**CLIFF STEARNS**
6TH DISTRICT, FLORIDA

**WASHINGTON:**
2370 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–0906
(202) 225–5744
FAX: (202) 225–3973
www.house.gov/stearns

**AIR FORCE CAUCUS,** CO-CHAIRMAN
**CHRONIC OBSTRUCTIVE PULMONARY DISEASE CAUCUS,** CO-CHAIRMAN
**CYSTIC FIBROSIS CAUCUS,** CO-CHAIRMAN
**CONGRESSIONAL HORSE CAUCUS,** CO-CHAIRMAN

# Congress of the United States
## House of Representatives
### Washington, DC 20515–0906

**COMMITTEE ON ENERGY AND COMMERCE**
SUBCOMMITTEES:
COMMUNICATIONS, TECHNOLOGY, AND THE INTERNET
RANKING REPUBLICAN MEMBER
ENERGY AND ENVIRONMENT
COMMERCE, TRADE, AND CONSUMER PROTECTION

**COMMITTEE ON VETERANS' AFFAIRS**
DEPUTY RANKING REPUBLICAN MEMBER
SUBCOMMITTEES:
HEALTH
OVERSIGHT AND INVESTIGATIONS

October 22, 2010

Phil Angelides
Chairman
Financial Crisis Inquiry Commission
1717 Pennsylvania Ave, N.W.
Suite 800
Washington, DC 20006-4614

Dear Chairman Angelides:

As your work at the congressionally created Financial Crisis Inquiry Commission (FCIC) begins to wind down, I write to draw your attention to a troubling matter involving former Treasury Secretary Henry Paulson, who testified before the Commission in May of this year. New evidence demonstrating Mr. Paulson had a clear conflict of interest during his time as Secretary of the Treasury and deliberately acted in the best interest of his former firm, Goldman Sachs, instead of in the interest of the American people, warrants the immediate attention of this Commission.

In a recent front-page article in the Miami Herald, former senior thrift regulator William Black pointed out that "No one was better positioned…than Mr. Paulson to understand exactly what the implications of his moving against the (housing) bubble would have been for Goldman Sachs, because he knew what the Goldman Sachs positions were." Mr. Black, who testified before the FCIC on September 21, 2010, went on to say that Mr. Paulson "knew that if he acted the way he should, that would have burst the bubble. Then Goldman Sachs would have been left with a very substantial loss, and that would have been the end of bonuses at Goldman Sachs." In addition, Richard Newsom, former senior thrift examiner and key investigator of the Lincoln Savings and Loan debacle of the 1980s, wrote to Congress detailing the regulatory lapses that he believes contributed to the financial crisis and has stated that it was "simply implausible that Paulson couldn't see the relation between delaying strong action by Treasury and the benefit to letting places like Goldman" reduce their risks.

Mr. Paulson's inaction and perhaps intentional failure to perform a required duty during his first 15 months as Secretary reveal his complicity in putting Wall Street before Main Street. During that time of government inaction, Goldman Sachs was able to sell off over $30 billion in toxic residential mortgage securities to pension funds, foreign banks and other investors, thus enabling the firm to safely exit a housing market that was on the brink of collapse. Goldman Sachs also managed to make huge profits by betting against

**OCALA**
115 S.E. 25TH AVENUE
OCALA, FL 34471
(352) 351–8777

**GAINESVILLE**
5700 S.W. 34TH STREET, #425
GAINESVILLE, FL 32608
(352) 337–0003

**ORANGE PARK**
1726 KINGSLEY AVENUE, #8
ORANGE PARK, FL 32073
(904) 269–3203

PRINTED ON RECYCLED PAPER

the very securities they were selling to unwitting investors. For this, they faced a civil fraud suit and paid a fine of $550 million to the Securities and Exchange Commission (SEC).

As you are aware, during Mr. Paulson's time at Goldman Sachs as its chief executive, the firm immersed itself into the business of purchasing risky subprime mortgages and subsequently repackaging them into securities and selling them off. Later, Goldman turned around and made billions in profits by betting against those same toxic mortgage securities. Under Mr. Paulson, Goldman Sachs took huge positions in a fraud-infested market. In fact, a much-noted 2006 Business Week article hailed Henry Paulson for being "one of the key architects of a more daring Wall Street, where securities firms are taking greater and greater chances in their pursuit of profits."

Upon becoming Treasury Secretary in mid 2006, Mr. Paulson chose not to address the risky mortgage lending practices that were rampant in the subprime market – the very same practices his former firm, Goldman Sachs, was taking advantage of and that Mr. Paulson himself had overseen as chief executive. What was the reason for Mr. Paulson's inaction?

