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Split decision

Bank of America shareholders take the unusual step of stripping CEO Kenneth Lewis of his chairman's role, but there was little usual about his dealings with Merrill Lynch—except that they may portend the future of politicized banks | *Jamie Dean*

CHARLOTTE, N.C.—Nearly three hours before embattled Bank of America (BofA) CEO Kenneth Lewis faced hundreds of anxious shareholders gathering to decide his fate at their annual meeting in downtown Charlotte, Judy Koenick wore her vote on a homemade T-shirt etched with large, black letters: "Fire!!! Kenneth Lewis."

Koenick, a shareholder from Chevy Chase, Md., paced on a sidewalk outside BofA headquarters, talking about the ire that caused her to travel to Charlotte for the April 29 meeting. Her anger hinged on two words: Merrill Lynch.

Indeed, much of BofA shareholders' exasperation with Lewis centered on the bank's acquisition of Merrill Lynch on Jan. 1. After learning in December that the troubled bank's fourth-quarter losses totaled a staggering $15.84 billion, Lewis did something that many shareholders couldn't forgive: He didn't tell them.

Lewis says Federal Reserve Chairman Ben Bernanke and then-Treasury Department chief Henry Paulson pressured him to proceed with the purchase of Merrill Lynch—and to keep their losses secret—fearing the bad news would worsen an already deplorable economic climate. Lewis—who had already accepted some $20 billion in government bailout funds for BofA—remained silent. Shareholders learned about Merrill Lynch's end-of-year hemorrhaging after the sale closed and then watched BofA's stock value plummet.

Outside BofA headquarters, Koenick says she lost a substantial portion of her retirement, pointing to a manila folder stuffed full of bank statements, shareholder letters, and a comic strip about a greedy banker to which she's pasted a photo of Lewis' head. She says she's not sympathetic to the intense pressure the CEO faced from two of the most powerful men in the country: "I don't care. Let him have the guts to say, 'I'm not going to lie to my shareholders.'"

By the end of the day, BofA shareholders would hand Lewis their razor-thin verdict: The 40-year veteran of the largest bank in America would remain CEO but lose his position as chairman of the board. Shareholders favored splitting the two positions by a margin of 50.34 percent, marking the first time shareholders have demanded such a split in a company in Standard & Poor's 500-stock index.

Considering that many financial experts praised Lewis' leadership before his involvement with Bernanke and Paulson, the BofA episode illustrates a troubling trend: an increasing federal entanglement in the banking system that could redefine the relationship between government and financial institutions and wage a simmering war on capitalism.

Many BofA shareholders were already simmering as they began lining up nearly two hours early for the meeting to be moderated by Lewis. Outside at the city's main intersection, protesters were already chanting: "Hey, hey, ho, ho, Ken Lewis has got to go!" Another group from the Service Employees International Union chanted: "Bank of America is in a spiral! Its greed is going viral!" One protester held a photo of Lewis' corporate jet. Another suit-clad man wore a Lewis mask and encouraged boos from his f-ellow protesters.

Inside, the crowd was more subdued, but still feisty. When a security guard jokingly offered shareholders a better place in line for $20, one shareholder sarcastically replied: "Hey, I could buy two shares for that today."

Actually, he was right: BofA shares were trading that week at around $9. That was up from a dismal $3 in March, but far below $40 about a year ago. A few days before the meeting, BofA announced a $4.2 billion profit for the first quarter, but the bank's shares still dipped more than 20 percent, as investors were skittish over a still-shaky economy and the Merrill Lynch revelations.

Those revelations came in January, more than two weeks after the Merrill Lynch sale closed. But untangling the complicated timeline means going back to July of last year, when BofA agreed to buy mortgage lender Countrywide Financial Corp. for $4 billion. Countrywide was near collapse under the weight of subprime loans gone bad and legal woes related to accusations of reckless lending practices. Financial experts said Lewis' willingness to absorb the spiraling company helped temporarily stabilize a faltering mortgage industry.

When Merrill Lynch faced an even bigger catastrophe in September, Lewis stepped in again, agreeing to buy the troubled investment bank for $50 billion. The proposed deal came with the economy convulsing from the stunning, domino-like collapse of banking giants like Bear Stearns and Lehman Brothers, as the subprime bubble violently erupted.

By October, the stock market was plummeting, BofA was reporting a 68 percent drop in profits, and Paulson was heading the Bush administration's assembling of a $700 billion bailout for banks. Congress battled over the details, and House Republicans soundly rejected the massive use of taxpayer funds for private banks, but Paulson's plan prevailed with Bush's approval. The Treasury targeted nine banks—including BofA—for the first $250 billion of infusions from the Troubled Asset Relief Program (TARP).

