And this MAC actually had a carve-out for changing market conditions.

Mr. FOSTER. The argument was it was unlikely, not impossible, and certainly these were circumstances like Delaware courts have not seen in the recent past.

Mr. PAULSON. Yes.

Mr. FOSTER. So are there specific issues of legal clarity? For example, some sort of safe harbor for CEO's that act in ways that might be construed in normal times as against their shareholders' interests, but because this is a time of systemic risk and they have been given direct orders from their regulators trying to avert systemic risk? Do you see any merit in that kind of carve-out?

Mr. PAULSON. It is something that I have—it is a very complicated issue, and it is one that I really don't feel qualified to have thought through all the arguments on this. But it is certainly one I think that bears consideration.

Mr. FOSTER. OK. Thank you. I yield back.

Ms. KAPTUR [presiding]. Mr. McHenry.

Mr. MCHENRY. Thank you, Madam Chair.

Secretary Paulson, thank you for your service to your country. This hearing is about the actions that took place in regard to one deal that we actually have a good bit of disclosure on because of the New York Attorney General's, in essence, public, now public testimony, about what occurred with that.

The reason why we are having these hearings is about the ramifications for the financial industry going forward. We want to make sure that government officials are really in keeping with what is appropriate. So that is why this hearing is occurring today.

Now, you have had a long history in the financial marketplace as chairman of Goldman Sachs. A couple of these great quotes about your service and your actions on Wall Street are here. One quote that I think says a lot is Jim Citrin, a column from September of last year, he says, describing you, "as direct, intense, powerful, serious, competitive, can-do, and, frankly, ballsy." One of his former Goldman executive committee members said, "Hank hasn't changed at all since he was at Goldman, literally."

There is no question by financial analysts or reporters or these committee members about your capacity to finish a deal, and I don't think the President had any concerns about that when he offered you the job.

Another Fortune Magazine described you back in 2003 as the investment community's steeliest, stealthiest power broker.

We get the idea. You have the capacity to get a deal done.

Now, as chairman of the Federal Reserve, Ben Bernanke had a different set of powers than you had as Treasury Secretary, is that true?

Mr. PAULSON. Oh, absolutely.

Mr. MCHENRY. So as Secretary of the Treasury, did you have the statutory authority to fire the Board of directors of Bank of America?

Mr. PAULSON. No.

Mr. MCHENRY. OK. No. So, in your testimony, you say that, "I mentioned the possibility that Federal Reserve could remove management and the board of Bank of America if the bank invoked the MAC clause." So, in essence, you were carrying a message from the Federal Reserve. Is that a good way to characterize this?

Mr. PAULSON. Well, I would prefer to characterize it the way I had to characterize it earlier. I had had a comprehensive conversation with Ken Lewis in which I reaffirmed the support that he was going to receive from the government because we were committed to every systemically important institution.

Mr. MCHENRY. And that support is also Fed, the Treasury, the whole regulatory gambit?

Mr. PAULSON. It is combined. And I expressed the view, and I expressed it in a strong language, that the MAC was not a legally valid option in the judgment of the Federal Reserve lawyers and expressed the judgment that, if he were to go ahead and do something like this and endanger his company, Merrill Lynch, and the system, it would be a lack of judgment. And then I explained to him, you know, I explained to him that the Federal Reserve had

the authority to replace management and the board. That is a supervisory authority.

Mr. MCHENRY. And that last phrase that you said there, you relayed the Fed's authority to replace the board, had you had discussions with the Fed and your staff had discussions with the Fed that was within their capacity?

Mr. PAULSON. Well, what I have said earlier, and I will repeat it, that I have no recollection of Ben Bernanke having ever talked with me directly about that authority. I do have—I participated on a number of calls and meetings where there was staff together, and I don't remember whether I heard someone expressly say that or whether it was just the tone and the forcefulness of that discussion. But I clearly had that understanding, and I think that understanding has been borne out by the e-mails the committee has released and some other things.

Mr. MCHENRY. When Mr. Issa asked you in the second set of questions here about this, you said we explained the Fed's statutory authority.

Mr. PAULSON. Right.

Mr. MCHENRY. Now, did your lawyers say this, or was it the Fed's lawyers that said that? Is that hard to recall?

Mr. PAULSON. As I said to you, I had that understanding. As you can imagine, when I am participating in as many discussions and calls, it is different. And what I have told you is I don't remember whether someone expressly mentioned that to me in so many words or whether it just was a logical conclusion. Because if you had heard the discussions that I had heard, where if you are running a regulated bank and your regulator says, "we don't think this is legally valid, we think if you do this, you are going to cause great harm to your company and to the financial system, it will be a lack of judgment." And if someone goes ahead and does that, it is a pretty logical conclusion that maybe even the regulator would be irresponsible if they didn't hold them accountable.

Mr. MCHENRY. Sure. My time is short—oh, my time is expired. I have additional questions. I hope you will have an additional round.

Ms. KAPTUR. I was letting the gentleman finish his line of questioning. Thank you.

Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Madam Chair. Mr. Paulson, thank you very much for your testimony.

Mr. Paulson, I think that you would agree with me—I am going back to some questions Mr. Kanjorski asked you. You would agree with me, even with those emergency circumstances you found yourself in, there is no reason to suspend ethical behavior, is there?

Mr. PAULSON. Absolutely not.

Mr. CUMMINGS. I didn't hear you.

Mr. PAULSON. Absolutely not.

Mr. CUMMINGS. And it is interesting that, as I read your testimony, and I read it several times, that you have expressed tremendous concern about our constituents and the people of America who are suffering greatly. And I was just wondering, were you aware of the Merrill Lynch \$3-plus billion worth of bonuses they were about to give out when this deal came down?

Mr. PAULSON. No, I wasn't.

Mr. CUMMINGS. And when did you find out about the \$3-plus billion in bonuses that the American people basically ended up paying?

Mr. PAULSON. My best memory of this was sometime around the middle of January, the day or so before we were putting this deal together, and when we were talking about the compensation restrictions for BofA, and I am not entirely certain, but I have a memory that someone on my staff said, in terms of Merrill Lynch, their bonuses have already been paid.

Mr. CUMMINGS. Do you think that was fair to the American people, to stockholders? Basically, what ended up is that the American people pretty much ended up paying Merrill Lynch's \$3 billion-plus bonuses that were apparently given out just before this deal went through. You understand that, right?

Mr. PAULSON. Well, I do understand the bonuses were paid before the deal went through.

Mr. CUMMINGS. Do you think that is fair, and do you think that is ethical?

Mr. PAULSON. In terms of—those are two different words.

Mr. CUMMINGS. Why don't we start with "ethical" first.

Mr. PAULSON. OK. In terms of ethical, I am not sure I would call that unethical, that Merrill Lynch paid out bonuses before the deal went through. Now, whether that is something that should have been done is another question.

Mr. CUMMINGS. Do you think that should have been done?

Mr. PAULSON. I wasn't there. I didn't make the decision. I don't think I should be judging that today.

Mr. CUMMINGS. Well, you judged everything else. You made a judgment with regard to Mr. Lewis. You made a judgment when you said that you felt that it would be a colossal lack of judgment for him to push the MAC. You made judgments all along where you made decisions affecting the American economy.

So why suddenly are you washing your hands of this? You have been bragging up there this morning all this time about the judgments you have made.

Mr. PAULSON. Yes, but I do not have all the facts on this situation.

Mr. CUMMINGS. Let me ask you this. I would like to clarify something that you testified to this morning. A letter we received from Mr. Bernanke and handwritten notes we received under subpoena indicate that it was Mr. Lewis who first brought up the issue of receiving a bailout.

Isn't it true that it was Bank of America who first brought up the bailout?

Mr. PAULSON. I am not sure exactly how it came up, but it very well could have been. I sure know that it was—with 100 percent certainty—it was Bank of America that came to us and said they have the losses and said they have a major problem and were considering triggering the MAC clause.

Mr. CUMMINGS. All right.

So, in December 2008, did you promise Mr. Lewis that you would provide Bank of America with enough capital to fill the \$12 billion "hole" created—let me finish, I want you to answer the whole ques-

tion—created by the losses at Merrill Lynch, or would it be fair to say that you at least intimated to Mr. Lewis that he could count on an amount equal to Merrill's losses in December?

Mr. PAULSON. We weren't as specific in terms of the amount and the losses, but we more than intimated. Both Ben Bernanke and I were very clear that we were committed to working with him to come up with a support program that we thought would work.

Mr. CUMMINGS. Let's talk about Goldman Sachs for a moment. Immediately before becoming Secretary of the Treasury, you were the chairman and CEO of Goldman Sachs, were you not?

Mr. PAULSON. Absolutely.

Mr. CUMMINGS. And as Treasury Secretary, you asked then Goldman board member Ed Liddy to take over as head of AIG, is that correct?

Mr. PAULSON. Yes.

Mr. CUMMINGS. Goldman has subsequently been revealed to be the largest recipient of AIG's counterparty payments, benefiting to the tune of more than \$13 billion after AIG was bailed out. I note that the firm repeatedly claimed that its exposure to AIG was fully hedged, and it was not material to the firm.

Just this week, Goldman posted a record \$3.34 billion in quarterly profits and plans to give out billions of dollars worth of bonuses, to the tune of \$600,000 on the average to 28,000 employees.

I just ask you one question, and this is my last question. The people in my district who are losing their homes and their insurance, the ones you talked about in your statement, their homes, their insurance, everything they have, some of them elderly going back to work, you know what they asked me? They said, "Cummings, that money that those folks are getting on Wall Street, those millions and billions, is that our money? Because our money went somewhere. We don't know where it went. But we know people are getting millions and billions of dollars."

"What about us? What about us who are out of work? What about us who have to send our kids to college in September after they have done everything they are supposed to do to prepare for college? What about us who don't have a house? What about us? You keep telling us the storm is going to be over, but when the storm is over, who is going to be living in my house?" What about them? And they are asking the question, is some of this money their money?

Mr. PAULSON. Mr. Cummings—

Mr. CUMMINGS. I just want to be able to answer them when I go home tonight.

Mr. PAULSON. I want to just say two things. First of all, I want you to know that I had no role whatsoever in any of the Fed's decisions regarding payments to any of AIG's creditors or counterparties, No. 1.

Second, what I would say to you is the thing that bothers you, bothers me, because the people that are paying the price had nothing to do with the problem. But the sad truth is that if these companies had gone down, they would be paying a bigger price. There would be more foreclosures. There would be more people that are unemployed.

So you are absolutely right in asking the question. You should keep asking the question. This is a terrible thing, and that is why I believe you and the other Members of Congress need to work so hard to put in the kinds of regulatory reforms and the kinds of powers that we need to have in place to make sure we don't have to go through something like this again.

Mr. CUMMINGS. I see my time is up.

Thank you, Madam Chairman.

Ms. KAPTUR. I thank the gentleman.  
Congressman Bilbray.

Mr. BILBRAY. Thank you, Madam Chair.

Mr. Secretary, I am sort of sitting here listening to this testimony and all at once realizing as we are in the micro, there is a macro message here. You did say the Fed has the authority to hire and fire the board of directors?

Mr. PAULSON. Well, what I said is I have an understanding that, under unusual circumstances, if the Federal Reserve is dealing with a regulated entity and that there are decisions made at that regulated entity that endangers the safety and soundness of that institution, then the Fed has the authority to hold them accountable.

Now, clearly in terms of corporate governance 101, we know how boards are selected and we know that boards select management. But there needs to be something for regulated entities where the regulator can protect the safety and soundness.

Mr. BILBRAY. I am sensing we have moved beyond where we have been historically been. We have gone into a brave new world where now, with a de facto nationalization of the industry, we are sitting here as a committee considering items that, in 1927, when this committee was founded, never dreamed that Washington would be determining what kind of decisions are made in either Wall Street or Main Street. Now Washington is making those determinations, and this brave new world we ventured into of nationalizing major industries really does place a strain on a system that was never designed to make the decision or to do the oversight as we are trying to do today. It never was perceived by the founders of this committee that we would be having this discussion.

My question to you as the Secretary, as we talk about other situations and talk about exit strategies, where is the exit strategy? What date can I tell my constituents that we will not have this discussion anymore, that this committee and Congress will not be discussing how we have influenced or directed the decisions in at least this major industry? When will we be out of the business of doing banking?

Mr. PAULSON. Well, I would say, first of all, that is the major question. It is a question I ask myself and it is a question that is easier to ask than it is to answer. But it is a question you should be asking, because we as a Nation needed to do some things that many of us found abhorrent. They just were better than the alternative.

So once the system is stabilized and the economy is turned, then there needs to be great consideration given to how we exit this and then how we put in place those reforms to really reduce the risk

that we are ever going to be back here again doing these sort of things.

But I can't stand here and tell you today that I have the answer to your question, but I hope it is soon.

Mr. BILBRAY. Well, let me say, I think the last administration had the public turn on them because they did not have an exit strategy for another situation. Regardless of who is in the making of this, if this administration doesn't develop an exit strategy, give some timelines that do not exist today, I think all of us are going to be held responsible for the fact that Washington has stepped into something, has started punching at this tar-baby and now has no way of extricating ourselves out of it, and we have now created a whole new environment of what is appropriate for the Federal Government to be doing, and we are down now having this hearing about who gets hired or fired, who is notified that if they don't do certain actions, there is going to be termination.

All of these things have never been perceived as being the appropriate position for the Federal Government, which now the Federal Government is engaged into. So extracting ourselves out of the situation is going to be something I think the American people are going to demand very soon.

Madam Chair, at this time, I would like to yield to the gentleman from the Carolinas, if I remember right.

Mr. MCHENRY. I thank my colleague from whatever that State is in the West, that is financially sound.

Secretary Paulson, just in continuation with my line of questioning before, from the notes we have on your schedule from December 19th, mid-December, December 19th is what we have, it shows you had roughly five phone calls with Dr. Bernanke, with Chairman Bernanke, that day. Was that fairly typical in those very busy days of multiple communications, one on one and at the staff level?

Mr. PAULSON. Yes. We had I am not sure five every day, but we had multiple conversations for 7 or 8 months there.

Mr. MCHENRY. And when you communicated with Chairman Bernanke, did you express—on this day, we have multiple calls with Chairman Bernanke, a couple calls to Ken Lewis, Geithner, a number of different folks throughout the day. Did you describe to Chairman Bernanke your conversation you had with Ken Lewis?

Mr. PAULSON. My conversation with who?

Mr. MCHENRY. Ken Lewis.

Mr. PAULSON. Oh, with Lewis. My conversation on which day, the 19th?

Mr. MCHENRY. Whatever day it was. Did you describe the conversations you had with Ken Lewis?

Mr. PAULSON. Oh, the conversation I had with Ken Lewis on the 21st.

Mr. MCHENRY. You talked to Ken Lewis multiple times in December. There are multiple conversations where he said they were considering MAC. You said it was bad. You then came back and said—

Mr. PAULSON. Absolutely. We communicated frequently and I would summarize that conversation—

Mr. MCHENRY. Your mic I think is off.

Mr. PAULSON. Can you hear me now? We communicated frequently, and I would summarize conversations.

Mr. MCHENRY. At the same time, did you keep your successor, Mr. Geithner, informed?

Mr. PAULSON. Yes, in a different way; Chairman Bernanke was a major decisionmaker. During this period, once Tim Geithner was the Secretary of Treasury-designate, then we wanted a very smooth transition, so I kept him posted on a variety of things. But I wasn't looking to him as a decisionmaker when I posted him.

Mr. MCHENRY. Thank you.

Ms. KAPTUR. I thank the gentleman.

Congressman Connolly.

Mr. CONNOLLY. Thank you.

And welcome, Mr. Secretary Paulson. Thank you for your patience today, given our schedule.

I would like to go back just a little bit and maybe I can start following up on my colleagues' questions about the MAC. It is our understanding that not once but twice Mr. Lewis threatened to invoke the MAC because they had discovered a \$12 billion problem in the Merrill Lynch deal, is that correct?

Mr. PAULSON. Well, what I remembered was \$18 billion pre-tax at one time and then \$22 billion pre-tax at the end, and \$15 billion after tax. But my numbers might be wrong.

Mr. CONNOLLY. OK. But in both cases, they threatened or discussed with you the possibility of invoking the MAC, is that correct?

Mr. PAULSON. Yes.

Mr. CONNOLLY. Your reaction was obviously negative in both instances. Why?

Mr. PAULSON. It was based upon the view of very experienced lawyers, and again I haven't heard this refuted elsewhere with any degree of vehemence, that there was a legally binding contract and that the MAC clause would not have been legally valid in this situation. The shareholders had voted in both companies. This was a Delaware company.

Mr. CONNOLLY. But that is really a legal matter, obviously not normally involving the Secretary of Treasury. Why would you care one way or another whether he was acting on misinformation, legal misinformation, and threatening to invoke the MAC?

Mr. PAULSON. I normally wouldn't care, but if you have a situation where a company, in doing something like this in a period of uncertainty and fear, could do grave damage, in the opinion of the regulator, to that company and to the whole system, I sure better care.

Mr. CONNOLLY. You were worried about the impact on a very fragile system at that time?

Mr. PAULSON. I was worried about the impact on a very fragile system, and also the impact on BofA, which was the biggest bank.

Mr. CONNOLLY. Given that concern, Mr. Secretary, at any time in that period, around December 2008, did you have any conversation that could be construed explicitly or implicitly as promising in exchange for their backing off the MAC threat or even going public with the \$12 billion or whatever the ultimate number was, in ex-

change for that silence or that proceeding forward, that there would be TARP funding available to Mr. Lewis and BofA?

Mr. PAULSON. We definitely had conversations, but it wasn't in exchange for. No matter what they did, you know, I felt a responsibility, and I know Ben Bernanke felt the responsibility, to keep the financial system from collapsing. So this was not a situation where, "gee, we will do this big favor for you." This was a situation where we were doing this for the American people. And it just so happened that there was an alignment of interests, because a BofA failure wouldn't have been good for the BofA shareholders either.

Mr. CONNOLLY. And this alignment, as you know, I know you have heard ad nauseam here today, Mr. Lewis construed as almost a threat by you and perhaps by Mr. Bernanke that if you didn't take the Federal money, we were going to fire you and your board. That is a far cry from how you characterized it as sort of a confluence of interests.

Mr. PAULSON. Well, no, I didn't—there are two different things, OK? The confluence of interest was just what I said, which was we certainly didn't want BofA to be unstable. In terms of my communication with him, I have been pretty direct. I wouldn't use the word "threat," but I have said what I said and I was very direct, and I intended to give a very direct, strong, clear message. And that was, I am not characterizing it as a threat, and Lewis didn't characterize it as a threat, but I did explain the Fed's powers.

But that was—in terms of the confluence of interest, to me that is just an obvious thing. If you follow the train of logic we have laid out here, you either accept the logic or you don't. Some people will say, well, there was no crisis, nothing would have happened to BofA, nothing would have happened to Merrill Lynch, nothing would have happened to the financial system. I can't satisfy those people.

Mr. CONNOLLY. Yes, and I am with you, Mr. Secretary. There was a crisis and I understand where you and the Federal Reserve chairman were coming from.

But I guess we are trying to understand, and I see my time is up, Madam Chairman. I hope I have the opportunity to return to some specific questions regarding the term conditions of the agreement to go forward with TARP funding.

Thank you.

Ms. KAPTUR. I thank the gentleman.

Mr. Schock.

Mr. SCHOCK. Thank you, Madam Chairman.

Following up on Mr. McHenry's questions about Tim Geithner's involvement about this, you stated, once he was nominated, you kept him informed. However, we have notes from Joe Price, who is the chief financial officer for Bank of America, basically chronicling the conversation that you had with Chairman Lewis and yourself, and in those documents, he says, "Fire BOD if you do it; irresponsible for country; Board of Directors; Tim G agrees."

In those conversations, did you ever invoke Tim Geithner's name or suggest in any way that he was on board in your view on this to apply additional pressure to Mr. Lewis or Bank of America?

Mr. PAULSON. I tell you, I have sure got no memory of that. Just none whatsoever.

Mr. SCHOCK. You don't remember mentioning Tim Geithner in the conversation with Mr. Lewis?

Mr. PAULSON. I don't. I don't remember it. Those are Joe price's notes, and someone would have to ask him. I don't even remember talking to Joe Price. I remember talking with Ken Lewis. And as I said, I posted Geithner. I didn't look at him as a decisionmaker, and I just don't have a memory in that kind of detail.

Mr. SCHOCK. So you never used him, to your recollection, as additional pressure, that he was on board?

Mr. PAULSON. Yes, I sure don't recall that.

Mr. SCHOCK. OK. There seems to be a lot of confusion or it seems we are arguing over semantics over whether or not you threatened Mr. Lewis or Bank of America, and I don't think it is necessary that we argue over the semantics of a threat. I think you have been very clear, at least in your earlier testimony, that if they went forward with invoking the MAC, that you would have moved forward with attempting to remove him from his position:

Mr. PAULSON. Well, I would not have moved forward. I didn't have the authority to do that. What I said to him was, I said to him, if he did something so irresponsible, I believe the Fed could do that as his regulator.

Mr. SCHOCK. And you further clarified that you felt that would be irresponsible, invoking the MAC?

Mr. PAULSON. Yes. Absolutely. Very clear.

Mr. SCHOCK. That is clear. OK. So maybe threat isn't the correct word. Maybe he felt pressure. Is that a fair term?

Mr. PAULSON. I would rather just tell you what you what I said and let you characterize it.

Mr. SCHOCK. Fair enough. I would like you to respond then to Mr. Bernanke's testimony. Ranking Member Issa asked him, if there were threats, which I know you don't like that term, or if people felt threatened to go through with the deals, it is OK, because it worked out. Do you agree with that?

Bernanke responded, "no, sir." In other words, it would not be appropriate for Ken Lewis and Bank of America to feel pressure.

Given Bernanke's acknowledgment at our last hearing that threatening to fire Bank of America's management to get them to go through with the merger would have been inappropriate, are you prepared to take responsibility for issuing such an inappropriate statement?

Mr. PAULSON. I will tell you, I certainly take responsibility for what I said, and what I said, I think it logically followed from—I laid out a train of events and I think it logically followed that is what a regulator should do.

I would say, I think, Chairman Bernanke, when he testified here last month, I think he acknowledged that if someone put their—made a decision that harmed their company, they deserve to be held accountable. And that certainly is what I was trying to communicate to Ken Lewis.

Mr. SCHOCK. You stated earlier that you took issue with Bank of America's reason for invoking the MAC. Did you ever personally read their legal justification?

Mr. PAULSON. Nope.

Mr. SCHOCK. You stated you relied on the legal basis or rather the Fed's legal staff for their view on the MAC as your justification. Are you aware—do you know the names of the legal staff that you relied on?

Mr. PAULSON. I listened in and participated in a number of calls where I heard the legal staff, and I do know some of the people, yes.

Mr. SCHOCK. Do you know if any of that legal staff had backgrounds or experience in mergers and acquisitions?

Mr. PAULSON. I know they were experienced lawyers. I do not know their specific experience in mergers.

Mr. SCHOCK. Come on now. There is a difference between being an experienced lawyer and an experienced lawyer in mergers and acquisitions that would know whether a company has the legal basis to invoke the MAC clause.

Mr. PAULSON. Let me tell you one other thing, OK? One other test. I have participated in deals and in markets for 32 years, and when I hear a lawyer say to a company, what is your legal justification, after two shareholder votes and with a MAC that is structured this way, and I am not getting very much back on the other side; I will tell you something, as someone who has been around in the markets, everything that I heard squared with my instincts and judgments.

Mr. SCHOCK. Were you aware that Bank of America had successfully invoked the MAC less than a year earlier on the Sallie Mae deal?

Mr. PAULSON. Was it after shareholder votes in a Delaware company?

Chairman TOWNS. The gentleman's time has long expired.

Mr. SCHOCK. I guess what I am trying to understand is if they legally had justification and the legal expertise to invoke the MAC clause once, I would question why they would come forward and justify that they could do it in this instance and be wrong.

Mr. PAULSON. I have told you how I made my judgment, and that is how I made the judgment, and I think it was the right judgment.

Mr. SCHOCK. Thank you.

Chairman TOWNS. The gentlewoman from Ohio, Congresswoman Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman.

Mr. Secretary, some contend the timing of what you call in your testimony a financial crisis unprecedented in our lifetime was actually a calculated Wall Street scenario underpinned with masterful deceit and extraordinary moral hazard. Your clarion call for the taxpayer bailout of Wall Street's excess came 6 weeks before a major national election when our government is the most vulnerable and tender, and Congress skittish.

What your orchestration yielded was an unprecedented dumping of private sector losses on the U.S. taxpayer. History will show that the U.S. Government and you knew about Wall Street's growing losses long before the Bank of America merger. In fact, Bank of America's purchase of Countrywide in January 2008 was but another positioning of private sector interests in preparation for what I call the greatest Hail Mary pass of all time in taking those Wall

Street losses and placing them on the next three generations. What interests me is who you helped and who you didn't.

Yesterday's New York Times reports that Goldman Sachs, the firm at which you spent your life, posted the largest quarterly profit in its 140-year history, \$3.4 billion. Each Goldman employee reportedly could earn \$770,000 this year. And the same paper's lead editorial yesterday states, "Across our Nation, unemployment is rising, foreclosures are surging, lending is still constrained." I wish I had an hour to talk to you about that.

It looks like some very rich people are profiting handsomely, and I can tell you that those profits at Goldman, they would resolve about one-quarter of the housing situation in Ohio that we face today.

Since appointment by President Bush as Secretary of Treasury in 2006 until today, have you or any of your family had any financial ties or investments related to Goldman Sachs in any way whatsoever?

Mr. PAULSON. No.

Ms. KAPTUR. Thank you. What about Bank of America?

Mr. PAULSON. Not that I know of.

Ms. KAPTUR. President Bush was not the first President you served. Who was the first President you served?

Mr. PAULSON. Richard Nixon.

Ms. KAPTUR. Richard Nixon. Who did you report to in the White House in those days?

Mr. PAULSON. I reported first to Lou Engman and then to John Ehrlichman.

Ms. KAPTUR. Thank you. Let me ask you about the deals you structured while at Treasury. In terms of the warrants that you structured in the \$10 billion Goldman Sachs deal, the term sheet provides that, once Goldman redeemed the preferred shares, it has the option to purchase back the warrants at a fair market value at a timing of its discretion.

Why did you draft a provision that allowed Goldman Sachs, the borrower, to determine when the taxpayers must sell their warrants?

Mr. PAULSON. You know, in terms of how a specific warrant deal was structured, I am sure that the deal that was structured for Goldman was the same as for all the other warrants.

Ms. KAPTUR. But why would you leave the taxpayer, who in this instance is the creditor, why would you let the borrower set the terms?

Mr. PAULSON. I would say this, Madam Congresswoman, those warrants are going to be very profitable for the taxpayer.

Ms. KAPTUR. Yes, they are going to be very profitable, sir. But if Goldman can set the terms of how the money can be redeemed, we are not going to get back what we deserve to get back for the American people.

Mr. PAULSON. Oh, there is a process, and it is not a process where Goldman Sachs sets the terms.

Ms. KAPTUR. Well, that is not what the term sheet provides, at a timing of its discretion. That is what the terms are. Could you check into that for me with your friends?

Mr. PAULSON. OK, I will check into it. But the timing is one thing. The process for how that is set is another.

Ms. KAPTUR. Well, I don't know how you are defining your terms there, but it is pretty clear that Goldman Sachs will determine when our taxpayers, when we will get our money back. That is a pretty serious question.

Let me go to another point here, and this is who you help and who you don't help. Last year, Warren Buffett bought into Goldman Sachs at a level of \$5 billion. Under your watch as Secretary of the Treasury, our taxpayers were forced to invest \$10 billion in Goldman, not counting the counterparty deal with AIG. Warren Buffett received 43.5 million options worth \$1.8 billion for his \$5 billion gamble. OK, our taxpayers, by contrast, got 9.5 million options worth \$500 million, one-fifth as much, for their investment, which was double his.

Buffet is being paid 10 percent interest on his preferred stock, yet taxpayers only get 5 percent for the first 5 years and 9 percent for the second 5 years. Buffet has a 10 percent call premium; taxpayers have no premium rights. Buffet got \$5 billion of present value for his \$5 billion investment. Taxpayers have \$4.9 billion of present value for their \$10 billion investment.

How is this fair and why did Warren Buffett get a better deal for his stockholders than you as Secretary of Treasury got for the American taxpayer at Goldman?

Mr. PAULSON. There is a very clear reason why. When we structured the capital to go into all of the banks, it was the middle of a crisis. Attractive capital was not available. The reason we had to do this is capital was not available. We wanted to do something that was available, not where we were providing it under duress, but providing capital which was structured so that the taxpayer would get paid back—

Ms. KAPTUR. At the call of Goldman whenever it sets the terms.

Mr. PAULSON. Well, first of all, the banks, we put out the capital. It is preferred stock. It wasn't voting. It was 5 percent initially, so the taxpayer is going to get paid back all of that money, 5 percent interest, and warrants as various firms, and a number of firms have done well and paid back.

But you do not stop, Madam Congresswoman, you do not stop a financial panic by putting capital and offering capital to banks on the terms—the only terms it is available in the middle of a crisis. So what we were doing was moving quickly to put capital to a range of major financial institutions that were picked because they were systemically important.

I would also argue to you that the fact that a number of those institutions have done well—

Ms. KAPTUR. Oh, they have done very well. Oh, yes, Mr. Paulson.

Mr. PAULSON. And have paid back the taxpayer is something we should all be pleased about rather than the reverse.

Ms. KAPTUR. Well, you know, I wish you had gotten a better deal for the taxpayers. You certainly got a good deal for a lot of your former clients.

I have additional questions, Mr. Chairman.

Mr. PAULSON. I think if you look at what the taxpayer is going to make on a number of these companies, it will have been good.

But the biggest advantage to the taxpayer, by far the biggest advantage to the taxpayer, is what didn't happen, and that we did not have a collapse and we did not have double the number of foreclosures in Ohio and double the level of—

Ms. KAPTUR. Oh, they are happening, Mr. Paulson. You ought to come and visit us in Ohio and see the results of your handiwork.

Mr. PAULSON. Well, I know how terrible it is. I am just telling you it would have been worse.

Ms. KAPTUR. If that is your best argument, that is not good enough.

Mr. PAULSON. I want to explain it to you, because you probably don't agree there was a crisis.

Chairman TOWNS. Mr. Fortenberry.

Ms. KAPTUR. I agree it was a crisis of your making—

Chairman TOWNS. The gentlewoman's time has expired.

Congressman Fortenberry from Nebraska.

Mr. FORTENBERRY. Thank you, Mr. Chairman.

