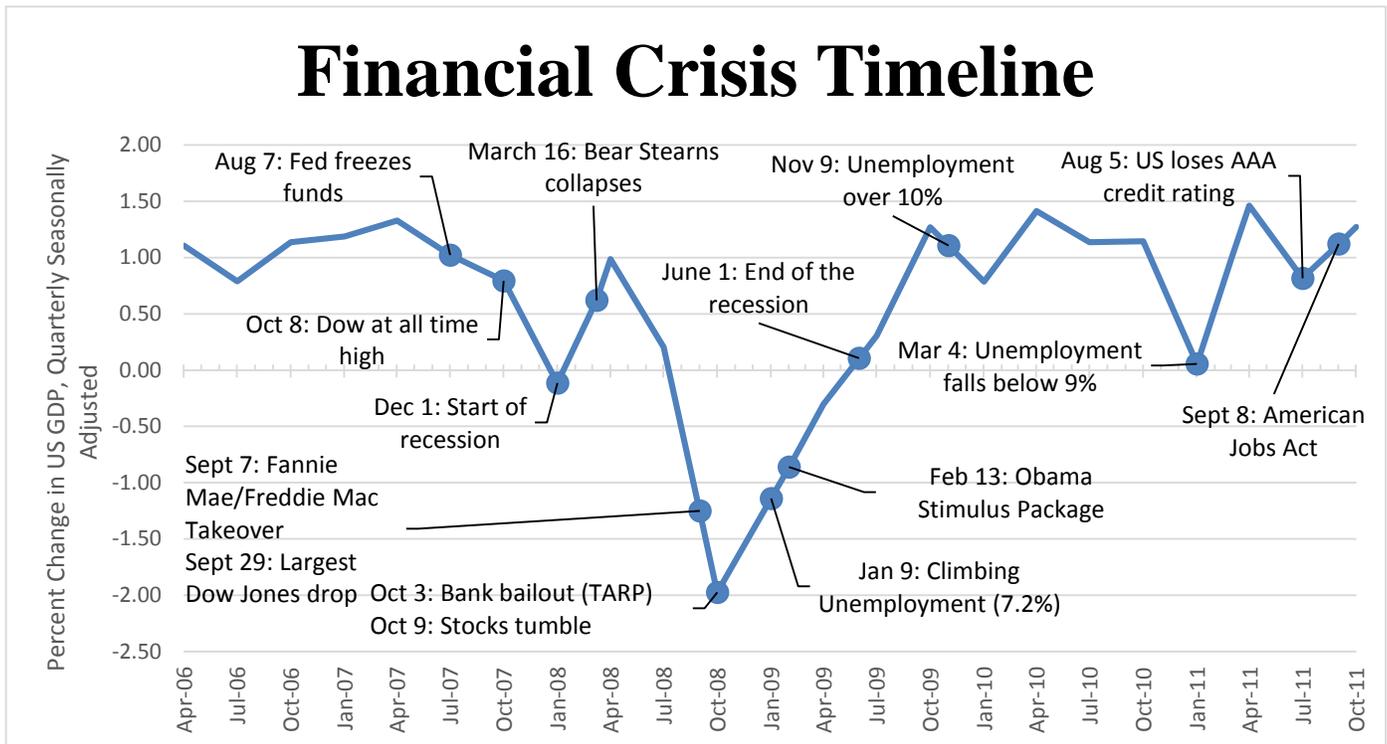


## A Chronology of the Financial Crisis

by Dennis McCuistion<sup>1</sup>



Most Americans did not recognize that the United States had a financial problem until 2007. When people recognized the problem, it was seen as a subprime mortgage issue. In fact, on January 4, 2008, the American Dialect Society voted "subprime" as the word of the year for 2007. Evidence of the impending crisis, however, emerged years earlier.

**The Brewing Storm.** Starting in 2004, homeowners witnessed the beginning of a steady rise in U.S. interest rates from 1 percent to 5.45 percent. Owners of subprime mortgages began defaulting as payments increased. Then, toward the end of 2005, Bear Stearns disclosed that the Securities and Exchange Commission — the chief federal financial regulator — intended “to recommend that the Commission bring a civil enforcement action against Bear Stearns in connection with Bear Stearns’ involvement in the pricing, valuation and analysis related to approximately \$62.9 million worth of collateralized debt obligations.”<sup>2</sup> By 2006, defaults on subprime mortgages rose to record levels.<sup>3</sup>

In May 2006, Merit Financial, Inc., one of Washington state’s largest mortgage brokerages, filed for bankruptcy and immediately began to wind-down operations. The sudden rise in mortgage rates crippled sales and hurt revenue, forcing the company to lay off

330 employees without warning. The 80 remaining workers managed existing accounts until the business officially closed later that month.<sup>4</sup>

**May 23, 2006**

**DJIA: 11, 278.61**

**Federal discount rate: 4.75 percent**

**U.S. unemployment rate: 4.6 percent**

In February 2007, New Century Financial, the second largest subprime mortgage originator in the United States, announced it would restate results for the first three quarters of 2006 to correct accounting-related errors to show loan repurchase losses. The same month, Hongkong and Shanghai Banking Corporation (HSBC) made a surprise announcement that the company would set aside 20 percent more capital than analysts had estimated to account for bad loans.<sup>5</sup> Meanwhile, two major subprime lenders, Mortgage Lenders Network USA Inc. and ResMae Mortgage Corp., filed for Chapter 11 bankruptcy. The Federal Home Loan Mortgage Corporation (Freddie Mac) ended the month by announcing it would no longer buy risky subprime mortgages or mortgage-related securities.

