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Transcript of FCIC Interview with Dr. Summers

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Recommended Citation

Angelides, Phillip; Seefer, Chris; Born, Brooksley; Edelberg, Wendy; Holtz-Eakin, Douglas; Summers, Lawrence; and Verrilli, Donald, "Transcript of FCIC Interview with Dr. Summers" (2010). *YPFS Documents (Series 1)*. 6439.
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1 UNITED STATES OF AMERICA

2

3 FINANCIAL CRISIS INQUIRY COMMISSION

4

5 Interview with Lawrence H, Summers, Phd

6

7 The commission met, pursuant to notice, at

8 2:07 p.m., Friday, May 28, 2010, in the

9 Office of the Financial Crisis Inquiry

10 Commission, when were present:

11

12 PHIL ANGELIDES, Chairman

13 CHRISTOPHER P. SEEFER, Esquire

14 BROOKSLEY BORN, Commissioner

15 WENDY EDELBERG,

16 DOUG HOLTZ-EAKIN, Commissioner

17 LAWRENCE H. SUMMERS, Phd

18 Director for the National

19 Economic Counsel, and Assistant

20 to the President, for Economic

21 Policy

22 DONALD VERRILLI, Esquire,

23 White House General Counsel.

24 ALSO ATTENDING,

25 Marne Levine

1 Roberto Gonzalez
2 George Mariso
3 Michael Gordon
4 Gary Cohen
5 Greg Feldberg
6 Ron Borzekowski
7 Randall Dodd
8 Scott Ganz
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1 PROCEEDINGS

2 (2:00 p.m.)

3 MR. SEEFER: Dr. Summers, thank you very
4 much for coming in today. My name is Chris Seefer,
5 of the Financial Crisis Inquiry Commission. We were
6 established by a statute called the Fraud
7 Enforcement and Recovery Act of 2009 last May, and
8 it tasks us with figuring out the various causes of
9 the financial crisis by the end of this year.
10 In that regard, we are talking to many people
11 that we hope can help us understand various causes,
12 and of course we have identified you as 1 person to
13 talk to. Thank you very much for coming in.
14 As you can see, we do have a court reporter, so
15 you've probably been through this drill before, I'll
16 try not to speak over you and vice versa, so we can
17 get a clear record. If you need a break, just say
18 so and we'll take a break. I know you wanted to
19 make a statement before you got started.
20 MR. VERRILLI: Yes, thank you Chris. I'm Don
21 Verrilli, of the White House Counsel's Office, and
22 I'm here today representing the interests of the
23 White House. As you know, Dr. Summers is a senior
24 white house official, and one of the President's
25 closest advisers.

1 The White House has agreed to make Doctor
2 Summers available for the purpose of this interview
3 today in recognition of the commission's important
4 mission. But we all need to recognize that even
5 agreeing to a step like this interview is an
6 extraordinary accommodation for this or any White
7 House to make.
8 We have had what I think are very productive
9 discussions with commission staff, regarding the
10 interview, and based on those discussions we are
11 confident and we hope to share a sense with you that
12 the interview can go forward in a way that helps you
13 accomplish your important work, and that respects
14 the interest of the Presidency.
15 Specifically, it is our understanding, based on
16 those discussions, that the interview today will
17 focus on the historical record and not on current
18 administration policy or current events that the
19 administration is confronting or may have to
20 confront. We have an agreement about that?
21 MR. SEEFER: Yes.
22 MR. VERRILLI: All right then, thank you.
23 MR. SEEFER: So Doctor Summers, our
24 statute tells us to look at 22 different areas. I'm
25 going to frankly ask you about several of those

1 areas. But before I do, I really just wanted to
2 broadly get your opinions to start on what you feel
3 were the primary causes of the financial crisis.
4 And then I'll ask more specific questions after we
5 hear that.
6 DR. SUMMERS: The beginning for me, the
7 right way to think about this financial crisis or
8 for that matter any major accident, to think in
9 terms of a number of factors which came together to
10 cause the crisis. In all likelihood, in the absence
11 of most of them, history would have plaid out quite
12 differently.
13 So I like to think of the factors in 4 broad
14 clusters. The first is the macroeconomic
15 environment. A combination of overconfidence caused
16 by a period of low volatility. Low interest rates,
17 very low interest rates, very substantial capital
18 inflows into the United States, relating to both
19 external economic conditions in the countries, and
20 to U.S. budget policy. The relatively easy
21 availability of credit contributed to a
22 macroeconomic environment that was prone to
23 speculative excess, broken asset and debt markets.
24 Second, obviously these are related, you had
25 quite a pervasive pattern of excessive leveraging

1 and risk taking. At 1 level that's a reflection of
2 what's surely a factor in most human failure, greed,
3 irresponsibility, and cupidity. At another level
4 it's a reflection of the incentive arrangements that
5 were poorly aligned, with respect to the
6 compensation of individuals, with respect to awards,
7 open to institutions. At another level, it was
8 reflects failures of regulation both gaps that
9 allowed leveraged decisions to be made without
10 serious review or allowed commitments to be made,
11 where such an equivalent to leverage, guarantees and
12 the like, without serious regulatory review. And
13 failures by regulators to fully assess risk in
14 situations where they were engaged in review. So a
15 situation speculative excess, combined with a
16 situation of excessive leverage created an
17 environment that was very easy for crisis to
18 develop. If you would like, a very, very dry
19 forest. The third factor was a set of evolutions
20 in our system that had made it more brittle, made it
21 brittle, and without the resilience that it had
22 earlier. It could be argued for some significant
23 interval, perhaps through the 1990s, that our
24 systems, the argument that Al Greenspan had made at
25 that time, had a resilience that came from credit

1 being provided on the 1 hand by banks, and on the
2 other hand through the capital markets. And that
3 there was some tendency when the banking system got
4 in trouble as it did in the early '90's, for capital
5 markets to take up the slack. And when capital
6 markets got in trouble, for the banking system to
7 take up the slack.
8 The ways in which securitization evolved, the
9 ways in which the shadow banking system evolved,
10 particularly as regards mortgages, ways in which the
11 derivatives markets evolve, created a system that
12 was very brittle, in the sense that there were a
13 large number of no's. Failure at any 1 of which
14 called the broad stability of the system into
15 question. And so the jump from crisis to systemic
16 collapse came to be a much shorter one.
17 A fourth factor was the lack of satisfactory
18 tools for crisis resolution that placed public
19 authorities in a situation where it was challenging
20 to act rapidly, decisively and legally. And that
21 faced them with, even if they were able to get the
22 legal authorities that they might wish, with
23 agonizing dilemmas's between on the 1 hand chaos,
24 confusion and potential collapse. And on the other
25 hand the indiscriminate infusion of large quantities

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1 of taxpayer money, with associated risks for
2 taxpayers and associated moral hazard consequences
3 down the road.
4 So while there are many, many aspects and
5 contributors, for me the broad list of the macro,
6 without a problematic macroeconomic environment, we
7 likely would have survived many of the other
8 problems that we would've had with the problematic
9 macroeconomic environment, but without excessive
10 leverage and failures of regulation consequences.
11 Quite likely it would have been less serious, even
12 with a flawed macroeconomic environment and
13 excessive leverage, without the degree of
14 brittleness and non-resilience that had emerged, we
15 would've had a better outcome. And even with all 3
16 of those, we might well have been in a much stronger
17 position if we had more satisfactory mechanisms for
18 containing failure.
19 I might just finally emphasize, because I
20 realize that I didn't say it again. When I spoke of
21 excessive leverage, the examples I used in my tone,
22 emphasized in financial institutions. Of course
23 excessive leverage by households, by businesses and
24 the decisions to extend excessive leverage to
25 households and to businesses are also part of the

1 leverage story.

2 MS. EDELBERG: Can I just ask 1 follow up

3 question? So what I keep coming back to is comments

4 like Chairman Bernanke's. Where he said early on

5 when we said our housing market turned, the sub

6 prime crisis was contained. And what did we know at

7 that time, and what did we not know at that time?

8 And the reason I keep coming back to that is

9 that I can't help but think, given how many smart

10 people were, would have had every incentive to avoid

11 a financial crisis, that what led to the financial

12 crisis was things they didn't see, or connections

13 that they didn't see.

14 So with that in mind, I look at your list and

15 there are a number of these things that we knew in

16 2005. We knew what was happening in the

17 macroenvironment, we arguably knew a huge amount

18 about leverage. It could be that there were parts

19 of leverage that we didn't understand, but we could

20 have understood them if we had looked in financial

21 institutions. We certainly saw what was happening

22 with undervalued ratios, and we understood what was

23 happening in the regulatory environment. I would

24 argue.

25 The part that I see on your list that I don't

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1 know that we appreciated in 2005, I'm trying to roll
2 back some time before the crisis, is the brittleness
3 of the system. Is that fair?
4 DR. SUMMERS: Well I think it's, I made 2
5 or 3 points. First, the brittleness would have
6 mattered less if the other factors that led the
7 resilience of the system to be tested, had not been
8 present. So even if your point was completely
9 right, it wouldn't follow that 1 should ascribe the
10 crisis only to the brittleness.
11 Second, I think it's in some ways simpler to
12 think about the problem activities of investors
13 who's motivation wasn't to fix the situation, but
14 only to evaluate it. And who were therefore operate
15 with fewer constraints. Obviously very large amount
16 of money were lost by people who had considerable
17 experience and considerable successful experience.
18 Hindsight is 20/20, and I think in retrospect
19 it's clear that the macroeconomic environment was
20 highly suspect in the ways that I described. I
21 actually was 1 who fairly early in this 2006/2007
22 gave some warning about various aspects of the
23 macroenvironment, it corresponded to my judgment.
24 But it wasn't that it was an obvious judgment, a
25 completely obvious judgement. While it seems

