2008

**Panel Discussion: Subprime Mortgage Meltdown and the Global Financial Crisis**

William Michael Treanor

Constantine N. Katsoris  
*Fordham University School of Law, ckatsoris@law.fordham.edu*

Jill E. Fisch

Stuart Kaswell

Steven M. Cohen

*See next page for additional authors*

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Authors
William Michael Treanor, Constantine N. Katsoris, Jill E. Fisch, Stuart Kaswell, Steven M. Cohen, Harvey Miller, Gretchen Morgenson, Richard Neiman, Giovanni Prezioso, and Muriel Siebert
LECTURE

THE EIGHTH ANNUAL ALBERT A. DE StefANO
LECTURE ON CORPORATE, SECURITIES AND
FINANCIAL LAW†

PANEL DISCUSSION:
SUBPRIME MORTGAGE MELTDOWN AND
THE GLOBAL FINANCIAL CRISIS

WELCOME
William Michael Treanor¹
Fordham University School of Law

OPENING REMARKS
Constantine N. Katsoris²
Fordham University School of Law

INTRODUCTION
Jill E. Fisch³
Fordham University School of Law

† The panel discussion herein was held at Fordham University School of Law on April 15, 2008. It has been edited to remove minor cadences of speech that appear awkward in writing and to provide sources and references to other explanatory material in respect to certain statements made by the speakers.


³ Jill E. Fisch is the T.J. Maloney Chair of Business Law at Fordham University School of Law and, at the time of this Lecture, was the Director of the Fordham Corporate Law Center. Jill E. Fisch – Biography, http://www.fordham.edu/law/faculty/fisch/main.htm.
MODERATOR
Stuart Kaswell⁴
*Bryan Cave LLP*

PANELISTS
Steven M. Cohen⁵
*Office of the New York State Attorney General*

Harvey Miller⁶
*Weil, Gotshal & Manges LLP*

Gretchen Morgenson⁷
*The New York Times*

Richard Neiman⁸
*New York State Banking Department*

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4. Stuart Kaswell is Executive Vice President and General Counsel of the Managed Funds Association, a hedge fund trade association. He was formerly a Partner in the securities and financial services group of Bryan Cave LLP. Press Release, Managed Funds Association, Managed Funds Association Hires Stuart J. Kaswell as Executive Vice President and General Counsel (Nov. 3, 2008), available at http://www.managedfunds.org/downloads/MFA%20Hires%20Stuart%20J%20Kaswell%20as%20EVP%20and%20General%20Counsel.pdf.


DEAN TREANOR: Good evening, everyone. My name is Bill Treanor. I’m the Dean of Fordham Law School. It’s my pleasure to welcome you tonight to the Eighth Annual Albert A. DeStefano Lecture on Corporate, Securities and Financial Law.

As you know, our topic tonight could not be timelier: “The Subprime Mortgage Meltdown and the Global Financial Crisis.”

I have to say I am just stunned by the quality of the panelists. I know we’re going to have a great discussion.

We actually are on a great roll in this room. The last event that we had here was last week, when we had Justice Breyer and Justice O’Connor speaking about judicial independence, with the Chief Justice of Ghana in the first row. And we made today’s Times editorial page. So that’s the standard. But I know this group will be able to achieve even better things. It’s very exciting.

One of the things that we are proudest of at Fordham Law School is our incredible business law program. We are ranked in the top twenty

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in the nation. We have an amazing business law faculty, full-time faculty, adjunct faculty — a group that I think is really unrivaled. Among the full-time faculty members whom we have here tonight are Susan Block-Lieb; Gus Katsoris, from whom you will be hearing in a minute; Sean Griffith; Richard Squire; Linda Sugin; Marcella Silverman; Carl Felsenfeld. If my eyes were better, I would probably be able to pick out even more members of the faculty. Thank you all for coming here tonight.

We have as our organizer the Fordham Corporate Law Center, which was established in 2001 under the leadership of John Peloso. The current chair is Paul Soden. We have a brilliant Faculty Director, Professor Jill Fisch, with whom I’ve taught corporate law and theory, so I know personally how good she is. She is our T.J. Maloney Professor of Business Law. And we are joined by T.J. Maloney here tonight, in the front row.

