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HEARING RE BANK OF AMERICA

AND MERRILL LYNCH: HOW DID A

PRIVATE DEAL TURN INTO A

FEDERAL BAILOUT? PART II

Thursday, June 25, 2009

House of Representatives,

Committee on Oversight and Government Reform,

Joint with

Subcommittee on Domestic Policy,

Washington, D.C.

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Committee Hearings

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The committees met, pursuant to call, at 10:00 a.m., in Room 2154, Rayburn Hon. Edolphus Towns [chairman of the committee] presiding.

Present: Representatives Towns, Kanjorski, Maloney, Cummings, Kucinich, Tierney, Clay, Watson, Lynch, Connolly, Quigley, Kaptur, Norton, Davis, Cuellar, Welch, Foster, Speier, Issa, Burton, Souder, Duncan, Turner, McHenry, Bilbray, Jordan, Fortenberry, Chaffetz, and Schock.

Staff Present: John Arlington, Chief Counsel - Investigations; Brian Eiler, Investigative Counsel; Jean Gosa, Clerk; Adam Hodge, Deputy Press Secretary; Carla Hultberg, Chief Clerk; Marc Johnson, Assistant Clerk; Mike McCarthy, Deputy Staff Director; Jesse McCollum, Senior Advisor; Ophelia Rivas, Assistant Clerk; Jenny Rosenberg, Director of Communications; Joanne Royce, Senior Investigative Counsel; Christopher Sanders, Professional Staff Member; Christopher Staszak, Senior Investigative Counsel; Ron Stroman, Staff Director; Jaron Bourke, Staff Director, Subcommittee on Domestic Policy; Brady Lawrence, Minority Staff Director; John Cuaderes, Minority Deputy Staff Director; Jennifer Safavian, Minority Chief Counsel for Oversight & Investigations; Dan Blankenberg, Minority Director of Outreach & Senior Advisor; Adam Fromm, Minority Chief Clerk & Member Liaison; Kurt Bardella, Minority Press Secretary; Seamus Kraft, Minority Deputy Press Secretary; Benjamin Cole, Minority Deputy Press Secretary; Christopher Hixon, Minority Senior Counsel; and Brien Beattie, Minority Professsional Staff Member.

Chairman TOWNS. The committee will come to order.

Today we are continuing our investigation of Bank of America's acquisition of Merrill Lynch. This was a most unusual transaction.

On September 15th, 2008, Bank of America announced that it was purchasing Merrill Lynch, creating one of the Nation's largest financial institutions. At the time it was a merger negotiated between two private parties designed for the exclusive benefits of private shareholders and paid for exclusively with private money.

Four months later, on January 16, 2009, the world discovered that Merrill Lynch had experienced a $15 billion fourth quarter loss. Most importantly, we discovered that the merger had taken place only after the Federal Government had committed to give Bank of America $20 billion in taxpayer money.

In short, Bank of America's acquisition of Merrill Lynch began in September 2008 as a private business deal, and was completed in January 2009 with a $20 billion tax bailout.

What happened in the interim has been shrouded in secrecy. But the broad outline is this: When Bank of America urged its shareholders to approve the acquisition of Merrill Lynch on December 5, 2008, there was no public disclosure of any problems with the transaction. However, Bank of America's CEO Ken Lewis has testified that just 9 days after the shareholder vote, he discovered a $12 billion loss at Merrill Lynch. Mr. Lewis said he told then Treasury Secretary Hank Paulson that he was strongly considering backing out of the deal. According to Lewis, Paulson ultimately told them that if he didn't go through with the acquisition he and the board would be fired.

Internal e-mails we have obtained from the Federal Reserve indicates officials there were very skeptical about Mr. Lewis' motives in threatening to back out of the Merrill Lynch deal. Fed Chairman Ben Bernanke thought Lewis was using the Merrill losses as a bargaining chip to obtain Federal funds. FDIC Chairwoman Sheila Bair was opposed to providing assistance saying, "My board does not want to do this."

In essence, Ken Lewis claimed that, "The government made me do it." But was Bank of America forced to go through with the deal, or was this just an old-fashioned shakedown?

These questions are particularly important, given the administration's new proposal to give broad new powers to the Federal Reserve. I believe that before Congress acts on the President's financial services reform proposal, we need to have a thorough understanding of what caused the current financial crisis and how the Federal Government responded.

Unfortunately, much of what the Fed, the Treasury, and other agencies did in these transactions remain shrouded in secrecy. It is time to yank the shroud off the Feds and shine some light on these events.

The Bank of America-Merrill Lynch deal is a case in point. New e-mails we have obtained from the Fed indicate that Fed officials may have attempted to keep other agencies in the dark about what was going on. A Fed e-mail discusses not telling the Office of the Comptroller of the Currency what is happening. Others discuss how to minimize the amount of information given to the SEC. In a remarkable exchange, Fed officials note that an SEC official can be counted on to be discreet.

I am not going to prejudge the issues. At this point we are not even close to finishing this investigation. Bank of America's CEO Ken Lewis gave us his story. Now it is Fed Chairman Bernanke's turn to give his side of the story. Next, it would be former Treasury Secretary Hank Paulson to give his side. We need to get all the facts out on the table before we are in a position to say what happened and when it happened. But I promise you this, we will follow this investigation wherever the road leads, and we will do our best to make sure the facts get out on the table where everyone can see them, by subpoena, if necessary.

Let me stop and thank Chairman Bernanke for coming today to this hearing, and I look forward to your testimony.

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

Mr. ISSA. Thank you, Mr. Chairman, for holding this second hearing in a series today. Our work together on a bipartisan basis should in fact be a model for all the Members of Congress.

Today, Chairman Bernanke is here as part of this process not because of one side or the other, but because we came to a consensus that for all the good work in a financial crisis, Oversight still needed to discover what was or wasn't done, was it consistent with the kind of behavior behind closed doors that we would like to always know is going on even when appropriately government shares information only discreetly with other government agencies.

Additionally, yours and my role as reformers is critical in a process in which the President's financial reform system or proposal has included broad and sweeping increases in Chairman Bernankeor his successor's powers.

Additionally, former Secretary Paulson, acting in good faith and in concert, in fact deserves his opportunity to tell us about the events.

Let there be no doubt, Mr. Chairman, all of us on the dais are aware that, 24/7, leaders of the Fed, the Treasury, the FDIC, the OCC, and the SEC all worked diligently to get us out of a financial crisis that was many years in the making, in almost every case not something in which those getting us out participated in in a direct way, and in fact was done in the best interests of the American people. And I want to thank Chairman Bernanke for his effort and his major role in that effort, which is still ongoing today.

Through the committee's investigation, we have learned the Federal Government, led by both Chairman Bernanke and then Secretary Paulson, made certain threats against Ken Lewis during a time in which he was in fact considering pulling out or renegotiating the Merrill Lynch merger. There have been conflicting reports under oath by Ken Lewis and by Secretary Paulson about what occurred. To his credit, Chairman Bernanke has been quick to give us written responses, both publicly and privately, that today we would hope lead to a thorough understanding of whether in fact there is a vast misunderstanding of what a threat was, what the intent was, whether or not what we often call and I have called a coverup was in fact simply appropriately determining why an agency should be not informed. I for one personally doubt that all of these can be explained away, but it is very possible that today hindsight will show us that if we all had to do it again, we would do it differently.

I think it is important today that we give Chairman Bernanke a full and complete opportunity to talk about the environment in which he was working, his desires and reasons for doing what he did, and where the discussions that he might or should or could perhaps replace the board and the CEO of Bank of America may have in fact been blown out of proportion, may have been misunderstood. I for one, though, am looking at Main Street America, the stockholders who in some cases got less than they would have gotten through other means. This includes Chrysler, General Motors, and of course Bank of America and Merrill Lynch.

I am also deeply concerned that, going forward, if the systemic risk proposal by the President, which would give vast authority over any entity, bank or otherwise, that represents a potential systemic risk is to be given to an agency, and if that, Mr. Chairman, is to be the Fed; and if that power is used, what will be the oversight? What will be the consultation? How will we know that, although the Fed has the lead, will the SEC, the OCC, and other agencies charged with their responsibilities always be kept informed?

I appreciate today, Mr. Chairman, that not everyone on the dais agrees that the focus is on what was done behind closed doors relating to this merger. Others may say, and it is their prerogative, that the question is, what did officers and directors of these companies do? I for one am also interested to hear that, but today primarily I would like to understand how we can have statements made by government officials be so different, and why the evidence provided today to us in the way of e-mails and other documentation appears to see changes and disagreements that cannot be explained away.

Mr. Chairman, I look forward to continuing this on a bipartisan basis. Your support and friendship and our ability to work together in a way not often found in Congress has made this Congress more effective, this committee more effective, and I thank you for your service, and yield back.

Chairman TOWNS. Thank you very much. I thank the ranking member for his statement and thank him for his words as well, kind words.

At this time I yield to the ranking member of the Subcommittee on Domestic Policy for 5 minutes, and of course the gentleman from Cleveland who has done a fantastic job, Congressman Kucinich.

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

Contrary to the popularly held belief that the government went too far in the Bank of America-Merrill Lynch deal, our investigation reveals that what is remarkable is what the government did not do.

In two meetings in December 2008, Bank of America's Ken Lewis asserted that he had only recently become aware of the deteriorating situation at Merrill Lynch. He asserted that he believed he could justify invoking the Material Adverse Event Clause, the MAC, to back out of the deal. And he asserted that he needed considerable help from the government, including $13 billion more in new cash, as well as protection from Merrill Lynch's losses.

Staff and officials at the Fed looked more closely for the basis for Lewis' assertions, and determined--and this is a quote--that they were somewhat suspect. End quote. The Fed found, in contradiction to Ken Lewis' representations, that Bank of America failed to do adequate due diligence in acquiring Merrill Lynch. The Fed found that Bank of America had known about accelerating losses at Merrill Lynch since mid-November, when shareholders could have used that information to decide on a ratification of the merger. And senior officials at the Fed believed that Bank of America could be in violation of securities laws for failing to inform shareholders about the Merrill Lynch losses known in mid-November. Furthermore, they believed that Ken Lewis' threat of invoking a MAC was a bargaining chip and was not credible; that Bank of America was experiencing its own losses independent of Merrill Lynch, and needed to be bailed out itself, and that there were serious doubts about the competence of Bank of America's management.

Yet in spite of the Fed's doubts felt about Ken Lewis' management of Bank of America, the Fed's leadership orchestrated an aid package that attached no meaningful conditions to the money. The Fed required no changes whatsoever in Bank of America's deficient corporate leadership. The Fed even gave Bank of America more money than what Ken Lewis had originally asked for.

The disconnection between the Fed's analysis of what went wrong at Bank of America and what the Fed was willing to do about it is significant for all of us and is the subject of today's hearing.

If the Bank of America-Merrill Lynch merger posed a systemic risk in December 2008, the post-rescue merger entity continues to pose a systemic risk or potential systemic risk in 2009. If bad decisions by corporate management can have systemic consequences, then the Fed's remedy in the Bank of America-Merrill Lynch case amplifies the risk posed by poor corporate leadership, because it signals that incompetence practiced by the management of a very large financial institution will be subsidized, not punished, by government regulators.

The Fed's decisionmaking process in the Bank of America-Merrill Lynch merger makes the case for a significant increase in accountability at the Fed. Its regulation of systemic risk needs to be subject to congressional oversight. Its interventions in markets to recover from the current financial crisis need to be audited by the Government Accountability Office, as I proposed in a bill and in an amendment adopted unanimously by this committee.

We can't afford to make the Fed a super regulator, as some have proposed, without also increasing its transparency in meaningful ways, as this committee has proposed through the Kucinich amendment.

I want to thank the chairman for the opportunity to work with you on this hearing, and I look forward to Mr. Bernanke's testimony. And I want to thank you, sir, for being here today. Thank you.

Chairman TOWNS. I thank the gentleman from Ohio.

We will now yield 5 minutes to the ranking member of the Domestic Policy Subcommittee, Congressman Jordan of Ohio.

Mr. JORDAN. Thank you, Mr. Chairman. I have a brief statement here.

Thank you for holding today's hearing on the government's involvement to purchase Merrill Lynch. I appreciate Chairman Bernanke's appearance before the committee today. His testimony is important to bring further transparency to the role of the Federal Government in the Bank of America-Merrill Lynch transaction and the overall financial crisis.

I am troubled by the information and documents that the committee's investigation has uncovered. They show that Mr. Bernanke and Mr. Paulson threatened to fire Ken Lewis and his board of directors in order to force the Bank of America to acquire Merrill Lynch.

I recognize that these actions took place in a time of significant economic challenges and uncertainty, but there must be limits to government action even in a time of crisis, and those limits must be respected. We must also keep in mind that this pressure was exerted after many of the Nation's banks were forced to accept taxpayer money through the TARP program. We know that in October of 2008, Mr. Paulson, Mr. Bernanke, Mr. Geithner, and Ms. Bair brought the CEOs of the largest private banks in America to the Treasury Department and demanded that they accept a partial nationalization of their banks. I look forward to learning more about Mr. Bernanke's role in this process as well.

Thank you again, Mr. Chairman. I would ask for unanimous consent to include in the record majority and minority reports and all documents referenced in those reports.

Chairman TOWNS. Without objection, so ordered.

[The information follows:]

******** COMMITTEE INSERT ********

Chairman TOWNS. Mr. Bernanke, it is a longstanding policy that we swear all of our witnesses in. Please stand and rise your raise your right hand.

[Witness sworn.]

Chairman TOWNS. Let the record reflect that the witness answered in the affirmative.

Mr. Bernanke, we would like for you to summarize your statement in 5 minutes, which will allow the members to raise questions with you. And of course, we have a light there. When it starts out, it starts out on green and then it goes into yellow and then it goes into red. Red means stop. So we thank you for that.

Thank you very much. You may begin.

STATEMENT OF BEN S. BERNANKE, CHAIRMAN, FEDERAL RESERVE BOARD

Mr. BERNANKE. Chairman Towns, Ranking Member Issa, and other members of the committee, I appreciate the opportunity to discuss the Federal Reserve's role in the acquisition by the Bank of America of Merrill Lynch.

Chairman TOWNS. Is it on, staff? Help me, because we can't hear him.

Mr. BERNANKE. I believe that the Federal Reserve acted with the highest integrity throughout its discussion.

Chairman TOWNS. We are still having trouble. We have some senior citizens up here. We are having trouble hearing you. Is there any way to turn the volume up on it? There is another one on the floor, a backup on the floor, staff. Better. Thank you very much.

Mr. BERNANKE. I would like the full extent of my time, if I may.

I believe that the Federal Reserve acted with the highest integrity throughout its discussions with the Bank of America regarding that company's acquisition of Merrill Lynch. I will attempt in this testimony to respond to some of the questions that have been raised.

On September 15, 2008, the Bank of America announced an agreement to acquire Merrill Lynch. I did not play a role in arranging this transaction, and no Federal Reserve assistance was promised or provided in connection with that agreement.

As with similar transactions, the transaction was reviewed and approved by the Federal Reserve under the Bank Holding Company Act in November 2008. It was subsequently approved by the shareholders of Bank of America and Merrill Lynch on December 5th. The acquisition was scheduled to be closed on January 1st, 2009.

As you know, the period encompassing Bank of America's decision to acquire Merrill Lynch through the consummation of the merger was one of extreme stress in financial markets. The government-sponsored enterprises, Fannie Mae and Freddie Mac, were taken into conservatorship a week before the Bank of America deal was announced. That same week, Lehman Brothers failed and American International Group was prevented from failing only by extraordinary government action. Later that month, Wachovia faced intense liquidity pressures which threatened its viability and resulted in its acquisition by Wells Fargo.

In mid-October, an aggressive international response was required to avert a global banking meltdown. In November, the possible destabilization of Citigroup was prevented by government action.

In short, the period was one of extraordinary risk for the financial system and the global economy, as well as for

Bank of America and Merrill Lynch.

On December 17, 2008, senior management of Bank of America informed the Federal Reserve for the first time that, because of significant losses at Merrill Lynch for the fourth quarter of 2008, Bank of America was considering not closing the Merrill Lynch acquisition. This information led to a series of meetings and discussions among Bank of America, the regulatory agencies, and the Treasury.

During these discussions, Bank of America's CEO Ken Lewis told us that the company was considering invoking the Material Adverse Event Clause in the acquisition contract, known as the MAC, in an attempt to rescind its agreement to acquire Merrill Lynch.

In responding to Bank of America in these discussions, 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 for three reasons.

First, in light of the extreme fragility of the financial system at that time, the uncertainties created by an invocation of the MAC might have triggered a broader systemic crisis that could well have destabilized Bank of America as well as Merrill Lynch.

Second, an attempt to invoke the MAC after 3 months of review, preparation, and public remarks by the management of Bank of America about the benefits of the acquisition would cast doubt in the minds of financial market participants, including the investors, creditors, and customers of Bank of America, about the due diligence and analysis done by the company, its capability to consummate significant acquisitions, its overall risk management processes, and its judgment of its management.

Third, based on our staff analysis of legal issues, we believed that it was highly unlikely that Bank of America would be successful in terminating the contract by invoking the MAC. Rather, an attempt to invoke the MAC would likely involve extended and costly litigation with Merrill Lynch that with significant probability would result in Bank of America being required either to pay substantial damages or to acquire a firm whose value would have been greatly reduced or destroyed by the strong negative market reaction to the announcement.

For these reasons, I believed that, rather than invoking the MAC, Bank of America's best option and the best option for the system was to work with the Federal Reserve and the Treasury to develop a contingency plan to ensure that the company would remain stable should the completion of the acquisition and the announcement of losses lead to financial stress, particularly a sudden pullback of funding of the type that had been experienced by Wachovia, Lehman, and other firms.

Ultimately, on December 30th, the Bank of America board determined to go forward with the acquisition. The staff of the Federal Reserve worked diligently with Treasury, other regulators, and Bank of America to put in place a package that would help shore up the combined companies' financial position and reduce the risk of market disruption. The plan was completed in time to be announced simultaneously with Bank of America's public earnings announcement which had been moved forward to January 16th from January 20th. The package included an additional $20 billion equity investment from the Troubled Asset Relief Program and a loss protection arrangement, or RingFence, for a pool of assets valued at about $118 billion. The RingFence arrangement has not been consummated, and Bank of America now believes that, in light of the general improvement in the markets, this protection is no longer needed.

