At House committee hearing

Ex-CEO, regulators trade blame for Lehman collapse

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The former CEO of the failed investment bank Lehman Brothers and a slew of federal regulatory officials appeared before the House Financial Services Committee Tuesday to discuss the collapse of the huge financial firm on September 15, 2008, the event which triggered the global financial crisis.

Richard Fuld, the former CEO, was unrepentant and arrogant, repeatedly denying that Lehman Brothers had been either badly managed or engaged in deliberate fraud, claiming that the company only failed because a financial panic caused a general pullout from deals by its trading partners (counter-parties).

The regulatory officials who testified also denied responsibility for the crisis, either claiming they lacked sufficient information or authority to forestall the collapse, or pointing to failures by their predecessors who held the same offices earlier.

The first panel featured Federal Reserve Chairman Ben Bernanke, Treasury Secretary Timothy Geithner, who was head of the New York branch of the Fed at the time Lehman collapsed, and Securities and Exchange Commission (SEC) chairwoman Mary Schapiro, an Obama nominee who succeeded Christopher Cox, the Bush appointee who headed the SEC in 2008.

Bernanke and Geithner admitted the significance of Lehman's 2008 collapse, but claimed the Fed had no power to intervene because of the firm's legal status as an investment bank regulated by the SEC rather than the Fed. Bernanke said that the Fed had no authority to provide capital or an unsecured guarantee to Lehman at the time, prior to the passage of th$e $700 billion bank bailout legislation, the Troubled Asset Relief Program (TARP).

Geithner sought to use the hearing as an occasion for promoting the Obama administration's financial reform bill, which was cleared by a key Senate panel last week and has already passed the House of Representatives.

Geithner endorsed the findings of the 2,200-page report on the collapse of Lehman by Anton Valukas, the independent investigator assigned to probe the biggest financial bankruptcy in US history. Valukas filed his report last month, presenting a scathing indictment of Lehman Brothers and its regulators.

The Valukas report charged that Lehman Brothers executives deliberately misled investors, auditors, regulators and even their own board of directors by creating a series of phony transactions with front companies, similar to those used by Enron before its 2001 collapse. Lehman engaged in repurchase agreements with these front companies, known as "Repo 105" transactions, to conceal as much as $50 billion in debts and make the company look solvent.

Every quarter, toxic assets were off-loaded to the front companies just in time to make the books look better, and then returned to Lehman once the auditors had signed off on the numbers.

While regulators were not informed about the particular nature of the "Repo 105" scheme, Valukas charged that they deliberately allowed the company to exceed its own stated exposure to risk.

Schapiro claimed that the SEC had been unable to penetrate the systematic fraud at Lehman because of "limited staff and resources," which resulted in assigning only 25 people to monitor the activities of the five largest US investment banks, which included Lehman Brothers and another firm that failed earlier in 2008, Bear Stearns.

However, as Dr. William K. Black, a professor of economics and former regulator, pointed out later in the hearing, "The SEC is the one who decided how many people to assign to these banks. If you only had 25 people, that's not an excuse, but an admission of guilt."

When Fuld was called to testify later in the day, he flatly denied the findings of the Valukas report, and even claimed "I have absolutely no recollection whatsoever hearing about Repo 105 transactions while I was CEO." He said he first learned of them after Repo 105 deals were identified by Valukas as a major factor in the Lehman collapse.

Fuld said that the examiner's report "distorted" Lehman's activities, and that the company and its "people" were "unfairly vilified." He did not explain how $50 billion worth of off-the-books transactions could be carried out regularly each quarter without the CEO and other top officials being aware of them.

The former Lehman boss initially refused to answer the direct question, posed by Democrat Paul E. Kanjorski, "Why did Lehman Brothers collapse?" After an hour of cajoling, Fuld finally responded, saying, "We could not convince the world about the condition that we were in. We had collateral, we had capital, and we had a solid plan."

In other words, Lehman was in perfect shape when it collapsed, never made any bad bets, never broke the law. He even claimed, "We at Lehman Brothers were risk-averse," an assertion that produced audible gasps from the panel.

A final group of witnesses included Valukas, Mathew Lee, a former Lehman Brothers vice president fired for raising issues about the legality of Lehman's activities, and William Black, the former regulator.

Valukas reiterated the findings of his lengthy report, and specifically rebutted Fuld's claim of ignorance, saying there was evidence to the contrary. "A fact-finder concluded that he in fact did know and acted upon information he knew or should have known," he told the committee. "There was at least one witness who testified that he discussed Repo 105 transactions with him and that there were documents sent to him by e-mail and otherwise, which reflected the Repo 105 transactions."

The clear implication was that Fuld was continuing the policy of falsification that led to Lehman's collapse, and may have committed perjury before the House committee.

Valukas also criticized regulators, saying the SEC under Cox decided to "stand by idly and simply acquiesce to management's decision" about the level of risk the bank would take.

Lee said he complained to Lehman executives and its auditor, Ernst & Young, that the "Repo 105" transactions that were making Lehman's financial position look better than it was. Lee was promptly fired, while the auditor did nothing in response to Lee's complaints.

Black agreed with the picture drawn by Valukas and Lee, but went even further, calling the executives of Lehman Brothers frauds and criminals. He said that the Valukas report showed that Lehman intentionally "misled investors as to the value of securities, and that is a felony."

He charged that Lehman executives knew that the securities they were selling, and keeping on their books, were worthless, but that they deliberately misled investors in order to defraud them. "Lehman was the leading purveyor of 'liar loans' in the world," he said. "Studies have shown that Lehman's liar loans had default rates of over 90 percent."

Two congresswomen, Anna Eshoo and Jackie Speier, spoke at Tuesday's hearing about the impact of the Lehman bankruptcy on their San Francisco Bay Area districts. Local governments and school districts in San Mateo County, California lost $155 million, part of an estimated $1.7 billion in losses by 40 municipalities throughout the US.

But no congressman, Democrat or Republican, drew any serious conclusions from the financial skullduggery and regulatory complicity revealed by the Lehman hearing. Democrats by and large used the hearing to argue for the toothless Obama administration "reform" bill. Republicans argued that since regulators failed so abysmally to spot Lehman's fraudulent activities, greater government regulation was not the answer.