In June 2007, two large hedge funds run by Bear Stearns experienced significant problems with \$20 billion of investments tied to subprime mortgages. On June 23, 2007, Bear Stearns agreed to lend \$3.2 billion to one of those troubled hedge funds to stave off its collapse. The Bear Stearns stock price reached \$170 a share late in December 2006, but news of the hedge-fund loan undermined investor confidence. By June 23, 2007, its stock had fallen 15 percent, to \$143.75 a share.

**June 23, 2007**

**DJIA: 13,360.26**

**Federal discount rate: 6.25 percent**

**U.S. unemployment rate: 4.6 percent**

A July 23, 2007, news outlets reported that as much as \$100 billion in losses could occur on subprime loans attached to national lenders.<sup>6</sup> One such lender, Countrywide Mortgage Company, had boasted a market share of more than 17 percent in 2006. Angelo Mozilo, Countrywide's Chairman and CEO, received \$120 million in compensation that year. In August 2007, Mozilo publically warned that his company faced "adverse conditions."<sup>7</sup> Just two months later, Mozilo responded to the negative publicity by saying, "Our divisions will have clear goals, built on our ruthless attack strategies to continue to grow profitably. Growing, winning and being the best is also hard wired into our DNA."<sup>8</sup>

In August 2007, France’s biggest mortgage bank, BNP Paribas, “barred the doors” on three funds invested in U.S. subprime mortgages. BNP said it based the decision on an inability to calculate fair value for the assets. The news roiled the markets and sent the Dow Jones tumbling 387 points.

At the same time, American Home Mortgage Investment Corporation filed for Chapter 11 bankruptcy protection, while Fitch Ratings downgraded Countrywide Financial Corporation to its third lowest investment-grade rating of BBB+. Meanwhile, the Fed used its open market operations to pump about \$24 billion into the U.S. banking system, hoping to keep short-term interest rates at the Fed's 5.25 percent target.<sup>9</sup>

<p><b>August 7, 2007</b> <b>Federal Reserve freezes funds</b></p> <p><b>October 9, 2007</b> <b>Dow Jones reaches an all-time high of 14,164.53</b></p>
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Mid-October 2007, Citigroup, J.P. Morgan Chase and Bank of America tried to raise a \$100 billion fund from among several of the commercial and investment banks to prevent asset sales of structured investment vehicles (SIV) — off-balance-sheet investment pools — from triggering a market meltdown. SIVs sell short-term debt and use the proceeds to buy longer term, higher yielding securities. At the time, there were approximately 30 SIVs with about \$400 billion in assets.

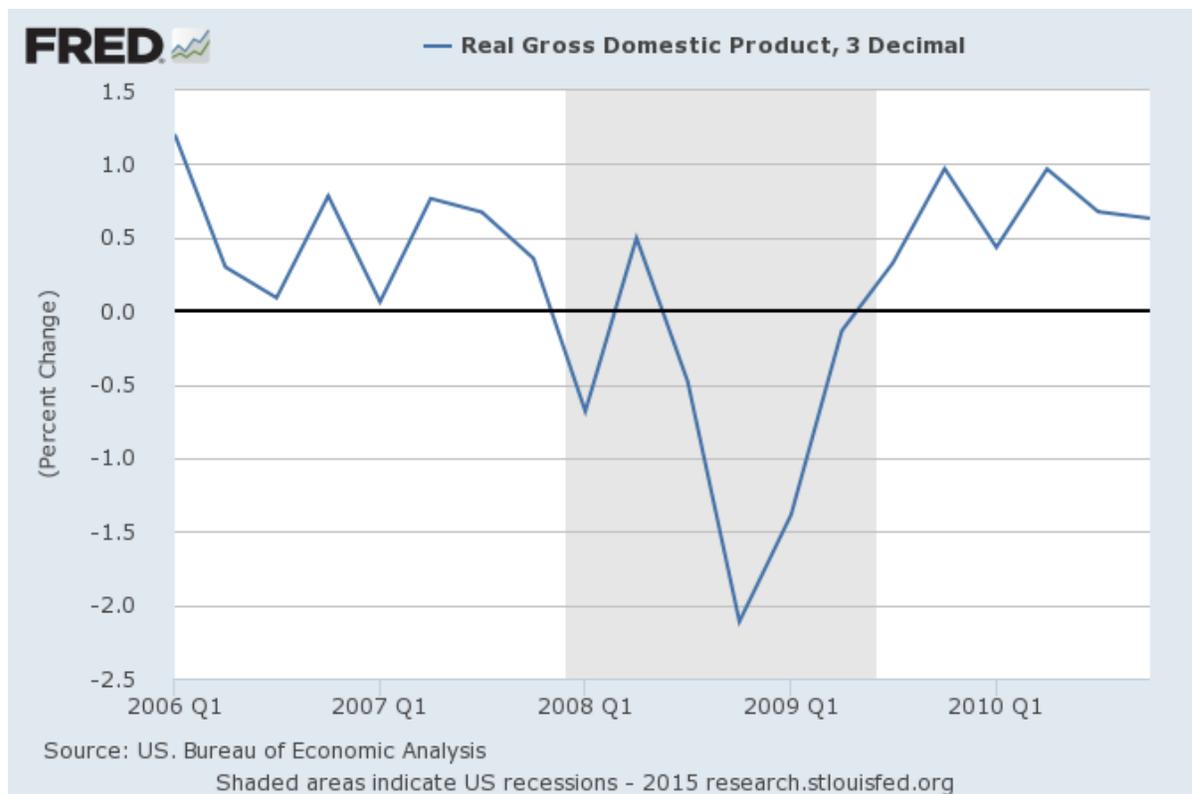
On October 31, 2007, Treasury Secretary Paulson issued a statement on Citigroup’s mortgage backed securities, saying, “I can’t say this strongly enough — with this triple A rated paper, the highest rated paper, most of the issues we are dealing with here are not credit issues, okay? Most of them are liquidity issues and . . . the mortgages that are backing up that paper are high quality mortgages.”<sup>10</sup>