But there was a glitch in the plan: Not every bank wanted the federal money, and some worried about shareholder reaction and the restrictions that would come with the TARP funds. Paulson pushed back, insisting the infusions were critical to stabilizing the economy. Bank leaders conceded. Testifying before the House Financial Services Committee about accepting the money, Lewis said: "At the urging of the U.S. government, Bank of America accepted TARP funds."

With the initial infusion of government cash, BofA leaders moved forward with plans to buy Merrill Lynch. The bank announced in October that then-Merrill Lynch CEO John Thain would become president of the combined company's global banking, securities, and wealth-management division when the sale was final.

As the two banks hammered out details, BofA shareholders met on Dec. 5 to approve the purchase. But a week later, Lewis considered backing out of the deal. His chief financial officer gave him sobering news: Merrill Lynch's projected losses for the fourth quarter would total some $12 billion. (The losses actually soared to over $15 billion.)

The next day, Lewis expressed his concerns to Paulson and Bernanke. What happened next isn't clear. But Lewis testified before New York's attorney general in February that the two men wanted him to do two things: proceed with the purchase and not tell shareholders about Merrill Lynch's losses. They offered another $20 billion in government aid and protection against $118 billion in troubled assets. Lewis accepted.

Lewis hasn't said he was directly ordered to stay quiet, but he has given a glimpse of the kind of pressure he faced from Bernanke and Paulson. Lewis described a phone conversation with Paulson when he told him he was considering killing the deal: "I can't recall if he said, 'We would remove the board and management if you called it [off]' or if he said, 'We would do it if you intended to.'"

When it came to keeping quiet about Merrill Lynch's losses before the sale was final, Lewis testified that Paulson and Bernanke were emphatic, saying disclosing the losses would "impose a big risk to the financial system" of the entire country. Lewis said Paulson told him: "We do not want a public disclosure."

An investigator questioning Lewis during the New York hearings about the Merrill Lynch losses asked: "Isn't that something that any shareholder at Bank of America . . . would want to know?" Lewis replied: "It wasn't up to me."

A spokeswoman for Paulson told *The Wall Street Journal* the secretary didn't believe Lewis could legally back out of the deal in December, and he wanted to safeguard the financial system. A spokeswoman for Bernanke said the chairman did not instruct anyone at BofA to withhold information about Merrill Lynch from the public.

At the shareholdersmeeting in Charlotte, Lewis seemed eager to move past the Merrill Lynch controversy, and he even downplayed the role of Paulson and Bernanke, saying: "We made our decision independent of any threat."

He also said the bank wasn't legally obligated to disclose its negotiations with the government.

Not everyone in the audience was satisfied. Though most shareholders gave Lewis a sustained round of applause when he entered the room, others lined up at microphones to tell the CEO how much money they had lost, and to ask why he didn't disclose information about Merrill Lynch. Gerald Abrams, a retired fisherman from Florida, asked: "Where was the due diligence?"

Lewis mostly listened stoically, standing behind a microphone for nearly four hours and offering few comments on difficult questions. But his patience broke with one shareholder who pressed hard for answers about Merrill Lynch. The CEO said he was limited in his ability to comment because of pending litigation, and he sharply told the shareholder: "If you want to know more, drop your lawsuit."

Lewis may not be able to avoid more questions about Merrill Lynch for long: Rep. Spencer Bachus, R-Ala., of the House Financial Services Committee said he would likely call hearings to investigate the role of the Treasury and Federal Reserve in the Merrill Lynch deal, and he may call Paulson, Bernanke, and Lewis to testify.

Shareholders also want answers about some $3.6 billion in bonuses Merrill Lynch paid to its employees before the sale to BofA closed in January. Both shareholders and taxpayers have expressed outrage over Merrill Lynch awarding the bonuses while the government poured in taxpayer funds.

BofA officials have said former Merrill Lynch CEO John Thain decided to pay the bonuses. (Lewis fired Thain in January, saying the BofA board was displeased with Merrill Lynch's fourth-quarter losses and blamed him.) BofA officials also said Thain decided alone to pay the multibillion-dollar bonuses. Thain bitterly rejects that notion, saying he consulted with BofA officials on bonus amounts. He also insists he was forthcoming about Merrill Lynch's losses and says his firing came as a surprise.

Back in the shareholders meeting, Koenick from Maryland couldn't conceal her surprise and anger toward Lewis over the Merrill Lynch deal, telling him: "I find it incredible that you would not stand up to the federal government."

