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In Crucible of Crisis, Paulson, Bernanke, Geithner Forge a Committee of Three

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The response to the gravest financial crisis in generations has been engineered to a remarkable degree by a committee of three.

From the rescue of Bear Stearns to the takeovers of Fannie Mae, Freddie Mac and American International Group, all the key decisions have been made by Treasury Secretary Henry M. Paulson Jr., Federal Reserve Chairman Ben S. Bernanke and Timothy F. Geithner, the president of the Federal Reserve Bank of New York.

It is this unusual collaboration among a consummate dealmaker, a professor and a seasoned public servant that could determine how the nation weathers the most profound threat to its economy in modern times. Despite their disparate backgrounds, the three men have formed a close, informal partnership built on rapid-fire phone calls and open debate that breaks the mold of Washington policymaking.

As they chart a government response to the crisis, the stakes could hardly be higher. If they succeed, they could tame the economic downturn and orchestrate a restructuring of Wall Street with minimal collateral damage. If they fail, the toll could be millions of jobs, trillions of dollars in lost wealth and a crisis of confidence in global capitalism.

Paulson, Bernanke and Geithner spent most of their careers in different worlds. They barely knew one another before beginning their current jobs and still rarely socialize -- though they have spent more time working together in recent months than with their wives.

Paulson, 62, is an investment banker who rose through the ranks of Goldman Sachs to lead the firm. A lanky former Dartmouth College offensive tackle and an intense workaholic, he said he agreed in 2006 to become the Bush administration's third Treasury secretary to prepare the government for a possible market crisis.

Bernanke, 54 and calm of demeanor, is one of the foremost scholars of financial crises, especially the Great Depression. Before being named Fed chairman in 2006, the largest organization he had run was Princeton University's economics department.

Geithner, 47, was a career staff member at the Treasury Department when Lawrence Summers, then a Treasury undersecretary, plucked him from obscurity in the early 1990s. He became a key member of the group that guided the Clinton administration's response to the international financial crises in the 1990s and has been honing his knowledge of Wall Street since taking over the New York Fed in 2003.

"The biggest thing is we are not competing with each other, we are working together," Paulson said in an interview. "I would say they have done so much to help me, and I would do anything to help them."

Their teamwork, which began when Paulson came to Washington, has had a far-reaching and controversial effect on the financial world. Critics say they have been inconsistent in their reactions to market events -- they allowed Lehman Brothers to collapse over the weekend but bailed out AIG on Tuesday -- leaving the markets uncertain about what the government would do for other firms on the brink. Those who praise the men say the rescues go only to firms whose demise would cause broad distress, not any firm that comes begging.

The men's close partnership has also drawn the normally independent Fed into collaboration with political authorities while exposing taxpayers to tens of billions of dollars, critics say. And some lawmakers say the concentration of power into the hands of these men is too great.

Yet by virtue of the division of labor among them, they are able to cobble together government responses that might otherwise be elusive.

The men's influence and their different roles were on full display Saturday, a night that remade modern Wall Street.

Storied investment house Lehman was on the brink of insolvency.

Paulson, trusted in the tight network of Wall Street executives and long experienced in reading between the lines of their comments, emerged from a private meeting with Merrill Lynch chief executive John A. Thain, and concluded that a proposed emergency sale of Lehman to Bank of America would not take place. Lehman's collapse, he realized, was all but certain.

He broke the news to the other two men and their senior staff members in a large conference room down the hall from Geithner's office on the 13th floor of the New York Fed. Plates of lasagna and papers littered the table.

It was gut-check time: Were they willing to let the firm fail even if it caused unpredictable ripples across the financial system?

On the speaker phone from Washington, Bernanke drew on his deep knowledge of past financial crises to be sure the group had considered every other option, and he shared the views he had gathered that afternoon of fellow central bankers in Europe and beyond.

Geithner's staff over previous weeks had studied the probable fallout of a potential Lehman bankruptcy and advised that the coming days, though difficult, would probably not be disastrous. He was ready to launch an effort to contain the damage in the financial markets.

In the end, the group agreed a government rescue of Lehman posed long-term dangers, possibly inviting other firms to take unnecessary risks in the belief they too would be bailed out if they stumbled. They had been discussing the prospect of a Lehman failure for weeks and determined that Wall Street could absorb the blow.

The meeting broke up.

High above the narrow streets of lower Manhattan, the committee of three had just decided that the 158-year-old Lehman would be allowed to fail.

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This partnership was born of an intellectual kinship that has brought the men closer than most of their predecessors and has been forged by the mounting financial crisis.

Before Paulson took office, there was radio silence between the Treasury and the New York Fed.

The two Treasury secretaries who preceded Paulson under the Bush administration had little Wall Street experience. Paulson's immediate predecessor, John Snow, even closed the Treasury's monitoring room, where staff members keep an eye on global stock, bond and currency markets around the clock, to save money.

Snow's contact with Bernanke, then in office just six months, was mainly limited to formal weekly breakfasts. There was little communication between Snow and Geithner.

That changed rapidly with Paulson.

A creature of the financial markets prone to firing off rapid phone calls to any potential source of information, he took to calling Geithner and Bernanke at all times of day, to bounce ideas off them or discuss the latest trouble spot in the markets.