Hello, Mr. Secretary, thank you for joining us today.

In your testimony, you stated that you would like Congress to create a new regulatory framework to be able to intervene and facilitate the orderly wind-down of a systemically important institution. What do you envision?

Mr. PAULSON. Well, I think something very similar to what has been suggested by the Obama administration makes sense, because there needs to be, when there is a real systemic risk, so this should not be done frivolously, when the system is at risk, there needs to be a way to avoid the normal bankruptcy process and let a regulatory body come in and handle the wind-down of the liabilities in such a way as it does not present a real danger to the public and the financial system.

If we have a different regulatory regime and if this authority is structured properly, then we won't be in a situation where institutions are too big to fail.

Mr. FORTENBERRY. Well, in that regard, what role do you foresee for the Treasury and for the Fed, for the FDIC?

Mr. PAULSON. Well, there have been a number of things that have been suggested. What we have suggested as part of the regulatory blueprint was the Fed playing the role of a macro stability regulator, being able to look across the whole economy and look across the capital markets for risk, being able to access and get information and having the authority to act.

In terms of the wind-down, if there is a potential failure, I think there needs to be a high bar. So there would need to be a determination by the Secretary of the Treasury, by the chairman of the Fed, by other regulators, that there is a true systemic issue. So this should not be an easy bar to get over. But when there is, then the regulator needs all of the powers to handle that wind-down.

Mr. FORTENBERRY. Given all of the turmoil in the economy in the last year, given the government's intervention, we are now left with the reality that 10 banks in this country control about 50 percent of the deposited assets. Is that a systemic risk, in your view?

Mr. PAULSON. It is something that makes me uncomfortable.

Mr. FORTENBERRY. So how would this new regulatory framework look at that potential situation?

Mr. PAULSON. Well, as I said, and I am just only going to deal with things that I said, I am saying nothing now that I didn't say when I was Treasury Secretary. We put forward a regulatory blueprint which called for greater consolidation of the banking regulation as opposed to the multiple regulators, and so I think having greater consolidation and stronger regulation, coupled with the wind-down powers so that you don't have banks or bank holding companies being too big to fail, I think is a meaningful way of dealing with the risk. Because, in my judgment, a regulation, no matter how good, is always going to be imperfect. So you need to have it in balance with the market discipline or moral hazard. That we got to a point where we couldn't rely on market discipline or moral hazard because it would have taken the system down.

But to the extent the infrastructure in the financial markets are fixed, and I am talking about the tri-party repo market, credit default swaps, and there is a lot of work being done there, and you have the wind-down powers so then we are not then held hostage by institutions that are too big to fail, I think there is an opportunity to get the balance right.

Mr. FORTENBERRY. Just to let you know, we have changed the expression "too big to fail" to "too big to succeed." That is part of the intention that I have in simply asking you the question, are we now in a place where we, because of debatable actions, and I have heard you clearly in your justifications and I am not trying to play "gotcha" here or anything, just looking ahead to say, are we now in a situation where the actions that were taken to try to stabilize the economy has left us with further vulnerability and the potential for systemic failure because of this highly concentrated control of the financial system in the hands of a few?

Mr. PAULSON. I understand your question, and there is going to be, because when you look at the number of banks, there is going to be a lot more consolidation before we are done, but I do understand your question and I think it is important we get this in balance.

Mr. FORTENBERRY. Thank you.

Chairman TOWNS. The gentleman's time has expired.

Congressman Clay from Missouri for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

And thank you, Mr. Paulson, for your candor today. Hopefully, we can continue in that vein.

Secretary Paulson, I have noted with great interest of your evolution from a proponent of no government interference in the free markets to a person who believes that government does and should have a role in the markets. I find that enlightening, somewhat welcoming, and also contradictory, often at the same time.

However, today I have questions on why we have companies that are too big to fail. I don't believe that. Many don't believe that. Of those that you obviously think are or were too big to fail, what distinguishes them from others? Why was Lehman Brothers allowed to fail and Merrill Lynch and Bank of America were not? What were the differences in systemic risk to the country in making the decision to rescue the latter and not the former? And why rescue and assist Goldman Sachs and not Lehman Brothers?

Mr. PAULSON. Well, let me—you know, I went through this earlier, and I will go through it again.

At the time when Lehman was failing, we didn't have the TARP, so we had no authority to put capital into Lehman Brothers, and we were unsuccessful in finding a buyer.

In the case of Bear Stearns, we had a buyer in J.P. Morgan, and the government could assist that buyer, but J.P. Morgan was providing the capital and able to guarantee the trading book.

Mr. CLAY. AIG. Talk about AIG.

Mr. PAULSON. Let me talk about AIG, because AIG is another one that was different. In AIG, it was perceived as being a liquidity problem, but at the insurance company level, we had regulated insurance companies that were well-capitalized and perceived as being stable. So the Fed could solve the liquidity problem by loaning against those insurance company assets, and the market accepted that.

Lehman Brothers had a capital hole and a liquidity problem, and we had been working with a group of industry participants to help finance a deal if we could get a buyer, and we were unsuccessful at getting that buyer. So once we had the TARP in place, we had other tools in the tool kit.

There has been a lot of confusion. For instance, people will say the Fed made a loan to Lehman Brothers after they failed against that collateral. That is true. The Fed made a loan, and that was to facilitate a liquidation and a bankruptcy. A Fed loan to Lehman Brothers by itself would not have filled the capital hole, would not have taken care of the trading book guarantee, and would not have prevented a bankruptcy.

So after Bear Stearns went, if you look at the record, you will look at the fact that Ben Bernanke and Hank Paulson each gave a number of speeches where we said we don't have the authorities that are necessary to deal with nonbanking institutions, financial institutions.

But your question gets asked by a lot of people, because these were complicated issues.

Mr. CLAY. But, look, let me tell you what my constituents are feeling. You know, we gave AIG \$180 billion because they were irresponsible, because they took risks, because they created these exotic products and enriched themselves. They were irresponsible, and yet they get rewarded through our tax dollars. Now we own them.

So, when does it stop? And what is the punishment for their irresponsibility?

Mr. PAULSON. Congressman, I can't tell you how much it pains me to be on the other side of this conversation, because I can't tell you how angry I was when I sat there that weekend in September when the management team came in and laid out the issues. And you are absolutely right.

But there was a situation where we had essentially an unregulated hedge fund on top of insurance companies. There is a huge gap in our regulatory system. This should never have been allowed to happen. It did happen. All I can say to you is you will never be able to explain that so your constituents can understand it, and that is a good thing, because we don't want to have to understand

this in this country. We don't want to be in a situation where this can happen again.

But all I can say to you is I believe that if the Fed had not taken that action, given the size of AIG, we would have had a global banking run. We would have had a financial system meltdown. The wealth that would have been lost in 401(k) programs, saving plans, the wealth that would have been destroyed this in this country, would have been—was tragic.

But now you have a situation where the government is an owner, the government is there, and we have to be careful we don't draw the line between trying to punish them and shooting ourselves and the taxpayer in the foot, because right now we should all want AIG to do well.

Chairman TOWNS. The gentleman's time has expired.

Mr. CLAY. You sure? I had 5 minutes.

Chairman TOWNS. In fact, you had 7.

Mr. CLAY. Thank you, Mr. Chairman. I yield back.

Chairman TOWNS. Thank you very much.

I ask unanimous consent that Mr. Stearns and Mr. Garrett be allowed to participate and, of course, without objection, so ordered. And I now call on Mr. Stearns.

Mr. STEARNS. Thank you, Mr. Chairman.

Mr. Paulson, I hear your pain when you said you are just pained to be on that side of the table answering the gentleman's question, but isn't it true that Goldman Sachs benefited from the AIG bailout? They got \$13 billion and was the largest recipient of the public funds from AIG. And, in fact, creating the collateralized debt obligation [CDO], formed the basis of the current crisis we have today. But while you were CEO of Goldman Sachs, you were an active part of that business.

So my problem is, when you say you are pained by AIG, I go back to your bait and switch when you came here to Congress and you suddenly decided, instead of buying the toxic loans, you were going to go out and start to give money to these people.

So if you didn't have any credibility on the bait and switch, how do you have any credibility today to come before you us and tell us that you are pained by AIG?

Mr. PAULSON. Well, let me respond—

Mr. STEARNS. Do you understand the credibility you have, you came here and said in this two-and-a-half page bill that you wanted \$750 billion. Then immediately after you got approval from Congress, you changed it. You baited us on, then you switched it.

And then you started giving money to these institutions, these top 15 institutions, when all these people who had the loans you could have worked out a homeowners' equity plan around this country to help the people who are actually having their homes foreclosed. You are helping AIG, and you are helping Bank of America, and you are bankrupting Lehman Brothers, who was your biggest competition.

Isn't there some point you should have recused yourself and said, "you know something, all my buddies in Goldman Sachs are over there? You know, I really feel that I shouldn't be making these decisions to let Lehman Brothers go bankrupt, that I really should recuse myself."

And the fact is you are coming here and say you feel the pain of AIG, it's just outrageous.

Mr. PAULSON. Well, I would like to respond to you, Congressman, because I find your statement outrageous.

Mr. STEARNS. Let me tell you, I have the time, Mr. Paulson. Let me just say one other thing.

Chairman TOWNS. No, I just want you to speak into the mic. Pull the mic to you.

Mr. STEARNS. Let me say one other thing here. You know, when you look at—you are saying to us you support the Obama administration giving more power to the Federal regulator, the Fed. But when you look, the Fed was on—Geithner was on board at the Fed, the New York Fed, dealing with all these institutions. He didn't get it.

And then we had this fellow who came up afterwards, Mr. Friedman, he was on the Goldman Sachs board. And he didn't last too long as the Fed chairman. Why? Because he had conflict of interest.

Is it possible that there's so much conflict of interest here that all you folks don't even realize that you are helping people that you are associated with and you should be recusing yourself for America's ethics?

Mr. PAULSON. Let me make several comments.

The first comment I will say is I came to Congress, I asked for the TARP, and I asked for authority to purchase illiquid assets.

Mr. STEARNS. But in 10 days you changed your opinion—

Mr. PAULSON. We changed because the situation changed dramatically.

Mr. STEARNS. In 10 days?

Mr. PAULSON. You betcha. If you look at what happened in that 10-day period, you look at what happened around the world, it changed dramatically. No. 1.

Mr. STEARNS. I don't want you to use all my time.

Mr. PAULSON. OK. Second—but I just want to respond to, second. I left Goldman Sachs, I sold my shares in Goldman Sachs.

Mr. STEARNS. Tax deferred too. You didn't have to pay any tax on your \$200 million, is that true?

Mr. PAULSON. I sold my shares in Goldman—

Mr. STEARNS. There is a clause that if you come into the administration, you sell your assets, it is tax deferred. You don't have to pay \$200—you had a \$200 million profit, and you didn't have to pay any tax. Isn't that true? Is that true or not? Yes or no.

Mr. PAULSON. Listen, you do not pay a profit when someone—a tax when someone makes you sell assets.

Mr. STEARNS. Maybe that was the incentive for you to become Secretary of Treasury so you didn't have to pay the tax there?

Mr. PAULSON. Oh.

The next thing I would say to you, and say it very, very clearly, is I, you know, I behaved with the—

Mr. STEARNS. You don't think you should have recused yourself when you asked Lehman to go into bankruptcy, you didn't put Bear Stearns in bankruptcy, and then you folded Merrill Lynch into—I mean, isn't there some point where you have to say, "hey, I have

a conflict of interest here?" You don't feel any kind of scintilla of ethics on this thing at all?

Mr. PAULSON. Totally. I operated very consistently within the ethics guidelines I had as Secretary of the Treasury. And when it became—when it became clear that we had some very significant issues with Goldman Sachs and with—

Mr. STEARNS. Why didn't you recuse yourself then?

Mr. PAULSON [continuing]. And with Morgan Stanley, what I did then, it would have been very wrong for me to recuse myself. What I did was I went and got a waiver from the ethics agreement. Because when we had concerns—

Mr. STEARNS. Who is in charge of the ethics agreement?

Mr. PAULSON. What?

Mr. STEARNS. Who is in charge of the ethics agreement that you got a waiver?

Mr. PAULSON. We have an Office of Ethics at Treasury and we have a White House Ethics Office.

Mr. STEARNS. So you got it from legal counsel at the White House?

Mr. PAULSON. We got it from the Government Ethics Office.

Chairman TOWNS. The gentleman's time is expired.

Mr. STEARNS. Thank you, Mr. Chairman, for the courtesy. And I ask unanimous consent that my opening statement be made part of the Record.

Chairman TOWNS. Without objection, so ordered.

The Congresswoman from California, Ms. Diane Watson.

Ms. WATSON. Thank you, Mr. Chairman. I appreciate your being here and for your patience.

A few minutes ago we talked about an institution that you thought would be able to deal with regulatory activities. How do you feel about the regulatory proposals that have been put forth by President Obama and Congress?

Mr. PAULSON. That's a pretty broad, general question.

Ms. WATSON. Have you been following them?

Mr. PAULSON. Yes. I would say I made, when I was Secretary at the Treasury, I put forward a number of regulatory proposals, put forward a regulatory blueprint.

And there are a number of things that the administration has put forward that I am very, very pleased about, the wind down authorities for nonbanking institutions, the idea that there be a macro stability regulator, the idea that there be a consolidation of banking regulators.

So I think there are some very positive ideas that have been put forward.

Ms. WATSON. Would you please, if we send you the exact questions, would you put your responses in writing so I can say that when we form this new regulatory system, these are some of the points that we ought to consider?

We are trying to unscramble eggs that are really rotten at this point, and we must move forward and correct this system. It's impacting on not only the United States but the rest of the world, too. We have to get it right, and I don't—I cannot be convinced that this wasn't seen back a year ago, the collapse.

But in trying to move on, I want to reiterate what has happened on Tuesday. It was reported that just 1 month after repaying their \$10 billion in aid, Goldman Sachs would be posting a second quarter net profit of \$3.44 billion.

I am curious to hear your perspective on their success despite the recession, given your 26 years of experience at Goldman Sachs and the unique role former Goldman employees have played in economic policy, considering that the last two chairmen of the Federal Reserve Bank of New York, the head of the World Bank, and the head of the New York Stock Exchange, and the former Assistant Secretary at Treasury responsible for TARP, Neel Kashkari, were all former Goldman Sachs employees.

And why do you believe Goldman Sachs has been able to bring in such profits despite the current economic conditions?

Mr. PAULSON. Yes—I don't have an answer for you. I have not worked at Goldman Sachs in 3 years, so I can't explain what they are doing that's working. But I can say I take some comfort, and I think all of you should, that there are a number of financial institutions that are more profitable today. And it looks increasingly like the government will be paid back with profits on a number of these plans.

And in terms of your request to me to give you something in writing, I will work with you on that. I don't have a staff like I used to, and I have a lot of requests.

Ms. WATSON. No. You can handwrite them. I do have a staff, and we will send you in writing what we would like to ask and what you think should be proposed. You can write it in hand. You can do pencil and paper.

Mr. PAULSON. I will do my best to work with you on it. Thank you.

Ms. WATSON. All right. I appreciate that. And do you think that Goldman Sachs has benefited from the economic crisis and the dissolution of some of their strongest competitors, such as Lehman Brothers?

Mr. PAULSON. I don't. I don't know what is the source of the profits, and I have no basis to speculate on it.

Ms. WATSON. OK. How was the determination made that institutions such as Bear Stearns, AIG, and Merrill Lynch should be saved either through direct assistance or acquisition, while Lehman Brothers would be allowed to fail? I am not quite clear, and I know you have addressed it.

Mr. PAULSON. Yes, I did, and I would just say to you, we did not have the legal powers we believed to do something in the Lehman Brothers case. We did not have the TARP to put capital in, and we did not have a buyer as we did in the case of Bear Stearns.

And so we were faced with sort of an unfortunate set of circumstances.

Ms. WATSON. And I will conclude, I see the red light, Mr. Chairman, but I just want to say if we have missed our oversight responsibilities, I need to know what you consider, in writing, and we will put that in our letter to you, what you consider government could do more of.

I do know that we did not, this committee, under the former administration, did not do the kind of oversight, maybe we were asleep at the wheel, or maybe we looked the other way.

But I would like to hear from you what government could do so we don't get in this situation again. And I think, really, it's worse than the depression of the 1930's.

Thank you, Mr. Chairman, for the extra minutes.

Chairman TOWNS. I thank the gentlewoman from California.

I now yield to Mr. Garrett of New Jersey.

Mr. GARRETT. I thank the chairman and thank the Secretary.

Before I begin, I would just make a comment. One of your comments when I was walking in the room with regard to AIG, saying that there was a gap with regard to coverage—not coverage, but gap with regard to authority and regulation there.

We have had a number of panels, Financial Services, look at this. And the bottom line is, the take-away that I have always heard is there is not a gap in authority, not a gap in regulation, that there were regulators there in place.

But what they actually admitted to was they had the authority, they had the personnel. But, you know what? They just missed it. They weren't looking in the right places, and it was just an error on the part of personnel.

Mr. PAULSON. And it may have been a gap in terms of capability when you look at the multiple regulators.

Mr. GARRETT. That's probably a good way to phrase it.

One of the things that you have said and others, Chairman Bernanke as well, that what we needed here is resolution authority, and that's what we need to answer her question going forward is resolution authority as well.

But here is a question I will pose for you hypothetically. Had we had resolution authority prior to the AIG situation, can you think and explain to me how it would be different?

I will just posit two thoughts to you. If you had the resolution authority and they tried to move in to try to wind down the firm in a more, quicker manner—but we know right now, there is no real market out right there. And the same reason we are not doing it right now is it would put a more, larger burden on the taxpayer, right?

And if you did it—what they are doing now, essentially, is saying we are going to do it out over a period of time. There's still the threat of a problem over it.

So help me understand why anything would be different significantly to the taxpayer and the structure had we had a wind down authority in place prior to the AIG situation?

Mr. PAULSON. With AIG it was necessary to keep the current—the company didn't go through bankruptcy.

Mr. GARRETT. Right.

Mr. PAULSON. Kept the current, kept the current corporate structure.

Mr. GARRETT. Right.

Mr. PAULSON. Worked within the legal framework.

Mr. GARRETT. Right.

Mr. PAULSON. The one thing that is similar is that the Fed made a loan, which is going to be repaid—

Mr. GARRETT. Yes.

Mr. PAULSON [continuing]. As pieces of the company are sold.

But since I don't know, you know, in terms of AIG—

Mr. GARRETT. Yes.

Mr. PAULSON. My role was giving the Fed support as they made this decision. But once the action was taken, I had no dealings. So I just don't know the details, and I think probably the Fed would be better to answer that question for you in terms of what they are doing now, what they might do differently with the resolution authority.

Mr. GARRETT. OK. I only posit the question because I do know you were not on the scene after the fact. But I just posit the question because I know you have said in the past, and here, too, I think, that we need the wind down authority.

But I am not really seeing, and I haven't got my hands around—from other witnesses as well, what would have been different in that situation.

And now we have the situation, as you well know, with the CIT, looking like that they are not going to be able to get a bailout, if you will. And so haven't we already set up the precedent, set up the situation, maybe going all the way back with Bear Stearns, that you create the conundrum of them saying that we look to the government to bailout, and under the administration proposals they say we are only going to bail out the Tier 1 entities. And CIT apparently just doesn't fall into that category, so they are not going to get the bailout.

So you have a disincentive now. You have a disservice to the taxpayer and disincentive to the taxpayer saying you are going to encourage companies like that in the future and say, boy, I better get into the Tier 1 situation again or else I am going to fall into the CIT situation. Isn't that the problem with the administration's proposal?

Mr. PAULSON. Well, I don't have all of the facts in terms of what has happened. When I was here, the regulators made CIT a bank holding company. They came in with a regulatory recommendation to Treasury. We funded, we funded them out of TARP. I have lost touch. I don't know what's happened.

But I understand the issue, the conundrum you have laid out. And that is why, really, the only answer is we need to exit from all of these programs as soon as we can.

Mr. GARRETT. Yes. But my fear is that we—and my question to you would be, are we not, would we not under the administration's proposal—and I know you spend some time looking at these things—basically perpetuating that situation going forward? In other words, we set the administration's plan into place, and we begin to identify certain entities as being too big to fail, the Tier 1 institutions, then the CITs of the world.

And I know you may not be up to speed, and neither am I, on the particulars right there, but the CITs of the world will say we want to get into that situation in the future, and that's the basic underlying flaw in the administration's proposal, that you perpetuate the problem.

Would you agree with that?

Mr. PAULSON. I do agree on one thing, that we don't want to move toward a situation in this country where we have certain organizations that are too big to fail and every one else can fail, and we want to get to a situation where no one is too big to fail.

Now, I don't know enough about the CIT to jump to the same conclusion you are about that. But I understand the dilemma you are pointing to.

Chairman TOWNS. The gentleman's time has expired.

I indicated to Mr. Paulson that we would get him out. He has a plane to catch.

So I would now like to yield closing statement to ranking member, Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman, and thank you for this hearing, and I look forward to the reform part of our oversight and reform.

At this time I will like to ask unanimous consent that the committee consolidate questions of the minority and the majority so that we can keep from overburdening Mr. Paulson and still work with him to get followup answers.

Chairman TOWNS. Without objection, so ordered.

Mr. ISSA. Thank you.

Mr. Paulson, I personally want to thank you as a private citizen for coming here and giving us so much of your time and your insight into what happened at this very difficult time.

There are unanswered questions. There are questions that we will never know. We will never know, had Merrill Lynch stayed on its own, stood on its own and received, let's say, half of the TARP money that the combined company received, would it, in fact, today be a viable, going concern?

Would the backup plans envisioned by the Treasury and the Fed, in case BofA were to back out, would they, in fact, have worked? We will never know that.

Mr. Secretary, I want to thank you for your attempts to make sure we never had to know it.

I, in fact, have been an outspoken critic of some of the activities, including the threats. I am and will continue to be an outspoken critic of expanding the Fed's role beyond the monetary supply and giving them a direct role in the systemic risk question. I do so because I believe that the Fed has a primary and premier obligation as an economic modeling organization.

Well, you have a long history in mergers and acquisitions, understanding of what a, "good merger" is and a "bad merger" is. That is not inherently a core talent that we expect to see in the Fed. So as we work to go forward to find the right models in case something like this happens again, and hopefully the right models to see it before it happens and prevent it, I hope you will continue to be a resource for us, because I do believe that the commission, which has just been formed, and this committee have an obligation to get it right so we don't have to do it again.

Mr. Chairman, I want to thank you for this series and for your continued partnership on a bipartisanship basis and particularly for your help today in making sure that everyone got their questions in, including those who have not yet asked them.

With that, I close and yield back and thank the chairman.

Chairman TOWNS. I thank you very much for your statement.

Let me just say, Mr. Paulson, thank you for coming.

But, still, there are some unanswered questions that I would hope that maybe you could give it to us in writing, that when they looked at the books at Merrill Lynch, they realized there was a \$9 billion shortfall. This is according to Mr. Lewis. And then, of course, it was discovered further that maybe it was a \$12 billion shortfall.

But my question to you, and hope that you give it back to us in writing, because when I asked you earlier today you didn't respond to it: How did it get from \$12 billion to \$20 billion? There's no real answer.

Mr. PAULSON. I can tell you. That one I can tell you I can't give it to you in writing, because I don't know. What I heard was a call on the 17th where the losses were \$18 billion pretax. By the 19th they were \$22 billion pretax. And what I said to people, that's a loss that takes my breath away.

When the market hears that, now, all I could say to you is December, the end of November and December were the worst months in the marketplace. And banks, it was the worst month for the economy. If you look at what was going on economically, it was the worst month in terms of credit products and banks losses.

And so I didn't—when I look at it, I wasn't shocked that this could have happened so quickly. But I don't have that explanation. You would have to get that from Merrill Lynch or BofA.

Chairman TOWNS. Yes. I could see this if we were talking about millions, but we are talking about billions, "B." It is like "B" in boy.

Mr. PAULSON. Yes, that was my reaction. I saw and witnessed things that I never had seen before.

And so what was going on in the marketplace at that point in time, what BofA and Merrill subsequently explained to me, was the products they had in inventory, the credit products, there was a big erosion in value based upon what was going on in the markets.

But I don't—I don't know. I heard about it for the first time on the 17th.

Chairman TOWNS. Let me just finish by saying last year, at the height of the financial crisis, major decisions were made about who was going to live and who was going to die. Lehman went down but AIG was saved. Bear Stearns was sold off, Bank of America received billions. Nine big banks were forced to take billions, when in many instances they didn't even ask for.

Most significantly, all of this was decided behind closed doors, with no oversight. In a way, the Bank of America-Merrill Lynch deal illustrates the dangers of concentrating enormous power in only one or two individuals.

When you turn over complete authority to the Treasury Department or the Fed, with no accountability and no checks and balances, this is what you get: oral commitments involving billions of dollars; seemingly arbitrary decisionmaking, and residual suspicion.

Mr. Paulson has stated that the principal regulatory agencies—the SEC and the FDIC—were consulted in this merger. I think it is clear that we need to hear next from former SEC Chairman Cox, and from FDIC Chairperson Bair to better understand the nature

and extent of their participation. I intend to schedule a hearing for that purpose following the August recess.

There are some unanswered questions here, and if we are going to reform our financial system, I think we need to have the answers to these questions.

So, Mr. Paulson, I want to thank you for taking the time to come, and I hope that you will become a resource in many, many ways to be able to help us to sort of unfold and get through this mess and to be able to come back stronger than ever before.

Thank you so much for testifying.

Mr. PAULSON. Thank you very much, Mr. Chairman. Thank you. Chairman TOWNS. This hearing is adjourned.

[Whereupon, at 2:55 p.m., the committee was adjourned.]

[The prepared statement of Hon. Gerald E. Connolly and additional information submitted for the hearing record follow:]

GERALD E. CONNOLLY  
11TH DISTRICT, VIRGINIA

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Opening Statement of Congressman Gerald E. Connolly  
Committee on Oversight and Government Reform  
"How Did a Private Deal Turn Into a Federal Bailout, Part III"

July 16<sup>th</sup>, 2009

Thank you, Chairman Towns for holding this series of hearings on the Bush administration bailout of the Bank of America. Following the testimony of Ken Lewis and Federal Reserve Chairman Ben Bernanke, it is clear that Mr. Lewis successfully bluffed the Treasury and Federal Reserve into subsidizing a private merger even when Mr. Bernanke doubted that Mr. Lewis would pull out of the merger without a bailout. Though the lessons are multitudinous, I believe we need to focus on limiting the capacity of private companies to wring tax dollars out of the Federal government to subsidize agreements that should be entirely private. These lessons are particularly pertinent in light of proposals to empower the Federal Reserve.

As the last hearing Mr. Bernanke's testimony confirmed, although the Federal Reserve had an important role establishing "ring fencing" for the Bank of America, former Treasury Secretary Paulson had the most frequent and direct interactions with Ken Lewis. On December 17<sup>th</sup>, 2008 Ken Lewis called Secretary Paulson to threaten that Bank of America might invoke a MAC clause to withdraw from its merger with Merrill Lynch, which had already been agreed to by shareholders. Following a Bank of America Board meeting on December 22<sup>nd</sup>, 2008 Ken Lewis called former Secretary Paulson to see if Mr. Paulson could put the bailout agreement, which the Bank of America Board had just discussed, in writing. Mr. Paulson told him that it should not be lest it prompt disclosure regulations.

Incredibly, when Mr. Lewis appeared before this Committee he testified that there was no concrete agreement between the Treasury and Bank of America for a bailout, just an "an agreement that we would work toward a solution." This is an unbelievable statement. Why would the Bank of America Board request that such a general agreement be put in writing? Why would such a general agreement prompt the disclosure requirements that were of great concern to Mr. Lewis and Mr. Paulson?

Even more remarkably, when I asked Mr. Lewis if there was any intentional reason not to put this "commitment" in writing, he said, "No, sir, because there was not enough specifics to put into writing." His statement, given under oath, clearly contradicts the email that he sent to the Bank of America Board on the evening of December 22<sup>nd</sup>, following his conversation with Mr. Paulson, in which he wrote that Mr. Paulson advised against putting their agreement in writing because that would prompt public disclosure laws which, Mr. Lewis wrote in his email, "of course, we do not want."

It is clear that Mr. Lewis bluffed his way into receiving a Treasury bailout of \$20 billion, in addition to Federal Reserve guarantees of ring fencing, based on what was understood to be an empty threat of invoking a MAC clause. It is a sad day in America when a wily CEO can trick former Treasury Secretary Paulson into paying Bank of America \$20 billion to execute a private sector merger. I hope that Congress has the sense to create the safeguards to ensure that this sort of corporate welfare, executed under the Bush Administration without any public oversight, never happens again.

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**Paulson Expected to Face Hard Questioning on Merrill Deal** [Next Article in Business \(11 of 39\) »](#)



Brendan Smalowski for The New York Times

Henry M. Paulson Jr., the former Treasury secretary, at a news conference last year. Mr. Paulson was expected to defend his record at the Treasury during a House committee hearing Thursday.

By **ZACHERRY KOUSS**  
Published: July 15, 2009

**Representative Edolphus Towns, Democrat of New York, demanded to know last month "who was holding the shotgun" that forced Bank of America into a hastily arranged marriage with the struggling Wall Street giant Merrill Lynch.**

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Mr. Towns, the chairman of the House Committee on Oversight and Government Reform, will get an answer at a hearing on Thursday when Henry M. Paulson Jr., the former Treasury secretary, tells lawmakers that he delivered a "strong message" to Bank of America's chief executive.

According to testimony prepared for the committee hearing, Mr. Paulson will say that he warned the chief executive, Kenneth D. Lewis, last December that abandoning the Merrill deal could result in his immediate dismissal.

Mr. Paulson will address questions from committee members, including many who contend he went too far by threatening to oust Mr. Lewis if he did not complete the

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Merrill deal, even if Mr. Lewis thought newly discovered losses at Merrill would hurt Bank of America's shareholders.

Mr. Paulson, now a visiting scholar at Johns Hopkins University, plans to defend his record vigorously. "I believe my remarks to Mr. Lewis were appropriate," Mr. Paulson said in his prepared testimony.

"Bank of America's completion of the merger, and the subsequent assistance from the government, not only protected our country's financial system but also was in the best interest of the shareholders, customers, employees and creditors of Bank of America and Merrill Lynch," he said, noting that the Fed had the authority as the bank's regulator to remove its management.

Mr. Paulson's statement tries to solidify his legacy as Treasury chief during one of the worst financial calamities in United States history. Without the strong intervention of the federal government last year, many more Americans would have lost their homes, their jobs, their businesses, their savings and their way of life, he said.