Importantly, the decision to go forward with the merger rightly remained in the hands of Bank of America's board and management, and they were obligated to make the choice that they believed was in the best interest of the shareholders and the company. I did not tell Bank of America's management that the Federal Reserve would take action against the board or management if they decided to proceed with the MAC. Moreover, I did not instruct anyone to indicate to Bank of America that the Federal Reserve would take any particular action under those circumstances. I agreed with the view of others that the invocation of the MAC clause in this case involved significant risk for Bank of America as well as for Merrill Lynch and the financial system as a whole, and it was this concern that I communicated to Mr. Lewis and his colleagues.

The Federal Reserve also acted appropriately regarding issues of public disclosure. As I wrote in a letter to this committee, neither I nor any member of the Federal Reserve ever directed, instructed, or advised the Bank of America to withhold from public disclosure any information relating to Merrill Lynch, including its losses, compensation packages, or bonuses, or any other related matter. These disclosure obligations belonged squarely with the company, and the Federal Reserve did not interfere with the company's disclosure decisions.

The Federal Reserve had a legitimate interest in knowing when Bank of America or Merrill Lynch intended to disclose those losses at Merrill Lynch. Given the fragility of the financial markets at that time, we were concerned about the potential for a strong adverse market reaction to the reports of significant losses at Merrill Lynch. If Federal Reserve assistance to stabilize these companies were to be effective, the necessary facilities would have to be in place as of the disclosure date. Thus, our planning was importantly influenced by the company's planned disclosure schedule, but the decisions and responsibilities regarding public disclosure always remained, as it should, with the companies themselves.

A related question is whether there should have been earlier disclosure of the aid provided by the U.S. Government to Bank of America. Importantly, there was no commitment on the part of the government regarding the size or structure of the transaction until very late in the process.

Although we had indicated to Bank of America in December that the government would provide assistance, if necessary, to keep the company from being destabilized, as it had done in other cases during this time of extraordinary stress in financial markets, those December discussions were followed in January by significant and intense negotiations involving the Bank of America, the Federal Reserve, the Treasury, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency regarding many key aspects of the assistance transaction, including the type of assistance to be provided, the size of the protection, the assets to be covered, the terms for payments, the fees, and the length of the facility. The agreement in principle on these items was reflected in a term sheet that was not finalized until just before its public release on January 16, 2009. The Federal Reserve Board and the Treasury completely and appropriately disclosed the information as required by the Congress in the Emergency Economic Stabilization Act of 2008.

In retrospect, I believe that our actions in this episode, including the development of an assistance package that facilitated the consummation of Bank of America's acquisition of Merrill Lynch, were done not only with the highest integrity but have strengthened both companies while enhancing the stability of the financial markets and protecting the taxpayers. These actions were taken under highly unusual circumstances in the face of grave threats to our financial system and our economy. To avoid such situations in the future, it is critical that the administration, the Congress, and the regulatory agencies work together to develop a new framework that strengthens and expands supervisory oversight and includes a broader range of tools to promote financial stability.

I would be pleased to take your questions. Thank you.

[Prepared statement of Mr. Bernanke follows:]

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Chairman TOWNS. Thank you very much for your testimony. I will begin with questions. And then, of course, we will allow each member to have questions.

Chairman Bernanke, did you instruct Hank Paulson to tell Ken Lewis that he and his board would be fired if they backed out of the Merrill deal?

Mr. BERNANKE. I did not.

Chairman TOWNS. Well, I understand that Mr. Paulson told Mr. Cuomo that you did. I just want to share that with you.

Mr. BERNANKE. I did not instruct Mr. Paulson or anyone else to convey such a threat or message to Mr. Lewis.

Chairman TOWNS. Did you personally tell Mr. Lewis that you would fire him or remove the Bank of America board if Mr. Lewis backed out of the Merrill Lynch deal?

Mr. BERNANKE. I did not.

Chairman TOWNS. Ken Lewis testified under oath here and also told his board of directors that you and Mr. Paulson made verbal commitments to him in December of 2008 to provide Bank of America with enough money to fill the hole created by the $12 billion loss created by Merrill Lynch?

In December of 2008, did you promise Mr. Lewis that you would provide Bank of America with enough capital to fill the $12 billion hole created by the losses at Merrill Lynch?

Mr. BERNANKE. I did not promise any specific amount of money. What was committed was the commitment of the government to work in good faith with Bank of America to develop a contingency plan that would ensure the viability of the company in case of a financial crisis.

Chairman TOWNS. Chairman Bernanke, in an e-mail the committee recently obtained under subpoena a top employee of the New York Federal Reserve communicates with your General Counsel regarding questions the SEC had about the Bank of America bailout.

Can you explain why Bank of America would complain about someone talking to the SEC and why it appears that Federal Reserve employees were not completely forthcoming with the SEC about what was going on at Bank of America?

Mr. BERNANKE. Chairman, I can't speak for Bank of America, but I will explain the Federal Reserve's position.

First of all, the Federal Reserve throughout this process has worked closely and collaboratively with the other regulatory agencies. As you know, the SEC has two specific functions. One relates to disclosure. And the Federal Reserve had no issues relating to disclosure. Those were issues for Bank of America and its shareholders.

Its second function has to do with oversight regulation. In that capacity, I am sure the SEC already knew about the losses at Merrill Lynch. From our perspective, the issue was that we needed to work with Bank of America to develop a package that assured the viability of the company in case of financial instability. The Bank of America's regulators besides ourselves were the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, whom we involved continually throughout the process and which I personally spoke to both John Dugan and Sheila Bair to make sure they were informed about the situation.

Chairman TOWNS. So you are saying you were forthcoming?

Mr. BERNANKE. I was, indeed, as appropriate with the other agencies.

Chairman TOWNS. Another e-mail we obtained recently, the head of the FDIC says to you there is strong discomfort with the Bank of America bailout package, and that the FDIC board does not want to do this.

Mr. Bernanke, what were the concerns at the FDIC about the Bank of America's bailout? And why did you and the Treasury Department go through with the bailout despite the concerns that the FDIC had?

Mr. BERNANKE. My recollection of the FDIC's concerns were not with the issues of trying to prevent instability. Their concern was the FDIC's own financial exposure to the deal. They noted that Merrill Lynch was not a bank and, therefore, they wanted to be sure to restrict whatever financial resources they committed to be relevant to the bank rather than to the acquired company. So they had concerns about the structure of the deal as it related to their own financial exposure, but in the end of course they did agree to contribute to the arrangement that the government put together.

Chairman TOWNS. Ken Lewis told the committee 2 weeks ago that he called you and asked you to put in writing the verbal commitment he said you and Hank Paulson made to him regarding a government bailout of the Merrill Lynch deal. What did he say to you exactly during that phone call? What did he say?

Mr. BERNANKE. He wanted to know if we could provide a written description of the commitment that he could use with his board. We were unable to provide such written description because we did not have any deal. We didn't have a transaction completed at that point, And so there was nothing specific that we could commit to. All we had was a good-faith agreement to work together to find some arrangement that would help avoid destabilization of the Bank of America.

Chairman TOWNS. My time has expired. I yield to the ranking member from California.

Mr. ISSA. Thank you, Mr. Chairman.

Following up on the chairman's line of questioning, you said you kept the OCC informed and had personal conversations. Can you explain from your own information you provided to us why Brian Peters of the Federal Reserve Bank in New York would say: Given the presence of the OCC on the call, I think we should not discuss or reference the call with Ken Lewis and Paulson?

Mr. BERNANKE. I don't know precisely what motivated that. All I can tell you is that on the 21st we had two conference calls which I participated in and which John Dugan participated in, and we provided him with all the information that I was aware of at that time.

Mr. ISSA. The e-mail that we received from Jeffrey Lacker, Federal Reserve Bank of Richmond, that indicates that in fact they felt there was pressure related to the MAC, how do you explain that? Is that just another independent person that misunderstood?

Mr. BERNANKE. Well, I don't recall the details of that conversation, but I would like to make two points. First, as I was--

Mr. ISSA. Let me just give you the details to make it accurate. Quote: Just had a long talk with Ben (Bernanke). Says that they think the MAC threat is irrelevant because it is not credible. Also intends to make it even more clear that if they play that card and they need assistance, management is gone.

Now, is he misunderstanding what the conversation he had with you in those quotations?

Mr. BERNANKE. I don't recollect everything that was said in that conversation. I would just like to make again two points, if I may.

Mr. ISSA. I would like to have your recollection. Do you believe that he is incorrect, according to your recollection? Because he is saying in a nutshell you planned to make a threat. Now, you may not have done it, but he is saying you planned. Is he lying?

Mr. BERNANKE. I don't recollect the details of that conversation. I would like to say two things, if I may. First, that as you point out, I never did make a threat. I never did raise this issue with Ken Lewis/Bank of America.

Mr. ISSA. Did you think that pulling the trigger on the MAC was a bargaining chip?

Mr. BERNANKE. May I make my second point?

Mr. ISSA. Briefly.

Mr. BERNANKE. I would just like to point out that what Mr. Lacker referred to was not--he didn't say that if Lewis were to invoke the MAC that he would be fired. He said that if he invoked the MAC and he required assistance, then there would be consequences. I think if somebody makes a decision that results in their company failing and being rescued by the government, I think there should be consequences for it.

Mr. ISSA. Let's go through the MAC. You threw money in almost on a daily basis without informing Congress that you planned to do it because events were moving that quickly that you discovered, and officers and directors of company after company, AIG, Wachovia, you name it, made these discoveries and came to you and you became aware of it on a daily basis. Isn't that true?

Mr. BERNANKE. We learned about some of these problems at a very late date. That is true.

Mr. ISSA. Let me put this in perspective. The Fed, the Treasury, the SEC, the FDIC, they were unable to predict on a day-by-day basis who was going to be next. That is what we all saw publicly and privately here. So why is it that between September and December, one would think it is an absence of fair due diligence to discover that a company that you are seeking to acquire, that we held hearings on because of Stan O'Neal's alleged mismanagement of that company, had deteriorated quickly and that they had not anticipated toxic assets going bad quickly? Why would that be unreasonable to assume in a deal in the environment in which day after day after day you are watching collapses of 100-year-old businesses?

Mr. BERNANKE. Well, we did raise the question of whether or not the Bank of America should have discovered those losses earlier. But that wasn't the relevant question for us in terms of maintaining the stability of the financial system going forward.

Mr. ISSA. But we are not talking about the stability of the financial systems. You said that you had three good reasons that B of A should not pull out. And one of them was that their credibility would be adversely affected and the whole market would be adversely affected if they could not have predicted in 2 months of due diligence by a company trying to get high dollar, in this case high stock exchange, in the transactions. So you have an arm's-length transaction in which people are trying to tell you only what they need to tell you to get the highest stock. And you are saying that, basically, in one of your three points that they would be viewed as inept.

Well, if I understand correctly, day after day after days regulators were discovering, oh--blank--another one's dropping and the market is seizing up.

In that environment, wouldn't it have been just as easy to say, you are looking at invoking the MAC? What are you trying to get to? Is your 80 cents to $1 exchange rate of stock--is it in fact materially different? And would you still go through with the deal but just at a slightly different amount?

Wouldn't that be the ordinary effect, rather than to say, directly and indirectly, a number of people clearly communicated, including Paulson, that they would in fact have to go through with this deal or else?

Mr. BERNANKE. It was my view and the view of our staff that if they tried to invoke the MAC, that the market would understand that the chances of their actually consummating; that is, of the MAC being successful, was quite low. As a result, both Merrill Lynch and Bank of America would probably be affected by a financial crisis at that moment. And that was our concern.

Mr. ISSA. Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman's time has expired. I now yield 5 minutes to the gentleman from Ohio, Congressman Kucinich.

Mr. KUCINICH. Chairman Bernanke, our investigation reveals that staff at the Fed quickly came to the conclusion that Ken Lewis' representations to the government in the meeting of December 17, 2008 were, as one put it, somewhat suspect. At the appropriate time I am going to insert into the record a number of documents that show that senior staff and officials at the Fed believed, in contradiction to Ken Lewis' representations, that Bank of America failed to do adequate due diligence in acquiring Merrill Lynch. The Fed found that Bank of America had known about accelerating losses at Merrill since mid-November, when shareholders could have used that information to decide on ratification of the merger. Your colleague, Governor Warsh, doubted the competence of Bank of America's top management to address the problems at Merrill and at Bank of America, writing to you, and I quote: "Spoke with folks--with BOA folks this morning, mostly Joe Price, CFO, did not instill a ton of confidence that they have got a comprehensive handle on this situation."

And the senior lawyer at the Fed believed that Bank of America could be in violation of securities laws for failing to inform shareholders about the Merrill losses known in mid-November. And this is writing to you. Quote, "Lewis should have been aware of the problem at Merrill Lynch 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."

Chairman Bernanke, did you agree with your senior staff and colleagues at the Fed who had drawn those unflattering conclusions about Ken Lewis' management of Bank of America?

Mr. BERNANKE. The staff and the principals at the Fed had serious concerns and questions about--

Mr. KUCINICH. Did you have serious concerns?

Mr. BERNANKE. I did have concerns and questions. But--

Mr. KUCINICH. About the characteristics of the management?

Mr. BERNANKE. I did have concerns. Yes.

Mr. KUCINICH. Our investigation also finds that there was considerable interest at the staff level in the Fed to attach meaningful conditions to whatever aid package you gave

Bank of America because of doubts about the quality of management of Bank of America. However, it is not evident, that you, yourself, had an interest in increasing accountability of Bank of America's management.

In talking points prepared by your staff for a conversation you would have with Bank of America, a number of restrictions were seriously proposed to accompany any Federal aid to Bank of America. I would like to go through some of these suggested conditions, and assess whether you in fact imposed those conditions on Bank of America.

Did you require any changes in Bank of America's top management in view of the considerable evidence amassed by your staff that Ken Lewis had not done adequate due diligence and may have committed securities fraud?

Mr. BERNANKE. Subsequently to the transaction, we have asked and required Bank of America to look at its top management, and they have made changes in their board.

Mr. KUCINICH. Was that a yes or a no?

Mr. BERNANKE. The answer is, yes, we have done that.

Mr. KUCINICH. Okay. Did you require more severe executive compensation limitations for Bank of America than had been required under the TARP program in which the conditions were deliberately not intended to be onerous so as to maximize participation by banks that did not need financial assistance?

Mr. BERNANKE. I believe the executive compensation restrictions that were imposed were those--the standard ones but the ones associated with extraordinary actions on the TARP.

Mr. KUCINICH. Did you require any limitation on various types of corporate expenses with Bank of America, other than those it had already imposed on itself?

Mr. BERNANKE. Not that I recall.

Mr. KUCINICH. Did you require a government foreclosure policy, such as was imposed by the FDIC in the case of IndyMac.

Mr. BERNANKE. Yes. I believe we did. I believe we did.

Mr. KUCINICH. Do you know for sure?

Mr. BERNANKE. I will get back to you, but it is my belief that we did.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. KUCINICH. We need to know that.

Now, Chairman Bernanke, isn't it true that there was a high-level concern at the Fed about neglecting the opportunity to press for greater accountability in Bank of America's corporate management?

Let me direct your attention to an e-mail sent to you by Eric Rosengren, President of the Boston Fed. It says, Dear Ben, I am concerned if we too quickly move to a RingFence 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, the U.K., replace senior management. The bank is maintaining operations without significant disruptions. I would not want to discard this option prematurely. That is a quote.

Chairman Bernanke, Ken Lewis came to you with a story that the Fed didn't believe. You were getting advice from your staff and from peers that considerable concessions should be required of Bank of America because of concern about the quality of top management, and yet you decided to give the aid away without any meaningful changes to Bank of America's corporate management or its compensation policies.

How do you explain that, Chairman.

Mr. BERNANKE. Congressman, the supervisory process is not a one time thing. It is an ongoing process. And in our ongoing supervisory process we have made demands of the Bank of America in terms of their management.

Mr. KUCINICH. So you give them the money first and then you start supervising?

Mr. BERNANKE. Well, we have the ability to insist on these changes at any point.

Mr. KUCINICH. Thank you, Mr. Chairman.

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

Mr. BURTON. Is Mr. Lewis lying?

Mr. BERNANKE. With respect to what, sir?

Mr. BURTON. I said is Mr. Lewis lying when he tells this committee that you put pressure on him along with Mr. Paulson?

Mr. BERNANKE. All I know is that I never said that I would replace the board and management if he invoked the MAC.

Mr. BURTON. What did you say? Sometimes there is an implication without a direct order.

Mr. BERNANKE. I expressed concerns about the effects of invoking the MAC both on the financial system and on the Bank of America itself, expressed those concerns, which is appropriate. But it was always his decision whether or not to go ahead and take that decision.

Mr. BURTON. Did Mr. Paulson lie when he told Mr. Cuomo that he was acting under your suggestions or orders to tell them that the board would be fired if they didn't comply?

Mr. BERNANKE. I believe he has modified that statement. I did not tell Mr. Paulson--

Mr. BURTON. What did you tell him?

Mr. BERNANKE. I didn't tell him anything like that.

Mr. BURTON. What did you tell him? You say you didn't tell him anything like that.

Mr. BERNANKE. Mr. Paulson and I had conversation on a variety of matters. All I can say is I am sure that I never told him to convey such a message to Ken Lewis.

Mr. BURTON. Mr. Paulson says in a letter from New York Attorney General Andrew Cuomo to Congress, told him that Paulson made the threat at the request of Bernanke. That is not correct?

Mr. BERNANKE. No.

Mr. BURTON. Did you say he modified his statement? How did he modify his statement? We don't have any information.

Mr. BERNANKE. He issued a statement to the effect that he did not receive that information from me, that he made inferences but he did not--as far as I know, he modified his statement on that particular issue.

Mr. BURTON. How about Mr. Lacker? Is he lying?

Mr. BERNANKE. He is summarizing a long conversation. I don't recall exactly what was said.

Mr. BURTON. Just had a long talk with Ben. Says they think the MAC threat is irrelevant because it is not credible. Also intends to make it even more clear that if they play that card and then need assistance, management is gone. You didn't say anything like that?

Mr. BERNANKE. I don't know if I did or not.

