Jeffrey Lacker address deleted

Jeffrey Lacker address deleted
12/20/2008 11:12 AM

To "Mac Alfriend" address deleted
address deleted , "Jennifer Burns"
, "James McAfee"
, Trish
Nunley address deleted

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.

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

REDACTED

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April 23, 2009

The Honorable Christopher J. Dodd,
Chairman
U.S. Senate Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Barney Frank, Chairman
House Financial Services Committee
Democratic Staff
2129 Rayburn House Office Building
Washington, DC 20515

Mary L. Schapiro, Chairman
U.S. Securities and Exchange Commission
Office of the Chairman
100 F Street, NE
Washington, DC 20549

Ms. Elizabeth Warren, Chair
Congressional Oversight Panel
732 North Capitol Street, NW
Rooms C-320 and C-617
Mailstop: COP
Washington, DC 20401

Re: Bank of America – Merrill Lynch Merger Investigation

Dear Chairpersons Dodd, Frank, Schapiro and Warren:

I am writing regarding our investigation of the events surrounding Bank of America's merger with Merrill Lynch late last year. Because you are the overseers and regulators of the Troubled Asset Relief Program ("TARP"), the banking industry, and the Treasury Department, we are informing you of certain results of our investigation. As you will see, while the investigation initially focused on huge fourth quarter bonus payouts, we have uncovered facts that raise questions about the transparency of the TARP program, as well as about corporate governance and disclosure practices at Bank of America. Because some matters relating to our investigation involve federal agencies and high-ranking federal officials charged with managing the TARP program, we believe it is important to inform the relevant federal bodies of our current findings. We have attached relevant documents to this letter for your review.

On September 15, 2008, Merrill Lynch entered into a merger agreement with Bank of America. The merger was negotiated and due diligence was conducted over the course of a tumultuous September 13-14 weekend. Time was of the essence for Merrill Lynch, as the company was not likely to survive the following week without a merger. The merger was approved by shareholders on December 5, 2008, and became effective on January 1, 2009.

The week after the shareholder vote – and days after Merrill Lynch set its bonuses – Merrill Lynch quickly and quietly booked billions of dollars of additional losses. Merrill Lynch's fourth quarter 2008 losses turned out to be $7 billion worse than it had projected prior to the merger vote and finalizing its bonuses. These additional losses, some of which had become known to Bank of America executives prior to the merger vote, were not disclosed to shareholders until mid-January 2009, two weeks after the merger had closed on January 1, 2009.

On Sunday, December 14, 2008, Bank of America's CFO advised Ken Lewis, Bank of America's CEO, that Merrill Lynch's financial condition had seriously deteriorated at an alarming rate. Indeed, Lewis was advised that Merrill Lynch had lost several billion dollars since December 8, 2008. In six days, Merrill Lynch's projected fourth quarter losses skyrocketed from $9 billion to $12 billion, and fourth quarter losses ultimately exceeded $15 billion.

Immediately after learning on December 14, 2008 of what Lewis described as the "staggering amount of deterioration" at Merrill Lynch, Lewis conferred with counsel to determine if Bank of America had grounds to rescind the merger agreement by using a clause that allowed Bank of America to exit the deal if a material adverse event ("MAC") occurred. After a series of internal consultations and consultations with counsel, on December 17, 2008, Lewis informed then-Treasury Secretary Henry Paulson that Bank of America was seriously considering invoking the MAC clause. Paulson asked Lewis to come to Washington that evening to discuss the matter.

At a meeting that evening Secretary Paulson, Federal Reserve Chairman Ben Bernanke, Lewis, Bank of America's CFO, and other officials discussed the issues surrounding invocation of the MAC clause by Bank of America. The Federal officials asked Bank of America not to invoke the MAC until there was further consultation. There were follow-up calls with various Treasury and Federal Reserve officials, including with Treasury Secretary Paulson and Chairman Bernanke. During those meetings, the federal government officials pressured Bank of America not to seek to rescind the merger agreement. We do not yet have a complete picture of the Federal Reserve's role in these matters because the Federal Reserve has invoked the bank examination privilege.

