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B of A Mess Jeopardizes Fed's Role in Oversight

By Steven Sloan, *American Banker*
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Growing uncertainty about Federal Reserve Board Chairman Ben Bernanke's role in pushing Bank of America Corp. to go through with its deal to buy Merrill Lynch & Co. is likely to delay regulatory restructuring plans and give ammunition to those seeking to prevent the central bank from receiving more power.

The White House has said it hopes to finalize by yearend a regulatory revamp that would give the Fed sweeping new powers over the country's largest firms.

But lawmakers from both parties said they were unwilling to give the Fed more authority until questions over Bernanke's role in the Bank of America-Merrill deal were answered.

"Let me just be quite clear, there's something rotten in the cotton here," said House Oversight and Government Reform Committee Chairman Edolphus Towns after a hearing with Bernanke on the subject. "We just need to know the role that all these people were supposed to play. Why didn't they perform? This is what we need to know before we talk about changing and rearranging in terms of regulations."

The hearing was supposed to focus on why the government had to chip in $20 billion to help B of A complete the deal. Kenneth Lewis, B of A's chief executive, told the New York attorney general that he wanted to back out of the deal, but Bernanke and then-Treasury Secretary Henry Paulson threatened to fire him and his board.

But after Republicans on the committee leaked e-mails on Wednesday that suggested the Fed ignored concerns from some regulators and left others in the dark entirely, the hearing turned to the broader question of whether handing the central bank more power would be wise. "What is at the heart of the matter is the Fed's role as a systemic regulator," said Rep. Jeff Fortenberry, R-Neb.

How the issue will play out in the House Financial Services Committee, which has jurisdiction over regulatory reform, is unclear. While Chairman Barney Frank may win enough support to pass a bill giving the Fed systemic risk powers, it is looking like an increasingly difficult fight.

Arguably the biggest threat for the Fed are e-mails that suggest the central bank purposely left the Office of the Comptroller of the Currency and the Securities and Exchange Commission in the dark as it deliberated over how to ensure the deal would be completed.

The Obama administration's plan calls on the Fed to work with other regulators in a council to oversee systemic risks. Lawmakers may be less inclined to go along if the Fed purposely hid information from fellow regulators.

"The Federal Reserve's cover-up of important information and willingness to exclude key regulatory partners such as the SEC and OCC raises troubling questions about its willingness to work collaboratively with its partners in the federal government," said Rep. Darrell Issa, the top Republican on the committee.

Rep. Towns, of New York, said regulatory reform must ensure that the various agencies cooperate. "Whatever we come up with has to break the wall between these different agencies," he said. "It seems to me there's too many sweetheart deals."

Despite an internal Fed e-mail that cautioned against discussing a conversation between Lewis and Paulson while an OCC official was on a conference call, Bernanke insisted that Comptroller of the Currency John Dugan was kept informed. "I don't know precisely what motivated" the e-mail, Bernanke said. "All I can say is that on Dec. 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."

The Fed chief said it was less important to keep the SEC informed because, unlike the OCC, the agency does not directly supervise B of A. "This was a bank and therefore the most pressing communication was with bank regulators," he said.

But lawmakers did not agree.

"Doesn't the SEC have a role in evaluating the bank as it relates to its investor relations?" asked Rep. Jackie Speier, D-Calif. "We're all one government, aren't we?"

Bernanke responded flatly: "We all have our spheres of responsibility as well."

Mark Calabria, the director of financial regulation studies at the Cato Institute and a former aide to Sen. Richard Shelby, said the sense that the Fed does not cooperate with other regulators damages the case that the central bank should have wide-ranging systemic authority.

"This 'we're the Fed: we don't play well with others' sort of attitude … undermines the push toward making the Fed the end-all, be-all," he said. "I don't see how any of this paints them the least bit flattering."

Lawmakers have grilled Bernanke over previous rescues, including those of Bear Stearns Cos. and American International Group Inc. But Thursday's hearing had particularly personal implications for the Fed chief, since President Obama must decide in the coming months whether to reappoint him. (Bernanke's term expires in January.)

No lawmaker called out against his reappointment, but the prospect was clearly in play.

David Min, an associate director for financial policy with the Center for American Progress, said Bernanke could ultimately survive this episode if the financial system continues to rebound. "If the stress tests were anywhere close to accurate, I think Bernanke is in good shape, because while people may be upset about the bailouts, what we are really looking for here is did they work," he said. "But if there are signs that the stress tests are — as some have criticized — overly optimistic and the financial system has severe problems at that point, it's an open question."

Bernanke's testimony comes two weeks after Lewis appeared before the panel, and Rep. Towns made clear that his investigation of the merger is not complete. Paulson is expected to testify next month and Rep. Towns said Thursday that leaders from the Federal Deposit Insurance Corp. and the SEC would be summoned to share their views.

"We are not even close to finishing this investigation," he said.

Stacy Kaper contributed to this article.