The House committee, which has already heard from Mr. Lewis and the Federal Reserve chairman, Ben S. Bernanke, is expected to pepper Mr. Paulson with questions about why the government decided to inject \$20 billion of taxpayer money into Bank of America to help it complete the Merrill deal.

Lawmakers, including Dennis J. Kucinich, Democrat of Ohio, have suggested that Mr. Lewis was the one who actually threatened the government by suggesting Bank of America would abandon the Merrill deal unless it received more federal aid.

"There has been a misconception here that the government put a gun to Bank of America to do the deal, when in fact it was Bank of America that put the gun to the government," Mr. Kucinich said at a hearing of the same committee in June.

At the hearing, Mr. Lewis testified that Mr. Paulson and Mr. Bernanke had pressed him to complete the Merrill deal last December after Bank of America learned of billions of dollars in additional losses at Merrill.

Mr. Bernanke also staunchly denied that he or anyone else at the Federal Reserve did anything improper in prodding the bank to complete its takeover of Merrill. At a testy hearing last month, he also denied accusations that he had threatened to oust the bank's top management if Bank of America pulled out of the deal.

Lawmakers have questioned whether Mr. Lewis was urged to withhold Merrill's staggering losses from shareholders before they voted on the merger.

"I did not -- nor to my knowledge did anyone at the Federal Reserve or the Treasury -- tell Mr. Lewis not to disclose any information to the public markets, including Merrill Lynch losses, that Bank of America believed it was legally required to disclose," Mr. Paulson said. Mr. Lewis has testified that his legal advisers said disclosures about the Merrill losses were not required.

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## NOTES/DIRECTIONS

HOUSE OVERSIGHT AND GOVT REFORM CMTE HOLDS HEARING ON THE BANK OF AMERICA TAKEOVER OF  
 MERRILL LYNCH WITH FORMER TREASURY SEC. HENRY PAULSON  
 WSOC WANTS A PKG ON THIS. HEARING ON CAP DA 5 - MEGAN WILL BLOG FROM HEARING

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FORMER TREASURY SECRETARY HENRY PAULSON IS SET TO TESTIFY BEFORE A HOUSE COMMITTEE ON JULY 16 ABOUT THE GOVERNMENT'S ROLE IN ENCOURAGING A CONTROVERSIAL DEAL BETWEEN BANK OF AMERICA AND MERRILL LYNCH AT THE HEIGHT OF THE FINANCIAL CRISIS. DEMOCRATS AND REPUBLICANS HAVE BEEN ZEROING IN ON THE DEAL AT THE END OF 2008 TO SEE WHETHER PAULSON, FEDERAL RESERVE CHAIRMAN BEN BERNANKE AND OTHER FEDERAL OFFICIALS EXERTED UNDUE PRESSURE ON BANK OF AMERICA TO COMPLETE THE DEAL.

THE TESTIMONY WILL BE THE FIRST THAT PAULSON GIVES TO CONGRESS SINCE LEAVING THE TREASURY DEPARTMENT AND COMES AS CONGRESS AND THE OBAMA ADMINISTRATION WEIGH A MAJOR OVERHAUL OF THE FINANCIAL SYSTEM. CONGRESSIONAL INVESTIGATORS ON THE HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM HAVE BEEN LOOKING AT WHETHER GOVERNMENT OFFICIALS THREATENED TO REMOVE BANK OF AMERICA'S CEO KENNETH LEWIS OR OTHER BANK MANAGERS IF THEY DID NOT FINALIZE THE DEAL. THE BANK WAS CONSIDERING PULLING OUT OF THE DEAL IN LIGHT OF BILLIONS OF DOLLARS IN EXPECTED LOSSES AT MERRILL. LEWIS AND BERNANKE HAVE BOTH TESTIFIED BEFORE THE COMMITTEE, WITH LEWIS SAYING THAT THE PRESSURE FROM THE GOVERNMENT DID NOT SWAY HIS DECISION TO FOLLOW THROUGH ON THE DEAL. BERNANKE DENIED MAKING ANY OVERT THREAT TO REMOVE MANAGEMENT. INVESTIGATORS HAVE SUBPOENAED HUNDREDS OF E-MAIL AND OTHER DOCUMENTS FROM THE FEDERAL RESERVE, AN INSTITUTION THAT TRADITIONALLY CHERISHES ITS INDEPENDENCE. BERNANKE, AT TESTIMONY LAST WEEK, CAME UNDER THREE HOURS OF CRITICISM, WITH DEMOCRATS AND REPUBLICANS APPEARING UNSWAYED AT THE END. IN A LETTER ANNOUNCING THE HEARING, COMMITTEE CHAIRMAN REP. EDOLPHUS TOWNS (D-N.Y.) LISTED A STRING OF QUESTIONS FOR PAULSON, INCLUDING WHETHER BANK OF AMERICA NEEDED FEDERAL MONEY TO COMPLETE THE MERRILL DEAL AND WHAT THE GOVERNMENT CAN DO TO PREVENT FUTURE CRISES.

**Dennis J. Kucinich**  
**Chairman, Domestic Policy Subcommittee**

**Joint Full Committee-Subcommittee Hearing on the Government's rescue of the  
Bank of America-Merrill Lynch merger**

**July 16, 2009**

**Slides and Documents**

Email from a senior adviser at the Federal Reserve, December 12, 2008

To: [Redacted]  
From: [Redacted]  
Subject: [Redacted]  
Date: [Redacted]

The following is a quick update and some preliminary views in advance of the call at 3:30 today.

We (FRB Richmond, FRB NY and Board staff) are continuing to gather needed info for full assessment of ML through Bank of America (BAC) management, though much of what is needed for a good preliminary assessment on ML is in our possession and being analyzed. We also had a pretty good sense already of conditions at BAC, which have also deteriorated recently as evidenced by their own projections for Q4 which (within significant variance in the past week or two, and we are currently working to update our views on BAC as a stand alone entity. As they themselves noted the other night at our meeting, even on a stand alone basis, the firm is very thinly capitalized in terms of tangible common equity (TCE) relative to assets and exposures.

- It is notable that a quick analysis of the TCE on stand-alone basis and as a combined entity decline in BAC's projected year-end 2008 stand alone basis, even as they are portraying the losses here. This is largely the result of decline and the fact that most capital in the combined BAC.

The preliminary assessment on the ML loss numbers is being overly optimistic in terms of its largest market say that with certainty and for all positions -- so the ML may not be over-stating the problems at ML to a large extent in an attempt to cushion the losses in advance of the upcoming sale. Details on the sources of the new \$4 billion of losses are being sought right now and that will be included in the analysis once we get a bit more clarity.

General consensus forming among many of us working on this is that given market performance over past several months and the...  
...the carrying into December...  
...It is reasonable to call into question the stability of the...  
...BAC management told us they still had not...  
...one wishes now that it possible since they have been doing the due diligence for months and hundreds of times would have made their much smaller and much effective

clear signs in the data we have that the deterioration at ML has been observably under way over the entire quarter – albeit picking up the significant around mid-November

Ken Lewis' claim that they were surprised by the rapid growth of the Losses seems somewhat suspect

## Restricted Federal Reserve Analysis of Bank of America & Merrill Lynch Merger, December 21, 2008

BAC management's contention that the severity of MER's losses only came to light is problematic and implies substantial deficiencies in the diligence carried out in advance of and subsequent to the acquisition.

These were clearly shown in Merrill Lynch's internal risk management reports that BAC reviewed during their due diligence

- MER's deterioration has been substantially worse than BAC's and all but ensures that the firm could not survive as a stand-alone entity without raising substantial new capital (and/or government support) that is unlikely to be available given the uncertainty about its prospects and further future losses.

- Management now projects Q4 after-tax losses of roughly \$14 billion for MER, and approximately \$1.4 billion after-tax quarterly net loss for BAC, which for BAC represents more than four times management's projected losses from just two weeks ago. The losses at MER will erode over 50% of MER's tangible common equity.

While the extent of the market disruptions that have occurred since mid-September were not necessarily predictable, BAC management was clearly aware that the severity of MER's losses was substantially greater than what was expected at the time of the acquisition.

- In the merger proxy statement and investor presentations the firm explicitly asserts that it has an understanding of MER's business activities, financial condition and prospects as well as an understanding of the outlook for the firm based on prospective economic and market conditions.
- Staff at the Federal Reserve has been aware of the firm's potentially large losses stemming from exposures to financial guarantees, which is the single largest area of risk exposure and driver of recent losses that have been identified by management. These were clearly shown in the risk management reports that BAC reviewed during their due diligence.

- The potential for losses from other risk exposures cited by management, including those coming from leveraged loans and trading in complex structured credit derivatives products ("correlation trading") should also have been reasonably well understood, particularly as BAC itself is also active in both these products.

- Having done a quick analysis on the specific positions/exposures at MER that generated the largest losses for MER in Q4, FRB staff see no clear indication that they were driven by overly aggressive marking down of positions in advance of the acquisition. This general conclusion notwithstanding, some of the marks do appear somewhat conservative and the appropriateness of the timing of the impairment charge taken against goodwill is hard to assess. On the other hand, credit valuation adjustments against financial guarantees are not particularly aggressive relative to those staff has observed at other firms.

The combined firm remains vulnerable to a continuing downturn.

Restricted Federal Reserve Analysis of Bank of America & Merrill Lynch Merger,  
December 21, 2008

- MER's identification has been substantially worse than BAC's and all but ensured that the firm could not survive as a capital (and/or government) support recipient.

The potential for losses from other risk exposures cited by management, including those coming from leveraged loans and the trading in complex structured credit derivatives products ('correlation trading') should also have been reasonably well understood, particularly as BAC itself is also active in both these products.

- Management saw projects Q4 approximately \$1.4 billion of exposures more than four times ago. The losses at MER will be

While the extent of the market of were not necessarily predictable, MER's losses only came to light if deficiencies in the due diligence on acquisition.

- In the merger proxy statement, it has an under condition and prospect based on prospective Staff at the Federal Reserve

stemming from exposures to financial guarantors, which is the single largest area of risk exposure and driver of recent losses that have been identified by management. These were clearly shown in Merrill Lynch's internal risk management reports that BAC reviewed during their due diligence.

- The Federal Reserve's due diligence on the acquisition of the financial guarantors was limited to the review of the financial guarantors' financial statements and the review of the financial guarantors' financial statements.

- Having done a quick analysis on the specific positions/exposures at MER that generated the largest losses for MER in Q4, FRB staff see no clear indication that they were driven by overly aggressive marking down of positions in advance of the acquisition. This general conclusion notwithstanding, some of the marks do appear somewhat conservative and the appropriateness of the timing of the impairment charge taken against goodwill is hard to assess. On the other hand, credit valuation adjustments against financial guarantors are not particularly aggressive relative to those that has observed at other firms.



Email from General Counsel to Chairman Bernanke, December 23, 2008

To: Scott Lewis  
Re: Per-BAC  
Date: 12/23/08 11:08 AM  
Priority: High

Thanks, Scott. Just to be clear, though we did not indicate that we believed that going forward we (safety and soundness) of his company. I think it may be just academic, but anyway: What would be the advance of a litigation but if requested by the defense that our analysts supported the safety and soundness merger and that we communicated that to Lewis?

✓ Scott Lewis (address deleted)

Scott  
Attorney/Personnel Request

12/23/08 10:18 AM Subject: Re: Per-BAC

A different question that doesn't seem to be the one Lewis is focused on is related to disclosure. Management may be exposed if it doesn't properly disclose information that is material to investors.

His potential liability here will be whether he knew (or reasonably should have known) the magnitude of the ML losses when BA made its disclosures to get the shareholder vote on the ML deal in early December.

Mr. chairman,  
Shareholder suits against management for decisions like this are more than successful. Courts will apply a "business judgment" rule that management while discretion to make reasonable business judgment is management liable for decisions that go bad. Witness Bear Stearns.  
There are also Sarbanes-Oxley requirements that management certify the accuracy of various financial reports. To comply with all those reporting and certification requirements, management must have a process in place to ensure that all relevant information is disclosed. Management must have a process in place to ensure that all relevant information is disclosed. Management must have a process in place to ensure that all relevant information is disclosed.  
his lawyers were much involved in that set of disclosures and Lewis was clear to us that he didn't hear about the increase in losses till recently.

All that said, I don't think it's necessary or appropriate for us to give Lewis a letter along the lines he asked. First, we didn't order him to go forward--we simply explained our views on what the market reaction would be and left the decision to him. Second, making hard decisions is what he gets paid for and only he has the

Fed Staff Recommendations, December 21, 2008

5. If, however, BA maintains that the distressed assets are the central cause of the expected pro forma weakness, and USG more clearly understands BA's rationale, then BA should be expected to be required to—

- \* take all the expected additional cushion for
- \* pay rates for any aid

BA should expect to be required to -

- \* provide some measure of upside compensation to the US Government.

Moreover, BA will be subject to restrictions on its business activities that, at a minimum, will include—

- \* a ban on dividends without US Government approval,
- \* more severe executive compensation limitations than those from the CPP,
- \* limitations on various types of corporate expenses,
- \* a government foreclosure prevention policy,
- \* restrictions on further acquisitions/transactions,
- \* requirements to raise additional capital in agreed time-frame, and
- \* more intrusive review and involvement by the US Government in the selection of management of BA, including the board of directors.

6. [BA has made clear previously to the regulators and to the marketplace that it believes this deal is strategically and financially good for BA in the medium-term. BA has said that the franchise value of ML is very strong and its long-term

more intrusive review and involvement by the US Government in the Selection of management of BA, including the board of directors.

and the other Federal Government agencies will consider and use all options available to address the situation at that time.]

**Eric  
Rosengren/BOS/FRS**

**To** Rita C Proctor/BOARD/FRS  
**cc** Donald L Kohn/BOARD/FRS@BOARD, Elizabeth A  
Duke/BOARD/FRS@BOARD  
**Subject** ring fencing

01/16/2009 03:29 PM

**Dear Ben:**

I wanted to follow up on my question this morning. Going forward I am concerned if we too quickly move to a ring fence strategy. Particularly if we believe that existing management is a significant source of the problem and that they do not have a good grasp of the extent of their problems and appropriate strategies to resolve them. I think it is instructive to look at the example of the Royal Bank of Scotland. They have consolidated assets of \$3.8 trillion. The UK

replaced senior management and currently owns 58% of the bank. The bank is maintaining operations without significant disruptions. Should problems get worse, the government may need to increase their stake. However, management has been changed, shareholders have been diluted to the extent of the losses realized to date required additional capital, and new outside directors are being selected. Such a strategy obviously has pitfalls, but I would not want to discard this option prematurely.

95

Eric

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Eric S. Rosengren  
President & CEO  
Federal Reserve Bank of Boston  
617.973.3090 Fax: 617.973.3173  
eric.rosengren@bos.frb.org

From: Tim P. Clark  
 To: Bruce C. Proctor; Donald L. Kohn; Kevin Walsh; Deborah P. Sailer; Roger Cole; Corvonn Stephenson; William R. Sullivan; Arthur Annala; Brian Patrick; Jennifer Burns; Mac Ashland; Randall S. Krasner; Scott Alvarez  
 Subject: Update on BAC ML  
 Date: 12/19/2008 02:29 PM

**The following is a quick update and some preliminary views in advance of the call at 3:30 today.**

We (FRB Richmond, FRB NY and Board staff) are continuing to gather needed info for full assessment of ML through Bank of America (BAC) management, though much of what is needed for a good preliminary assessment on ML is in our possession and being analyzed. We also had a pretty good sense already of conditions at BAC, which have also deteriorated recently as evidenced by their own projection for Q4 having gotten significantly worse in the past week or two, and we are currently working to update are views on BAC as a stand alone entity. As they themselves noted the other night at our meeting, even on a stand alone basis, the firm is very thinly capitalized in terms of tangible common equity (TCE) relative to assets and exposures.

- It is notable that a quick analysis of the TCE/assets ratios of BAC and ML on stand-alone basis and as a combined entity implies that the recent decline in BAC's projected year-end 2008 stand alone number appears to be driving as much of the decline in the combined pro forma ratios as the losses at ML, even as they are portraying the losses at ML as being the key issue here. This is largely the result of declining ratio at BAC stand alone and the fact that most capital in the combined entity will be coming from BAC.

The preliminary assessment on the ML loss numbers is that ML does not appear to be being overly aggressive in some of its larger markdowns -- though we can't yet say that with certainty and for all positions -- so the size of the losses/write downs may not be over-stating the problems at ML to a large extent in an attempt to 'kitchen sink' the losses in advance of the acquisition date. Details on the sources of the 'new' \$4 billion of losses are being sought right now and that will be included in the analysis once we get a bit more clarity.

General consensus forming among many of us working on this is that given market performance over past several months and the clear signs in the data we have that the deterioration at ML has been observably under way over the entire quarter -- albeit picking up significant around mid-November and carrying into December -- Ken Lewis' claim that they were surprised by the rapid growth of the losses seems somewhat suspect. At a minimum it calls into question the adequacy of the due diligence process BAC has been doing in preparation for the takeover. [As an aside, BAC management told us they could not provide electronic versions of ML files, and one wonders how that is possible since they have been doing the due diligence for months and having e-files would have made that much simpler and more effective for them. May have helped limit their current surprise.]

As per our meeting with management the other night, BAC management has identified a \$78 billion portfolio of positions and exposures that are causing the problems at ML. Those are as follows:

<b>Merrill Lynch 'Legacy Portfolio'</b>	
\$ millions	
Leveraged Finance	7,309
CRE	5,013
ABS CDO (Super Senior)	776
Residential Mortgages, largely Non-US	4,008
Current Exposure to Financial Guarantors (net of CVA/reserve)	9,325
CPI/PCG	3,428
Investment Portfolio	20,968
Current Exposure to Credit Derivatives Product Companies	3,732
Private Equity (net)	10,784
Asset Based Lending	13,170
<b>Total</b>	<b>78,513</b>

NY Fed is working today to analyze the key positions as well as others at ML to see how much further deterioration is likely or may be coming from this portfolio. The firm has substantial continuing notional hedges purchased from financial guarantors (\$53 billion) and from credit derivative product companies (\$18 billion) that could drive exposures to those sources higher and generate further associated write-downs in the value of the hedges if those entities deteriorate further.

~~Charlotte Fed folks have the lead in updating our analysis of BAC on a stand alone~~ basis, both the current and projected condition of the firm. Notable issues are the thin level of tangible common equity relative to assets and exposures, the recent deteriorating condition noted above and what appear to be quite optimistic underlying assumptions for the economy and performance of assets and markets in 2009 that are driving a relatively positive projection for the firm's stand alone condition out through 2009. Even if the projections are an adequate reflection of expected losses from some portfolios going forward, they appear to clearly not be well prepared for any further deterioration in economic conditions and/or asset performance. Which is to say the firm is not well prepared to withstand substantial unexpected losses that would result from further economic deterioration and market disruptions. BAC has a number of sources of potential vulnerability in its own portfolios, including consumer loans, particularly credit cards and mortgage-related, as well as relatively large exposure to commercial real estate-related positions and a commercial lending portfolio (funded and commitments) with a very large share of the dollar value of exposures stemming from 'BB' and below-rated borrowers.

We plan to finalize the analyses described in this note today/tonight and work this weekend to create a forward-looking view of the extent of the vulnerabilities for the combined entity, which we will shoot to wrap up by Sunday night and provide the full analysis Monday morning.

please forward to any relevant parties I may have accidentally left of the distribution and let me know if you have any questions  
tim

Tim P. Clark  
Senior Advisor  
Banking Supervision & Regulation  
Federal Reserve, Board of Governors

**Analysis of Bank of America & Merrill Lynch Merger**

*Restricted FR  
(Second Draft)  
December 21, 2008*

**I. Summary Overview**

**Bank of America (BAC) has sufficient resources to consummate the merger with Merrill Lynch (MER).**

- Upon consummation of the merger, based on current projections for both firms, the combined entity would have an 8.6% Tier I risk based capital ratio and a Tier 1 leverage ratio of 5.2%. However, the amount of tangible common equity at the combined firms will be among the lowest of the large BHC at 2.2% on day one of the acquisition.
- An immediate vulnerability would be BAC's access to market funding. On a stand alone basis, BAC has a significant short term funding dependence. MER has significant dependence on the government funding programs, and will likely increase the short term funding pressure on the combined firm.
- The principal vulnerability of the combined firm, similarly to other large BHCs, would be:
  - Potential losses from BAC's consumer and commercial credit portfolios, which will be contingent upon the economic environment going forward and will be realized over time.
  - MER has the largest exposure to financial guarantors across US financial institutions. Unlike the timing of loss recognition in the loan portfolios, losses associated with financial guarantor exposures could be realized in a more compressed timeframe. Moreover, the timing of potential losses from these exposures is highly uncertain.

**From the perspective of regulatory capital, Bank of America ("BAC") currently exceeds regulatory minima for well-capitalized on a stand-alone basis, with an expected Tier I capital ratio of 9.2% at year-end 2008. However, only about one third of the firm's Tier I capital is in the form of tangible common equity.**

- When viewed from the standpoint of tangible common equity to total assets (the TCE ratio) the firm is among the more thinly capitalized of the five largest domestic BHCs. This ratio is closely watched by analysts and investors and further deterioration of the firm's TCE ratio would likely cause increased uncertainty among market participants about the firm's prospects.

**Since September, continued economic deterioration and substantial market disruptions have weakened the condition of both firms.**

- MER's deterioration has been substantially worse than BAC's and all but ensures that the firm could not survive as a stand-alone entity without raising substantial new capital (and/or government support) that is unlikely to be available given the uncertainty about its prospects and further future losses.
- Management now projects Q4 after-tax losses of roughly \$14 billion for MER, and approximately a \$1.4 billion after-tax quarterly net loss for BAC, which for BAC represents more than four times management's projected losses from just two weeks ago. The losses at MER will erode over 50% of MER's tangible common equity.

While the extent of the market disruptions that have occurred since mid-September were not necessarily predictable, BAC management's contention that the severity of MER's losses only came to light in recent days is problematic and implies substantial deficiencies in the due diligence carried out in advance of and subsequent to the acquisition.

- In the merger proxy statement and investor presentations the firm explicitly asserts that it has an understanding of MER's business activities, financial condition and prospects as well as an understanding of the outlook for the firm based on prospective economic and market conditions.
- Staff at the Federal Reserve has been aware of the firm's potentially large losses stemming from exposures to financial guarantors, which is the single largest area of risk exposure and driver of recent losses that have been identified by management. These were clearly shown in Merrill Lynch's internal risk management reports that BAC reviewed during their due diligence.
  - The potential for losses from other risk exposures cited by management, including those coming from leveraged loans and trading in complex structured credit derivatives products ('correlation trading') should also have been reasonably well understood, particularly as BAC itself is also active in both these products.
  - Having done a quick analysis on the specific positions/exposures at MER that generated the largest losses for MER in Q4, FRS staff see no clear indication that they were driven by overly aggressive marking down of positions in advance of the acquisition. This general conclusion notwithstanding, some of the marks do appear somewhat conservative and the appropriateness of the timing of the impairment charge taken against goodwill is hard to assess. On the other hand, credit valuation adjustments against financial guarantors are not particularly aggressive relative to those staff has observed at other firms.

The combined firm remains vulnerable to a continuing downturn.

- At the time of the completion of the merger, based on current projections for both firms, the combined entity would have an 8.6% Tier 1 capital ratio, and a TCE ratio

of less than 2.2%. This is in relation to BAC's stand-alone ratios of 9.2% and 2.6%, respectively.

- Based on stress analysis performed by staff, under moderate and severe stress scenarios the combined BAC-MER firm would be among the most vulnerable of the largest domestic BHCs, but not substantially more vulnerable than many others.
- In the event that actual losses were in line with stress projections, TCE and Tier I capital would be substantially eroded, with Tier I risk based capital ratios of 6.4% and 4.0%, respectively, under the moderate and severe stress tests.
- Resulting from the impacts of a moderate or severe recession, our scenario analysis suggests that the combined entity would need to raise roughly \$21 billion and \$67 billion of Tier I capital, achieve a Tier I risk-based capital ratio of 7.5% at year-end 2009.

December 21, 2008

**Talking points for BankAmerica Discussion**

**[Bracketed language below is for further internal discussion purposes and subject to revision based upon briefing by Staff this afternoon]**

1. Abandonment of the transaction on the eve of consummation, especially after the extensive preparations that BA has already taken, would surprise the market and have serious adverse effects not only for ML, but also for BA. Of course, it would have negative implications for the System.
  - \* The market would doubt the judgment of BA's management and its ability to perform adequate due diligence and manage risks. It would call into question the risks inherent BA's existing footprint, including Countrywide.
  - \* ~~Abandoning the transaction would expose the weaknesses in BA's capital and asset quality, as analysts attempt to determine why BA did not believe it had the resources to acquire ML.~~
  - \* The market would conclude that BA was too weak to address the problems at ML, particularly because ML brings with it \$10 billion in Government TARP capital in addition to its own capital.
  
2. BA's assertion that it would successfully exercise the material adverse effects clause is not credible, according to Fed and other key US Government (USG) attorneys.
  - \*The public assertion of the claim, however, would likely cause the demise of ML in much the same fashion as the collapse of Lehman.
  - \*This would cause significant reputational consequences for BA, in the markets, with the public and with the regulators.

3. If USG were to provide aid to BA in connection with the acquisition of ML, BA would look very weak in the eyes of the market (e.g., look more like Citi and less like JPM)

\* Except for the GPP (which has already provided BA with \$15 billion and promised BA another \$10 billion upon completion of the ML transaction), the Fed and Treasury have established a policy on assisting only troubled companies in time-constrained, emergency situations.

\* The ML deal has taken place in full view of the market over an extended period of time and without any indication of extraordinary weakness. Markets will be focused on the 2009 pro forma financials, not the 4Q ML write-downs.

\*Were the US Government to provide aid at this point, it would appear that BA was itself too weak to acquire ML and had poor leadership and inadequate risk-management systems in place across its entire footprint.

4. In spite of all of this, if BA believes that aid from USG is essential, and the USG chooses to provide aid to BA, it will come at a price – both economically and reputationally. Assistance, generally, has taken any/all of three forms – regulatory, capital, or with respect to distressed assets. [We may need to revise this judgment later today]

\*Regulatory: Relief takes various forms [but we must be alert here that extraordinary relief might smack of forbearance and markets and ratings agencies may not be as tolerant as regulators]

\*Capital: [The central problem here is likely to be insufficient capital in a fast deteriorating economic environment. The solution, thus, may well be a new capital raise, which could include a mix of private and public capital as USG could provide backstop in various forms].

\*Distressed Assets: [The pool of “distressed assets” at ML have already undergone massive write-downs, so tail-risk looks smaller than in other situations. Also, the size of the distressed pool looks relatively small compared to size of pro forma BA balance sheet]

5. If, however, BA maintains that the distressed assets are the central cause of the expected pro forma weakness, and USG more clearly understands BA's rationale, then BA should be expected to be required to —

- \* take all the expected losses from any designated portfolio plus provide an additional cushion for extraordinary losses;
- \* pay rates for any aid it receives significantly in excess of the CPP ; and
- \* provide some measure of upside compensation to the US Government.

Moreover, BA will be subject to restrictions on its business activities that, at a minimum, will include—

- \* a ban on dividends without US Government approval,
- \* more severe executive compensation limitations than those from the CPP,
- \* limitations on various types of corporate expenses,
- \* a government foreclosure prevention policy,
- \* restrictions on further acquisitions/transactions,
- \* requirements to raise additional capital in agreed time-frame, and
- \* more intrusive review and involvement by the US Government in the selection of management of BA, including the board of directors.

6. [BA has made clear previously to the regulators and to the marketplace that it believes this deal is strategically and financially good for BA in the medium-term. BA has said that the franchise value of ML is very strong and its long-term prospects appear good. BA should proceed with the deal and manage the deal as capably as possible, including consideration of announcing a capital raise]

\*[BA should consider the following contingent support of USG. That is, if unforeseen market events threaten the viability of BA, the Federal Reserve and the other Federal Government agencies will consider and use all options available to address the situation at that time.]

From:   
 To: Scott Alvarez   
 Subject: Re: Fw: BAC   
 Date: 12/23/2008 11:08 AM   
 Encrypted

Thanks, Scott. Just to be clear, though we did not order Lewis to go forward, we did indicate that we believed that going forward would be detrimental to the health (safety and soundness) of his company. I think this is remote and so this question may be just academic, but anyway: What would be wrong with a letter, not in advance of a litigation but if requested by the defense in the litigation, to the effect that our analysis supported the safety and soundness case for proceeding with the merger and that we communicated that to Lewis?

▼ Scott Alvarez <sup>address deleted</sup>

Scott Alvarez/<sup>address deleted</sup> To: <sup>address deleted</sup>  
 cc:  
 12/23/2008 10:18 AM Subject Re: Fw: BAC

Mr. chairman,

Shareholder suits against management for decisions like this are more a nuisance than successful. Courts will apply a "business judgment" rule that allows management wide discretion to make reasonable business judgments and seldom holds management liable for decisions that go bad. Witness Bear Stearns. A different question that doesn't seem to be the one Lewis is focused on is related to disclosure. Management may be exposed if it doesn't properly disclose information that is material to investors. There are also Sarbanes-Oxley requirements that the management certify the accuracy of various financial reports. Lewis should be able to comply with all those reporting and certification requirements while also completing this deal. His potential liability here will be whether he knew (or reasonably should have known) the magnitude of the ML losses when BA made its disclosures to get the shareholder vote on the ML deal in early December. I'm sure his lawyers were much involved in that set of disclosures and Lewis was clear to us that he didn't hear about the increase in losses till recently.

All that said, I don't think it's necessary or appropriate for us to give Lewis a letter along the lines he asked. First, we didn't order him to go forward--we simply explained our views on what the market reaction would be and left the decision to him. Second, making hard decisions is what he gets paid for and only he has the full information needed to make the decision--so we shouldn't take him off the hook by appearing to take the decision out of his hands.

Let me know if you'd like any more info on this.

Scott  
 ▼ <sup>address deleted</sup>

From: Scott Abarex  
To:  
Subject: Re: Pw: BAC  
Date: 12/23/2008 11:23 AM  
Encrypted

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I agree we and Treasury gave our views on what we thought the likely effects would be of not proceeding, but that's different than ordering Lewis to proceed. We didn't take the decision out of his hands or threaten punitive supervisory action if he didn't proceed. I want to avoid the Fed being the centerpiece of the litigation. Lewis needs to have every incentive to analyze the facts and document and justify his decision. If he thinks he can rely on us, he'll assert there was nothing he could do and he can be reckless--not the right incentive. Moreover, once we're in the litigation, all our documents become subject to discovery and, as you'll remember from Deborah's presentation, some of our analysis suggests that Lewis should have been aware of the problems at ML earlier (perhaps as early as mid-November) and not caught by surprise. That could cause other problems for him around the disclosures BA made for the shareholder vote. In any event, we can always decide at the time of litigation whether to help even if now we hold fast.