<p><b>October 31, 2007</b> <b>DJIA: 13,930.01</b> <b>Federal discount rate: 5.00 percent</b> <b>U.S. unemployment rate: 4.7 percent</b></p>
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On November 26, 2007, Citigroup acknowledged that it had a problematic \$45 billion mortgage portfolio and announced a commitment to work with the Association of Community Organizations for Reform Now (ACORN), a political activist group, to “help distressed borrowers remain in their homes.”<sup>11</sup> Citigroup already had 46,000 borrowers in default.

On December 7, 2007, Treasury Secretary Paulson announced a plan to minimize foreclosures, but claimed there was “no federal funding involved.”<sup>12</sup> The *Washington Post* reported there were an estimated 1.2 million subprime, adjustable-rate mortgage-holders who would be eligible for fast-track consideration for refinancing or modification.<sup>13</sup>

In December 2007, despite terrible market conditions, Goldman Sachs, a U.S.-based global investment firm, reported a record net annual income of over \$11 billion. The company earned \$4 billion that year after betting securities backed by risky home loans would fall in value. The firm had underwritten mortgage debt obligations and collateralized debt obligations and other complex securities and sold them to unsuspecting purchasers.<sup>14</sup> Goldman Sachs later admitted to providing investment ideas that it had already traded on, sometimes betting against the very investments it recommended to clients.<sup>15</sup>



**December 1, 2007**  
**The recession officially begins**

On December 29, 2007, the U.S. Census Bureau announced new home sales in November 2007 were down 34.4 percent from November 2006. This was the largest year-

to-year decline since a 35.3 percent drop in January 1991 during a previous national recession. The Federal Deposit Insurance Corporation (FDIC) also reported that real estate holdings accounted for 58 percent of the total assets of U.S. banks, up from 45 percent from 2000. The syndicated loan market neared collapse by the close of 2007, with hundreds of billions in debts outstanding. These loans had little chance of being sold without a loss and banks responded by issuing virtually no collateralized loan obligations in the latter part of the year. As a result, mark-to-market accounting — a measure of fair-market value for a financial product — generated significant losses. Merrill Lynch, Citigroup and Bear Stearns began restructuring their deals to provide more protective provisions, but borrowing costs continued to increase, while leverage decreased. The first half of 2007 witnessed nine of the 10 largest leveraged buyouts in U.S. history.

**December 29, 2007**

**DJIA: 13,365.87**

**Federal discount rate: 4.75 percent**

**U.S. unemployment rate: 5.0 percent**

In January 2008, Bank of America acquired troubled lender Countrywide for approximately \$4 billion in stock.

On February 9, 2008, the Bush administration proposed a \$168 billion stimulus package intended to save the economy from a potential collapse. Among other things, the bill extended tax rebate checks to more than 111 million U.S. households and increased both the limit and size of mortgages Fannie and Freddie could buy.

In February 2008, home prices nationwide dropped 12.7 percent from a year earlier, the sharpest decline since record-keeping began 20 years prior. Net income for all banks in 2007 was only \$646 million, the lowest quarterly earnings since the 1990 recession.

In March 2008, Treasury Secretary Paulson suggested the U.S. government phase out the Office of Thrift Supervision (OTS) and the National Credit Union Association and replace them with one sole regulator.

In March 2008, Bear Stearns reached the brink of bankruptcy and the Federal Reserve lent it money to prevent a bankruptcy filing. The Fed then guaranteed \$29 billion of Bear Stearns' assets to facilitate a take-over by firm J.P. Morgan Chase and Company. J.P. Morgan quickly agreed to buy the 85-year-old Bear Stearns at \$2 a share, less than one tenth of its market price. J.P. Morgan and the Federal Reserve guaranteed the company's trading obligations, but the Asian market still dropped 4 percent. A former director of monetary affairs at the Fed, Vincent Reinhart, concluded that the bailout, "eliminated forever the possibility that the Fed could serve as an honest broker."<sup>16</sup>

**March 16, 2008**

**Bear Stearns collapses**

On July 5, 2008, in the *Wall Street Journal*, financier Ted Forstmann said,

“We are in a credit crisis the likes of which I’ve never seen in my lifetime. The credit problems in this country are considerably worse than people have said or know. I didn’t even know subprime mortgages existed, and I was worried about the credit crisis. I think we’re in about the second inning of this. The creation of much too much money caused all of this excess....”<sup>17</sup>

On July 30, 2008, President George W. Bush signed into law a housing bill that again increased the size of the loans Fannie and Freddie could buy. The bill increased the FHA’s money lending authority by \$300 billion, provided local governments with \$3.9 billion to buy foreclosed properties and extended \$15 billion in temporary tax cuts for home buyers. In addition, the housing bill gave the Treasury Department authority to buy stock in Fannie and Freddie, although Treasury officials said those government entities could never fail.

