

EXCERPTS FROM
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Sections (g) through (i), pages 1516-1539

(g) The Government’s Preparation for the “Lehman Weekend” Meetings at the FRBNY	1516
(h) On the Evening of Friday, September 12, 2008, the Government Convened a Meeting of the Major Wall Street Firms in an Attempt to Facilitate the Rescue of Lehman	1523
(i) Lehman’s Bankruptcy Filing	1535

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**g) The Government’s Preparation for the “Lehman Weekend”
Meetings at the FRBNY**

The FRBNY, Treasury Department, the SEC and the Federal Reserve coordinated actions in what became known as the “Lehman Weekend” meetings of September 12-

14, 2008, at the FRBNY, in which the Government attempted to orchestrate a private-sector rescue of Lehman.

On Wednesday, September 10, 2008, FRBNY staff put together a draft gameplan for a “liquidity consortium” of major Wall Street banks to “provide a forum where these firms can explore possibilities of joint funding mechanisms to avert Lehman’s insolvency.”⁵⁸⁸⁹ Although a draft, the staff’s proposed gameplan is an instructive, contemporaneous record of the thinking of some in the FRBNY with respect to how to approach Lehman during the uncertain week of September 8, 2008.

The draft gameplan contemplated that the meeting would occur “at the very latest” on Friday the 12th.⁵⁸⁹⁰ Consortium members would be given “[v]ery little advance” notice, “2 hours max,” in order to “minimize the risk of outside leaks.”⁵⁸⁹¹ The gameplan further specified: “FRBNY to host. [Treasury Secretary Henry] Paulson delivers introductory remarks.”⁵⁸⁹² Substantively, the gameplan provided that the officials from the assembled banks would be

⁵⁸⁸⁹ FRBNY, Liquidity Consortium (Sept. 10, 2008), at p. 1 [FRBNY to Exam. 003517]; e-mail from Michael Nelson, FRBNY, to Christine Cummings, FRBNY, *et al.* (Sept. 10, 2008) [FRBNY to Exam. 003516] (distributing Liquidity Consortium outline with the subject line, “revised liquidity gameplan”). Possible consortium members would include those depository and investment banks with exposures to Lehman through loans, triparty repos and derivatives; such firms would include: Citibank, Credit Suisse, Deutsche Bank, Goldman Sachs, Morgan Stanley, Merrill Lynch, JPMorgan, and the Royal Bank of Scotland. FRBNY, Liquidity Consortium (Sept. 10, 2008), at p. 1 [FRBNY to Exam. 003517].

⁵⁸⁹⁰ *Id.*

⁵⁸⁹¹ *Id.*

⁵⁸⁹² *Id.* at p. 2.

told by Paulson that they have until the opening of business in Asia (Sunday night N[ew] Y[ork] time) to explore whether they can jointly come up with a credible plan to recapitalize Lehman to an extent necessary to enable an orderly winding down. Paulson conveys willingness of the official sector to let Lehman fail.⁵⁸⁹³

The draft states that the FRBNY should fix a maximum amount that it would be willing to finance to the consortium, “but not divulge our willingness to do so to the consortium.”⁵⁸⁹⁴ Similarly, the draft states that the FRBNY must “hone in on the monetary figure we think the consortium will have to provide in new capital,” as well as “the type/maximum amount of any FR [Federal Reserve] financing to support the consortium.”⁵⁸⁹⁵ Geithner later told the Examiner that any extension of Government funding to Lehman contemplated in the gameplan draft was contingent on Lehman having a willing buyer.⁵⁸⁹⁶

As of September 10, 2008, the FRBNY had settled on the public line that no government funds would be invested to rescue Lehman.⁵⁸⁹⁷ This public line was a bargaining strategy to encourage a private consortium of banks to provide the funds themselves.⁵⁸⁹⁸ The draft liquidation consortium gameplan, however, did not foreclose

⁵⁸⁹³ *Id.*

⁵⁸⁹⁴ *Id.* at p. 2.

⁵⁸⁹⁵ *Id.* at p. 5.

⁵⁸⁹⁶ Examiner’s Interview of Timothy F. Geithner, Nov. 24, 2009, at p. 9 (when shown the Liquidity Consortium gameplan document, Geithner confirmed that the FRBNY would have considered extending financing to Lehman, but only if a willing buyer for the firm had surfaced).

⁵⁸⁹⁷ Examiner’s Interview of Thomas C. Baxter, Jr., Aug. 31, 2009, at p. 7.

⁵⁸⁹⁸ *Id.* (shown the Liquidity Consortium gameplan document, Baxter confirmed the Examiner’s understanding that the references in the document to a “willingness” in the official sector to let Lehman

the possibility that the FRBNY would finance some amount of liquidity; despite noting legal and fiscal obstacles in other areas, the draft did not raise any concern about the possibility of FRBNY financing.⁵⁸⁹⁹ The gameplan slated the FRBNY to communicate with “foreign supervisors” on the evening of Friday September 12 while the consortium convened for its initial meeting.⁵⁹⁰⁰

A more detailed draft timeline for the implementation of the FRBNY’s liquidation consortium plan was circulated the next morning, Thursday, September 11, 2008.⁵⁹⁰¹ The timeline provided that later in the morning Geithner would (1) inform Bernanke and Paulson that the FRBNY would convene the liquidity consortium on Friday; and (2) ask Paulson to make an introductory address to the group.⁵⁹⁰² Geithner would then contact BofA CEO Kenneth Lewis to probe BofA’s interest in acquiring

“fail,” and the FRBNY’s unwillingness to “divulge” the amount of financing it was willing to extend to the consortium was a “strategy” to encourage the gathered banks not to expect a “Bear Stearns solution,” and thus to contribute their own funds to an industry solution to the Lehman problem).