Scott

1/9/09

BB, DK, KCS  
Bailey, Liang,  
Madison  
Cole, Mark (D)

Art Angelo  
Baxter

Treasury  
Paulson

FDK  
Shacka Bar

Dugan

Lacker  
Richmond  
Charlotte

BA

KCS  
Threshold R  
why have  
how proceed  
Debate on how proceed

BB: Leuro approached BB about  
involving MFR clause to escape ML deal  
↳ even if could,  
would have rough consequences  
for BA, not only ML, and Sydney  
↳ worried abt market dynamic  
& effect on BA (vs. KL + BB)

↳ BB been careful not to push or promise  
but agreed to consider whether  
some solution could be found

HP: - believe market operating & prepared  
for disappointing earnings for  
all  
↳ BA debt has disappointing earnings

↳ magnitude of losses breath-taking  
↳ interesting that BA approached  
for help; BA traditionally  
tries to distinguish selves  
from others

↳ need comprehensive response

②

-TARP: Fully committed  
but expect to have \$50b  
unspent by Jan 20

↳ more dangerous to not do this  
than to do it.

↳ told Obama team 2d chance  
is for them to use, not  
Paulson, but deliberations  
ongoing

↳ if don't solve this, problem  
could be much worse  
for system + confidence

↳ even tho preferred & common  
better, will provide confidence

↳ need some reinforcing as well

↳ need to do this next week  
↳ better before Jan 20

Dugan: don't want to run risk  
that it looks weak  
↳ strong contagion effect

-strongly support package of cap. & r.r. infra

③

Bar: no doubt significant FDI problem

can't base determination on  
share price

↳ need systemic reason  
don't have yet

↳ FDIC guarantee program  
helpful

↳ no evidence of runs yet

↳ need specific info abt stress point  
↳ what is liquidity risk?

HP: agree not abt share price,  
too confidence lost as  
price goes to zero

- losses of ML size will shake  
market

↳ keep in mind sheer size  
of problem

SB: if get into abt stress point  
need to consider who should act:

- only 20% assets from DI

- need for assistance in ML

- think hard abt role of FDIC

(4)

H.P.: ML now part of B/A  
 ↳ loss of confidence in ML  
 hurts B/A

↳ B/A management concerned

↳ could

S.B.: want to avoid constrained DI bail-out

- think B/A won't "inject"  
 when earnings announced

- options  
 ↳ covered bond guarantee  
 ↳ other structures on consumer  
 assets

- not sure ML fix is long term fix

H.P.: don't want to do this  
 unless stuck as leaving  
 prefer waiting for new program, TARP 23

but can't wait + so concerned dot system  
 ↳ willing to commit TARP funds

- willing to invest ~~15-20b~~ 15-20b

- not enough, so need asset wrap  
 1000 - 300 b raise

⑤

~ very imp FDIC part of action

~ if don't act, jeopardize system

Richmond/Chelton: ML losses

↳ TCE looks vulnerable

↳ liquidity at risk

↳ mkt not anticipating this  
size loss

↳ sizable short term

funding at bit that

could run + would cause  
problem

FDIC: Guarantee program has lots of  
capacity + is available  
+ sup regulatory cap still high

Alford: mkt expects bit to report  
profit  
w/ 11, report \$1, 5 b loss

HL: losses to be announced  
so far beyond expectations

Bair: need more info  
- unsecured funding guaranteed  
↳ what are vulnerabilities?

⑥

HP: understand FDIC needs more info

- need to proceed down road  
so USG has options

BB: Dugan + Richmond id vulnerabilities  
↳ will provide info to FDIC  
↳ FDIC already on exam  
of OCC + FRB

DK: vulnerable now  
- TARP used, new TARP  
not ready  
- many losses abt to be  
announced + mkt  
shaken

HP: open to talking abt stock terms,  
but don't think non cumulative  
option makes sense.  
↳ less protection for taxpayers  
- will figure out terms

Bar: Q: whether gov't preferred helps?  
- is it better to tackle recession  
problem separately?

HP: recession problem is large + complex;  
Treas thinks, at same time

②

Art: assets

BA proposed \$180.6 negligence

- of OCC + FDIC

↳ 12.46 seems most likely to be workable

↳ 92.6 ML exposures causing most pain

↳ abt \$70.6 synthetic de

↳ Fed still considering how it could finance

↳ still thinking

KW - want to get 3rd party to review assets to help value

- could consider taking more assets from BA (in place of ML de)  
 ↳ what assets wld make investors feel more comfortable abt company

Dragon: plenty of BA assets that likely will suffer losses

↳ main shock to what is abt ML  
 ↳ taking on BA assets clouds BA + hurts

⑧

HP: care abt stabilizing BA,  
not meeting size marks

Lacher: agree w/ began risk of  
disrupting narrative

KW: step forward

- staff to identify stress points  
+ get into BFDIC as needed

- Trean + KW discuss security  
of BA

- staff see if can get  
considerable of assets in pool

- get term sheet to BA  
+ see if BA can move  
earnings announcement  
forward

HP: try for earnings announcement  
Jan 16

Eric  
Rosengren/BOS/FRS

To Rita C Proctor/BOARD/FRS

cc Donald L Kohn/BOARD/FRS@BOARD, Elizabeth A  
Duke/BOARD/FRS@BOARD

01/16/2009 03:29 PM

Subject ring fencing

Dear Ben:

I wanted to follow up on my question this morning. Going forward I am concerned if we too quickly move to a ring fence strategy. Particularly if we believe that existing management is a significant source of the problem and that they do not have a good grasp of the extent of their problems and appropriate strategies to resolve them. I think it is instructive to look at the example of the Royal Bank of Scotland. They have consolidated assets of \$3.8 trillion. The UK

replaced senior management and currently owns 58% of the bank. The bank is maintaining operations without significant disruptions. Should problems get worse, the government may need to increase their stake. However, management has been changed, shareholders have been diluted to the extent of the losses realized to date required additional capital, and new outside directors are being selected. Such a strategy obviously has pitfalls, but I would not want to discard this option prematurely.

Eric

---

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President & CEO  
Federal Reserve Bank of Boston  
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eric.rosengren@bos.frb.org



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### Live Blog: Scott MacFarlane Blogs From Inside BofA Hearing

Posted: 10:26 am EDT June 25, 2009 Updated: 12:56 pm EDT June 25, 2009

**WASHINGTON, D.C.** -- Live Blog: Scott MacFarlane Blogs From Inside BofA Hearing  
**12:35 p.m. June 24, 2009**

Filibuster time. Perhaps it's fatigue. Perhaps it's simply a coincidence.

But the past hour of today's hearing surrounding Ben Bernanke's handling of Charlotte-based Bank of America has become long-winded and aimless. Members of Congress are using their allotted time to speak about the pitfalls of government intervention into the financial system, but not to question Bernanke about Bank of America itself.

Democratic Rep. Stephen Lynch broke the blockade by asking, "In this TARP deal, are taxpayers getting the (voice) they want (in Bank of America) considering how much money they put into the

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### Arresting Photos

deal." Bernanke responded that the Federal Reserve has encouraged the financial institutions to put "independent" people onto their boards of directors.

11:56 a.m. June 24, 2009

Democratic Rep. Elijah Cummings of Maryland, in a voice so loud and authoritative it shook my chair, just asked Ben Bernanke if he thought Bank of America CEO Ken Lewis was "competent" at his job.

Bernanke dodged it, saying it wasn't a "yes or no" question.

Bernanke then twice repeated his earlier claim "I didn't threaten him."

California Republican Rep. Brian J. Bilbray then equated this hearing with an "inquisition."

11:42 a.m. June 24, 2009

Hickory Republican Rep. Patrick McHenry, moments ago, told WSOCTV.com, Bernanke's claim he doesn't recall pressuring Ken Lewis into the deal with Merrill Lynch "is convenient."

McHenry said there is growing concern in the Charlotte-area about the impact this merger will have on local jobs. He said there are also worries about government overreaching into the local banking industry.

11:53 a.m. June 24, 2009

The Federal Reserve Chairman again defended the Bank of America deal. He said it prevented a further meltdown of financial system. "I very, very much regret being involved in (some large recent financial decisions), but I saw no alternative."

But a long row of Congressmen are indicating they don't believe Bernanke's claim he didn't pressure Ken Lewis into the deal.

10:57 a.m. June 24, 2009

If someone lying? If so, who?

Ben Bernanke, under questioning from Indiana Republican Dan Burton, repeatedly declined to call former Treasury Secretary Henry Paulson a "liar."

Rep. Burton produced statements from Paulson suggesting Bernanke leaned on Bank of America, even threatening CEO Ken Lewis' job, to push through the Merrill Lynch deal. When asked if Paulson was lying, Bernanke repeatedly said "I don't recall" saying that.

10:38 a.m. June 24, 2009

Ben Bernanke, under questioning by House Government Reform Committee Chairman Edolphus Towns, just repeatedly denied threatening to fire Bank of America CEO Ken Lewis, if Lewis backed out of the deal to merge with Merrill Lynch.

Bernanke then said the Federal Reserve worked "closely and collaboratively" with other federal regulators during the Bank of America-Merrill Lynch deal. He said this even as House Committee members displayed emails from Fed staffers indicating the agency was trying to keep other agencies, including the Securities and Exchange Commission in the dark.

10:13 a.m. June 24, 2009

Fed Chairman Ben Bernanke just walked into a cavernous hearing room on Capitol Hill. Three water bottles sit next to his right arm. (He's sitting beneath some bright, hot TV lights)

Bernanke is about to be grilled by angry Congressional leaders who've obtained questionable emails from Fed staffers. Those emails show the Fed attempting to keep other government agencies in the dark about the deal.

Bernanke will address questions about his tactics and allegations he threatened to fire Bank of America execs if they didn't do the deal with Merrill.

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Questions for the Record for Mr. Henry Paulson  
Rep. Kaptur

1. Bank of America (BoA) bought the sick puppy called Countrywide for \$4 billion in Jan 2008. Soon came the force-feeding of taxpayer funds to BoA that mysteriously rose under your watch by billions --from \$12 billion to \$20 billion, and now \$45 billion. Has this infusion of taxpayer guaranteed money might actually a collusive reward for BoA for agreeing to take on both sick puppies (Countrywide/Merrill) knowingly? That favored firm would be rewarded handsomely as its toxic paper was dumped on the backs of the US taxpayer. Now it has become an even larger and more powerful money center bank.
2. Mr. Paulson, the weekend that Lehman collapsed, AIG was in a precarious place. You were leading a group in determining if AIG should be helped. Goldman Sach's, CEO, Lloyd Blankfein, participated in this meeting. Can you explain why the CEO of a company with a business interest, and a huge one at that was present in the room? By saving AIG, the American public paid many banks fully on billion dollar contracts. If AIG had collapsed these banks would not get their money.

Was AIG just a funnel for money to Wall Street?

What other CEO's were in the room, and why were they present?

3. How much of Bank of America's September shortfall was due to toxic assets from its purchase of Countrywide in Jan 2008 vs. the toxic paper pending from the Merrill purchase in the fall of that year?
4. Why would Ken Lewis and the Bank of America enter into an agreement to purchase / merge with Merrill, Lynch when they did?
5. Wasn't Bank of America the only major solvent U.S. Bank at the time that could even bailout Merrill?
6. Wasn't Bank of America asked to bailout Merrill before the problems at Merrill became apparent to the rest of the world and American Taxpayers?
7. How could have invoking the MAC have hurt Bank of America and its shareholders?
8. Why did President Obama have to have Tim Geithner the pres. of the New York Fed as his Treasury Secretary?

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EDWARD BENNETT WILLIAMS (1920-1988)  
PAUL R. CONNOLLY (1922-1978)

March 8, 2010

The Honorable Marcy Kaptur  
9th District, Ohio  
Committee on Oversight and Government Reform  
2157 Rayburn House Office Building  
Washington, D.C. 20515-6143

Dear Representative Kaptur:

We write on behalf of former Treasury Secretary Henry M. Paulson in response to the questions submitted on your behalf in connection with the July 16, 2009 Bank of America hearing. A copy of the text of your questions is attached to this letter.

Question 1 asks about the reasons the federal government provided Bank of America with financial assistance under the Troubled Asset Relief Program. Mr. Paulson addressed that issue in his oral testimony before the Committee on July 16, 2009. *See* Hearing Transcript at 32.

Question 2 asks about the federal government's involvement with AIG and is premised on the assumption that Mr. Paulson was "leading" the federal government's decisions with respect to the payment of AIG counterparties. As Mr. Paulson explained to the Committee, those decisions were made by the Federal Reserve. *See* Hearing Transcript at 39, 53. Accordingly, that question should be directed to the Federal Reserve.

Questions 3, 4, and 5 ask questions about Bank of America's financial situation and its decision to acquire Merrill Lynch, and so those questions should be directed to Bank of America.

Question 6 is premised on the assumption that Bank of America was "asked to bailout Merrill." That assumption, however, is at odds with CEO Ken Lewis's

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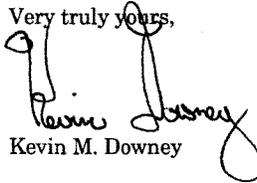
The Honorable Marcy Kaptur  
March 8, 2010  
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explanation to the Committee that Bank of America made its decision to purchase Merrill Lynch "because we saw the potential benefits . . . and we did so without any promise or expectation of governmental support." Written Testimony of Kenneth D. Lewis (July 11, 2009).

Question 7 asks about the consequences to Bank of America and its shareholders had it attempted to invoke the MAC clause in its agreement with Merrill Lynch. Mr. Paulson addressed that issue in his written testimony to the Committee. See Written Testimony of Henry M. Paulson (July 16, 2009) at 3-4.

Question 8 asks why President Obama appointed Secretary Geithner to his positions as Secretary of the Treasury. Mr. Paulson cannot speak to President Obama's motivations.

Very truly yours,

A handwritten signature in black ink, appearing to read "Kevin M. Downey". The signature is written in a cursive style with a large, looping flourish at the end.

Kevin M. Downey

Attachment

PATRICK T. McHENRY  
MEMBER OF CONGRESS  
10TH DISTRICT, NORTH CAROLINA

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The Honorable Edolphus Towns  
Chairman  
Committee on Oversight and Government Reform  
U.S. House of Representatives  
Washington, DC 20515

Dear Chairman Towns:

In connection with the Oversight and Government Reform Committee's hearing on July 16, 2009, "Bank of America and Merrill Lynch: How did a Private Deal Turn Into a Federal Bailout? Part III," I ask that you submit to the witness, Henry Paulson, the following questions for the hearing record:

- 1) Phone records obtained by the Committee show that at 2:40 p.m. on December 19, 2008, you placed a call to Ken Lewis at Bank of America. Immediately after speaking with Mr. Lewis, you then called Tim Geithner at 2:55 p.m.
  - a. Can you detail what was discussed in that conversation?
  - b. What did Mr. Geithner specifically say to you regarding the MAC?
- 2) Further Committee records show that Mr. Geithner sent you an email the following day, December 20, reading, in part: "BofA/ML. Can't MAC. Have to close." On that same day, Mr. Geithner also 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?"
  - a. This indicates that the leg work in handling the merger, at least at the staff level, was being done by the New York Federal Reserve. Is that accurate?
- 3) Explain again the Federal Reserve's statutory authority regarding the removal of Bank of America's Board of Directors.
- 4) In your testimony before the Committee on July 16, you stated that you informed Ken Lewis of the Federal Reserve's authority to remove the Board of Directors. Additionally, handwritten notes obtained by the Committee chronicle a conversation between you and Ken Lewis regarding Mr. Lewis's desire to pull the MAC clause.

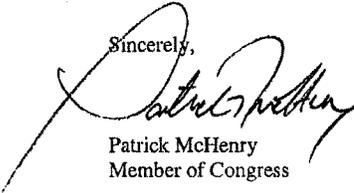
These notes include the comments: "Fire BOD if you do it – irresp[onsible] for country. Tim G. agrees."

- a. You were pressuring Mr. Lewis to go through with the Merrill Lynch merger by stating that you had the ability to remove Bank of America's Board. Were you doing this on your own, or was this at the behest of the Federal Reserve?

---

Mr. Chairman, I appreciate your leadership of the Oversight and Government Reform Committee. If you or your staff has any questions regarding the aforementioned questions, please contact Alexis Rudakewych on my staff at 5-2575.

Sincerely,



Patrick McHenry  
Member of Congress

cc: The Honorable Darrell Issa

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EDWARD BENNETT WILLIAMS (1920-1988)  
PAUL R. CONNOLLY (1922-1978)

March 8, 2010

The Honorable Patrick T. McHenry  
10th District, North Carolina  
Committee on Oversight and Government Reform  
2157 Rayburn House Office Building  
Washington, D.C. 20515-6143

Dear Representative McHenry:

We write on behalf of former Treasury Secretary Henry M. Paulson in response to the questions submitted on your behalf in connection with the July 16, 2009 Bank of America hearing. A copy of the text of your questions is attached to this letter.

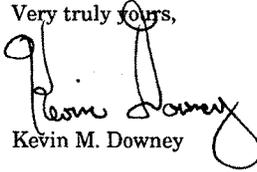
Question 1 asks about the content of a conversation between Mr. Paulson and current Treasury Secretary Geithner. Mr. Paulson has testified before the Committee about the nature of his communications with Mr. Geithner during the relevant time period. *See* Hearing Transcript (July 16, 2009) at 40, 42.

Question 2 asks about the work done by the New York Federal Reserve. That question should be addressed to the New York Federal Reserve.

Question 3 asks about the Federal Reserve's statutory authority. Mr. Paulson provided information on that subject on page 5 of his written testimony to the Committee. *See* Written Testimony of Henry M. Paulson (July 16, 2009).

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The Honorable Patrick T. McHenry  
March 8, 2010  
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Question 4 asks about a December 21st conversation between Mr. Paulson and Ken Lewis, the former CEO of Bank of America. Mr. Paulson testified extensively about that conversation both in writing and before the Committee. *See, e.g.,* Written Testimony at 3-5; Hearing Transcript at 13, 36

Very truly yours,  
  
Kevin M. Downey

Attachment

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Thursday, July 16, 2009  
Room 2154 of the Rayburn House Building

**“Bank of America and Merrill Lynch: How Did a  
Private Deal Turn Into a Federal Bailout? Part III”**

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*Paulson's Complaint; Lehman Brothers disappeared with Hank Paulson's reputation. He wants it back Newsweek May 25, 2009*

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[Lehman Brothers](#) disappeared with Hank Paulson's reputation. He wants it back

**BYLINE:** By Evan Thomas And Michael Hirsh; With Suzanne Smalley, Matthew Phillips and Nick Summers

**BODY:**

Hank Paulson, former master of the universe, sits in a nondescript office in northwest Washington, D.C. He is trying to work on his memoirs, but he is struggling. He doesn't seem like the onetime All-Ivy tackle at Dartmouth, the Harvard M.B.A. who ran Goldman Sachs, the prince of Wall Street who went on to become secretary of the Treasury. He comes across more like an athlete who has lost a game and can't stop talking about the dropped pass, the missed shot. He is trying to explain the weekend last September when [Lehman Brothers](#) went down—and the financial world collapsed.

The conventional wisdom, he admits, congealed quickly: It was a mistake for the government to let Lehman die, and the blame rested squarely with Hank Paulson. On the day that Lehman filed for bankruptcy, Paulson had tried to get out ahead of the story. If Lehman couldn't save itself, he told reporters, then he wasn't about to ask the taxpayers to step up. "I never once considered it appropriate to put taxpayer money on the line," he said. The message was that the government would no longer bail out failing companies—that would just invite more foolish risk-taking. It would create a "moral hazard."

But of course, in the weeks and months since the fall of [Lehman Brothers](#), the government has gone on to bail out banks and other financial firms to the tune of hundreds of billions of dollars. So why didn't it save Lehman? If only the government had rescued Lehman, a financial panic could have been averted. Or so the story goes. The narrative was set from the beginning by Paulson's moralizing tone, followed by a market crash—and, as the once mighty bankers crawled out of the wreckage, the anguished testimony before Congress of Dick Fuld, the CEO of Lehman, who portrayed Paulson as a backstabbing Judas. "Until they put me in the ground," Fuld said, leaning into the microphone and baring his teeth, "I will wonder."

Paulson insists that he did not turn his back on Lehman. "There's no company that I spent more time with and worked harder to save. That's sort of the irony of the narrative that we wanted them to go under," he told NEWSWEEK in one of his first extended interviews since leaving office. He also dismisses the argument that the fall of Lehman provoked a panic. "It is absolutely a fiction that Lehman was anything more than a symptom." He says a perfect storm of other near failures caused the financial crisis—the troubles at Fannie and Freddie, the news that AIG faced huge liabilities from its financial insurance gambles, the teetering of giant mortgage lender Washington Mutual on the edge.

All this is true enough, but it doesn't mean that Paulson knew what he was doing when Lehman went down. The panicked scenes that played out between bankers and policymakers during Lehman's last days were recounted in the newspapers in the weeks that followed. But now, more than half a year later, and with the most acute moments of the financial crisis behind us, the key players are better able to reflect on the decisions they made. Perhaps no one has spent more time reconstructing the events than Paulson. In retrospect, it appears that Paulson was not the callous titan of Wall Street, but rather an earnest, sometimes bewildered man caught in a whirlwind he could not tame or even fully understand. He did the best he could, reaching, sometimes lurching for answers, but in the end he was rescued by the sort of nerdy professor type who might have been devoured on the trading floors of Wall Street. To the extent that there was a hero during those weeks, it was arguably Ben Bernanke, the quiet, shy chairman of the Federal Reserve, whose problem-solving and salesmanship before a skeptical Congress were critical to avoiding financial disaster.

Paulson was known as "the Hammer" as a 6-foot-1, 200-pound tackle on the Dartmouth football team because he seemed to explode at the snap of the ball. Tenacity and drive, more than brainpower, have distinguished his career. He has been a champion arm-twister and shrewd enough: when he rescued Goldman's IPO in the wake of the Russian financial crash in 1998 he made hundreds of millions for his partners and shortly thereafter became their leader. Yet Paulson can be oddly inarticulate

for such a powerful man. He is not a Wall Street smoothie: no trophy wife (he remains married to his college sweetheart), and at Goldman he was known for wearing penny loafers, not handmade Italian shoes. He's an avid bird watcher. A nonsmoking, nondrinking Christian Scientist, he did not head for the Hamptons on the weekend but visited his mother in Barrington, Ill. Yet, physically imposing, radiating a confident forcefulness, he came to stand for the dominating Goldman brand. In the Wall Street hierarchy, Goldman is the smartest and most confident of them all: the firm makes bets, but only ones it feels sure to win.

The Lords of Goldman, who tend to come from Ivy League schools, looked down on the hustlers at lower-ranked firms like Lehman, who came out of state schools and the trading pits. Lehman was an old firm, but its modern incarnation was built in the image of its scrappy CEO, Fuld, who came from the trading floor and liked to make big, risky bets. Fuld was called "the Gorilla," a nickname some might have resented. Fuld kept a toy gorilla in his office. His ethos was us (the public-school guys--Fuld went to the University of Colorado) against them (the Harvard know-it-alls like Paulson of Goldman Sachs). Paulson and Fuld have known each other for years. For the record, as well as in private, Paulson describes Fuld as a "good guy" and even as a "friend." (Fuld declined to speak to NEWSWEEK). But knowledgeable Wall Streeters and government officials who asked to remain anonymous in order to speak more freely say that Paulson regarded Fuld as a gambler who lost sight of reality.

Paulson began having his doubts about Fuld--and the future of Lehman--as early as October 2007, when Lehman made a big bet on commercial real estate even though there were signs the deal was unwise. Paulson remained dubious about Lehman's rosy earnings reports for the first half of 2008, and when the red ink began to show in June, he began urging Fuld to scale back Lehman's leverage and find a buyer or a fresh infusion of capital. He was frustrated, say these knowledgeable sources, when Fuld stubbornly demanded terms that were too favorable to Lehman to attract any buyers or investors.

Fuld's 31st-floor midtown office had sweeping views of the Hudson River and the New York City skyscrapers. In early September, the executive suite of Lehman Brothers--became a kind of war room; day and night, Fuld's lieutenants paddled about, munching M&M's and chugging Diet Cokes, as they searched, with growing desperation, for a solution. A South Korean bank had seemed interested in investing, then backed off. Fuld and his men tried to stay hopeful. Six months earlier, in March, JPMorgan had rescued the failing investment bank Bear Stearns--with the help of a loan from the federal government. In early September, the Feds seized control of Fannie Mae and Freddie Mac, the two mortgage giants sucked down by the collapsing real-estate market. Surely, the Lehman team believed, the Feds would step in to help--if Lehman could only find a buyer.

Paulson does not seem to have grasped the urgency of the looming disaster. Although top financial experts were warning about the housing bubble back in 2006, Paulson--by his own admission--was not paying much attention to the way banks were sliding and dicing mortgages and selling them as complex securities. "I didn't understand the retail market; I just wasn't close to it," he told NEWSWEEK. But while he was at Goldman, he had lobbied Congress--successfully--for new rules allowing investment houses to at least double the amount of leverage they could carry.

In September, Lehman reported huge third-quarter losses, totaling nearly \$4 billion. Two days later, the Feds stepped in. On Friday, Sept. 12, the heads of the Wall Street investment banks were summoned to an emergency meeting at the New York Federal Reserve. The black Town Cars began pulling up to the fortresslike Fed, which sits atop much of the nation's gold reserve, around 6 p.m. Paulson was there, along with Tim Geithner, president of the New York Fed. The century-old building was going through asbestos removal, so Paulson had to set up his command center in a makeshift conference room. "The furnishings were like a Ramada Inn in Toledo," recalled one of the participants, who, like the others who were there at the time, would not speak for the record because of the sensitivity of the negotiations. Paulson told the assembled Wall Street chieftains that it was up to them--not the taxpayers--to find a solution to the Lehman mess.

Back at Lehman, no one really believed that the Feds would stay on the sidelines. They thought Paulson was bluffing. But he wasn't. Paulson would later say that he was powerless--that under the laws governing the Federal Reserve, the government could not make a loan to an investment bank that lacked the necessary collateral. Paulson believed that Lehman had a multibillion-dollar hole in its balance sheet. There was not nearly sufficient collateral. Federal Reserve chairman Bernanke took the same view. To this day, former Lehman officials insist to NEWSWEEK that Paulson and Bernanke never told them that the Fed was required by law to stay out of the game. Speaking not for attribution (because of pending lawsuits from disgruntled former shareholders), these Lehmanites recall a lot of talk from Paulson about moral hazard, which they regarded as posturing from a Goldman stuffed shirt.

Fuld did not attend the summit meeting at the Fed; the Lehman board instead sent his No. 2, Bart McDade. Fuld refused to accept the signs that the end was near. He stayed in his office at what he called "the Mother Ship," working the phones, searching for a white knight. On that same weekend, he was reaching out to Ken Lewis, chairman of Bank of America. B of A was big enough to buy Lehman, and Lehman offered the giant bank a chance to get in the Wall Street game with a veteran player. But as Friday night dragged into Saturday, Lewis was not calling back. "Dick didn't understand," recalls a colleague who was there. According to this person, Fuld kept asking, "What's the story? Why is he not calling me? What's happening here? I don't understand it." Even in the cutthroat world of dealmaking, calls are usually returned, if only to say no. Fuld thought Lewis was being rude. Unknown to the Lehman team, Lewis had been buying a Wall Street firm that day--just not Lehman Brothers. The chairman of the Bank of America had been secretly closeted with John Thain, the chairman of Merrill Lynch, at B of A's corporate apartment in the Time Warner Center. Merrill, like Lehman, was in deep financial trouble. But Merrill employed a vast network of retail stockbrokers that made it an attractive target for B of A.

Another important person was not returning Fuld's calls that day: Hank Paulson was suddenly nowhere to be found. (Fuld was calling "every 10 minutes," according to a former Treasury official who was present.) Later, the Lehmanites suspected that Paulson had quietly encouraged Thain of Merrill to meet with Lewis of Bank of America, and they saw a plot. Thain, like Paulson, is a Goldman Sachs alumnus. Some on the Lehman team later groused that the Goldman men had gotten together to stab Lehman in the back--to ruin Lehman's courtship of Bank of America by secretly arranging the marriage of Merrill and B of A. To NEWSWEEK, Paulson rejected this notion, though he acknowledged that he did encourage Thain to speak to Lewis--simply because Merrill was in trouble, too.

Never known for giving up, Fuld had one more card to play--with Barclays, a well-known British bank. Indeed, as late as Sunday morning, some of Fuld's lieutenants believed they had a deal. But complications arose: the British government was balking, and Barclays shareholders had not been given a chance to meet. Time was running out. Sunday evening, Lehman's McDade returned from all-day meetings with other Wall Street barons and top government officials at the Fed with some very bad news: the government wanted Lehman to declare bankruptcy--that night, before the markets in Europe and Asia opened. "I can't believe it," Fuld said when he learned the Barclays deal had fallen through, according to someone who spoke with him about Lehman's position late Sunday. A call came from Christopher Cox, the head of the Securities and Exchange Commission. Over the speakerphone, Cox informed the Lehman bosses, "You have a grave responsibility." The Lehman executives were aghast. They knew that the consequences of a bankruptcy would be severe--that Lehman would default on debts owed to big Wall Street players. Paulson also knew the consequences would be serious. But none of the top federal officials foresaw just how bad it would get--money markets so severely hit that, for a time, it seemed that massive, global bank runs were a real possibility.

They were saved by the quick thinking of the chairman of the Federal Reserve. Ben Bernanke is so mild, his voice is gentle and sometimes quavery. He grew up in a small South Carolina town and spent his life as an academic. But Bernanke's academic specialty was the Great Depression, and the lesson he learned, above all, was that the federal government could not afford to wait to step in. In the days after the fall of Lehman, Bernanke basically threw open the banking window of the Fed and poured out \$1 trillion in loans. "People are referring to you as 'The Loan Arranger,' with your faithful companion Hank," Barney Frank, the irrepressible chairman of the House Financial Services Committee, told Bernanke.