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1 obvious today, is I gave those warnings at that
2 time, I was aware that it was a quite common, and
3 really very widely held view that when the Dow
4 reached the 6000 range in 1996 that it had a bubble
5 element as well. And ex post, that judgement
6 appears not to have been the right one.
7 So I think the judgment of when you have a
8 bubble, all these looks much easier ex post than it
9 does ex ante. Any moments in markets there are
10 bears and the ones who were bears at the moment the
11 ex posts were peaks, tend to look like they were
12 very wise. So I don't think that the fact that
13 somethings were out there is quite as definitive.
14 I think an element, I think a very, very
15 important element in understanding the crisis, and
16 it's somewhere between like the second and third
17 factors on my list, was that people who buy low
18 investment grade credit or junk credit, believe it's
19 going to be credit worthy and believe it's going to
20 work out, or they wouldn't buy it. But they do so
21 with the understanding that failure is a
22 possibility, and based on a consideration of the
23 possibility of failure and the risks associated with
24 it. The investment in top grade securities, AAA
25 securities, AAA tranches, in various kinds of

1 collateralized instruments, comes with relatively
2 little consideration of risk, because it's just
3 assumed to be safe.
4 And so when the failure of what has previously
5 been assumed to be safe comes into doubt, you can
6 get a very substantial panic reaction. It's as if
7 somebody has said, somebody has used the analogy, it
8 would take a very little bit of botulism, the
9 smallest risks to change life quite profoundly if
10 people wondered about the integrity of the water
11 supply which they had previously completely relied
12 on as being safe. So that was in part a source of
13 the brittleness, and that brittleness has elements
14 in the structure of the financial system.
15 But it also has elements in what the size of
16 the bubble turned out to be. It also has elements
17 in how much leverage there was, because if there had
18 been less leverage, even with the bursting of a
19 bubble, the previously safe securities wouldn't
20 have. So I understand why you are going to the
21 question of brittleness, but at least in my view, to
22 really trace it through, and to capture this aspect
23 of the previously safe not being the gestalt
24 changing, with respect to the previously safe.
25 You'd have to look to all 4 of the factors that I

1 talked about.

2 MR. SEEFER: Understanding your point

3 about folks that invest in AAA's and perhaps don't

4 consider losing anything to panic, one of the

5 factors in our statute is looking at the credit

6 rating agencies, and in fact our next hearing is

7 going to be on credit agencies. What are your

8 opinions about the role they plaid in the crisis?

9 DR. SUMMERS: There are aspects that I

10 know more about, there are aspects that I know less

11 about. There are probably no aspects that I know

12 enough about. Credit ratings would be an aspect

13 that I know less about.

14 There is no question that the credit rating

15 agencies made huge errors, and that uncritical

16 reliance on the credit rating agencies, while credit

17 rating agencies were making huge errors, was an

18 important aspect of the problem. And obviously the

19 credit rating agencies and those who in regulation

20 make use of their product, I'm talking about this,

21 phrases like investment grade, have a lot of

22 soul-searching to do.

23 I would make 2 other remarks. The first is

24 that I think they sort of go in opposite directions.

25 The first is that, and again, I think you will find

1 people who can speak to this, speak to what I am
2 about to say much in much more nuance than I can.
3 You'll find that there was some activity of the
4 credit rating agencies which is like what most
5 people's image of what a credit rating agency does.
6 I issued a bond, you rate the bond, and after I've
7 issued the bond you evaluate the bond.
8 There came to be at least a substantial amount
9 of activity, particularly in the synthetics area,
10 where it is at least frequently alleged that the
11 rating agency was a partner or at a minimum a close
12 advisor, or was more actively involved and rather
13 more extensively compensated in the design and the
14 rating process. And that obviously raises more
15 serious kinds of questions.
16 At 1 level, you know the distinction can't be
17 drawn with precision. If I evaluate and you rate,
18 If I issue and then you rate. Suppose I issue it
19 this way, how would you rate it? Suppose I issue it
20 that way, how would you rate it? How does iterative
21 question asking differ from cooperating in the
22 design? There are clearly some difficult
23 distinctions in that area. But I think one has to
24 think that where there is more extensive
25 involvement, that's an area that requires I think

1 particular scrutiny, I think it receives particular
2 scrutiny at least in some versions of the financial
3 legislation now under consideration.
4 The other point I would make though, goes in a
5 somewhat different direction, just in assessing
6 credit rating agencies. Is that you have a number
7 of specialized entities concerning credit risk and 1
8 is the credit rating agencies. Another who's
9 difficulties also have contributed in a non-trivial
10 way to the crisis is the bond insurance agencies.
11 And the bond insurance agencies did dismally in many
12 cases. And the 1 thing that you can say about the
13 bond insurance agency is that their failure was not
14 due to the incentive problem that the credit
15 agencies had. They were in a position where they
16 were on the hook if a bond they insured failed. So
17 they had massive incentives to avoid it, and made
18 many of the errors that the credit agencies made.
19 So my instincts would be that it may slightly
20 oversimplify what I think is a very deep problem to
21 attribute it in a dominant way to incentive
22 problems, rather than to intellectual problems,
23 given the pervasiveness of the problem, even where
24 there were very strong incentives to avoid.
25 Now again, particularly in the synthetics

1 cooperative area, I think there were real questions
2 that can be asked about the arrangement. The issues
3 are a place where I have had a little bit of an
4 occasion to think about these issues. Similarly,
5 there are some similarities with the set of issues
6 involved in the work of accountants auditing,
7 designing tax policies, doing consulting business,
8 how one draws lines. There is a place where these
9 things have been fairly substantially considered.
10 MR. SEEFER: So am I understanding you
11 correctly that when it comes to the Ambacs and the
12 MBIAs and I guess we can throw AIG in there when we
13 talk about the bond insurers, that there was more a
14 function of I guess a lack of intellectual
15 firepower, so to speak?
16 DR. SUMMERS: Intellectual firepower, I
17 think I would rather make the slightly more narrow
18 statement that corresponds to what I have some
19 chance of knowing. Which is it wasn't an incentive
20 problem, in the sense that they have very strong
21 incentives to do right. It was a judgment error,
22 whether the judgment has to do with the
23 unsatisfactory quality of information they received,
24 or the intellectual judgments they made about that
25 information, I don't have a basis for making any

1 judgment at all about that question.
2 MR. SEEFER: I understand that, another
3 area that we're looking at, another area that the
4 statute tells us to look at, is the role of
5 executive compensation and compensation packages in
6 general. And whether it's Ambac, MBIA or AIG or any
7 other company, there are still compensation
8 incentive structures where the managers incentives
9 may not necessarily be aligned with the company. I
10 mean have you thought about it at all, for the
11 Ambac's and the MBIA's and the AIG's?
12 Let me go back to your 4 factors, and ask you
13 about what you wrote, what you said in a speech
14 before the Brookings Institution on March 13th of
15 2009. And in there you were talking about how
16 there's 2 kinds of economic downturns. One, you
17 know, monetary policy and rising inflation, and then
18 of course the financial crisis, the spontaneous
19 correction of financial excess, as you said. You
20 talked about how we get 2 or 3 of these a century,
21 and I'm wondering if you just think, given these 4
22 factors, that if you had the fourth factor, if you
23 did have satisfactory tools for regulation by
24 government, could we avoid these financial crises s
25 2 or 3 times a century?

1 DR. SUMMERS: In my tone, as I spoke to
2 the 4 factors, was to suggest that I thought that
3 with any one of them fixed you would make the
4 situation substantially better, and that would be my
5 belief. If you're going to have fires, it is
6 vastly, vastly, vastly better to have an effective
7 fire department than not to have an effective fire
8 department. But it doesn't quite follow, if you
9 just have an effective fire department it's okay to
10 have fires.
11 So I don't want to be heard as suggesting that
12 with satisfactory resolution authority everything
13 else can be allowed to rip, and that you won't have
14 serious problems. I do think that with the right
15 kinds of resolution authority the risk of a crisis
16 becoming systemic and coming to the brink of
17 bringing the system to the brink of breakdown could
18 be quite significantly attenuated.
19 MR. SEEFER: Let me ask you some follow
20 ups on your 4 factors. Several of them are in our
21 statute, not surprisingly are within your 4 factors
22 so far. In the article that you and Mr. Geithner
23 wrote in the Washington Post on June 15th of last
24 year, "A New Financial Foundation" it was called.
25 And 1 of the first things you talked about in terms

1 of the macroenvironment was the global imbalance of
2 savings, which is 1 of the first things we are
3 supposed to look at in the statue.
4 Any further comment on how that contributed to
5 the financial crisis, other than the way you
6 explained and described in the first factor?
7 DR. SUMMERS: I think you have 2 or 3
8 aspects. There is an aspect which is that when
9 money is cheap it's more attractive to borrowers.
10 And the very substantial availability of funds from
11 countries that for a variety of reasons were seeking
12 to accumulate liquid reserves, and the posture of
13 monetary policy reflecting concerns about deflation
14 led to money being cheap, which in turn encouraged
15 borrowing to buy, which in turn encouraged higher
16 asset prices. I think that's 1 aspect.
17 A second, and I think logically not completely
18 independent, but somewhat separate aspect is that a
19 very large demand for safe assets called forth a
20 desire to supply them, which in turn drove the
21 creation of the apparently safe assets, which were
22 subject to the gestalt changes that I described, and
23 also drove the rather large and substantial
24 activities around tranching, and the creation of
25 synthetic securities, which may, given the absence

1 of transparency and with problems in regulation,
2 contributed to the brittleness of the system.
3 CHAIRMAN ANGELIDES: Can I just ask a
4 question?
5 MR. SEEFER: Of course.
6 CHAIRMAN ANGELIDES: Can I probe this for
7 a minute? Which is obviously you've identified that
8 there is a demand for the safe assets, perhaps 1 and
9 that's spurred the creation of a whole set of
10 products to satisfy that demand. But I keep
11 thinking about the other end of the chain. Which is
12 at the other end of the chain, at least the first
13 set of products, before you got into the synthetics
14 and mezzanine CEO's. What is it that drove American
15 consumers to borrow so substantially? What were the
16 driving factors there? Now, not to give the answer,
17 but obviously if someone is offering you cheap money
18 for the option, money, I can see that. But was it
19 that people were over their skis, in terms of being
20 able to meet their needs, wages were flat, money was
21 cheap. People saw the ability to borrow to buy
22 assets that they thought had appreciation? What
23 were the driving factors at the other end?
24 DR. SUMMERS: I'm not sure that I can
25 articulate them neatly into categories, but I guess

