Crash of the Titans

Merrill Lynch's salvation spelled Lehman Brothers' doom.

By John Carney

IT WAS LATE AT NIGHT, and I was standing in Elaine's on Manhattan's Upper East Side. The saloon was crowded, with the bar almost invisible through the crowd of drinkers, the bartender just a voice and an occasional arm outstretched with a glass of gin, beer, or whiskey. The patrons grew louder as the night wore on.

"Do you know what the most important thing to look for in a place like this is?" Tom asked me as we pushed through the crowd to a small area beyond the nave of the bar.

I told him I didn't know what that would be. He cleared some space by using his elbows to nudge the drinkers on his left and right. After a moment, he was leaning on a stretch of open bar and ordering drinks from the bartender.

"Wood," he said. "In a bar like this the most important thing is to grab a stretch of wood."

Tom is a big man. In his late fifties now, he's tall and suffers from what my father used to call "Dunlap's disease," as in, his belly dun lap over his belt. He holds himself like a man who has accomplished something great. Most of the times we've met, the impression was softened by his warm, friendly smile. But Tom (which is not his real name) wasn't smiling that night at Elaine's.

He made his career at Merrill Lynch, the legendary Wall Street firm that was once the third largest investment bank in the United States. Three weeks earlier, Merrill agreed to sell itself to Bank of America, a huge commercial bank based in Charlotte, North Carolina. It's not an easy pill to swallow: this man who has spent his life working on Wall Street, first as a floor trader and later as an investment manager, wakes up to discover he now works for a bank with tellers, ATMs, and free iPod Shuffles for customers who open savings accounts.

In some ways, Tom and his fellow Merrill Lynch employees are the lucky ones. Only a few days ago, on the same Sunday afternoon that Merrill Lynch agreed to sell itself for $50 billion to avert a deepening financial crisis, the fourth largest investment bank, Lehman Brothers, filed for bankruptcy protection and slipped toward liquidation. Surely Merrill's fate was less humbling.

But Tom was inconsolable: "The day they take the letters MER off the ticker at the New York Stock Exchange, they'll take out a piece of my heart."

It would be several weeks before the world learned the truth about what happened to Merrill Lynch and Lehman Brothers. Newspaper reports made vague mention of a "deepening financial crisis," as if human agency played no part in the tumultuous events. It almost sounded as if some vengeful pagan gods had returned from an ancient epic and were throwing down once proud financial titans to teach mankind about the dangers of hubris.

But it wasn't a mythical deity or some kind of metaphorical financial quicksand that brought down Lehman Brothers and Merrill Lynch. They had made themselves vulnerable through what might be called a comedy of errors, if the consequences weren't so grave and expensive. The final acts that toppled them were a pair of phone calls from another bank, J.P. Morgan Chase, Tom told me.

In the days leading up to that weekend in mid-September, both Lehman and Merrill heard from top executives at J.P. Morgan. Those executives explained to their counterparts at Merrill and Lehman that concerns over their firms' financial health had grown. To alleviate those fears, the investment banks were required to put up billions of dollars of additional collateral against debts they owed J.P. Morgan and its clients. Having suffered tens of billions of losses, neither Merrill or Lehman could meet this call for more collateral.

What happened next was even more extraordinary. At the headquarters of the New York Federal Reserve, the surviving Wall Street firms and national banks met to see if Lehman Brothers could be rescued. For much of the weekend it appeared that Bank of America would buy Lehman, according to people who talked to me about the meeting. All at once something changed, however, and Bank of America was no longer interested.

Tom ordered a couple of more beers. Two not-so-young-anymore women stopped by to tell him hello. One told me she was a dental hygienist from Staten Island, but she couldn't name a town on Staten Island. She mentioned the "Staten Island Bridge," which doesn't exist. I got the impression that she works with Tom at Merrill and is worried she'll soon be out of job. She was trying on new identities, seeing what it would be like to be someone else entirely. When the girls moved on, Tom continued his story.