The frontman remained Paulson, who seemed to stumble about through late September and early October. It was Bernanke who persuaded Paulson to go to Capitol Hill for massive bailout money, but it was a very tough sell, and Paulson nearly blew it. Congress originally rejected the bailout and approved it only with last-minute revisions--and after the stock market had plummeted. Bernanke's low-key but incisive manner worked better with lawmakers than Paulson's bluster. With the House resisting Paulson's proposal to give him virtually unlimited authority to disperse funds to banks, House Speaker Nancy Pelosi announced that she was getting ready to leave town the weekend after Lehman's collapse and would be back Monday. Bernanke quietly but forcefully piped up, "We may not have an economy on Monday." Paulson is proud that he and Bernanke were able to prevent the entire global financial system from collapsing, through their emergency use of the Treasury's Exchange Stabilization Fund and Fed guarantees that kept money-market funds afloat. "If we hadn't come up with that, whoa," says Paulson.

At Lehman, the story is over--but not quite. Many of the Lehman traders found jobs at Barclays, where they trade today. The atmosphere is not quite the same. No one wears neckties, and there are no longer Brazilian shoeshine boys walking the rows of trading consoles, offering a shine for \$10. But when the traders answer the phones, they sometimes still defiantly shout, "Lehman!"

Paulson's book, which will be published in October by Business Plus, will play down Lehman's fall and play up the steps taken by the government to save the economy. And in some ways, he's right. Though Lehman's collapse traumatized policymakers and banks for months--no one talks about moral hazard any more--it was mainly a sideshow to a larger crisis. Off the football field, the Hammer, it appears, was sometimes more of a nail.

With Suzanne Smalley, Matthew Phillips and Nick Summers

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1/9/09

BB, DK, KL

Bailey, Lewis

Madigan  
Cole, Mark De

Art Angelo  
Buxter

Treasury  
Paulson

FDC  
Shelia Bair

Dugan

Lacker  
Richard  
Charlotte

BA

KW

Threshold Q

why here

how proceed

Details on how proceed

BB: Lewis approached BB about  
involving MRE clause to escape ML deal  
↳ even if could,  
    ↳ would have rough consequences  
    for BA, not only ML, and System  
    ↳ worried abt market dynamic  
    + effect on BA (both KL + BB)

↳ BB been careful not to push or promise  
but agreed to consider whether  
some solution could be found

HP: - believe market expecting + prepared  
for disappointing earnings for  
all

↳ BA debt has disappointing earnings

↳ magnitude of losses breath-taking  
↳ interesting that BA approached  
for help; BA traditionally  
tries to do things much silves,  
from others

↳ need comprehensive response

②

-TARP: fully committed  
but expect to have \$50b  
in spent by Jan 20

↳ more dangerous to not do this  
than to do it.

↳ told Obama team 2d chance  
is for them to use, not  
Paulson, but deliberations  
ongoing

↳ if don't solve this, problem  
could be much worse  
for system + confidence

↳ even tho preferred a common  
better, will provide confidence

↳ need some refinancing as well

↳ need to do this next week  
↳ better before Jan 20.

Dugan: don't want to run risk  
that BT looks weak  
↳ strong contagion effect

-strongly support package of cap + margin

③

Bair: no doubt significant if BA problem

can't base determination on  
share price  
↳ need systemic reason  
don't have yet

↳ FDIC guarantee program  
helpful  
↳ no evidence of runs yet  
↳ need specific info abt stress point  
↳ what is liquidity risk?

HP: agree not abt share price,  
the confidence lost as  
price goes to zero

- losses of ML size will shake  
market  
↳ keep in mind sheer size  
of problem

SB: if get into abt stress point  
needs consider who should act

- only 20% assets from DI
- need for assistance in ML
- think hard abt role of FDIC

(4)

HP: ML now part of BA  
 ↳ loss of confidence in ML  
 hurts BA

↳ BA management concerned

↳ could

SB: want to avoid continued DI bail-out

- think BA won't "implode"  
 when earnings announced

- options

↳ covered bond guarantee  
 ↳ other structures on consumer  
 assets

- not sure ML fix is long term fix

HP: don't want to do this  
 unfair stuck as leaving  
 prefer waiting for new program, TARP 2

but can't wait + so concerned about system  
 ↳ willing to commit TARP funds

- willing to invest ~~\$15-20b~~ \$15-20b

- not enough, so need asset wrap  
 \$100-300 to raise

⑤

very imp FDIC part of action

- if don't act, jeopardize system

Richmond/Charlotte: ML losses

↳ TCE looks vulnerable

↳ liquidity at risk

↳ mkt not anticipating this

size loss

↳ sizable short term

funding at BA that

could run + would cause

problem

FDIC: Guarantee program has lots of

capacity + is available

+ cap regulatory cap still high

Albrand: mkt expects BA to report

prob't

will report \$1.5b loss

HL: losses to be announced

so far beyond expectations

Bair: need more info

- unsecured funding guaranteed

↳ what are vulnerabilities?

⑥

HP: understand FDIC needs more info

- need to proceed down road  
so USG has options

BB: Dwyer + Richmond id vulnerabilities

↳ will provide info to FDIC

↳ FDIC already on exam

of OCC + FRB

DK: vulnerable now

- TRAP used, new TRAP  
not ready

- many losses abt to be  
announced + mkt  
shaken

HP: open to talking abt stock terms,

but don't think non cumulative

option makes sense.

↳ less protection for taxpayers

- will figure out terms

Bar: Q whether govt preferred policy?

- is it better to tackle non-cumulative  
problem separately?

HP: non-cumulative problem is large + complex;

Treat them as same time

(7)

Art: assets

BA proposed 180.5 r/sence

- w/ OCC + FDIC

↳ 124.5 seem most likely  
to be workable↳ 92.5 ML exposures causing  
most pain

↳ abt 870.5 synthetic de

↳ Fed still considering  
how it could  
finance

↳ still thinking

KW - want to get 3rd party to  
review assets to help  
value- could consider taking more  
assets from BA (in place of ML de  
↳ what assets wld  
make investors feel  
more comfortable  
abt companyDuncan: plenty of BA assets  
that likely will suffer losses↳ main shock to risk is abt ML  
↳ taking on BA assets depends  
BA + herts

⑧

HP: care abt stable injury BA,  
not meeting size marks

Lester: agree w/ budget risk of  
disrupting narrative

KW: steps forward

= staff to identify stress points  
+ get info to FDIC as needed

= Treas + KW discuss security  
of BA

- staff see if can get  
comfortable w/ assets in pool

- get term sheet to BA  
+ see if BA can move  
earnings announcement  
forward

HP: try for earnings announcement  
Jan 16

394 STATEMENT OF KENNETH D. LEWIS, CHIEF EXECUTIVE OFFICER, BANK  
395 OF AMERICA

396 Mr. LEWIS. Chairman Towns, Ranking Member Issa,  
397 Subcommittee Chairman Kucinich, and Ranking Member Jordan, as  
398 has been said, my name is Ken Lewis, and I am Chief Executive  
399 Officer of Bank of America.

400 This Committee is reviewing important issues, and I hope  
401 my remarks will be helpful to you.

402 Let me tell you a little bit about Bank of America. Our  
403 business lines include deposits, wealth and investment  
404 management, corporate investment banking, credit cards, and  
405 mortgages. We have a deep commitment to serving all the  
406 communities in which we operate. We have committed to land  
407 and invest \$1.5 trillion in low and moderate income  
408 communities over the next 10 years.

409 As everyone here is aware, the financial services  
410 industry underwent considerable turmoil in 2008. Bank of  
411 America was affected by that turmoil but, nonetheless, earned  
412 a profit of \$4.2 billion for the year. We also made two  
413 significant acquisitions, Countrywide and Merrill Lynch.

414 There does not appear to be any debate that these  
415 acquisitions were in the best interest of the financial  
416 system, the economy, and the Country. The failure of

467 percent.

468       Now let me briefly walk you through the decision to  
469 purchase Merrill Lynch. We made that decision in September  
470 2008. We did so because we saw the potential benefits I just  
471 described, and we did so without any promise or expectation  
472 of governmental support.

473       In mid-December, I was advised that Merrill Lynch had  
474 significantly raised its forecast of its losses, and we  
475 contacted officials of the Treasury and Federal Reserve to  
476 inform them that we had concerns about closing the  
477 transaction. At that time, we were considering declaring a  
478 material adverse change, which, as a matter of contract law,  
479 can, if upheld, allow an acquirer to avoid to consummate a  
480 deal. Treasury and Federal Reserve representatives asked us  
481 to delay any such action and expressed significant concerns  
482 about both the systemic consequences and the risk to Bank of  
483 America in pursuing this course.

484       We and the Government explored Government support as  
485 would limit the risk of proceeding with the transaction. We  
486 both were aware that the global financial system was in  
487 fragile condition and that a collapse of Merrill Lynch could  
488 hasten the crisis.

489       For its part, Bank of America concluded that there was  
490 serious risk to declaring a material adverse change and that  
491 proceeding with the transaction with governmental support was

531 Mr. LEWIS. Thank you for the question. The financial  
532 markets in the fourth quarter of 2008 suffered a massive  
533 credit meltdown, something that probably had not been seen  
534 during our lifetimes, and we saw that happening in September  
535 and in October, and we saw things that were evidenced in our  
536 own book that suggested that things were bad and getting  
537 worse. We also had heard rumors on the street that other  
538 banks were suffering losses as well. So the losses at that  
539 particular time were not concerning because they were  
540 consistent with others in the marketplace and what we were  
541 seeing as well.

542 But then, in mid-December, the forecast losses  
543 accelerated dramatically. So it wasn't that we didn't know  
544 about losses. The concern was the fact that these losses  
545 accelerated, and that was what gave us the grave concern.

546 Chairman TOWNS. Let me put it this way. Did you move  
547 forward with the Merrill deal because of pressure from  
548 Government officials or because you thought it was in the  
549 best interest of Bank of America and its shareholders?

550 Mr. LEWIS. There has been a lot of talk about the  
551 pressure from the Federal Government. It is true that we  
552 were told that if we went through or--I can't remember the  
553 exact words, so please give me license with word for word,  
554 but basically if we went through with calling the MAC, that  
555 the Government could or would remove management and the

647 Mr. KUCINICH. Now, Mr. Lewis, isn't it true that you  
648 understood the composition and performance of Merrill's  
649 portfolio because it was similar to your own in that it was a  
650 portfolio that contained complex structured derivative  
651 products? Isn't that true?

652 Mr. LEWIS. It is true. The issue, though, is nobody  
653 predicted a meltdown like occurred in the fourth quarter of  
654 2008.

655 Mr. KUCINICH. But you were getting weekly reports, and  
656 you certainly understood Merrill because of the similarities  
657 in the composition and performance of their portfolio. Now,  
658 our investigation found that the Fed believed you should have  
659 understood the potential for losses at Merrill because your  
660 own portfolio was similar to Merrill's.

661 I want you to look at the following from the Fed's  
662 restricted analysis of Bank of America and the Merrill Lynch  
663 merger, dated December 21st, 2008. "The potential for  
664 losses from other risk exposures cited by management,  
665 including those coming from leverage loans and trading and  
666 complex structured credit derivative products--what they also  
667 call correlation trading--should also have been reasonably  
668 well understood, particularly as Bank of America itself is  
669 also active in these products."

670 Now, Mr. Lewis, how do you explain the apparent  
671 contradiction between your sworn testimony and the Fed's

1044 Mr. ISSA. Okay. And the U.S. Treasury Secretary, any  
1045 similar power?

1046 Mr. LEWIS. No, sir, I don't think he would have the  
1047 power.

1048 Mr. ISSA. Okay. But when acting in concert, you would  
1049 perceive that threat to be real, that he could execute on  
1050 that threat, of having you and/or your board relieved.

1051 Mr. LEWIS. My perception was that he was speaking on  
1052 behalf of himself and the regulators. And my perception was,  
1053 in concert, they would have that power.

1054 Mr. ISSA. Thank you.

1055 Chairman TOWNS. Thank you very much.

1056 I now yield to the gentleman from Pennsylvania who has  
1057 been working on these issues for more than 20 years,  
1058 Congressman Kanjorski.

1059 Mr. KANJORSKI. Thank you very much, Mr. Chairman.

1060 Mr. McHenry made a comment in his introduction of you  
1061 that Bank of America has business relations with 98 percent  
1062 of the Fortune 500 companies. What I want to know is what  
1063 are the 10 companies that aren't doing business with you?

1064 [Laughter.]

1065 Mr. LEWIS. I don't know, but it is a very interesting  
1066 question.

1067 Mr. KANJORSKI. Get home and check that.

1068 Mr. Lewis, in some regard we have important questions

1955 everything done at once.

1956 Mr. CONNOLLY. I am sorry, I cannot hear you.

1957 Mr. LEWIS. We were working on a goal of getting

1958 everything done at once so that we didn't have an

1959 announcement of something that would cause more damage to the

1960 economy. But nobody ever told us that we should not disclose

1961 a disclosable event.

1962 Mr. CONNOLLY. So, for example, nobody at the Federal

1963 Reserve and no one at the United States Treasury urged you to

1964 manage the timing of the disclosure so that Merrill's

1965 earnings and the receipt of TARP money were all disclosed in

1966 January?

1967 Mr. LEWIS. The target was to do that so that we didn't

1968 damage the economy any more.

1969 Mr. CONNOLLY. So there were discussions about that with

1970 the U.S. Treasury and with the Federal Reserve.

1971 Mr. LEWIS. It was about announcing everything at once.

1972 Mr. CONNOLLY. I understand, but the timing is

1973 interesting; let's announce it in January, not in December.

1974 Was there something critical that had happened on Wall Street

1975 that made it better in January than December?

1976 Mr. LEWIS. There was not an agreement in December.

1977 Mr. CONNOLLY. I am sorry?

1978 Mr. LEWIS. There was not an agreement in December.

1979 Mr. CONNOLLY. There was not an agreement among whom?

2005 reluctance in accepting them and the exhortation from  
2006 Secretary Paulson at that time to accept them and the issue  
2007 of don't disclose the \$12 billion worth of losses you had  
2008 just discovered?

2009 Mr. LEWIS. No, absolutely not.

2010 Mr. CONNOLLY. It never came up?

2011 Mr. LEWIS. No.

2012 Mr. CONNOLLY. Why did you accept TARP funds if you  
2013 didn't think you needed them?

2014 Mr. LEWIS. Because after hearing the various regulators,  
2015 I felt like, given what they were saying about the potential  
2016 of further deterioration in the economy, that we should have  
2017 a healthy fear of the unknown.

2018 Mr. CONNOLLY. How much in TARP funds did you accept, Mr.  
2019 Lewis?

2020 Mr. LEWIS. Fifteen billion.

2021 Mr. CONNOLLY. That is a lot of money for insurance  
2022 against the unknown, especially if your initial reaction was  
2023 we don't need them.

2024 Mr. LEWIS. Yes. But if you then see that credit  
2025 meltdown of epic proportions that happened in the fourth  
2026 quarter, it may not have been such a big insurance policy  
2027 after all.

2028 Mr. CONNOLLY. My time is almost up. One final question.  
2029 Greg Curl replaced Amy Brinkley at BoA's Chief Risk Officer.

2030 Given the fact that Mr. Curl failed to notice \$12 billion of  
2031 Merrill Lynch's losses, is it wise to have Mr. Curl be your  
2032 Chief Risk Officer, and did you approve of that decision?

2033 Mr. LEWIS. Mr. Curl didn't miss the instruments which  
2034 caused the loss. What happened is we did not anticipate the  
2035 meltdown of such significant proportions in the fourth  
2036 quarter. So he had identified everything properly; no one  
2037 thought things would get as bad as it did in the fourth  
2038 quarter. And I made that decision.

2039 Mr. CONNOLLY. You made the decision that Mr. Curl should  
2040 go ahead to become the CRO.

2041 Mr. LEWIS. To become the COO. I am sorry, the CRO.

2042 Mr. CONNOLLY. Thank you. My time is up.

2043 Chairman TOWNS. Let me thank you too. Let me announce  
2044 that we have two votes on the floor and that we will recess  
2045 until 12:30, and we will be returning at 12:30 and, of  
2046 course, continue the questions. So the Committee is in  
2047 recess until 12:30.

2048 [Recess.]

2049 Chairman TOWNS. The Committee will resume. May I remind  
2050 the witness that he is still under oath.

2051 At this time, I yield five minutes to the gentlewoman  
2052 from California, Ms. Diane Watson.

2053 Ms. WATSON. Thank you, Mr. Chairman, and thank you, Mr.  
2054 Lewis for enduring all of this time.

2489 weren't you told you wouldn't get it?

2490 Mr. LEWIS. I think I have seen that in an email, but I  
2491 don't--

2492 Mr. KUCINICH. Were you told that, yes or no?

2493 Mr. LEWIS. I do not recall being told that.

2494 Mr. KUCINICH. Isn't it true that given the precarious  
2495 state of your balance sheet and especially your inadequate  
2496 levels of tangible common equity, you believed at the time  
2497 you reasonably could need financial assistance from the  
2498 Government in the future?

2499 Mr. LEWIS. The preferred stock does nothing to help your  
2500 tangible common equity ratio.

2501 Mr. KUCINICH. You wouldn't think about it? I mean, if  
2502 you got \$15 billion in October and you are going to come back  
2503 two months later and ask for another \$20 billion--you to 15  
2504 and then, two months later, \$20 billion--doesn't it show that  
2505 it really increased your Tier 1 capital ratio? Doesn't it  
2506 show that?

2507 Mr. LEWIS. Not tangible.

2508 Mr. KUCINICH. Tier 1.

2509 Mr. LEWIS. Tier 1, yes.

2510 Mr. KUCINICH. Now, Mr. Lewis, the Government believed  
2511 that you knew or should have known about the Merrill losses  
2512 long before you said you did based on data that Bank of  
2513 America possessed and had reasonably reviewed. The

K.L. Lewis

Describe that call, please.

A. I told him that we were strongly considering the MAC and thought we actually had one. He said, "We probably should talk," and he said, "Could you be here by 6 o'clock," -- I think it was; give me license on that, I think it was around 6 o'clock -- "on the 17th, and I'll have a meeting arranged with me and the Feds, Ben Bernanke." So we did that.

Q. So when did you call him on the 17th, about what time?

A. I don't remember.

MR. LAWSKY: Let me show you a calendar, if it helps. Does that say "Leave at 3"?

THE WITNESS: Yes.

MR. LAWSKY: And you have "Hurley at noon."

THE WITNESS: My best recollection is that it was mid-morning, but I don't remember talking -- I don't put things like that on my calendar.

MR. LAWSKY: Does that say "Gone to D.C."?

THE WITNESS: Correct. So sometime

K.L. Lewis

it might trigger some recollection.

A. I think I got it now. I remember, for some reason, we wanted to follow up and see if any progress -- as I recall, we, actually, had not agreed not to call a MAC after the conversation that we had, and so I tried to get in touch with Hank, and, as I recall, I got a number that was somebody at the Treasury kind of guard-like thing. He had a number for Hank, and Hank was out, I think, on his bike, and he -- this is vague; I won't get the words exactly right -- and he said, "I'm going to be very blunt, we're very supportive of Bank of America and we want to be of help, but" -- I recall him saying "the government," but that may or may not be the case -- "does not feel it's in your best interest for you to call a MAC, and that we feel so strongly," -- I can't recall if he said "we would remove the board and management if you called it" or if he said "we would do it if you intended to." I don't remember which one it was, before or after, and I said, "Hank, let's deescalate this for a while. Let me talk to our board." And the board's reaction was one of "That threat, okay, do it. That would be systemic risk."

1 K.L. Lewis

2 to help you with this. But I can't time it.

3 MR. CORNGOLD: And had you considered  
4 prior up to this Sunday conversation using  
5 the potential invocation of the MAC clause as  
6 a way to extract some changes from Merrill,  
7 whether it be price changes or conduct  
8 changes?

9 THE WITNESS: This was about just a  
10 shear magnitude of loss, and either you do it  
11 or you don't. Behavioral changes, or  
12 whatever, wouldn't fill that hole what we  
13 thought was \$12 billion, which turned out to  
14 be \$15 billion.

15 Q. Did Paulson ever say to you during this  
16 time period -- or Bernanke, or people who work with  
17 them -- "Have you told Thain or Merrill what's  
18 going on here?"

19 A. I think, at some point -- Thain used to  
20 work for Hank. I vaguely recall he asked me if he  
21 knew, and I said "No." I said, "We had not talked  
22 to Merrill."

23 MR. LAWSKY: Did you have a view, at  
24 this time, about what invoking the MAC and  
25 backing out of the deal would do to Merrill?

1 K.L. Lewis

2 MR. CORNGOLD: Do they sometimes,  
3 because of who you are, do they contradict?

4 THE WITNESS: I don't know what you  
5 mean.

6 MR. CORNGOLD: Is it always the case  
7 that what's in the country's best interest is  
8 in Bank of America's shareholders' best  
9 interest?

10 MR. LIMAN: You mean ever in history?

11 MR. CORNGOLD: You made the point that  
12 sometimes they intertwine. Pregnant in that  
13 is, sometimes they don't intertwine. That's  
14 why I'm asking you if that's what you meant,  
15 or do you mean that they always intertwine.

16 THE WITNESS: I mean that in this  
17 particular case they intertwine -- is a  
18 better way of saying it.

19 Q. At the point in time of this board  
20 meeting, though, you were relating to the board  
21 that you felt you had a commitment from the Fed and  
22 the Treasury to make good on whatever harm is  
23 caused by the increased losses at Merrill Lynch; is  
24 that right?

25 A. I had verbal commitments from Ben

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K.L. Lewis

Bernanke and Hank Paulson that they were going to see this through, to fill that hole, and have the market perceive this as a good deal.

MR. CORNGOLD: Isn't the only way to fill that hole, though, to give you money, not to give you money that you would have to pay back at some interest rate with some potential equity interest, too?

THE WITNESS: No. I think you have to separate the fact that, yes, there is still some short-term paying -- it's more short-term paying now than we would have had had all this not happened, but longer term we still see a strategic benefit. So we saw it as a short term versus a long term impact on the company.

MR. CORNGOLD: When you entered into the initial contract with Merrill Lynch did you get a fairness opinion about the transaction?

THE WITNESS: Yes.

MR. CORNGOLD: From whom?

THE WITNESS: Chris Flowers something.

MR. CORNGOLD: And did you get a fairness opinion from anyone about the

1 K.L. Lewis

2 A. No.

3 Q. Did you not do that because of the  
4 statements made by Mr. Paulson?

5 A. No. The price itself being renegotiated  
6 wouldn't have solved the issue. It was a MAC --  
7 you have a lower price, obviously, but you still  
8 have that hole.

9 Q. But it would help?

10 A. Excuse me. After the instructions by  
11 Paulson, etc., no, I didn't have a chance.

12 MR. LIMAN: Absent the ability to clear  
13 MAC, is there any way to renegotiate the  
14 price?

15 THE WITNESS: Plus, it was said that "We  
16 want this deal done on time on these terms."  
17 There wasn't an ability to renegotiate.

18 Q. Why wouldn't you be able to renegotiate  
19 the price and still do it in a timely matter?

20 MR. LIMAN: You mean absent a MAC or  
21 with a MAC?

22 Q. You can always renegotiate.

23 A. Not when you're told that you can't.

24 Q. That's my question: Would you have  
25 tried to renegotiate the price if you weren't told

1 K.L. Lewis  
2 not to by Mr. Paulson?  
3 A. Yes.  
4 Q. And why was it that you couldn't  
5 renegotiate the price?  
6 A. I can't speak for Hank and the others,  
7 so it was pretty clear they wanted everything to  
8 stay as it was.  
9 Q. I understand that you can't speak for  
10 him. I guess what I'm trying to say is, someone  
11 who recently told you that if you did something  
12 he'd remove senior management from the board, it  
13 seems to me that they would have to kind of pull,  
14 that they could accelerate the timing of things,  
15 they could change the price, they could use their  
16 influence to help a fair resolution of the deal.  
17 MR. LIMAN: I'm sorry. The questions are  
18 very convoluted. Is your question, did he  
19 consider asking Merrill to give up their  
20 legal rights in the deal?  
21 MR. MARKOWITZ: That's not my question.  
22 MR. LIMAN: Is your question, did they  
23 have legal rights to change the deal absent  
24 the MAC? Ask a proper question.  
25 MR. MARKOWITZ: My questions are proper;

515 Chairman TOWNS. Thank you very much for your testimony.  
516 I will begin with questions. And then, of course, we will  
517 allow each member to have questions.

518 Chairman Bernanke, did you instruct Hank Paulson to tell  
519 Ken Lewis that he and his board would be fired if they backed  
520 out of the Merrill deal?

521 Mr. BERNANKE. I did not.

522 Chairman TOWNS. Well, I understand that Mr. Paulson  
523 told Mr. Cuomo that you did. I just want to share that with  
524 you.

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

527 Chairman TOWNS. Did you personally tell Mr. Lewis that  
528 you would fire him or remove the Bank of America board if Mr.  
529 Lewis backed out of the Merrill Lynch deal?

530 Mr. BERNANKE. I did not.

531 Chairman TOWNS. Ken Lewis testified under oath here and  
532 also told his board of directors that you and Mr. Paulson  
533 made verbal commitments to him in December of 2008 to provide  
534 Bank of America with enough money to fill the hole created by  
535 the \$12 billion loss created by Merrill Lynch?

536 In December of 2008, did you promise Mr. Lewis that you  
537 would provide Bank of America with enough capital to fill the  
538 \$12 billion hole created by the losses at Merrill Lynch?

539 Mr. BERNANKE. I did not promise any specific amount of



BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

April 30, 2009

**BEN S. BERNANKE**  
CHAIRMAN

The Honorable Edolphus Towns  
Chairman  
Committee on Oversight and  
Government Reform  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letters of March 30, 2009, and April 23, 2009, regarding discussions between the Federal Reserve, U.S. Treasury Department and Bank of America Corporation about Bank of America's acquisition of Merrill Lynch & Co. I will not attempt to characterize or address conversations of members of the Treasury Department, and will address only my involvement and the involvement of the Federal Reserve.

I will begin by directly addressing the matters raised in your letters. The Federal Reserve acted with the highest integrity throughout its discussions with Bank of America regarding Bank of America's acquisition of Merrill Lynch. Let me be clear: At no time during these discussions did I or any member of the Federal Reserve direct, instruct or advise anyone at Bank of America to withhold from public disclosure information about Merrill Lynch, its anticipated or actual losses, its compensation packages or bonuses, or any other related matter. Neither the Federal Reserve nor I threatened to terminate, fine or take supervisory action against anyone at Bank of America if they disclosed any of the firm's or Merrill Lynch's information related to these matters. It has long and consistently been my view and the view of the Federal Reserve that questions regarding disclosure of information under the federal securities laws are best addressed by the relevant institution and its legal counsel because they are better positioned to understand clearly the materiality of the information and the institution's disclosure obligations and responsibilities. It is a practice we followed in this case as well.

Beginning on December 17, 2008, we participated in several discussions with management of Bank of America about its plans to acquire Merrill Lynch. These discussions occurred at the request of the management of Bank of America, and, importantly, after Bank of America had announced the deal and gained the approval of its shareholders and the shareholders of Merrill Lynch and after the Federal Reserve had approved the transaction under the Bank Holding Company Act.

The Honorable Edolphus Towns  
Page Two

Through the course of these discussions, management of Bank of America outlined the estimated losses at Merrill Lynch for the fourth quarter of 2008. It also raised the prospect that the U.S. government provide assistance to facilitate the acquisition of Merrill Lynch by Bank of America, given the expected size of those losses and the state of the markets and the economy. In addition, these conversations included discussion of the potential market reaction to Bank of America choosing not to proceed with the acquisition of Merrill Lynch as well as the potential market reaction if the U.S. government provided aid to Bank of America. The discussions did not encompass compensation levels or bonuses of Merrill Lynch employees.

We are continuing to search and collect our records for the information you have requested in your two letters and expect to complete that search shortly. All of the information collected thus far consists of confidential supervisory information or confidential business information, both of which have traditionally been regarded as material that should not be made public, especially in the case of institutions that continue to operate. We propose to work with your staff to develop appropriate procedures for reviewing this information in a manner that maintains its confidentiality.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to be "A. A.", written in a cursive style.

Cc: Chairman Christopher Dodd, Senator Richard Shelby  
Chairman Barney Frank, Representative Spencer Bachus

MINUTES OF SPECIAL MEETING OF BOARD OF DIRECTORS  
OF  
BANK OF AMERICA CORPORATION

December 22, 2008

Pursuant to due notice, a special meeting of the Board of Directors of Bank of America Corporation (the "Corporation") was held by telephone at 4:00 p.m. EST on Monday, December 22, 2008.

The following Directors were present constituting a quorum: Messrs. William Bartel, III, Frank P. Bramble, Sr., John T. Collins, Gary L. Countryman, Tommy R. Franks, Charles K. Gifford, Kenneth D. Lewis, Walter E. Massey, Thomas J. May, Thomas M. Ryan, O. Temple Sloan, Jr., Robert L. Tillman, and Mmes. Monica C. Lozano, Meredith R. Spangler and Jackie M. Ward.

Also present were: Messrs. J. Steele Alphin, Keith T. Banks, Gregory L. Curl, Bruce Hammonds, Liam E. McGee, Brian T. Moyrithen, Joe L. Price, Richard K. Struthers, and Mmes. Amy Woods Brinkley, Barbara J. Desoer, Annie M. Finucane, and Alice A. Herald, officers of the Corporation.

Mr. Lewis chaired the meeting and Ms. Herald kept the minutes.

Mr. Lewis noted that roll call had been taken. Mr. Lewis stated that he had spoken to most of the Directors by telephone earlier in the day regarding the events of the preceding weekend.

Mr. Lewis stated the purpose of the special meeting is to insure that the Board is in accord with management's recommendation to complete the acquisition of Merrill Lynch & Co., Inc. ("Merrill Lynch"), as scheduled on January 1, 2009, pursuant to the terms of that certain Agreement and Plan of Merger ("Merger Agreement"), dated September 15, 2008, after due consideration of the undertakings and admonitions of the federal registrars.

Mr. Lewis reported that a series of calls had occurred between management of the Corporation and federal regulators as well as individual calls with Mr. Paulsen, Secretary of the Treasury ("Treasury") and Mr. Bernanke, Chairman of the Board of Governors of the Federal Reserve ("Fed"). He reported the key points of the calls to be: (i) first and foremost, the Treasury and Fed are unified in their view that the failure of the Corporation to complete the acquisition of Merrill Lynch would result in systemic risk to the financial services system in America and would have adverse consequences for the Corporation; (ii) second, the 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; (iii) third, the Treasury and Fed have confirmed that they will provide assistance to the Corporation to restore capital and to protect the Corporation against the adverse impact of certain Merrill Lynch assets; and (iv) fourth, the Fed and Treasury stated that the investment and asset protection promised could not be provided or completed by the scheduled closing date of the merger, January 1, 2009; that the merger should close as scheduled; and that the Corporation can rely on the Fed and Treasury to complete and deliver the promised support by January 20, 2009, the date scheduled for the release of earnings by the Corporation.