⁵⁸⁹⁹ The “Open Issues” section of the document identifies issues to be resolved in advance of the consortium meeting. FRBNY, Liquidity Consortium (Sept. 10, 2008), at pp. 2-3 [FRBNY to Exam. 003517]. These issues include: shareholder approval for any deal emerging from the meeting; the risk that creditors could put Lehman into involuntary bankruptcy prior to a resolution; and the need to obtain “[r]egulatory approvals,” including from regulators outside of the United States. *Id.* Concern over legal authority or financial means to intervene to rescue Lehman is not present under the “Legal” sub-section of the draft agenda’s “Open Issues” discussion. *Id.*

⁵⁹⁰⁰ *Id.* at p. 2.

⁵⁹⁰¹ E-mail from Michael Nelson, FRBNY, to Christine Cumming, FRBNY (Sept. 11, 2008) [FRBNY to Exam. 003513] (cover e-mail); FRBNY, Timeline – Liquidation Consortium (Sept. 11, 2008) [FRBNY to Exam. 003514].

⁵⁹⁰² FRBNY, Timeline – Liquidation Consortium (Sept. 11, 2008), at p. 1 [FRBNY to Exam. 003514].

Lehman.⁵⁹⁰³ If Lewis declined to make a bid on behalf of BofA, or if Lehman rejected the bid, the FRBNY would proceed with its consortium plan.⁵⁹⁰⁴

The September 11 draft timeline contemplated that the FRBNY would prepare the final list of consortium members on the evening of September 12, and settle on “minimum capital contributions expected from the consortium” as well as the “level” or “type of liquidity to be offered, if necessary, by the Federal Reserve.”⁵⁹⁰⁵ The timeline would have the FRBNY contact foreign regulators on the evening of September 12.⁵⁹⁰⁶

The timeline proposed that on Saturday and Sunday, after the consortium was convened, it would engage in due diligence on Lehman’s assets in order to gauge the feasibility of any recapitalization plan, and report its progress to Bernanke, Paulson, and Geithner.⁵⁹⁰⁷ If no plan was forthcoming, the FRBNY would “reach out to regulators in DC and abroad to inform them of potential market disruptions at the opening of business on Monday and/or possible bankruptcy filing by Lehman.”⁵⁹⁰⁸

In his interview with the Examiner, FRBNY General Counsel Thomas Baxter described the Government’s approach to the Lehman crisis succinctly. There were two possible models for Government intervention, Baxter explained: (1) the FRBNY could

⁵⁹⁰³ *Id.*

⁵⁹⁰⁴ *Id.*

⁵⁹⁰⁵ *Id.*

⁵⁹⁰⁶ *Id.*

⁵⁹⁰⁷ *Id.* at p. 2.

⁵⁹⁰⁸ *Id.*

extend a “Maiden Lane”-style non-recourse loan to a potential purchaser of Lehman, as it did to JPMorgan with Bear Stearns;⁵⁹⁰⁹ or (2) the FRBNY could convene a consortium of private market participants to finance Lehman’s bad assets, as it had in the case of the near-failure of the hedge fund Long Term Capital Management (“LTCM”) in 1998.⁵⁹¹⁰ The goal, Baxter said, was to make Wall Street view the LTCM intervention, rather than the Bear Stearns intervention, as the model for Lehman.⁵⁹¹¹

The FRBNY’s actions in the Bear Stearns rescue placed public funds at risk and stood in contrast to the FRBNY’s approach to LTCM. LTCM was a hedge fund that had become over-leveraged and was brought to the brink of collapse by market conditions caused by Russia’s default on its debt obligations in 1998.⁵⁹¹² The FRBNY feared that LTCM’s creditors and counterparties would close out their positions, and liquidate collateral supporting those positions simultaneously. Such an *en masse* liquidation, the

⁵⁹⁰⁹ In order to contain the economic fallout of the Bear Stearns near collapse and to facilitate an acquisition of the failed investment bank by JPMorgan, on March 16, 2008, the Federal Reserve Board of Governors granted the FRBNY authority to extend a \$29 billion senior loan to a newly-created Delaware LLC called “Maiden Lane.” JPMorgan also extended a \$1 billion subordinated note to Maiden Lane. Maiden Lane, in turn, purchased \$30 billion of illiquid assets from Bear Stearns, as marked-to-market by Bear on March 14, 2008. The transfer involved \$30 billion in illiquid real estate-related assets from Bear Stearns to Maiden Lane. Because the FRBNY loan was styled as a non-recourse loan, the FRBNY’s commitment was secured only by the portfolio of assets held by Maiden Lane. Thus the U.S. Government was responsible for any losses in the event the liquidation of the transferred assets could not fully repay the principal advanced by the FRBNY. See FRBNY, Press Release: Summary of Terms and Conditions Regarding the JPMorgan Facility (Mar. 24, 2008), available at <http://newyorkfed.org/newsevents/news/markets/2008/rp080324b.html>.