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1 I could suggest several. First, there was optimism
2 founded on recent experience. House prices, for
3 that matter car prices, had been robust for a
4 substantial period of time. The set of phenomena
5 the economists were calling, "The great moderation"
6 had led households to a sense that their incomes
7 would be relatively robust. By and large those who
8 had borrowed had . . . it had turned out reasonably
9 well for a quite long period of time. And in
10 general, this is a sort of nonscientific
11 generalization, but financial messes, both for
12 individuals and firms and for countries tend to made
13 when there's a ton of behavior that takes the form
14 of doing today what you wish you had done yesterday.
15 When people buy things that have just gone up,
16 because they've just went up, that's what causes
17 bubbles. When people borrow, because people who
18 borrowed a decade ago and it ended up working out
19 well for them, that tends to be when you get
20 over-leveraging. So I think there was an element in
21 the household system.
22 Second, we had the innovativeness and to some
23 extent the greed and irresponsibility of lending
24 institutions combined with inadequate regulation.
25 In the spring of the year 2000, Andrew Cuomo and I

1 issued a report on predatory and subprime lending
2 practices, that talked about no doc loans, talked
3 about loans with adjustable rates with inadequate
4 disclosure of the adjustment. It talked about a
5 variety of the other practices that became famous.
6 So it had to do with household decisions, but you
7 know there is a saying about life insurance, that
8 it's sold, not bought. And something similar can be
9 said about a fair amount of lending activity. So
10 the absence of satisfactory consumer financial
11 regulation, coupled with a plausible story as to why
12 consumers were better off borrowing created strong
13 incentives for the excess borrowing on the consumer
14 side.
15 MS. EDELBERG: I want to ask a quick
16 question on global imbalances.
17 CHAIRMAN ANGELIDES: Just 1 small point.
18 So how much of any of it was driven by flat wages,
19 need to borrow versus the optimism, the wishing you
20 had done yesterday what you're about to do now, the
21 availability of product?
22 DR. SUMMERS: You know it's-
23 CHAIRMAN ANGELIDES: And I don't know if
24 there is any, I have asked the staff whether that
25 can really be quantified.

1 DR. SUMMERS: Here is why I am having
2 trouble answering. It's a terrific question, but
3 I'm having a little trouble answering. On the 1
4 hand if wages had risen, if you had a period when
5 real wages were rising significantly, I'm sure there
6 would've been less need for borrowing and there
7 would have been more wherewithal to repay. And by
8 the way, if the environment with rising wages and
9 higher incomes, there would have been more upwards
10 pressure on housing prices, which would have also
11 averted some of the problems.
12 So at 1 level I agree with you, and I should
13 say-
14 CHAIRMAN ANGELIDES: I don't know-
15 DR. SUMMERS: The reason why I didn't put
16 more emphasis on it, is because it related to the
17 arguument that was made a little bit earlier. The
18 type of argument that was made a little bit earlier.
19 Wages were, wages have been relatively stagnant for
20 middle-class families for a long time. And so I'm
21 not sure that wages that were stagnant and had been
22 stagnant are so much a cause of the problem. On the
23 other hand you can argue that in a period when
24 investment was particularly strong, federal budget
25 position was better in the 1990s, You did see some

1 significant wage growth. Perhaps if that whole
2 pattern had continued, that too would have
3 contributed to reducing these problems.
4 MS. EDELBERG: So on global imbalances,
5 global imbalance confuses me for a couple of
6 different reasons. And you seem like a good person
7 to get clarity from. So I can understand why
8 monetary policy would've made it cheap to borrow in
9 the U.S. Short-term, and Vince Rinehart has this
10 argument, that it's actually the steepness of the
11 yield curve that matters, and that makes some sense
12 to me. But I don't understand why monetary policy
13 or really even certain parts of the world economy
14 saving a lot of money means that they have to bring
15 that money into the U.S, and invest it in assets
16 that are part of an asset bubble. And part of what
17 I'm looking at there, is I'm looking at the gross
18 flows, which is the net flows. And money has gone a
19 lot this way, money has gone a lot that way. This
20 doesn't seem like it's an inevitability. That the
21 global imbalances create an asset bubble within the
22 U.S. And that it's monetary policy to blame,
23 partly.
24 DR. SUMMERS: Well again, I think it was
25 the nature of the way I laid out the factors to

1 suggest that it was the 4 of them coming together
2 that caused the crisis. Which is to say that no 1
3 of them made the crisis inevitable.
4 MS. EDELBERG: Right.
5 DR. SUMMERS: So in that sense-
6 MS. EDELBERG: I'm sorry, I meant the
7 asset bubble.
8 DR. SUMMERS: -I relate to what you are
9 saying, if you, and I don't doubt that with nothing
10 different in the rest of the world, if there had
11 been more responsibility and better risk management
12 systems, stronger regulation, that led to less
13 leverage and better judgments by financial
14 intermediaries, that it would've had a significant
15 effect on the pattern that emerged in asset prices.
16 So that's certainly right as well.
17 If the question is though why is large
18 accumulation of reserves by China for example,
19 relevant to this whole phenomenon, I'd come back to
20 2 factors, to the 2 things that I tried to get at
21 before. That ceteris parabus, other things equal,
22 there's higher, it's a higher level of savings in
23 the world, and there is a tendency for real interest
24 rates to be equalized around the world, you'll have
25 lower real interest rates, which contribute to more

1 mortgages, and that many of the savers, to use, I
2 don't know who's phrase it was, first Keynes I think
3 and then Frank Amagliani's phrase. Preferred
4 habitat. If you had a substantial increase in
5 saving on the part of those who had a preferred
6 habitat, in safe liquid securities, then that's
7 going to affect the relative pricing of safe liquid
8 securities, which in turn is going to influence the
9 incentive to create them, which in turn is going to
10 influence the EPG, Treasury Bills, AAA tranches.
11 Which in turn is going to influence the demand for
12 the assets with which they can be attached,
13 mortgages and ultimately housing.
14 MR. SEEFER: You mentioned the paper that
15 you and Mr. Cuomo came out with in the spring of
16 2000, when you were talking about irresponsible
17 lending practices and predatory lending, and you and
18 Mr. Geitner mentioned the same thing, in the June
19 15th, 2009 Post article, and surprise, surprise, our
20 statute tells us to look at the role of fraud and
21 abuse in the financial crisis.
22 CHAIRMAN ANGELIDES: Is there a statute
23 that they tell us not to look at?
24 MR. SEEFER: And I believe that you are also on
25 record as saying, "If we would've had a Consumer

1 Protection Agency it would've been able to protect
2 against these subprime abuses."
3 So I guess I have a two-part question. One,
4 generally do you have opinions on the role of fraud
5 and abuse, in particular predatory lending in the
6 crisis, and why do you think having a Consumer
7 Protection Agency will help, since I think we've had
8 some failures in regulation which contributed to the
9 crisis too?
10 CHAIRMAN ANGELIDES: Or maybe the question
11 is why it might have helped-
12 MR. VERRILLI: I prefer the Chairman's
13 formulation of the question.
14 CHAIRMAN ANGELIDES: That's fine, that's
15 fine. It was inadvertently effective.
16 DR. SUMMERS: If you look at certain areas
17 where you see the greatest problems emerge in the
18 housing market, you also see the highest fraction of
19 mortgage activity that would fall within the kinds
20 of categories that Secretary Cuomo and I had
21 identified in our predatory loans document, you
22 would have no down payment loans without documented
23 income, substantial adjustability in rates, that was
24 poorly disclosed, inadequate appraisal practices,
25 questionable compensation arrangements, involving

1 all participants, the realtors and so forth.
2 So I think the nexus between some of the most
3 problematic elements of the housing market in the
4 lending practices suggested by the pervasiveness of
5 the lending practices, and their particular
6 pervasiveness in the places where the housing market
7 was most serious.
8 With respect to the question consumer financial
9 regulators, I think there are probably 3 arguments.
10 First, when you have consumer responsibility in the
11 agencies, whose primary mission and criteria for
12 success is safety and soundness, inevitably there
13 will be some tendency to prefer things that
14 contribute to profitability to things that might
15 interfere with profitability. Even with the best
16 motives and judgment.
17 Second, you have a substantial amount of
18 consumer lending activity, an activity that placed
19 substantial pressure also on activity in banks took
20 place outside the banking system. And it is to be
21 expected that activities placed in banking agencies
22 can place consumer lending and banking agencies,
23 however you define those agencies, more attention
24 would be paid to banks then will be paid to
25 non-banks, as in fact proved to be the case.

1 Third, there is just a cultural if you like,
2 feature around those who are appointed to the
3 positions and those who are at political level
4 decisions, and those who choose to spend their
5 career in the civil service positions, that when the
6 primary mission is around monetary policy, or when
7 the primary mission is around safety and soundness,
8 those who will end up with the responsibility will
9 be people who have more experience in and more
10 passion for what is the primary mission.
11 That's why over time we as a country have come
12 to have large numbers of independent regulatory
13 agencies, rather than place all the responsibility
14 with some focus in the mission. So those seem to me
15 to be the reasons why one would expect that
16 established in December, the Occupational Health and
17 Safety Administration will lead to more focus on
18 occupational health and safety than placing the
19 responsibility of the Commerce Department whose
20 mission is to promote America and economic growth,
21 one can give a large number of similar examples.
22 So those are the judgements that have lead me
23 for quite some time to favor a Consumer Protection
24 Agency.
25 MS. EDELBERG: I'm sorry, I just want to

1 make sure I understand. And I'm not talking about
2 any of the legislation that's being proposed, just
3 thinking backwards. Would you include, so when you
4 said monetary policy, my ears perked up. Are you
5 saying, does that even include the Federal Reserve?
6 Right? That the Federal Reserve with its primary
7 goal of monetary policy, then the people who are
8 rising up through those ranks were most focused on
9 that primary mission, and not on regulation, and
10 perhaps that was true at Treasury, perhaps that was
11 true at other?
12 DR. SUMMERS: Well I think that was, I
13 mean my comments really went, the Federal Reserve,
14 and there are people in this room that probably know
15 more about the structure from year 1. Probably know
16 more about the details of the structure of the
17 Federal Reserve than I do. But I think it would be
18 fair to say that the Federal Reserve employs a
19 substantial number of people whose mission is around
20 helping to calibrate and set monetary policy,
21 including monetary policy with a view towards
22 financial stability. It employs a substantial
23 number of people whose work is focused on various
24 aspects of financial market conditions and financial
25 suitability, including in particular the supervision