Mr. BURTON. You know, one of the things, I was chairman of this committee for 6 years and we did a lot of investigating. One of the things that I learned was in order to keep people from perjuring themselves they couldn't remember anything.

Are you sure you can't remember?

Mr. BERNANKE. I am sure I can't remember. But I think it is important to note that whatever conversation I had with Mr. Lacker, who is a Federal Reserve official, that I did not--in subsequent conversations with Mr. Lewis did not make that threat.

Mr. BURTON. Why did you keep the SEC in the dark?

Mr. BERNANKE. I did not keep the SEC in the dark. We were working carefully and closely with our other regulatory agencies. The agencies that were most relevant for the Bank of America discussion were those that were involved in regulating the Bank of America and in the transaction. That would have been the Treasury, the Federal Deposit Insurance

Corporation and the Office of the Comptroller of the Currency, who were well-informed.

Mr. BURTON. Well, according to the New York Attorney General, Mr. Cuomo, Hank Paulson said that he intentionally kept the SEC out of the loop about your efforts to police the Bank of America merger with Merrill Lynch. This seems to be backed up by the following exchange between your General Counsel Scott Alvarez and a New York Fed official: The New York Fed officials asked have we conveyed anything to the SEC regarding the Bank of America situation? They know something is up. How much, if anything, has been shared with the SEC? Mr. Alvarez has replied, I have not discussed this with the SEC. Bank of America has complained that someone did talk to the SEC with the result that the SEC called late last week to say that they heard the Bank of America was negotiating a Citi type deal with the U.S. Government and to ask Bank of America to explain the unexpectedly high losses at Merrill Lynch.

You didn't direct any of those?

Mr. BERNANKE. I did not.

Mr. BURTON. Does Mr. Alvarez work for you?

Mr. BERNANKE. He does.

Mr. BURTON. He does? He did this on his own?

Mr. BERNANKE. Again, I would emphasize that the issues at hand did not directly involve the SEC. They involved the

OCC--

Mr. BURTON. Are you his boss?

Mr. BERNANKE. I'm sorry.

Mr. BURTON. Are you his boss?

Mr. BERNANKE. Yes.

Mr. BURTON. Mr. Alvarez.

Mr. BERNANKE. I am.

Mr. BURTON. Would he do something like this, make this kind of a statement that could cause these kinds of problems without your authority?

Mr. BERNANKE. I didn't have any knowledge of this particular exchange. And again, the rationale for it, as I understand now, having discussed it with him, is that the agencies that were relevant to our transaction were the FDIC, the OCC, and the Treasury. That is the ones that we kept closest in communication.

Chairman TOWNS. The gentleman's time has expired. Mr. Foster from Illinois.

Mr. FOSTER. Thank you for appearing here, Chairman Bernanke. I appreciate it and I am sure everyone here does.

Just for clarity, at any point in these negotiations did you or anyone you know of point out to Mr. Lewis that the government agencies had the power to remove him and/or the Bank of America board?

Mr. BERNANKE. I did not.

Mr. FOSTER. Now, without any specific reference to the case at hand, do you believe that there are circumstances in which the CEO of a systemically important firm might be expected to have his shareholders take a bullet to protect the overall health of the economy in a crisis situation?

Mr. BERNANKE. No. That is not appropriate under supervisory practice, and we have not done that.

Mr. FOSTER. So do you believe that there is any need for any additional legal clarity about the duties of a CEO to the shareholders, to the regulators, and to the overall economy in times of systemic crisis?

Mr. BERNANKE. Well, that might be something for Congress to consider, but I think the rules as they currently stand are quite clear that you can't force somebody to take actions against the interest of that company for systemic reasons alone.

Mr. FOSTER. So you did not sense at any time in this that there were ambiguities that would be better if they had been made explicit in law?

Mr. BERNANKE. It was always clear in our thinking and in our advice to Mr. Lewis that it was not just an issue with the financial system but also an issue of Bank of America specifically that was at risk and that he should take that into consideration when he made his decision.

Mr. FOSTER. So it was the indirect benefits to the shareholders from not having the whole system collapse that he was optimizing for?

Mr. BERNANKE. Correct.

Mr. FOSTER. Now, if you accepted that federal recapitalization of both Merrill and Bank of America were probably inevitable, do you think that the net effect of the merger was just representative of the reshuffling around of the total funds that we would eventually have to commit or do you think it is a more complicated situation than that?

Mr. BERNANKE. No, I think the combination strengthened the two companies and particular what we learned during the crisis was that the investment banking model was not very stable, that it was subject to funding problems. By combining Bank of America, with a large retail deposit base, it was possible to solve some of those funding problems to some extent.

Mr. FOSTER. Thanks again. I yield back the balance of my time.

Chairman TOWNS. I yield to the gentleman from Ohio, Mr. Jordan.

Mr. JORDAN. Thank you, Mr. Chairman. Chairman Bernanke, let me go back to what I think sort of starts this pattern of pressure on behalf of the government, pattern of intimidation. I want to go back to the October 13 initial meeting that my understanding is you, Mr. Paulson, Ms. Bair, Mr. Geithner had the nine biggest banks come here to Washington. Was that meeting something that you and Mr. Paulson decided needed to happen? Was that your call, his call? How did that happen?

Mr. BERNANKE. My recollection is Mr. Paulson's decision. But we all participated in that meeting.

Mr. JORDAN. Mr. Lewis in his testimony a few weeks ago he said the meeting--he described the meeting with the four of you on one side, the nine CEOs of the banks on another. They were given a form to sign where they had to write in the amount of TARP money, bailout money that they felt that was needed or that you suggested. The impression he left with this committee was that they had to comply. In fact, I asked him permanently. Did anyone express any reservations at that meeting about accepting taxpayer money? He said, yes, one of the other CEOs in fact did express reservations. Nevertheless, they signed that. He also indicated that the entire meeting took less than an hour.

Is that an accurate description of what took place in that meeting?

Mr. BERNANKE. I think the time was less than an hour. Yes.

Mr. JORDAN. And he also said when I asked him did he know what the meeting was going to be about when he came here to Washington, he informed the committee that he had no idea it was going to be about signing a form being forced to accept TARP money.

Is that accurate?

Mr. BERNANKE. I don't know.

Mr. JORDAN. Well, let me ask it this way. Did you inform the nine CEOs of the banks who were called to Washington that the meeting was going to be about them taking TARP money from the legislation that had just enabled that to happen that frankly had just been passed two weeks prior to that?

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[11:00 a.m.]

Mr. BERNANKE. I was not in contact with the nine CEOs. I think the Treasury was in contact with them.

Mr. JORDAN. Do you believe that Mr. Paulson let them know what the meeting was about?

Mr. BERNANKE. I do not know.

Mr. JORDAN. But the recollection of how I described the meeting and how Mr. Lewis described the meeting, that is in fact what took place that day? Less than an hour, nine CEOs given a form they had to sign saying they were going to take a certain amount of government money.

Mr. BERNANKE. Mr. Paulson strongly urged them to take capital and argued that, given what was going on in the world at that time, which was a global financial crisis, that it was very much in their interest and the interest of the financial system for them to do so, and they signed the forms.

Mr. JORDAN. Again, Mr. Lewis felt like they had to sign that form, had to comply, based on the testimony he gave this committee. Then we jump forward 2 months ahead to December, and we have the e-mail and letter that both Mr. Issa and Mr. Burton had brought up. The letter that Mr. Cuomo a New York AG sent to Members of Congress, where he said, Secretary

Paulson has informed us that he made the threat dealing with the Merrill Lynch acquisition at the request of Chairman Bernanke.

We also have the e-mail from Mr. Lacker, the Richmond Fed chairman talking about, just had a long talk with Mr. Bernanke, who says that I think the maximum is irrelevant because not credible, also tends to make it even more clear that if they play that card and they need assistance management is gone.

And then the third one I would point out, too, is the e-mail from Mr. Angulo at the New York Fed which deals with the disclosure concern. Also this is in December of last year where he says: I think I will ask Merrill Lynch a current estimate of the fourth quarter.

And he makes a statement: If I get a sense that Merrill Lynch is leaning toward an early January filing, I will try to steer them toward a later filing.

I mean, I guess what I am trying to point out is you have all this pattern here and--which, as I asked Mr. Lewis when he was here, if what took place at the October 13th had an impact on his decision making, his thought process, as he moves through this dealings in December with you and with Treasury relative to the Merrill Lynch acquisition.

Do you see how a reasonable person could reach the conclusion that there, in fact, was this pattern of pressure from the government?

Mr. BERNANKE. No, not if you're sufficiently informed. As I said, I did not tell Mr. Paulson to convey any threats. The e-mail from Mr. Lacker was a summary of a long conversation. It very explicitly said that problems with the management would be related to their needing assistance in an emergency situation. And as I said--

Mr. JORDAN. Need assistance? They already had assistance. You made him take it on October 13th. So I don't see how those two clauses--you made that point when Mr. Issa was questioning you. They already had assistance. You made them take $15 billion October 13th.

Mr. BERNANKE. No, they revoked the MAC, against our advice, and then they had to be rescued on a Sunday afternoon operation at great cost and risk. That would hardly be an accommodation for the management's quality.

Chairman TOWNS. The gentleman's time has expired.

Mr. JORDAN. Thank you.

Chairman TOWNS. The gentlewoman from California, Congresswoman Speier.

Ms. SPEIER. Thank you, Mr. Chairman.

Mr. Bernanke, what went into your decision to allow Lehman to fail?

Mr. BERNANKE. It bears very much on this discussion. The problem was that we were unable to save it within legal means. We had made every attempt to do so, but we had no legal authority to inject capital at that time, and we had no legal authority to compel Mr. Lewis, for that matter, to buy Lehman, and therefore we had no way to prevent a failure. If we could have done so, we would have done so.

Ms. SPEIER. Well you did, in fact, save AIG that same weekend.

Mr. BERNANKE. The conditions were quite different, because there the financial products division was part of a much larger insurance company which could provide the collateral for a loan to replace the loss of liquidity that that financial company was experiencing. So it was a very different situation.

Ms. SPEIER. So if you had TARP funds at the time, you would have saved Lehman Brothers as well.

Mr. BERNANKE. I believe we would have at least given that a try.

Ms. SPEIER. Let me ask you about the process that you went through in determining to give Bank of America $15 billion in October. Why that number, how did you come up with that number?

Mr. BERNANKE. I did not develop that number. I'm sure it was related to the size of the firm and its capital ratios.

Ms. SPEIER. Who came up with that number?

Mr. BERNANKE. I'm not certain. It was probably Treasury, but I'm not certain.

Ms. SPEIER. You are not certain who came up with the number?

Mr. BERNANKE. No.

Ms. SPEIER. And so the $10 billion that was given to Merrill Lynch at a subsequent point in time, you don't know who came up with that number either?

Mr. BERNANKE. This was TARP money and this was the Treasury's responsibility.

Ms. SPEIER. And you didn't have conversations with Mr. Paulson about this?

Mr. BERNANKE. I don't recall.

Ms. SPEIER. As I look at it, it appears that if you take the $15 billion that B of A got in October, the $15 billion that Merrill got, the $20 billion that was given to the B of A in January, that pretty much pays for what the B of A paid for Merrill. So did the American people basically subsidize the purchase of Merrill Lynch to B of A?

Mr. BERNANKE. No. The American people made a capital investment, on which they are currently getting dividends, and which I expect they'll be fully repaid.

Ms. SPEIER. The obligation to inform the OCC and SEC, do you believe you have an obligation to inform them about any erratic conditions of companies that you come in contact with?

Mr. BERNANKE. It depends what kind of company it is. This was a bank, and therefore the most pressing communication were with the bank regulators, the FDIC and the OCC, which we did inform. And I personally informed both Mr. Duggan and Ms. Bair about the situation, and we had them on conference calls to discuss the situation in some detail. The SEC is not directly a supervisor of Bank of America.

Ms. SPEIER. May not be a supervisor, but certainly the way they engage in their business relative to stock is of interest to the SEC, is it not?

Mr. BERNANKE. Repeat the question, please.

Ms. SPEIER. Doesn't the SEC have a role in evaluating the bank as it relates to its investor relations.

Mr. BERNANKE. Yes, but that's the Bank of America's responsibility, not ours.

Ms. SPEIER. Well, we're all one government, aren't we?

Mr. BERNANKE. Well, we all have our spheres of responsibility as well.

Ms. SPEIER. So you didn't believe you had a responsibility to inform the SEC.

Mr. BERNANKE. Well, we were dealing with an emergency situation, and our focus was on the agencies that were most relevant to the situation. That was the banking regulators, so that's who we focused on.

Ms. SPEIER. But some of these e-mails would suggest that there was an active interest in not telling the SEC certain things, and that they were finding out through other means. I mean, this is a government. We are all part of the government. It's really our responsibility to work together. So it appears that someone was trying to hide the ball, and I'm just trying to understand why.

Mr. BERNANKE. There was just no priority to go to the SEC, but we did disclose to them what was going on. And I think it's appropriate for them to know, broadly speaking, what was going on.

Ms. SPEIER. Do you believe that the Bank of America had a responsibility to inform its shareholders and the American people that it was going to get another injection of $20 billion from the United States Government?

Mr. BERNANKE. That was--

Ms. SPEIER. Earlier than January 20?

Mr. BERNANKE. That was Bank of America's decision and their counsel.

Ms. SPEIER. I'm just asking you.

Mr. BERNANKE. I'm not a lawyer. I can't tell you.

Ms. SPEIER. Do you think you had a responsibility as the head of the Fed to tell the American people that we were going to inject another $20 billion into the Bank of America earlier than January 20?

Mr. BERNANKE. My responsibilities are very explicitly set out by the Emergency Economic Stabilization Act, which says that after the completion of a deal we must report within 1 week, which we did.

Ms. SPEIER. So you don't think you had any further responsibility.

Mr. BERNANKE. We followed the law exactly.

Ms. SPEIER. In hindsight--you know, hindsight is always 20/20--is there anything that you would do differently?

Mr. BERNANKE. I think it was a very successful transaction. It helped stabilize the financial markets. It put the two companies back on a healthy path. It protected our economy, and it was a good deal for taxpayers. I think I have nothing that I regret about the whole transaction. I think it was, in fact, a very successful operation overall and it achieved the public policy objectives that were very important.

Ms. SPEIER. I yield back.

Chairman TOWNS. The gentlewoman's time is expired. I yield to the gentleman from Utah, Congressman Chaffetz.

Mr. CHAFFETZ. Thank you, Mr. Chairman. I appreciate it.

And thank you, Chairman, for being here. A question. For those recipients of the TARP money, do you have the power and authority to replace the board or its president?

Mr. BERNANKE. That's a good question. The Treasury with its ownership--

Mr. CHAFFETZ. Thank you.

Mr. BERNANKE. You're welcome. The Treasury with its ownership, obviously, has some influence, but it has not used that influence.

Mr. CHAFFETZ. But it could.

Mr. BERNANKE. I suppose it could, yes. The supervisors of the Federal Reserve can make changes or recommend changes in management if we believe that the management--

Mr. CHAFFETZ. Let me move on. My time is short. I appreciate it.

So on this December 17th meeting you are meeting in person, you have their chairman--or the CEO, Lewis, who is there expressing that he might invoke the MAC.

And then in your written testimony today on page 2, it says, quote, in responding to Bank of America in these discussions I expressed concern that invoking the MAC would entail significant risks.

Going down to your point you made on number two, mid-sentence it said, because you had concerns and you expressed this back, it cast doubt in the minds of the financial market participants, including investors, creditors and customers about the due diligence and analysis done by the company, its capability to consummate significant acquisitions, its overall risk management processes and judgment of its management.

How is that not a threat? If you have the power and authority to release the board of directors and fire the CEO and you are questioning their judgment and you are saying if you don't go through with this deal, how is that not a threat?

Mr. BERNANKE. I never said anything about firing the board and the management.

Mr. CHAFFETZ. But if you are questioning somebody's judgment and you are in the supervisory role with the authority to let them go, how is that not a threat?

Mr. BERNANKE. I was focusing particularly--and this was based on supervisory advice--on the reaction of the marketplace. What you have to understand is that during this period the markets were extraordinarily fragile, and very quickly money could pull away from a bank and put it into serious trouble, very quickly. That's what happened to Wachovia, for example.

Mr. CHAFFETZ. So you think that was a threat--your belief on what the threat would be from the market. But how could that not be a threat directly to Mr. Lewis and its board of directors, if you are questioning their judgment?

Mr. BERNANKE. We advised him that we didn't think it was a good idea from the perspective of Bank of America for him to take that action. However, if he had taken it, it was his option to take it. And if he had taken it and there had been no adverse consequences, we would not have had much basis for responding to that.

Mr. CHAFFETZ. With all due respect, I'm just not buying that. You are in charge, you have the ability to affect their outcome, to fire them, to let them go. You are telling them that if they don't come to the same conclusion as you do that they would obviously--everybody in the room, everybody in the marketplace, would know that their judgment was miscalculated.

I think that's a threat, and I think it's reasonable for the CEO and the board of directors to take that as a threat. I don't see any other conclusion. If we were sitting across the table, you controlled my destiny, that's one of the consequences.

Mr. BERNANKE. Well, we don't control his destiny unconditionally. We would have to make a case that he made decisions that were damaging to the company. And if he had made that decision and the company had prospered, there would be no basis whatsoever for any action.

Mr. CHAFFETZ. All right. I'm going to move on.

I want to go to page 4 of your testimony here. It says in the second--in the kind of mid-paragraph, this is from your testimony today--neither I nor any member of the Federal

Reserve ever directed, instructed or advised Bank of America to withhold from public disclosure any information related to Merrill Lynch.

And yet in an e-mail of December 22, e-mail number 18, we get this quote from Art Angulo. I believe Mr. Jordan referenced this earlier. Quote: I'll ask Merrill Lynch's current estimate of fourth quarter losses versus market expectations and whether and when Merrill Lynch intends to file an 8(k). If I get a sense that Merrill Lynch is leaning towards an early January filing, I'll try to steer him towards a later filing.

That is so inconsistent with the comment that you made. Do you see that they're consistent or is there an inconsistency here?

Mr. BERNANKE. Well, I didn't see that e-mail exchange until after I had written my letter. But having looked now at the exchange, I note that if you look at the subsequent e-mails, that in fact Merrill Lynch had taken its disclosure decision and Mr. Angulo did not attempt to make them change it.

