Opening Statement of Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform
Causes and Effects of the Lehman Brothers Bankruptcy
October 6, 2008

On Friday, Congress passed a $700 billion rescue package for Wall Street. This was something no member wanted to do. If Wall Street had been less reckless or if federal regulators had been more attentive, the financial crisis could have been prevented.

But we voted for the $700 billion rescue because the consequences of doing nothing were even worse. The excesses on Wall Street had caused a credit freeze that threatened our entire economy.

The $700 billion rescue plan is a life-support measure. It may keep our economy from collapsing, but it won't make it healthy again.

To restore our economy to health, two steps are necessary. First, we must identify what went wrong. Then we must enact real reform of our financial markets.

Over the next three weeks, we will start this process in this Committee. We will be holding a series of five hearings on the financial meltdown on Wall Street. We'll examine how the system broke down, what could have been done to prevent it, and what lessons we need to learn so this won't happen again.

Today's hearing examines the collapse of Lehman Brothers, which on September 15 filed for bankruptcy, the largest bankruptcy filing in American history.

Before the Lehman bankruptcy, Treasury Secretary Paulson and Federal Reserve Chairman Bernanke told us our financial system could handle the collapse of Lehman.

It now appears they were wrong. The repercussions of this collapse have reverberated across our economy. Many experts think Lehman's fall triggered the credit freeze that is choking our economy and made the $700 billion rescue necessary. Lehman's collapse caused a big money market fund to "break the buck," which caused investors to flee to Treasury bills and dried up a key source of short-term commercial paper. It also spread fear throughout the credit markets, driving up the costs of borrowing.

Over the weekend, we received the written testimony of Richard Fuld, the CEO of Lehman Brothers. Mr. Fuld takes no responsibility for the collapse of Lehman. Instead, he cites a "litany of destabilizing factors" and says: "In the end, despite all our efforts, we were overwhelmed."

In preparation for today's hearing, the Committee received thousands of pages of internal documents from Lehman Brothers. Like Mr. Fold's testimony, these documents portray a company in which there was no accountability for failure.

In one e-mail exchange from early June, some executives from Lehman's money management subsidiary, Neuberger Berman, made this recommendation:

> Top management should forgo bonuses this year. This would serve a dual purpose. Firstly, it would represent a significant expense reduction. Secondly, … it would send a strong message to both employees and investors that management is not shirking accountability for recent performance.

The e-mail was sent to Lehman's executive committee. One of its members is George H. Walker, President Bush's cousin, who was responsible for overseeing Neuberger Berman. Here's what he wrote to the executive committee: "Sorry team. I'm not sure what's in the water at 605 Third Avenue today. … I'm embarrassed and I apologize."

Mr. Fuld also mocked the Neuberger suggestion that top management should accept responsibility by giving up their bonuses. His response was: "Don't worry – they are only people who think about their own pockets."

Another remarkable document is a request submitted to the compensation committee of the board on September 11, four days before Lehman filed for bankruptcy. It recommends that the board give three departing executives over $20 million in "special payments."

In other words, even as Mr. Fuld was pleading with Secretary Paulson for a federal rescue, Lehman continued to squander millions on executive compensation.

Other documents obtained by the Committee undermine Mr. Fuld's contention that Lehman was overwhelmed by forces outside its control. One internal analysis reveals that Lehman "saw warning signs" but "did not move early/fast enough" and lacked "discipline about capital allocation."

In 2004, the Securities and Exchange Commission relaxed a rule limiting the amount of leverage that Lehman and other investment banks could use. As this Lehman chart shows, that proved to be a temptation the firm could not resist.

At first, Lehman's bets paid out. As Mr. Fuld's testimony recounts, Lehman achieved "four consecutive years of record-breaking financial results" between 2004 and 2007.

These were lucrative years for Lehman's executives and Mr. Fuld. Lehman paid out over $16 billion in bonuses. Mr. Fuld himself received over $30 million in cash bonuses. His total compensation during these four years exceeded $260 million.

But while Mr. Fuld and other Lehman executives were getting rich, they were steering Lehman Brothers and our economy towards a precipice.

Leverage is a dangerous double-edged sword. When it works — as it did from 2004 to 2007 — it magnifies investment gains. But when asset values decline — as the subprime market did — leverage rapidly consumes a company's capital and jeopardizes its survival.

Mr. Fuld's actions during this crisis were questionable. In a January 2008 presentation, he and the Lehman board were warned that the company's "liquidity can disappear quite fast." Yet despite this warning, Mr. Fuld depleted Lehman's capital reserves by over $10 billion through year-end bonuses, stock buybacks, and dividend payments.

In one document, a senior executive tells Mr. Fuld that if the company can secure $5 billion in financing from Korea, "I like the idea of aggressively going into the market and spending 2 of the 5 in buying back lots of stock (and hurting Einhorn bad!!)." This action might have inflicted short-term losses on a short seller Lehman despised, but it would have burned through even more capital. Mr. Fuld's response: "I agree with all of it."

What's fundamentally unfair about the collapse of Lehman is its impact on the economy and taxpayers. Mr. Fuld will do fine. He can walk away from Lehman a wealthy man who earned over $500 million. But taxpayers are left with a $700 billion bill to rescue Wall Street and an economy in crisis.

Risk-taking has an important role in our economy. But federal regulators are supposed to ensure that these risks don't become so large they can imperil our entire economy. They failed miserably. The regulators had a blind faith in the market and a belief that what was good for Mr. Fuld and other executives on Wall Street was good for America. We are now all paying a terrible price.

We can't undo the damage of the past eight years. That's why I reluctantly voted for the $700 billion rescue plan. But we can start the process of holding those responsible to public account and identifying the reforms we need for the future.

These are the goals of today's hearing and the other hearings we will be holding this month.