1 of financial institutions. And it employs a
2 significant, but I suspect quite a bit smaller
3 number of people whose mission is around consumer
4 protection or the enforcement of anti-discrimination
5 statutes and the like.
6 My comment was to suggest that the orientation
7 of the institution was heavily enough to the first
8 2, to make you wonder about the third. But I think
9 you may have been seeking to see whether I was
10 expressing a view about the second, relative to the
11 first. And I was quite consciously not saying
12 anything about that.
13 MR. SEEFER: Obviously 1 area we're
14 looking at was the growth in subprime loans and
15 broader non-traditional mortgage loans over time,
16 and the reasons for that growth. And areas that
17 we've been looking at include the originate to
18 distribute models, securitization, whether that was
19 creating demand for all the GSEs, and other things
20 that escape my mind right now. But do you have any
21 opinions on the causes of the growth of the non
22 traditional mortgage product in the decade of the
23 2000s?
24 DR. SUMMERS: As you noted, a great deal
25 of the growth took place in the 2000s, took place in

1 particular over a period when I wasn't in
2 government, wasn't in the financial markets and
3 wasn't especially watching. So you'll have access
4 to the people with a keener sense than I.
5 My impression is that in a period of quite
6 robust housing price performance, default rates on
7 almost every kind of loan had been very low for a
8 long time. And therefore it appeared profitable if
9 the experience of the previous period continued to
10 hold. To make loans, even loans underwritten to
11 less rigid criteria than had been the case
12 previously.
13 Entrepreneurs sought to do that. The
14 additional public policy, subsidy to the activity
15 that was provided by the fact that the GSE's were at
16 a certain point significantly encouraged by being
17 given low income credit, or credit towards their
18 affordability goals, to hold these loans was
19 obviously a reinforcement, both in a direct
20 financial sense, and probably a broader moral sense
21 to this kind of activity.
22 What fraction of the. . . to what extent they
23 bear responsibility, that the GSE extension in, to
24 what extent that's responsible for a large part of
25 the growth in subprime predatory, or small part of

1 the growth in subprime predatory is a question in
2 your place. I would think was an important one, but
3 not 1 where I know enough to presume to venture a
4 view.
5 I think it is legitimate to explore the extent
6 to which we may, there are other aspects that are
7 appropriate to explore here. I have raised
8 questions during the time I was at the Treasury
9 about the magnitude of the implicit subsidy through
10 the aura of government credit support, and how large
11 a subsidy that was to the GSEs. Some of which flow
12 to their shareholders, but some of which flowed to
13 the nation's housing market, and flowed therefore
14 into housing. And the magnitude of that all
15 increased, both as their activities expanded quite
16 substantially, and as their leverage increased.
17 There were efforts I made some, Chairman Greenspan
18 made some in the very late '90's and the early 2000s
19 to address the questions that were raised by the
20 GSE.
21 There is a broader question to be asked which
22 goes to the very substantial benefits that our
23 society generates from being a society in which
24 families are enabled in many circumstances
25 encouraged to own their own homes on the 1 hand.

1 But on the other hand homes are large, permanent
2 rather illiquid assets, and home ownership may not
3 be appropriate as an objective for people in all
4 circumstances. Certainly, the suggestion has been
5 made, in so far as it caused gazes to be averted
6 from some of the more egregious subprime practices,
7 so far as to cause some lack of scrutiny of the GSEs
8 at a certain point I think it was problematic around
9 the approach we as a country take, in terms of the
10 degree of encouragement of home ownership.
11 But the other hand we have derived enormous
12 benefit as a country from home ownership. There's
13 all kinds of evidence on the benefits for children,
14 and families that own their own homes and so forth.
15 So I think it is an area that needs very
16 considerable thought and there obviously were some
17 excesses in the kinds of ways credit was provided,
18 but I wouldn't presume to judge where the right
19 balances were.
20 MS. EDELBERG: Should we be thinking of
21 putting the subsidy to the GSEs in the same category
22 as all of the subsidies to home ownership in the tax
23 code? Whether it's the relative tax rates for
24 homeowners, versus renters, the fact that you can
25 write off mortgage interest?

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1 DR. SUMMERS: Just so we're all clear
2 MR. VERRILLI: That would be great.
3 MS. EDELBERG: My question was totally
4 theoretical.
5 DR. SUMMERS: Just so I'm not being
6 misunderstood. The GSEs currently are in
7 conservatorship, so you are in a rather different
8 framework than we were previously.
9 With respect to the previous question, there
10 are sort of 2 questions, to analyze the GSEs, and I
11 don't know whether 1 was written while you were the
12 CBN director or not, Commissioner Holtz-Eakin, but
13 CEO has periodically written reports that say in
14 careful ways what I am about to say.
15 To reach the question you first have to decide
16 how large the subsidy was to the GSEs, which depends
17 on the judgment of what their creditworthiness is,
18 and how to think about their creditworthiness in the
19 absence.
20 Second, in so far as you have formed views on
21 how large the subsidy is, you need to decide to
22 what extent it's being passed on to homeowners, and
23 to what extent its sticking to their shareowners.
24 My suspicion is that analysts would tend to judge
25 that the GSE subsidy, while important in a number of

1 respects, was probably not huge, relative to the tax
2 subsidy. Or to take another issue that is vexed,
3 the aspects associated with the deductibility of
4 property taxes.
5 MR. SEEFER: You found stickiness though?
6 CHAIRMAN ANGELIDES: Yet the bulk of the
7 subsidy went to the shareholders, a de minimis base
8 point reduction,in Morgan Chase.
9 MR. SEEFER: Turning back to causes for
10 the increase in non-traditional mortgage products.
11 Another thing we've looked at since we first asked
12 you this question. In 2003, you saw the big refi
13 boom, and then after that the feds started to
14 tighten. I think you saw, I think relatively more
15 home purchase loans that you did refis. In your
16 opinion did monetary policy and other factors in
17 that part of the decade contribute to the increase
18 in non-traditional mortgage loans? Do you think it
19 had any role?
20 DR. SUMMERS: Monetary policy was itself
21 responsible to a whole range of macroeconomic
22 conditions, including a set of issues associated
23 with the pressure of capital inflows, in intervals
24 when short-term interest rates rose for some time.
25 But there was less impact on long-term rates than

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1 many expected. But I was not watching markets
2 closely enough for me to have an opinion that would
3 be particularly helpful for you.
4 MR. SEEFER: According to a transcript
5 that I saw at least of an April 22nd 2010 PBS news
6 hour, it was about you. You know that you said that
7 there was no question, you know, that things had
8 happened on Wall Street, where the reason we had
9 this financial crisis and you mentioned a couple of
10 things. Mistakes on Wall Street, the mortgage area,
11 the subprime bubble, house price appreciation, loans
12 that borrowers could not afford, and you said that
13 credit errors on Wall Street brought financial
14 institutions to the brink of insolvency.
15 Can you maybe give us a little more color on
16 the mistakes that were made in the mortgage area,
17 and then in credit errors that were made on Wall
18 Street? Or was the transcript wrong?
19 (Laughter.)
20 DR. SUMMERS: No, the transcript was I
21 assume right. That always makes me nervous when
22 people read back things I've said. But that one
23 actually felt fine.
24 (Laughter.)
25 As you were reading it back, no, I'm just not

1 sure that I've got a lot to add to what I've been
2 saying. There were obviously very substantial
3 misjudgments of the risks associated with
4 mortgage-backed securities that were made by many
5 financial institutions to purchase those securities,
6 and as a consequence lost very large amounts of
7 money. And those errors, as a matter of logic could
8 have been averted by, if the houses on which
9 mortgage were written had not collapsed in value,
10 then there couldn't have been those errors.
11 If there had been limits on the leverage, and
12 the initial equity in those houses, then even if the
13 houses had collapsed, there would have been much
14 less money lost, if the guys who held
15 mortgage-backed securities or contemplated holding
16 mortgage-backed securities, had foreseen the risks
17 associated with them, and paid appropriate prices,
18 they wouldn't have lost large volumes of money that
19 would've been a major source of risk associated with
20 the system. And if they have been prudent in their
21 diversification and in the extent of their
22 risk-taking, the magnitude of the consequences of
23 their errors on the first 3 points would have been
24 less serious for the health of the financial system.
25 MR. SEEFER: Obviously it's always hard to

1 call a peak, and you know very few people are
2 successfully calling peaks and troughs, but I really
3 want to ask though, why were there such serious
4 errors in judgement given the underlying quality of
5 the collateral, I mean you had . . . and there were
6 a lot of, it seems to me, yellow and red lights
7 going off. Home prices rising at 10, 11, 15 percent
8 a year. I think certainly a level of knowledge about
9 the type of instruments in the market, no doc loans,
10 very high debt to income ratios, extraordinary, no
11 proven ability, no respective ability to pay. So
12 loans really made on rapidly escalating collateral
13 prices, without ability to service the loans.
14 Knowledge which I guess to many people wasn't
15 available, that we really did have a. . . you now
16 hear no one could have anticipated a 30% decline in
17 national house prices. Of course many of these
18 securities become impaired by mid 2007, when house
19 prices have dropped off 1 or 2%, and we had a 2%
20 drop in the '90 to '93 area. Of course mostly
21 driven by regional drops.
22 I guess just fundamentally, if you step back,
23 why was there such, do you think, a lack of
24 understanding, a lack of due diligence, the
25 magnitude of error about the underlying

1 collateral?

2 Dr. SUMMERS: I think you would be much

3 better advised to ask those who made these errors.

4 To ask those who made these errors what they're

5 thinking and their judgments on that question would

6 be much, much more valuable than my judgment. I

7 think it seems incredible in retrospect, but much

8 always seems incredible in retrospect. The fact

9 that something that was very commonly said in those

10 days on a national basis, house prices had never

11 come down. It had never happened over a 50 year

12 period, and people thought therefore that meant that

13 it wouldn't happen. It is a substantial

14 contributor. I'm not able, I don't think I ever

15 knew, and certainly don't know now the precise

16 dynamics of the pricing of these securities. I

17 suspect that when they failed in 2007, even if house

18 prices had not fallen much yet, the decline in

19 mortgage-backed securities reflected what was at

20 that point a reasonable expectation that there would

21 be significant declines in housing prices. So it's

22 not that they were so leveraged that they were

23 vulnerable, that they were that incredibly

24 vulnerable to a period of stagnant house prices.