So in the event, he did not make any attempt to effect the disclosure.

Mr. CHAFFETZ. But the intent is still there right.

Mr. BERNANKE. But he did not take the action.

Mr. CHAFFETZ. Do you feel in any way, shape or form that you adversely affected or threatened Mr. Lewis or the board of directors?

Mr. BERNANKE. I do not.

Mr. CHAFFETZ. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much. The gentleman from Virginia Mr. Connolly.

Mr. CONNOLLY. Thank you, Mr. Chairman. And welcome Chairman Bernanke.

Mr. Bernanke, I guess I come at it just a little bit differently than my friend from Utah. I guess I'm interested in who was really threatening whom. At what point did you learn from Mr. Lewis that the deal with Merrill Lynch, oops, had a $12 billion hold to it that they hadn't realized in doing their due diligence?

Mr. BERNANKE. On December 17th.

Mr. CONNOLLY. I can't hear you, sir.

Mr. BERNANKE. On December 17th when he called Secretary Paulson.

Mr. CONNOLLY. On December 17?

Mr. BERNANKE. Yes.

Mr. CONNOLLY. And when in retrospect, to your knowledge, did they learn they had a $12 billion problem?

Mr. BERNANKE. They claimed they had not known any earlier than the 14th of December, and we have no direct evidence to the contrary.

Mr. CONNOLLY. Were you concerned about the lack of due diligence on their part?

Mr. BERNANKE. We did have concerns about it, yes.

Mr. CONNOLLY. Did you take it as a threat or do you think--well, did you take it as a threat or did other senior Federal officials perhaps discuss it as a threat, implied or otherwise, that Mr. Lewis, far from being a victim here, was actually manipulating the Federal Government that we're going to back out of this deal because of that $12 billion problem we didn't catch, unless in exchange we get some assurance from you the TARP money will help us cover that little $12 billion problem?

Mr. BERNANKE. I was concerned about that when I first heard about this, that there might be some attempt to get government support or government subsidy on that basis. After some meetings with Mr. Lewis my impression became that he was genuinely undecided about what to do and rather uncertain about how to go forward. So that impression faded after some time, but I was worried about that at the beginning.

Mr. CONNOLLY. Was there any discussion about, at that time when you learned about it, Chairman Bernanke, the need to disclose this to the public and to the shareholders of Bank of America?

Mr. BERNANKE. We leave the disclosures to the responsibility of the management of Bank of America and their counsel. And we left that decision to them completely.

Mr. CONNOLLY. You are aware of the fact that under oath Mr. Lewis said that there was no deliberate attempt to keep this from the public, that people were just trying to work out the details. When in fact, subsequently, this committee is in possession of an e-mail from him dated, I believe, December 22nd, that in conversations with both the Fed and with Treasury, strong reaction on the part of the Federal officials not to disclose or to put anything in writing because they didn't want at that point this to come out in the public fora because of adverse reactions in the market.

Mr. BERNANKE. I never conveyed any such thought.

Mr. CONNOLLY. When asked--well, let me read to you, if I may, the minutes of the December 22nd--an excerpt from the minutes of the December 22nd BOA board hearing or meeting.

He, Mr. Lewis, reported that in addition to the previously described conversations he had spoken again with Mr. Bernanke, who stated that he, Mr. Bernanke, had spoken to other Federal regulators, and we are informed of the commitment of the corporation by the Fed and Treasury that all concur with the commitment of the Federal regulators, obviously to BOA.

Could you comment on that? What is that in reference to and what is the nature of the commitment he's referring to?

Mr. BERNANKE. Well, as I mentioned before, we did inform--the Treasury and the Fed informed the FDIC and the OCC about the situation, and about the Fed and Treasury's commitment to work in good faith with the Bank of America to find a transaction, a package, that would avoid destabilization of the company in the event of a financial crisis. I can say that the other agencies certainly were in sympathy with the idea of trying to stabilize the company. But at that point there had not been any specific transaction laid on the table, and so there was no agreement on a specific shape and structure of the transaction.

Mr. CONNOLLY. I'm going to have to sneak this in in a mouthful. If you would respond, Chairman Bernanke, because my time is about to be up.

When and how did you learn that Mr. Lewis had threatened not once--threatened not once, but twice, to invoke the MAC and back out of the Merrill Lynch deal? And to what extent were you concerned, and did you have conversations with Secretary Paulson that that would sort of unravel a lot of things and therefore we had to accelerate the TARP funding for BOA? And did you take it, or, to your knowledge, did Secretary Paulson take it as an implied threat that if I don't get that, I'm going to go public and let everybody know we're pulling out of the deal?

Mr. BERNANKE. When I first heard about it on December

17th, I took that as a possibility which I was concerned about, but subsequently I thought that, as I said, that Mr. Lewis was genuinely uncertain about how to proceed.

Mr. CONNOLLY. Mr. Chairman, my time is up. But I just want to say on the record, while some want this narrative to be this poor CEO of our, you know, moderately sized bank with the hob-nailed boot of government on his neck forcing him to do things he didn't want to do, I believe the narrative lends itself to a very different interpretation of a wily CEO of a major corporation gaming the system because he could recognize an opportunity when he saw it, and it was a $15 billion to $20 billion opportunity.

My time is up. I thank the Chair and I thank Chairman Bernanke.

Chairman TOWNS. I thank the gentleman. I yield now 5 minutes to the gentleman from Tennessee, Congressman Duncan.

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

Chairman Bernanke, many articles and columns had described the actions taken by the Fed in regard to the Bank of America-Merrill Lynch dealing and other dealings of that time period as being--following too-big-to-fail policies.

Would you describe your activities in that time period in that way, and do you think there needs to be more control or a little closer oversight by the Fed and other Federal regulators of the biggest banks and financial firms?

Mr. BERNANKE. Yes, I do to the last part. Too-big-to-fail is not a policy, it's a major problem. We were faced on numerous occasions in the last year with large firms whose failure, like Lehman, would significantly disrupt the world financial system and the world economy. We had no good options to deal with those companies.

It's extraordinarily important, as I've said for some time, that as Congress reforms the financial regulatory system that we develop a resolution regime for solving failing systemically critical firms, that we increase the oversight of those firms, and that we take steps to make sure that too-big-to-fail will not be a problem in the future. So I agree very strongly with that.

Mr. DUNCAN. And let me ask you, I've read many articles over these last few months and I've seen all different sorts of figures as to how much money in total the Fed has loaned, pledged, paid in all the different bailouts. Would you tell us what you believe the total amount to be that the Fed has committed over these last few months?

Mr. BERNANKE. In terms of bailouts, the amount of money we had involved in AIG and Bear Stearns is about $100 billion.

Mr. DUNCAN. And in other actions that you've taken, I've seen figures as high as--I've seen figures like $2.2 trillion.

Mr. BERNANKE. Our balance sheet is $2.2 trillion, but more than half of that is U.S. Government bonds and government-guaranteed mortgage-backed securities, which have no risk and which are supporting the mortgage markets of the United States. A good portion of the remainder is short-term collateralized loans to financial institutions which are very safe and help provide liquidity to support the financial system.

So none of that I would characterize as a bailout, other than the moneys that were involved in the AIG and Bear Stearns situations, which we got involved in with great regret, and I hope that the system will be changed so that there it will never be necessary in the future.

Mr. DUNCAN. But Congress Daily says this morning that Fed officials purposefully declined to consult with other financial regulators, and one e-mail expressed concern the SEC employee, quote, knows something is up.

The Wall Street Journal reported that you and Mr. Paulson attended two weekly meetings of the Financial Stability Oversight Board and refused or declined to disclose the seriousness of the problems that were being faced by the Bank of America and Merrill Lynch at that time.

What would you say to the majority of this Congress who has now co-sponored--who have now co-sponsored the bill to require audits of the Federal Reserve? Do you feel that the

Federal Reserve is operating with too much secrecy and too much refusal to disclose information that you have to other Federal banking regulators?

Mr. BERNANKE. The Federal Reserve has made enormous strides in the last year under my chairmanship to expand the information that we release. We release monthly information on all the various programs that we have. We've developed a Web site and a monthly report that involves all kinds of information. We think we are quite transparent.

We are happy to work with Congress if they have further concerns about any of our programs. We are more than happy to work with you to make sure that you are comfortable that they are well managed and are serving a public purpose.

Mr. DUNCAN. Do you think it would cause problems for the Fed or for the economy if that legislation was to pass?

Mr. BERNANKE. My concern about the legislation is that if the GAO is auditing not only the operational aspects of our programs and the details of the programs, but is making judgments about our policy decisions, that would effectively be a takeover of monetary policy by the Congress, a repudiation of the independence of the Federal Reserve, which would be highly destructive to the stability of the financial system, the dollar, and our national economic situation.

Mr. DUNCAN. Thank you.

Chairman TOWNS. Thank you, the gentleman from

Tennessee. Thank you very much.

I now yield 5 minutes to the gentlewoman from Ohio, Marcy Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman, very much.

And, Chairman Bernanke, welcome to this committee. I am very concerned about those who create money in our society and how we hold them accountable. For those who counterfeit, if we can find them, most often they go to jail for a long time. But to those who create money in sophisticated ways through our financial system and then do great damage, sometimes they are more difficult to apprehend and prosecute.

Today I would like to explore the relationship between the Bank of America, Merrill Lynch and a firm called BlackRock that went public in 1999, after its founding about a decade earlier.

Let me say I'm also concerned that there may be some clever foxes in the henhouse over there at the Fed as our Nation proceeds to dig out of this housing collapse, which still continues in regions like my own, and hold those truly responsible accountable.

Now, as I understand it, the Bank of America acquired Merrill Lynch last September, but at the time of that acquisition, because of several relationships, Bank of America actually also bought BlackRock which now owns a near majority share of Bank of America. Recently--that had to do with the interrelationship between BlackRock and Merrill Lynch, as you know.

Recently the Fed has just hired BlackRock to execute at least four contracts, and maybe five, to analyze and handle the troubled assets of Freddie Mac and Fannie Mae, making BlackRock the dominant player in pricing these distressed assets. I am concerned that BlackRock and its chief executive officer Mr. Fink may not be fair and impartial in conducting these responsibilities because they in fact have been heavily involved in inventing, creating and trafficking in those instruments for most of the last two decades, indeed doing the risk analysis associated with them and selling billions of them to the Government of the United States.

So one of my questions Mr. Bernanke, is do you know in what year Mr. Fink sold his first tranche of mortgage-backed securities to Freddie Mac? The first tranche was $1 billion. Do you know what year that occurred in?

Mr. BERNANKE. I do not.

Ms. KAPTUR. Do you think that's important for you to know?

Mr. BERNANKE. No, I don't, because the arrangements we have with BlackRock and with other asset management companies are carefully set up to prevent conflicts of interest, to set up firewalls between the portion of the company that's working for us and the portion of the company that's engaging in other market activities.

Ms. KAPTUR. Do you know what other instruments BlackRock and its subsidies sold to the Federal Government over the last 10 years?

Mr. BERNANKE. No, I don't.

Ms. KAPTUR. You do not. Well, I would say that I think it's pretty important for you to know some of that. Because one of the difficulties with these securities is you can't unwind them. You cut them up in pieces, you sell them off. And given what we know about these pools of toxic assets, I have to say that I ask whether the Fed could actually be in collusion with Mr. Fink in covering up his own potential fraud by giving him the opportunity to shift the portfolios and have access to information that no one on this committee has access to, in ways favorable to those clients he served and in ways favorable to that company today.

How can we assure ourselves that is not happening.

Mr. BERNANKE. We can provide you with the contracts we have with BlackRock. And they involve very careful controls to make sure there's a separation between the parts of the company that are working managing the assets of the Fed according to our instructions, and the other parts of the company that are involved in a variety of asset management activities.

Ms. KAPTUR. Well, you know, Mr. Chairman, when you appeared before the Budget Committee, I asked you for those contracts. And I want to thank you because they were finally placed on the Web site of the Fed. However, the contracts that were placed there have multiple exhibits missing.

For example, the investment guidelines are absent, except for one single statement of policy objective. The fee schedules and the payments are omitted, along with the designated representatives of the Federal Reserve Bank of New York, as well as key personnel.

Given that you are using taxpayer dollars to pay these contracts, why omit the fee schedule and payment procedures?

Mr. BERNANKE. We have a committee that works through all of these different types of information, some of which is confidential or proprietary, and releases all that it believes is appropriate. But I will go back and talk to them and make sure they are looking at all those issues.

Ms. KAPTUR. Well, I will tell you, the housing crisis is at the heart of this economic crisis. And if we are going to fix what's gone wrong in this society, it seems to me that those who hold extraordinary power to create money--and certainly the New York Federal Reserve has more power in that than any regional reserve bank does, or people who live on the street that I live on where homes are being foreclosed as we sit here. Something went seriously wrong.

And I hear what you said this morning, but I am deeply concerned that the Fed itself is involved in the manipulation of the markets, of the mortgage markets, particularly the toxic assets that the public of the United States now owns. And I am not convinced what you've said to me about the contracts that the Fed has signed with BlackRock will be properly administered in a way that will be fair and impartial to all holders. And I hope that you can provide information to the record to convince me that my suspicions are unwarranted.

[The information follows:]

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Chairman TOWNS. The gentlewoman's time is expired. Congressman Souder from Indiana.

Mr. SOUDER. Thank you. I think that there was some prediction as you went into office that it was going to be a relatively activist Fed, and I think that you certainly have been an activist Fed.

Do you see in the descriptions as we look at these e-mails--and I think cases can be made that there was a certain feeling of intimidation at Bank of America at the same time that Bank of America probably used the situation to try to leverage their best gain--do you see how you got involved here as something extraordinary in the sense of you felt the system was collapsing, or is this going to be a repetitive pattern of the Fed? Obviously we--

Chairman TOWNS. Could the gentleman talk directly into the microphone? We are having difficulty hearing you.

Mr. SOUDER. That several other times in--whether it be the Asian flu or various mini-crises, had you been Fed chairman taken this aggressive a role?

Mr. BERNANKE. The past 2 years have been the worst financial crisis since the 1930s. It has threatened disability of the global financial system and the global economy. Extraordinary actions had to be taken. We've learned a great deal from them. And as I said in my testimony, I hope that Congress will take actions to ensure that the system will remain stable and that no such actions will be needed in the future.

I very very much regret being involved in them, but I saw no alternative at the time.

Mr. SOUDER. And how do you see yourself extricating at this point--given the fact that you've been fairly politicized, your Treasury is directly political, you have quasi-political entities that you are working with now indirectly in TARP and TARF and all the different programs, we have equity stake in companies--how do you get yourself untwined from this so you are not totally politicized?

Mr. BERNANKE. Well, we work closely with the Treasury to deal with the crisis. As the crisis ends, we will withdraw all of our nonstandard programs. We saw just a couple of weeks ago that ten banks repaid their TARP money, and, as we go forward, will expect to see more withdrawal of programs and support as the economy normalizes and the financial system normalizes.

Mr. SOUDER. Do you see yourself--because in this particular case, part of the problem was that Bank of America moved into the nonbank sector with Merrill Lynch, and that about 40 percent of our lending--and, as you know, one of my challenges has been recreational vehicles and autos and how we get money into floor plans and how to do that type of thing, most of that was the nonbank sector--how do you see the Fed in the future dealing with this nonbank sector which isn't normally where you would be?

Mr. BERNANKE. Well, there are a number of suggestions in the administration's reform plan and other reform plans for dealing with that. Certainly the extraordinary steps we've taken, for example, to revitalize the asset-backed securities market--we're seeing a lot of progress there, by the way, as that market revitalizes and financial systems normalize. We will certainly withdraw and not be involved in that any further.

Mr. SOUDER. And do you see yourself or see the Fed in the future being--I mean, we've gone back and forth here. Sometimes we want an independent Fed, sometimes we say, well, you are all the government, you ought to be sitting down at one table and working out this strategy. Where do you see the Fed going based on this experience and getting increasing--I mean, I don't see in the short term you are getting less politicized, because you are in the middle of everything now and everybody is asking you to do this, do that.

Mr. BERNANKE. In a financial crisis I think the American people expect their government to work collectively and cooperatively to try to solve the problem. We've worked closely with both the former Treasury and the current Treasury as well with other agencies, and that's relevant to the crisis. We have maintained very strong independence on monetary policy. That's critical going forward. And we expect, of course, as the financial crisis eases, to stand down on the financial crisis-related policies.

Mr. SOUDER. And agreeing that we were in deep trouble last fall, how would you--because one of your expertise is deflation, and sometimes when it's your expertise you have a tendency to anticipate--in this case I think we've proven we have had deflation--but you in your career projected it was going to happen before, and it didn't.

How would you have a guideline that says, oh, we're going to have these extraordinary interventions? How did you determine that this was the greatest thing and the greatest crisis since the Great Depression when it wasn't there yet?

Mr. BERNANKE. Well, it was my judgment based on history, lots of research, and reading and thinking and experience, that the collapse of major financial firms can be very detrimental to the economy. And if there was any doubt about that, the failure of Lehman Brothers and the near failure of AIG should put that to rest.

I think it's critically important as we go forward that we find measures to avoid such a situation in the future, and I very much would like, again, not to be involved in such activities.

Mr. SOUDER. And you've outlined the challenge, because some feel that some failures would have cleansed the system, some believe that they would have brought down the whole thing. And, in fact, this debate has occurred probably at least five times in the last 15 years as to we were at the precipe.

And the question is, is that if it's going to lead to this much intervention every time there's extraordinary discretion in a few individuals to say--I mean, I'm not disagreeing on this one; I voted every single time, with great political duress, for each of the financial interventions. But the process here concerns me, and the more data we get the more it concerns me.

Mr. BERNANKE. Again, if we have a resolution regime that will be more appropriate for resolving these firms in a crisis, we can avoid this problem in the future.

Chairman TOWNS. The gentleman's time is expired. I now yield 5 minutes to the gentlewoman from California, Congresswoman Watson.

Ms. WATSON. Thank you, Mr. Chairman. And thank you, Mr. Bernanke, for coming here.

I'm going to give you a series of events, and I will give you a list of questions. You can answer them all together.