Bank of America's attempt to exit the merger came to a halt on December 21, 2008. That day, Lewis informed Secretary Paulson that Bank of America still wanted to exit the merger agreement. According to Lewis, Secretary Paulson then advised Lewis that, if Bank of America invoked the MAC, its management and Board would be replaced:

> [W]e wanted to follow up and he said, 'I'm going to be very blunt, we're very supportive on Bank of America and we want to be of help, but' -- as 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 of "That threat, okay, do it. That would be systemic risk."

In an interview with this Office, Secretary Paulson largely corroborated Lewis's account. On the issue of terminating management and the Board, Secretary Paulson indicated that he told Lewis that if Bank of America were to back out of the Merrill Lynch deal, the government either could or would remove the Board and management. Secretary Paulson told Lewis a series of concerns, including that Bank of America's invocation of the MAC would create systemic risk and that Bank of America did not have a legal basis to invoke the MAC (though Secretary Paulson's basis for the opinion was entirely based on what he was told by Federal Reserve officials).

Secretary Paulson's threat swayed Lewis. According to Secretary Paulson, after he stated that the management and the Board could be removed, Lewis replied, "that makes it simple. Let's deescalate." Lewis admits that Secretary Paulson's threat changed his mind about invoking that MAC clause and terminating the deal.

Secretary Paulson has informed us that he made the threat at the request of Chairman Bernanke. After the threat, the conversation between Secretary Paulson and Lewis turned to receiving additional government assistance in light of the staggering Merrill Lynch losses.

Lewis spoke with individual Board members after his conversation with Secretary Paulson. The next day, December 22, 2008, the Board met and was advised of Lewis's decision not to invoke the MAC. The minutes of that meeting listed the key points of Lewis's calls with Secretary Paulson and Chairman Bernanke:

> (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 system in America and would have adverse consequences for the Corporation; (ii) second, the Treasury and Fed state 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.

The Board Minutes further state that the "Board clarify[ied] that is [sic] 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 failed to complete the acquisition of Merrill Lynch."

Another Board meeting was held on December 30, 2008. The minutes of that meeting stated that "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."

Despite the fact that Bank of America had determined that Merrill Lynch's financial condition was so grave that it justified termination of the deal pursuant to the MAC clause, Bank of America did not publicly disclose Merrill Lynch's devastating losses or the impact it would have on the merger. Nor did Bank of America disclose that it had been prepared to invoke the MAC clause and would have done so but for the intervention of the Treasury Department and the Federal Reserve.

Lewis testified that the question of disclosure was not up to him and that his decision not to disclose was based on direction from Paulson and Bernanke: "I was instructed that 'We do not want a public disclosure.'"

Secretary Paulson, however, informed this Office that his discussions with Lewis regarding disclosure concerned the Treasury Department's own disclosure obligations. Prior to the closing of the deal, Lewis had requested that the government provide a written agreement to provide additional TARP funding before the close of the Merrill Lynch/Bank of America merger. Secretary Paulson advised Lewis that a written agreement could not be provided without disclosure.

Lewis testified that there was no discussion with the Board about disclosure to shareholders. However, on the night of December 22, 2008, Lewis emailed the Board, "I just talked with Hank Paulson. He said that there was no way the Federal Reserve and the Treasury could send us a letter of any substance without public disclosure which, of course, we do not want." The December 30 Board meeting minutes further reflect that Bank of America was trying to time its disclosure of Merrill Lynch's losses to coincide with the announcement of its earnings in January and the receipt of additional TARP funds: "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 earning [sic] release on January 20, 2009."

It also bears noting that while no public disclosures were made by Bank of America, Lewis admitted that Bank of America's decision not to invoke the MAC clause harmed any shareholder with less than a three year time-horizon:

Q. Wasn't Mr. Paulson, by his instruction, really asking Bank of America shareholders to take a good part of the hit of the Merrill losses?

A. What he was doing was trying to stem a financial disaster in the financial markets, from his perspective.

Q. From your perspective, wasn't that one of the effects of what he was doing?

A. Over the short term, yes, but we still thought we had an entity that filled two big strategic holes for us and over long term would still be an interest to the shareholders.