**September 15, 2008**

**DJIA: 10,917.51**

**Federal discount rate: 2.25 percent**

**U.S. unemployment rate: 6.1 percent  
(highest rate in several years)**

**Takeover of AIG.** On September 15, 2008, Lehman Brothers Holdings, Inc., with over \$600 billion in assets, filed the largest bankruptcy in U.S. history after investors demanded a return of funds Lehman Brothers had tied to subprime mortgage investments. The Reserve Primary Fund, a money market mutual fund, responded by “breaking the buck” or dropping net asset value below \$1 for only the third time in the 37-year history of money funds.

The U.S. government took over the failing insurance firm American International Group, Inc. (AIG) the following day. AIG had guaranteed hundreds of billions of financial instruments issued by Lehman through credit default swaps, an insurance policy on bonds investors acquired to guard against default. Since the company had written tens of billions of dollars’ worth of these credit default swap contracts and had no reserves tied back to them, the Treasury feared AIG’s failure to meet its obligations would create a global financial meltdown and provided an \$85 billion rescue loan.

Former New York Attorney General Eliot Spitzer told Fareed Zakaria on CNN one year later that “I told people...AIG was at the center of the web. The financial tentacles of

this company stretched to every major investment bank. The web between AIG and Goldman Sachs is something that should be pursued.”<sup>18</sup>



**September 7, 2008**

**Treasury Department takes over Fannie Mae and Freddie Mac**

**The Bailout.** On September 18, 2008, SEC Chairman Cox, Treasury Secretary Paulson and Fed Chairman Bernanke requested a fiscal package from Congress in order to purchase distressed assets from financial companies, in what became known as a bailout package. Later that day, Paulson and Bernanke told the President George W. Bush that, “If we don’t do this (bailout), we risk an uncertain fate.”<sup>19</sup>

The weekend of September 28, the Fed, the FDIC and the Office of the Comptroller of the Currency (OCC) worked to prevent the collapse of Wachovia Bank after the company found itself saddled with bad loans and falling stock prices. The following Monday, September 29,

the House defeated the bailout package, causing markets to tumble.

**September 29, 2008**

**DJIA: 10,365.45  
(largest drop ever, 777.68 points)**

On October 3, 2008, Congress approved and President Bush signed into law the 450-page, \$700 billion rescue plan. The Emergency Economic Stabilization Act of 2008 (EESA) authorized the Treasury to spend up to \$700 billion on a Troubled Asset Relief Program (TARP).

**Critics Question Constitutionally.** Though the Bush administration and many legal scholars had no problem with the EESA and TARP, some critics questioned the constitutionality of these actions. For example:

- Attorney Robert A. Levy of the Cato Institute said, “The Federal Government has no constitutional authority to spend taxpayers’ money to buy distressed assets, much less to take an ownership position in private financial institutions.”<sup>20</sup>
- Bruce Fine, former Associate Deputy Attorney General in the Reagan administration, argued that “EESA was unconstitutional at birth. Any statute authorizing the Executive Branch to ‘purchase’ an asset carries with it [an] . . . authorization for the government to ‘take’ that asset by eminent domain.” He concluded that the government had “taken private property for the purpose of encouraging private lending to the private sector.”<sup>21</sup>
- Former New Jersey Superior Court Judge Andrew Napolitano called the TARP legislation “merely tips of an unconstitutional big government iceberg,” which was “so obviously in conflict with the plain words of the Constitution that one wonders how Congress gets away with it.”<sup>22</sup>
- Attorney William J. Watkins, Jr. of the Independent Institute wrote that under the separation of powers between the Executive and other branches of government, “legislative power typically cannot be exercised by members of the Executive Branch or the Judiciary . . . with the EESA, the Secretary of the Treasury is given czar-like power over a large segment of the private market.” He added that the “purchase and management of bank assets [was now] left to his best judgment.”<sup>23</sup>

**October 3, 2008**  
**Congress passes bank bailout package, also known as TARP**

Although TARP funds were originally designed primarily for the purchase of mortgage backed securities — so-called “toxic assets” — the government used the first \$350 billion to inject capital into commercial and investment banks.<sup>24</sup> Later that month, the U.S. government added an additional \$37.8 billion to the AIG bailout package.