25 There are a set of questions about mortgages.

1 There are then a set of questions that I don't feel
2 at all authoritative on. But I think are perhaps
3 relevant to your broader inquiry, having to do with
4 how these judgements were made. Judgements about
5 risk made by the people who were doing the trading?
6 Were the judgments made independently? How is the
7 process of coming to judgment supervised? These are
8 all questions in terms of, there is an element of
9 understanding the cognitive aspect of why an error
10 was made, and then one has an explanation of what
11 the cognitive pattern is. There's still the
12 question of what kinds of scrutiny were applied to
13 the judgments when they were made. And there is the
14 question of what kind of conviction, how much was
15 put at risk around this.
16 And then I think there's also an aspect which I
17 touched on earlier, which goes to the question of
18 resilience. Which is the consequences for the
19 system of 1 financial institution making mistakes
20 alone is very different than the consequences for
21 the system of multiple financial institutions making
22 the same mistakes. Because then when it comes time
23 to unwind, everybody is unwinding in the same
24 direction. That goes to various incentive problems.
25 Keynes wrote famously about it being better to be

1 wrong conventionally, than right unconventionally.
2 I'm not sure whether that's right or not, but I'm
3 sure if you are going to be wrong, it's better to
4 be wrong conventionally, then to be wrong
5 unconventionally.
6 That leads to a fair amount of band-wagoning.
7 MS. EDELBERG: So now is the perfect time
8 for this question. We have been struggling with
9 common shock versus liquidity shock? Well no,
10 there's 2 different shocks. So there is the
11 question of-
12 MR. VERRILLI: I'm sorry, I'm just asking
13 Dr. Summers whether he wants a break.
14 DR. SUMMERS: No, I'm okay. I can go for
15 the whole session.
16 MR. VERRILLI: Just let us know.
17 MS. EDELBERG: Okay. So 1 of the things
18 that we're struggling with is that a lot of
19 financial institutions get in trouble all at once,
20 and there's a question as to whether that's in
21 trouble all at once. I guess that's part of the
22 hypothesis, that they got in trouble all at once.
23 And part of this hypothesis is, they got in trouble
24 all at once because they were all basically exposed
25 to either the same asset, which was the mortgage

1 shock, or actually they were all exposed to the
2 same utter dependence on liquidity and they were
3 basically just all exposed to a liquidity shock.
4 Or there was some shock, there was little bit
5 of E coli in the system, and we actually had
6 contagion and it spread through, due to
7 interconnectedness. Does that seem like a fair,
8 yes? So we are trying to differentiate between
9 those 3 stories.
10 DR. SUMMERS: I know this sounds like a
11 wiseguy answer, I don't mean to give a wiseguy
12 answer. I can't really walk across the street
13 without both my right shoe and my left shoe, and so
14 I don't quite know how to answer. Is it my right
15 shoe that causes me to walk across the street, well
16 yes. Does my left shoe cause me to walk across the
17 street? Yes. Is it both my shoes? So I think the
18 answer is that all of those were present. I think
19 it is certainly the case that many of the same
20 judgments were reached in many financial
21 institutions. And so when those judgments proved to
22 be problematic, the problems were common to many
23 institutions.
24 Second, when the errors were propagated, the
25 fact that the institute judgments were common to

1 many institutions meant that it was difficult to
2 unwind the securities. In the speech that you
3 referred to earlier, I spoke about a variety of
4 different vicious cycles that kicked in 2 or 3
5 times a century. The first of those was
6 de-leveraging, leading to Sally, leading to more
7 de-leveraging. And so you have a kind of contagion
8 that comes from that, reinforced by losses make
9 lending more difficult, make losses on other capital
10 assets.
11 And then you have the elements of illiquidity
12 that clearly were coming from rising credit spreads
13 coming from changing macroeconomic conditions. So I
14 don't know that you can ... if all 3 were important
15 and all 3 were importantly, at least to my mind,
16 interconnected and I don't know that you can
17 precisely say what their relative importance was.
18 CHAIRMAN. ANGELIDES: Can I?
19 MS. EDELBERG: Yes.
20 CHAIRMAN ALGELIDES: Another question that
21 is related in a way is this. The dot com bubble was
22 about a 5 or 6 trillion dollar shock, the housing
23 bubble was about a 5 to 6 trillion dollar real
24 shock, the latter appears to have cruised to
25 financial crisis, the former did not, why?

1 DR. SUMMERS: The largest simple
2 explanation of it-
3 CHAIRMAN ANGELIDES: We're doing our dirty
4 laundry, these are the debates we've been having.
5 We're letting you adjudicate all of them.
6 MR. SEEFER: Or suck you in, 1 of the 2.
7 DR. SUMMERS: In many ways it's an
8 incomplete answer, but I think the first sentence
9 is that if Larry Summers loses a dollar then he's a
10 dollar poorer. As a consequence, he will spend
11 less, maybe he'll spend a nickel less, that way
12 he'll lose the dollar over his life. Maybe he'll
13 just feel he's got to get it back this year, and
14 he'll spend a dollar less.
15 If a bank that has a tier 1 capital ratio of 5%
16 feels a need to maintain that 5% tier 1 capital
17 ratio loses a dollar, then they have to rein in $20
18 of balance sheet activity, and so it's the
19 difference between the nickel when the assets sit
20 proximately within an individual who is going to
21 spread it over time, and the $20 when the assets are
22 sitting heavily at a levered financial institution
23 that I think is the beginning of understanding why
24 it's so much more serious.
25 COMMISSIONER HOLTZ-EAKIN: So that was my

1 first answer too, 1 was leveraged, 1 wasn't. So my
2 next question is, why? Why didn't we see this sort
3 of derivatives and financial innovation against the
4 dot com stock bubble that we saw against the housing
5 bubble?
6 DR. SUMMERS: Can I ask for clarification
7 here?
8 COMMISSIONER HOLTZ-EAKIN: Sure thing.
9 DR. SUMMERS: I guess the leverage was
10 inherent in the nature of, of course some of that
11 stock would have been leveraged, correct? Not
12 nearly to the same extent.
13 COMMISSIONER HOLTZ-EAKIN: That's where
14 I'm going next.
15 DR. SUMMERS: Okay. I think that would
16 be. It's been a while since I was a more pure
17 academic, and thought about-
18 COMMISSIONER HOLTZ-EAKIN: Welcome to my
19 club.
20 DR. SUMMERS: Thought about these kinds
21 of questions Doug, but I think 2 aspects that 1
22 might want to think about are the volatility, at
23 least as it was judged as of that time, associated
24 with stocks, was very substantially greater than the
25 volatility associated, I mean any theory of leverage

1 would emphasize that you lever more that which is
2 less volatile. And the volatility of stocks was
3 quite different.
4 Second, the leverage associated with commercial
5 real estate. I think that's probably the most
6 important thing. Second thing is people like to
7 live in their homes. People like to begin living in
8 their homes that they are going to own at a
9 relatively young age, before they have accumulated
10 sufficient assets to buy it. And therefore the
11 substantial leverage derives from the desire to live
12 in a house before one is in a position to buy the
13 house for cash. In contrast, the dominant, sort of
14 the dominant role of housing is to be lived in. A
15 dominant role ultimately is of stocks, is to prepare
16 for one's retirement or to save. So if you look at
17 the leverage of stocks in the United States, the
18 feasible amount of leverage is much less than it
19 would be on houses. Nobody can borrow 80 percent on
20 their stocks, because of the different volatility,
21 but for the most part, stocks are not levered to the
22 extent that they could. To the extent that they
23 could be levered, reflecting judgements about risk
24 and return and savings for retirement, and the
25 degree of volatility that would be associated with a

1 levered portfolio isn't something that most people
2 would be likely to want. You do see substantial
3 leverage in the small business area, and you've seen
4 some of the kinds of adverse developments, vicious
5 cycles in community banks and the like.
6 MS. EDELBERG: But that gets us into
7 foreclosure crisis, some part of our foreclosure
8 crisis. At least the 1 before you get the feedback
9 effect from the economy tanking. But that doesn't
10 necessarily get us ... so I can understand
11 households leveraging, typically leveraging their
12 home gets us maybe more foreclosures. But it
13 doesn't get us why the financial system didn't
14 figure out how to leverage the dot com bubble. And
15 certainly at the time there was lots of rhetoric
16 about how we're in a new economy, stock prices are
17 never going to come down, it's a brave new world.
18 So why didn't the financial system figure out how to
19 do this? Why did they only do this with housing? Is
20 that it?
21 Dr. SUMMERS: Well I think part of the
22 answer to that, partly volatility-
23 MS. EDELBERG: You said volatility-
24 DR. SUMMERS: Volatility. You know I
25 think relative to what's actual volatility. It's

1 often said that people have a tendency to confuse
2 price discovery with price volatility. And so you
3 see in the stock market a price every day, it goes
4 up 100 points or it goes down. You don't see the
5 price of your house everyday. If there was a mark
6 to market price for your house everyday, it would
7 appear quite volatile. Not seeing that price, you
8 probably think of the differences in volatility as
9 being rather less than... think of the difference in
10 volatility as being even greater than it in fact is.
11 CHAIRMAN ANGELIDES: Can I ask one last
12 question, and then I will leave all of you to finish
13 this up, and then I will eagerly await reading the
14 whole transcript. But I would like to ask you 1
15 question. So looking back, as we all know,
16 hindsight is 20/20. Very few of us are perfect at
17 calling things, right time, right place. If you
18 were to look back at your service during the Clinton
19 Administration and you were to look at frankly
20 mistakes or errors or things you would have done
21 differently that may have been foundational. Not to
22 causing the crisis, but may have been contributors
23 to. What do you think are the biggest markers you
24 look back on? And I say that not just
25 personally,it's not a gee, would I Larry, if you

