Statement of the Honorable Jackie Speier
House Committee on Financial Services
Hearing on the Effect of the Lehman Brothers Bankruptcy on State and Local Governments
May 5, 2009

Chairman Frank, Ranking member Bachus, and colleagues:

I thank you for convening this hearing today to examine the devastating impact the failure of Lehman Brothers has had on state and local governments and other publicly funded entities. Although my district has been hit particularly hard, this truly is a national problem, as you will hear from the witnesses today from California, Colorado and Florida. There are affected communities in at least 20 states, from Alaska to Washington to Massachusetts. Some of the losses are relatively small—only $18 in Tennessee as far as we can tell—but Minnesota lost more than $56 million, Missouri lost $50 million, Oregon lost $173 million, and Arizona lost $61 million. You will hear from one of today's witnesses that Florida, already hurt hard by natural disasters and the recession, lost more than $465 million.

I would like to ask for unanimous consent to enter testimony from some other affected entities into the record.

As you know, Ms. Eshoo and I have introduced a bill—HR 467—that would require the Treasury Department to repurchase certain Lehman investments held by these government entities at full face value using TARP funds. The Treasury Department asserts it still has more than $135 billion left in its TARP arsenal. It has used hundreds of billions of those taxpayer funds to save Wall Street. We are asking that it use just $1.7 billion of those taxpayer provided funds to save Main Street.

Lets be clear. Lehman is the only major investment bank the federal government did not prop up last September when Wall Street went into freefall, seemingly overnight. Bear Stearns, the first to be helped - and deemed “too big to fail”, was half the size of Lehman Brothers. Negotiations the weekend of September 13 between the Treasury, the Fed, Lehman Brothers and Merrill Lynch resulted in Merrill - with Treasury’s help - being acquired by Bank of America. Goldman Sachs and Morgan Stanley were each allowed to become bank holding companies. Lehman then was allowed to go into bankruptcy—the largest in our history. In the words of Nobel Prize winner Paul Krugman, the decision to let Lehman fail was the event that “basically brought the entire world capital market down.”

The decision by the Treasury and Fed to allow Lehman to fail was arbitrary and caught many taxpayer-funded agencies unprepared. They had watched the takeover of Countrywide by Bank of America and the bailout and takeover of Bear Stearns by JP Morgan and concluded, like many others, that since in those cases noteholders had been made whole, Lehman was unlikely to declare bankruptcy. But Secretary Paulson did not offer Lehman the same guarantees it had offered the others. And if these local governments had chosen to sell their Lehman investments prior to maturity, they would have suffered a definite and substantial loss, negatively affecting the whole investment pool.

It is not like these government bodies were using taxpayer funds to speculate in the market. The public agencies we are talking about invested in Lehman corporate bonds and notes as part of a strict, safe and conservative investment strategy. In fact, most of the debt instruments in question were highly-rated right up until the moment of Lehman's collapse. San Mateo County's pooled investments in Lehman were rated A-1 for its "floating rate" securities and A for its corporate bond. That investment Pool is prohibited under state law from investing in equities, and is limited to conservative instruments such as US Treasury obligations, highly rated commercial paper, certificates of deposit and the like. Preservation of principal is of primary importance—to minimize credit risk while recognizing and controlling market risk, matching maturities with capital expenditures and other planned outlays. Diversification plays a big role in that effort. San Mateo County only invested 5.9% of its pool in Lehman as part of its diversification strategy. It also holds similar investments with Morgan Stanley.

These local governments provide critical services and programs that every American family and business relies on to protect public safety, provide healthcare services, respond to emergencies and educate our children. Given our current economic situation, these services are more essential than ever, and the local governments providing them are already struggling with greater demand for services and declining tax revenues to fund them. These losses represent hundreds of jobs lost for construction, teachers, public safety, healthcare, and other services, and class rooms, fire stations, jails and other projects that will halt or never get started.

I believe the Treasury already has the power to do what we are asking. Section 103 of the Emergency Economic Stabilization Act, that we passed last Fall, instructs the Treasury Secretary to take into consideration "the need to ensure stability for United States public instrumentalities, such as counties and cities that may have suffered significant increased costs or losses in the current market turmoil." We requested that Secretary Paulson take such action last Fall, and we have made the same request of Secretary Geithner in February, but have gotten no response.

There seems to be no limit to the amount of assistance we are willing to provide to the likes of AIG, Citigroup, Bank of America, and Goldman Sachs, let alone the foreign interests whose speculative derivative deals have been fully paid through the taxpayer-funded bailout of AIG. Goldman not only has been the beneficiary of $10 billion of TARP money directly, but it has gotten another $13 billion through its credit default swaps with AIG. All while it reported a $1. 8 billion quarterly profit and is seeking to repay its $10 billion in TARP funds because it doesn’t like the compensation strings that come with it. If AIG had been forced to declare bankruptcy, the financial institutions like Goldman doing business with it would have wound up in court, just like San Mateo County has had to do with Lehman, fighting to get pennies on the dollar for their claims. I say let Goldman repay its bailout and use that money where it is really needed—our local communities.

Restoring the value of these Lehman Bonds is perhaps the fastest way to bring relief to communities across America, allowing them to pay their employees, maintain current levels of service and immediately put shovels in the ground on already approved projects.

Maybe in the grand scheme of things $1.7 billion is just not seen as a big enough problem. To the local governments, school districts, sanitation and water districts and the communities they serve, these losses are devastating. How ironic that they should be left wishing they had invested in credit default swaps with AIG—if they had we wouldn’t have to be here today.