First, despite the fact that the plan for a merger was announced on September 15th of 2008, there was no mention of the $20 billion capital injection from the government until January 16th. At that point during the negotiations between Bank of America, Merrill Lynch and the Federal Government, was it determined that this money would be necessary for the merger to be finalized? And then, given that as of January 16th, Merrill Lynch's projected losses for the fourth quarter were approximately $15.3 billion, how was the sum of the $20 billion agreed upon?

And finally in this set of questions, to date how much of this money has been drawn down and how has it been used?

Mr. BERNANKE. Well, at the time that Merrill Lynch and Bank of America initially announced their merger agreement in the middle of September--this was before the Congress had passed the TARP law, and so there had been no--at that time, no capital injection and no expectation of capital injection. Both Merrill Lynch and Bank of America receives capital in the middle of October during the intense phase of the banking crisis. An additional $20 billion was injected, as you say, on January 16th. That was based on a review of what the supervisors and the other experts of the Federal Reserve believed would be sufficient to reassure the market that Bank of America would be stable going forward.

They have used that capital to support their activities, including lending, and they of course are repaying the government dividends. They hope to repay at least part of the TARP in the future.

Ms. WATSON. I'm sure this might be the experience in other Members' offices. I represent a district out in Los Angeles and we get calls every day, up to 10 and 30 calls, of people who have gone to the bank and they're not having their loans restructured. And I'm very curious about where that money went when it went into the system. It's like trying to unscramble eggs. But I know the consumers and the owners of property are not being assisted with refinancing their loans.

Let me go on. In testimony before the committee on June 11th, Bank of America's CEO Ken Lewis claimed that the revelation of a $12 billion loss at Merrill Lynch on December 14th of 2008 caused him to consider invoking the Material Adverse Effect clause, referred to as MAC, to back out of the deal 9 days after shareholders had voted to approve the acquisition. However in an e-mail on December 19th, the bank's supervision officer of the New York Fed, Tim Clark, stated that Lewis' claim that they were surprised by the rapid growth of the losses seems somewhat suspect.

Chairman Bernanke, given that shortly after the deal was announced in September, Bank of America has installed 200 people at Merrill Lynch to thoroughly review their books, and do you believe Mr. Lewis was honestly surprised by the acceleration of losses?

Mr. BERNANKE. I have no way of knowing. We did have concerns about the quality of the due diligence, but I have no direct evidence that he was in fact informed about the losses.

Ms. WATSON. Well, 200 people were installed at Merrill Lynch, so that seems like they were going to dig very deeply. You know, somewhere the due diligence kind of fizzled out. And I just think that Bank of America's due diligence was not as thorough as it should be.

Do you believe that there were insights into Merrill Lynch's books that the government had that Bank of America did not?

Mr. BERNANKE. I can't answer that with certainty. We would have had some information about Merrill Lynch because we were working with the SEC to supervise it after we began lending to investment banks. But I don't think that we had knowledge of the size of losses either. I'm quite sure we did not.

Ms. WATSON. All right. Mr. Chairman, I'm going to try to make another statement and questions, and if the time runs out, I would ask Mr. Bernanke to give me his answers in writing.

In an e-mail on December 20th, the president of the Federal Reserve Bank of Richmond, Jeffrey Lacker, described a telephone conversation with you where you expressed the belief that the MAC threat is irrelevant because it's not credible, and that you plan to make it even more clear that if they play that card and then need assistance, management is gone.

So do you remember the phone call with Mr. Lacker that the e-mail was referring to, and do you believe that Mr. Lewis' claim that he would invoke the MAC and back out of the deal where credible? And had the Bank of America decided not to complete the merger, would the Fed have pursued the removal of their management and board? And had the Fed ever taken action to remove the management of a private entity before? Do your best.

Mr. BERNANKE. I was concerned initially about whether this was a serious proposal to invoke the MAC, because I did believe that it would be very detrimental to the Bank of America as well as to the financial system. I never made any threat to Mr. Lewis regarding removing the board and the management.

One example of where the Federal Reserve removed management was in the case of AIG, where there was an agreement that the CEO would be replaced upon the acquisition--upon the consummation of the loan we made to stabilize that company.

Chairman TOWNS. The gentlewoman's time is expired.

Ms. WATSON. Thank you, Mr. Chairman. Thank you Mr. Bernanke.

[The information follows:]

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Chairman TOWNS. Congressman McHenry from North Carolina.

Mr. MCHENRY. Thank you, Mr. Chairman.

Chairman Bernanke, thank you for your testimony. I know this is certainly not easy to recall what happened in those very, very busy days in the fall, and you've certainly had a very challenging tenure with the Federal Reserve. You didn't come in at easy times. So thank you for your service to your country.

And during your testimony in front of Financial Services, which I'm on, in your numerous comments you worked very closely in the fall with the former Secretary of the Treasury, Mr. Paulson, is that correct?

Mr. BERNANKE. That's correct.

Mr. MCHENRY. And in some testimony, some comments, it was almost daily or hour-by-hour conversations throughout the fall with your counterpart there.

Mr. BERNANKE. Daily certainly.

Mr. MCHENRY. Certainly. And with then-New York Fed head Tim Geithner you also had significant involvement with him on a very regular basis; is that true?

Mr. BERNANKE. That's correct.

Mr. MCHENRY. So the combination of the two, in the context of this event, this controversy that we're analyzing today, did you have conversations with those two about Bank of America?

Mr. BERNANKE. I had conversations with Secretary Paulson who, of course, was the Treasury Secretary at that time. And we talked about, for example, plans for how we might structure a package to help Bank of America avoid being destabilized.

At that point, at that time, President Geithner had already been designated as the Treasury Secretary nominee, and therefore he recused himself from detailed intervention or involvement in such transactions. We did give him basic information so that he would be informed, but he was not involved in the details of the package that was put together for Bank of America.

Mr. MCHENRY. So he was not directly involved and recused himself because of the confirmation hearings and the potential of going from the Fed to the Treasury and the conflicts that would pose.

Did you have conversations with Mr. Geithner to keep him informed of what was going on?

Mr. BERNANKE. I did.

Mr. MCHENRY. There was an e-mail from Tim Geithner on December 20th at 8:02 in the morning: Are you all over B of A slash ML, and are you getting what you need from the troops? And this was to Kevin Warsh.

Now, this e-mail sort of raises to me that while Mr.

Geithner was concerned--and we have another chain here that says that he has basically washed his hands in concern for a potentially tough confirmation hearing. That makes sense. But it seems to me that he was all over this. Is that your impression?

Mr. BERNANKE. No. My impression is that he was informed about the general situation. I would assume that when he meant the "troops," he was referring to the staff at the New York Fed, where he was still the president. But I should say, to the best of my knowledge, he was not involved in the detailed negotiations that developed the package for Bank of America.

Mr. MCHENRY. In an e-mail--we know from a subpoenaed e-mail from the Fed that Mr. Geithner was, like you said, aware, and was at least aware of an ultimatum to Ken Lewis as well.

And he says: Can't MAC have to close.

There's also notes from Bank of America with the CFO, Mr. Price, who said: Fire BOD. If you do it--meaning the MAC--Tim G agrees.

So it seems that he was very involved, Tim Geithner was very involved step by step in this process, if not working through third parties.

Mr. BERNANKE. My only association with Mr. Geithner during this period was occasional phone calls to update him on the general developments. I'm not aware of any other involvement.

Mr. MCHENRY. Two additional things just to wrap up. Did you have conversations about Paulson's conversation with--did you have a conversation with Mr. Paulson about his discussions with Ken Lewis? Because there's been testimony, and we've heard, that Paulson said very clearly that he would fire Ken Lewis and the board. And it seems to me in the reading of all this stuff, is that the government became one. And so perhaps what Mr. Paulson said was thought of as coming from you. And there could be some of this, you know, coming about. So--confusion coming about after the fact.

Mr. KUCINICH. [Presiding.] The gentleman's time is expired, but the witness can answer your question, of course.

Mr. MCHENRY. Could you describe the conversation you had with Mr. Paulson about his conversation with Mr. Lewis?

Mr. BERNANKE. He reported back to me that Mr. Lewis, as I recall, had decided not to invoke the MAC. And that laid open the basis for developing the transaction. But, again, I never told anyone to threaten Mr. Lewis.

Mr. MCHENRY. Thank you.

Mr. KUCINICH. I thank the gentleman. The Chair recognizes Mr. Cummings of Maryland. You may proceed.

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

Mr. Bernanke, as I've listened to you very carefully, I think I get it. I think I get it. You were so intertwined in this thing, and, following up on one of Mr. McHenry's questions, that it's hard to see where your participation ended and where Paulson's began.

And I just take it to your own statement. One of the first things you say in your background is: On September 15th, Bank of America announced an agreement to acquire Merrill Lynch. I did not play a role in arranging this transaction and no Federal Reserve assistance was promised or provided in connection with that agreement.

Is that accurate? Yes or no.

Mr. BERNANKE. Yes.

Mr. CUMMINGS. All right. Well, then you go on to talk about all the things you did to--I'm confused. Let's talk about this whole situation with one of the things you did.

This is your statement. It says: In responding to the Bank of America and these discussions I--talking about yourself--expressed concern that invoking the MAC would entail significant risk.

And then you go on to talk about that: We had Mr. Lewis who testified before us that he's been an experienced guy in this whole banking stuff for many, many years. He took this MAC situation very seriously.

And then Paulson comes along and you come along, according to your own testimony, and you say, you know, I don't think that you are right on this. But basically, it sounds like you did not believe in the competence of Mr. Lewis. I'm just finding this out today?

Is that right, did you think he was competent? Yes or no.

Mr. BERNANKE. That's not a yes or no question. I think on this particular issue, I think that invoking the MAC would have been a mistake. And I would like to mention, sir, that the first reference was to the original September deal in which I was not involved in any way.

Mr. CUMMINGS. Yeah, but you're all wound up in the rest of it, all the way down to the end, based on your testimony.

Mr. BERNANKE. Certainly, I was.

Mr. CUMMINGS. So you felt that he was competent--incompetent with regard to this issue, the MAC, although he was an experienced banker, although he had a fiduciary duty to his shareholders, to his board--and I know that you are always very concerned about disclosure, right? That's a major, is it not?

Mr. BERNANKE. Certainly.

Mr. CUMMINGS. Certainly. And so--but the man who would be held responsible if his bank went down, you say to him when he says--when you pulls up this material, this MAC, and says, do you know what, I don't do this, but I'm taking this very seriously, and I think I better declare a MAC here.

So when he declares it, after all his experiences and what have you, then you come along and says, although it's your duty to disclose certain things, although it's your duty and you are going to be the one who's going to get hit if this thing falls down, I'm going to put my judgment above your judgment; is that basically right?

Mr. BERNANKE. No, that's not right. I offered my views based on my experience as a Federal Reserve Chairman and based on the advice I got from staff at the Federal Reserve that invoking the MAC would not be a good idea for the Bank of America. He himself was uncertain about what to do. But at all times it was his decision to make, and he understood that, I believe.

Mr. CUMMINGS. Well, I don't know whether you saw his testimony, but the man did everything he could not to--we got him to a point where he basically said he felt threatened, but he tried to say that he wasn't threatened. There was not a person in this room who did not understand that he was threatened. You even used the word several times in this hearing. You used it, I didn't, you did.

Mr. BERNANKE. To say that I did not threaten anyone.

Mr. CUMMINGS. No, no, no, no, no. I said that you used the word that he was "threatened." I think you may have been referring to Paulson. And so all I'm saying to you is that I can see how we got to where we've gotten to, where it appears as if we've got Paulson saying--I mean we've got Lewis saying that you may have been behind the scenes doing some things. We've got you saying that you were behind the scenes doing some things. But at the same time, you come back and say, well, you know, I just gave my opinion, you know, it's not--it was up to him.

I do not think--and I'm asking you, do you think it was up to him when Paulson comes to him and says, I'm going to fire you and I'm going to release your board? Is that the way you would want things to happen in this regard?

Mr. BERNANKE. I don't know what Paulson said to him.

Mr. KUCINICH. The gentleman's time is expired.

Mr. BERNANKE. But it was his decision.

Mr. KUCINICH. Excuse me. The gentleman's time is expired, but the witness should answer the gentleman's question.

Mr. BERNANKE. As I said, I don't know what Mr. Paulson said to him, but it was always his decision, and I did not threaten him.

Mr. CUMMINGS. Thank you.

Mr. KUCINICH. The Chair recognizes Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman.

Mr. Chairman, I know this whole process looks like an inquisition. We're not here to indict, just to question and to find out--try to work out the reality here. I think it's a little more confrontational than it should be traditionally. Let's just remember you are placed in that position of being under oath, and I'm hearing testimony going back and forth, so I'm trying to find out how two people may perceive something differently, how words may be changed back and forth.

So let me just ask you, at that time or at this time, did you believe that Merrill Lynch was too big to fail?

Mr. BERNANKE. I thought very likely that if Merrill Lynch failed, it was after all bigger than Lehman Brothers, that it would create a very serious problem in the financial markets. I did.

Mr. BILBRAY. So as a manager you pretty well felt Merrill Lynch needed to be addressed one way or the other to keep it from going under.

Mr. BERNANKE. I thought letting it fail would pose a serious risk, although it's not clear that we could have prevented it from failing.

Mr. BILBRAY. Okay. Now, I saw you made a statement here, and it's in the record, that when someone said, did you invoke a threat or something else, that if they invoked the MAC there would be repercussions to management.

And we can pull up the record. I'm almost sure you said, no, I didn't say it that way, but I did indicate that if they invoked the MAC, and there was--what was it--they needed assistance afterwards, that if there was--this created a situation where they needed assistance, then there would be a problem. And that the clarification there was that it wasn't just the MAC, but if they did the MAC and then needed to come to us for assistance because of that arrangement, then there would be hell to be paid. That was the inference of your statement at that time.

Mr. BERNANKE. That was what was in Mr. Lacker's e-mail about a conversation between us, but I did not make that statement to Mr. Lewis. Although I don't think it's unreasonable if someone makes a decision that endangers his company, that he would be accountable for that.

Mr. BILBRAY. Okay. That's why I want to clarify, Mr. Chairman, because today you did make the comment that you felt that way and you felt comfortable with that. You indicated, I thought you indicated, that you communicated that at that time that--not just that if they invoked a MAC, but if there was assistance needed later, after they invoked a MAC, then there would be repercussions.

Mr. BERNANKE. I don't believe I said that.

Mr. BILBRAY. Mr. Chairman, I would ask that that testimony--because we need to clarify that, because I heard something from you today that sounds very familiar. And that's why I went back to that statement about, It wasn't just about the MAC. It was the MAC; then if they needed assistance, then that management should be held responsible.

And I just thought that your statements today kind of reflected the statement of the 12-20-08 statement. So we can go back into the record and see that. I'm just trying to help you clarify what you said today.

Mr. KUCINICH. Is the gentleman submitting something into the record?

Mr. BILBRAY. Yes, please.

Mr. KUCINICH. Without objection.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. BILBRAY. Now, when you get into this, you said we did not guarantee BIA anything, and you said there was no dollar amount referenced. But could you in this conversation, instead of saying we will pay this much out or we'll get out of it, could there have been any other discussion? Statements like: Look, if there's a concern, if there's a problem here, we'll take care of it or we'll make you whole, you won't--this deal will not impact you in the long run, that we'll cover the difference.

Mr. BERNANKE. We committed to work with them to make sure they would be a stable company and that they would not collapse because of this issue.

Mr. BILBRAY. Okay. I'm trying to clarify here because we're going with testimony. So in other words, you are in a situation where you've got to handle this Merrill Lynch problem anyway. You have what looks like a merger forming, all at once the BOA starting to get cold feet, may pull it apart. They're seeing it from the BOA, I mean Bank of America, taking on this burden. You see, you are going to have a burden one way or the other.

Is it safe to say that from a management point of view, it looks simpler to get them to take this on so you can manage it as a single piece, rather than going back and forth?.

RPTS JURA

DCMN BURRELL

[12:00 p.m.]

Mr. KUCINICH. The gentleman's time has expired. Do you want to put that in a question and then Mr. Bernanke can answer?

Mr. BILIRAKIS. Let me finish with this. You stated today that if you had it to do all over again, you believe today that you would do it exactly the same? Later in your testimony--

Mr. KUCINICH. I am going to take it as a question.

Mr. BILIRAKIS. I will take the question. How do you explain the fact that today you did add a conditioning clause that you did exactly what you needed to do for what you knew at that time? Does that leave you a question? With that statement that you made today, does that leave in the back of your mind that maybe there are things you know today that you would have done differently?

Mr. KUCINICH. The witness may answer the question.

Mr. BERNANKE. I don't know of anything material that would have affected that, given the powers we had and the situation at the time.

Mr. KUCINICH. I thank the gentleman. The Chair recognizes Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman. Thank you, Chairman

Bernanke, for coming today.

You have stated that the Fed acted appropriately regarding issues of public disclosure. You have further stated that neither you nor any member of the Federal Reserve ever directed, instructed, or advised Bank of America to withhold from public disclosure any information relating to Merrill Lynch, including the losses, the compensation packages, or bonuses. And I can believe that, and I have found you to be a person of integrity of the highest degree.

Retrospectively, looking at the developments that occurred with the whole saga of Bank of America-Merrill Lynch, and the Department of Treasury, and looking at the losses investors, both institutional and individuals, absorbed, do you feel that you had some responsibility to disclose some of this information that you knew was being withheld?

Mr. BERNANKE. No. The information about the losses was the responsibility of Bank of America to disclose, and it was up to them with their counsel to determine when that was appropriate. We were required, we the government were required to disclose the terms of the deal within a week after it was consummated, and we did that.

Mr. CLAY. At what point does the welfare of the investor become as important as the institution invested in?

Mr. BERNANKE. The welfare of the investor is very important. And my concern was that the system would collapse, that Bank of America would collapse, which would hardly be a good thing for the investors.

Mr. CLAY. And that was your responsibility then.

Mr. BERNANKE. My responsibility is to protect the overall financial system. But I have to do that within the boundaries of supervisory practice and law.

Mr. CLAY. And at what point should you disclose information to the public?

Mr. BERNANKE. With respect to this particular issue, the law is clear that any action regarding TARP needs to be disclosed within a week, and we did that.

Mr. CLAY. Do you believe that the people were better served by being uninformed in making their investment decisions, especially when official America knew there were misrepresentations in the financial status of B of A?