Mr. Lewis reiterated that he had discussed in detail the content of the previous conversations with federal regulators with the Board. He reported that in addition to the previously described conversations, he had spoken again with Mr. Bernanke who stated that he, Mr. Bernanke, has spoken to other federal regulators, including the Office of the Comptroller of the Currency ("OCC") and the FDIC, and has confirmed that the OCC, FDIC, the current and incoming Treasury officials, and the incoming economic team of the new administration are informed of the commitment to the Corporation by the Fed and Treasury and that all concur with the commitment of the combined federal regulators ("federal regulators") to the Corporation.

Mr. Lewis stated that, based on his discussions with members of the Board, management recommended that the Corporation not exercise the MAC clause under the Merger Agreement with Merrill Lynch and that the Corporation proceed and close the Merrill Lynch acquisition on January 1, 2009, as originally contemplated. The Board discussed with Mr. Moynihan

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Mr. Lewis stated further that the Corporation will proceed diligently with the work required to document the commitment from the Fed, Treasury and others to facilitate an announcement of the commitment in conjunction with the Corporation's earnings release on January 20, 2009.

Mr. Lewis restated that management's recommendation is based on the following facts: instruction from the Fed and Treasury not to exercise the MAC clause in the Merger Agreement; the assurance of the Fed and Treasury that the Corporation can complete the acquisition of Merrill Lynch on the verbal commitment of the Fed and Treasury to have a transaction evidencing the Fed and Treasury's committed assistance in existence no later than January 20, 2009; the scheduled date of the Corporation's earnings release; and Mr. Lewis' comfort with the assurances which have been made by the Fed and Treasury and clarification that funds under the TARP program are available for distribution to the Corporation to fulfill the commitment of the Treasury and Fed.

Mr. Lewis noted that no vote was required by the Board, but that he wished to open the recommendation for discussion among the Board and management.

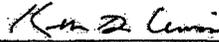
Discussion ensued, with the Board clarifying that it was not persuaded or influenced by the statement by the federal regulators that the Board and management would be removed by the federal regulators if the Corporation were to exercise the MAC clause and fail to complete the acquisition of Merrill Lynch. The Board concurred it would reach a decision that it deemed in the best interest of the Corporation and its shareholders without regard to this representation by the federal regulators.

Further discussion ensued including accurate characterization by the federal regulators of their commitment to the Corporation when announced; the relevant assets of Merrill Lynch; the importance of the timing of the announcement of the commitment of the Fed and Treasury; the Corporation's dividends and incentive compensation; the desirability of a written commitment from the federal regulators; the reliability of the representatives of the federal regulators; the desirability of asset purchases and equity infusions; the Corporation's ability to further negotiate after the consummation of the merger; further inquiry regarding specific assurances by the federal regulators; the Corporation's recent responses to certain requests of federal regulators;

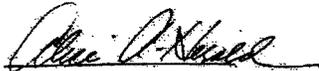
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After discussion, the Board requested that management obtain further clarification of certain potential terms, conditions and assurances regarding the commitment from the federal regulators.

There being no further business to come before the Board, the meeting was adjourned.



Kenneth D. Lewis  
Chairman of the Board



Alice A. Herald  
Secretary

MINUTES OF SPECIAL MEETING OF BOARD OF DIRECTORS  
OF  
BANK OF AMERICA CORPORATION

December 30, 2008

Pursuant to due notice, a special meeting of the Board of Directors of Bank of America Corporation was held at 4:00 p.m. on Tuesday, December 30, 2008.

The following Directors were present constituting a quorum: Messrs. William Barnet, III, Frank P. Bramble, Sr., John T. Collins, Gary L. Countryman, Tommy R. Franke, Charles K. Gifford, Kenneth D. Lewis, Walter E. Massey, Thomas J. May, O. Temple Sloan, Jr., Robert L. Tillman, and Mmes. Monica C. Lozano, Patricia E. Mitchell, Meredith R. Spangler and Jackie M. Ward.

Also present were: Messrs. Brian T. Moynihan, and Joe L. Price, and Mmes. Amy Woods Brinkley, and Alice A. Herald, officers of the Corporation.

Mr. Lewis called and chaired the special meeting and Ms. Herald kept the minutes.

Mr. Lewis advised the Board that he wished to fully inform the Board regarding discussions between management of the Corporation and federal regulators which had occurred since the Board meeting of December 22, 2008, including the federal regulators' dim view of the economy.

Mr. Lewis reported that the Board had requested that management obtain greater clarity regarding the assurances provided to him by Mr. Bernanke, Chairman of the Board of Governors of the Federal Reserve ("Fed") and Mr. Paulson, Secretary of the Treasury ("Treasury") and to advance the completion of the commitment to the Corporation from the federal regulators on which the Board and management would rely to consummate the scheduled acquisition of Merrill Lynch & Co. ("Merrill Lynch"). He reported that management had requested that the Treasury and the Fed confirm the terms and conditions of their commitment before the closing date of the acquisition of Merrill Lynch on January 1, 2009. He

further reported that management had engaged in a series of telephone calls and communications with the federal regulators to obtain greater certainty with regard to the terms and conditions of the federal regulators' commitment.

Mr. Lewis reported that in his conversations with the federal regulators regarding the Corporation's pending acquisition of Merrill Lynch, he had stated that, were it not for the serious concerns regarding the status of the United States financial services system and the adverse consequences of that situation to the Corporation articulated by the federal regulators (the "adverse situation"), the Corporation would, in light of the deterioration of the operating results and capital position of Merrill Lynch, assert the material adverse change clause in its merger agreement with Merrill Lynch and would seek to renegotiate the transaction.

Further, Mr. Lewis reported that it was also made clear to the federal regulators that, because of the federal regulators' express concerns regarding the adverse situation that would occur if the Corporation failed to acquire Merrill Lynch, it is appropriate that the federal government make the Corporation whole for the deterioration in Merrill Lynch's operating results and financial condition.

Mr. Lewis described the conversations that had occurred predominately with Mr. Walsh, with whom Mr. Bernanke had directed management to communicate. He reported the purpose of such conversations was to sufficiently detail the needs and expectations of the Corporation to the federal regulators before the effective date of the acquisition of Merrill Lynch.

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Mr. Lewis stated that the Corporation did not have a written agreement with the federal regulators and that the Corporation could only rely on the oral commitments of Messrs. Bernanke and Paulson and their senior representatives at the Treasury and Fed, including Mr. Walsh. Mr. Lewis explained that written assurances would not be received before January 1, 2009, because any written assurances would require formal action by the Fed and Treasury, which formal action would require public disclosure. Mr. Lewis also reported that according to the federal regulators any written assurances delivered prior to January 1, 2009, would not, in any event, provide sufficient detail to provide comfort to the Board and management of the commitment by the federal regulators.

In accordance with the recommendation of the Board at the preceding meeting, Mr. Lewis reported that management has obtained detailed oral assurances from the federal regulators with regard to their commitment and has documented those assurances with e-mails and detailed notes of management's conversations with the federal regulators. Mr. Lewis reported the dates and times of certain of the communications and the significant extent of management's efforts. Mr. Lewis then discussed in detail several of the conversations between Mr. Price and Mr. Walsh establishing essential elements of the commitment of the federal regulators, including: (i) an agreement from the federal regulators that their commitment be fully documented on or before January 20, 2009; (ii) a confirmation of the continuing and strong admonition of the federal regulators that failure of the Corporation to consummate the acquisition of Merrill Lynch would cause significant systemic risk to the financial system and the economy of the United States and would be specifically adverse to the Corporation; and (iii) the commitment of the federal regulators to deliver assistance in the form of capital and asset protection to the Corporation.

Mr. Lewis noted that Mr. Price has shared with the government management's expectations as to the amount of capital expected to be provided to the Corporation and the general construct of any equity position to be received by the federal regulators, as well as the Corporation's efforts with counsel and the Corporation's accountants with regard thereto. Mr. Lewis also noted that Mr. Price had been clear in his discussions regarding the Corporation's concerns about preventing dilution of the interests of the existing shareholders of the Corporation.

Mr. Lewis shared the Corporation's expectations presented to the federal regulators regarding the amount of proposed protection from the federal regulators against the impact of the on and off balance sheet assets of Merrill Lynch, the specific assets identified, current carrying values and related items, including the government's rate and order of absorption of losses upon reduction of market values and substantial discounts to original market values. He reported that management has also asserted clearly in discussions with the federal regulators that any "premium" charged by the government for such insurance should be modest. He also stated the Corporation's proposal insulates the most troubling Merrill Lynch assets, and retains upside potential for the Corporation.

Mr. Lewis stated that management has been insistent with the federal regulators that clarity exist with regard to their commitment. He reported that management is confident

that Mr. Warsh understands the Corporation's position clearly. He further confirmed that Mr. Bernanke had assured him the Corporation would not be penalized by accepting the commitment of the federal regulators and that acceptance of the commitment would be beneficial to the Corporation and its shareholders. Mr. Lewis also noted, however, that the details of the commitment were not finalized.

Mr. Lewis explained that recent discussions had begun to address concerns raised by the supervisory regulators of the Fed. These regulators had expressed concern regarding the Corporation's ability to remain stable in light of their own view of the economy, the Corporation's earnings prospects and the stability of the banking industry. Mr. Lewis reported the Fed's objective is that the Corporation remain above reproach as a stable member of the financial system as the recession continues.

Mr. Lewis described the federal regulators' dim view of the near term economy and their projections of the economy's impact on the Corporation's earning prospects for 2009. He reported the regulators concern that weakened earnings and dividend payments could cause capital issues for the Corporation by early in the second quarter in view of the low tangible common equity ratio.

Mr. Lewis shared his and Mr. Price's conversations with the federal regulators, particularly Mr. Warsh, who articulated the government's desire for an injection of new private capital into the industry and future offerings of common stock by the Corporation in which the government would participate. He described discussions with the regulators regarding projected target common equity ratios, dividends, ring-fencing of certain assets of the Corporation, capital cushions for the Corporation and the government's long term and short term views regarding the provision for additional equity. Mr. Lewis explained the government's desire to see of a reduction of the Corporation's dividend to a nominal amount, perhaps 5 cents per share per quarter to protect the Corporation's capital.

Mr. Lewis stated the federal regulators' clear position that if the Corporation declined on an equity infusion at this time only to later come back and request that the government make a further equity infusion with respect to the Corporation, its terms would be onerous to the Corporation.

Mr. Lewis discussed the implications of government ownership of a portion of the Corporation and two potential transactions with the government: a capital injection including a wrap of certain assets and a capital offering including ring-fencing of certain assets of the Corporation. He noted that both potential transactions remain under discussion with the federal regulators.

Mr. Lewis stated that no definitive agreement has been reached with the federal regulators, but that management of the Corporation had clearly explained to the federal regulators the terms and conditions required by the Corporation to consummate the acquisition of Merrill Lynch on January 1, 2009. In return, he reported, management has received strong assurances from all relevant federal regulators and policy makers that the Corporation will receive adequate and appropriate assets to neutralize the impact to the financial condition of the Corporation resulting from the Corporation's acquisition of Merrill Lynch on January 1, 2009. He stated that federal regulators had advised management of their desire that the Corporation remain stable and their willingness to assist the Corporation to raise capital, if necessary, to stabilize the Corporation's asset base.

Mr. Lewis concluded his remarks by stating that management will continue to work with the federal regulators to transform the principles that have been discussed into an appropriately documented commitment to be codified and implemented in conjunction with the Corporation's earnings release on January 29, 2009.

Robust discussion ensued, including the Corporation's recourse should the federal regulators fail to comply with their assurances on which the Board and management have relied.

Mr. Price elaborated on his conversations with Messrs. Bernanke and Paulson. He reported that he had confirmed to Mr. Bernanke and Mr. Paulson the reliance of the Board and management on the federal regulators' assurances. He described the alternatives potentially available to the Corporation in a transaction with the government and the terms and conditions of agreements between the federal regulators and other institutions in the industry.

Mr. Moynihan

REDACTED

REDACTED

Further discussion ensued including backstops available to the Corporation,  
capital ratios and dividends.

After summary remarks by Mr. Lewis, there being no further business to come  
before the Board, the meeting was adjourned.



Kenneth D. Lewis  
Chairman of the Board



Alice A. Herald  
Secretary

Jeffrey Locker,<sup>address deleted</sup>



Jeffrey Locker,<sup>address deleted</sup>  
12/20/2008 11:12 AM

To "Mac Alfriend"<sup>address deleted</sup>, "Sally Green"  
address deleted, "Jennifer Burns"  
"James McAfee"  
Trish

Nunley<sup>address deleted</sup>

cc

Subject The ChairMan

Just had a long talk with Ben. Says 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 then need assistance, management is gone. (Forgot to tell him KL is near retirement.) Hopes a Citi-like deal can be done w/o us taking 3rd loss, but if we got away w/ the gov just backstopping \$74 that would be cheap given the size of the companies. He'd be surprised if that's all it takes though.

From: Donald L. Kohn  
 To: Scott Alvarez; Kevin Warsh  
 Cc: Brian E. Madigan; Chairman's Email Address Redacted; Michelle A. Smith  
 Subject: Re: BoFA  
 Date: 12/30/2008 08:34 PM

Agree with scott until last sentence. "If trouble occurs" implies we wouldn't work with them to head off trouble. One of the options discussed today was a limited ringfence maybe plus capital raise announced on Jan 20. It's tricky because of tarp, but tarp should have some unused, though committed, resources. I think such a plan is risky for BAC because its an admission of weaklness. Very different circumstances from BS-JPM. But if bac and our staff think it's needed we shouldn't rule out. Could be necessary to buy time to the more general tarp capital injection.

Sent from my BlackBerry Wireless Handheld

▼ [Scott Alvarez](#)

----- Original Message -----

From: Scott Alvarez  
 Sent: 12/30/2008 07:58 PM EST  
 To: Kevin Warsh  
 Cc: Brian Madigan; Donald Kohn; Chairman's Email Address Redacted; Michelle Smith  
 Subject: Re: BoFA

Mr. Chairman,

Ken will want to get you to commit as much as possible on this call. I'd be cautious for two reasons. First, we aren't sure yet what exactly we should do here. There is some disagreement between the OCC and BA, on the one hand, and our collective staff (Board, Richmond and NY), on the other, about what type and how big of a problem exists at BA (as opposed to ML). Any help will depend on getting our arms around that, and then judging the market reaction to our aid. Second, our potential solutions depend significantly on some amount of TARP money being available when it comes time to act and on the FDIC being willing to play a role like it did in Citi. BA won't want a loan, which is all we can do on our own. The availability of TARP money around January 20 will depend on Paulson's ability to convince Congress to give the funds to Tim, on Congress acting without imposing new restrictions on hows the funds are to be used, and on whether a new, unexpected problem arises before January 20 (or whenever the next tranche is granted). So we can't be sure at this point what we can do.

So, I'd stick to the message you suggested before. Consummating the deal is important to BA and ML as well as financial markets. Failure to consummate at this point would send bad signals about BA, not just ML. And we will watch carefully how events develop and work with BA if trouble occurs.

Happy to talk with you about this.

Scott

▼ [Kevin Warsh/BOARD/FRS](#)

Kevin

From: "Bair, Sheila C." [SBair@FDIC.gov]  
Sent: 01/14/2009 08:43 PM EST  
To: Company's Email Address  
Subject: What we could do -- maybe

Dear Ben,

Strong discomfort with this deal at the FDIC, for all of the reasons you and I have discussed. Also, I understand from staff that the size and composition of the pool is still somewhat up in the air, so it is difficult for us to evaluate the adequacy of BoA's 10 billion deductible. Here is the best I think we can do. The FDIC will take 25% of the USG 10 billion loss share, which corresponds with the percentage of the ringfenced assets coming out of the insured entities. We will do the loss share with Treasury, pro-rata (taking 25 cents to their 75 cents for each dollar of loss) and similarly share pro rata with the preferred shares and warrants issued by BofA as premia. We will also amend the TLGP program to facilitate BofA doing a guaranteed covered bond deal, while announcing that we will entertain applications from other TLGP participants to do the same. We will work in good faith with you, Treasury, BofA and PIMCO to determine the appropriate deductible.

Let me know if you think this will work. My board does not want to do this, and I don't think I can convince them to take losses beyond the proportion of assets coming out of the depository institutions.

Sheila

PS Reading the term sheet, I think the FRB has ably covered itself on the tail risk. You guys are tough!

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This message was secured by **ZixCorp**<sup>(R)</sup>.

## Seeking Alpha $\alpha$

# Bank of America Corporation Q4 2008 Earnings Call Transcript

January 19, 2009 | about: [BAC](#)

Bank of America Corporation ([BAC](#))

Q4 2008 Earnings Call

January 16, 2008 7:00 am ET

### Executives

Kevin Stitt – Investor Relations

Kenneth D. Lewis – Chairman, President and Chief Executive Officer

Joe L. Price – Chief Financial Officer

### Analysts

Matthew D. O'Connor - UBS

Nancy Bush - NAB Research, LLC

Michael L. Mayo - Deutsche Bank North America

### Presentation

#### Operator

Welcome to today's quarterly earnings announcement teleconference. (Operator Instructions) It is now my pleasure to turn the program over to Kevin Stitt. Please begin Sir.

#### Kevin Stitt

Good morning. This is Kevin Stitt, Bank of America Investor Relations. Before Ken Lewis and Joe Price begin their comments, let me remind you that this presentation does contain some forward-looking statements regarding both our financial condition and financial results. These statements involve certain risks that may cause actual results in the future to be different from our current expectations.

These factors include, among other things, changes in economic conditions, changes in interest rates, competitive pressures within the financial services industry and legislative or regulatory requirements that may affect our businesses. For additional factors please see our press release and SEC documents.

With that, let me turn it over to Ken Lewis.

<http://seekingalpha.com/article/115373-bank-of-america-corporation-q4-2008-earnings-cal...> 7/15/2009

**Kenneth Lewis**

**Good morning.** Welcome to today's program. (Operator Instructions) It is now my pleasure to turn the conference over to Kevin Stitt.

**Kevin Stitt**

This is Kevin Stitt, Bank of America Investor Relations. Before Ken Lewis and Joe Price begin their comments, let me remind you that this presentation does contain some forward-looking statements regarding both our financial condition and financial results. These statements involve certain risks that may cause actual results in the future to be different from our current expectations.

These factors include among other things, changes in economic conditions, changes in interest rates, competitive pressures within the financial services industry and legislative or regulatory requirements that may affect our businesses. For additional factors please see our press release and SEC documents. With that, let me turn it over to Ken Lewis.

**Kenneth D. Lewis**

Good morning. I don't need to tell you what extraordinary times we are experiencing. The economy and subsequently the credit markets literally hit a wall starting in September and culminating late in December with the greatest impact of my almost 40 years in banking. As you have seen in earnings reports so far, no body operating in the capital markets or lending to the consumer has been immune.

While 2008 was a very disappointing year, we still made a \$4 billion profit even as we experienced more than \$10 billion in capital market losses and \$27 billion in credit costs. We suffered as the economy slowed materially as we are a long credit risk and our core activities of commercial and consumer lending as well as in our capital markets businesses. So the question on my mind and your minds is what are we doing about it?

We managed our risk position down during 2008, reducing wherever we could the relevant positions in every area. Due to illiquidity we could not get that risk down far enough. We continued to re-work our credit risk appetite and consumer. We have instituted LTV, debt-to-income ratios and other restrictions which are prudent in light of the times we are facing. This approach raises concerns with legislators and other constituencies that we may be pulling back on credit when consumers, small businesses and commercial customers need it most.

There is no doubt our overall appetite on credit risk is greatly reduced. Given the right costs and provisions here and throughout the industry how could it be otherwise? Nonetheless, as you will see in a few minutes, even as we seek to reduce risk we continue to offer loans and credit to individuals and small businesses and corporate customers. We originated \$115 billion in new credit during the fourth quarter alone.

In our core company we have revisited and revised our unsecured underwriting terms and card terms, focusing on the programs that will produce better charge off results. In our commercial areas we continue to aggressively work on the credit book to reduce our exposures. During the last two years we have purchased sizeable credit exposures in our acquisitions of Countrywide and LaSalle which have added to our credit positions but we continue to restructure these operations and work to reduce risk levels.

We have been working on the integration plans for Merrill since September and now carry through those plans. So where does that leave us?

The core businesses at Bank of America continue to operate quite well. We continue to grow our franchise focusing on customers and associates. We have had healthy growth in checking accounts and deposits. Customers continue to seek us out as a company of strength. Metrics on customer favorability, brand awareness, customer satisfaction and purchase consideration all improved last year and we continue to be a leader in helping to find solutions to the credit crisis.

We are proud of this record. I think it is important for investors to understand that we do this because it is good business. The recession and credit crisis will end someday and people will remember that our company was there for them in hard times. That will be an essential element in our opportunity to return to the kind of profitability all of us want out of our company.

With that backdrop I will discuss fourth quarter earnings focusing mainly on the highlights across the company with some specific comments on individual businesses. Then Joe will go into more detail on certain issues including the actions we announced today, the capital markets, credit quality, net interest income and Merrill Lynch. Finally, we will touch on our thoughts for 2009 and discuss some of the near-term trends that will impact earnings.

On January 1 we completed the purchase of Merrill Lynch establishing a company unrivaled in its breadth of financial services and global reach. This merger reinforces Bank of America's position as a leading global financial institution. The merger creates, in our opinion, the most attractive U.S. consumer banking franchise with broad earnings, diversification and an attractive run deposit base. We are one of the largest wealth management businesses in the world with approximately 20,000 financial advisors and more than \$2 trillion in client assets, a world leader in the global markets and corporate investment banking businesses particularly in the areas of lending, debt and equity writing, trading, liquidity, payments management, research and merger and acquisition advice and unparalleled in the number of commercial clients we touch through business lending and treasury services.

Longer term, the combination should be an earnings powerhouse with leading market share in almost all of its businesses. We are happy that John Thain has assumed a major role at Bank of America. John is in charge of Global Corporate Investment Banking as well as Global Wealth and investment management both of which will incorporate most of Merrill's businesses.

Since most of you are focused on the short-term let's turn to that. Last quarter we said that market turbulence, economic uncertainty and rising unemployment would take its toll on quarterly earnings and that has certainly been the result for the fourth quarter both at Bank of America and particularly at Merrill Lynch. The United States is currently in a severe recession affecting all sectors of the economy. Congress has passed the Financial Stabilization Plan as well as other programs put in place and are starting to stabilize credit markets and promote liquidity but at a pace slower than any of us would like. We believe it will take time before any substantial benefits are seen in the health of the consumer and the impact on GDP growth.

Consequently, we think the prudent decision is to take our dividend to \$0.01 rather than to wait and see how earnings will ball up in 2009. This reduction will preserve approximately \$2 billion in quarterly dividends that would have been paid out. You saw in the release that Merrill Lynch experienced a fourth quarter loss of \$15.5 billion that Joe will talk about in a moment. That loss materialized late in the quarter in December and presented us with a decision.

We went to our regulators and told them that we could not close the deal without their assistance. As a result, we have agreed to the issuance of \$20 billion in tier-1 qualifying TARP preferred as well as the issuance of an additional preferred of \$4 billion in exchange for an asset guarantee as essentially insurance protection of accrual of capital markets related to assets. We believe those actions were in the best interest of Bank of America and the financial system by limiting significant additional downside risk.

These actions also allow us to turn our attention to consolidating and recognizing the long-term strategic benefits of the two companies.

Turning to earnings, Bank of America in the fourth quarter reported a loss of \$1.8 billion or \$2.4 billion after deferred dividends or \$0.48 per diluted share. However, for the entire year we did remain profitable earning \$4 billion or \$2.6 billion after preferred dividends.

As we experienced in the third quarter, earnings in the fourth quarter were seriously impacted by the headwinds of continuing high credit costs, severe market turbulence and losses weighted to one-time events. Although it is difficult to focus on what is going right at this time, I do think it is imperative to understand that most of our businesses do remain profitable for the fourth quarter. Both consumer and small business banking with earnings of \$835 million and global wealth and investment management with earnings of \$511 million.

Within global corporate investment banking business lending made \$301 million and treasury services made \$756 million. While these earnings in these businesses in some cases are substantially lower than earnings in normal times, they are still profitable even with the significant increases in credit costs, lower customer activity and public market headwinds.

An additional positive is that our retail businesses are experiencing a significant growth in deposits even as we operate in a lower interest rate environment. Average core retail deposits grew almost \$12 billion or 2% including the expected run off in deposits at Countrywide. If you exclude the impact of Countrywide, retail deposits grew just short of \$19 billion or 3.5% which we believe is a multiple of the overall market and was done while we maintained pricing discipline.

As we experienced during the MBNA integration, approximately \$7 billion of deposits left Countrywide after initiating more rational pricing. The combination of deposit growth and anticipated stabilization of the markets should have a positive impact in 2009. However, more than offsetting the positives this quarter were several events related to the market turbulence.

These events included losses associated with CDM exposure, auction rate securities and legacy trading books; write downs in letters financed, CMBS and private equity, additional support of the Columbia cash funds and a challenging trading environment that impacted our trading results. In addition, the economy weakened in the third quarter as evidenced by rising unemployment, bankruptcies and continuing home price declines.

This weakening drove to additional credit deterioration across our loan portfolio causing us to add substantially to our line items for loan losses. Total revenue for the fourth quarter was approximately \$16 billion on FTE basis, down approximately \$4 billion or 20% from the third quarter. Net interest income rose 12% from the third quarter while non-interest income decreased 68%.

Driving much of the decrease in non-interest income was this impact of continued [multi] construction and trading account profits, equity investment income and other income. Non-interest expense decreased 6% from the third quarter driven by lower personnel costs primarily incentive compensation. Provision expense of \$8.5 billion increased by \$2.1 billion from the third quarter. Net charge offs rose \$1.2 billion to \$5.5 billion. The increase in reserves of approximately \$3 billion brings the allowance for loan to lease losses to \$23.1 billion or 2.5% of our loan to lease portfolio.

Earnings in each of our businesses were significantly impacted by all the factors I have just detailed. Let's spend a few minutes discussing each of those businesses.

Global consumer and small business banking earned \$835 million, down \$504 million from the third quarter as stable revenue levels, lower expenses and lower taxes partially offset an increase in provision expense of \$1.1 billion. The retail deposit story remains very positive as I have mentioned. Though the pace of growth is down from levels a year ago we continue to generate net new checking and savings accounts. For the second year in a row we grew net new checking accounts by more than 2 million. The recent drop in interest rates is driving a significant increase in mortgage applications, mainly refi's, which is providing a very good start to production levels for 2009.

Global wealth and investment management earned \$511 million in the fourth quarter which is actually up from the third quarter and from the fourth quarter a year ago. Driving the comparison from last quarter was the fact that our support of the Columbia cash funds of \$226 million was less than the support from the third quarter.

Global corporate investment banking lost \$2.4 billion in the quarter as positive earnings and business lending was \$301 million and treasury services was \$656 million were offset by the market results and CMAS. Treasury services actually had a pretty good year with earnings this quarter up significantly from the third quarter. For the full year they earned \$2.7 billion benefiting from core deposit growth and the flight to quality.

Business lending produced quarterly average commercial loan growth of \$10 billion or 3% with revenue growth up 15%. CMAS lost \$3.6 billion which Joe will address in a minute.

Not included in the three business segments is equity investment income of negative \$387 million. These results were driven by minimal cash gains offset by lower valuations and impairments.

Now before I turn it over to Joe let me make a couple of comments about the current environment some of which reference my earlier comments. As I said, the economy is experiencing a severe recession. We are seeing home prices; rising unemployment and bankruptcies make it difficult to predict the timing of an economic rebound. We believe the economy will continue to be challenged throughout 2009 with some potential early signs of stabilization during the second half of the year. Currently employment weakness is expected to continue through a good part of 2009 as it lags the trend in GDP with unemployment rising in excess of 8%.

Credit quality will continue to be an issue in the next few quarters with provision and charge offs remaining at elevated levels and perhaps not improving until the latter half of 2009. Our tier-1 capital ratio is estimated to be 9.15% at year-end with a tangible common ratio of approximately 2.83%. As a point of reference if you consider the OCI associated with higher quality NBS that we expect will pay off in full and the restricted CCB shares that would add more than 40 basis points to the ratio or 3.27%. My point being that this ratio, while important, is impacted by certain factors that don't really influence how we run the business.

Joe will discuss what our pro forma ratios will look like given our actions so far this year. Given our economic outlook we still believe most of our core businesses can produce positive earnings for 2009 assuming a continued tight grip on expense levels across the company. We expect these earnings will also be accretive to capital in 2009. Remember, we sold some of our CCB investment in January which will result in an approximate pre-tax gain of \$2 billion in the first quarter.

Most importantly we remain committed to serving our customers and clients while driving profitability during these tougher times. I know I am repeating myself here but these times continue to be increasingly difficult on all of us including our shareholders, associates and our customers. With the expanding investment in our company by the Federal government we intend to play a major role in restoring the economy of the United States to a healthy rate of growth. We will do this by providing credit to consumers, small and large businesses and state and local governments.

I have recently created a senior management team to oversee the Bank of America credit initiative which will meet weekly to review lending levels in each of the categories that I mentioned. This team will report monthly to the public on lending activity. This reporting will be in addition to any reports requested by our regulators, the Treasury or Congress. Going forward the role of banks must be to fuel the economy with credit while abiding by the inescapable transparency and accountability inherent in the use of public money for any purpose.

Bank of America acknowledges the responsibilities that accompany the use of public funds and stands ready to play the role as the leading bank to help refurbish the economic recession and restore America as the world's leader in business innovation and progress. Our acquisitions of both Countrywide and Merrill Lynch were directed at strengthening the franchise but also contributed to marketplace stability and we remain a partner for our customers and clients critically providing credit, helping them restructuring their balance sheets and giving them advice on how to best navigate their individual financial situations.

Most of you I think are well aware of our home loan modification program that is projected to modify over \$100 billion in mortgages and over three years keep up to 630,000 borrowers in their homes. We have 6,000 associates in our home retention division working with borrowers. During 2008 the home retention division completed over 300,000 workouts. We are working out two troubled loans for every one on which we foreclose. Bank of America last year provided more than \$150 billion toward lending, investing and grant dollars to America's small businesses and communities and to support lower to moderate income individuals and communities. Bank of America's \$1.5 trillion commitment in 10 years is unparalleled in the business.