Jill is assisted by Professor Caroline Gentile, who has done a great job in putting this together.

The current Chair of our Corporate Center is Paul Soden, who is with us here in the front row.

I want to make sure that you all know that we have our Journal of

18. See supra note 2.
26. See supra note 3.
Corporate and Financial Law\textsuperscript{29}, which is really more and more influential. We were cited by the Supreme Court in the \textit{Arthur Andersen} case.\textsuperscript{30} We’ve got recent issues of the \textit{Journal} outside.

We are incredibly proud of this series. In the eight years that we have had the DeStefano Lecture, we have \[had\] a series of brilliant lecturers and panels that have done so much to illuminate business law topics.\textsuperscript{31}

I’d like to acknowledge, representing Mr. DeStefano’s firm, Becker Ross\textsuperscript{32}, Partner Howard Justvig\textsuperscript{33}, of the Class of 1976, who is joined by his wife Flora and brother Gerard.

Without further ado, I want to turn matters over to Professor Gus Katsoris, a legend, who will deliver formal remarks. Then we will be hearing from the equally legendary Professor Jill Fisch.

Gus?

\textbf{OPENING REMARKS}

\textbf{PROF. KATSORIS:} Good evening ladies and gentlemen.

On behalf of the DeStefano family, I would like to welcome you to the Eighth Annual DeStefano Lecture. Unfortunately, the family could not be with us tonight, but send their regrets along with their warmest regards.

These lectures are being sponsored by the firm of Becker Ross. The lecture series bearing Al’s name has had a most distinguished track record.

I would like to reflect upon the Second DeStefano Lecture in the year 2002, when we explored the explosive topic “Enron: What Went Wrong?”\textsuperscript{34} I had the pleasure of chairing that panel, which included

\begin{footnotesize}
\textsuperscript{31} See Fordham Law Corporate Law Center, Highlights of Prior Programs, http://www.fordham.edu/law/faculty/fisch/priorprograms.html [hereinafter Highlights].
\textsuperscript{32} Becker Ross, LLP is a law firm located in New York, N.Y. See Becker Ross, LLP, Marhub NY 4532571 (LEXIS).
\textsuperscript{33} See Howard Justvig – Biography, Marhub NY 453257 (LEXIS).
\textsuperscript{34} Symposium: Albert A. DeStefano Lecture on Corporate Sec. & Fin. Law, Panel Discussion, \textit{Enron: What Went Wrong?}, 8 Fordham J. Corp. & Fin. L. 1 (2002)
\end{footnotesize}
Kurt Eichenwald, author of *Serpent on the Rock*, and one of the leading financial writers of *The New York Times*; and Dan Dooley, who is nationally recognized as one of the foremost forensic accountants. The great abuses that led to the collapse of Enron and the unfortunate demise of the accounting firm Arthur Andersen were frankly and openly discussed that evening.

Shortly thereafter, the remedial legislation, called Sarbanes-Oxley, was enacted to impose greater accountability and transparency, thus helping to prevent future disasters like Enron.

However, if anyone thought that legislation alone would bring an end to economic meltdowns, they were sadly mistaken, for last summer we discovered there was a new virus in our midst, called subprime mortgages. Moreover, this virus was not contained to subprime mortgages, as it opened the floodgates to such issues as: bank liquidity, the infusion of capital from sovereign wealth funds, restrictions on student loans, the contraction of consumer credit, the

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37. See generally Enron Panel Discussion, supra note 34.
uncertainty of counter-party guarantees, potential downgrading of bond insurers, auction rate securities, naked short selling, and the elimination of the uptick rule, just to name a few.

Admittedly, the Enron debacle and the present problems are distinguishable. But there is a common denominator, and that common denominator is greed.

Ironically, a few years ago, in 1999, with the removal of the barriers to bank diversification by the repeal of Glass-Steagall, we were led to believe that such diversification would lessen the overall exposure to risk. How wrong they were, as we have recently witnessed some of the major players involved in this subprime morass experiencing the collapse of their market value.

Before we discuss tonight’s topic, I would like to say a few words about the man after whom this lecture series was named, Al DeStefano.

Al stands for the best Fordham Law School has to offer. He graduated first in his class, went on to become a partner in the Becker firm, specializing in corporate matters and mergers and acquisitions. In his spare time, he devoted himself to numerous charitable endeavors.