1 look back in terms of policies undertaken in the
2 late 90's, were there policies undertaken that may
3 have accelerated, exacerbated, sewn the seeds in
4 some way of this that, on reflection, part of this
5 process is to reflect back at what we did and should
6 have done differently. Hopefully with the mind of
7 making different judgements in the future.
8 DR. SUMMERS: Well I think the financial
9 reform bill, without getting into its details, that
10 is under discussion today reflects something that is
11 fairly close to my thinking, and I suspect the
12 thinking of many of us who served in the Clinton
13 administration.
14 As to what type of structure best reduces the
15 risk of financial crisis, if we had been more
16 successful in calling, in recognizing the need for,
17 foreseeing the need for, applying political pressure
18 for and in legislating the kinds of measures that we
19 have now judged and we now see as essential, I think
20 that would have put the country in a better position
21 than it was, coming into this crisis.
22 I say that with the recognition of on 1 hand
23 this bill proved to be not perfect, that's always
24 the case, and with the recognition that markets
25 changed very, very dramatically during the 2000 and

1 after period. So it would in some areas probably
2 have required great foresight. And with the
3 knowledge that the political constellation, in terms
4 of the appetite of Congress for regulation in
5 various areas was quite different in the 1990's.
6 But I guess when I asked myself what I would
7 have wished, it goes back to the kinds of proposals
8 that we are now putting forward.
9 MR. ANGELIDES: Well sir, just to probe
10 that, just a little. So the "Shadow Banking
11 System", a system of relatively unregulated or
12 lightly regulated institution, many depend on short
13 term money. Did people see that there would be
14 risks inherent in that system or just not identify
15 with that point? The calculation on derivatives was
16 that there wouldn't be the kind of growth in the
17 marketplace? And again, it's very hard to be
18 prescient. Was it mostly that they were unseen
19 risks, or that the political calculus just isn't
20 there to move on risks unless they become wholly
21 evident?
22 DR. SUMMERS: I think others would have to
23 sort of go back and try to... I think it may be
24 useful to do this kind of thing to think of risks
25 that were present but not recognized. Risks that

1 could clearly have been foreseen and risks that
2 really substantially emerged after 2000.
3 And I think, I don't doubt that there were
4 elements of all 3. I'm not sure that I could
5 distinguish in a careful way what the proportions of
6 those 3 categories of risk were.
7 CHAIRMAN ANGELIDES: Okay, 1 last one on
8 this. In terms of, for example, risks recognized
9 and not acted upon, can you identify any of those
10 from the '90s and 1 other, looking back, the most
11 substantial risk present, but not fully recognized?
12 DR. SUMMERS: Well I think the risks that
13 were probably recognized, I'm not sure that I
14 understand the 2 parts. Well the first was
15 recognized and not fully acted on. What was the
16 second?
17 CHAIRMAN ANGELIDES: And that was present,
18 but at the time not recognized, but looking back and
19 saying, okay, that's the 1 where winding this clock
20 back, that was a ticking time bomb?
21 DR. SUMMERS: You know, I think that with
22 respect to risks that were recognized but not fully
23 acted on, I think the sets of risks associated with
24 the mortgage market and housing finance were
25 recognized by many, and not... the system didn't act

1 as fully on them as we would have liked, or than
2 many would have wished.
3 I'm not sure that I can give an answer, in
4 terms of risks that were recognized that were there
5 at the time, but not recognized. There are clearly
6 a set of issues around derivatives, where it's very
7 clear that by 2008 our regulatory frame work with
8 respect to derivatives was manifestly inadequate.
9 It's clear that there were derivatives extant
10 in the 1990s. It's clear that the derivatives that
11 proved to be by far the most serious, those
12 associated with credit default swaps increased 100
13 fold between 2000 and 2008, and it's clear that
14 some, including Commissioner Born warned about
15 derivatives very strongly in the 1990s. And so
16 whether derivatives constituted an area where the
17 situation evolved very substantially, the warnings
18 that we gave this area needed to be continually
19 watched, weren't heeded as credit default swaps
20 rose, or whether an alternative way to think about
21 it would be that there was a risk there that was
22 foreseen at the time, that was not adequately
23 perceived at the time.
24 A question of interpretation on which different
25 people will take different views.

1 CHAIRMAN ANGELIDES: I appreciate it very
2 much. Thank you, and I'm sorry for having to exit,
3 but as I said, I know that my colleagues here will
4 ask better questions than me, and I look forward to
5 seeing the transcript. Thank you very much.
6 DR. SUMMERS: Thank you, Mr. Chairman.
7 CHAIRMAN ANGELIDES: Thank you.
8 MS. EDELBERG: Do you have any questions
9 on derivatives? This seems like a good time.
10 MR. SEEFER: That's actually, I was going
11 to say a perfect segway.
12 CHAIRMAN ANGELIDES: I wandered it in for
13 you.
14 MR. SEEFER: One of the things that we're
15 asking everybody on derivatives is just their
16 general opinion of what role do you think, if any,
17 derivatives played in the financial crisis? Whether
18 there as a cause, whether as a problem or anything?
19 And then not just predatory derivatives, but any
20 kind of derivatives.
21 DR. SUMMERS: You know I think the
22 overwhelmingly, clearly the events at AIG and AIG's
23 use of credit default swaps to take on a set of
24 risks that then proved to threaten its viability,
25 which, given it's interconnection, threatened major

1 systemic risk, was obviously a critical aspect of
2 understanding the crisis.
3 There are issues it seems to me a variety of
4 issues to explore there, where I'm just not into -
5 what my duties have been for the last 18 months -
6 into the details enough to make judgments.
7 Clearly if their unregulated derivatives
8 affiliate had been extensively regulated in the way
9 proposed in 1999, but was never something Congress
10 was prepared to act on, that might have offered the
11 prospect of reducing the risks.
12 There are many who argue that the real source
13 of the problem was AIG's desire to take risk and the
14 lack of comprehensive risk regulation of AIG. And
15 so even if somehow there hadn't been derivatives,
16 they would've taken the risk, and if their overall
17 risk taking had been regulated, it would have worked
18 their way into the problem.
19 There are others who argue that if their
20 derivatives activities had been non-bilateral, had
21 been through appropriate clearing arrangements, that
22 involved the appropriate posting of margin, it would
23 not have been possible to build up the risk
24 positions that were built up. And I think all those
25 positions have a certain logic to them, and the

1 approach that we've taken with respect to
2 derivatives in the legislation, that many people
3 have taken, since they are a matter of public
4 record, is really to address all the possibilities.
5 To insist on comprehensive regulation of AIG,
6 and others systemically important financial
7 institutions, which should independent of any
8 regulation of particular instruments have offered
9 the prospect of eliminating or attenuating that
10 problem. And also to require any major financial
11 participants, the use of substantially enhanced
12 transparency, and the use of appropriate clearing
13 arrangements. So that however 1 judges that
14 historical question, there is an element of belt and
15 suspenders in the regulatory approach of this
16 proceeding.
17 There is an important set of issues which I
18 don't have a clear set of views on. Having to do
19 with, aside from the situation at AIG, what were the
20 roles of derivatives activity, both in leading to
21 runs of various kinds on major financial
22 institutions at difficult moments in complicating
23 the process of workout in leading to market
24 breakdowns. My impression is that many people at
25 least feel that in terms of the continued operating

1 and functioning of derivatives, markets, that was
2 less of a major problem that many people would've
3 expected, given the magnitude of all of the other
4 problems.
5 But no doubt, derivatives issues played an
6 important role in the thinking with respect to many
7 different aspects of the work out of the crisis.
8 And as I say, the judgment we've come to is that a
9 sort of belt and suspenders approach, that gets at
10 derivatives is part of risk regulation of
11 institutions, and gets at derivatives markets per
12 se, offers the best prospect of success, and clearly
13 for some variety of reasons, I think there is a
14 sense that the, that credit default swaps in
15 particular raised questions.
16 There are questions that I think are very
17 important for financial regulation that are not just
18 systemic risks questions. Issues going into
19 transparency, in their execution, issues with
20 respect to manipulation and market integrity. And
21 there are a set of issues that have arisen for some
22 time, with respect to, in the equity area that with
23 the rise of credit default swaps, now exist in the
24 credit default swap area of control rights divorced
25 from economic or their non-coincident with economic

1 interests.

2 ALl of those require, and I believe are

3 receiving regulatory attention. As a consequence,

4 all of this has arisen really over quite a

5 remarkable developments, in terms of these markets

6 where some of these instruments, particularly credit

7 default swaps just about doubled every single year

8 from 2000 on.

9 MR. SEEFER: Let me ask you, in terms of

10 what you said about if AIGFP would have been

11 regulated as proposed in '99. Well the CFMA passed

12 and that wasn't the case.

13 DR. SUMMERS: Excuse me.

14 MR. SEEFER: Sure.

15 DR. SUMMERS: You didn't mishear me, but I

16 think you may have misunderstood CFMA. The proposal

17 that I referred to is a proposal that would have

18 regulated the risk taking capital adequacy and the

19 like, with respect to derivatives affiliates.

20 CFMA went in various ways to the ability to

21 regulate the market, the market and the process of

22 trading on derivatives, as distinct from the

23 financial position of affiliates or the entities

24 that traded derivatives.