Q. What do you mean by "short-term"?

A. Two to three years.

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

As this crucial recovery process continues, it is important that taxpayers have transparency into decision-making. It is equally important that investor interests are protected and respected. We hope the information herein is useful to you in your federal regulatory and oversight capacities and we remain ready to assist further in any way. We also note that we have been coordinating our inquiry with the Special Inspector General for the Troubled Asset Relief Program, whose investigation also remains open.

Very truly yours,

Andrew M. Cuomo
Attorney General of the
State of New York

cc: Neil Barofsky
Special Inspector General
Troubled Asset Relief Program

<u>MEMORANDUM</u>

TO: Chris Hixon
FROM: Nicole Patterson
DATE: June 21, 2009
RE: Henry Paulson's public statements regarding the Bank of America – Merrill Lynch merger

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After the close of the Bank of America – Merrill Lynch merger on January 1, 2009, questions arose as to the involvement of then-Treasury Secretary Henry Paulson, and Federal Reserve Chairman Ben Bernanke, particularly their involvement in pressuring Bank of America CEO Ken Lewis. Since then, Secretary Paulson has issued a number of statements (via spokespeople) which are detailed below.

Secretary Paulson's public statements relate to two different issues: (1) whether Mr. Lewis was forced by Secretary Paulson to continue with the Bank of America – Merrill Lynch merger ("the merger"); and (2) whether Mr. Lewis was pressured not to disclose the losses of Merrill Lynch to Bank of America shareholders. Over a short period of time, Secretary Paulson's statements have changed regarding the first issue; however, Secretary Paulson has consistently denied pressuring Mr. Lewis regarding any disclosures to Bank of America shareholders.

Pressure to Continue with the Merger

In a letter dated on April 23, 2009 and submitted to Senator Chris Dodd, Representative Barney Frank, Mary Schapiro (SEC Chairman), and Elizabeth Warren (Chair of the Congressional Oversight Panel), the Attorney General of New York,

Andrew Cuomo, discussed the involvement of Secretary Paulson in the merger.[1] Mr. Cuomo's letter was based on his office's investigation of the merger which included Mr. Lewis's testimony to Mr. Cuomo and Secretary Paulson's statements to Mr. Cuomo.[2] This letter contains the first known public statements given by Secretary Paulson regarding the merger.

Mr. Lewis testified that he informed Secretary Paulson on December 21, 2008 that Bank of America still wanted to exit the merger by invoking the MAC clause.[3] According to Mr. Lewis, Secretary Paulson then threatened to remove Bank of America's management and board if Bank of America invoked the MAC clause, thereby exiting the merger.[4] In an interview with Mr. Cuomo's office, Secretary Paulson "largely corroborated Lewis's account" regarding threatening Mr. Lewis.[5]

> Secretary Paulson indicated that he told Lewis that if Bank of America were to back out of the Merrill Lynch deal, the government either could or would remove the Board and management. Secretary Paulson told Lewis a series of concerns, including that Bank of America's invocation of the MAC would create a systemic risk and that Bank of America did not have a legal basis to invoke the MAC (though Secretary Paulson's basis for the opinion was based on what he was told by Federal Reserve officials).[6]

It was (or arguably should have been) obvious to Secretary Paulson that his threat swayed Mr. Lewis because, according to Secretary Paulson, Mr. Lewis's response to the threat was "that makes it simple. Let's deescalate."[7]

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[1] *See, e.g.* Andrew Cuomo, *Letter regarding Bank of American – Merrill Lynch merger investigation (April 23, 2009), available at* http://www.oag.state.ny.us/media_center/2009/apr/pdfs/BofAmergLetter.pdf
[2] *See id.*
[3] *See id.*
[4] *See id.*
[5] *Id.*
[6] *Id.*
[7] *Id.*

While Secretary Paulson had admitted to threatening Mr. Lewis, the question remains as to whether he was acting on his own behest. Apparently, even Secretary Paulson is uncertain. His first response, which was given to Mr. Cuomo, was that he was not acting for himself. "Secretary Paulson has informed us that he made the threat *at the request of Chairman Bernanke*."[8] In fact, according to the Wall Street Journal

> Paulson initially asserted to Cuomo's investigators that he couldn't answer questions about the threat to Mr. Lewis (of losing his job and his board's jobs) because he was speaking on behalf of Bernanke and the Fed had asserted privilege over those conversations, says a person present at the interview. He later answered.[9]