In addition to Mr. Paulson's seemingly deliberate inaction during his first year as Treasury Secretary, the aforementioned Miami Herald article by Greg Gordon reveals that Mr. Paulson was not fully divested from Goldman Sachs. The article reports that despite other divestments Mr. Paulson was forced to make under government ethics rules, Mr. Paulson's wife and his son remained trustees of the Paulsons' Bobolink Foundation, which was backed by over $100 million in Goldman Sachs stock. According to the article, the Paulsons' foundation still had $33.5 million invested in Goldman Sachs funds more than a year and half into Mr. Paulson's term as Treasury Secretary.

Respectfully, I would like to request that the FCIC investigate the claims made by former regulators William Black and Richard Newsom and determine whether Mr. Paulson's inaction constituted nonfeasance, which according to tort law is a passive failure to act when under an obligation to do so, or if his actions constituted misfeasance or even malfeasance, whereby Mr. Paulson actively took part in actions that caused harm and caused the financial meltdown. The Commission should kindly keep in mind that Mr. Paulson had the needed authority and influence to ensure our financial regulatory agencies put a stop to the risky lending practices that led to the crisis. Furthermore, I ask the Commission to determine whether the Office of Government Ethics explicitly allowed Mr. Paulson to keep millions in Goldman Sachs stock through his foundation while he was still serving as Secretary, or whether Mr. Paulson did so without government approval.

To the detriment of American taxpayers, Mr. Paulson has refused to comment on these serious charges. As such, I believe the FCIC is poised to shed light on the accusations surrounding Mr. Paulson's seemingly deliberate inaction and his clear conflicts of interest with former firm Goldman Sachs.

Thank you for your continued leadership as Chairman of the Financial Crisis Inquiry Commission and for the hard work the Commission has done on behalf of the American people. I look forward to the Commission's final report at the end of the year.

With kind regards, I am

Sincerely,

Cliff Stearns
United States Representative

CS:nda

Cc: the Honorable Bill Thomas, Commission Vice-Chairman

enclosure

The Miami Herald
Posted on Sun, Oct. 10, 2010

# Inaction by Treasury's Paulson a boon to Wall Street

By GREG GORDON
McClatchy Newspapers

Henry Paulson has received widespread acclaim for his bare-knuckled decision-making as the treasury secretary at the peak of the 2008 financial crisis, but former federal regulators say he missed multiple chances to contain the disaster.

Among the prime beneficiaries of Paulson's inaction in 2006 and 2007 was Goldman Sachs, the investment banking behemoth he ran before he was named to former President George W. Bush's Cabinet.

Paulson's failure to intervene also enabled top executives of other Wall Street firms to continue cashing big bonus checks, while less privileged Americans lost their jobs, their homes and their retirement savings in the worst economic catastrophe since the Great Depression.

Paulson and Federal Reserve Chairman Ben Bernanke have been widely praised for engineering the Wall Street bailouts, which avoided systemic chaos, and they'll probably get more plaudits if the government recovers much of the $400 billion in loans it made to financial institutions.

But while Paulson has been criticized, unfairly or not, because $12.9 billion of the bailout money went to Goldman, he's drawn little scrutiny for what he did in his first 18 months in office, during the final frenzied stages of the housing bubble.

In his eight years as Goldman's chief executive, Paulson had presided over the firm's plunge into the business of buying up subprime mortgages to marginal borrowers and then repackaging them into securities, overseeing the firm's huge positions in what became a fraud-infested market.

During Paulson's first 15 months as the treasury secretary and chief presidential economic adviser, Goldman unloaded more than $30 billion in dicey residential mortgage securities to pension funds, foreign banks and other investors and became the only major Wall Street firm to exit the housing market safely. Goldman also racked up billions of dollars in profits by secretly betting on a downturn in home mortgage securities.

"No one was better positioned ... than Mr. Paulson to understand exactly what the implications of his moving against the (housing) bubble would have been for Goldman Sachs, because he knew what the Goldman Sachs positions were," said William Black, a former senior thrift regulator who delivered the harshest criticism of the former secretary.

Paulson "knew that if he acted the way he should, that would have burst the bubble. Then Goldman Sachs would have been left with a very substantial loss, and that would have been the end of bonuses at Goldman Sachs."

Black has emerged as a leading expert on the subprime meltdown and has testified multiple times to congressional committees and to the Financial Crisis Inquiry Commission, the congressionally appointed panel that's investigating the causes of the disaster.

A second Paulson critic, retired senior thrift examiner Richard Newsom, wrote to Congress about the regulatory lapses that he said contributed to the crisis. In a phone interview, he said that it was "simply implausible that Paulson couldn't see the relation between delaying strong action by Treasury and the benefit to letting places like Goldman" reduce their risks.

