

At Moment of Truth, U.S. Forced Big Bankers to Blink

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U.S. Treasury Secretary Henry Paulson looks over his entourage after announcing that the Treasury Department will take equity stakes in potentially thousands of banks totaling about \$250 billion.

WASHINGTON -- On one side of the table sat Treasury Secretary Henry Paulson, flanked by Federal Reserve Chairman Ben Bernanke and Federal Deposit Insurance Corp. Chairman Sheila Bair. On the other side sat the nation's top bank executives, who had flown in from around the country, lined up in alphabetical order by bank, with Bank of America Corp. at one end of the table and Wells Fargo & Co. at another.

It was Monday afternoon at 3 p.m. at the Treasury headquarters. Messrs. Paulson and Bernanke had called one of the most important gatherings of bankers in American history. For an hour, the nine executives drank coffee and water and listened to the two men paint a dire portrait of the U.S. economy and the unfolding financial crisis. As the meeting neared a close, each banker was handed a term sheet detailing how the government would take stakes valued at a combined \$125 billion in their banks, and impose new restrictions on executive pay and dividend policies.

The participants, among the nation's best deal makers, were in a peculiar position. They weren't allowed to negotiate. Mr. Paulson requested that each of them sign. It was for their own good and the good of the country, he said, according to a person in the room.

During the discussion, the most animated response came from Wells Fargo Chairman Richard Kovacevich, say people present. Why was this necessary? he asked. Why did the government need to buy stakes in these banks?

Morgan Stanley Chief Executive John Mack, whose company was among the most vulnerable in the group to the swirling financial crisis, quickly signed.

Bank of America's Kenneth Lewis acknowledged the obvious, that everyone at the table would participate. "Any one of us who doesn't have a healthy fear of the unknown isn't paying attention," he said. This account is based on interviews with participants, government officials and banking-industry executives.

Regulators had spent the weekend crashing out their latest strategy to restore confidence to America's battered banking system. As markets tumbled last week and foreign governments began taking dramatic steps, U.S. officials coalesced around a plan that would include guaranteeing bank debt and a big capital injection. Policy makers wanted to deliver a "confidence shock," one participant said.

Treasury and government officials held multiple meetings and conference calls on Saturday. Dozens of officials gathered at Treasury's headquarters Sunday morning and stayed into the evening, lunching on sandwiches from Potbelly Sandwich Works.

They kept coming back to the same question: Is the plan too sweeping? Policy makers knew they were taking unprecedented steps. It would take years to disentangle banks from the federal government. Some of these temporary steps would be hard to undo.

Policy makers debated how the government's capital injections should be structured, especially the question of the dividend banks would pay. Make it too high, and that risked draining firms of needed funds and scaring off other potential rescue recipients. Make it too low, and taxpayers wouldn't be compensated for their risk. Another challenge: Inject capital without scaring away private investors.

A final deal between regulators was hashed out in Mr. Paulson's office Sunday afternoon. For Mr. Paulson, who had spent a career as an investment banker, the decision marked a reversal. Just weeks earlier, he had said that injecting capital directly into banks would appear to be a sign of "failure."

The top bankers were then told to show up for a meeting Monday at 3 p.m., but were given few details. Expecting an uproar over the plan, government officials secretly planned to break off the first meeting, giving CEOs time to vent, talk to their boards, clear their heads, and reconvene at 6:30 p.m.

In Mr. Paulson's call with Morgan Stanley's Mr. Mack, people familiar with the matter say, the CEO asked the Treasury secretary the reason for the meeting. Mr. Paulson responded: "Come on down, we'll tell everyone at the same time," adding, "I think you'll be pleased."

Also at the 3 p.m. gathering was New York Fed President Timothy Geithner, along with Fed Governor Kevin Warsh and Comptroller of the Currency John Dugan. Behind them were lawyers and staff. The meeting took place in the Treasury secretary's conference room, which faces a courtyard and is outfitted with mahogany chairs, antique wall sconces and chandeliers.

It struck some of those in the room as fortunate that Citigroup Inc. and Wells Fargo are so far apart in the alphabet. The two firms just last week were locked in a bitter battle over control of banking giant Wachovia Corp., a fight Wells Fargo eventually won. Citigroup is still seeking billions of dollars from Wells Fargo in damages for swooping in on the Citigroup deal after regulators had already blessed it. With the firms sitting alphabetically, at least the heads of the two rivals, Mr. Kovacevich and Citigroup Chief Executive Vikram Pandit, wouldn't have to sit next to each other.

Mr. Paulson said the public had lost confidence in the banking system. "The system needs more money, and all of you will be better off if there's more capital in the system," Mr. Paulson told the bankers.

After Mr. Kovacevich voiced his concerns, Mr. Paulson described the deal starkly. He told the Wells Fargo chairman he could accept the government's money or risk going without the infusion. If the company found

it needed capital later and Mr. Kovacevich couldn't raise money privately, Mr. Paulson promised the government wouldn't be so generous the second time around.

Mr. Bernanke said the situation was the worst the country had endured since the Great Depression. He said action was for the collective good, an understated appeal. The room was silent as he described the economy's fragile condition.

Mr. Geithner, whose job as New York Fed chief makes him the central bank's main man on Wall Street, delivered the most sobering news. He described how much preferred stock the government was going to buy from each firm. The government would take \$25 billion in Citigroup, \$10 billion in Goldman Sachs Group Inc., and so on.

The CEOs shot off questions, peppering officials for details about how the share purchases would be structured and how it might constrain them. At one tense moment, Mr. Bernanke jumped in to calm nerves. The meeting didn't need to be confrontational, he said, describing paralysis in the market and the threat that posed to everyone in the room.

U.S. officials argued the plan represented a good deal for the banks: The government would be buying preferred shares, and thus wouldn't dilute their common shareholders. And the banks would pay a relatively modest 5% in annual dividend payments.

The meeting ended at about 4 p.m. By 6:30 p.m., all of the sheets had been turned in and signed by the CEOs. No second meeting was held.

—*Michael M. Phillips, Aaron Lucchetti and Dan Fitzpatrick contributed to this article.*