Based on those two statements, it would seem that Secretary Paulson was certain that he threatened Mr. Lewis at Chairman Bernanke's request. However, after Mr. Cuomo's letter was publicized, Secretary Paulson issued two statements in response. The first statement said, in part,

> Their discussions centered on the Fed lawyer's opinion that the merger contract was binding, and the US Treasury's commitment to ensuring that no systemically important financial institution would be allowed to fail. *Secretary Paulson's words were his own. Chairman Bernanke did not instruct him to indicate any specific action the Fed might take.* By referring to the Fed's supervisory powers, Paulson intended to deliver a strong message reinforcing the view that had been consistently expressed by the Fed, as Bank of America's regulator, and shared by the Treasury that it would be unthinkable that Bank of America take this action for which there was no reasonable legal basis and which would show a lack of judgment.[10]

After directly contradicting what he said to Mr. Cuomo, a couple of hours later, Secretary Paulson issued another statement:

> To clarify the earlier statement, Secretary Paulson does not take exception with the Attorney General's characterization of his

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[8] *Id.* (emphasis added)

[9] Heidi Moore, *Paulson: 'Creating More Questions Than It Answered' (April 24, 2009), available at* http://blogs.wsj.com/deals/2009/04/24/paulson-creating-more-questions-than-it-answered/

[10] *Id.* (emphasis added)

> conversation with Ken Lewis. *His prediction* of what could happen to Lewis and the Board *was his language, but based on what he knew to be the Fed's strong opposition to Bank of America attempting to renounce the deal.*[11]

With no further statements since, it appears that Secretary Paulson has settled on the fact that his "words were his own;" however, they were "based . . . on the Fed's strong opposition to Bank of America attempting to renounce the deal."[12]

Pressure Not to Disclose

According to Mr. Lewis, in his testimony to Mr. Cuomo, "Bank of America had determined that Merrill Lynch's financial condition was so grave that it justified termination of the deal pursuant to the MAC clause."[13] Despite this, Bank of America did not disclose to its shareholders the preparation to invoke the MAC clause or Merrill Lynch's losses.[14] Mr. Lewis testified that "his decision not to disclose was based on direction from Paulson and Bernanke."[15] Secretary Paulson, though, said otherwise:

> Secretary Paulson, however, informed this Office that his discussions with Lewis regarding disclosure concerned the Treasury Department's own disclosure obligations. [When] Lewis had requested that the government provide a written agreement to provide additional TARP funding before the close of the . . . merger[,] Secretary Paulson advised Lewis that a written agreement could not be provided without disclosure.[16]

In a statement issued by Secretary Paulson after the publication of Mr. Cuomo's letter, Secretary Paulson tried to clarify his conversation with Mr. Lewis regarding the agreement to provide additional TARP funding:

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[11] *Id.* (emphasis added)
[12] *Id.*
[13] *See, e.g.* Andrew Cuomo, *Letter regarding Bank of American – Merrill Lynch merger investigation (April 23, 2009), available at* http://www.oag.state.ny.us/media_center/2009/apr/pdfs/BofAmergLetter.pdf
[14] *See id.*
[15] *Id.*
[16] *Id.*

> In a separate conversation, Secretary Paulson said he could not provide a letter because there was not yet a specific action plan and he believed that Treasury releasing a vague letter reiterating Treasury's public commitment to prevent systemically important institutions rattle markets by creating more questions than it answered. *Questions of BofA's disclosures were left up to Bank of America.*[17]

Secretary Paulson has not issued any other statements regarding the pressure on Mr. Lewis not to disclose; and several news agencies have interpreted Secretary Paulson's above statement as a denial of advising Mr. Lewis on disclosure issues.[18]

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[17] Heidi Moore, *Paulson: 'Creating More Questions Than It Answered' (April 24, 2009)*, *available at* http://blogs.wsj.com/deals/2009/04/24/paulson-creating-more-questions-than-it-answered/ (emphasis added).

[18] *See, e.g.* David Cho and Tomoeh Murakami Tse, *U.S. Forced Bank Board to Carry Out Merrill Deal (April 24, 2009)*, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/04/23/AR2009042302461.html.