"Overcommunication never hurts," Paulson said. "If it is something significant, I would just pick up the phone and call Ben. . . . One of the things I do is I create an atmosphere where I am so direct and so open and collaborative with people I trust that it brings out the same in them." (Bernanke and Geithner declined to speak publicly for this report, as is their custom.)

Paulson also revived the President's Working Group on Financial Markets to open communication with other regulators, including the Securities and Exchange Commission, and reopened the Treasury markets room, staffing it with employees detailed from the New York Fed.

He even showed advance texts of his speeches to Bernanke and Geithner. The first time, Paulson was surprised to get a heavily marked-up version from Geithner in return. Paulson set up a call, and the two went through the speech line by line.

Paulson and Bernanke kept up the weekly breakfasts, alternating the meal between their personal dining rooms at the Treasury and the Fed. The menu was always the same: juice, a Diet Coke for Paulson, and plain oatmeal with skim milk. "If I'm feeling wild and crazy, I may put a few raisins in there," Paulson said.

As the financial crisis began in August 2007, the phone calls became more frequent -- often quick, and unplanned. The three developed a Socratic style; one man would present an idea, and the others would challenge it, consider its flaws and ultimately find ways to tweak it.

Within the fraternity, the man who takes the lead depends on which agency is primarily responsible for the matter at hand.

Last fall, Paulson took charge in persuading leading banks and mortgage firms to modify the loans of homeowners at risk of foreclosure -- consulting Bernanke along the way.

When Geithner engineered the rescue of failing investment bank Bear Stearns in the middle of a cold March night, he had Paulson and Bernanke on the phone to get their input and blessing.

Paulson took the lead on the government takeover of Fannie Mae and Freddie Mac, but Bernanke advised him closely, and Geithner played a supporting role in calculating the impact on the financial markets.

And within the past week, all three were deeply involved in the decisions to throw AIG one lifeline and deprive Lehman of another.

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In many ways, the collaboration is a throwback to the relationships among President Bill Clinton's Treasury Secretaries Summers and Robert Rubin and former Fed chairman Alan Greenspan. That troika, once dubbed the "Committee to Save the World" for its efforts to prevent overseas financial crises from spilling over into the U.S. economy, also had a deep intellectual connection and similar résumés. (Rubin was a former Goldman Sachs chief executive, Summers a longtime academic and Greenspan an experienced government operative). Like Paulson, Bernanke and Geithner, the original committee to save the world frequently called one another on the fly, openly debated issues and buried their egos when they interacted.

There are differences, though. For instance, the New York Fed was less intimately involved in that collaboration than Geithner is now. (Geithner made a cameo appearance in the earlier incarnation, appearing as a member of the Treasury's "brain trust" in the Time magazine article that popularized the phrase "the Committee to Save the World.") But the current upheaval has been centered on Wall Street, and Geithner, as head of the New York Fed, is the government's emissary.

The current circle is too tight for some critics, who say the closely guarded independence of the Fed may be threatened by Bernanke's intense collaboration with Paulson.

"The Federal Reserve is in the game in a lot of respects right now because it is the only really flexible entity in Washington. The Fed can make decisions more quickly than the political system can," said Vincent Reinhart, an American Enterprise Institute scholar and former senior Fed staff member. "But I'm not so sure that independence is fungible, that in terms of reputation, we're now getting to where the Fed is being viewed as too close to political decision-makers."

New Jersey Gov. Jon S. Corzine (D), Paulson's predecessor as the head of Goldman Sachs, raised a second concern, faulting the new troika for being inconsistent in its responses to recent crises.

"There's no ability for the markets to have a strategic understanding of what's expected out of the Treasury and the Federal Reserve," said Corzine.

Whenever Paulson, Bernanke and Geithner have talked to lawmakers or delivered tough messages to executives of companies such as Bear Stearns or AIG, the three men have put up a united front.

But among themselves, at times, they've disagreed.

Geithner and Bernanke balked at elements of a blueprint, engineered by Paulson, to overhaul financial regulation that was announced in March. In particular, he proposed giving the Fed new responsibility for overseeing overall financial stability but was vague about whether new authority would come with it. Paulson also proposed moving day-to-day bank supervision out of the Fed, with which Geithner strongly disagreed.

After some tense conversations, the three agreed to disagree. The debate left no scars, Paulson said, and reinforced the candid working relationship they were developing.

As they have become closer, their interaction has lacked the pomp and formality that often accompanies high government office.

As the financial crisis accelerated this summer, the three men increasingly intruded on one another's family time.

After working through most of Labor Day weekend, Paulson and Bernanke went home Monday afternoon to see their families for a few hours. Neither could stop thinking about the failing mortgage giants Fannie Mae and Freddie Mac.

Paulson was taking his bike out for a ride with his wife through Rock Creek Park near his home when he suddenly decided to call Bernanke on his cellphone. The Fed chairman had taken his family on a rare outing to a Washington Nationals game with the season tickets he splits with White House Chief of Staff Josh Bolten.

Paulson and Bernanke chatted briefly about the score -- the Nationals were cruising to victory over the Philadelphia Phillies, their seventh straight win -- and then dove right into a detailed discussion of how the takeover would be carried out. There were hundreds of technical and legal issues to work out. Had these waited for formal consultation, a resolution could have been long in coming, if at all.

So as Paulson's wife rode on ahead and the crowd cheered at National Stadium, the two men, all but oblivious to their surroundings, talked on and on, laying out exactly how they would enact what was at that point the biggest government takeover in history.

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