The collateral call had sparked panic at Merrill. Its top executives were gathered together by its CEO, John Thain, a man who looks a bit like a real-life Clark Kent. One of the executives, Greg Fleming, had a relationship with Ken Lewis, who runs Bank of America. Fleming suggested that Merrill approach Bank of America and propose that they do a deal together. A few phone calls back and forth, and Merrill had agreed to be acquired, pushing Lehman out of the way and into bankruptcy.

The announcement that Merrill was being acquired by Bank of America caught many on Wall Street by surprise. Lehman had been regarded as the critical patient, closest to death. Merrill was regarded as the next troubled bank on the list, but it had jumped the line, securing a wealthy sponsor before it needed to be rescued.

Tom and I stepped outside. I lit a cigarette with the last match in my book. Tom lit his off the tip of mine. He still had more to tell me, but the hour was late. He turned his collar up against the cool October night air and walked toward the curb, an outstretched arm hailing a taxi.

Like many others on Wall Street, Tom is convinced that the old investment banks are beyond recovery and that those financial institutions still standing must be transformed or perish. Most, he tells me as he gets into the taxi, are too accustomed to their ways to reinvent themselves. They are finished.

With that, he shut the door and his cab sped away, down the avenue and into the night. ■

John Carney is the editor of Cluster-Stock.com, *a Wall Street news and gossip site.*

Fire Sale

How finance, insurance, and real estate lobbyists bought a bailout.

By Kelley Beaucar Vlahos

THERE WAS LITTLE in the federal bailout bill that most Americans could wrap their arms, much less their minds, around. What did strike a chord—and one of the rare notes of consensus—was that greedy executives of failed institutions should have to give up their high salaries and golden parachutes before getting a life raft from Uncle Sam.

But the CEO's needn't be too alarmed. The $2 billion their industry has invested in Washington politicians over the last 20 years will likely bring healthy returns. Pesky details like "who" and "how much" to penalize were kicked down the road or left wide open for interpretation—nothing a few fat friends on the right committees and a team of crack lobbyists can't handle.

The hard lesson here will be that hard lessons are for chumps who can't afford otherwise.

"The money always pays off," said Melanie Sloan, head of the Center for Reform in Elections in Washington. "It's all about being there, being in the room" when the details take shape behind closed doors on Capitol Hill. "And you're not in the room if you're not making these contributions or having highly-paid lobbyists well placed."

The finance/insurance/real estate (FIRE) sector has given approximately $180 million to House and Senate candidates in the current election cycle, and $116 million to presidential candidates, including $25 million to Barack Obama and $22 million to John McCain.

According to the Center for Responsive Politics, the FIRE sector is the biggest contributor to federal candidates in Washington. Companies cannot give directly, so they leave it to bundlers to solicit maximum contributions from employees and families. They might have been brought down to earth this year, but they've given like gods: Goldman Sachs, $4.8 million; Citigroup, $3.7 million; J.P. Morgan Chase & Co., $3.6 million; Merrill Lynch, $2.3 million; Lehman Brothers, $2.1 million; Bank of America, $2.1 million.

Some think the long-term effect of such contributions to individual candidates was clear in the roll-call votes for the bailout. Take the controversial first House vote on Sept. 29. According to CRP, the "ayes" had received 53 percent more contributions from FIRE since 1989 than those who voted against the bill, which ultimately failed 228 to 205. The 140 House Democrats who voted for the bill got an average of $188,572 in this election cycle, while the 65 Republicans backing it got an average of $185,461 from FIRE—about 23 percent more than the bill's opponents received. A tinkered bill was passed four days later, 263 to 171.

"The lobbying effort on the bailout has been brief but intense. To make up for time they do not have, interest groups have undoubtedly capitalized on relationships they've built over many years. And in Congress, campaign contributions are an essential tool for building relationships," said CRP's Sheila Krumholz.