But if some shareholders think Lewis' role is incredible, the role of Bernanke and Paulson is worth examining as well. Mark Calabria is the director of financial regulation studies at the Cato Institute and a former senior staffer on the U.S. Senate Committee on Banking, Housing, and Urban Affairs. Calabria says the power that Bernanke and Paulson exerted is sobering: "To think that any man can spend a trillion dollars in public money is frightening."

Calabria thinks Lewis should have disclosed Merrill Lynch's losses, but he says Bernanke and Paulson shouldn't have asked him to keep quiet, if they did. The officials' combined pressure was likely tremendous, he said: "The only way you could kick it up a notch is if the president were coming to you personally."

As the government's role in banking increases, Calabria says political pressure will build to satisfy taxpayers who feel invested in companies: "If you're having trouble paying your mortgage, you may think: 'I'm bailing them out, so they should bail me out.'" Politicians could feel pressure to lean on banks to deliver cut-rate services to disgruntled constituents. "But these banks aren't going to get back to being healthy again by making bad loans," says Calabria.

Meanwhile, another possibility for increased government control of banks looms: Treasury Secretary Timothy Geithner says the president's economic team may encourage TARP-funded banks that need to raise more capital to convert the government's preferred shares to common stocks. That would make the government's investment in banks immediately available as capital.

But since common stocks carry voting rights, the move could also make the government the majority shareholder in several banks, including BofA. Lewis told shareholders he didn't have enough information to comment on the possibility, but he didn't rule it out. Financial experts said regulators would likely tell BofA officials they needed to raise billions of dollars in additional capital based on results of government stress tests of banking institutions.

Calabria warns that if the government ends up with voting rights in banks, "they're going to get lobbied from every special interest group in Washington." That pressure could be hard to resist, he says: "There are some powerful constituencies that I think the government isn't going to want to irk."

Those constituencies were already lining up at the Bank of America meeting: Stephen Lerner of the Services Employees International Union stood outside near a media tent wearing a sticker that read: "I'm a taxpayer-owner of Bank of America and all I got was this lousy sticker."

Lerner—whose group led efforts to split the chairman and CEO roles at BofA—said all taxpayers are now shareholders in banks taking government funds. Lerner sped through a list of demands he wants the government to impose on banks like BofA: raising wages, expanding health-care coverage, and allowing workers to form unions. Lerner acknowledges those are demands his group has wanted for years: "Now that we're the biggest owners of Bank of America, we [taxpayers] should have a say in the policy."

A few feet away, Dennis Meyer munched on a granola bar and waited for a cab. The BofA shareholder traveled to Charlotte from Kansas City and said he's upset over the money he's losing as he nears retirement—money he had hoped to use to help pay for college for his six grandchildren. But despite his losses, Meyer said he hopes government will soon be out of banking: "You can't have politics involved in running a bank."

Out of tune

| Timothy Lamer

Last week's controversy over the government's plan to restructure Chrysler could be a textbook example of the truism that "he who pays the piper calls the tune." A look at some flows of money makes it easy to understand why the major groups involved—the Obama administration, the United Auto Workers (UAW) union, such big banks as Citigroup and Morgan Stanley, and a group calling itself a committee of "non-TARP lenders" to Chrysler—acted the way they did.

The plan, engineered by the White House, sought to keep Chrysler out of bankruptcy by transferring the company's assets to the UAW, Fiat of Italy, and the U.S. and Canadian governments. In return, senior lenders to the company would receive $2.25 billion for the $6.9 billion they had loaned the automaker—meaning they would lose about 67 cents for each dollar loaned.

The UAW would be a big winner under the plan. The union gave $5 million to the Obama presidential campaign, and during the Chrysler negotiations enjoyed what *The New York Times* called a "rare front seat" for a labor group. The UAW would receive 55 percent of the company's assets under the plan. The big banks, which were negotiating with the same government that has given them billions under TARP, agreed to make themselves big losers, recovering only about 33 cents for each dollar invested in Chrysler.

But the non-TARP lenders, a group of smaller funds that owe financial allegiance to the people who invest with them, refused to go along with such a low figure and sent Chrysler to bankruptcy court. This earned the wrath of powerful Democrats, who blasted them as "speculators" (President Obama) and "vultures" (Michigan Congressman John Dingell). Thomas E. Lauria, a lawyer for non-TARP lenders, claimed the administration threatened to damage the reputations of his clients if the clients didn't go along with the plan.

The White House denies that claim. But even if outright intimidation didn't happen, it's clear that political concerns were at the heart of the plan. The danger is that in this era of bailouts, banks and businesses will make decisions based on the political needs of government leaders instead of on market realities. If that leads to more and more bailouts, then taxpayers may decide they don't like the sound of the tune they're funding.

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