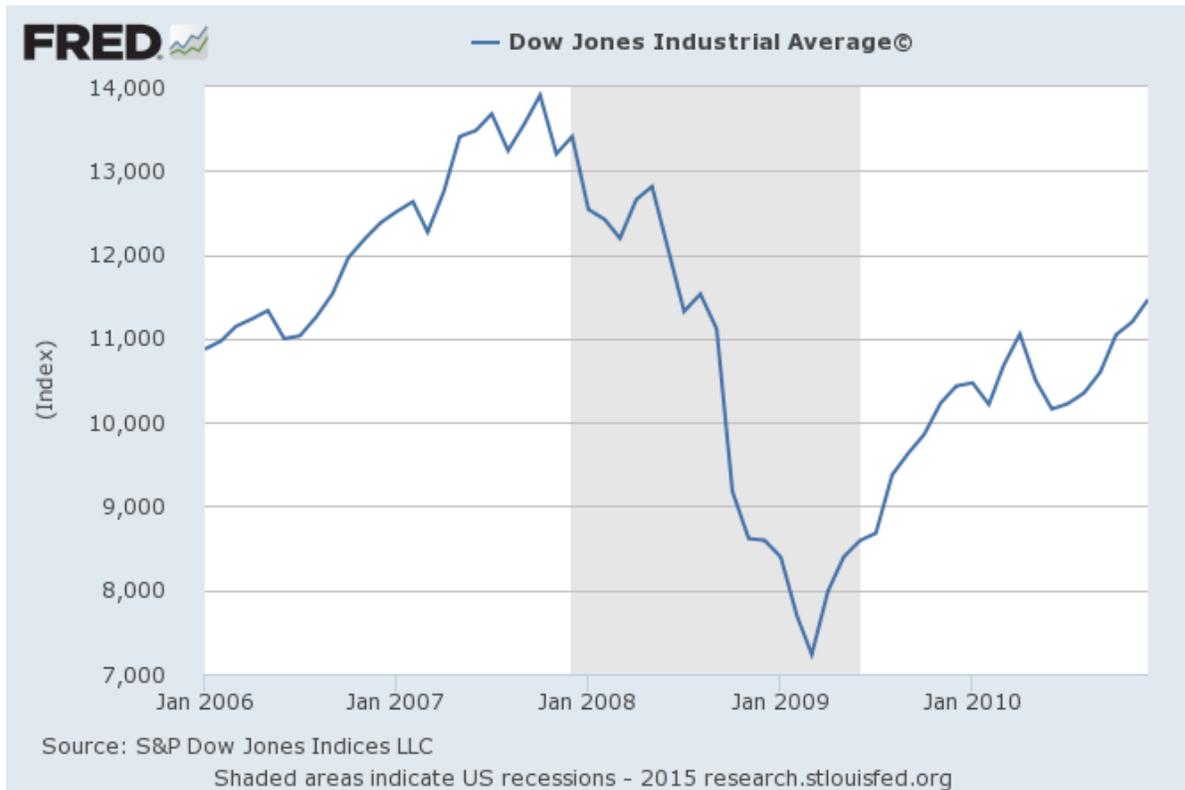
From October 6 to October 10, 2008, the Dow Jones experienced its most turbulent time in history.<sup>25</sup> A few days later, Paulson and Bernanke summoned the heads of nine banks and announced they were the new recipients of federal investments. [See the table.]

Bank of America	\$25 billion	Goldman Sachs	\$10 billion
Citigroup	\$25 billion	Bank of N.Y. Mellon	\$ 3 billion
Wells Fargo	\$25 billion	State Street Bank	\$ 2 billion
Merrill Lynch	\$10 billion		

Paulson and Bernanke instructed the attendees that they would take the money as preferred stock, paying a 5 percent dividend for the first five years and then 9 percent thereafter. As part of the deal, the Treasury reserved the right to buy common stock equal to 15 percent of its total investment and the banks had to comply with restrictions on executive compensation, dividend payments and other things.<sup>26</sup> The remaining \$125 billion was designated for the purchase of equity positions in thousands of other banks.

The bill itself was replete with the usual pork handed out by Congress. Congressman Barney Frank’s (D-Mass.) added his own provision specifically designed to help OneUnited Bank. Regulators had previously demanded that OneUnited, a minority-owned financial institution connected to Congresswoman Maxine Waters (D. Calif.) and located in Frank’s district, raise fresh capital and name an independent board. (Regulators had also urged the bank to stop payment on both a Porsche used by one of its executives and the chairman’s \$6.4 million beach front home in Pacific Palisades, California.) Instead, the bank received \$12 million in TARP funds after losing all its capital, which was tied to investments in Fannie Mae.

**October 9, 2008**  
**Stocks begin to tumble, and the Dow Jones industrial average experiences worst weekly decline ever. International exchanges also experience steep declines shortly after.**



In late-October 2008, Congress began expressing concerns over the changing Treasury strategy. Alabama Senator Richard Shelby said, “The Treasury has deviated significantly from its original course,” referring to the bailout program.<sup>27</sup> Democratic Senators Dodd and Schumer also questioned the shifting strategies, worried that some banks would use the money to buy other banks. Schumer said, “There are far better uses of taxpayer dollars than continuing dividend payments to shareholders.”<sup>28</sup>

The American Bankers Association and the Independent Community Bankers Association, originally supportive of TARP, were outraged that some monies could be used to buy other banks.<sup>29</sup> On October 27, 2008, Fred Becker of the National Association of Federal Credit Unions said, “I do not think that it is appropriate use of economic stabilization funds for banks to gobble up other banks.”<sup>30</sup> On October 31, 2008, Senator Dodd called for hearings on the issue because, “The intent certainly wasn’t for healthy banks to buy healthy banks — it’s infuriating.”<sup>31</sup>

**Citibank Bailout.** On November 24, 2008, the Treasury injected another \$20 billion into Citigroup to prevent the company from failing, in addition to the original \$25 billion invested in October. The government also insured another \$306 billion of Citi’s mortgage-backed securities. The terms of the agreement stipulated that Citi would cover the first \$29 billion in losses and the government would cover 90 percent of the rest, in exchange for \$7

billion in preferred shares. To receive the funds, Citi agreed to implement its previous proposal to modify delinquent mortgages in order to decrease the number of foreclosures. This move effectively committed the industry to a “cram down,” allowing bankruptcy judges to rewrite mortgage contracts. In the fourth quarter of 2008, Citi lost \$8.3 billion. Citi insiders lamented that the financial institution was “too big to fail, too s--- to buy.”<sup>32</sup> By January 30, 2009, the stock was trading at 20 percent of book value.

