

## **Ben S Bernanke: Acquisition of Merrill Lynch by Bank of America**

Testimony by Mr Ben S Bernanke, Chairman of the Board of Governors of the US Federal Reserve System, before the Committee on Oversight and Government Reform, US House of Representatives, Washington DC, 25 June 2009.

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Chairman Towns, Ranking Member Issa, and other members of the Committee, I appreciate the opportunity to discuss the Federal Reserve's role in the acquisition by the Bank of America Corporation of Merrill Lynch & Co., Inc. I believe that the Federal Reserve acted with the highest integrity throughout its discussions with Bank of America regarding that company's acquisition of Merrill Lynch. I will attempt in this testimony to respond to some of the questions that have been raised.

### **Background**

On September 15, 2008, Bank of America announced an agreement to acquire Merrill Lynch. I did not play a role in arranging this transaction and no Federal Reserve assistance was promised or provided in connection with that agreement. As with similar transactions, the transaction was reviewed and approved by the Federal Reserve under the Bank Holding Company Act in November 2008. It was subsequently approved by the shareholders of Bank of America and Merrill Lynch on December 5, 2008. The acquisition was scheduled to be closed on January 1, 2009.

As you know, the period encompassing Bank of America's decision to acquire Merrill Lynch through the consummation of the merger was one of extreme stress in financial markets. The government-sponsored enterprises, Fannie Mae and Freddie Mac, were taken into conservatorship a week before the Bank of America deal was announced. That same week, Lehman Brothers failed, and American International Group was prevented from failing only by extraordinary government action. Later that month, Wachovia faced intense liquidity pressures which threatened its viability and resulted in its acquisition by Wells Fargo. In mid-October, an aggressive international response was required to avert a global banking meltdown. In November, the possible destabilization of Citigroup was prevented by government action. In short, the period was one of extraordinary risk for the financial system and the global economy, as well as for Bank of America and Merrill Lynch.

### **Discussions regarding the possible Termination of Agreement to acquire Merrill Lynch**

On December 17, 2008, senior management of Bank of America informed the Federal Reserve for the first time that, because of significant losses at Merrill Lynch for the fourth quarter of 2008, Bank of America was considering not closing the Merrill Lynch acquisition. This information led to a series of meetings and discussions among Bank of America, the regulatory agencies, and Treasury. During these discussions, Bank of America's CEO, Ken Lewis, told us that the company was considering invoking the Material Adverse Event clause in the acquisition contract, known as the MAC, in an attempt to rescind its agreement to acquire Merrill Lynch.

In responding to Bank of America in these discussions, I expressed concern that invoking the MAC would entail significant risks, not only for the financial system as a whole but also for Bank of America itself, for three reasons. First, in light of the extreme fragility of the financial system at the time, the uncertainties created by an invocation of the MAC might have triggered a broader systemic crisis that could well have destabilized Bank of America as well as Merrill Lynch. Second, an attempt to invoke the MAC after three months of review, preparation, and public remarks by the management of Bank of America about the benefits

of the acquisition would cast doubt in the minds of financial market participants – including the investors, creditors, and customers of Bank of America – about the due diligence and analysis done by the company, its capability to consummate significant acquisitions, its overall risk-management processes, and the judgment of its management. Third, based on our staff analysis of the legal issues, we believed that it was highly unlikely that Bank of America would be successful in terminating the contract by invoking the MAC. Rather, an attempt to invoke the MAC would likely involve extended and costly litigation with Merrill Lynch that, with significant probability, would result in Bank of America being required either to pay substantial damages or to acquire a firm whose value would have been greatly reduced or destroyed by a strong negative market reaction to the announcement. For these reasons, I believed that, rather than invoking the MAC, Bank of America's best option, and the best option for the system, was to work with the Federal Reserve and the Treasury to develop a contingency plan to ensure that the company would remain stable should the completion of the acquisition and the announcement of losses lead to financial stress, particularly a sudden pullback of funding of the type that had been experienced by Wachovia, Lehman, and other firms.

Ultimately, on December 30, the Bank of America board determined to go forward with the acquisition. The staff of the Federal Reserve worked diligently with Treasury, other regulators, and Bank of America to put in place a package that would help to shore up the combined company's financial position and reduce the risk of market disruption. The plan was completed in time to be announced simultaneously with Bank of America's public earnings announcement, which had been moved forward to January 16, 2009, from January 20, 2009. The package included an additional \$20 billion equity investment from the Troubled Asset Relief Program and a loss-protection arrangement, or ring fence, for a pool of assets valued at about \$118 billion. The ring-fence arrangement has not been consummated, and Bank of America now believes that, in light of the general improvement in the markets, this protection is no longer needed.

Importantly, the decision to go forward with the merger rightly remained in the hands of Bank of America's board and management, and they were obligated to make the choice they believed was in the best interest of their shareholders and company. I did not tell Bank of America's management that the Federal Reserve would take action against the board or management if they decided to proceed with the MAC. Moreover, I did not instruct anyone to indicate to Bank of America that the Federal Reserve would take any particular action under those circumstances. I agreed with the view of others that the invocation of the MAC clause in this case involved significant risk for Bank of America, as well as for Merrill Lynch and the financial system as a whole, and it was this concern that I communicated to Mr. Lewis and his colleagues.

## **Disclosures**

The Federal Reserve also acted appropriately regarding issues of public disclosure. As I wrote in a letter to this Committee, neither I nor any member of the Federal Reserve ever directed, instructed, or advised Bank of America to withhold from public disclosure any information relating to Merrill Lynch, including its losses, compensation packages or bonuses, or any other related matter. These disclosure obligations belong squarely with the company, and the Federal Reserve did not interfere in the company's disclosure decisions.

The Federal Reserve had a legitimate interest in knowing when Bank of America or Merrill Lynch intended to disclose the losses at Merrill Lynch. Given the fragility of the financial markets at that time, we were concerned about the potential for a strong, adverse market reaction to the reports of significant losses at Merrill Lynch. If federal assistance to stabilize these companies were to be effective, the necessary facilities would have to be in place as of the disclosure date. Thus, our planning was importantly influenced by the companies'

planned disclosure schedule. But the decisions and responsibilities regarding public disclosure always remained, as it should, with the companies themselves.

A related question is whether there should have been earlier disclosure of the aid provided by the U.S. government to Bank of America. Importantly, there was no commitment on the part of the government regarding the size or structure of the transaction until very late in the process. Although we had indicated to Bank of America in December that the government would provide assistance if necessary to keep the company from being destabilized, as it had done in other cases during this time of extraordinary stress in the financial markets, those December discussions were followed in January by significant and intense negotiations involving Bank of America, the Federal Reserve, the Treasury, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency regarding many key aspects of the assistance transaction, including the type of assistance to be provided, the size of the protection, the assets to be covered, the terms for payments, the fees, and the length of the facility. The agreement in principle on these items was reflected in a term sheet that was not finalized until just before its public release on January 16, 2009. The Federal Reserve Board and the Treasury completely and appropriately disclosed the information as required by the Congress in the Emergency Economic Stabilization Act of 2008.

In retrospect, I believe that our actions in this episode, including the development of an assistance package that facilitated the consummation of Bank of America's acquisition of Merrill Lynch, were not only done with the highest integrity, but have strengthened both companies while enhancing the stability of the financial markets and protecting the taxpayers. These actions were taken under highly unusual circumstances in the face of grave threats to our financial system and our economy. To avoid such situations in the future, it is critical that the Administration, the Congress, and the regulatory agencies work together to develop a new framework that strengthens and expands supervisory oversight and includes a broader range of tools to promote financial stability.

I would be pleased to take your questions.