Mr. BERNANKE. Well, again, those judgments were up to Bank of America. Our job was to try and make sure that the system was stabilized, and that was our primary focus.

Mr. CLAY. Mr. Chairman, why did you think it was necessary for B of A to acquire Merrill Lynch when Lehman had been allowed to fail? What was the thinking of saving AIG, Merrill, and Citigroup when these companies failed to adequately perform and uphold their fiduciary responsibilities to its stockholders? What made these three different from Lehman?

Mr. BERNANKE. We made extraordinary efforts to prevent Lehman from failing. We were unsuccessful partly because we couldn't find a merger partner. Bank of America was a potential merger partner. They decided against it, and we didn't try to coerce them to do it. We didn't have the powers to save Lehman, and that's why they failed, very much--we were very concerned about it, and our concerns proved to be justified.

With respect to the other cases, we did everything we could to avoid a systemic failure because of the risk of the financial system. AIG, as I mentioned earlier, was possible to address because the large insurance company provided collateral for a loan that would allow us to provide liquidity to the Financial Products Division, which was the source of the problem.

After the Congress passed the TARP legislation, it was then much more direct and easy to address these problems. If we'd have had the TARP money in September, we might have been able to address the Lehman problem.

Mr. CLAY. Was it really necessary to salvage AIG? I heard your explanation, but--

Mr. BERNANKE. I do believe so.

Mr. CLAY. --they failed. They failed their own investment. They failed themselves.

Mr. BERNANKE. I had no sympathy for AIG, and particularly for the Financial Products Division. But my concern was that if it failed that the consequences would have been a worldwide banking run, a severe financial meltdown, and very unknown but difficult consequences for the global economy, and I didn't feel that I could take that chance.

Mr. CLAY. And I guess we thought the same about American auto makers a few months ago; that they just couldn't fail, either, they couldn't go into bankruptcy. But we know a different story now.

Thank you, Mr. Chairman, for your responses.

Mr. Chairman, I yield back.

Mr. KUCINICH. I thank the gentleman.

The Chair recognizes Mr. Fortenberry. You may proceed, sir.

Mr. FORTENBERRY. Thank you, Mr. Chairman, and thank you, Chairman Bernanke, for your appearance here today.

I read your testimony, and it appears to me to be a reasonable explanation of your role in the Bank of America-Merrill Lynch merger and the advocacy of certain additional bailout funds. However, while that is the narrow purpose of this hearing, to unpack whether or not there were any conflicts there, and certainly you can understand the cynicism in that we have got conflicting impressions from you and Mr. Lewis about the nature of this deal, I think fundamentally what is at issue here, what is the heart of the matter, is the Fed's future role as a systemic regulator. In that regard, let me go back to a couple of points that were just touched on.

Do you believe it was in the best interest of this country for Merrill Lynch and Bank of America to be merged and to receive the bailout funds that they received, first the $25 billion between the two companies and then later the $20 billion, as Bank of America expressed concern, or let's put it another way, waffling about the potential deal?

Mr. BERNANKE. I think it was critical that we avoided the failure of those firms and the implications that would have had for our financial system. We did so in a way that protected the taxpayer, and again I think we did the right thing.

Mr. FORTENBERRY. One thing that concerns me about this, though, is information that we have from the FDIC Chairman Sheila Bair, who wrote to you prior to the final bailout monies being received by Bank of America. She said there had been strong discomfort with this deal at the FDIC for all of the reasons you and I have discussed.

What did you discuss?

Mr. BERNANKE. My recollection was that her concern was not about taking action to stabilize Bank of America. Her concern was that the FDIC would have financial exposure as part of the transaction, and she was concerned in particular because the transaction involved not only a bank but also an investment bank, which was not in her sphere of responsibility. So it was the details of the transaction, I understand it, that were her concern, not the basic idea of taking steps to stabilize the company.

Mr. FORTENBERRY. Currently we have a situation, it is my understanding, where 10 major banks control about 50 percent of deposited assets in this country, Bank of America being the largest. Is this a systemic risk?

Mr. BERNANKE. We have a lot of large banks, and under our current system and particularly in the current circumstances with financial conditions the way they are, the failure of one of those firms would be very dangerous for the American economy, and that is why I believe that the centerpiece of financial regulatory reforms should be steps to get rid of too-big-to-fail, to find measures that allow a large firm to fail when it is appropriate, but to do so in a way that doesn't bring everything else down with it.

Mr. FORTENBERRY. Well, I agree with that assessment, but I think it is pointing to the need to, in whatever future regulatory framework that we have, to consider the fact that we have 10 banks controlling a majority of assets in this country, and that systemic risk is very real. Do you agree with that?

Mr. BERNANKE. It's certainly real now. But I think there are steps that could reduce the risk associated with those things.

Mr. FORTENBERRY. What could be those steps potentially?

Mr. BERNANKE. Well, for example, greater oversight, capital, and supervision of those companies. A resolution regime that would--

Mr. FORTENBERRY. That assumes failure.

Mr. BERNANKE. In the case of failure, that is correct. But that would create more market discipline because lenders to those banks would know that they wouldn't necessarily be made whole in the case of a failure and they would therefore exert more discipline on those companies.

Mr. FORTENBERRY. The point I am driving at, are these too big? Are these banks too big?

Mr. BERNANKE. I think it is important that banks have no incentive to grow just to become too big to fail. But large banks probably have some other economic purposes, including global transactions, networks, and the like. I doubt we can go back to the world with only very small banks.

Mr. FORTENBERRY. But we are concerned that this level of concentration in the hands of too few is a potential systemic problem.

Mr. BERNANKE. It is a legitimate concern, Congressman, absolutely.

Mr. FORTENBERRY. Mr. Chairman, I would like to yield the remainder of my time to Mr. Burton.

Mr. KUCINICH. The gentleman has the remainder of the time, about a minute.

Mr. BURTON. Thank you very much.

You indicated that Secretary Paulson's comment that he made that threat at the request of Chairman Bernanke was changed later on by Mr. Paulson. But what he said was, and I think this ought to be in the record, his prediction of what could happen--talking about you--his prediction of what could happen to Lewis and the board was his language--was Paulson's language, but based on what he knew to be the Fed's strong opposition to Bank of America attempting to renounce the deal.

You were the Fed. And he said it was based upon the knowledge that the Fed's strong opposition to Bank of America attempting to renounce the deal was something that he knew to be the case, and that he was in effect speaking on behalf of what you had said to him.

Mr. KUCINICH. The gentleman's time had expired. Chairman Bernanke, you are directed to answer his question though.

Mr. BERNANKE. We were strongly opposed to that action for the reasons I have described.

Mr. KUCINICH. Is that your answer?

Mr. BERNANKE. Yes.

Mr. KUCINICH. I thank the gentleman.

The Chair now recognizes Mr. Welch. Thank you.

Mr. WELCH. Thank you, Mr. Chairman.

Mr. Bernanke, I have one comment and two questions. My comment is thank you for your incredible service in very turbulent times. You have been very sturdy, and I think all of us really appreciate that.

Two questions, one about Mr. Lewis and Bank of America, and then following up on what Mr. Fortenberry was asking about.

Mr. Lewis was here, and he had a number of different stories on a single transaction. He told the shareholders that this Merrill deal was a great deal for them, and persisted in that story even in December after he found out about a $9 billion additional deterioration. And to, frankly, my amazement and shock, he never bothered to tell the shareholders the news that led him to the next assertion he made, that that was so dire that he might invoke the nuclear option of the MAC clause. And then he told us basically that--using his words--he didn't use the word "threat," but he said there was heavy pressure from the Fed and Treasury to go through with this deal, with the assurance that the American taxpayer through the Fed and the Treasury would back up any of the toxic assets from Merrill. And I'll just ask one specific question about that.

One of his assertions to the board was that the Treasury and Fed have confirmed they will provide assistance to the corporation to restore capital and protect the corporation against the adverse impact of the Merrill Lynch assets. And he went on to say: The corporation can rely on the Fed and Treasury to complete and deliver the promised support by January 20, the date scheduled for the release of earnings by the corporation.

In your recollection, is that an accurate statement by Mr. Lewis?

Mr. BERNANKE. We did indicate that we would work with him in good faith to develop a transaction, develop a package that would preserve the stability of this company, and we proposed to do that by January 20th. That is correct.

Mr. WELCH. And that included backing up the toxic assets on Merrill's balance sheet?

Mr. BERNANKE. There were no specifics about how we were going to do it. There were different possible approaches, in the event that RingFence is apparently not even going to be consummated.

Mr. WELCH. What he was specifically referring to was the news that they were aware of, that Merrill had far more toxic assets than had been disclosed to shareholders when they approved the deal in the early part of December. So is it your recollection that the assurance he gave his board that the Fed and Treasury would back up the toxic assets on Merrill was accurate?

Mr. BERNANKE. Well, he knew that in the case of Citi, for example, that we had used both capital and a RingFence. So, clearly, that was one of the options that we were discussing as part of the transaction.

Mr. WELCH. Why don't I get to this question that was started by Mr. Fortenberry. You have wisely stated, in my view, that we need a new regulatory regime to protect the economy from systemic risk. And there's really two approaches that can be taken, and the Congress has to make a judgment which is the better one to go. One is a super sized regulator or some entity that has the capacity to monitor the risk of these huge financial conglomerates that when they go down bring us all with them. That is one approach.

The other approach is to take the view that if an institution is too big to fail, it is too big to exist. And the virtue of that, frankly, is that it brings them down to a size where we don't have to depend on the vigilance of regulators being overcome by the influence of the financial industry.

So my question to you is, does it make sense for Congress to pursue a policy that says if an institution is too big to fail without threat to the economy, it is in fact too big to exist and, instead of regulating it, we should break it up?

Mr. BERNANKE. Well, there are two options. One is to allow large banks to take steps to protect the economy if in fact one comes to the brink of failure, which is what Treasury's proposal, for example, includes. The other possibility is to restrict the size of the banks.

I think it is legitimate to discuss both options. I would just point out that very large banks do have an economic function, a global reach, diversity of activities. But Congress may wish to look at different options. I don't want to prejudge what you will be deliberating.

Mr. WELCH. Thank you. I yield back.

Mr. KUCINICH. The gentleman yields back. When our colleagues on the Republican side have others show up, they will be recognized. In return, we recognize Mr. Kanjorski.

Mr. KANJORSKI. Mr. Chairman, thank you for your testimony. And I have listened to a lot of my colleagues today use words like "threats," even "lies," "lying." The reality is if a judge cautions an attorney that certain conduct would constitute contempt, it is not a threat. Is it? That is telling him the power of the court. It is laying out what the rules are. I can't see how people are jumping to the conclusion that by either yourself or the

Secretary of Treasury informing a bank officer or a board that there were powers of the government to take action in a certain way which could constitute removal of the CEO or the board, that doesn't constitute a threat. That is informing them of what the powers are. Isn't it?

Mr. BERNANKE. As long as the reason for exerting that power is legitimate; i.e., that the manager took actions that prejudiced his own company.

Mr. KANJORSKI. And then that would be an issue that later on could be determined. But, nevertheless, it is not a threat. It is telling the truth.

Mr. BERNANKE. Yes, sir.

Mr. KANJORSKI. These are the confines of the power we have, and we're willing to use it. And I am glad somebody told them that, if they did. I don't know if they did, because--I doubt whether they seriously did. I listened to Mr. Lewis both here and as a witness, and I interviewed him individually. And he's sort of rather happy with the acquisition that he made and it accounted for 75 percent of its profits of the Bank of America in the last quarter. So I would suspect that about 6 months to a year from now he is going to be telling this tremendous victory of his of acquiring Merrill Lynch.

But all that being said, I don't know why we are spending our time to find out what happened between the 15th of September and January 1st. All we all know is a hell of a lot went over the dam, and particularly in that spectacular 2-week period after September 15th.

I want you, one, before you leave here to tell this committee and the American people what kind of jeopardy the American system and the world system was in so we reiterate that moment, that we weren't all a bunch of relaxed confident people walking around making clear judgments, but we were working--making emergency judgments, working 20 and 24 hours a day, and not with the clearest heads in the world. Is that correct?

Mr. BERNANKE. Thank you, sir, for that opportunity. September was an incredibly intense period of financial crisis. Many of the largest firms in America came under very severe pressure.

The failure of Lehman Brothers and near failure of AIG were important reasons why the world economy went into a nosedive that lasted for the entire second half or second--fourth quarter of 2008 and the first quarter of 2009.

The Treasury, the Federal Reserve, and other agencies worked overtime to try to prevent additional failures and additional crises. Fortunately, the Congress provided the TARP funding in early October. In mid-October, there was an incipient global banking crisis that involved responses by policymakers around the world, the U.K., Australia, Japan, Germany, and elsewhere. The United States was able to join in that effort because of the TARP money. We averted at that time a global financial meltdown which, in my opinion, very likely would have created a depression-like environment in the United States far more severe than the recession we have seen recently.

Mr. KANJORSKI. Thank you very much, Mr. Chairman. And I gave you your shot; now I am going to come back at you.

Mr. BERNANKE. Sure.

Mr. KANJORSKI. The thing we have to decide is what we are going to do in the future and how we are going to handle it. And one of the things in the last several months--and I have been involved in investigations of everything from the Madoff case to other transactions in the market. But what--studying the inside of our regulatory authorities, I find that, although they may have the authority, they may have the money to act, they sometimes don't know how to act or don't act properly. And, as a result, they have all the authority in the world to prevent something from happening, but it happens anyway. And I want to say that charge would lie against the Federal Reserve, and that is where we are hung up in the course of a dilemma.

The Federal Reserve, as I can see it, had several opportunities to prevent this economic crisis. One is the long used 14 years of power to lay down the conditions on mortgage obligations in this country, that all the way through, about 12 of those 14 years the Federal Reserve failed to take any action until you came on the scene and finally did enact a set of standards across the board. If they had enacted earlier those standards, most of these toxic assets we talk about wouldn't be circulating around the world with the imprimatur that they're supported and passed on by the United States Government.

Two, there are issues with the Federal Reserve that they are now acquiring additional powers when they failed to use their past powers.

Could you address those two issues.

Mr. BERNANKE. Certainly. And I agree with you--

Mr. KUCINICH. The gentleman's time has expired, but please answer the question.

Mr. BERNANKE. Congressman Kanjorski, you are right that the Federal Reserve was late to invoke those consumer protection powers. We have been very aggressive, as you know, for the past couple of years. I think it is very important if the Fed retains those powers that we strengthen the priority that those have in our decision making and that we strengthened accountability that we report frequently to Congress about what we are doing in these areas. So that is very important.

In terms of additional powers, I think it is worthwhile pointing out that if we look, for example, at the Treasury's proposal to make the Fed the consolidated supervisor of systemically critical firms, that it's not major difference in terms of powers from what we currently have, which is being an umbrella supervisor of all the financial holding companies. Rather, it would be not so much a change in powers but a change in approach whereby we would take a systemic systemwide approach in how we would regulate those firms rather than looking at them bank by bank or firm by firm.

So it is not a massive increase in powers. It is really a change in their strategy.

Mr. KUCINICH. I thank the gentleman for his response. The Chair recognizes Mr. Turner.

Mr. TURNER. Thank you, Mr. Chairman.

Mr. Bernanke, I want to thank you for being here today. I know that we have had very difficult times, and certainly you and Mr. Paulson and others we know have worked diligently to try to restore the financial security of the country.

There are divergent opinions, though, of the actions that are taken and to how we should approach them. I have voted against every bailout that has come before this Congress, and I have done that because I felt that the programs that were put before us were not clearly defined; the scope of the costs or expense was not clearly defined;

the ability to hold people accountable was difficult to ascertain in programs that were undefined. And I think that we are seeing now, as the American public looks at this, there's a lot of unintended consequences. There are things that are happening that the American people are saying, well, I didn't quite think that that's what it's going to be.

I know you are facing a lot of questions today concerning Bank of America and Merrill Lynch, and they go right to the heart, I think, of questions concerning the Federal Government's proper role in private enterprise. How do we step in appropriately? How do we not step in?

You know, the Federal Government has very mixed performance when it comes to the issues of interfering or intervention in private enterprise. Frequently, this committee has hearings on issues as basic as our contracting processes with private enterprise. We are not a very good customer. Many times issues arise where people wonder whether there's been abuse of processes, conflicts of interest. So when you then put another layer of us just not being a customer but us being an investor, an entity that is providing a bailout, or even an owner, people have a great deal of concern.

Yesterday, I introduced House Joint Resolution 57, the Preserving Capitalism in America Amendment. It is a proposed amendment to the United States Constitution. It came about as a result of my discussion with people back home because several people that I spoke to said that they did not believe that enough people were taking a stand to say this is wrong, I don't believe that this should have happened in this manner. I know we have difficulty, but I don't agree with this structure. I don't agree that we should own General Motors.

The Constitutional amendment would limit the ability of the Federal Government to acquire an ownership interest in a private corporation. It does give the government the ability to issue loans. It also allows us to invest in public authorities, public use corporations, and also allows investments by government pension funds.

It turns out that, as I was discussing this with people in my community, that limiting government ownership over private enterprise is not a new idea. We found that at least eight State Constitutions have in some form limited the State's ability to acquire stock or equity in a company apparently as a result of the panic of 1837, which you would know a whole lot more about than I do as a result of your great historical expertise.

But a number of people have concerns as the Obama administration moves forward, as the bailouts in the financial sector move forward, as our domestic automobile industry becomes publicly owned.

The Constitutional amendment that I dropped yesterday was dropped with 102 original cosponsors. Nearly a quarter of the House stepped forward and said, I want to support a Constitutional amendment because we don't think it can be done by statute, that could say: We understand that there are times when action needs to be taken. We understand when intervention needs to occur. But we do not believe that ownership is a structure that should be an available option. We are very concerned about what happens next.

For example, we have a huge ownership interest in General Motors. We don't in Ford. Let's say both of them bid on a government contract. What happens then? Can Ford be assured that they are going to have the equal treatment when the government's virtually bidding for its own contract?

I would like your thoughts on the amendment. And if that amendment was in place, I would like your thoughts as to how you would have gone about--and how TARP funds would have been used and some of these other things could have been structured in a way where we wouldn't have ended up with ownership but you would have responded to our financial crisis.