**November 24, 2008**

**DJIA: 8,443.39**

**Federal discount rate: 1.25 percent**

**U.S. unemployment rate: 6.8 percent**

On November 25, 2008, news reports revealed the government had assumed approximately “\$7.8 trillion in direct and indirect financial obligation[s]” in 2008. That total was equal to “half the size of the nation’s entire economy” and far eclipsed “the \$700 billion that Congress authorized for the Treasury’s financial rescue plan.”<sup>33</sup> That same month, the U.S. Treasury replaced a \$123 billion loan with a \$150 billion package.

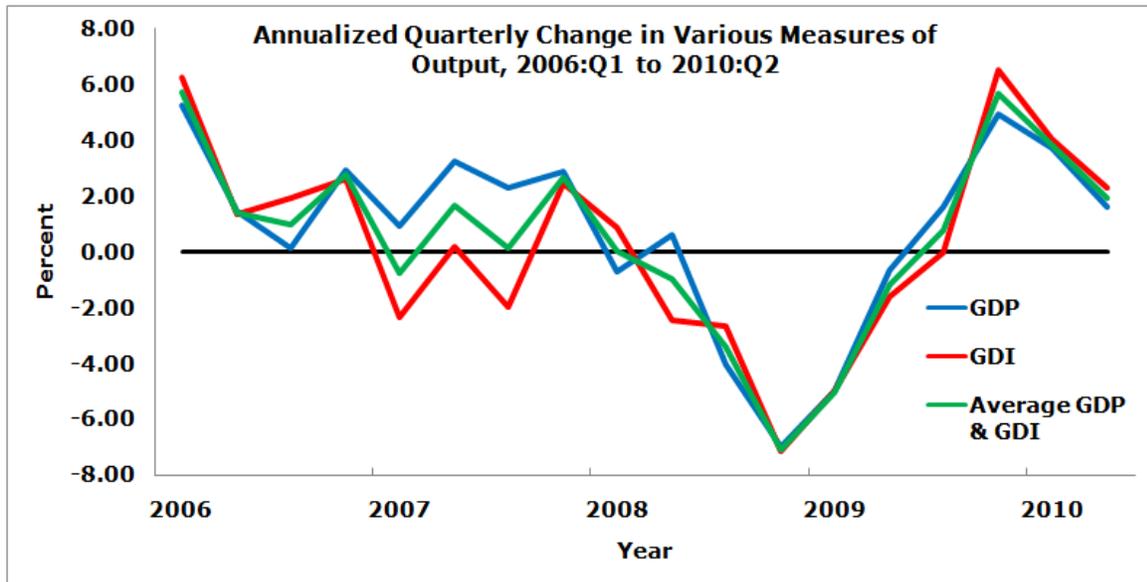
On December 22, 2008, Bank of New York Mellon refused to comment on how it used \$3 billion in TARP funds saying, “We’re choosing not to disclose that.”<sup>34</sup> J.P. Morgan Chase said the same. The Associated Press contacted 21 banks that received at least \$1 billion tied to the bailout and all refused to offer information, some having no knowledge of where the money went.

**Auto Industry Bailout.** On December 24, 2008, the Fed approved General Motors Acceptance Corporation’s (GMAC) request to become a bank holding company so that it could receive TARP funds. In turn, the Treasury committed \$6 billion to GMAC by purchasing \$5 billion in senior preferred equity paying 8 percent per annum and gave a \$1 billion loan to General Motors which it invested back into GMAC through a rights offering or the option to purchase additional shares at a discounted rate in proportion to existing ownership.<sup>35</sup> This was in addition to the \$17.4 billion emergency loan to rescue GM and Chrysler early that month. Interestingly, Cerberus Capital Management, which owned a controlling half of GMAC and 100 percent of Chrysler, was then under the chairmanship of the former Bush Administration Treasury Secretary John Snow.

On December 27, 2008, Senators Diane Feinstein (D-Calif.) and Olympia Snowe (R-Maine) said they would propose legislation to require recipients of TARP money to report how it was spent. The legislation would also prohibit companies from spending taxpayer dollars on lobbying or political contributions. By this time, TARP had committed more than the \$350 billion, forcing Congress to authorize yet another bailout package.

In December 2008, the Business Cycle Dating Committee of the National Bureau of  
*America’s Think Tank*

Economic Research officially announced the U.S. economy had been in a recession for one year.<sup>36</sup>



Source: NBER Business Cycle Dating Committee. Available at <http://www.nber.org/cycles/recessions.html>.

