6-13-2008

**FRB Email Kohn to Bernanke re Lehman**

Donald L. Kohn

Ben S. Bernanke

https://elischolar.library.yale.edu/ypfs-documents/4776

This resource is brought to you for free and open access by the Yale Program on Financial Stability and EliScholar, a digital platform for scholarly publishing provided by Yale University Library. For more information, please contact ypf@yale.edu.
It should stabilize the situation at least for a time. But there are deeper problems--
the very large surprise on the loss undermined credibility and raised questions about
what else might be hidden, and the basic business model is in doubt in terms of the
long-term viability of the firm. They are a "bond house" that grew in recent years by
being aggressive in mortgage securitization etc. One of the hedge fund types on
Cape Cod told me that his colleagues think Lehman can't survive--the question is
when and how they go out of business not whether. He claimed this was a widely
shared view on the Street.

--- Chairman Bernanke ---

Why doesn't the equity raise help more? If they are really solvent then
liquidity backup should be effective.

--------------------------

Sent from my BlackBerry Wireless Handheld

--- Original Message -----

Ben, We had two calls with frbny this afternoon on this subject. The
first included Treas and SEC; the second just us and Treasury.
Lehman has settled on the 6b capital infusion this afternoon and put
out an announcement to that effect. It came out after the market
close and I don't know what it effect it had on after-hours trading.
During the trading day their stock fell another few percent, a bad
showing relative to the other financial sector stocks which mostly rose
a few percent. CDS spreads didn't change much during the day. Their
liquidity is sticking pretty well, but some counterparties are asking for
more margin and dialing back exposures, so there's a slow erosion
going on. To some extent the drop in stock prices and counterparty
cautions reflects possibility that this is Thursday of BS weekend, and
equity holders could wake up Monday morning with no value. Fuld
talked to Tim and to Steel late this afternoon. He really has no
alternative plan at this point. Lining up SWF investors is a slow
process and there is nobody is interested in buying them. Tim and Bob
thought Fuld was asking for two things—albeit very indirectly; for us to
tell people to buy their stock Monday morning and to say something
positive about the firm. Both rejected both requests—the second on the
thought that saying something would cause more harm than good. We
really don’t have any options to provide confidence in the firm. Bob
Tim and I talked some about what Hank might say in Japan if asked.
We formulated something like the lines Tim and I used in the past
week—primary dealers have learned lessons from March and are
reducing leverage, building capital and bolstering liquidity; they are
stronger than they were a few months ago. Part of the first call was
given over to thinking about options in the event the slow erosion of
confidence turns into a rout and liquidity fled quickly. None are good,
given the lack of interest by a purchaser. Private equity partners are a
possibility; turning into a FHC with Fed consolidated regulation would
take time to get regulatory approvals and provide uncertain relief
unless they acquired a lot of deposits very fast; creating a bad bank,
on the UBS model, with the lousy mortgages they hold would require
interest from equity investors to buy into the bad bank; using our
balance sheet to facilitate an orderly wind down with the discount
window or by assuming the liabilities a la JPM is hard because we don’t
have the authorities of the fdic (as well as for policy reasons). Staff of
Treas., Board and frbnyn will continue to explore alternatives tomorrow,
just in case. Don