Business lending remains strong and we have continued making loans to states and municipalities in a time of extraordinary uncertainty. Our team is doing everything they can to operate as efficiently as possible and to build the earnings power of the franchise so when conditions improve you will see the benefits.

With that I will turn it over to Joe to expand a bit on the quarter as well as some of the points I have references.

#### **Joe Price**

Thanks Ken. As Ken mentioned we entered into several agreements with various government agencies in light of Merrill Lynch's fourth quarter loss. These actions will replenish capital and provide protection, essentially insurance, against significant downside risk on a pool of \$118 billion in capital markets related exposures. Now in doing this we have insulated in large part future significant losses from the asset classes that drove Merrill Lynch's loss. This wrapped pool includes assets that when combined with other losses where exposure no longer exists represents some 2/3 of Merrill Lynch's fourth quarter loss.

In doing so we expanded the coverage to include substantially similar exposures on the Bank of America platform as these assets will be managed together in the ongoing company. From the standpoint of the Bank of America capital markets loss in the fourth quarter the pool includes assets that drove about the same percentage of our losses. Generally speaking, the wrap covers domestic, pre-disruption or legacy leverage loans and commercial real estate loans, those that were largely acquisition related facilities originally intended to be securitized, CDO's, financial guarantor counter-party exposure, certain trading counter-party exposure and certain investment securities.

Terms of the agreement are that in exchange for us issuing preferred stock of \$4 billion which pays a dividend of 8% and warrants, the combined government agencies will absorb 90% of the losses on this pool after the initial \$10 billion first loss that we retained. We retained 10% of the losses in excess of the first loss division. We will continue to manage these assets in the ordinary course of business and retain the income from the aggregate pool.

There are some more details in our filings on the specific provisions. While platforms still carry market and credit risk, while entering the agreement we have limited the downside on much of the capital market legacy cash positions as well as select counter-parties in exchange for the first loss position and a premium. Assets included in the wrap will carry a 20% risk weighting for capital purposes.

Let me now turn to earnings and begin by elaborating a bit more on fourth quarter results before turning to credit quality, capital and Merrill Lynch. Turning first to GCIB, and more specifically capital markets and advisory services.

As Ken mentioned this was one of the most difficult capital market environments in history and the fourth quarter was particularly severe. Prices continue to decline across a broad spectrum of asset classes. Global de-leveraging accelerated. Volatility and illiquidity continue to disrupt equity and credit markets and correlation trades experienced significant diversions, all of which made for an incredibly challenging backdrop in addition to normal fourth quarter seasonality.

Now all this led to very disappointing results. Net loss of \$3.6 billion in CMAS. On a positive note, investment banking fees were up 30% from the third quarter to \$618 million. Now we would characterize our market disruption charges this quarter as approximately \$4.6 billion. These charges continued to be centered in CDO related write downs as well as couple of other areas.

Let me start with leverage lending where we ended the quarter with exposure of \$3.6 billion which is all funded, down \$2.9 billion from September. \$1.7 billion of the reduction was the transfer of bonds to the corporate investment portfolio where they will be carried as an investment. The remaining reduction was a combination of sales, write downs and terminations. Legacy or pre-disruption exposure is down \$2.3 billion and is carried at \$0.67.

During the quarter we wrote down an additional \$425 million versus \$648 million in the first nine months of 2008 as valuations continue to erode due to spread widening. On the CMBS side we ended the year with \$7.6 billion in exposure, down 7% from the third quarter of which \$6.9 billion is funded. As always, I remind you approximately 80% is comprised of larger ticket, floating rate debt most of which is acquisition related. This floating rate debt was written down approximately \$500 million.

We also recorded approximately \$328 million of losses associated with equity investments we made in acquisition related financing transactions. There were several other legacy books where we continued to record losses including \$740 million in structured credit trading of which about \$400 million was counter-party valuation losses. This book, as well as our other credit products, experienced losses as cash spreads gapped out disproportionately and extreme dislocations and basis correlations occurred.

We also lost \$589 million on non-U.S. high grade NBS as the severe spread movements were not limited to the U.S. Now finally in the supplemental packet you can see our CDO and sub-prime related exposure along with the changes during the quarter where we recorded losses of \$1.7 billion.

The losses were largely comprised of approximately \$648 million of super senior CDO write downs, a charge of approximately \$400 million to reflect the counter-party risk associated with our insured super senior position and additional write downs of \$423 million mainly on positions we retained from CDO liquidations.

At the end of December our un-hedged, sub-prime super senior related exposure dropped to just below \$1 billion, \$980 million to be specific, while bonds retained from the liquidations were about \$2 billion. Un-hedged super senior related exposure including the securities retained from liquidations now total \$5.3 billion. Our remaining hedged exposure of \$1.5 billion which is all high grade is carried at \$0.41 on the dollar and approximately 71% of the wrappers are from mono lines.

This exposure is included on the schedules in the supplemental package along with the relevant information.

Before I move off these legacy exposures let me say that the domestic CMBS and leverage loans as well as the CDO's both hedged and un-hedged are now covered under the government wrap.

As I told you last quarter we agreed to offer to buy back auction rate securities that we sold to certain customers. During the fourth quarter we actually repurchased approximately \$4.7 billion bringing our total holdings to \$7.6 billion. Valuation declines in the quarter cost us approximately \$410 million of which most was recorded in the GCIB unit. Our estimated remaining repurchase commitment was \$675 million at year-end.

Now let me switch to credit quality. We began seeing a decidedly negative impact on our customers from the slowing economy, particularly the consumer and these pressures accelerated in December. This is evident in spending patterns as well as credit performance. As result, fourth quarter provision of \$8.5 billion exceeded net charge off's resulting in the addition of approximately \$3 billion to the reserve. Reflective of continued economic stress on the consumer, reserves were added for most consumer related products, most notably home equity, credit card and consumer lending.

Now the reserve addition also includes \$750 million associated with the reduction in expected principle cash flows on the Countrywide impaired portfolio driven by continued deterioration in the economy and the home price outlook. On the commercial side we added approximately \$460 million to the reserves for small business, broad based deterioration in the non-real estate commercial portfolios as well as the home builder portfolio.

This commercial increase is reflective of a slow down in consumer spending, continued global financial markets turmoil and housing value declines. Our reserve now stands at \$23.1 billion or 2.5% of our loan and lease portfolio. On a held basis, net charge off's in the quarter increased 52 basis points from the third quarter to 2.36% of the portfolio or \$5.5 billion. On a managed basis, total net losses in the quarter also increased 52 basis points to 2.84% of the managed loan portfolio or about \$7.5 billion.

Managed net losses in the consumer portfolios were 3.46% versus 2.89% in the third quarter. Managed consumer credit card net losses represent 54% of total consumer losses. Managed consumer credit card net losses as a percent of the portfolio increased to 7.16% from 6.4% in the third quarter. 30 day plus delinquencies in managed consumer credit card increased 79 basis points to 6.68% while 90 day plus delinquencies increased 28 basis points to 3.16%.

We have continued to see increased delinquencies across our card portfolio even more so in the states most affected by housing problems. California and Florida make up a little less than a quarter of our domestic consumer card book but represent about 1/3 of the losses. Clearly with unemployment levels projected to go beyond 8% in the U.S. we would expect the consumer credit card net loss ratio to increase as well and probably exceed unemployment levels by at least 100 basis points and be further impacted by decreasing loan levels.

Credit quality in our consumer real estate business also continued to deteriorate from the third quarter. Our largest concentrations are in California and Florida which combined represent about 40% of the home equity portfolio and represent about 65% of the losses. Home equity net losses increased approximately \$149 million to \$1.1 billion or 2.92% versus 2.53% in the prior quarter. 30 plus performing delinquencies increased 47 basis points to 1.75% while NPA's increased 41 basis points to 1.86%.

We have seen HELOC utilization rates tick up about 200 basis points to 52% driven by additional draws and slower payments. Our ending home equity balance of \$153 billion was up slightly during the quarter. New business and increased utilization net of pay downs contributed approximately \$5.1 billion in growth which was partially offset by closed accounts and charge offs.

As we said last quarter with the increased economic and credit pressures we continue to believe that the loss rate will cross the 4% mark in 2009. Our residential mortgage portfolio showed an increase in net losses to \$466 million or 73 basis points for the quarter. That would be 62 basis points net of the insurance wrap that we have on that product. Excluding our community investment act portfolio and that portfolio totals 7% of the residential book; losses would have been \$340 million or 57 basis points so about 46 basis points net of both the CRA and the insurance wrap.

We have continued to see increased delinquencies and losses across our portfolio, again even more so in the states most affected by the housing problems. California and Florida, which combined comprise 42% of the balances drove 63% of the net losses. Although approximately \$119 billion or 48% of our residential mortgage portfolio carried the risk mitigation protection it does not cover our CRA programs.

\$70 million of net losses this quarter were covered by insurance which reduces the net losses to 62 basis points on the portfolio versus the reported 73 basis points. I should note that we continue to reduce home loan balances through sales or by converting them to securities as examples of many actions taken to fortify liquidity. This has the effect of bringing down the average loan balances thereby negatively impacting the reported loss rate. However, having said that we do see continued deterioration and worsening economic conditions could drive a loss rate in excess of 100 basis points net of our insurance.

Turning to our other consumer portfolios, the auto portfolio at the end of December was about \$26 billion in loans. Net losses in the quarter were \$155 million or an annualized 2.44% of the portfolio up from 1.68% in the third quarter. Although a portion of this increase was due to seasonality in this business, reduced collateral values as well as economic stress on the consumer also contributed to the higher losses.

Within car services we have the consumer lending business that has about \$28 billion which is mostly comprised of unsecured consumer loans. Largely due to increased unemployment and increased bankruptcies this portfolio is also experiencing rising delinquencies and losses. Net credit losses were 10.37% in the fourth quarter, up 193 basis points over the third.

Loss rates have also been impacted by tightening in underwriting criteria resulting in a significant slow down of new loan production. Like our own portfolios, California and Florida continue to have out-sized delinquency and loss contributions in relation to the outstandings. During the quarter we increased reserves on this portfolio by about \$450 million to a level of around 12.3% of ending loans.

Switching to our commercial portfolios, new charge offs increased \$399 million in the quarter to \$1.36 billion or 159 basis points, up 46 basis points from the third quarter. The deterioration this quarter was broadly spread across various businesses although on a semi-positive note small business had the smallest increase, i.e. about \$35 million, we have seen in several quarters. Net losses in small business, which are reported as commercial loan losses, increased to 11.5%.

If you exclude small business from commercial domestic our total commercial loss rate is about 99 basis points. Further excluding commercial real estate where losses have been concentrated in home builders, the loss rate is 65 basis points.

As we have discussed before, many of the issues in small business relate to the rapid growth of the portfolio over the past few years which is now compounded by current economic trends. The continued increases are consistent with the seasoning of these vintages and while clearly too high they are generally in line with our forecast from last quarter.

Reservable criticized utilized exposure in our commercial book increased to 8.9% of the book from 7.45% at the end of the third quarter. The increase is scattered across industries, lines of businesses and products. Commercial NPA's rose \$1.7 billion to \$6.8 billion. Nearly 56% of commercial NPA's was in the commercial real estate business spread across home builders, retail and apartments.

Let me move off credit quality and discuss net interest income. Compared to the third quarter on a managed and fully tax equivalent basis, net interest income was up \$1.5 billion of which core, which excludes our trading related margin, represented \$994 million. The increase in core NII was driven mainly by lower short-end rates on market based funding and core deposit products.

The core net interest margin on a managed basis increased 16 basis points over third quarter to 3.95% due primarily to the improved rate environment. As you can see in our material our interest rate positioning is now asset sensitive to parallel moves in rates compared to our liability sensitive position at the end of September. The change in sensitivity is primarily due to the changes in the forward curve as well as the absolute low level of rates.

Due to this low level of rates some of our longer term assets are re-pricing faster while our shorter term liabilities have already or are unable to re-price much lower. Given how low rates are an asset sensitive position makes sense as we are positioned to benefit as rates rise in the future. While we are asset sensitive to parallel moves in interest rates we continue to benefit from curve steepening.

As a heads up we expect net interest income to drop in the first quarter for seasonal reasons as well as the negative impact of lower interest rates on our asset re-pricing.

Now let me switch and talk about fourth quarter results for Merrill Lynch. As Ken mentioned Merrill Lynch's fourth quarter preliminary results totaled \$15.5 billion loss. In our supplemental material we have included a preliminary P&L and balance sheet. The Merrill Lynch data we are providing today is a preliminary overview as Merrill's ordinary and usual process for analyzing the numbers continues. Once the results are fully complete Merrill Lynch and Co. will file a form 10K for 2008 so there will be more information in that report for you.

Before I take you through the details on the large items let me say that the difficult capital markets environment, particularly the severe impact late in the fourth quarter, hit the Merrill Lynch platform very hard. As asset prices continued to decline across all categories, volatility and illiquidity spread throughout the markets and the correlation trades were really hit hard. All this led to very disappointing results.

However, starting off on a positive note, Global Wealth Management continued to deliver solid results despite the environment with global private client net revenues down only 10% sequentially and even less in the U.S. advisory

portion of the business, a testament to the quality of the franchise. Certain other businesses also performed relatively well such as investment banking down only 4% sequentially and commodities which was up substantially on strength in trading gas and coal in Europe.

Now in the fourth quarter Merrill Lynch overall reported negative revenues by \$12.6 billion. Let me take you through the principle drivers of those losses and the related remaining exposures. Starting with the transitory leverage lending exposures, charges totaled \$1.9 billion during the quarter driven by several credits under significant duress. Remaining exposure in that transitory book totaled \$5.6 billion carried on average at \$0.42 on the dollar or \$2.4 billion on a market value basis. The portfolio is comprised mainly of less liquid positions such as revolvers and bridge loans.

Of this total market value about \$1 billion is domestic and covered under the wrap. The remaining commercial real estate exposure excluding the First Republic portfolio is \$9.7 billion. Commercial real estate losses were \$1.1 billion of which \$475 million related to whole loan conduits. The remaining whole loan conduit exposure is \$3.8 billion and is currently carried at \$0.72 on the dollar of which about \$2 billion is covered under the wrap. The remaining \$600 million of losses were due to real estate related debt and equity investments involving smaller credit in the [DMDA and the Pack Rim]. The remaining exposure of these investments was \$5.7 billion at the end of the year.

The U.S. super senior ABS CDO losses were \$369 million this quarter and remaining un-hedged exposure was \$800 million. It is carried about \$0.14 on the dollar. The hedged loan exposure is just over \$1 billion and it is carried at about \$0.20 on the dollar. Both of these are to be covered under the wrap. Merrill Lynch experienced a loss of about \$300 million on the financial guarantors covering the U.S. super senior ABS CDO's. The remaining receivable from guarantors on that portfolio is \$1.5 billion and this exposure is also covered under the wrap.

Regarding credit default swaps with mono line financial guarantors excluding those I just mentioned covering the U.S. ABS CDO's, total notional was \$50 billion with a mark to market before adjustment for counter-party risk of \$12.8 billion, \$7.8 billion after the counter-party risk adjustment. As part of Merrill Lynch's correlation trading and credit trading books they have entered into various derivative contracts with mono line insurers to hedge risk in the portfolios. Of the notional amount of the insurance of about \$50 billion, one half relates to CLO and various hybrid basket trades and the other half relates primarily to CMBS and RMBS on which the underlying collateral varies from AAA to BBB.

To date, Merrill has taken credit valuation adjustments of approximately 39% on the receivable balance. Both the remaining receivable balance as well as the remaining net notional are covered under the wrap. CBA taken during the fourth quarter on these exposures totaled about \$3 billion.

Merrill Lynch also recorded about \$1.2 billion in losses on their U.S. banks investment portfolio during the quarter. This portfolio had a year end market value of \$10.4 billion with \$9.3 billion of cumulative loss adjustments recorded in OCI reducing their shareholder's equity at year-end. As you know, OCI gets adjusted to purchase accounting so carrying or market value will be equal to our basis at acquisition. The remaining market value 95% is covered under the wrap.

Counter-party valuation costs on the derivatives book other than the mono lines I talked about just a minute ago during the quarter were almost \$2.5 billion. This cost included approximately \$800 million due to the narrowing of Merrill Lynch spreads due to the merger announcement which would normally provide an offset but obviously in this case went the same direction. There is about \$17 billion of selected counter-party notional on derivatives, \$3.2 billion of which is mark to market and is covered under the wrap previously discussed.

Write downs on private equity and principle investments totaled \$1.7 billion driven by valuation adjustments on private holdings and marks on the public holdings. Other write downs included \$2.3 billion in goodwill impairment related to the fixed income and investment banking businesses.

In addition to pressure on legacy exposures, the market dislocation and contagion caused many businesses to have very weak results particularly credit, proprietary trading and principle investments. As I mentioned earlier while large write downs occurred in the fourth quarter we have limited the significant downside risk in these asset classes under the wrap.

We will provide more details on the Merrill Lynch exposures and what portion is covered under the wrap in future SEC filings.

Since we closed the acquisition of Merrill Lynch on January 1, the results I just detailed are not reflected in our fourth quarter. Integration efforts continue to move ahead and we remain confident in the long-term prospects of the combined

company. So let me quickly cover some of the merger specifics.

We issued approximately 1.4 billion Bank of America shares at an exchange rate of .8595 for each Merrill share. I'll give you some preliminary purchase accounting estimates but realize they will probably change somewhat as we are currently finalizing those.

From an accounting standpoint under the revised purchase accounting guidelines we will mark Merrill Lynch's balance sheet to fair value levels as of January 1. As required under FAS 141R the total purchase price for the transaction will be reported for accounting purposes as the value as of the close or \$29.1 billion. That includes the \$20.5 billion in common shares and the \$8.6 billion in preferred equities.

Subtracting Merrill Lynch's estimated tangible book value, adjusted for the impact of the preliminary purchase accounting of approximately \$19.8 billion, and \$3.9 billion in identifiable intangibles net of tax, results in goodwill of about \$5.4 billion. Other changes in purchase accounting adjustments from our prior disclosures include using the actual year-end number for Merrill Lynch's total shareholders equity which at \$20.6 billion reflects the fourth quarter loss and incorporating a write down on Merrill Lynch's debt of \$15.5 billion reflecting fair value given Merrill Lynch's year-end credit spreads.

As you can see, total assets at Merrill Lynch at the end of December before purchase accounting marks were \$663 billion. Loans held for investment net of the allowance were \$58 billion and deposits were \$98 billion. Expect some shifting around of what is in the accrual book versus the market books as we move further down the path of consolidating operations and management.

You can see from the material our updated restructuring costs of \$3 billion pre-tax or \$2 billion after tax is consistent with our initial estimates. At this point we expect to hit our target cost save of \$7 billion pre-tax and it looks like we will get more in 2009 than expected. We originally indicated 20-25% but now it looks like we could be north of 35%. This will likewise accelerate our merger charges a little.

Under FAS 141R the \$2 billion of after-tax restructuring charges will be reported through the income statement as restructuring expense through 2011. The restructuring charge for 2009 is estimated to be approximately half of the total spread somewhat evenly over the four quarters.

Given the size of the balance sheet, adding Merrill Lynch to Bank of America would reduce Bank of America's tier-1 capital by approximately 45 basis points. 8.7% on a pro forma basis which includes the \$10 billion of preferred that funded January 9 that was part of the initial TARP equity program. Adding incremental preferred issuance we announced this morning plus the risk weighted asset adjustment due to the asset wrap, pro forma tier-1 would be approximately 10.67%. Estimated risk weighted assets from Merrill after purchase accounting adjustments of approximately \$379 billion for your reference.

Adjusting for the wrap, combined risk weighted assets dropped by around \$70 billion.

As a reminder, we also strengthened tier-1 somewhat two weeks ago with the sale of some of our investment in China Construction Bank, generating a pre-tax gain of approximately \$2 billion.

Turning to tangible common, as Ken mentioned earlier we ended the quarter at 2.83%. On a pro forma basis including Merrill Lynch and the other actions that ratio would be 2.66%. If you consider the same adjustments that Ken mentioned earlier related to higher quality debt securities and our restricted shares of CCB you could add about another 30 basis points to the ratio so call it just under 3%.

We are clearly comfortable running the company at this level of tier-1 realizing that it is in excess of what is appropriate and more normal times is needed. The tangible ratio, while adequate, will be rebuilt through earnings given the dividend action we announced this morning. While I am not going to predict capital ratio levels at the end of March, we will continue to be more efficient with the use of our balance sheet including the combined trading books of Bank of America and Merrill Lynch.

From an earnings perspective we believe Merrill Lynch on a GAAP basis will be dilutive to Bank of America's earnings over the next two years due to what we believe will be below normal investment banking and trading environments. While we have not formally guaranteed the debt of Merrill Lynch we clearly view it as supporting a critical part of our ongoing operations.

Before turning it back to Ken let me say a couple of things about liquidity. Parent company liquidity remains strong with time to required funding at 23 months on a pro forma basis with Merrill Lynch. It is actually 37 months before Merrill Lynch at the end of the year. The additional actions today, meaning the TARP capital, will add an additional 7 months to that for our parent company liquidity. Also during our fourth quarter we rated nearly \$20 billion in debt under the TOGP primarily at the holding company level to ensure robust and excess liquidity to prepare for the Merrill Lynch merger. Our primary bank [BANA] is running the highest levels of excess cash in the company's history on a daily basis and although somewhat inefficient from a margin perspective it is prudent given the environment.

Positive inflows remain strong and customers clearly prefer to keep cash in safe and liquid form. This is one of the strongest aspects of our franchise and where we truly benefit from being the largest coast-to-coast financial institution.

With that now let me turn it back to Ken.

#### **Kenneth Lewis**

Thank you Joe. Going into 2009 let me reiterate that there is considerable uncertainty about the economic environment and the ongoing health of the consumer. Due to that uncertainty we won't go into the detail we have provided in the past as far as our expectations for 2009. However, those banks with market presence and strong balance sheets can weather and even benefit from the situation and we do feel good about our relative position in our businesses versus the competition.

Making pro forma revenue comparisons between 2008 and 2009 is difficult given the market disruptions and losses experienced by both companies in 2008. However, we believe core net interest income will benefit given the favorable rate environment. However, trading net interest income will drop given the targeted reduction in the trading books and as was mentioned before we expect net interest income in the first quarter to be down due to seasonal impacts as well as lower pricing of assets but then positive in comparison in each of the quarters thereafter.

Non-interest income will obviously grow if you assume some stabilization in the markets but I will let you hazard a guess on the health of the global markets in 2009. One area we do have control over is non-interest expense. For 2009 we originally targeted approximately 20% of the \$7 billion in cost savings from the Merrill integration and we now believe, as Joe said, we can get closer to 35% or even north of 35%.

Additional cost savings from Countrywide and LaSalle should also have a positive impact on expense levels. Consumer credit quality will continue as a headwind due to what appears to be further deterioration in housing and unemployment levels and its subsequent impact on consumer asset quality.

Similarly, we would expect to see challenges in the consumer dependent sectors of our commercial portfolio. Given this scenario, for the next several quarters we would expect net losses to be at or above levels we experienced in the fourth quarter. While provision is dependent on future credit losses, everything we are seeing currently points to no relief in provision for at least the next several quarters.

Clearly a real positive for us in 2009 would be for the trading environment to settle down. Under that scenario we can manage through the tough credit environment which unfortunately is with us for the next few quarters.

With that let me open it for questions.

#### **Question-and-Answer Session**

##### **Operator**

(Operator Instructions) The first question comes from the line of Matthew D. O'Connor – UBS.

##### **Matthew D. O'Connor - UBS**

How should we think about all this non-common equity that you and other banks have? At the end of the day we think about the lion defense against losses it is common equity, loan loss reserves and pre-provision earnings and all this doesn't really address any of that and the fact the \$3 billion you paid up per year in dividends reduces the common equity. I can appreciate it helps from a liquidity side which is already very strong at Bank of America but does it matter having 8.5% tier-1 versus 10% tier-1 when the common equity is still relatively low?

**Joe Price**

As I made in the comments, obviously tier-1 is a critical measure and it is one that we clearly manage by because it gives the composition of the asset mix much more specific to our institution. Having said that, you have heard us say before every ratio has its day in the sun and is critical at different points in the cycle. We clearly view the common equity ratio as something that needs to be focused on. It affected, as I mentioned before and Ken mentioned by certain other attributes that go into OCI and all, while we feel very comfortable it is adequate at the level it is that is one of the areas we have to focus on to build and that was, as I mentioned before, why the dividend reduction will help rebuild that.

**Matthew D. O'Connor - UBS**

Obviously to rebuild the TCE you can have organic earnings, you can change the balance sheet as you mentioned, capitalize as well on the common side but can you talk about how meaningful some of the balance sheet reductions might be as we think about 2009? I can appreciate a lot of prepayment fees are being pretty low right now and it is tough to divest these assets but what are some expectations on how meaningfully you can reduce the balance sheet?

**Kenneth Lewis**

Just look at what the pro forma that most though in terms of what the balance sheet would look like and it is probably \$300 billion less than what you would have thought it would have been so that gives you kind of an idea of what you can do in a fairly short period of time.

I'll turn it over to Joe after that.

**Joe Price**

I think a lot of the securities businesses I think still have sizeable opportunity because traditionally those businesses weren't necessarily focused on for aggregate gross balance sheet level given the matched books and some of the natural risk offset so you kind of managed on a net risk basis and allowed some of the balance sheet to get bigger. That was some of the areas the team focused on coming into year-end but it has clearly still got some opportunity and that doesn't really have a material impact on the business flow and business activity. So we think there are areas clearly like that which will help us.

**Matthew D. O'Connor - UBS**

Separately, the Countrywide marks have been pretty aggressive at the time when the deal closed. Any update on how you are feeling with those marks at this point?

**Joe Price**

I don't know if you caught it, I referred to it in the comments and Kevin has got it at the back of the presentation, a package that kind of shows you the impaired loan pool performance. We did update those marks. We kind of re-forecasted cash flow and we added about \$750 million of additional marks to the impaired loan portfolio. That was focused principally in the pay option ARM product which is the one that we have always kind of viewed as some of the biggest downside risk.

**Operator**

The next question comes from Nancy Bush - NAB Research, LLC.

**Nancy Bush - NAB Research, LLC**

Could you just tell us the \$118 billion that is being back stopped here says it is "primarily for Merrill Lynch." Could you just put out what is from Merrill Lynch and what is from legacy BAC?

**Joe Price**

Don't hold me to this exactly but think of it as 75% Merrill Lynch legacy assets and about 25% of similar types of assets

<http://seekingalpha.com/article/115373-bank-of-america-corporation-q4-2008-earnings-cal...> 7/15/2009

off the Bank of America platform.

**Nancy Bush - NAB Research, LLC**

Is there something special about those? Or did you just decide to throw them in because the risk factor? I'm trying to sort of separate out this TARP investment and what happened at Merrill and what happened at legacy BAC to trigger this.

**Joe Price**

Let me give you a personal response and Ken may want to elaborate. We were going through the process and we looked at first of all what drove the losses on the Merrill Lynch platform during the fourth quarter and what were the remaining risk assets. That was the focus of the process. There were certain assets that just fall out of the criteria for the wrap based on the different agency criteria. We then said we had similar assets on the Bank of America platform and since you operationally manage some of this stuff together it would not necessarily make sense to have overlapping positions in the same credit name so we reached across and said what are the similar Bank of America capital markets assets. That is kind of the process we went through to devise what would be [inaudible].

**Nancy Bush - NAB Research, LLC**

Ken, a question for you and I think everybody is trying to grapple with this morning. What if anything was missed in due diligence of Merrill Lynch that brought us to this point? If you could just elaborate on your view of that.

**Kenneth Lewis**

In a nutshell, much, much higher deterioration of the assets we identified than we had expected going into the fourth quarter. So our forecast of losses and Merrill Lynch's forecast of losses and frankly I would think most anybody in the capital markets business would have forecasted a lower loss rate than what we saw. So it wasn't an issue of not identifying the assets. It was that we did not expect the significant deterioration which happened in mid to late December that we saw.

**Nancy Bush - NAB Research, LLC**

We know that the TARP investments are necessary right now to get us through this period but I'm sure that you don't like your company being called a ward of the state. Much of the banking industry is coming to that but for BAC when do you anticipate you will be able to get out from under all these government "investments?"

**Kenneth Lewis**

I wish I knew because then I would know what the economy is going to do over the next few years. Clearly as soon as possible, to kind of reinforce your point. If you just start looking at pre-provision and normal capital markets, this company will generate huge amounts of profit when we get a normal economic environment. Not even a great one, just a normal one. It is almost directly correlated to how fast do you think the economy will come back.

**Operator**

The next question comes from Michael L. Mayo - Deutsche Bank North America.

**Michael L. Mayo - Deutsche Bank North America**

What is pro forma tangible book value? I guess it is \$11.44 at the end of the fourth quarter but including Merrill Lynch what would that be?

**Joe Price**

I have been thinking about ratios so much let me get Kevin to come back.

**Michael L. Mayo - Deutsche Bank North America**

Just to follow-up to that last question, were you able to walk away from the Merrill Lynch deal? If it was so much worse as of mid December couldn't you say hey let's renegotiate or let's do something?

**Kenneth Lewis**

Let me just kind of take you through that. It is a very legitimate question. As we saw the anticipated fourth quarter losses accelerating we did evaluate our rights under the merger agreement and during that time we spoke to and were in close coordination with officials from both Treasury and Federal Reserve. The government was firmly of the view that terminating or delaying the closing of the transaction could lead to significant concerns and could result in serious systemic harm. A re-pricing, assuming it could be agreed, would have required a new stockholder vote both at Bank of America and at Merrill Lynch and therefore it would have been delayed by at least a couple of months. That would have led to considerable uncertainty and could have well cost more than the re-pricing we would have saved.

I think in recognition of the position that Bank of America was in, both the Treasury and Federal Reserve gave us assurances in December that we should close the deal and the government would provide the assistance we were talking about particularly putting a fence around some of the assets we were most concerned about. So in view of all those considerations and in view that strategically Merrill Lynch remains a solid franchise, we just thought it was in the best interest of our company and our stockholders and the country to move forward with the original terms and the timing.

**Michael L. Mayo - Deutsche Bank North America**

What I think I hear is you are kind of helping out the country and doing a little bit of a favor, so why in turn is the company put in some chains in terms of the executive compensation limits? It seems like the regulators got tougher on Bank of America as a whole because you went out of your way to kind of make Merrill Lynch work. Am I misreading something here?