Mr. BERNANKE. Well, I agree with you that limited government ownership, limited government intervention in the private sector is frequently a good policy. And in that respect, I think that is a very good approach.

I should say, though, that in order to make that a viable policy in our financial sector we need to have a set of rules and regulations that can allow financial firms to fail. And I believe in failure. You know, failure--capitalism without failure is like religion without sin, somebody said. You need to have failure. But you have to have failure in a way that is not going to bring down the entire system. So if you are going to do that, you need to also have rules and regulations that allow the orderly wind-down, the orderly failure of large financial firms.

Mr. TURNER. Before we conclude, Mr. Chairman, if you'd allow me. So I don't believe you are saying, are you, that you think that the only way you could have intervened is to result in ownership; that there weren't structures of loans and other assistance that could have been provided that wouldn't have ended up in the Federal Government having an ownership interest? And then of course, therefore, where we get this conflict of, well, how is the government going to execute its government interest?

Mr. BERNANKE. I have to think about that. But if you look at banking crises in history, in Japan and Sweden, in the U.S. In the '30s, and so on, frequently you do have a period of capital being injected by the government, which essentially is a temporary ownership. Usually those things are temporary.

But, again, I am not sure what the alternative would be. I would be happy to think about it. But in order to avoid ever having government ownership again, you need to figure out a way to avoid having the crisis in the first place, And I think that should be the first priority.

Mr. TURNER. I appreciate the thoughts, because people are obviously very concerned about this. And this looks like a line that perhaps we should not take.

Thank you so much.

Chairman TOWNS. [Presiding.] Thank you so much. Yield to the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. Thank you, Mr. Chairman. As someone who voted against the TARP, I just want to comment on your kind remarks in saying that through the wisdom of Congress we passed the TARP bill. Number one, as you may remember, TARP was presented to us as a way to purchase toxic mortgages. It was never used for that. So what we voted for was never put into action.

Number two, several weeks after we did the TARP bill, we also passed a TARP corrections bill. It was a 400-page bill that we passed to correct all the mistakes that we made in TARP. So I am not so sure that the wisdom of Congress is necessarily accurately ascribed in that statement.

I do want to say I agree with Chairman Kanjorski about the context in which you took all this action. The sky was falling, it was a very difficult time. But I do want to say the reason we are going over this chronology is because we have granted the Fed enormous independence, and there is sometimes a tension between the premise of the taxpayers' interest and the power of the Fed and the independence of the Fed, and that is why we are going over this.

There has been a lot of back and forth today. But, basically, what the facts are is that Merrill got into trouble very early in '07 when E. Stanley O'Neal was there. It was a very difficult situation. There was a merger proposal that you supported quite strongly between Bank of America and Merrill Lynch. There was an agreement to enter into that merger. And then at some subsequent time there were major losses. There were early losses, $8.4 billion that occurred in 2007. It looked like an additional $12 billion that was discovered by Mr. Lewis on December 14th, 2008. And then he announced his desire or his intention to invoke the MAC. And then we have a difference of opinion, and that is on one side some folks are saying that you or Mr. Paulson threatened Mr. Lewis. Other people say it was simply iron-fisted encouragement to have him stay in the deal. In any event, he did that. He stayed in the deal. And there is an interesting e-mail from you, and I just want to go over this because I am interested in the taxpayers' position.

It says here--this is from you, Mr. Chairman, to Scott

Alvarez. And it says: I had a good conversation with Lewis just now. He confirms his willingness to drop the MAC--the opposition to the deal going forward--and to work with the government to develop whatever support package might be needed for earnings announcement dates around January 20th. We discussed his common equity issue. We agreed that having a significant amount of TARP capital in the form of common--common equity--was not an ideal solution given the ownership implications. But we agreed both to think about possible solutions, parenthesis, a government backstop of a capital raise or a government common with limited control rights.

Now, it sounds to me like Ken Lewis is concerned about his job. And for the American taxpayer to get voting rights in return for their TARP money, Mr. Lewis would be gone, I believe. Is that the concern that you believe Mr. Lewis expressed regarding the TARP being presented with rights, voting rights for the American taxpayer in that deal?

Mr. BERNANKE. I don't know exactly what his concern was. It may have also been involved in just concern about government intervention in his management and in the operations of the company.

Mr. LYNCH. Well, there was a--this discussion, it is what it is. It indicates that Mr. Lewis is concerned about the taxpayer having some input here, some control. And it sounds like your--it says: But we agreed to think about possible solutions to that, a backstop of capital raise or government taxpayer involvement here with limited control rights. And I am just wondering whether--in this deal to provide this support, whether the taxpayers are getting the full leverage that they should have gotten given the amount of assistance we put into this company, into this deal.

Mr. BERNANKE. Well, the company is subject both to the restrictions of the TARP and the Treasury's provisions on executive compensation and the like, and they are also subject to--as has been discussed, they are subject to the supervisory oversight of the Federal Reserve and the OCC. And we have taken actions, for example, to ask them to add independent directors to their board and make other appropriate changes to their company.

Mr. LYNCH. Could we have not gotten greater protections for the American taxpayer in this deal than what we did in terms of--considering that we are saving this company with the American taxpayers' assistance and we don't gain the control that I think is commensurate with that support?

Mr. BERNANKE. Well, the--I am not quite sure. I would have to go back and look at that e-mail again. At that time the TARP money was all provided in the form of preferred stock, which is--on the one hand is not voting but on the other hand is senior to common equity and, therefore, is safer.

Mr. LYNCH. They get paid first. I understand that. But it is the lack of--it seems like Mr. Lewis was most concerned with lack of input or lack of control on the part of the taxpayer. And I think that would have helped us, you know, in this deal if we had had greater control on behalf of the American taxpayer.

Mr. Chairman, my time has expired. Again, Mr. Chairman, I thank you for appearing and helping us with our work. I yield back.

Chairman TOWNS. Thank you very much. I now yield 5 minutes to the gentleman from Massachusetts, Mr. Tierney.

Mr. TIERNEY. Thank you, Mr. Chairman.

Mr. Bernanke, I want to discuss, if I can, for a second, is this another way that public money seemed to have flowed to some of these financial institutions? Back in March of 2009, AIG disclosed the name of certain of the counterparties, people that they had credit default swaps agreements with, and Bank of America was among them as well as others. It appears from our records here that there were losses in the so-called super senior multi-sector credit default swaps, the portfolio that AIG had, and that it created a liquidity problem. They had obligations, that if there were problems in that portfolio they had to put more cash in or more collateral security for their obligation.

The Federal Reserve Board of New York then provided $85 billion in a loan to AIG. The testimony here was that then that money was used to buy out the contracts and cancel them. That is how they took care of that obligation. What was of concern to me and some others was that the counterparties appeared to have received 100 percent, even though testimony from people at AIG before this committee said that they thought that there were a lot of contentious reasons to think they did not owe 100 percent, if they owed anything at all, on those particular obligations, that there had been serious negotiations about whether they should pay anything to these counterparties and, that if they should pay something, how much less than 100 percent they should pay.

When we pressed Mr. Liddy, AIG, for background on that for just how the negotiations went, why it is they paid 100 percent, his comment was that he was the wrong person to talk to; that in fact the Fed had all of those documents and paperwork because they in fact struck the deal.

So my question to you is, why was 100 percent paid on these various obligations, including the one to Bank of America? And what was the rationale there? Why weren't the interests of the--the public money interests protected so that there was a better negotiation than just forking over 100 percent?

Mr. BERNANKE. Sir, I don't see on what basis that less than 100 percent could have been paid. They were contractual obligations. Failure to pay them would have allowed the creditors to force bankruptcy, which was exactly what we were trying to avoid. This is precisely why we need a resolution regime which would allow the resolver to haircut creditors and to abrogate existing contracts. But under current law you can't avoid bankruptcy without paying off the existing contracts.

Mr. TIERNEY. Well, except that the people that were running AIG said that they thought that there were certainly issues involved in that they didn't owe money; that the default may not have occurred, or if it occurred, it didn't obligate them to pay a full amount. These people that were running the company, that had made the contracts, that felt very strongly they had been negotiating on these for a period of time and apparently thought that they could have struck deals that would have not obligated 100 percent. These are contractual issues. So it could have been done. And yet, once they turned that matter over to Fed, the Fed and their inferences was, just rolled over and gave 100 percent to Bank of America, Citibank, other people. And it looks to others from the outside that we were trying to make those people healthy, unquestionably, by taking public money and putting it in their coffers by folding on that deal.

So my question to you is, will you produce to this committee copies of all the credit derivative contracts that AIG Financial Products Corporation had with those third-party counterparties, including all the details of the terms and conditions of the contracts? All documents and correspondence regarding the creation of Maiden Lane 3, the special purpose vehicle that was created by the Fed to do these transactions, and including the negotiations that went on for that? And then, all documents and correspondence concerning the management and overside of Maiden Lane Trust so that we can get a look at those documents and make an assessment on that?

Mr. BERNANKE. I think we just--in our recent release, I think we just released a whole set of documents related to those issues. But if you have specific--we just created a monthly publication that provides a lot of information about the Maiden Lanes, for example. If you would send us a letter with a specific request, we will see what is available.

Mr. TIERNEY. We certainly will. When you say you will see what is available, I mean, we want everything that is available. And the question to you is, when we make that request, will you provide it?

Mr. BERNANKE. If I am able to do so, I will.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. TIERNEY. Thank you. I yield back.

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

Mr. DAVIS. Thank you very much, Mr. Chairman. And, Chairman Bernanke, thank you for being here and your long patience and endurance.

Let me just ask you, how involved is the Fed in the day-to-day management of Bank of America? For example, does the Fed have veto power on major decision making at Bank of America? And, has any consideration been given to replacing upper-level management?

Mr. BERNANKE. The Fed is not involved in day-to-day management. That is the responsibility of the board and the management. We are involved in evaluating the capital, the assets, liquidity, and the management of the corporation. We have had concerns about aspects of the management, and we have asked the board in particular to add independent directors, which they are in the process of doing, and we will continue to be very careful and monitor the management situation. But we do not take daily decisions. That is not our job.

Mr. DAVIS. Mr. Chairman, let me ask you, when the government invested heavily in AIG, Fannie Mae, and Freddie Mac, the management was actually replaced. Why was the fate of Mr. Lewis so different in this instance?

Mr. BERNANKE. Well, I think in this case that the merger was undertaken in good faith. It was--at the time looked like a reasonable combination. A lot of firms suffered severe losses in the fourth quarter. It was one of the worst quarters I think in history in terms of financial losses.

Our judgment at the time was that he could continue to lead the company, and we have not addressed that, but obviously we will continue to evaluate management and the board as we go forward and make sure that we are comfortable with the leadership of Bank of America.

Mr. DAVIS. In an e-mail from Mr. Warsh to yourself on December 30th, Mr. Warsh writes, and I quote: Ken Lewis is going to call you to reaffirm the understanding you have. Ken may also raise his favorite perennial issue; that is, the Richmond supervisory team on the same page as the board. Richmond staff was on our call today, but prior to the call it sounds like they may have threatened a little more than ideal. Need to get rid of dividend and fast. I told price system will be making joint determinations.

My question is, to your knowledge, do you think that Mr. Lewis' interaction with the supervisory team at the Richmond Fed threatened, coerced in any way Mr. Lewis?

Mr. BERNANKE. Well, the Federal Reserve in general throughout last year was concerned about Bank of America's capital and particularly its tangible common equity. And the Federal Reserve Bank of Richmond, which was the supervisor of Bank of America, was interested in having Bank of America increase their capital perhaps by reducing their dividend or through other measures.

At the various points there were some confusions, I think, about what the position of the Fed was because there were miscommunications between the Richmond Fed and the Board of Governors in Washington. And Mr. Lewis, far from being intimidated, was free to call me and ask me for resolution of these issues, and we made sure that everybody was on the same page and got that cleared up.

Mr. DAVIS. So it would be a normal interaction in terms of--

Mr. BERNANKE. Yes. A normal process.

Mr. DAVIS. --than, look, I am having some concerns with Richmond, and that kind of thing?

Mr. BERNANKE. Yes.

Mr. DAVIS. Mr. Chairman, let me ask you. You have gone on record as supporting increased transparency in connection with the Federal Reserve operation. Yet the bailout of Bank of America was done behind closed doors without investor public knowledge or input. Could the American people really understand in any way what happened? I mean, what really happened? Was Mr. Lewis bullied into going forward with his own bad deal? Or, did Mr. Lewis recklessly agree to pay too much for Merrill Lynch so that the Federal Government felt backed into a corner when faced with the prospect of Lewis backing out of the Merrill deal? And of course we experience the inevitable bankruptcy of Merrill Lynch.

Could you respond to those?

Mr. BERNANKE. Yes, sir. Today I think has been very productive in terms of transparency and more information about what happened. Clearly, it was a very difficult period and many complex problems that were being addressed. But, as I have indicated, I believe that we solved this problem without in any way taking steps that were either beyond the law or unethical. And I believe we did the right thing in order to stabilize both companies and the financial system.

Mr. DAVIS. Thank you very much. And thank you, Mr. Chairman.

Chairman TOWNS. The gentleman's time has expired. Congresswoman Norton for 5 minutes.

Ms. NORTON. Thank you, Mr. Chairman. And we do appreciate the transparency you are trying to bring to this transaction. I am not inclined to second-guess the judgment of people in the midst of trying to deal with a problem arising, problem after problem, in the midst of a crisis, an unusual crisis at that. I am interested in Bank of America's options under the circumstances. Bank of America had shareholders. We did have a series of rather unusual late-developing facts or factors to come to light in the process of the negotiations for this agreement.

I am wondering if it would not be true that--let me lay the predicate for this by saying you apparently--the Legal Division apparently had an opinion that no Delaware court had been found that--I am quoting now--that have found a MAC or material adverse effect to have occurred in the context of a merger agreement. Well, one would have to know the facts surrounding those circumstances. And to suppose that they could not possibly have been at the same level of intensity as these, because we were in the middle of a national economic crisis. That aside, I can understand from that one sentence that, without knowing what the case law was, that there was that conclusion.

But could not Bank of America have negotiated a reduction in price with Merrill had it invoked the MAC clause? Wouldn't you think that would be the logical thing to try to do, given the obligation to the shareholders?

Mr. BERNANKE. First, we did review the case law, and I think it was quite applicable. I am not a lawyer, but the advice I got was that it bore very directly on the situation that we were looking at, specifically, that short-term losses, no matter how large, are not basis for a MAC in this particular case. Only long-term durationally significant losses in revenue or revenue production are grounds. And, of course, Merrill Lynch has proved to be a profitable acquisition for Bank of America.

The why not negotiate a better price? That wasn't the issue that Lewis originally raised. He was talking about just breaking off the merger. But I think that would have also been very dangerous, because the markets would have been faced with the uncertainty of whether or not the deal was going to go through. Merrill Lynch would probably not be able to survive absent the support of Bank of America, and so there would have been an immediate problem with Merrill Lynch which would have created broader problems in the financial markets.

I don't think--

Ms. NORTON. Even if they threatened to do that in the context of negotiating?

Mr. BERNANKE. Well, you can't negotiate anything unless you are willing to go through with your threat, as you know.

Ms. NORTON. It happens every day.

Mr. BERNANKE. And so, therefore, there would have to be a probability in the minds of market participants that in fact Bank of America would not go through with the merger.

Ms. NORTON. So you think that would have been considered a bluff?

Mr. BERNANKE. I think that would have been destabilizing as well. Yes.

Ms. NORTON. And in consummating, though, the merger as it was originally planned, in effect didn't the Bank of America shareholders take a good part of the hit of the Merrill losses?

Mr. BERNANKE. Not in our view. As I said, when I talked to Mr. Lewis about this, I stressed that not only was invoking the MAC bad for the financial system broadly, but I thought--our opinion was that it would be bad for Bank of America itself. And, in particular, if invoking the MAC had caused Bank of America either to fail or to become--have to be saved on some emergency basis by the government, that clearly would not have been good for the shareholders of Bank of America. Now of course, in the end he had to make the judgment of what to do. But that, in my opinion, it was not obvious at all that invoking the MAC was a good thing for the Bank of America shareholders.

Ms. NORTON. And you think he made that decision on his own without undue influence from the government in any way?

Mr. BERNANKE. I believe he did.

Ms. NORTON. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much. Mr. Chairman, I know we have an agreement that we would finish at 1:00. Would it be possible for you to stay until 1:10? Would that create a problem for you? And I understand agreement. Okay.

Mr. BERNANKE. Yes.

Chairman TOWNS. Thank you very much. Let me say to the members, what we will do is divide 10 minutes on each side. And of course--so why don't we yield 5 minutes to the ranking member on the committee.

Mr. ISSA. Thank you, Mr. Chairman. I will be brief. I just want to go through a couple of quick questions.

First of all, it appears as though much of the media thinks the end justifies the means, meaning that even if there were threats or if people felt threatened to go through with deals, it is okay because it worked out. Do you agree with that?

Mr. BERNANKE. No, sir. We used only legal and ethical means.

Mr. ISSA. I appreciate that. Do you also agree that at all times the rule of law and the expectations that are written in both the letter and the broader meaning of the law should be the guidance for all transactions done behind closed doors by Federal officials?

Mr. BERNANKE. Yes, sir.

Mr. ISSA. As we choose to find ways to resolve the ambiguity between Ken Lewis, Hank Paulson, yourself, and of course a number of people whose e-mails have been cited today, are you prepared to answer in writing--not return here probably--additional questions that may come up that would help us clear that up?

Mr. BERNANKE. Yes.

Mr. ISSA. Do you at this time believe that, intentionally, Ken Lewis, Hank Paulson, or any of the people we have cited today in e-mails intended to lie in their statements?

Mr. BERNANKE. I have no judgment on that.

Mr. ISSA. But you believe in good faith that they think what they are saying is true, at least as far as you know?

Mr. BERNANKE. As far as I know.

Mr. ISSA. Do you think that Federal regulators should pick winners and losers as they go through trying to figure out in a crisis like this who gets to own who or who gets bailout money and who doesn't?

Mr. BERNANKE. I think all these interventions are very unfortunate, and they are only made necessary by the extreme circumstances.

Mr. ISSA. Earlier, one of the people we mentioned was Mr. Lacker. In light of his e-mail paraphrasing a longer discussion, do you intend to speak to him and try to clarify how the difference in interpretation could have happened?