Newsom gained a reputation as a super-sleuth while working with Black to investigate Charles Keating's California-based Lincoln Savings and Loan, which imploded and cost taxpayers $2 billion in the 1980s to pay off the thrift's losses.

In July, Goldman paid $550 million to settle a Securities and Exchange Commission civil fraud suit over its 2007 sale of one offshore bundle of risky mortgage securities. It faces private lawsuits alleging fraud in similar deals.

Paulson declined to be interviewed or to respond to questions for this article. However, an extensive review by McClatchy Newspapers of his public record - including his recently published book on the crisis, "On the Brink," his speeches, policy statements and testimony to congressional panels during and after his time in office - has found no evidence that he sought to curb risky mortgage lending before the subprime market froze in 2007.

A Goldman Sachs spokesman said that the firm knows of no communication with Paulson's office requesting a delay in a federal crackdown on subprime lenders.

Paulson has testified that upon taking office on July 10, 2006, he ordered aides to prepare for the "next crisis," though he didn't know what it might be. He said that he "saw immediately ... huge gaping holes in the regulatory system" and "put a plan in place" to mitigate risks. However, he said he lacked the authority to intervene in specific matters with two key enforcement agencies that he oversaw.

But Black, Newsom and other experts whom McClatchy interviewed said that Paulson had all the authority and influence he needed as Bush's chief economic adviser and could have had the heads of the two financial regulatory agencies fired if they refused to rein in the risky lending.

The government's failure to limit risky lending before the crisis is all the more puzzling because an assistant FBI director, Chris Swecker, was so concerned about mortgage fraud in September 2004 that he called a news conference to issue a public warning. Swecker said that fraud in home loans was threatening to reach "epidemic" proportions

and trigger a repeat of the 1980s S&L debacle, which cost taxpayers more than $100 billion.

Silicon Valley real estate and mortgage broker Michael Blomquist had grown so upset about mortgage fraud that he shuttered his business in January 2004 and began warning federal regulators about the looming "perfect storm" in the housing industry.

Federal inaction instead kept the bonuses flowing on Wall Street.

In 2006 and 2007, as the housing bubble finally burst, Goldman distributed $22.3 billion in year-end profit-sharing rewards to its 31,000 employees and $112 million in bonuses to Paulson's successor, Lloyd Blankfein, company financial disclosures show.

Collectively, Citigroup and four other Wall Street investment houses with sizable subprime businesses awarded their CEOs more than $180 million in salaries and bonuses in 2006 and 2007, the firms' SEC disclosures show.

Paulson was already a billionaire when he left Goldman on June 28, 2006. On his way out the door, the firm awarded him an $18.7 million bonus and $110 million for the nearly 1.2 million restricted company shares and stock option grants he'd accrued. Government ethics rules forced Paulson and his wife, Wendy, to divest $490.9 million in Goldman common stock and their interests in 43 investment funds. Paulson put at least $375 million in additional assets into a blind trust.

However, the Paulsons didn't sever all their financial ties to Goldman. Wendy Paulson and their son, Henry III, remained trustees of the Bobolink Foundation, which the bird-watching couple had launched years earlier to support environmental causes and backed with more than $100 million of Paulson's Goldman stock. The foundation still had $33.5 million invested in Goldman funds 18 months into Paulson's term as treasury secretary.

Black said that as CEO, Paulson had to know when he left Goldman that the firm's subprime mortgage exposure imperiled its future.

By June 30, 2006, Goldman had amassed an inventory of $80.7 billion in home mortgage securities, according to a person who saw the internal figure, who insisted on not being identified because of the sensitivity of the information.

A senior Goldman official, who was made available on the condition of anonymity, said the figure exaggerated the firm's exposure because it included safer investments in securities issued by Fannie Mae and Freddie Mac, the giant, quasi-government agencies that hold more than $5 trillion in U.S. home loans. As it turned out, Fannie's and Freddie's stock plummeted, too, after they eventually got into the subprime market, ran up huge debts and Paulson led their government seizure in September 2008.

Goldman has said it was acting as a middleman for clients in most of its residential mortgage dealings, but it's also acknowledged that it faced major exposure in December 2006, when senior company officials decided to reduce the firm's housing risks.

Goldman had effectively bet against the housing market in 2004 and 2005, when Paulson was still the CEO, buying billions of dollars in insurance protection on subprime securities. At the end of 2006, Goldman says, it decided to sell off its mortgage securities while stepping up those bets against the market.

It's unclear when Paulson first learned about his former firm's stealthy exit strategy.

Goldman spokesman Michael DuVally said that the firm decided to "reduce our mortgage exposure ... based on the conditions we saw in the market," and is "not aware of any communication with Treasury on this topic, nor would we ever expect to have this kind of communication."

