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2 DCMN HERZFELD

3 THE CAUSES AND EFFECTS OF THE LEHMAN

4 BROTHERS BANKRUPTCY

5 Monday, October 6, 2008

6 House of Representatives,

7 Committee on Oversight and

8 Government Reform,

9 Washington, D.C.

10 The committee met, pursuant to call, at 10:09 a.m., in
11 Room 2154, Rayburn House Office Building, Hon. Henry A.
12 Waxman [chairman of the committee] presiding.

13 Present: Representatives Waxman, Maloney, Cummings,
14 Kucinich, Tierney, Watson, Higgins, Yarmuth, Braley, Norton,
15 McCollum, Cooper, Van Hollen, Sarbanes, Welch, Davis of
16 Virginia, Shays, Mica and Turner.

17 Staff Present: Kristin Amerling, General Counsel; Caren
18 Auchman, Press Assistant; Phil Barnett, Staff Director and
19 Chief Counsel; Jen Berenholz, Deputy Clerk; Alison Cassady,
20 Professional Staff Member; Brian Cohen, Senior Investigator

21 | and Policy Advisor; Zhongrui "JR" Deng, Chief Information
22 | Officer; Greg Dotson, Chief Environmental Counsel; Miriam
23 | Edelman, Special Assistant; Earley Green, Chief Clerk; David
24 | Leviss, Senior Investigative Counsel; Karen Lightfoot,
25 | Communications Director and Senior Policy Advisor; Jennifer
26 | Owens, Special Assistant; Leneal Scott, Information Systems
27 | Manager; Roger Sherman, Deputy Chief Counsel; Mitch Smiley,
28 | Special Assistant; Lawrence Halloran, Minority Staff
29 | Director; Jennifer Safavian, Minority Chief Counsel for
30 | Oversight and Investigations; A. Brooke Bennett, Minority
31 | Counsel; Brien Beattie, Minority Professional Staff Member;
32 | Molly Boyl, Minority Professional Staff Member; Larry Brady,
33 | Minority Senior Investigator and Policy Advisor; Alex Cooper,
34 | Minority Professional Staff Member; John Cuaderes, Minority
35 | Senior Investigator and Policy Advisor; Adam Fromm, Minority
36 | Professional Staff Member; Todd Greenwood, Minority
37 | Professional Staff Member; Patrick Lyden, Minority
38 | Parliamentarian and Member Services Coordinator; Brian
39 | McNicoll, Minority Communications Director; Nick Palarino,
40 | Minority Senior Investigator and Policy Advisor; and Mark
41 | Marin, Minority Professional Staff Member.

42 Chairman WAXMAN. The meeting of the committee will
43 please come to order.

44 On Friday, Congress passed a \$700 billion rescue package
45 for Wall Street. This was something no Member wanted to do.
46 If Wall Street had been less reckless, or thorough regulators
47 had been more tentative, the financial crisis could have been
48 prevented. But we voted for the \$700 billion rescue because
49 the consequences of doing nothing were even worse.

50 The excesses on Wall Street have caused a credit freeze
51 that threatened our entire economy. The \$700 billion rescue
52 plan is a life-support measure. It may keep our economy from
53 collapsing, but it won't make it healthy again. To restore
54 our economy to health, two steps are necessary. First we
55 must identify what went wrong, then we must enact real
56 reforms for our financial markets.

57 Over the next 3 weeks, we will start this process in
58 this committee. We will be holding a series of five hearings
59 on the financial meltdown on Wall Street. We'll examine how
60 the system broke down, what could have been done to prevent
61 it, and what lessons we need to learn so this won't happen
62 again.

63 Today's hearing examines the collapse of Lehman
64 Brothers, which, on September 15th, filed for bankruptcy, the
65 largest bankruptcy filing in American history. Before the
66 Lehman Brothers bankruptcy, Treasury Secretary Paulson and

67 Federal Reserve Chairman Bernanke told us our financial
68 system could handle the collapse of Lehman. It now appears
69 they were wrong. The repercussions of this collapse have
70 reverberated across our economy. Many experts think Lehman's
71 fall triggered the credit freeze that is choking our economy,
72 and that made the \$700 billion rescue necessary.

