9-1-2009

# FCIC Notes of the Commission Informal Session 9-16-2009

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FINANCIAL CRISIS INQUIRY COMMISSION

Confidential Attorney Work Product

September 23, 2009

To: Phil Angelides, Chair, Financial Crisis Inquiry Commission
Bill Thomas, Vice-Chair, Financial Crisis Inquiry Commission

From: Tom Greene

Subject: Notes of the Commission Informal Session on September 16, 2009

The commission met in informal session at the Capitol Hilton on September 16, 2009. Each commissioner was asked to discuss their respective views of the role of the commission and the focus or foci of the commission's work.

John Thompson

Commissioner Thompson commented that it will be impossible to cover twenty-two major topics in fifteen months. The commission needs to "condense to "2-3" subjects. He expressed concern about a "waning sense of concern on the Hill" for financial reform. He suggests that we "reduce [the investigation] to key elements and advance" the publication date for a report.

He would focus on:

- Reasonable market signals that were ignored, noting particularly that historically home prices have gone up 2-3% and just prior to the crisis prices rose 8-10%.

- Activities to which regulators "turned a blind eye," like offshore vehicles.

He noted that "you can't regulate greed," but that you can "introduce safeguards to prevent abuses."

Senator Graham

Senator Graham expressed his hope that the commission would issue a "unanimous report." He noted that one of our initial issues would be what we choose as "day 1" of the report, noting the time required by the 9/11 commission to choose where to start their narrative, and the implications of alternate choices.

The written report, in his view, will be "the most important product" of the commission, and should represent "a cross between William Shakespeare and Adam Smith."
As a model for unanimity, he cited a commission chaired by Alan Greenspan containing "strong partisans." Even so, that commission came to "significant conclusions." He cited Greenspan as saying, "Every member has a right to his or her opinion but not a right to the facts." He concluded that the commission is most likely to achieve a unanimous report if we "focus on the facts."

Brooksley Born

Commissioner Born expressed concern that the commission's work "not be used to delay" financial reform. The commission should not repeat "work already done," arguing that "some, though not all, causes of the crisis have surfaced." She noted that the statute required the commission to "explore 22 issues and explore institutions that failed."

She focused particularly on OTC derivatives that were "absolutely deregulated in 2000;" "failures in bank supervision" and "failures in compensation" that made the taking of "excess risk" and "failure inevitable." She suggested that a major focus of the commission should be on the "shadow banking system," by which she means "firms that replaced banking functions without regulation, specifically equity requirements."

Peter Wallison

Commissioner Wallison argued for "diagnosis first, prescription second," suggesting that major financial reforms should await the report of the commission.

He noted the enormous sums involved in subprime mortgages and paper based on those loans in the world and in the portfolios of Freddie Mac and Fannie Mae, firms he has studied for many years. In addition, there were and are large numbers of Alt-A mortgages that are also defaulting in significant numbers. Many of the firms that failed, he noted, specifically Bear, Stearns and Lehman Brothers, had significant exposure to these mortgages.

He suggested that a particular focus of the commission should be on the question of, how much did bad mortgages contribute to the crisis? And in this regard, he is particularly interested in understanding the difference between the collapse of past bubbles and this crisis. He observed that "this time the bubble rose higher and the effects were much worse."

Heather Murren

Commissioner Murren started by commenting that the commission should "acknowledge all [22] areas" that it is required to review by law but probe the most important areas in "greater depth."

She is concerned that the crisis is being spoken of in "the past tense." Based on her experience in Nevada, the crisis is still extant. She feels that live issues should be a "focus of the investigation." She pointed to ARMs that are expected to reset in October as an example of such a current problem. She expressed concern that "if we just look at the past, we may miss current issues and issues on the horizon."

Her ambition for the final report is that it "help the non-financial professional" to understand the crisis. To that end, the report should communicate its points in an "approachable and understandable way."

<u>Doug Holtz-Eakin</u>

Commissioner Holtz-Eakin commented that the commission "should move as quickly as it can." He noted in this regard that important work has already been done by the administration, Congress and academia. The "quicker we can survey this research, the better we will be," he commented.

He thinks that every crisis has a "trigger," and in this crisis it was housing. But finding the trigger is not enough. We must understand the "propagation" mechanisms of the crisis. He pointed to "securitization and credit rating agencies." He also wants to examine the question of why "traditional backstops did not work," noting "regulatory" failures and failures of "internal governance" as areas of particular concern.

<u>Byron Georgiou</u>

Commissioner Georgiou commented that "95% of American taxpayers feel like they have been cheated." He would like to know what criteria were used to define firms that were "too big to fail." When Warren Buffett stepped into save a financial firm, he demanded intrusive terms to guarantee his investment; taxpayers should have had the same kinds of protections.

He pointed to the fact that banking no longer reflected the financial model reflected in the film, "It's a Wonderful Life." In this crisis, no one in the chain of securitization "bore responsibility," but merely passed risky investments on to nameless investors. He suggests that we "bring back old-fashioned banking." He feels strongly that everyone in the chain should "share risk." If not, we "separate risk from responsibility" and create disincentives to "due diligence."