**Kenneth Lewis**

I think you have to think about it in a broader perspective that there are going to be issues with others and there have been issues with others and we did think we were doing the right thing for the country but at the same time from the government's perspective they have got to have some template and not have us be seen as being given favoritism.

**Kevin Stitt**

The tangible book value including the Merrill Lynch shares is just under \$10. Call it \$9.93 or something like that.

**Michael L. Mayo - Deutsche Bank North America**

So it goes down by about \$1.50 or so.

**Kevin Stitt**

Right.

**Michael L. Mayo - Deutsche Bank North America**

When do you think you will be building up book value next quarter? All things considered? I guess the question is do your pre-provision, pre-tax profits help offset the credit losses? How do you think about that?

**Kenneth Lewis**

This is almost a facetious thing to say but if I could annualize the first two weeks it would be building quite a bit. But it has only been two weeks and you wouldn't know. Yes, we would but obviously we are subject to what happens in the economy.

**Kevin Stitt**

Thanks everyone.

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As filed with the Securities and Exchange Commission on October 30, 2008

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 8-K****CURRENT REPORT  
PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**Date of Report (Date of earliest event reported):  
October 26, 2008**BANK OF AMERICA CORPORATION**

(Exact name of registrant as specified in its charter)

<b>Delaware</b>	<b>1-6523</b>	<b>56-0906609</b>
(State of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

**100 North Tryon Street**  
**Charlotte, North Carolina 28255**  
 (Address of principal executive offices)

**(704) 386-5681**  
 (Registrant's telephone number, including area code)

**Not Applicable**  
 (Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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**ITEM 1.01. ENTRY INTO A MATERIAL DEFINITIVE AGREEMENT.**

On October 26, 2008, Bank of America Corporation (the "Registrant") entered into a Letter Agreement (the "Purchase Agreement") with the United States Department of the Treasury ("Treasury"), pursuant to which the Registrant agreed to issue and sell (i) 600,000 shares of the Registrant's Fixed Rate Cumulative Perpetual Preferred Stock, Series N (the "Series N Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 73,075,674 shares of the Registrant's common stock, par value \$0.01 per share (the "Common Stock"), for an aggregate purchase price of \$15,000,000,000 in cash. The Purchase Agreement is attached as Exhibit 10.1 hereto and is incorporated herein by reference.

The Series N Preferred Stock will qualify as Tier 1 capital and will pay cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series N Preferred Stock may be redeemed by the Registrant after three years. Prior to the end of three years, the Series N Preferred Stock may be redeemed by the Registrant only with proceeds from the sale of qualifying equity securities of the Registrant (a "Qualified Equity Offering"). The restrictions on redemption are set forth in the Certificate of Designations described in Item 5.03 below.

The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to \$30.79 per share of the Common Stock. The Warrant is attached as Exhibit 4.2 hereto and is incorporated herein by reference.

If the Registrant receives aggregate gross cash proceeds of not less than \$15,000,000,000 from Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of Common Stock issuable pursuant to Treasury's exercise of the Warrant will be reduced by one half of the original number of shares, taking into account all adjustments, underlying the Warrant. Pursuant to the Purchase Agreement, Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant.

The Series N Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. Upon the request of Treasury at any time, the Registrant has agreed to promptly enter into a deposit arrangement pursuant to which the Series N Preferred Stock may be deposited and depository shares ("Depository Shares"), representing fractional shares of Series N Preferred Stock, may be issued. The Registrant has agreed to register the Series N Preferred Stock, the Warrant, the shares of Common Stock underlying the Warrant (the "Warrant Shares") and Depository Shares, if any, as soon as practicable after the date of the issuance of the Series N Preferred Stock and the Warrant. Neither the Series N Preferred Stock nor the Warrant will be subject to any contractual restrictions on transfer, except that Treasury may only transfer or exercise an aggregate of one-half of the Warrant Shares prior to the earlier of the redemption of 100% of the shares of Series N Preferred Stock and December 31, 2009.

In the Purchase Agreement, the Registrant agreed that, until such time as Treasury ceases to own any debt or equity securities of the Registrant acquired pursuant to the Purchase Agreement, the Registrant will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic

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Stabilization Act of 2008 (the "EESA") as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series N Preferred Stock and the Warrant, and has agreed to not adopt any benefit plans with respect to, or which covers, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing.

Simultaneously with the Registrant's entry into the Purchase Agreement, Merrill Lynch & Co., Inc. ("Merrill Lynch") entered into an agreement with Treasury (the "Merrill Agreement") which allows Merrill Lynch to sell preferred stock and warrants to Treasury for a purchase price of \$10,000,000,000 prior to January 31, 2009 under certain circumstances. Treasury has agreed with the Registrant that if the closing of the transactions contemplated by the Agreement and Plan of Merger dated as of September 15, 2008 by and between Merrill Lynch and the Registrant occurs prior to the closing of the issuance and sale of Merrill Lynch preferred stock and warrants to Treasury as contemplated by the Merrill Agreement, Treasury will purchase and the Registrant will issue (i) 400,000 additional shares of the Series N Preferred Stock (or such other series of the Registrant's preferred stock with substantially identical terms) and (ii) a warrant to purchase 48,717,116 additional shares of Common Stock with an exercise price of \$30.79 and substantially identical terms to the Warrant, for an aggregate purchase price of \$10,000,000,000.

**ITEM 3.02. UNREGISTERED SALES OF EQUITY SECURITIES.**

The information set forth under "Item 1.01 Entry into a Material Definitive Agreement" is incorporated by reference into this Item 3.02.

**ITEM 3.03. MATERIAL MODIFICATION TO RIGHTS OF SECURITYHOLDERS.**

Upon issuance of the Series N Preferred Stock on October 28, 2008, the ability of the Registrant to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its Junior Stock (as defined below) and Parity Stock (as defined below) will be subject to restrictions, including the Registrant's restriction against increasing dividends from the last quarterly cash dividend per share (\$0.32) declared on the Common Stock prior to October 14, 2008. The redemption, purchase or other acquisition of trust preferred securities of the Registrant or its affiliates also will be restricted. These restrictions will terminate on the earlier of (a) the third anniversary of the date of issuance of the Series N Preferred Stock and (b) the date on which the Series N Preferred Stock has been redeemed in whole or Treasury has transferred all of the Series N Preferred Stock to third parties. The restrictions described in this paragraph are set forth in the Purchase Agreement.

In addition, pursuant to the Certificate of Designations, the ability of the Registrant to declare or pay dividends or distributions on, or repurchase, redeem or otherwise acquire for consideration, shares of its Junior Stock and Parity Stock will be subject to restrictions in the event that the Registrant fails to declare and pay full dividends (or declare and set aside a sum sufficient for payment thereof) on its Series N Preferred Stock. These restrictions are set forth in the Certificate of Designations described in Item 5.03.

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“Junior Stock” means the Common Stock and any other class or series of stock of the Registrant the terms of which expressly provide that it ranks junior to the Series N Preferred Stock as to dividend rights and/or rights on liquidation, dissolution or winding up of the Registrant. “Parity Stock” means any class or series of stock of the Registrant the terms of which do not expressly provide that such class or series will rank senior or junior to the Series N Preferred Stock as to dividend rights and/or rights on liquidation, dissolution or winding up of the Registrant (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).

**ITEM 5.02. DEPARTURE OF DIRECTORS OR CERTAIN OFFICERS; ELECTION OF DIRECTORS; APPOINTMENT OF CERTAIN OFFICERS; COMPENSATORY ARRANGEMENTS OF CERTAIN OFFICERS.**

The information concerning executive compensation set forth under “Item 1.01 Entry into a Material Definitive Agreement” is incorporated by reference into this Item 5.02.

**ITEM 5.03. AMENDMENT TO ARTICLES OF INCORPORATION OR BYLAWS; CHANGE IN FISCAL YEAR.**

On October 27, 2008, the Registrant filed a Certificate of Designations (the “Certificate of Designations”) with the Delaware Secretary of State for the purpose of amending its Certificate of Incorporation to fix the designations, preferences, limitations and relative rights of the Series N Preferred Stock. The Series N Preferred Stock has a liquidation preference of \$25,000 per share. The Certificate of Designations is attached hereto as Exhibit 3.1 and is incorporated by reference herein.

**ITEM 9.01. FINANCIAL STATEMENTS AND EXHIBITS.**

(d) Exhibits.

The following exhibits are filed herewith:

<u>EXHIBIT NO.</u>	<u>DESCRIPTION OF EXHIBIT</u>
3.1	Certificate of Designations for the Series N Preferred Stock
4.1	Form of Certificate for the Series N Preferred Stock
4.2	Warrant for Purchase of Shares of Common Stock
10.1	Letter Agreement, dated October 26, 2008, between the Registrant and United States Department of the Treasury, with respect to the issuance and sale of the Series N Preferred Stock and the Warrant

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**BANK OF AMERICA CORPORATION**

By: /s/ TERESA M. BRENNER  
Teresa M. Brenner  
Associate General Counsel

Dated: October 30, 2008

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**INDEX TO EXHIBITS**

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As filed with the Securities and Exchange Commission on January 22, 2009

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**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

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**FORM 8-K**

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**CURRENT REPORT  
PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**Date of Report (Date of earliest event reported):**  
January 15, 2009

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**BANK OF AMERICA CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State of Incorporation)

**1-6523**  
(Commission File Number)

**56-0906609**  
(IRS Employer Identification No.)

**100 North Tryon Street**  
**Charlotte, North Carolina 28255**  
(Address of principal executive offices)

**(704) 386-5681**  
(Registrant's telephone number, including area code)

**Not Applicable**  
(Former name or former address, if changed since last report)

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Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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**ITEM 1.01. ENTRY INTO A MATERIAL DEFINITIVE AGREEMENT.****Issuance of Preferred Stock and Warrants to the Treasury**

On January 15, 2009, Bank of America Corporation (the "Registrant") entered into a Securities Purchase Agreement (the "Purchase Agreement") with the United States Department of the Treasury (the "Treasury"), pursuant to which the Registrant sold (i) 800,000 shares of the Registrant's Fixed Rate Cumulative Perpetual Preferred Stock, Series R (the "Series R Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 150,375,940 shares of the Registrant's common stock, par value \$0.01 per share (the "Common Stock"), for an aggregate purchase price of \$20,000,000,000 in cash. The Purchase Agreement is attached as Exhibit 10.1 hereto and is incorporated herein by reference.

The Series R Preferred Stock will qualify as Tier 1 capital and will pay cumulative dividends at a rate of 8% per annum. The Series R Preferred Stock may not be redeemed by the Registrant until the Registrant has redeemed its Fixed Rate Cumulative Perpetual Preferred Stock, Series N and Fixed Rate Cumulative Perpetual Preferred Stock, Series Q. The restrictions on redemption are set forth in the Certificate of Designations described in Item 5.03 below.

The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to \$13.30 per share of the Common Stock. The Warrant is attached as Exhibit 4.2 hereto and is incorporated herein by reference.

Under the Purchase Agreement, the Registrant agreed to certain compensation limitations applicable to its senior executive officers and certain other senior managers, and amended its benefit plans to the extent necessary to effect such limitations.

The Series R Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. Upon the request of the Treasury at any time, the Registrant has agreed to promptly enter into a deposit arrangement pursuant to which the Series R Preferred Stock may be deposited and depository shares ("Depository Shares"), representing fractional shares of Series R Preferred Stock, may be issued. The Registrant has agreed to register or designate a registration statement for the Series R Preferred Stock, the Warrant, the shares of Common Stock underlying the Warrant (the "Warrant Shares") and Depository Shares, if any, as soon as practicable after the date of the issuance of the Series R Preferred Stock and the Warrant. Neither the Series R Preferred Stock nor the Warrant will be subject to any contractual restrictions on transfer.

**Government Guarantee of Certain Assets of the Registrant**

Also on January 15, 2009, the Registrant reached an agreement on a summary of terms with the Treasury, the Federal Reserve Board (the "Federal Reserve") and the Federal Deposit Insurance Corporation (the "FDIC," and together with the Treasury and the Federal Reserve, the "USG") under which the USG will provide loss sharing on approximately \$118 billion of the Registrant's assets.

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Under the terms of this arrangement, the Registrant will be responsible for the first \$10 billion of eligible losses on the guaranteed assets. Any additional eligible losses will be borne 90% by the USG and 10% by the Registrant. As a result of the USG loss sharing, the covered asset portfolio will have a new risk weighting of 20%.

As a fee for this arrangement, the Registrant will issue preferred stock and warrants to Treasury and the FDIC. In addition, with respect to the non-recourse loan facility provided by the Federal Reserve, the Registrant will pay a fee of 20 basis points per year on the undrawn portion of the lending commitment and will pay interest at a rate equal to the overnight indexed swap rate plus 300 basis points on drawn amounts.

The summary of terms of the USG arrangement is attached as Exhibit 10.2 hereto and is incorporated herein by reference.

**ITEM 3.02. UNREGISTERED SALES OF EQUITY SECURITIES.**

The information set forth under "Item 1.01 Entry into a Material Definitive Agreement" is incorporated herein by reference into this Item 3.02.

**ITEM 3.03. MATERIAL MODIFICATION TO RIGHTS OF SECURITYHOLDERS.**

Pursuant to the terms of the Purchase Agreement, the Registrant's ability to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its Junior Stock (as defined below) and Parity Stock (as defined below) is subject to restrictions, including restrictions against paying a quarterly cash dividend per share of more than \$0.01 on the Common Stock, without the prior approval of the Treasury. The redemption, purchase or other acquisition of trust preferred securities of the Registrant or its affiliates also will be restricted and shall require the prior approval of the Treasury. These restrictions will terminate on the earlier of (a) the third anniversary of the date of issuance of the Series R Preferred Stock and (b) the date on which the Series R Preferred Stock has been redeemed in whole or the Treasury has transferred all of the Series R Preferred Stock to third parties. The restrictions described in this paragraph are set forth in the Purchase Agreement.

In addition, pursuant to the Certificate of Designations, the ability of the Registrant to declare or pay dividends or distributions on, or repurchase, redeem or otherwise acquire for consideration, shares of its Junior Stock and Parity Stock will be subject to restrictions in the event that the Registrant fails to declare and pay full dividends (or declare and set aside a sum sufficient for payment thereof) on its Series R Preferred Stock. These restrictions are set forth in the Certificate of Designations described in Item 5.03.

"Junior Stock" means the Common Stock and any other class or series of stock of the Registrant the terms of which expressly provide that it ranks junior to the Series R Preferred Stock as to dividend rights and/or rights on liquidation, dissolution or winding up of the Registrant. "Parity Stock" means any class or series of stock of the Registrant the terms of which do not expressly provide that such class or series will rank senior or junior to the Series R Preferred Stock as to dividend rights and/or rights on liquidation, dissolution or winding up of

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the Registrant (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).

**ITEM 5.02. DEPARTURE OF DIRECTORS OR CERTAIN OFFICERS; ELECTION OF DIRECTORS; APPOINTMENT OF CERTAIN OFFICERS; COMPENSATORY ARRANGEMENTS OF CERTAIN OFFICERS.**

The information set forth under "Item 1.01 Entry into a Material Definitive Agreement" is incorporated herein by reference into this Item 5.02.

**ITEM 5.03. AMENDMENT TO ARTICLES OF INCORPORATION OR BYLAWS; CHANGE IN FISCAL YEAR.**

On January 16, 2009, the Registrant filed a Certificate of Designations (the "Certificate of Designations") with the Delaware Secretary of State for the purpose of amending its Certificate of Incorporation to fix the designations, preferences, limitations and relative rights of the Series R Preferred Stock. The Series R Preferred Stock has a liquidation preference of \$25,000 per share. The Certificate of Designations is attached hereto as Exhibit 3.1 and is incorporated herein by reference.

**ITEM 9.01. FINANCIAL STATEMENTS AND EXHIBITS.**

(d) Exhibits.

The following exhibits are filed herewith:

<b>EXHIBIT NO.</b>	<b>DESCRIPTION OF EXHIBIT</b>
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10.1	Securities Purchase Agreement, dated January 15, 2009, between the Registrant and the United States Department of the Treasury, with respect to the issuance and sale of the Series R Preferred Stock and the Warrant
10.2	Summary of Terms, dated January 15, 2009

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**BANK OF AMERICA CORPORATION**

By: /s/ Teresa M. Brenner  
Teresa M. Brenner  
Associate General Counsel

Dated: January 22, 2009

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exclusive ownership and direct control of Company or its Subsidiaries or accountants (including all means of access thereto and therefrom), except for any non-exclusive ownership and non-direct control that would not reasonably be expected to have a material adverse effect on the system of internal accounting controls described below in this Section 3.6(c). Company (x) has implemented and maintains disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) to ensure that material information relating to Company, including its consolidated Subsidiaries, is made known to the chief executive officer and the chief financial officer of Company by others within those entities, and (y) has disclosed, based on its most recent evaluation prior to the date hereof, to Company's outside auditors and the audit committee of Company's Board of Directors (i) any significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) which are reasonably likely to adversely affect Company's ability to record, process, summarize and report financial information and (ii) any fraud, whether or not material, that involves management or other employees who have a significant role in Company's internal controls over financial reporting. These disclosures were made in writing by management to Company's auditors and audit committee, a copy of which has previously been made available to Parent. As of the date hereof, there is no reason to believe that Company's outside auditors, chief executive officer and chief financial officer will not be able to give the certifications and attestations required pursuant to the rules and regulations adopted pursuant to Section 404 of the Sarbanes-Oxley Act, without qualification, when next due.

(d) Since December 28, 2007, (i) neither Company nor any of its Subsidiaries nor, to the knowledge of Company, any director, officer, employee, auditor, accountant or representative of Company or any of its Subsidiaries has received or otherwise had or obtained knowledge of any material complaint, allegation, assertion or claim, whether written or oral, regarding the accounting or auditing practices, procedures, methodologies or methods of Company or any of its Subsidiaries or their respective internal accounting controls, including any material complaint, allegation, assertion or claim that Company or any of its Subsidiaries has engaged in questionable accounting or auditing practices, and (ii) no attorney representing Company or any of its Subsidiaries, whether or not employed by Company or any of its Subsidiaries, has reported evidence of a material violation of securities laws, breach of fiduciary duty or similar violation by Company or any of its officers, directors, employees or agents to the Board of Directors of Company or any committee thereof or to any director or officer of Company.

3.7 **Broker's Fees.** Neither Company nor any of its Subsidiaries nor any of their respective officers, directors, employees or agents has utilized any broker, finder or financial advisor or incurred any liability for any broker's fees, commissions or finder's fees in connection with the Merger or any other transactions contemplated by this Agreement, other than as set forth in Section 3.7 of the Company Disclosure Schedule and pursuant to letter agreements, true, complete and correct copies of which have been previously delivered to Parent.

3.8 **Absence of Certain Changes or Events.** (a) Since June 27, 2008, no event or events have occurred that have had or would reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect on Company. As used in this Agreement, the term "Material Adverse Effect" means, with respect to Parent or Company, as the case may be, a material adverse effect on (i) the financial condition, results of operations or business of such

party and its Subsidiaries taken as a whole (provided, however, that, with respect to clause (i), a "Material Adverse Effect" shall not be deemed to include effects to the extent resulting from (A) changes, after the date hereof, in GAAP or regulatory accounting requirements applicable generally to companies in the industries in which such party and its Subsidiaries operate, (B) changes, after the date hereof, in laws, rules, regulations or the interpretation of laws, rules or regulations by Governmental Authorities of general applicability to companies in the industries in which such party and its Subsidiaries operate, (C) actions or omissions taken with the prior written consent of the other party or expressly required by this Agreement, (D) changes in global, national or regional political conditions (including acts of terrorism or war) or general business, economic or market conditions, including changes generally in prevailing interest rates, currency exchange rates, credit markets and price levels or trading volumes in the United States or foreign securities markets, in each case generally affecting the industries in which such party or its Subsidiaries operate and including changes to any previously correctly applied asset marks resulting therefrom, (E) the execution of this Agreement or the public disclosure of this Agreement or the transactions contemplated hereby, including acts of competitors or losses of employees to the extent resulting therefrom, (F) failure, in and of itself, to meet earnings projections, but not including any underlying causes thereof or (G) changes in the trading price of a party's common stock, in and of itself, but not including any underlying causes, except, with respect to clauses (A), (B) and (D), to the extent that the effects of such change are disproportionately adverse to the financial condition, results of operations or business of such party and its Subsidiaries, taken as a whole, as compared to other companies in the industry in which such party and its Subsidiaries operate) or (ii) the ability of such party to timely consummate the transactions contemplated by this Agreement.

(b) Since June 27, 2008 through and including the date of this Agreement, Company and its Subsidiaries have carried on their respective businesses in all material respects in the ordinary course of business consistent with their past practice.

(c) Since June 27, 2008 through and including the date of this Agreement, neither Company nor any of its Subsidiaries has (i) except for (A) normal increases for or payments to employees (other than officers subject to the reporting requirements of Section 16(a) of the Exchange Act (the "Executive Officers")) made in the ordinary course of business consistent with past practice or (B) as required by applicable law or contractual obligations existing as of the date hereof, increased the wages, salaries, compensation, pension, or other fringe benefits or perquisites payable to any Executive Officer or other employee or director from the amount thereof in effect as of June 27, 2008, granted any severance or termination pay, entered into any contract to make or grant any severance or termination pay (in each case, except as required under the terms of agreements or severance plans listed on Section 3.11 of the Company Disclosure Schedule, as in effect as of the date hereof), or paid any cash bonus in excess of \$1,000,000 other than the customary year-end bonuses in amounts consistent with past practice and other than the monthly incentive payments made to financial advisors under current Company programs, (ii) granted any options to purchase shares of Company Common Stock, any restricted shares of Company Common Stock or any right to acquire any shares of its capital stock, or any right to payment based on the value of Company's capital stock, to any Executive Officer or other employee or director other than grants to employees (other than Executive Officers) made in the ordinary course of business consistent with past practice under the Company Stock Plans or grants relating to shares of Company Common Stock with an aggregate

value for all such grants of less than \$1 million for any individual, (iii) changed any financial accounting methods, principles or practices of Company or its Subsidiaries affecting its assets, liabilities or businesses, including any reserving, renewal or residual method, practice or policy, (iv) suffered any strike, work stoppage, slow-down, or other labor disturbance, or (v) except for publicly disclosed ordinary dividends on the Company Common Stock or Company Preferred Stock and except for distributions by wholly-owned Subsidiaries of Company to Company or another wholly-owned Subsidiary of Company, made or declared any distribution in cash or kind to its stockholder or repurchased any shares of its capital stock or other equity interests.

3.9 Legal Proceedings. (a) Neither Company nor any of its Subsidiaries is a party to any, and there are no pending or, to Company's knowledge, threatened, legal, administrative, arbitral or other proceedings, claims, actions, suits or governmental or regulatory investigations of any nature against Company or any of its Subsidiaries or to which any of their assets are subject.

(b) There is no judgment, settlement agreement, order, injunction, decree or regulatory restriction (other than those of general application that apply to similarly situated savings and loan holding companies or their Subsidiaries) imposed upon Company, any of its Subsidiaries or the assets of Company or any of its Subsidiaries (or that, upon consummation of the Merger, would apply to Parent or any of its Subsidiaries).

3.10 Taxes and Tax Returns.

(a) Each of Company and its Subsidiaries has duly and timely filed (including all applicable extensions) all material Tax Returns required to be filed by it on or prior to the date of this Agreement (all such Tax Returns being accurate and complete in all material respects), has paid all Taxes shown thereon as arising and has duly paid or made provision for the payment of all material Taxes that have been incurred or are due or claimed to be due from it by federal, state, foreign or local taxing authorities other than Taxes that are not yet delinquent or are being contested in good faith, have not been finally determined and have been adequately reserved against under GAAP. The federal, state and local income Tax Returns of Company and its Subsidiaries have been examined by the Internal Revenue Service (the "IRS") or other relevant taxing authority for all years to and including 2001, and any liability with respect thereto has been satisfied or any liability with respect to deficiencies asserted as a result of such examination is covered by reserves that are adequate under GAAP. There are no material disputes pending, or written claims asserted, for Taxes or assessments upon Company or any of its Subsidiaries for which Company does not have reserves that are adequate under GAAP. Neither Company nor any of its Subsidiaries is a party to or is bound by any Tax sharing agreement or arrangement (other than such an agreement or arrangement exclusively between or among Company and its Subsidiaries). Within the past five years (or otherwise as part of a "plan (or series of related transactions)" within the meaning of Section 355(e) of the Code of which the Merger is also a part), neither Company nor any of its Subsidiaries has been a "distributing corporation" or a "controlled corporation" in a distribution intended to qualify under Section 355(a) of the Code. Neither Company nor any of its Subsidiaries is required to include in income any adjustment pursuant to Section 481(a) of the Code, no such adjustment has been proposed by the IRS and no pending request for permission to change any accounting method has been submitted by Company or any of its Subsidiaries. Neither Company nor any of its Subsidiaries has

participated in a "listed transaction" within the meaning of Treasury Regulation Section 1.6011-4(b)(2) subsequent to such transaction becoming listed.

(b) As used in this Agreement, the term "Tax" or "Taxes" means (i) all federal, state, local, and foreign income, excise, gross receipts, gross income, ad valorem, profits, gains, property, capital, sales, transfer, use, payroll, employment, severance, withholding, duties, intangibles, franchise, backup withholding, value added and other taxes, charges, levies or like assessments together with all penalties and additions to tax and interest thereon and (ii) any liability for Taxes described in clause (i) above under Treasury Regulation Section 1.1502-6 (or any similar provision of state, local or foreign law), as a transferee or successor or by contract.

(c) As used in this Agreement, the term "Tax Return" means a report, return or other information (including any amendments) required to be supplied to a governmental entity with respect to Taxes including, where permitted or required, combined or consolidated returns for any group of entities that includes Company or any of its Subsidiaries.

(d) Without regard to this Agreement or the Stock Option Agreement, Company has not undergone any "ownership change" within the meaning of Section 382 of the Code and, other than as a result of an acquisition by Company or any of its Subsidiaries, the availability of any net operating loss and other carryovers available to Company or its Subsidiaries has not been affected by Sections 382, 383 or 384 of the Code or by the SRLY limitations of Treasury Regulation Sections 1.1502-21, 1.1502-21T or 1.1502-22.

(e) Company and its Subsidiaries have complied in all material respects with all applicable laws relating to the payment and withholding of Taxes (including withholding of Taxes pursuant to Sections 1441, 1442 and 3402 of the Code or any comparable provision of any state, local or foreign laws) and have, within the time and in the manner prescribed by applicable law, withheld from and paid over all amounts required to be so withheld and paid over under applicable laws.

#### 3.11 Employee Matters.

(a) Section 3.11 of the Company Disclosure Schedule (which shall be delivered by Company to Parent within five business days following the date hereof), sets forth a true, complete and correct list of each material "employee benefit plan" as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), whether or not subject to ERISA, and each material employment, consulting, bonus, incentive or deferred compensation, vacation, stock option or other equity-based, severance, termination, retention, change of control, profit-sharing, fringe benefit or other similar plan, program, agreement or commitment, whether written or unwritten, for the benefit of any employee, former employee, director or former director of Company or any of its Subsidiaries entered into, maintained or contributed to by Company or any of its Subsidiaries or to which Company or any of its Subsidiaries is obligated to contribute, or with respect to which Company or any of its Subsidiaries has any liability, direct or indirect, contingent or otherwise (including any liability arising out of an indemnification, guarantee, hold harmless or similar agreement) or otherwise providing benefits to any current, former or future employee, officer or director of Company or

any of its Subsidiaries or to any beneficiary or dependent thereof (such plans, programs, agreements and commitments, herein referred to as the "Company Benefit Plans").

(b) Except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect, (i) each of the Company Benefit Plans has been operated and administered in all material respects with applicable law, including, but not limited to, ERISA, the Code and in each case the regulations thereunder; (ii) each Company Benefit Plan intended to be "qualified" within the meaning of Section 401(a) of the Code has received a favorable determination letter from the Internal Revenue Service, or has pending an application for such determination from the Internal Revenue Service with respect to those provisions for which the remedial amendment period under Section 401(b) of the Code has not expired, and, to the knowledge of the Company, there is not any reason why any such determination letter should be revoked; (iii) with respect to each Company Benefit Plan that is subject to Title IV or Section 302 of ERISA or Section 412 or 4971 of the Code, as of the last day of the most recent plan year ended prior to the date hereof, the actuarially determined present value of all "benefit liabilities" within the meaning of Section 4001(a)(16) of ERISA did not exceed the then current value of assets of such Company Benefit Plan or, if such liabilities did exceed such assets, the amount thereof was properly reflected on the financial statements of Company or its applicable Subsidiary previously filed with the SEC; (iv) no Company Benefit Plan provides benefits, including, without limitation, death or medical benefits (whether or not insured), with respect to current or former employees or directors of the Company or any Company Subsidiary beyond their retirement or other termination of service, other than (1) coverage mandated by applicable law or (2) death benefits or retirement benefits under any "employee pension plan" (as such term is defined in Section 3(2) of ERISA); (v) no Controlled Group Liability has been incurred by the Company, a Company Subsidiary or any of their respective ERISA Affiliates that has not been satisfied in full, and no condition exists that presents a risk to the Company, a Company Subsidiary or any of their respective ERISA Affiliates of incurring any such liability; (vi) neither the Company nor any Company Subsidiary contributes on behalf of employees of the Company or any Company Subsidiary to a "multiemployer pension plan" (as such term is defined in Section 3(37) of ERISA) or a plan that has two or more contributing sponsors at least two of whom are not under common control, within the meaning of Section 4063 of ERISA; (vii) all contributions or other amounts payable by the Company or a Company Subsidiary with respect to each Company Benefit Plan in respect of current or prior plan years have been paid or accrued in accordance with generally accepted accounting principles; (viii) neither the Company nor a Company Subsidiary has engaged in a transaction in connection with which the Company or a Company Subsidiary reasonably could be subject to either a civil penalty assessed pursuant to Section 409 or 502(i) of ERISA or a material tax imposed pursuant to Section 4975 or 4976 of the Code; and (ix) there are no pending, threatened or anticipated claims (other than routine claims for benefits) by, on behalf of or against any of the Company Benefit Plans or any trusts related thereto which could reasonably be expected to result in any liability of the Company or any Company Subsidiary.

(c) Each Company Benefit Plan that is a "nonqualified deferred compensation plan" within the meaning of Section 409A(d)(1) of the Code (a "Nonqualified Deferred Compensation Plan") and any award thereunder, in each case that is subject to Section 409A of the Code has been operated in compliance in all material respects with Section 409A of the Code since January 1, 2006, based upon a good faith, reasonable interpretation of (A) Section 409A of