⁵⁹¹⁰ Examiner’s Interview of Thomas C. Baxter, Jr., Aug. 31, 2009, at p. 8.

⁵⁹¹¹ *Id.*

⁵⁹¹² General Accounting Office, *Long-Term Capital Management: Regulators Need to Focus Greater Attention on Systemic Risk*, Report to Congressional Requesters (Oct. 29, 1999), at 42.

FRBNY believed, would result in “a likelihood that a number of credit and interest rate markets would experience extreme price moves and possibly cease to function for a period of one or more days and maybe longer.”⁵⁹¹³ After remedies short of Government intervention had failed, the FRBNY convened a consortium of LTCM’s major creditors to devise an industry-created plan to recapitalize the hedge fund. Thus, on September 22 and 23, 1998, 14 banks and securities firms met at the FRBNY’s offices, created a term sheet for a recapitalization of the hedge fund and, ultimately, committed to inject \$3.6 billion in LTCM to avoid a disorderly liquidation.⁵⁹¹⁴ As former FRBNY President William McDonough emphasized in his testimony before the U.S. House of Representatives: “[T]his was a private sector solution to a private sector problem, involving an investment of new equity by Long-Term Capital’s creditors and counterparties.”⁵⁹¹⁵

Rather than a Bear Stearns-style “bailout” for Lehman,⁵⁹¹⁶ the FRBNY went forward with plans for a LTCM-style “liquidation consortium” on September 12, 2008.

⁵⁹¹³ Statement by William J. McDonough, President of the Federal Reserve Bank of New York Before the Comm. on Banking and Financial Servs., U.S. House of Representatives, Oct. 1, 1998, at 4.

⁵⁹¹⁴ *Id.* at pp. 6-7; GAO Report to Congressional Requesters, Long-Term Capital Management: Regulators Need to Focus Greater Attention on Systemic Risk (Oct. 29, 1999), at 44.

⁵⁹¹⁵ Statement by William J. McDonough, President of the Federal Reserve Bank of New York Before the Comm. on Banking and Fin. Servs., U.S. House of Representatives, Oct. 1, 1998, at p. 7.

⁵⁹¹⁶ Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 9.

h) On the Evening of Friday, September 12, 2008, the Government Convened a Meeting of the Major Wall Street Firms in an Attempt to Facilitate the Rescue of Lehman

By all accounts, the liquidation consortium meetings at the FRBNY began largely as conceived in the draft agenda and timelines. The FRBNY convened a meeting of the major Wall Street financial institutions, all of which agreed to finance Lehman's bad assets and thereby facilitate the sale of Lehman to one of its suitors.⁵⁹¹⁷ However, the deal foundered on the issue of whether Barclays would be able to guarantee Lehman's outstanding trades, as requested by the FRBNY.

True to the FRBNY's draft gameplan, Geithner spoke with Callum McCarthy, then-Chairman of the British Financial Services Authority ("FSA") on September 11, and informed McCarthy of FRBNY plans to convene "a consortium of financial institutions . . . to rescue Lehman."⁵⁹¹⁸

During the morning of September 12, 2008, John S. Varley, Group Chief Executive of Barclays, spoke with Paulson.⁵⁹¹⁹ Varley informed Paulson that Barclays was interested in making a bid for Lehman.⁵⁹²⁰ Paulson responded that any purchaser would need to make a bid before the end of the weekend, after which time the

⁵⁹¹⁷ *Id.* at pp. 9-10.

⁵⁹¹⁸ Financial Services Authority (U.K.), Statement of the Financial Services Authority (Jan. 20, 2010), at p. 2.

⁵⁹¹⁹ *Id.* at p. 3.

⁵⁹²⁰ *Id.*

Government planned to place Lehman into an orderly wind-down.⁵⁹²¹ According to the FSA, in a conversation later that day, Alistair M. Darling, Chancellor of the Exchequer, advised Paulson “that no transaction with Barclays would be possible if the level of risk to Barclays was inappropriate.”⁵⁹²² Paulson “accepted this and advised that the FRBNY might be prepared to provide Barclays with regulatory assistance to support such a transaction if it was required.”⁵⁹²³

On the evening of Friday, September 12, 12 investment bank CEOs were summoned to the FRBNY’s headquarters at 33 Liberty Street in New York City.⁵⁹²⁴ Bernanke remained in Washington, given the possibility that the Federal Reserve might need to exercise its emergency lending powers, which would require him to convene a Federal Reserve Board meeting.⁵⁹²⁵ The CEO participants present at 33 Liberty included: JPMorgan’s Jamie Dimon, Morgan Stanley’s John Mack, Citigroup’s Vikram Pandit and Robert Wolf of UBS. Executives from Lehman Brothers did not attend.⁵⁹²⁶

Paulson opened the meeting by noting the absence of Lehman representatives.⁵⁹²⁷ Paulson said their absence was intentional, because the meeting was convened to

⁵⁹²¹ *Id.*

⁵⁹²² *Id.* at p. 5.