He thought that "few vehicles performed as advertised." He suggests that the commission will have bi-partisan/non-partisan agreement" if we examine this problem. He commented that we "don't want to cap profit but we could force responsibility."

<u>Doug Holtz-Eakin</u>

Commissioner Holtz-Eakin rejoined that in his view the statute required the commission to look at the "causes of collapse," not the "policy response to the crisis."

<u>Peter Wallison</u>

Commissioner Wallison suggested that the statute did not require the commission to make policy recommendations."  Rather, he said, we were to uncover "just the facts."  In this regard, we had to go beyond "urban myths" and "assumptions" to get to the real "facts."

<u>Bill Thomas</u>

Vice-Chair Thomas commented that as a legislator, a "win" meant that he was able "to get people together to pass a law."  Here a win is a report that is understandable.  He said that while we could produce "a Ph.D. thesis," we need to explain the crisis to "someone who needs a plain language explanation of the crisis because it screwed up his life."  If such an explanation is not forthcoming, people will believe "black stories" that erode the credibility of government and other institutions.

He said that our job is not to "pass judgment" but to "report the facts."  An issue that requires particular attention is, "Who watches the watchers" when regulation of the "Masters of the Universe" fails."  He believes strongly in the 'creativity of markets" so regulators should "get in and get out quickly," minimizing untoward effects on free markets.

He thinks that it is possible for the commission to "get to unanimity" if the final report is "comprehensible," "understandable" and a "quality" product.

<u>Phil Angelides</u>

Chairman Angelides singled out three important issues. First, as to the report, we should not narrowly construe the commission's mandate.  The "report" requirement should encompass possible interim reports and information we make available on the Web.  The report, broadly understood, is the most important task of the commission but if we can agree, we might also be able to make policy recommendations.

Second, on timing, he suggests that the economy is like a man who just had a heart attack who is starting to feel better and beginning to go back to old, destructive habits.  The patient, like the economy, still needs a "full diagnostic" to avoid problems in the future.

He suggested that if we can match the timing of our hearings and any potential interim reports, we should try to "intelligently meet the needs of Congress."  He noted that in 2010, legislation is expected to be marked up concerning Freddie Mac and Fannie Mae, mortgage servicers and corporate governance.

Third, "just the facts, ma'm" should be our approach.  A lot of work has already been done but it is "fragmented."  The commission should have a "hard target focus on what happened, when."  He noted that an area that has not gotten a lot of attention is "naked" swaps which were done in very significant amounts. He commented that "before we get to motivation," we need to uncover "what happened."

Heather Murren

Commissioner Murren commented that she perceives a public expectation that the commission will make recommendations. If we are not to do so, the chairman should make that clear early in the process.

Bill Thomas/Phil Angelides

Both agreed that the factual report was the first priority, and only if that is done properly should the commission take on recommendations.

Senator Graham

Senator Graham noted that as a member of the 9/11 Commission, a key issue was what goes into chapter 1 of the report because it will color the public's perception of what happened and ultimate acceptance of the report, noting some of the options before that commission.

Also based on his 9/11 Commission experience, he thinks the ultimate report should be a "narrative with a clear beginning and end," and not a series of interim reports or policy papers "stapled together."

Bill Thomas

Vice-chair Thomas suggested that the report should "start with an overview, and then drill down."

Peter Wallison

Commissioner Wallison argued that the investigation should start with a series of "hypotheses" to structure the investigation and ultimate report. If that is not the approach, he is "concerned that the commission will collect a lot of facts but they will not be structured" or useful. He noted the importance of the research unit or research director in developing these hypotheses.

Brooksley Born

She suggested 4-5 people who "bring together expertise" on the crisis to assist in shaping the investigation and report.

Bill Thomas

Vice-chair Thomas expressed concern that some experts may have already made up their minds about the nature and causes of the crisis. To the extent we rely substantially on experts, the commission "needs to have a sampling of views."

Doug Holtz-Elkin

Commissioner Holtz-Elkin noted that when he ran CBO, he had expert assistants who "ran teams" under his general guidance in sophisticated investigations.

John Thompson

Commissioner Thompson argued that the commission should decide "what it wants to do before [locking into] a structure."

Brooksley Born

Commissioner Born commented that we could present "experts at a hearing to get issued surfaced, and to get added publicity."

John Thompson

Commissioner Thompson refocused the group on the report, noting that we are required to report on the firms that failed as well as firms that would have failed absent federal relief. He suggested that the two questions for the commission are "(1) what triggered the need for federal money and (2) what needs to be put in place to forestall problems in the future."

Decisions/Action Items

1. Commission dinner on October 19, starting at 7:00 p.m.
2. Commission meeting on October 20, starting at 9:00 a.m.
3. Staff to talk to heads of key financial agencies.
4. Staff to talk to key people in the industry.
5. Staff to suggest a protocol for commissioner contact with members of financial industry. The protocol would not limit such contacts but be in the nature of a "heads up" to staff on the contacts and what may have been learned. Commissioner Born noted that some industry actors, notably rating agencies, were reaching out to educate the public.
6. Commissioners requested to send to the chair, vice-chair and executive director their perspectives on the handful of items that should be given priority in the investigation and report.

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