25 MR. SEEFER: Thank you. What I wanted to

1 ask you, in terms of the regulation not of the
2 market but of the entity. AIG was regulated, the
3 OTS was it's consolidated regulator. So there was
4 regulation and I believe they had jurisdiction,
5 since they were a consolidated operator, to look at
6 FP. Any opinion on the role of regulation in AIG?
7 DR. SUMMERS: Well I think it's, again
8 there are various aspects of macro and the financial
9 markets have been professional preoccupations of
10 mine. Structure of financial regulation has not
11 historically been so. You'll be able to find people
12 with much greater expertise than I have. But I
13 think it's fair to say that it is very widely felt
14 that the regulation of AIG on a consolidated basis
15 by its consolidated supervisor, DOTS, was manifestly
16 inadequate. In addition to the results on evidence
17 of form, the extent of scrutiny, extent of analysis
18 and reporting. One could buttress that conclusion,
19 although I'm not the one that's informed enough to
20 do it.
21 My impression is that the view is quite widely
22 held that the regulation was inadequate, if you
23 believed that systemic regulation of such
24 institutions was appropriate. That the regulation
25 was inadequate, even without reaching the judgment

1 about the results of the regulation.
2 COMMISSIONER BORN: May I ask a couple of
3 follow-up questions on things that Larry has already
4 talked about a little bit. On the credit default
5 swap funds, some of the issues we're looking at, and
6 I wondered if you had thought about these things and
7 had an opinion on them.
8 One, whether credit default swaps tended to
9 fuel or accelerate the securitization process,
10 because AIG was insuring through CDS the top AAA
11 tranches, and thereby allowing them to be AAA rated
12 and to seem like very secure investments?
13 DR. SUMMERS: I don't have expertise to
14 make that judgment, either in terms of detailed
15 knowledge of what it was that AIG was insuring. I
16 suppose the question would arise, would there have
17 been other ways. Without insuring them, they could
18 have written a letter of guarantee on them. Which
19 would have been tantamount to insuring them.
20 So whether one should think of that in terms of
21 a credit default instrument or not, I think it is at
22 least something one would want to study. But I
23 don't know enough about it to have a view. I think
24 that's part of it.
25 COMMISSIONER BORN: Well the second

1 hypothesis we're looking at is, there were
2 instruments called synthetic CDO's, which were
3 composed either entirely or partly of credit default
4 swaps, rather than mortgage-backed securities. They
5 were in essence credit default swaps on existing
6 mortgages or existing mortgage-backed securities or
7 existing CDOs. And we are looking at whether that
8 amplified the market for securitization and thereby
9 made it a larger market, and continued it for a
10 longer period of time, after the mortgage market was
11 really shutting down, so there weren't
12 mortgage-backed securities available to fund these
13 things?
14 DR. SUMMERS: I don't have enough granular
15 knowledge of the quarter by quarter evolution of the
16 market to be helpful. I think in general, I think 1
17 needs to always ask the question, if a financial
18 market participant has for whatever reason, bad
19 judgment in grade, misaligned incentives and
20 intellectual misunderstanding of how the world is
21 working, has decided to take on a certain risk,
22 whether by regulating instruments rather than by
23 regulating that financial institution, one is going
24 to succeed in getting them not to take on that risk
25 and how that's going to happen, is a question that I

1 think one always has to keep in mind in designing
2 regulatory regimes.
3 The orientation that runs through the financial
4 regulation bill is towards a belt and suspenders
5 approach, as you force a lot, you regulate capital
6 if you're systemically important, you regulate
7 transparency in general so that people can see
8 what's going on and see instruments where there are
9 particular problems, you also regulate there.
10 But I would worry a little bit about the hope
11 that by regulating instruments in a world where
12 people can innovate, you will succeed in controlling
13 overall risk taking.
14 COMMISSIONER BORN: Another thing that
15 we're looking at is the need to rescue AIG. And
16 it's potential interconnectedness with other
17 counterparties through the credit default swaps,
18 through other kinds of mechanisms. I wonder what
19 your views are on that?
20 DR. SUMMERS: There are certainly 2 sets
21 of questions that are implicit in that, in the
22 issues that you raise, and I can distinguish between
23 them, but I can't say a great deal about either. As
24 a general matter, my view having been in government,
25 having been out of government, is that when you're

1 out of government is very difficult to know all of
2 the information, all the pressures, all the
3 constraints, and all the opportunities on those that
4 are making the decisions. So it's very, very
5 difficult to second guess or ask questions. I
6 wasn't in government at the time.
7 I would find it very surprising if a compelling
8 argument could be made that simply allowing AIG to
9 file for bankruptcy and letting the chips fall where
10 they would, in a way that was done at Lehman would
11 have been an availing strategy at that moment.
12 With respect, that would have seemed quite hard to
13 believe to me that, that would have been a viable
14 option.
15 With respect to the way in which transactions
16 were handled, and then respective decisions that
17 were made, I have enormous respect for the people
18 who were in authority at that time, and the sense of
19 the fog of war that would've surrounded the
20 decision-making at points like that. But I don't
21 have nuanced opinions on the ways in which decisions
22 were made or the particular structures that were
23 adopted, or the ways in which dealings were made.
24 COMMISSIONER BORN: One last question. In
25 terms of the runs on investment banks, other

1 institutions, do you think that there was any role
2 played by with respect to derivatives in those runs?
3 Do you have any views on that?
4 DR. SUMMERS: I alluded to that
5 possibility, to say that I didn't know enough to say
6 to be confident either yes or no. My impression is
7 that there were probably issues involving the
8 posting of margin bilaterally, and concern about
9 margin being lost in the event of failure that led
10 to runs, and contributed to the pressure on
11 institutions, which in turn contributed to their
12 desire to hoard cash, which contributed to the
13 freezing of the system. And that there was, again,
14 my impression, not my firm knowledge, is that there
15 were behaviors that served to strike for the case
16 for more multilateral, joint and severally liable
17 kinds of clearing arrangements, so the kind that are
18 contemplated in this legislation, that I might say
19 is the kind that in the 90's, mid 90's were
20 essentially prohibited by law. And where we worked,
21 including in the CFMA to establish permissive
22 frameworks that enabled the clearing houses to
23 engage in a certain amount of suasion. Which is of
24 course, is a step significantly short of the step
25 that's contemplated in the current legislation.

1 Which is essentially to mandate for a wide swaths of
2 these transactions, the use of clearinghouse house
3 clearing arrangements.
4 MS. EDELBERG: So going to an earlier
5 government intervention when the market was in
6 trouble, long term capital management. So can you
7 talk about your role in that? And then whether or
8 not you think that any of the government response to
9 long-term capital management created any moral
10 hazard that had an affect?
11 MR. VERRILLI: Just in terms of the
12 answer. Of course Doctor Summers will answer the
13 question. There is a parallel constraint on his
14 ability to answer during that period of time, to the
15 extent that you're asking about his communications
16 with President Clinton, or deliberations. That
17 would be... I think we would have to have President
18 Clinton's lawyer here. That would be off limits,
19 for the same reasons as the current situation. But
20 with that constraint-
21 MS. EDELBERG: I'll happily defer to
22 whatever you think is,
23 MR. VERRILLI: We'll carve that part out.
24 MS. EDELBERG: Yes.
25 DR. SUMMERS: My personal role as things

1 happened was not large, because my preoccupation was
2 on the international area, where there was plenty
3 going on at that time. I would say that I am
4 probably pretty familiar with . . . I think it's
5 very important to distinguish between what went on
6 in the LTCM context and in a variety of other
7 contexts. Other than sandwich money at the New York
8 Fed, no taxpayer money was involved in the LTCM
9 case.
10 The role that was played by the official sector
11 was a coordination role in brokering what was a
12 mutually advantageous set of arrangements for the
13 various participants. So if I were to think about
14 various events that were generating of moral hazard,
15 I wouldn't be inclined to put great weight on LTCM.
16 A degree of financial cost, subsequent litigation
17 and such on those at LTCM was perhaps not as large
18 as it could imaginably have been, but was large
19 enough that I think any operator would be at very
20 substantial pains to avoid the fate that befell
21 LTCM. I think LTCM did point out a variety of
22 issues around transparency, around regulation of
23 prime brokers. Some of which we pursued at that
24 time, some of which are addressed in this
25 legislation.

1 I also think 1 has to be slightly careful in
2 thinking about moral hazard. Moral hazard is a bad
3 thing, confidence is a good thing. And in a sense
4 anything that is successful in reducing run risks,
5 is that the provision of confidence, or is that the
6 establishment of moral hazard? That's part of why
7 these are such complex subjects.
8 MS. EDELBERG: Well that's fair enough.
9 But certainly market participants, and certainly in
10 retrospect, market participants viewed what the
11 government did with LTCM as extraordinary government
12 involvement. That the government took an unusual
13 step over and above what they typically do, and did
14 it because they thought that LTCM had some sort of
15 systemic role in the economy, or in the financial
16 system? Whether or not there was taxpayer money at
17 stake. I mean there is an opportunity cost
18 associated with government actions. They may do 1
19 thing and not another. They chose to go in and-
20 DR. SUMMERS: No, I don't... we may have
21 different readings of the views about the
22 participants.
23 It was an extraordinary circumstance, and in
24 that extraordinary circumstance government did
25 something that was extraordinary. Perhaps not

1 surprisingly in an extraordinary circumstance
2 government would do something that was
3 extraordinary.
4 We were busy, we had a lot to do, I suppose.
5 But I'm not sure the opportunity cost of a week of
6 the Federal Reserve President and New York's time is
7 a factor, that would loom enormously.
8 MS. EDELBERG: No, I meant the government
9 could actually be going around brokering deals that
10 it thought were to the good of the economy.
11 Elsewhere, the government chooses not to get
12 involved in that activity, because it chooses to do
13 other things, with it's political capital.
14 DR. SUMMERS: I suppose, I think that's
15 fair, and I think that 1 of the reasons for the
16 effort, rather substantial efforts involving both
17 the private and the public sector in the wake of
18 LTCM, was to contemplate rather more satisfactory
19 legal frameworks for the self executing failure of
20 hedge funds, which were a test. Amaranth, there
21 were a number of failures of reasonable sized
22 financial institutions that didn't have the same,
23 the systemic consequences, in part because of a
24 variety of things that were put in trade after LTCM
25 changed settlement procedures, changed margin

1 procedures and the like.
2 There were a variety of special factors that
3 mostly went to urgency, immediacy and externality
4 that lead to the judgements that were made during
5 LTCM. And while there's much that one can question
6 in financial markets, I think it's, at least I have
7 not heard the case convincingly made that some
8 aspect of what happened at LTCM either set a
9 precedent that led to a variety of misguided
10 government interventions, or lead to a set of
11 expectations that somehow contributed to problems
12 down the road. But you know, perhaps there are
13 other arguments with respect to the LTCM experience.
14 MR. VERRILLI: Just, if you could hang on
15 for 1 second. It's about 3:15, so I just want to
16 make sure that we know that we are coming up on our
17 2 1/2 hour limit here. So we have a report that
18 needs to get done, and I know you've got another
19 that has to get done.
20 MS. EDELBERG: Sorry, I'll ask you a
21 question on a different front. Though I do really
22 want to know what you think about what those factors
23 were, but I will put that aside, in leading to one
24 of the extraordinary involvements of LTCM.
25 Shadow banking system versus traditional

1 banking system. There is a question, 1 of the
2 things we're wrestling with is, did different things
3 happen to 2 different financial sectors, or did the
4 same thing happen to both of these financial
5 sectors? And you know, to the extent that something
6 different happened to these 2 different sectors, was
7 it because of the different regulatory environments
8 that these 2 different sectors were in, or is that
9 actually a red herring, and in fact you know, you
10 had talked a little bit earlier about the interplay
11 between the banking sector and capital sector, and 1
12 used to save the other, etc. How do we think about
13 the interplay?
14 DR. SUMMERS: You had a set of problems in
15 the mortgage company sector for example that were
16 not heavily caused by or causal to the banking
17 system. So far as those were important issues, one
18 could probably think of the 2 systems with some
19 degree of separateness.
20 You had a set of issues arising out of
21 securitization, where the 2 systems proved to be
22 auction rate securities, where the 2 systems proved
23 to be rather more closely linked than many had
24 supposed. So I think there were elements in this of
25 both aspects of your question.