⁵⁹²³ *Id.*

⁵⁹²⁴ Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 9.

⁵⁹²⁵ Examiner’s Interview of Ben S. Bernanke, Dec. 22, 2009, at p. 9.

⁵⁹²⁶ Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 9.

⁵⁹²⁷ *Id.*

discuss Lehman specifically.⁵⁹²⁸ Paulson noted the absence of BofA and Barclays Capital executives as well, due to the fact that these banks were involved in potential deals to acquire Lehman.⁵⁹²⁹

Paulson stated that the purpose of the meeting was twofold. First, the Government tasked the CEOs with creating a plan to facilitate the acquisition of Lehman, and second, if such a plan was not forthcoming, Paulson stated the onus was on the CEOs to provide the Government with the means to resolve the consequences of Lehman's failure.⁵⁹³⁰ Moreover, with regard to the financing of any potential rescue of Lehman, Paulson stated: "Not one penny will come from the Government."⁵⁹³¹ Paulson did not elaborate, but Lehman's only options were to be rescued by a firm (or a consortium of firms) or to file for bankruptcy on Monday, September 15.⁵⁹³²

Secretary Paulson told the Examiner that no Government aid would be forthcoming because he concluded that the Government lacked authority to inject capital into struggling institutions.⁵⁹³³ While Paulson allowed that under Section 13(3)

⁵⁹²⁸ *Id.*

⁵⁹²⁹ Examiner's Interview of Henry M. Paulson, Jr., June 25, 2009, at pp. 15-16.

⁵⁹³⁰ *Id.* at p. 16.

⁵⁹³¹ Examiner's Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 9 (reporting Paulson's statement).

⁵⁹³² *Id.* Cox said that most attendees "probably assumed that [Secretary Paulson's statement of no government help] was a negotiation" strategy and were "generally surprised when in fact there was no money there." Examiner's Interview of Christopher Cox, Jan. 8, 2010, at p. 15.

⁵⁹³³ Examiner's Interview of Henry M. Paulson, Jr., June 25, 2009, at p. 16.

of the Federal Reserve Act the Fed might be able to lend against any collateral,⁵⁹³⁴ he feared that providing emergency funds to the ailing bank would cause its clients to flee, ensuring its demise.⁵⁹³⁵

That weekend, Lehman's "financial team" came on-site to the FRBNY and "opened their books" to representatives from the investment banks in order to work out the details of any potential rescue.⁵⁹³⁶ Barclays was permitted to examine Lehman's books, in order to conduct the due diligence necessary to determine whether it would acquire Lehman.⁵⁹³⁷ Baxter noted concern among the firms that by negotiating a rescue for Lehman, they would be "financing a sweetheart deal for one of their competitors."⁵⁹³⁸ Nevertheless, due diligence and planning continued.

But Barclays and the British regulators had their own reservations. During the evening of September 13, 2008, Barclays advised the FSA that the FRBNY was asking Barclays to guarantee Lehman's financial obligations in a manner similar to that

⁵⁹³⁴ Section 13(3) provides that a Federal Reserve Bank may, "[i]n unusual and exigent circumstances" lend to any individual or corporation so long as the lending is "secured to the satisfaction" of the Federal Reserve Bank. 12 U.S.C. § 343. But the Fed and FRBNY emphasized that they could not lend against insufficient collateral. Examiner's Interview of Ben S. Bernanke, December 22, 2009, at 2 (then-FRBNY President Timothy F. Geithner informed Chairman Bernanke that the Fed would be "lending into a run," and that, while a loan might help pay off some counterparties, it would not save Lehman. Chairman Bernanke concluded that Lehman was insolvent and lacked any collateral, given that its assets fell short of obligations that would come due).

⁵⁹³⁵ Examiner's Interview of Henry M. Paulson, Jr., June 25, 2009, at p. 16.

⁵⁹³⁶ Examiner's Interview of Thomas C. Baxter, Jr., May 20, 2009, at pp. 9-10.

⁵⁹³⁷ Financial Services Authority (U.K.), Statement of the Financial Services Authority (Jan. 20, 2010), at p. 5.

⁵⁹³⁸ Examiner's Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 10.

provided by JPMorgan when it acquired Bear Stearns.⁵⁹³⁹ Barclays recognized, and the FSA confirmed, that British regulations would require shareholder approval before such a guaranty could be granted.⁵⁹⁴⁰ Later that evening, Barclays advised the FSA that “because of the guarantee” issue, it was “unlikely that a suitable structure to purchase Lehman could be put in place which would satisfy [its] Board.”⁵⁹⁴¹ McCarthy spoke to Geithner that evening about the state of the negotiations, and McCarthy reported that although no proposal had yet been shown to the FSA by Barclays, “if one was it would raise significant issues.”⁵⁹⁴² Yet, because no proposal had “been put forward . . . it was impossible to say whether any particular proposal would prove acceptable.”⁵⁹⁴³

On the afternoon of Sunday, September 14, 2008 (London time), the FSA informed the FRBNY that the guaranty issue would need to be resolved before any take-over could be approved.⁵⁹⁴⁴ According to the FSA, Geithner replied that the FRBNY had arranged for a consortium of Wall Street firms to take Lehman’s illiquid assets, but that a guaranty from Barclays “would still be required.”⁵⁹⁴⁵ Barclays, the FSA

⁵⁹³⁹ Financial Services Authority (U.K.), Statement of the Financial Services Authority (Jan. 20, 2010), at p. 7.

