10-1-2009

Gretch Newson's Notes on Oct 2009 FCIC Business Managment and Roundtable Meeting

United States: Financial Crisis Inquiry Commission (FCIC)

Gretchen Kinney Newsom

John W. Thompson

Hal S. Scott

Thomas Greene

Legislative Update:

Tom Green: OTC Derivatives format of 2009 - exception process , etc. out of committee this week

Consumer Agency

Two wild cards: health reform.

Heather: Comment period for SEC revisions to SEC regulations - mutual funds –

Bill: by the time we finish our report – they will not be completely done with their work – no inclined to participate in the comment period for SEC.

PA: staffing directive to Tom – we should have a function here that monitors and reports to senior staff and Commission the major regulatory and legislative updates – regular report.

BG: guiding principals: in sync with what Congress is doing if possible. Perspective: big ideas – that affect men and woman of the nation.

PW: doubtful Congress will concentrate on Fannie and Freddie in the near future.

Keith: quality over speed. Sequence important: consumer agency. GSE proposal due first week in February.

Brooksley: stay focused on our work and not spend too much effort responding to Congress/political needs. Be careful on interim reports.

PA: fact based reports – hearings- anything put out factually based and double and triple checked.

PA: broad view that we should focus on doing job – contribute to politics/Congress if it follows work plan. Directive: to Tom again that he should make regular reports to Commission

KH/JWT/HM: make recommendations

PA: get there first with agreement on the facts with consensus.

JWT: build foundation with facts but install roof with prescriptions

---

TG; Administrative/Personnel.

Furniture/Phones. Emails this week. 20 some professionals. Getting initial cadres hired is focus.

Done 34 interviews out of 248 resumes. Review of resumes. Interview and reference checks at same time. First flight of 6 employees to Chair/Vice-Chair by end of the week. Team leaders and GC and research manager. Stanley Sporkin Lynn Turner.   Need to build the bank of research director – **PA to share email of research director position with Commission**. Objectivity.

Keith: one email address for people who want to be hired. One email address to direct comments to.

Byron: provide materials to staff and distribute to Commission.

Phil: **directive: clearing house for articles. Clipping service – set up on website. Also ability to share with Commissioners - highly valuable articles – special places. Bill: committees do this all the time. BB: routine for fed agencies. Phil: 1) subscribe to clipping service; 2) weekly service of key articles worth the Commission's attention 3) box for Commissioners to share their key articles with one another.**

TG: web presence forthcoming.

Draft work plan:

PA: financial crisis more inclusive/broader than Wall Street.

BT: Structure. This is a political document. As you go through the document – under each of the paragraph is listed the statute inquiry – sets it up as an adherence to the statute rather than what we're going to learn – short on the belief that there is a different structure in explaining the crisis. Would rather see more inclusive structure that may include additional lines of inquiries.

Senator Graham: diagnose the problem. PA: pg 7.

John W. Thompson: Brooksley's outline. Simple 5 questions.

PA: Take out the Statute an you still have the an appropriate outline. Statute directive could/sould be a footnote.

Ketih: likes concept of structure. Suggest modification: backdrop section seems to combine two different concepts: do crisis, then macro economic bubble, then housing, then securitization, then collapse of large institions, then general discussion and specific cases of large institutions, then what policies were implemented and then where we are now. Look at regulators in each of these areas – apply to chonology of work.

Heather: Agrees. Nomenclature move to regulators. Heather: put regulators first - setting then outcome. Heather: font and size put statute on same stature of outline – PA: footnote.

PW: likes structure. Hopes we don't spend too much time perfecting this – changes wil happen. This is a logical structure. Let's get started.

DHE: likes Keith amendment to weave regulators into each section. How will the hearings be structured? How will firms be selected for study?

Tom: consumers at the table, someone who handled securities, mortgage analyzers, panels of experts

PA: top to bottom of the food chain. Hearings have to be done in a way that is informative to the public and interesting.

Keith: risk that person selected could skew and prejudice story. Leans toward academics.

PA: need both experts and real people who were making real decisions.

BB; strongly opposed to limiting hearings to institutions. Doesn't think examination of individual institutions will allow a full story – will allow for reed and fraud within the institution but will not allow us to see bigger picture. Take advantage of expertise

Heather: balance of both players and institutions important. Hedge Fund mananager that put own money at risk and equity analysts that called it.

Phil: hearings that ordinary Americans can listen to and gain knowledge from. Not circus. Important to look at broader issues and also specific institutions.