**Second Bailout (TARP II).** On January 15, 2009, Congress approved an additional \$350 billion known as TARP II.<sup>37</sup> New Treasury Secretary Timothy Geithner promised to “broaden its scope . . . to municipalities, small businesses, homeowners and other consumers.”<sup>38</sup> Henry Paulson, Ben Bernanke and Geithner entrusted the details of a bailout/rescue plan to 35-year-old former Goldman Sachs banker, Neel Kashkari. Some media outlets assailed the decision, believing the new head of the TARP fund should have been a leader of recognized stature, not a 30-something assistant secretary.<sup>39</sup> Soon after, Bank of America requested \$20 billion in relief funds for its takeover of Merrill Lynch, claiming the bank’s losses were too high.<sup>40</sup>

Senator Elizabeth Warren (D-Mass.) head of the TARP oversight panel — which also included Jeb Hensarling (R-Texas), former New Hampshire Governor John Sununu (R), university economist David Moss, and New York State Bank Commissioner Richard Nieman — testified before Congress on February 5, 2009, that the “Treasury [had] paid substantially more for assets it purchased under the \$700 billion financial rescue program than their market value at the time.”<sup>41</sup> She suggested the Treasury paid \$254 billion for preferred stock and warrants actually worth approximately \$176 billion, creating a short-fall of \$78 billion. Besides the shortfall, TARP had failed to repair the markets. The House Financial Services Committee believed the situation resulted from poor lending practices and held hearings demanding banks lend more.<sup>42</sup>

**February 13, 2009**  
**Stimulus package enacted**

**February 14, 2009**  
**DJIA: 7,850.41**  
**Federal discount rate: 0.50 percent**  
**U.S. unemployment rate: 8.3 percent**

**The Stimulus.** On February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act (ARRA), also known as the economic stimulus package. Robert Rector, of the Heritage Foundation, predicted the stimulus bill would cause “federal welfare spending to explode upward by more than 20 percent, rising from \$491 billion in fiscal year 2008 to \$601 billion in fiscal year 2009,” the largest expansion of welfare in the nation’s history.<sup>43</sup> Rector said the 10-year fiscal burden would not be the \$787 billion proponents of ARRA claimed, but \$1.34 trillion, or \$17,400 for each household paying income tax in the United States.

**AIG Settlement.** In March 2009, the *Wall Street Journal* uncovered information about James Cole, an attorney whose firm, Bryan Cave LLP, had been paid approximately \$20 million to oversee AIG Group. He was installed as a monitor or independent consultant as part of a \$126 million settlement struck in November 2004 between AIG and the Justice Department and the SEC. That pact, called a deferred prosecution, arose from allegations the insurer sold products that helped companies manipulate their financial earnings. His responsibilities broadened in November 2006 after a separate settlement with the SEC and New York State authorities wherein AIG paid \$1.6 billion to resolve an inquiry into accounting irregularities and bid-rigging allegations. Cole regularly attended AIG board committee meetings, including at least two audit committee meetings in 2008 and was a long-time friend of Attorney General Eric Holder.

In March 2009, Congress was furious when it learned that previously agreed to bonuses to retain and compensate certain AIG employees had amounted to \$159 million. Barney Frank and others introduced legislation to put a 90 percent tax on bonuses received by any employee making \$250,000 or more at a firm that received \$5 billion or more in bailout funds. Others complained that AIG was not subject to regulation; but on March 17, 2009, acting OTS Director Scott Polakoff said AIG was definitely subject to regulation during the time it took on so much risk. Then, on March 29, 2009, an AIG employee took out a full-page ad in the *Wall Street Journal*, announcing his resignation. That same day, the WSJ reported AIG still had \$1.6 trillion in derivatives exposure.

On April 17, 2009, news outlets reported Edward Liddy had taken over as chief executive of AIG. Reports claimed his executive compensation was set at \$1 a year, likely in response to congressional inquiries over \$3 million in Goldman Sachs Group stocks he owned during his five-year tenure as a member of the board of Goldman Sachs. Liddy owned these stocks prior to joining the Goldman Sachs board and elected to receive payment for his board services in the form of stock. In a March congressional hearing, Representative Maxine Waters questioned Treasury Secretary Geithner about the influence of Goldman Sachs in the bailouts: “Underneath all of this is a conversation about the linkages and the connections of a small group of Wall Street types that are making decisions. That’s what is causing a lot of distrust.”<sup>44</sup>

On April 21, 2009, Inspector General Neil Barofsky issued a 250-page quarterly report to Congress about the TARP plan. The report detailed a public/private partnership using Treasury, Federal Reserve, and private investor money totaling \$2 trillion. Part of those monies would be used to purchase troubled real estate-related securities from financial institutions with a dollar from private investment, a dollar from the Treasury and a nonrecourse loan.<sup>45</sup>

On April 22, 2009, media outlets reported financial firms had lobbied to cut the costs of exiting obligations tied to TARP funds. Firms had particular issues with warrants the government received after it bought preferred stock in roughly 500 banks. Additional reports noted that Noble Prize recipient and Columbia University Professor Joseph Stiglitz had recently recommended the breakup of big banks. During his testimony before the joint Economic Committee of Congress on April 21, 2009, Stiglitz told committee members that he remained skeptical about TARP and its use. Other prominent economists, including MIT Professor Simon Johnson and Federal Reserve Bank of Kansas City President Thomas Hoenig, also claimed to be skeptical of the government bailout program.