⁵⁹⁴⁰ *Id.*

⁵⁹⁴¹ *Id.*

⁵⁹⁴² *Id.*

⁵⁹⁴³ *Id.*

⁵⁹⁴⁴ *Id.* at p. 8. Baxter advised the Examiner that the FRBNY did not learn that providing a guaranty had become an issue until “late” on Sunday, September 14. Examiner’s Interview of Thomas C. Baxter, Jr., Aug. 31, 2009, at p. 8.

⁵⁹⁴⁵ Financial Services Authority (U.K.), Statement of the Financial Services Authority (Jan. 20, 2010), at p. 8.

and the FRBNY continued to discuss the regulatory and prudential obstacles presented by the guaranty issue throughout the day on September 14. By late afternoon or early evening, however the FSA and Barclays “agreed that neither the Barclays Board nor the FSA could approve any transaction structure that required Barclays to provide the guarantee asked for by the FRBNY.”⁵⁹⁴⁶

Over the weekend, the assembled banks had agreed to provide at least \$20 billion in financing to facilitate Lehman’s acquisition by Barclays.⁵⁹⁴⁷ According to Government witnesses, it was not for want of cooperation, coordination or Government pressure that Lehman was not acquired.⁵⁹⁴⁸ Rather, those Government representatives present for the meetings laid the failure of the deal on Barclays’ inability to guarantee trading losses associated with the acquisition.⁵⁹⁴⁹

Baxter was clear in his conviction that the inability of Barclays to obtain a guaranty was due to the unwillingness of the British government, specifically the FSA, to waive the British legal requirement that Barclays obtain a shareholder vote on the issue.⁵⁹⁵⁰ This critical viewpoint was uniformly held among the FRBNY witnesses interviewed by the Examiner. Voigts agreed that a sale of Lehman was not possible because Barclays was unable to obtain a waiver from the FSA to guarantee Lehman’s

⁵⁹⁴⁶ *Id.* at p. 10.

⁵⁹⁴⁷ Examiner’s Interview of Henry M. Paulson, June 25, 2009, at p. 18.

⁵⁹⁴⁸ Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 9.

⁵⁹⁴⁹ *Id.*; Examiner’s Interview of Jan H. Voigts, Aug. 25, 2009, at p. 7.

⁵⁹⁵⁰ Examiner’s Interview of Thomas C. Baxter, Jr., Aug. 31, 2009, at p. 8.

obligations.⁵⁹⁵¹ Geithner echoed these comments, stating that a deal during Lehman Weekend was impracticable because Lehman lacked a buyer.⁵⁹⁵² In Geithner's view, had Lehman had a buyer in Barclays or any other third party, the Government would have extended financing to that buyer to help facilitate the sale.⁵⁹⁵³ Bernanke also attributed the Government's ultimate inability to rescue Lehman to the absence of a buyer for the firm.⁵⁹⁵⁴

Baxter stated his belief that the British government simply did not want Barclays to acquire Lehman, and therefore refused to allow Barclays to guarantee the deal, or otherwise backstop the transaction.⁵⁹⁵⁵ The FSA explained to the Examiner that, because Barclays was one of the U.K.'s clearing banks, "it was important to ensure that Barclays did not expose itself to a level of risk that would weaken it to an extent that could have a wider systemic impact on the U.K. financial system."⁵⁹⁵⁶ Further, Chairman McCarthy told Chairman Cox that there was no precedent for waiving the U.K. law requirement that Barclays obtain shareholder approval prior to agreeing to any guaranty in these

⁵⁹⁵¹ Examiner's Interview of Jan H. Voigts, Aug. 25, 2009, at p. 7.

⁵⁹⁵² Examiner's Interview of Timothy F. Geithner, Nov. 24, 2009, at p. 9.

⁵⁹⁵³ *Id.*

⁵⁹⁵⁴ Examiner's Interview of Ben S. Bernanke, Dec. 22, 2009, at p. 2.

⁵⁹⁵⁵ Examiner's Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 10.

⁵⁹⁵⁶ The Examiner sought, but was not granted, an interview with the FSA decision makers; but the FSA did provide written answers to questions. Financial Services Authority (U.K.), Statement of the Financial Services Authority (Jan. 20, 2010), at p. 6.

exigent circumstances.⁵⁹⁵⁷ Cox indirectly confirmed to the Examiner that the FSA acted reasonably.⁵⁹⁵⁸ For his part, Baxter stated that there was a “policy issue” with the FRBNY providing a backstop for an acquisition by a British bank.⁵⁹⁵⁹ Baxter said that the FRBNY lacked this authority because the FRBNY could not issue a guaranty to support the transaction.⁵⁹⁶⁰ Rather, the FRBNY could only provide secured financing in support of such a transaction.⁵⁹⁶¹ Baxter stated that he found it “shocking” that the deal would founder for lack of a guaranty, and that it was the financing of the deal, rather than the guaranty which should have been the most challenging barrier to overcome in any rescue of Lehman.⁵⁹⁶²

Paulson distinguished the Government’s action to intervene to backstop AIG, from the absence of Government action to backstop Lehman. According to Paulson, Lehman had liquidity problems and no hard assets against which to lend.⁵⁹⁶³ AIG, by contrast, Paulson said, had a capital problem at the holding company level, but

⁵⁹⁵⁷ *Id.* at p. 10.