Mr. BERNANKE. I have done so already, and he didn't have any further recollection.

Mr. ISSA. Okay. And then I would like to yield to Mr. Burton the balance of this 5 minutes.

Mr. BURTON. Let me just say that I don't want to dwell on this, but one of the biggest problems I have is the government telling the private sector what to do and how to do it. We had the head of General Motors literally fired by the government. Now, there might have been justification for his removal, but I didn't think the government ought to be telling somebody who is answerable to the stockholders what they are supposed to do.

One of the things that concerns me is on December 5th, Bank of America's stockholders approved that sale or that purchase and that merger when they thought it was a $9 billion loss. And then the 14th, they found out it wasn't $9 billion but $12 billion. And then, because they decided that they didn't want to do that, they contacted you and Mr. Paulson. And whether Mr. Paulson said directly you told him to do it or not to do it, but the inference was there, that the Fed said if they pull out of this deal, their board and the CEO is going to be gone.

Mr. Lacker said on the 20th, 2 days before they made the decision to go ahead with it, he said: Just had a long talk with Ben. Says they think that the MAC threat is irrelevant because it is not credible. Also intends to make it even more clear that if they play this card and then need assistance, the management is gone.

So even though they were going to incur $3 billion more in liabilities, because of the pressure put on by you and Mr. Paulson they went ahead with that deal because they thought they and their management was going to be fired.

Now, that is the problem I have. The government is coming in and saying you are going to do this or else. This is not a socialistic society. This is a government of free enterprise and of the people and by the people and for the people. And what bothers me is they thought they were incurring $9 billion; they found out it was $12 billion. And you told them--you and Mr. Paulson told them: You are going to do this or else. And I just think this is wrong.

You can make a response, if you'd like.

Mr. BERNANKE. My response, sir, is I never said that to Mr. Lewis.

Mr. BURTON. You never said this to--Mr. Lacker is wrong?

Mr. BERNANKE. Mr. Lacker, who is an internal person at the Fed--and, again, those are his words summarizing a much longer discussion--said a more subtle thing than what you are saying. What he said was that if they took this decision and if they were required to be rescued, that if this decision led the markets to attack Bank of America and create a destabilization of the company and the government had to come in on Sunday night and save them, that we would take that into account in thinking about management. That is a very different thing. And, also, I did not say that to Mr. Lewis.

Mr. BURTON. What about your attorney who said that you were going to put pressure on them? I brought that up in my previous 5 minutes.

Mr. BERNANKE. Well, again, I did say very strongly--

Mr. BURTON. He works for you.

Mr. BERNANKE. I said to Mr. Lewis that we strongly believed that invoking the MAC was bad not only for the financial system but for Bank of America. But I didn't tie it directly to replacing him or the board.

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

Mr. KUCINICH. I thank the gentleman.

Chairman Bernanke, your staff believed that Bank of America knew about Merrill Lynch's accelerating losses in mid-November, a full month before coming to you and weeks before its shareholders voted to approve the merger. Those fourth quarter losses rose to over $15 billion out of the pockets of Bank of America's shareholders. But I want to ask you, did the Fed know about those accelerating losses before the Fed approved the merger at the end of November?

Mr. BERNANKE. No, I don't think we did.

Mr. KUCINICH. Well, may I introduce into evidence this e-mail, which is from Dennis Herbst of the New York Fed to Audrey Overby of Merrill Lynch. And it is dated Wednesday, September 17th. It says: Hope this gets to you, Audrey. Our management--that is the New York Fed--has asked to continue the flash report on a daily basis, and I am sure you will share it with the SEC.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. KUCINICH. So the Fed was receiving detailed information by which they could have concluded that the overwhelming losses at Merrill Lynch were more than problematic and that the Fed could have done something if they chose to.

Now, are you familiar with this e-mail, or are you saying that there is no--

Mr. BERNANKE. We are certainly involved in a light way in the oversight of those--of Merrill Lynch since we began to lend to them. But we are not their formal supervisor, and our information about their losses would certainly not be--

Mr. KUCINICH. But, Mr. Chairman, the Fed knew what Bank of America knew. You were saying earlier with respect to Bank of America, as a matter of fact you were--you really put on them the responsibility to notify the SEC. But yet you knew--you knew before the merger was approved.

Mr. BERNANKE. In November? We didn't know about the $14 billion. I am sure we didn't know that.

Mr. KUCINICH. But you knew about Merrill Lynch's condition before you approved the merger. Now, you--did you not? Did you not know about their financial condition was failing before you approved the merger? If not--if you say no again, that flies in the face of this e-mail that came from somebody at the New York Fed who is tracking Merrill Lynch on a daily basis.

Mr. BERNANKE. Well, they are tracking it. But it is difficult to know what these valuations are. They have to be done by professional asset managers. I was not aware. All I can say is I was not aware and I don't think anyone at the Fed was aware of the $14 billion in losses.

Mr. KUCINICH. But there's an e-mail here saying that the Fed is following up with the request for daily P&L, profit and loss, relative to Merrill Lynch. Now if--and, Mr. Chairman, I am going to enter that into the record as well.

Chairman TOWNS. Without objection.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. KUCINICH. When you permitted the merger of this company that was too big to fail, you knew the company would be a significant player in four of the five critical financial markets; namely, wholesale payments, foreign exchange, U.S. Government and agency securities, and corporate and municipal securities.

Isn't it true that the combined entity of Bank of America and Merrill as a significant player in four or five critical financial markets was a key rationalization for Fed action to bail out the merger?

Mr. BERNANKE. I don't know. I would have to get back to you on that.

Mr. KUCINICH. Excuse me?

Mr. BERNANKE. I would have to get back to you on that. I don't recall the details.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. KUCINICH. Well, I am going to read a quote from a Fed memorandum entitled Considerations Regarding Invoking the Systemic Risk Exception for Bank of America Corporation. And the quote is: An inability of these organizations to fulfill their obligations in these markets and the related systems would lead to widespread disruptions in payment and settlement systems in the U.S. as well as abroad.

Now, in our investigation we have not encountered any evidence that the Fed considered the potential for systemic risk when you approved the merger of Bank of America and Merrill Lynch, which only weeks later was too big to fail.

Now, Chairman Bernanke, did you really believe that Ken Lewis' threat to invoke a MAC was a bargaining chip, as you stated in an e-mail dated December 21st, 2008?

Mr. BERNANKE. I thought initially that it might be. Yes.

Mr. KUCINICH. Did his use of a bargaining chip help him obtain a deal he would not have otherwise received had he merely asked for increased assistance from the government?

Mr. BERNANKE. As I also said I think in a later e-mail, after listening to him and having more discussions, I came to the conclusion that he was really uncertain about what to do. We provided advice, which he ultimately took, and we took steps to prevent the destabilization of his company and the financial system.

Mr. KUCINICH. Mr. Chairman, I ask you for one more minute.

Chairman TOWNS. Yield the gentleman an additional minute.

Mr. KUCINICH. Isn't it true that you did not believe the Merrill losses merited special attention from the government?

Let me direct your attention to handwritten notes from your first meeting with Ken Lewis on December 17th, 2008. You reportedly stated the downside of $50 billion doesn't sound big for Bank of America. The $50 billion refers to Merrill assets that Lewis had wanted protection for from the government. The record clearly shows you did believe that there would be systemic consequences if Bank of America took steps to back out of its deal with Merrill Lynch irrespective of whether it would win in court.

So, did the threat of a MAC, which you believe would have serious consequences, influence your willingness to give Bank of America financial assistance when you didn't believe it needed to have it?

Mr. BERNANKE. We had demonstrated with Citigroup, for example, that if we saw a major financial institution about to fail and to risk the stability of the financial system, we would try to take steps to stabilize it. So I think we would have done that in any event.

Mr. KUCINICH. Mr. Chairman, I just want to conclude with this point. Mr. Bernanke has testified that he was concerned about systemic collapse. We all understand that. He was concerned about Bank of America's collapse. We understand that. And he said that the Bank of America collapse would hardly be a good thing for investors. That was your testimony.

But if the Fed knew that Merrill Lynch was failing before the shareholders voted, why did you not inform the SEC about this? If they knew about it, if you knew about it before you approved the merger, why did you approve the merger?

Mr. BERNANKE. The $14 billion of losses that Mr. Lewis reported to us, I don't believe that we--I am sure we didn't know about that in November.

Chairman TOWNS. The gentleman's time has expired. I now yield 5 minutes to Mr. Issa.

RPTS MERCHANT

DCMN NORMAN

[1:00 p.m.]

Mr. ISSA. Thank you, Mr. Chairman. Mr. Jordan is going to be primary closing. I just want to wrap up a couple things I heard.

As you probably know, Neel Kashkari has appeared before this committee multiple times. And in our questioning of him, the one thing we found is he didn't know at that time how much he had paid for things, he didn't know what they were worth, he didn't know how they valued them, but he was going to get back to us and never did. I understand he has left the government.

But what that has told me, because it occurred in real time, it occurred exactly when these things were going on, that on a day-to-day basis you didn't know what assets were worth, including these toxic assets; is that roughly correct?

Mr. BERNANKE. It's very difficult to know what they're worth.

Mr. ISSA. I appreciate that, and I appreciate your service in trying to do the best you could in this tough situation. But one thing, and my last question is, when it came to the MAC. You had said just a moment ago that it only could be invoked if, in fact, you had forward-looking lesser revenues, that it was not material to the balance sheet--if I can paraphrase you--but to the income statement. That's what I heard you say.

Mr. BERNANKE. That's what I understood the memorandum to say.

Mr. ISSA. And I appreciate that. But if that's true, then isn't it true that if you have to restate your income prospectively or retrospectively, then by definition the go forward is reduced? In other words, if you never made as much as you thought you made because the assets materially degraded because they were never going produce what you had said in the past, then in fact it is a MAC event. So losses accumulating could well have been a viable reason to predict that the enterprise value going forward was less? Wouldn't you say that was correct based on normal accounting?

Mr. BERNANKE. I shouldn't drift into securities law which I'm not an expert. The advice of my attorneys was that the MAC would be unlikely to succeed. And even if there was a significant probability of not succeeding, it could have caused a lot of disruption in the financial markets.

Mr. ISSA. We appreciate your effort here. I am going to turn the rest over to Mr. Jordan. And thank you for everything you did and everything you tried to do to help our country.

Mr. JORDAN. Mr. Bernanke, when did you know that you would not be able to go in and buy the toxic assets, the mortgage-backed securities? Because if you remember back, I mean the whole package was sold to the United States Congress based on what you told Members of Congress, what Mr. Paulson told Members of Congress.

And I think I asked this question. You're a sharp guy, MIT graduate, Ph.D. In economics, Mr. Paulson is a smart guy, Mr. Geithner is a smart guy, you convinced the Congress you could go in, you could put some value on these assets, you could clean them off the books, everything would be wonderful after that point.

And yet ten days after we passed this--and I didn't vote for it--but ten days after you passed it, you bring the nine biggest banks to Washington, don't tell them what the meeting is about, and you completely change strategy.

So when did you know you would not be--did you know before Congress voted on it, or did you know after Congress voted on it, when you would not be able to go in and purchase these securities and do what you told us you were going to do?

Mr. BERNANKE. Well, we knew after. One of the reasons, one of the problems was--

Mr. JORDAN. Here's what I don't understand. This was a month long--I remember the first conference call we listened into as Members of Congress was in September. You had a whole month, and yet within ten days the strategy-- probably within a few days the strategy.

So you had a whole month leading up to this convincing the Congress you could do this, and yet within ten days a complete change; and yet you're bringing nine banks to Washington, not telling them what it's about, not telling them you're going to force them to sign a form, take taxpayer money and completely change strategy.

And you look at, as we went through some of the things here, the pattern of some might say deception, where the banks come to Washington not knowing what the meeting is about. Mr. Angulo does the letter saying we're going steer Merrill Lynch on how to disclose to the public what is going on on this merger, what is happening with Merrill Lynch.

I think it's a reasonable question to say when did you know this, and if you didn't know until after October 3rd, what took you so long to figure it out? You had a month as we were going through this whole thing, and, frankly, two weeks of debate in this Congress. You remember they sent us home for a few days, come back, and we passed this after a second vote.

Mr. BERNANKE. I would be happy to answer that question. The drawback of the asset purchase plan, as we discovered, was that it took some time, probably some months, to put it into operation. We thought perhaps that would be possible. But, unfortunately, the banking situation deteriorated very quickly, and by Columbus Day we had a global banking crisis. And the only way to stop the crisis from spreading and creating a huge problem was to inject capital, to have guarantees and to take the various steps we took.

So this was the only way to do it as quickly as was needed, given the way the situation changed. So what changed was the financial situation between October 3rd and October 14th. And we had no way to do the other approach because it would just take too long.

Mr. JORDAN. Mr. Chairman, I've got a few seconds. I'm going to completely change gears here. Tell me--and if you can go after this, I appreciate it--the money supply. I mean, I didn't get a chance to ask you questions when you were in front of the Budget Committee, and I apologize. A lot of people, a lot of sharp people, are very nervous about where we are with the amount of money out there in the system right now.

Talk to me briefly, if you can, about your concerns there and how we're going to deal with what I think a lot of people believe is going to be real inflationary concerns in the not-too-distant future.

Mr. BERNANKE. The money is not in the system in any real way. The money is electronic deposits from banks sitting in the Federal Reserve accounts. They're not being used, not being loaned, they're not circulating. The key issue here is can we unwind this money creation and low interest rates in time to head off inflation when the economy begins to recover? We have all the tools we need to do that, we believe we can do that. We will certainly remove that stimulus in time. And we are committed to price stability, and we will make sure that it happens.

Chairman TOWNS. [Presiding.] I thank the gentleman. I yield to the gentleman from Ohio.

Mr. KUCINICH. For unanimous consent, I ask unanimous consent to put into the record two sets of documents we received with subpoenas containing the e-mails and excerpts of documents I referred to today.

Chairman TOWNS. Without objection, so ordered.

[The information follows:]

******** INSERT 4-1 ********

Mr. KUCINICH. Thank you.

Chairman TOWNS. I yield 2 minutes to the gentlewoman from Ohio, Congresswoman Kaptur.

Ms. KAPTUR. I thank the Chairman and I thank Chairman Bernanke for his endurance. We all have to do our jobs. I would like to insert into the record the information and background on the relationship between Bank of America, Merrill Lynch and BlackRock.

Chairman TOWNS. Without objection, so ordered.

[The information follows:]

******** COMMITTEE INSERT ********

Ms. KAPTUR. I thank the Chairman. I would like to ask Chairman Bernanke to submit for the record from the Fed how did Bank of America end up owning 49 percent of BlackRock?

In 2004 the FBI warned the public and the administration mortgage fraud was headed toward an epidemic level in our country. The Fed did nothing.

Now, the Fed under your watch, has hired BlackRock, a firm owned 49 percent by Bank of America, headed by a man who invented the subprime instrument when at First Boston and then later at BlackRock, who traded billions of dollars of these securities to Freddie Mac and Fannie Mae over the last decade.

I quote a sentence and will place in the record from Bloomberg News: Fink's rocket-like rise when at First Boston was largely a result of his creative work with mortgage-backed securities, slicing and pooling mortgages and selling them as bonds. And he took his concept to Freddie Mac where he sold the company's board on a billion package.

[The information follows:]

******** COMMITTEE INSERT ********

Ms. KAPTUR. That was just the beginning of it. Chairman Bernanke, what material can you provide this committee and to the record that will explain how the Fed will avoid conflicts of interest in self-dealing by that firm and its CEO in the execution of contracts you have signed with BlackRock?

Mr. BERNANKE. We'll provide you with the contracts and with a letter explaining how it works.

Ms. KAPTUR. I thank you.

Some lawyers have said systemic fraud or controlled fraud have characterized the mortgage securitization process. Will you permit the FBI access to the mortgage instruments being managed by BlackRock as the Fed contracts are executed and fulfilled?

Mr. BERNANKE. If there's a reason for the FBI to investigate and the FBI has a right to investigate, we would not stand in the way of an appropriate investigation.

Ms. KAPTUR. Thank you.

How many contracts has the Fed signed with BlackRock to handle Freddie Mac paper and Fannie Mae mortgage securities under your purview, and how much will BlackRock be paid for those services?

Mr. BERNANKE. We've hired four asset managers to manage our mortgage-backed securities portfolio. BlackRock is one of them. I don't know how much we're paying them.

Ms. KAPTUR. Will BlackRock be handling Freddie Mac paper?

Mr. BERNANKE. They'll be managing GSE guaranteed paper, so that would include Freddie, Fannie and Ginnie.

Ms. KAPTUR. I would seriously urge your staff to go back and look at the operations of BlackRock and Mr. Fink's operations at First Boston before he founded BlackRock in relation to what they transacted with Freddie Mac and when they did that.

Chairman TOWNS. The gentlewoman's time has expired.

Ms. KAPTUR. Thank you very much, Mr. Chairman and Mr. Bernanke.

Chairman TOWNS. Thank you. Thank you very much.

Let me thank the Chairman for his time, of course, today. At the outset of this hearing I said that it's time to shine some light on the events surrounding Bank of America's acquisition of Merrill Lynch. At this point I would say we got a peak, not much, but we don't have full sunshine yet.

I would make three observations before we close:

Number one, there are significant inconsistencies between what we have been told today, what we were told 2 weeks ago by Ken Lewis, and what the Fed's internal e-mails seem to say. It is still unclear whether Bank of America was forced by the Federal Government to go through with the

Merrill deal, or whether Ken Lewis pulled off what may have been the greatest financial shakedown in a long, long time.

As a result of this hearing we have learned that the SEC and the FDIC played a role in this transaction as well. But as I indicated, we're going wherever the road leads us. So therefore let me say that we're going to talk to the SEC and we're going to talk to the FDIC. We're going to talk to former Treasury Secretary Hank Paulson. He has agreed to appear before the committee in July, and I look forward to that hearing.

But we also need to hear from the FDIC and the SEC so that we can better understand what happened during the dark days of last December. So we will be hearing from them as well.

So, Mr. Chairman, let me thank you again for your time. And I might have taken you 2 minutes over, but I'm sorry about that, I apologize. Thank you very much. Therefore now the committee is adjourned.

[Whereupon, at 1:18 p.m., the subcommittees were adjourned.]

SPEAKER LISTING

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