1-27-2010

Peter Solomon Follow Up From Thomas Greene

Thomas Greene

Peter J. Solomon

January 27, 2010

Via FedEx

Mr. Peter J. Solomon
Founder and Chairman
Peter J. Solomon Company
520 Madison Avenue
New York, NY 10022

Re: Financial Crisis Inquiry Commission Hearing on January 13, 2010

Dear Mr. Solomon:

On January 20, 2010, Chairman Angelides and Vice Chairman Thomas sent you a letter thanking you for testifying at the January 13, 2010 hearing and informing you that the staff of the FCIC might be contacting you to follow up on certain areas of your testimony and to submit written questions and requests for information related to your testimony. During the hearing, some of the Commissioners asked you to answer certain questions in writing. Please provide your response to the question below by February 26, 2010.

1. What questions would you suggest that the Commission ask the CEOs of the banks, government regulators, or any other public or private entity related to the causes of the financial crisis?

The Commissioners and staff of the FCIC sincerely appreciate your continued assistance with this inquiry. If you have any questions or concerns, please do not hesitate to contact Chris Seefer at (202) 292-2799, or cseefer@fcic.gov.

Sincerely,

Thomas Greene
Executive Director

cc: Phil Angelides, Chairman, Financial Crisis Inquiry Commission

Bill Thomas, Vice Chairman, Financial Crisis Inquiry Commission

PETER J SOLOMON COMPANY

Peter J. Solomon
Chairman

520 Madison Avenue
New York, New York 10022

TEL: 212.508.1601
FAX: 212.508.1633
pjs@pjsolomon.com

February 3, 2010

RECEIVED
FEB 12 2010
By

Mr. Phil Angelides, Chairman
The Honorable Bill Thomas, Vice Chairman
Financial Crisis Inquiry Commission
1717 Pennsylvania Ave., NW – Suite 800
Washington, DC 20006-4614

Dear Chairman Angelides and Vice Chairman Thomas:

This letter responds to Mr. Thomas Greene's letter of January 27, 2010, clarifies my view of the role Gramm-Leach Bliley played in contributing to the financial crisis and makes a proposal.

Let me say it was my privilege to appear before the Financial Crisis Inquiry Commission. Panel 2 on January 13th was informative and the Commissioners' questions were to the point and perceptive.

First, in regard to the questions posed by Mr. Greene, I would suggest that the Commission focus on three questions:

1. For the commercial bank CEO's: What is the relationship between the extension credit and the non-credit investment banking services provided and charged corporate borrowers? The question relates to "bundling", that is, tying credit decisions to other services for which the corporate customer pays the lender.

2. For all commercial banks, investment banks and regulated entities: What effect did the passage of Gramm-Leach-Bliley have on the way you conducted your business? What was the effect of the change to "functional" regulation from "entity" regulation?

3. For the regulators, the primary question is: What were the industry or political forces that led to certain decisions? For example, in a simple case, how did the S.E.C. happen to eliminate the long-standing "short selling" rule? To what extent did political pressure from the White House, Congress or the industry influence this and other such decisions?

Second, I do want to follow-up on some of the comments I made in my testimony and during the Commissioners' questioning. Specifically, I want to focus on the role of the Gramm-Leach-Bliley Act of 1999 in the crisis.

As I testified, the effect of the Act generally was to legitimize the extension of financial firms into new areas and to give Congressional approval and recognition to the obliteration of historical business differences encapsulated in the Glass-Steagall Act. For 65 years, commercial banks, investment banks, insurance companies, S&Ls, investment advisors, all pursued different kinds of business. Gramm-Leach-Bliley removed the barriers.

In the world of Glass-Steagall, it made sense to have a regulatory geography based on the singular activity of each business. Thus, the Fed, FDIC and OCC had responsibility for commercial banks; the S.E.C. regulated investment banks and investment advisors; the CFTC supervised futures dealers; OTS regulated S&Ls; and insurance companies generally fell under the supervision of State Commissioners.

In the last decades, lines of business blurred. The conglomeration of businesses was blessed and codified by Gramm-Leach-Bliley. It is not clear that diversification allowed by Gramm-Leach-Bliley in itself caused the crisis. What is clearer is that the restructuring of the regulatory geography mandated in the Act, putting regulation on a "functional" basis rather than an "entity" basis, made regulation less effective.

This part of the Gramm-Leach-Bliley Act has not worked. Financial conglomerates are too complex. Activities of the financial institutions are spread around subsidiaries of holding companies in a complex manner, making it impractical to assign regulators to subsidiaries in the way Gramm-Leach-Bliley had hoped. Gramm-Leach-Bliley, therefore, achieved the almost impossible result - simultaneous chaotic overlaps and large gaps in regulation.

Third, a single regulator is the most effective means of creating uniform and coherent regulatory oversight. To accomplish this objective requires merging virtually all the regulatory functions into one regulator as the UK has done with the FSA. Thus, the OCC, SEC, OTS and CFTC would all become part of an entity that might be called the US FSA.

I would not propose merging the FDIC into this new regulator. The tension between the FDIC's responsibility for protecting the insurance fund and effecting resolutions and the chartering responsibility housed in the US FSA is desirable. Those seeking bank charters naturally want to see institutions grow and expand their activities, while insurer/resolution authorities are naturally conservative wanting to contain growth and complexity.

The new consolidated regulator ("US FSA") would be created from the merger of a number of current regulators. Alternatively, the Fed could be the surviving institution.

It has the obvious expertise, despite clear lapses in its regulatory effectiveness over recent years.

At the hearing, I argued against the construct of a "Council of Regulators", in favor of a single regulator, namely, the Fed because of its cadre of professions. While I continue to favor a single regulator, I fear that placing the Fed in that role might compromise its primary responsibility of managing the nation's monetary policy. The House legislation increasing oversight on the Fed shows how tempting it will be for Congress to exert political influence on the Fed. Virtually all economists agree that reducing the Fed's independence in setting monetary policy would be a dangerous step.

In sum, the amalgamation of most of the existing regulators into a US FSA now seems the best solution to control a dynamic and innovative financial system.

I hope the above comments are helpful. Let me know if I can provide further assistance.

With best wishes,

Yours truly,

PJS:jev

cc: Mr. Thomas Greene, Executive Director