⁵⁹⁵⁸ Examiner’s Interview of Christopher Cox, Jan. 8, 2010, at p. 18. (Cox recalled a specific conversation on the subject, but after SEC counsel would not permit him to recount that conversation, invoking the “deliberative process” privilege, Cox answered the general question: “In all your conversations with the FSA, did they ever take an unreasonable position?” Chairman Cox responded: “At no time in my dealings with the FSA did I think they were unreasonable; they had reasons for what they did.”).

⁵⁹⁵⁹ Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 10.

⁵⁹⁶⁰ *Id.*

⁵⁹⁶¹ *Id.*

⁵⁹⁶² *Id.*

⁵⁹⁶³ Examiner’s Interview of Henry M. Paulson, Jr., June 25, 2009, at p. 16.

otherwise had regulated insurance companies that were perceived by the market as stable, well-capitalized, and having real value.⁵⁹⁶⁴

A bankruptcy filing by the holding company was another of the contingency plans discussed at the FRBNY that weekend.⁵⁹⁶⁵ The Government concluded that an *en masse* liquidation of the holding company would be “awful,” and should be avoided.⁵⁹⁶⁶ Nevertheless, assuming no alternative was available, the plan envisioned by the Government would be for LBHI to file for Chapter 11, while JPMorgan continued to lend to LBI as a going concern. LBI would then be eased into a SIPA proceeding, and wound down in an orderly way.⁵⁹⁶⁷ This plan did not play out once Barclays came back to the bargaining table with a proposal to acquire the broker-dealer after LBHI entered bankruptcy.

On Sunday September 14, Baxter and Cox participated in a conference call with Lehman’s Board of Directors.⁵⁹⁶⁸ Also present on the Government side of the call were SEC General Counsel Brian Cartwright and Alan Beller of Cleary Gottlieb Steen & Hamilton, who was engaged by the Treasury Department.⁵⁹⁶⁹ Baxter said the call was

⁵⁹⁶⁴ *Id.*

⁵⁹⁶⁵ Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 10.

⁵⁹⁶⁶ *Id.*

⁵⁹⁶⁷ *Id.* at pp. 10-11.

⁵⁹⁶⁸ Lehman Brothers Holdings Inc., Minutes of Meeting of Board of Directors (Sept. 14, 2008) [LBEX-AM 003932] (noting that Baxter and Cox addressed the Board by telephone).

⁵⁹⁶⁹ Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 10.

arranged at the request of Paulson and Geithner.⁵⁹⁷⁰ According to Lehman Board minutes, Baxter and Cox emphasized that the Board needed to make a decision regarding whether to file for bankruptcy quickly, and that this was a decision for the Board alone.⁵⁹⁷¹ Baxter recalled making statements to this effect.⁵⁹⁷² Cox recalled that he did not mention bankruptcy, but rather stated that whatever decision Lehman might make needed to be made immediately.⁵⁹⁷³ Cox also recalled that “others from the Fed” who were on the call added that the Government had made it clear in earlier meetings that Lehman should file for bankruptcy.⁵⁹⁷⁴ Baxter said he made the point “that opening on Monday was not an option because of the chaos in the markets.”⁵⁹⁷⁵

Also that evening, the Federal Reserve broadened the collateral eligible for financing through the PDCF “to closely match the types of collateral that can be pledged in the triparty repo systems of the two major clearing banks.”⁵⁹⁷⁶ However, the FRBNY limited the collateral LBI could use for overnight financing to the collateral that

⁵⁹⁷⁰ *Id.*

⁵⁹⁷¹ Lehman Brothers Holdings Inc., Minutes of Meeting of Board of Directors (Sept. 14, 2008), at pp. 5-6 [LBEX-AM 003932].

⁵⁹⁷² Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 11.

⁵⁹⁷³ Examiner’s Interview of Christopher Cox, Jan. 8, 2010, at p. 17.

⁵⁹⁷⁴ *Id.*

⁵⁹⁷⁵ Lehman Brothers Holdings Inc., Minutes of the Meeting of the Board of Directors (Sept. 14, 2008), at pp. 5-6 [LBEX-AM 003932]; Examiner’s Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 10.