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45. See James J. Eccleston, Escape From “Auction Rate Securities”, 154 CHI. DAILY L. BULL. No. 67 (Apr. 4, 2008).
As an adjunct member of our faculty, he shared his enormous knowledge and experience with our students. Most importantly, Al was straight as an arrow. What you saw was what you got.

Through this lecture series we hope to remind ourselves of our mission: to produce skilled professionals of character, integrity, and compassion – people like Albert A. DeStefano.

Events of the last decade have shown us the enormous breakdown in ethical and professional standards. Greed has replaced compassion. Self-interest has replaced loyalty. Enrichment has replaced righteousness. Deceit has replaced transparency.

Many can share in the blame, starting with the mortgage brokers or loan reviewers, or the lenders and investment bankers who transferred subprime mortgages and securities and sold them throughout the world. Lawyers, regulators, and rating agencies were not much help, either.

Had the skilled professionals involved in packaging and selling these products been a little more concerned with their fiduciary obligations to the investing public, we might not be here today. In the case of subprime mortgages and related products, what you saw was not necessarily what you got.

Tonight we are fortunate to have with us a panel of distinguished experts who will explore the causes of this virus and the effect it had on the various areas of our economy, and hopefully tell us whether we are in the third inning, the fifth inning, or the ninth inning of this fiasco; suggest some remedies to alleviate the problem; and, most importantly, to prevent it from recurring.

At this point, it is my great pleasure to present Jill Fisch, who will present the panel. Jill is the Director of our Corporate Law Center. It gives me great pleasure to present to you one of our own, Jill Fisch.

INTRODUCTION

PROF. FISCH: Thanks, Gus.

I’m Jill Fisch. I’m the Director of the Fordham Corporate Law Center. I am here to add my words of welcome to those of my colleagues.

55. Id. at 2084.
56. Id. at 2070-73.
I am delighted to see you all here tonight. I am delighted with our panel. I will keep my remarks brief because I know you really want to hear from them.

I want to thank our panel for being here. I am going to introduce them to you in a minute.

Of course, I want to thank the Becker Ross firm for establishing this lecture series. As Dean Treanor has mentioned, it has been just a terrific series and we have had some really spectacular programs.

I also want to acknowledge the Corporate Center’s Board of Advisors; our Corporate Practice Partners, several of whom are here tonight; and special thanks to Jeanne Rosendale57, who was instrumental in putting this program together. We couldn’t have done it without her, so I want to give her a special word of thanks.

I want to acknowledge the hard work of my colleagues, Professor Caroline Gentile58 and the Executive Director of the Center, Ann Rakoff59. They really worked hard putting this program together and in encouraging all of you to be here.

Just as a reminder, tonight’s lecture marks the Corporate Center’s second public lecture of this academic year. In the fall, SEC Commissioner Paul Atkins60 delivered the A.A. Sommer Jr. Lecture.61 This fall the Corporate Center also hosted its biannual academic conference, the Eugene P. and Delia S. Murphy Conference on Corporate Law.62 This year’s conference, “Protecting Investors and the Securities Markets” (you will agree a timely topic) featured presentation and discussion of papers by leading academics, as well as a keynote address by Delaware Vice Chancellor Leo Strine63.

Finally, we had here at the Law School almost a dozen practitioners over the course of this academic year, many of them loyal Fordham

58. See supra note 28.
62. See Highlights, supra note 31.
alumni, to meet more informally with students in our Business Law Practitioners Series.\(^{64}\)

We are starting to plan next year’s events. Just yesterday, I received confirmation that Elisse Walter\(^{65}\), Senior Executive Vice President [of] Regulatory Policy and Programs at FINRA, has agreed to deliver next year’s Sommer Lecture. That Lecture is scheduled for November 6, 2008. Mark your calendars now.\(^{66}\) This is sure to be a great event.

If you aren’t already on our mailing list and you want to be informed of this and other upcoming programs, send us an e-mail or drop off a business card so we can be sure to keep you up-to-date.

Tonight’s program, as you know, deals with the subprime lending crisis. In planning this program, we were particularly interested in the broad effect that the crisis has had – and continues to have – on the financial markets. We have debated everything, in our planning calls and in the hallways with our students, from the contributing factors to the crisis to the proposals that seemed to emerge almost on a daily basis for regulatory reform.

