

United States House of Representatives
Committee on Financial Services
Washington, DC 20515

March 16, 2010

VIA FACSIMILE

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank:

Last week, the report of Lehman Brothers' court-appointed bankruptcy examiner, Anton R. Valukas, was made public. The Valukas Report details significant transactions that took place at Lehman that at best can be described as questionable, and which at worst depict an accounting fraud that rivals Enron. The Valukas Report details how Lehman Brothers used accounting gimmicks to hide its debt and mask its insolvency. According to the Report, Lehman used a transaction known as "Repo 105" to temporarily move liabilities off its balance sheet — pretending to sell them while promising that it would immediately buy them back. Lehman's fraud was so egregious that Lehman could find no U.S. law firm to bless the practice. The Valukas Report found "materially misleading" accounting and "actionable balance sheet manipulation."

More disturbing, the Valukas Report also details significant failings on the part of the New York Federal Reserve and the Securities and Exchange Commission (SEC) which merit this Committee's full attention. The *New York Times* reported in its March 16, 2010, editions that:

Almost two years ago to the day, a team of officials from the Securities and Exchange Commission and the Federal Reserve Bank of New York quietly moved into the headquarters of Lehman Brothers. They were provided desks, phones, computers — and access to all of Lehman's books and records. At any given moment, there were as many as a dozen government officials buzzing around Lehman's offices. These officials, whose work was kept under wraps at the time, were assigned by Timothy Geithner, then president of the New York Fed, and Christopher Cox, then the S.E.C. chairman, to monitor Lehman in light of the near collapse of Bear Stearns.

Despite this intensive on-site presence, the New York Fed and the SEC stood idly by while the bank engaged in the balance sheet manipulations detailed in the Valukas Report. Either the SEC and the New York Federal Reserve failed to discover the ongoing accounting fraud at Lehman, or they turned a blind eye to the ongoing fraud as government officials sought to rescue Lehman in the period leading up to its September 2008 collapse. In either case, the actions of these two regulators represent a grave failure and should be explored at a public hearing, particularly in light of pending House and Senate proposals that would greatly expand the Federal Reserve's regulatory powers.

Perhaps even more troubling are the actions of the New York Federal Reserve in administering a series of "stress tests" designed to assess Lehman's financial condition. As described by the Valukas Report,

After March 2008 when the SEC and FRBNY began onsite daily monitoring of Lehman, the SEC deferred to the FRBNY to devise more rigorous stress-testing scenarios to test Lehman's ability to withstand a run or potential run on the bank. The FRBNY developed two new stress scenarios: "Bear Stearns" and "Bear Stearns Light." Lehman failed both tests. The FRBNY then developed a new set of assumptions for an additional round of stress tests, which Lehman also failed. However, Lehman ran stress tests of its own, modeled on similar assumptions, and passed. It does not appear that any agency required any action of Lehman in response to the results of the stress testing.

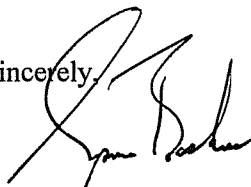
Not only did the New York Fed fail to require Lehman Brothers to take any corrective action, but it was also during this period that the Bank loaned Lehman Brothers billions of dollars through a new program that opened the discount window to investment banks, effectively putting taxpayers at risk by lending to an institution that may not only have been insolvent but fraudulent as well.

Accordingly, I am writing to request that the Committee hold hearings, as soon as possible, to explore the allegations of accounting fraud that may have taken place at Lehman and the potential misfeasance of the SEC and the New York Federal Reserve in their supervision of Lehman in the months following the bail-out of Bear Stearns in March 2008 through Lehman's bankruptcy in September 2008.

This hearing should specifically examine the adequacy of the New York Fed's and SEC's monitoring of Lehman Brothers after the collapse of Bear Stearns; the decision by the New York Fed to give Lehman access to the Primary Dealer Credit Facility; and the efforts of the New York Fed to avert Lehman's bankruptcy in 2008. This hearing should include testimony from Treasury Secretary Geithner, who was president of the New York Fed at the time the New York Fed embedded itself at Lehman, former Chairman of the Securities Exchange Commission Christopher Cox, and Richard Fuld, the former Chief Executive Officer of Lehman Brothers. In addition, this Committee should request all relevant documents — including e-mails, phone records, and meeting notes — from the New York Fed, the SEC, and Lehman Brothers regarding the government's supervision of Lehman, Lehman's access to the Federal Reserve's credit facilities, and efforts to rescue or sell Lehman in September 2008.

Thank you for the consideration of my request.

Sincerely,

A handwritten signature in black ink, appearing to read "Spencer Bachus", written over the word "Sincerely,".

Spencer Bachus
Ranking Member