⁵⁹⁷⁶ FRBNY, Press Release (Sept. 14, 2008), *available at* <http://www.federalreserve.gov/newsevents/press/monetary/20080914a.htm>.

was in LBI's box at JPMorgan as of Friday, September 12, 2008.⁵⁹⁷⁷ This restriction was referred to as the "Friday criteri[on]."⁵⁹⁷⁸ In addition, the FRBNY imposed larger haircuts on LBI's PDCF borrowing than it did on other investment banks,⁵⁹⁷⁹ and the haircuts imposed on LBI's PDCF borrowing were larger than under Lehman's pre-bankruptcy triparty borrowing.⁵⁹⁸⁰

In connection with Lehman's preparations to file the LBHI Chapter 11 petition, the FRBNY, acting as a lender of last resort, advised Lehman that it would provide up

⁵⁹⁷⁷ Examiner's Interview of Robert Azerad, Sept. 23, 2009, at p. 5; Examiner's Interview of Christopher Burke, July 7, 2009, at p. 3. An experimental allocation by Lehman to the PDCF on Monday morning showed at least \$72 billion of eligible Lehman securities being swept into the PDCF system. See e-mail from John N. Palchynsky, Lehman, to Craig L. Jones, Lehman, *et al.* (Sept. 15, 2008) [LBEX-DOCID 076981]; see also Lehman, PDCF Schedule of Eligible Securities (Sept. 14, 2008) [LBEX-DOCID 405695].

⁵⁹⁷⁸ Examiner's Interview of Robert Azerad, Sept. 23, 2009, at p. 5; Examiner's Interview of Christopher Burke, July 7, 2009, at p. 3. According to Azerad, this restriction prevented Lehman from posting the range of collateral to the PDCF that other firms were allowed to post after September 15, 2008. Examiner's Interview of Robert Azerad, Sept. 23, 2009, at p. 5; see also e-mail from Timothy Lyons, Lehman, to Ian T. Lowitt, Lehman (Sept. 14, 2008) [LBEX-DOCID 070210] (stating "the fed is letting the other eighteen broker dealers fund a much broader range of collateral than us").

⁵⁹⁷⁹ Examiner's Interview of Christopher Burke, July 7, 2009, at p. 3; see also e-mail from Ricardo S. Chiavenato, JPMorgan, to Christopher Carlin, JPMorgan, *et al.* (Sept. 15, 2008) [JPM-2004 0055329]; Examiner's Interview of Robert Azerad, Sept. 23, 2009, at p. 5. According to Azerad, the Fed imposed the wider haircuts on Lehman because the Fed was not willing to take any losses in its overnight financing of Lehman. *Id.*

⁵⁹⁸⁰ See e-mail from Sindy Aprigliano, Lehman, to Paolo R. Tonucci, Lehman, *et al.* (Sept. 15, 2008) [LBEX-DOCID 4572426, 4579671] (attaching list of an estimated haircut impact of approximately \$4 billion); e-mail from Sindy Aprigliano, Lehman, to George Van Schaick, Lehman, *et al.* (Sept. 15, 2008) [LBEX-DOCID 077028] (discussing the larger haircuts imposed by the Fed on Lehman's PDCF borrowing); e-mail from Robert Azerad, Lehman, to Susan McLaughlin, Lehman, *et al.* (Sept. 15, 2008) [LBEX-DOCID 457643] (explaining the PDCF haircuts would "result in a \$4 billion drain in liquidity . . ."); see also Lehman, PDCF Schedule of Eligible Securities (Sept. 14, 2008) [LBEX-DOCID 405695] (detailing the PDCF haircuts applied to Lehman for the various categories of accepted securities); e-mail from Ricardo S. Chiavenato, JPMorgan, to Christopher Carlin, JPMorgan, *et al.* (Sept. 15, 2008) [JPM-2004 0055329]. *But see* e-mail from Sindy Aprigliano, Lehman, to Paolo R. Tonucci, Lehman, *et al.* (Sept. 15, 2008) [LBEX-DOCID 068353] (stating the haircut impact from using the PDCF would be \$2 billion).

to two weeks of overnight secured financing through the PDCF to allow LBI to accomplish an orderly liquidation.⁵⁹⁸¹

Baxter rejected the idea that “moral hazard” arguments played a role in “allowing” Lehman to fail. Baxter said the whole purpose of the FRBNY’s extraordinary actions that weekend was to rescue Lehman in some form:⁵⁹⁸² “In no way was the idea to make Lehman a ‘poster child’ for moral hazard.”⁵⁹⁸³ “Clearly,” Baxter said, “my sense was that [the Government] was not just going through the motions” and that Lehman was not “sacrificed to moral hazard.”⁵⁹⁸⁴ Baxter attributed the failure of the rescue effort to the British government’s refusal to offer a guaranty to backstop the acquisition.⁵⁹⁸⁵ In his interview, Paulson said that although economic health depends on Wall Street firms believing that the Government cannot and will not rescue them in a crisis, economic stability was nevertheless more important to the economy than moral hazard.⁵⁹⁸⁶

⁵⁹⁸¹ Examiner’s Interview of Shari D. Leventhal, Apr. 30, 2009, at pp. 4-5. Some FRBNY employees thought the FRBNY was risking too much exposure with the two-week funding timeframe. *Id.* at p. 5.

⁵⁹⁸² *Id.*

⁵⁹⁸³ *Id.*

⁵⁹⁸⁴ *Id.*

⁵⁹⁸⁵ *Id.* There were two distinct issues: (1) The U.K. regulators’ refusal to waive the shareholder vote requirement necessary to approve a Barclays guaranty of outstanding Lehman trades; and (2) Lehman’s failure to obtain a guaranty from Barclays, or any other entity, for potential trading losses.