Although business scandals and crises regularly erupt on the global financial landscape (Gus mentioned Enron, and I too was thinking of Enron; it’s still a recent enough memory that my students recognize the name when I talk about it in Corporations [class]), few events in recent history have had such an extensive impact on the economy and the global markets as the subprime crisis.

To help us understand the crisis, let me turn to the panel. I will introduce them in alphabetical order – and our panelists are conveniently arranged in alphabetical order so you can follow along with me. All of our panelists’ qualifications and credentials are just too numerous to cover in detail, so I hope they will forgive me for a little editing.

We start with Steven M. Cohen\(^{67}\), Counselor and Chief of Staff of the Office of the New York State Attorney General. Mr. Cohen was a Partner in the Litigation Department of Cooley Godward Kronish LLP,
where he specialized in white collar criminal defense and the trial of criminal and civil matters. Prior to that, he served as an Assistant United States Attorney and as a staff attorney in the New York Regional Office of the Securities and Exchange Commission. He is a graduate of New York University and received his law degree from the University of Pennsylvania Law School.

Next in order, Harvey Miller 68, Senior Partner [at] Weil, Gotshal & Manges LLP, where he created and developed the firm’s Business Finance & Restructuring Department which, as I understand it, specializes in reorganizing distressed business entities and represents creditors, investors, and purchasers of distressed businesses and assets. He previously served as Managing Director and Vice Chairman of Greenhill & Co., an international investment banking firm. He is the author of numerous publications and the recipient of a host of awards for distinguished service and excellence; a graduate of Brooklyn College and Columbia Law School.

Gretchen Morgenson 69 is Assistant Business and Financial Editor and columnist at The New York Times. She has covered the world’s financial markets for The Times since May 1998, and won the Pulitzer Prize in 2002 for her “trenchant and incisive” coverage of Wall Street.70 Her articles are a frequent source of authority in legal academia. I ran a LEXIS search yesterday and found that she has been cited in 342 scholarly articles, which is quite impressive, on topics ranging from executive pay, stock options, bankruptcy, scandals on Wall Street, and a host of other topics. Ms. Morgenson began her career at Vogue magazine, and after several years as a stockbroker (so she was down in the trenches there learning the inside story) returned to journalism, working for Money magazine, Forbes, and Worth magazine before joining The Times. She has also written two books. She is a graduate of St. Olaf College.

Richard Neiman 71 is the forty-third Superintendent of Banks for the New York State Banking Department. Immediately prior to joining the Banking Department, Mr. Neiman served as President and Chief Executive Officer of TD Bank USA, a wholly-owned subsidiary of The Toronto-Dominion Bank. Mr. Neiman began his career with the Office

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68. See supra note 6.
69. See supra note 7.
70. Id.
71. See supra note 8.
of the Comptroller of Currency in Washington, D.C., serving as Special Assistant to the Chief Counsel. He then spent ten years at Citicorp, holding a variety of legal and regulatory positions. He returned to Washington, D.C., and served as the Director of Regulatory Advisory Services for PriceWaterhouse. Mr. Neiman graduated from American University School of Government and received his law degree from Emory.

Giovanni Prezioso72 is a Partner in the Washington, D.C. office of Cleary Gottlieb Steen & Hamilton. I once worked there too, a very long time ago. His practice is focused on securities and corporate law matters, and he has served as counsel to a variety of major financial institutions, public companies, and trade associations. From 2002 until 2006, he served as General Counsel of the Securities and Exchange Commission. Under his leadership, his office coordinated the implementation of the enforcement and regulatory provisions of the Sarbanes-Oxley Act, so he knows a good deal about regulatory reform and how to make it work. Mr. Prezioso currently serves as the Chair of the Executive Council of the Federal Bar Association Securities Law Committee. He is a graduate of Harvard College and Harvard Law School.

Muriel “Mickie” Siebert73 is the Founder, Chairwoman, and CEO of Muriel Siebert & Co., Inc. Ms. Siebert has been called “the first woman of finance” – the first woman to own a seat on the New York Stock Exchange, the first to head a New York Stock Exchange member firm, and the first woman Superintendent of Banking for the State of New York. Ms. Siebert is involved with a wide range of nonprofit, civic, and women’s organizations. Although she didn’t finish college, Ms. Siebert holds eighteen honorary doctorate degrees, more than any of us academics. Her autobiography, Changing the Rules – Adventures of a Wall Street Maverick74, was published in 2002.