73 Lehman's collapse caused a big money market fund to
74 break the buck, which caused investors to flee to Treasury
75 bills and dried up a key source of short-term commercial
76 paper. It also spread fear throughout the credit markets,
77 driving up the costs of borrowing.

78 Over the weekend we received the testimony, the written
79 testimony, of Richard Fuld, the CEO of Lehman Brothers. Mr.
80 Fuld takes no responsibility for the collapse of Lehman.
81 Instead he cites a, quote, litany of destabilizing factors,
82 end quote, and says, quote, in the end, despite all our
83 effort, we were overwhelmed, end quote.

84 In preparation for today's hearing, the committee
85 received thousands of pages of internal documents from Lehman
86 Brothers. Like Mr. Fuld's testimony, these documents portray
87 a company in which there was no accountability for failure.
88 In one e-mail exchange from early June, some executives from
89 Lehman's money management subsidiary Neuberger Berman made
90 this recommendation: Top management should forego bonuses
91 this year. This would serve a dual purpose. Firstly, it

92 | would represent a significant expense reduction; secondly, it
93 | would send a strong message to both employees and investors
94 | that management is not shirking accountability for recent
95 | performance.

96 | The e-mail was sent to Lehman's executive committee.
97 | One of its members is George H.--George H. Walker, President
98 | Bush's cousin, who is responsible for overseeing Neuberger
99 | Berman. And here is what he wrote the executive committee.
100 | Quote, sorry, team. I'm not sure what is in the water at 605
101 | Third Avenue today. I'm embarrassed, and I apologize, end
102 | quote.

103 | Mr. Fuld also mocked the Neuberger suggestion that top
104 | management should accept responsibility by giving up their
105 | bonuses. His response was, quote, don't worry, they are only
106 | people who think about their own pockets, end quote.

107 | Another remarkable document is a request submitted to
108 | the compensation committee of the board on September 11th, 4
109 | days before Lehman filed for bankruptcy. It recommends that
110 | the board give three departing executives over \$20 million
111 | in, quote, special payments. In other words, even as Mr.
112 | Fuld was pleading with Secretary Paulson for a full rescue,
113 | Lehman continued to squander millions on executive
114 | compensation.

115 | Other documents obtained by the committee undermine Mr.
116 | Fuld's contention that Lehman was overwhelmed by forces

117 | outside of its control. One internal analysis reveals that
118 | Lehman saw warning signs, but did not move early/fast enough,
119 | and lacked discipline about capital allocation.

120 | In 2004, the Securities and Exchange Commission relaxed
121 | a rule limiting the amount of leverage that Lehman and other
122 | investment banks could use. As this chart--Lehman chart
123 | shows--and if we could have that posted, I would appreciate
124 | it--that proved to be a temptation the firm could not resist.

125 | So in 2004, the SEC allowed greater leverage, and Lehman and
126 | other banks couldn't resist that and took on more leverage.

127 | At first Lehman's bets paid out. As Mr. Fuld's
128 | testimony recounts, Lehman achieved 4 consecutive years of
129 | record-breaking financial results between 2004 and 2007.
130 | These were lucrative years for Lehman's executives and Mr.
131 | Fuld. Lehman paid out over \$16 billion in bonuses. And we
132 | do have the chart now on the screen. Lehman paid out over
133 | \$16 billion in bonuses. Mr. Fuld himself received over \$40
134 | million in cash bonuses. His total compensation during these
135 | 4 years exceeded \$260 million.

136 | But while Mr. Fuld and other Lehman executives were
137 | getting rich, they were steering Lehman Brothers and our
138 | economy toward a precipice. Leverage is a double-edged
139 | sword. When it works as it did in 2004 to 2007, it magnifies
140 | investment gains. But when asset failures decline as the
141 | subprime market did, leverage rapidly consumes a company's