Roundtable

Keith: have the names of the panelists been given to the press. Phil: (firm) this is a closed session meeting and has not been given to the media as a story.

PA: closed session – informal discussion. Applies to the Commission as well. TY – 15 minutes opening remarks and then interactive discussion.

Martin Bailey first.

Things that caused large financial crisis – large institutions lacked controls. Regulators should have done more. Credit rating agencies and lack of transparency. Continual flow of money into the credit rating agency. Something went wrong in SEC.

Stagnant wages: directly no, indirectly, tis might have impacted the crisis.

Deregulation generally good, but this era had potholes (energy/Enron)

Thinks Fannie/Freddie/FHA did contribute to crisis. Home ownership good but we went too far by encouraging over leverage. Part of the pblem, not whole problem.

Hal S. Scott

General failure in risk management. Accounting failure. SEC said accounting wasn't an impact. This is open to debate – should e of interest.

Mortgage modifications

Probe on what they scale was on fraud and mis-conduct. Tax-payer funding in Tarp could have been reduced by having private sector absorb more loss.

Significant losses due to kind and structure.

Simon Johnson

Blame the greedy banks, but not a populist. Where did the boom come from?

Look at the curve of compensation for investment banking – same schemes as the 1920's.

Discussion:

Hal: most important regulation is people suffer consequences of actions. Need to understand why we cannot impose losses on debt holders.

Martin: continue to work with BASE II.

PW: ow did repelling of glass stegal affect the crisis: Simon:

Martin: crisis started with housing crisis.

Simon: housing, but how it was magnified by the markets.

Heather: to what extent would corporations/regulators act differently if individuals were held accountable? Martin: we do have a corporate governance problem. Simon: unlikely to have huge affect.

Martin to send additional writings on countries w/o crisis. (Australia) Canada? Lesson learned by others?

BB: role of OTC in crisis: Hal = significant factor.

Martin: talk to Darrel Duffey – expert on derivatives

Continuation of Work Plan

Phil summary:

Bill expressed concern about 22 and not letting it be conscriptive. More foot notes than governors.

John that there be a cohesive narrative and get to recommendations after diagnosis.

Keith suggested changes in order with attention to micro and macro and weave regulatory framework into each area.

Doug: Ok on outline and interested in how hearings would work. Not look only at individual institutions but also larger subject matter.

Heather: reinterated recommendations. And giving context to individual institutions and other participants

Peter: Ok –go.

Graham: reflective of leg time line where able.

BB: look beyond companies and larger context.

PA: many ways info gathered. Closed session gathering of info. Public hearings: may be multi days. Span of December – August to do set of hearings. Can't cover all ground in public hearings.

Bill: could hold hearings on either coast and not have everyone there. Only need 3-4 commissioners at hearing to gather input. Byron supportive of meeting outside of DC.   Bill: benefit to the people to vent. PA: when you do a regional hearing you will get regional feedback – report/coverage needs to be national and not local.

Peter: we should be looking at facts and analysis – panelists did so in prepared remarks, but we started asking about recommendations. Need to focus on mandate FIRST. Bill: straw man – we could take 10 years.

BB: **Commission staff should invite panelists to submit other studies (by other people) to the Commission**

Bob: line between diagnosis and prescription not as hard as previously thought Agrees that we should look at market factors.

PA: after math and status of the problem identified by the Commission – have things been addressed or fixed?

PA: in our analysis of the problems – look to other countries and find applicability. Bill disagrees – apples and oranges.

BB: international regulators did just a bad job – don't get too hung up on finding similiararities – wary of structural solutions.

Byron: largest IPO's and securities in Asia, not London/New York

PA: do look at those money centers.

Bill: how do we reach agreement with international community

Keith: most valuable services we can provide to plicy makers is a list of incorrect statements on what caused the crisis.

BREAK for RECORDING DOWNLOAD (2 minutes)

BB: define who the major institutions are that would have failed lest help from Treasury Dept. Check with the Treasury. Come up with the list.

BT: more of a benefit if we examine the evidence – this institution is causative of the crisis.

PA: agrees to develop initial list of institutions. Should be an early product.

BB: will be political issue as a number of institutions.

Heather: companes already preparing for this by sending letters to shareholders saying they only tok $ to help the government

Keith: no way institutions will reveal list of institutions that may have failed.

Bill: no need to follow statute as directive.

Phil: this is a clear directive.

John: we'll be scapegoat if we make this declaration.

BB: need a process for how we interpret this section and apply it.