⁵⁹⁸⁶ Examiner’s Interview of Henry M. Paulson, Jr., June 25, 2009, at p. 22.

i) Lehman's Bankruptcy Filing

LBHI filed for bankruptcy protection on Monday, September 15. The FRBNY was surprised by the consequences that Lehman's filing had in terms of funding LBIE, which was taken into administration by British regulators due to inadequate capitalization.⁵⁹⁸⁷ The FRBNY was unaware that LBIE was financed entirely by the parent – that is, that LBHI pulled liquidity into New York, and would then re-route that funding to LBIE in the U.K.⁵⁹⁸⁸ Baxter said he was unaware until that Monday that LBIE was dependent on its LBHI parent, but he learned otherwise when LBHI was forced to file for bankruptcy due to cross defaults from LBIE going into administration in the U.K.⁵⁹⁸⁹ Even then, Baxter assumed that the Bank of England had the capacity to fund LBIE in a manner similar to that by which the FRBNY funded LBI through the Primary Dealer Credit Facility discount window for broker-dealers.⁵⁹⁹⁰ The FSA told the Examiner that once it became known that LBHI would file for bankruptcy, the FSA asked the FRBNY if financing (via the FRBNY's discount window for broker-dealers) would be made available to LBIE and was told that it would not.⁵⁹⁹¹

⁵⁹⁸⁷ Examiner's Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 11; Examiner's Interview of Jan H. Voigts, Aug. 25, 2009, at pp. 7-8 (noting surprise at the extent to which LBIE was dependent on LBHI, the consequences of LBHI's bankruptcy, and the importance and complexity of intercompany funding within Lehman generally).

⁵⁹⁸⁸ Examiner's Interview of Thomas C. Baxter, Jr., May 20, 2009, at p. 11.

⁵⁹⁸⁹ *Id.*

⁵⁹⁹⁰ *Id.*

⁵⁹⁹¹ Financial Services Authority (U.K.), Statement of the Financial Services Authority (Jan. 20, 2010), at pp. 10-11.

Following Lehman's bankruptcy, Lehman, through its broker-dealer, LBI, relied on the PDCF to obtain \$40 to \$50 billion in overnight financing needed to repay its clearing banks.⁵⁹⁹² In addition, Lehman funded itself after the bankruptcy filing through two other FRBNY programs, the Open Market Operations ("OMO") and the Term Securities Lending Facility ("TSLF"),⁵⁹⁹³ as well as triparty term repos that had not yet expired.⁵⁹⁹⁴ The FRBNY's overnight financing of LBI began Monday evening, September 15, with Lehman borrowing approximately \$28 billion via the PDCF.⁵⁹⁹⁵ The FRBNY's overnight financing continued through Thursday morning, September 18, 2008.⁵⁹⁹⁶ LBI was placed into SIPA proceedings on September 19, 2008.

⁵⁹⁹² See e-mail from David A. Weisbrod, JPMorgan, to Jamie L. Dimon, JPMorgan, *et al.* (Sept. 15, 2008) [JPM-2004 0080146] (listing Lehman's triparty repo borrowing at \$51 billion (\$28 billion from the PDCF, \$2 billion from Barclays, and \$21 billion from other investors) for Monday); Alvarez & Marsal, Summary of Meeting with James Hraska on 10/08/08 [Draft] (Oct. 8, 2008), at pp. 1-4 [LBEX-AM 003302] (listing the Fed's funding of Lehman (via the PDCF, OMO, and TSLF) for the week following the LBHI petition).

⁵⁹⁹³ Examiner's Interview of Christopher Burke, July 7, 2009, at p. 4; Alvarez & Marsal, Summary of Meeting with James Hraska on 10/08/08 [Draft] (Oct. 8, 2008), at pp. 1-4 [LBEX-AM 003302].

⁵⁹⁹⁴ See e-mail from David A. Weisbrod, JPMorgan, to Jamie L. Dimon, JPMorgan, *et al.* (Sept. 15, 2008) [JPM-2004 0080146-47] (listing \$21 billion in "mainly term repos" as part of LBI's triparty borrowing for September 15).

⁵⁹⁹⁵ See e-mail from Edward J. Corral, JPMorgan, to William Walsh, JPMorgan, *et al.* (Sept. 15, 2008) [JPM-2004 0031195] (notifying the Fed that the Lehman assets used in LBI's \$28 billion PDCF repo on Monday night satisfied the Friday criterion). Earlier on Monday, Lehman estimated that it would borrow up to \$35 billion through the PDCF on Monday night. See e-mail from Sindy Aprigliano, Lehman, to Robert Azerad, Lehman (Sept. 15, 2008) [LBEX-DOCID 1071653] (providing John Feraca's PDCF estimate of \$27 billion plus a buffer of \$8 billion); e-mail from Robert Azerad, Lehman, to Susan McLaughlin, Lehman, *et al.* (Sept. 15, 2008) [LBEX-DOCID 071550] (estimating \$34 billion of PDCF borrowing); e-mail from Paolo R. Tonucci, Lehman, to Susan McLaughlin, Lehman, *et al.* (Sept. 15, 2008) [LBEX-DOCID 071550] (estimating \$28.3 billion for the collateral value of the PDCF borrowing).

⁵⁹⁹⁶ Examiner's Interview of Robert Azerad, Apr. 20, 2009, at p. 5.