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1 MR. SEEFER: So as we wind down; too big
2 to fail. What are your opinions on what makes an
3 institution too big to fail, and how did it
4 contribute to the financial crisis? In looking
5 forward, not looking forward, and do you avoid it?
6 Is the answer simply more capital, more liquidity,
7 or is the answer something else?
8 DR. SUMMERS: Too big to fail refers to a
9 situation where an institution, at least for me,
10 refers to a situation where an institution derives a
11 significant benefit from what the market sees as a
12 government provided put, caused by the fact that its
13 failure would have catastrophic consequences. And
14 if you accept that definition, there are several
15 ways, there's 3 broad categories of approach and to
16 constraining too big to fail.
17 The first is by making failure less likely. So
18 even if there is a perception that the government
19 will come in and will support it if it fails, that's
20 kind of not a relevant factor, because an assumption
21 even ex governments support is that it won't fail.
22 And the agenda for doing that is sort of broadly the
23 regulatory agenda towards the institution, with at
24 least 3 specific elements. Capital leverage
25 standards, liquidity standards, and restrictions

1 which go to riskiness, which goes into everything
2 from compensation arrangements to limitations on
3 proprietary trade or the like.
4 Second category measures systemic measures that
5 make failure more acceptable, clearing for
6 derivatives, multilateral clearing for depravities
7 is 1 such example. Measures which enable the system
8 to survive the failure of the institution.
9 And the third is managers, is what I call or
10 think of as local measures, can make failure a
11 viable option. And that is resolution frameworks
12 which provide for a framework for going through a
13 bankruptcy type of procedure rapidly and with a
14 minimum of uncertainty. Plan your own funeral type
15 arrangements, is a kinder vision in this build.
16 I don't think there's any single silver bullet
17 with respect to, too big to fail. But I think that
18 it can be quite substantially curtailed in the ways
19 that I just described.
20 MR. SEEFER: We are almost out of time, so
21 1 of the things I definitely want to ask you is what
22 haven't you told us, that you think is important for
23 us to know? I know we've asked you a lot.
24 DR. SUMMERS: You gave me a pretty open
25 first question, where I had a chance to touch on

1 every aspect. The only thing I would say in
2 conclusion I guess, is something that I've said in a
3 number of my speeches on this, if you'll permit me
4 on that. If you'll permit the somewhat overdrawn
5 and oversimplified analogy.
6 If you look at the history of automobile safety
7 in the United States, it was dismal, it was
8 terrible. And the first major contribution that the
9 young Daniel Patrick Moynihan made to public policy
10 was an essay he wrote on automobile safety. What it
11 basically said in that essay was that the then
12 prevalent approach, which was based on lots of
13 drivers had, and lots of criminality for reckless
14 driving. Because if we could only get people to
15 drive safely, then we would have fewer automobile
16 accidents. It was basically a terrible failure.
17 And he basically felt that we should move from
18 an approach that was based on human betterment,
19 making people better, to an approach that was
20 directed at making the system better for people who
21 were as they were.
22 I think with respect to the financial system,
23 people are going to be avaricious, people are going
24 to extrapolate from the recent past, people are
25 going take advantage of gambles that are favorable

1 to them. People, whether in the private sector or
2 the public sector, are going to have highly
3 imperfect foresight. So the lesson is that the
4 system needs to be safe for ignorance, and safe for
5 human fallibility. And the system that has those
6 characteristics, that's why some of the themes that
7 I kept coming back to were capital and leverage.
8 Why in a number of different contexts I used the
9 phrase belt and suspenders, why I wanted to allow
10 some overlap in regulatory functions with some
11 separateness of the consumer.
12 And I guess as you think about causes, I would
13 resist the temptation to take a list of causes and
14 make judgments about their relative importance, in
15 favor of thinking about the multiple stages at which
16 an accident might have been avoided.
17 Was World War I caused by the assassination of
18 the Archduke, or was World War I caused by the
19 ascension of Germany and the difficulty of the
20 international system to accommodate the ascension of
21 Germany? I kind of think it's a somewhat sterile
22 agenda to try to distinguish the respective roles of
23 those 2 factors, rather than recognizing that a
24 strategy for maintaining peace can usefully address
25 the events pointed out by both of those things.

1 And I guess my thought would be that if I have
2 not been entirely definitive in answering some of
3 your questions, part of the reflection of the vast
4 amounts that I don't know, and it's in part a
5 reflection of a judgment that there are these
6 multiple levels of causation associated with
7 different levels of solution, that you have to think
8 about with respect to a crisis like this.
9 MR. SEEFER: I certainly don't think it's
10 the plan to look at the 22 sections and assign
11 percentages at the end of the year.
12 DR. SUMMERS: Right.
13 MR. SEEFER: So thank you very much
14 – MS. EDELBERG: But on the flip side, the
15 perfect storm is something I think worth resisting.
16 It suggests that it just happened. That there were
17 so many factors, who could ... you know. I think we
18 need to find something in between.
19 DR. SUMMERS: I'm sure I've been unclear,
20 but I didn't think that I had been that unclear.
21 Nothing in what I've tried to say this afternoon,
22 and certainly nothing in my last thought should have
23 been interpreted as any excuse for fatalism.
24 Indeed, the notion of causation at multiple levels
25 actually has as it's implication that there are

1 multiple independent strategies, the success of only
2 1 of which would have been sufficient. And so it
3 seems to me to suggest that this was a perfect storm
4 is in some ways, it's sometimes invoked. I
5 recognize that the notions of a perfect storm are
6 invoked to suggest a DSX Mac and so that there can
7 be avoidance of responsibility on anyone's part.
8 I've got a rather different view, which is that it
9 requires many contributing elements.
10 And if the navigation system had been better on
11 the ship, if the systems for keeping the ship stable
12 in waves had been better. There are multiple ways
13 in which the accident could have been averted. And
14 I think the more one sees it in that way, the more
15 different avenues one is lead to pursue and the
16 greater the prospect of doing it.
17 In contrast, I think if you take more, and no
18 one here is doing it, the morality play view of a
19 crisis, you are then left with the aspect, can you
20 change the aspects of human nature that Aristophanes
21 and Shakespeare wrote about. And that's probably a
22 more daunting challenge than establishing
23 multilateral clearing mechanisms. That's why I put
24 it in the way that I did.
25 COMMISSIONER BORN: May I just ask 1 final

1 thing? I'm taking from everything that you are
2 saying that you would not attribute the financial
3 crisis to the sole factor of a housing problem?
4 That it may have been 1 of the issues, but
5 obviously it came in the context of all the rest of
6 the activities?
7 DR. SUMMERS: I like to use the metaphor
8 when thinking about the financial crisis of a very,
9 very, very dry forest, into which someone throws a
10 cigarette butt. And then the question is did the
11 cigarette butt cause the fire?
12 Well there is a sense in which the answer to
13 that question is clearly, yes. But there is also a
14 sense in which, I think this is your point,
15 Commissioner. If that cigarette butt hadn't arisen,
16 if it was a very, very, dry forest, there likely
17 would have been a fire in any event. Look, I think
18 a question that, and again I'm just quoting myself
19 from things I've said in the past. That the last
20 generation, we've seen the 1987 crisis, the stock
21 market crash, the S & L debacle, Mexico, LTCM, Asia,
22 Russia, the NASDAQ bubble, Enron, now this. And so
23 what you probably think of this, this financial
24 crisis is much more profound in some ways, but comes
25 off a background of a financial system that has been

1 too often a source of too much instability, and I
2 think that perspective has to inform how we think
3 about its regulation.
4 MR. BARKER: Thank you very much
5 Dr. Summers, for your time.
6 DR. SUMMERS: Thank you.
7 MR. VARRILLI: Thank you. And before we
8 go off the record, I just want to say for the larger
9 group, about 2 things first. That we appreciate
10 very much that you were able to structure this
11 interview in a way that worked for you and for us as
12 well.
13 Second that Chris and I discussed the rules of
14 confidentiality applying to your Treasury Department
15 interviews that we all agree apply here. And what
16 that means as far as we're concerned, is that we are
17 going to review the transcript, decide whether
18 anything is confidential from our point of view.
19 Don't know whether we'll conclude that anything is.
20 But our understanding is, until we have had the
21 opportunity to do that, the contents of this
22 interview and transcript, both will remain
23 confidential.
24 MR. SEEFER: Does the record reflect that
25 everybody is copying? Very good.

1 MR. VARRILLI: That's on the record.
2 MR. SEEFER: Okay, I guess that's
3 correct.
4 MR. VARRILLI: That's correct.
5 MR. SEEFER: Thank you very much.
6 (WHEREUPON, the proceedings were concluded at 4:30
7 p.m.)
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1 I, Charles Hoffman, do hereby certify:
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4 That the foregoing proceedings were taken
5 before me at the time and place herein set forth; that
6 any witnesses in the foregoing proceedings, prior to
7 testifying, were placed under oath; that a verbatim
8 record of the proceedings was made by me using machine
9 shorthand which was thereafter transcribed under my
10 direction; further, that the foregoing is an accurate
11 transcription thereof.
12 I further certify that I am neither
13 financially interested in the action nor a relative or
14 employee of any attorney of any of the parties.
15 IN WITNESS WHEREOF, I have this date
16 subscribed my name.
17
18 Dated: June 8, 2010
19
20
21 ___________________________________
22 CHARLES HOFFMAN
23
24
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