DuVally said that Goldman sustained $2.9 billion in net mortgage-related losses in 2007 and 2008. The firm, however, also earned $1.5 billion to $2 billion in a settlement of exotic mortgage bets disclosed last spring, with $3 billion in unsettled bets outstanding.

In testimony last May to the Financial Crisis Inquiry Commission, Paulson said he didn't recognize the scale of the disaster until it was too late and couldn't have stopped it anyway because so many bad loans already had been issued that "most of the toothpaste was out of the tube."

Criticism for botched regulatory judgments has fallen mainly on lower-level officials and on Bernanke's predecessor at the Fed, Alan Greenspan, who failed to use the federal government's authority to regulate non-bank mortgage lenders, which originated 80 percent of the $2.5 trillion in subprime loans.

Paulson, however, oversaw two regulatory agencies that supervised federally insured institutions, which accounted for the remaining 20 percent: the Office of Thrift Supervision, which policed savings and loans, and the Office of the Comptroller of the Currency, which regulated banks.

The Office of Thrift Supervision demurred even though lenders it regulated, such as Seattle-based Washington Mutual Bank, had assumed enormous risks with exotic mortgage products. Washington Mutual Inc. - WaMu's parent, with $307 billion in assets - collapsed in September 2008 in the biggest bank failure in U.S. history.

For its part, the comptroller of the currency has been under fire for adopting rules in 2004 that precluded state agencies from bringing actions against national banks under predatory lending laws.

In his book, Paulson wrote that when he took office, "I chose to define my role broadly."

In fleeting mentions of the Office of Thrift Supervision and the Office of the Comptroller of the Currency, though, he said he was barred by law from "interfering" with their specific regulatory matters, so he made sure that financial regulators met frequently and coordinated actions.

However, in response to McClatchy Freedom of Information Act requests for all

communications between Paulson's office and the Office of Thrift Supervision and between his office and the Federal Deposit Insurance Corp. about the looming subprime dangers, both agencies said that no such records existed.

Black, who was a senior vice president and general counsel of the Federal Home Loan Bank of San Francisco during the S&L crisis, disputed Paulson's narrow reading of his authority. He said that Paulson was prohibited from interceding in specific cases, but easily could have weighed in with the two agencies' enforcement strategies or asked Bush to replace their leaders.

Paulson "is condemned first and foremost for lack of leadership and a lack of honesty," said Christopher Whalen, who watches over Wall Street as a managing director of Institutional Risk Analytics. "He can't say it's not his job. ... As a Cabinet official and as a fiscal officer of the United States, he has a keen interest in systemic risk."

Paulson's inaction in late 2006 and 2007 came during a period when lending criteria were disintegrating in favor of so-called "liars' loans," for which applicants weren't required to document their income, said Black, who's now an associate professor of economics and law at the University of Missouri-Kansas City.

The most dangerous loans offered teaser interest rates that would shoot higher in two to five years and saddle borrowers with crushing monthly payments. From Jan. 1, 2006, through 2007, mortgage lenders issued more than $1.6 trillion worth of these types of loans, according to data from the industry newsletter Inside Mortgage Finance.

Black and other former regulators said that Paulson could have reined in this flood of loans by:

-Directing the Office of Thrift Supervision to beef up its dwindling number of thrift examination teams and to prohibit subprime lending by federally insured firms such as Countrywide Savings and Loan, the IndyMac Bank and WaMu, which together issued more than $360 billion in dicey mortgages in 2006, according to International Monetary Fund data and company disclosures.

-Pressing Comptroller of the Currency John Dugan to rescind his agency's 2004 rules barring state enforcement agencies from cracking down on abusive lending tactics.

-Using his influence in the Bush administration to stop Fannie Mae and Freddie Mac from buying subprime securities and allowing the industry to grow even bigger.

-Weighing in against proposed international banking standards, which subsequently went into effect, that would allow foreign banks to hold low reserves when they bought Triple A-grade securities, such as subprime bonds whose ratings were grossly inflated.

While forgoing those steps, Paulson repeatedly voiced opposition to what he considered over-regulation of banks and investment banks. He particularly complained about a provision in the 2002 Sarbanes-Oxley securities restructuring law that requires corporate officers to submit sworn statements to the SEC vouching that their firms' internal financial

controls were adequate.

Like Bernanke and Greenspan, Paulson and his aides have testified to congressional panels and the Financial Crisis Inquiry Commission that they lacked the tools to recognize the scope of the systemic problems until it was too late.

"We all made mistakes," Paulson told the commission in May.

© 2010 Miami Herald Media Company. All Rights Reserved.
http://www.miamiherald.com