Bernanke and Former Secretary of the Treasury Paulson insisted that Bank of America takeover Merrill Lynch in December 2008. Bernanke and Paulson reportedly told Bank of America CEO Ken Lewis, “We do not want a disclosable event.”<sup>46</sup> The merger closed on January 1. Investors and taxpayers did not learn until later that the government had invested another \$20 billion in loan-portfolio insurance in Bank of America and that Merrill had lost \$15 billion in the last three months of 2008. Ken Lewis testified before New York Attorney General Andrew Cuomo that Paulson threatened him against cancelling the buyout of Merrill Lynch. “No wonder no banker in his right mind trusts the Fed or Treasury,” an editorial concluded, “and no wonder nobody but Pimco and other Treasury favorites is eager to invest in the TALF, the PPIP, or any of the other programs that require trusting the government as a business partner.”<sup>47</sup>

Neil Barofsky, the special Inspector General assigned to oversee TARP investment, had criticized the Fed’s term asset-backed securities loan facility (TALF) for relying too much on the major credit-rating agencies to determine the safety of securities for taxpayers. Under TALF, the New York Fed provided non-recourse loans to private firms to buy AAA-

rated pools of assets. However, a April 28, 2009 *Wall Street Journal* editorial questioned whether one could trust the AAA ratings based on Barofsky's conclusions that, "Securities ratings have proven to be unreliable and largely irrelevant to actual performance of the security." The editorial continued, "arguably, the wholesale failure of the credit-rating agencies to rate adequately such securities is at the heart of such securitization market collapse, if not the primary cause of the current credit crisis."<sup>48</sup>

On May 12, 2009, it was reported that the government had largely forced out co-owners Cerberus Capital Management and General Motors during the GMAC bailout. The government then reconstituted a 7-person board, including the former Fannie Mae Chief Financial Officer Robert T. Blakely, and appointed two members to oversee the large GMAC equity stake held in trust. In essence, the company was now a "bank potentially owned and regulated by the government...in an ambitious merger in a troubled industry directed by a board in flux."<sup>49</sup>

The government challenged Chrysler's creditors to defy them. According to a Wall Street Journal report, when JPMorgan Chase and others requested auto task force leader Steven Rattner pay the \$6.9 billion owed them, Rattner offered only \$2 billion without the opportunity for negotiation. Chrysler's four main lenders, Citigroup, JPMorgan, Goldman and Morgan Stanley, were already indebted to the Treasury as a result of receiving TARP funds. Critics complained the administration had violated a principle of American capitalism by unfairly demonizing financial firms despite their vital function to the economy. An administration official responded, "You don't need banks and bond holders to make cars."<sup>50</sup>

On May 13, 2009, Todd Zywicki, law professor at George Mason University, argued that "fleecing lenders to pay off politically powerful interests, or governmental threats to reputation and business from a failure to toe a political line?" He added that Americans "might expect this behavior from a Hugo Chavez, but it would never happen here, right? Until Chrysler." He then went on to say, "Secured creditors — entitled to first priority payment under the 'absolute priority rule' — have been browbeaten by an American President into accepting only 30 cents on the dollar of their claims...[while] the United Auto Workers Union...will get about 50 cents on the dollar."<sup>51</sup>

On May 12, 2009, Goldman Sachs settled a lawsuit by the Massachusetts Attorney General over their subprime mortgage originations for \$50 million. Although Goldman officials never acknowledged wrong-doing, the company paid \$50 million in relief to subprime mortgage holders and another \$10 million to the state to end the inquiry. The suit originated with an investigation of Fremont Investment & Loan, a California subprime lender whose assets were purchased by Goldman.

On May 14, 2009, reports surfaced that Secretary Geithner had told the Independent Community Bankers of America small banks could receive up to 5 percent of their risk-weighted assets in TARP funds. Reportedly many insurance companies backed away from taking TARP funds because it was "not the happiest money in the world."<sup>52</sup>

In May 2009, it was reported that GMAC, LLC, would receive \$7 billion as the first installment of a new government aid package, one that could reach \$14 billion. The government neared full ownership GMAC and General Motors Corporation. The Wall Street Journal said, “What began as an emergency batch of loans to GM, Chrysler and GMAC in December — totaling just over \$20 billion — now looks likely to balloon well beyond \$50 billion and could approach \$100 billion by the end of the year.”<sup>53</sup>

Also in May 2009, Chrysler, LLC announced that C. Robert Kidder, lead director at MorganStanley, would replace Robert Nardelli as Chairman after the company completed its bankruptcy reorganization. The Treasury Department then planned to select four of the nine board members of Chrysler’s new board. The state treasurer of Indiana, however, filed suit against the move since the state held some of Chrysler’s senior debt in retirement plans for Indiana teachers and state police. State officials expressed outrage that the U.S. government had put together a restructuring plan that only gave senior creditors 29 cents on the dollar.

<p><b>June 1, 2009</b> <b>Official end of the recession</b></p> <p><b>November 6, 2009</b> <b>Unemployment rises above 10%</b></p>
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As 2010 began, lending decreased primarily from lack of demand, not the banks’s unwillingness to lend. According to National Bureau of Economic Research’s Business Cycle Dating Committee, a peak in economic activity occurred in December 2007. The peak marked the end of the expansion that began in November 2001 and the beginning of a new recession. The recession lasted until the June 2009 when the committee determined the trough of economic activity occurred.<sup>54</sup>

<p><b>March 4, 2011</b> <b>Unemployment falls below 9%</b></p> <p><b>August 5, 2011</b> <b>United States government loses AAA credit rating</b></p> <p><b>September 8, 2011</b> <b>The American Jobs Act is enacted</b></p>
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