Byron: ones that went bankrupt and one that received substantial amount from government (Amount TBA).

Heather: probably clear language on what constitutes a bank failure.

Keith: probably not that hard. Hank and Tim already did work by listing those who received money and the add those that did already fail. Add TALF (?) money.

BB: we do have to decide what qualifies an institution (auto companies)

Phil: develop list and have it brought back sooner than later. We'll needs rules to structure selection of specific institutions.

PA: within a week/few days – revised work doc. Sent to Commission. Additional comments: direct to Tom, Phil, Bill. Get initial draft for new employees.

Keith: state timeframe as to when list (etc) will be structured.

PA: by November: draft work plan converted into a timeline GANT chart .

Keith: make work plan public?

PA/Pter/Bill/Brooksley: no.

Other Items of business: Dinner night before. David Moss.have studied crisis over time and government responses. Expert on bubbles and government responses. Pair with Ken Rooff/Carlyn Reinhart.

Should we alwys assume the night before is a dinner. Have the dinner here at FCIC.

Dinner night before.

Luigi Zingales first.

What caused crisis is addiction to risk., short term credit.

Professor John Taylor.

Consider making recommendations like 9-11 Commission. Also, they issued report cards. Would like to report on empirical data he's working on.

First Part: Origins of Crisis

Began in Summer 2007. Money market spreads jumped.

Rapid increase in housing prices.

Was there a global savings glut that caused this crisis (alternative theory). Doesn't add up.

Part II: Why did it continue for so long

Credit problem and problem with banks balance sheets. Thought it was equity – missed the point and made it worse by postponing recognition of real problem (fuel on fire: reduction of interest rates- inappropriate action by the government)

What was explanation for bailing out Bear Sterns – no description on policy and whether government would continue to intervene.

Panic had enormous harm on economy. What caused the panic –most important. Lehman didn't tank until three weeks after Black Day – panic is what caused the crisis. $700 billion request with 2.5 pages of explanation. This showed the world we didn't have a strategy – scary. Rebounds in every index in January after panic quells.

John Talyor – government intervention caused this.

Dr. Stiglitz:

Lots of candidates for what contributed to crisis. Most important contributors: simply a real estate and credit bubble – normal.

Tide Crisis – central banks management of reserves. Basically it was a real estate bubble and the bubble broke. People foret what the factor was that causes the bubble to break.

Look at what was really going on in credit default swaps – who was buying and why. Single biggest bailout was AIG and that was credit default swaps. Legislation enabled that market to grow.

Believes its really the financial markets that failed (similar to Luigi) – also failed to distribute wealth.

Structure of bonuses encouraged excessive risk taking and short sighted behavior.

Credit markets froze because they should – no one knew their balance sheets. Government was ambiguous on who they would protect – blames government for not doing something about corporate governance – it was fundamental opacity of financial institutions to blame.

Most important lesson – private sector will undertake short term risks and this can harm society.

Joe: Regulators (greenspan) so engrossed with notion that markets were efficient and you can't dampen bubble . Warning signs in housing prices to rental, growth in housing, would yield to off balance market.

Luigi: Chris Meyer, Journal of Economic Perspective – no bubble.

Joe: part of regulatory structure should include those who will be harmed by the bubble.

Peter: why were these bad loans made – who wanted these loans? Luigi: $1.5 trillion in sub-prime loans; Peter - $4.5 trillion.

Joe: failure of financial markets and regulation.

Luigi: Bank of Spain – provision more in good times for preparation of bad times – more commitment to public service. Two counties in world that didn't submit themselves to IMF assessment: China and US.

Luigi to deliver paper via Susan.

Joe: Poland taxes and regulators.

Holtz-Eakin and Murren departed at 3:13pm

PA gave directive to TG to provide Commission short paper on explanation of BASEL I and BASEL II.

Byron: was failure in market incentives a primary contributor to crisis? Joe: service providers responsible for restructuring own 2nd mortgages – biased.

BB: OTC as a reason for crisis?

Luigi – lack of collaboration and information major contributor. Big banks hae edge – large players screwing up market to their advantage. John Taylor: if no AIG – we would have had the same thing

Joe: Tax policy encouraged this. Would have taken away capital gains for real estate.

Bill: prime mover – incentive to be opaque – need something to be opaque over – excess flow would have come from somewhere, but at a different level.

OK to provide questions to panelists – get their responses.

Meeting adjourned at 3:37pm

Move to adjourn Wallison/Graham)