Last but not least, our moderator this evening is Stuart Kaswell75, a Partner in the Financial Services Group at Dechert LLP and head of the firm’s Broker-Dealer, Financial Institutions, and Market Regulatory Practice.76 Prior to joining Dechert, Mr. Kaswell was Senior Vice

72. See supra note 9.
73. See supra note 10.
75. See supra note 4.
76. At the time of this Lecture, Mr. Kaswell was a Partner in the Financial Services
President and General Counsel for what was then called the Securities Industry Association, now known as SIFMA. He served as Securities Counsel to the House Committee on Energy and Commerce and as a branch chief in the Division of Market Regulation of the Securities and Exchange Commission. Mr. Kaswell has written widely on securities-related matters. He is profiled in *Who’s Who in America* and was recently listed in the peer-reviewed “Washington, D.C., Super Lawyers.” He graduated from Vassar College and received his law degree from the Washington College of Law of the American University.

So as you can see, we have a wide range of experience, expertise, and background. On behalf of the Fordham Corporate Law Center, I welcome you. I’m delighted that you are here.

I now turn over the floor to Stuart Kaswell.

**Panel Discussion**

**MR. KASWELL:** Thank you on behalf of all the panelists. Thank you for that glowing introduction. Considering the previous group here, these are big shoes to fill, but I’m confident the panelists I am privileged to sit next to will meet that challenge.

Tonight we will try to divide this topic up into three pieces. We are going to address them not necessarily in equal time, but rather will try to divide it up so that we have manageable things to talk about.

First, how did we get here? How did the subprime problem start and extend around the world? If you had told me a year or so ago that this would spread all around the world and we would have situations like Northern Rock in the United Kingdom as part of the subprime crisis, I would have been incredulous. I guess I still am.

The second part will be: Where are we now? What’s the current situation? Or, as Professor Katsoris said, what inning are we in? I see the Fed sort of acting like a specialist used to on the New York Stock
Exchange, providing liquidity in circumstances that we haven’t seen in some time.80

Third, and what I think we should spend the most time on, is: Where do we go from here? What should be the remedies that we look for? What are the right answers going forward? Do people have the right incentives to do the right things in the future?

There are lots of different topics that we can bring into this conversation, and I hope we will.

My goal, too, is to make this a conversation, not like so many of the legal conferences where each person gets a couple of minutes, talks about a case or two, and then we move on. I want this to be a much more interactive panel. I will try to encourage everybody to chip in, so if I haven’t heard from you I will probably call on you. I guess they’re used to doing that in law schools.

With that, I would start with: How did we get here? Why do you think we’re in this fix? How did the problem start? How did we find ourselves in such a fix?

MR. MILLER: I think, as Gus said, we have established in the last few years two basic drives of humanity: greed and sex. I don’t know if the order is correct, but certainly that’s it.

MR. KASWELL: Am I in the right room? [Laughter]

MR. MILLER: How did we get here? Because (1) there is no institutional memory. The discussion about Enron and the frauds that occurred there was quickly forgotten.81 And (2) we moved into an economy where greed became good. Gecko82 was a prophet of what was going to happen. If you live in an economy where credit becomes freely available (and we live in a very credit-induced society), you are going to keep expanding that credit base until the cycle is going to end. The bubble is going to burst at some point in time.

We live in a laissez-faire economy. I don’t want to point any fingers at Mr. Greenspan, but regulatory oversight disappeared and exuberance took over.83 I think he used the expression “excessive exuberance.”84

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81. See Sarbanes-Oxley Act, supra note 38 (discussing the collapse of Enron and the enactment of Sarbanes-Oxley).
82. WALL STREET (20th Century Fox 1987).
83. See Jon Hilsenrath, Markets Police Themselves Poorly, But Regulation Has Its
We started with this concept that every single American is entitled to own a home. 85 Whether you can afford it or not, you are entitled to own a home. If you ever saw that play *Glengarry Glen Ross* 86, the people who were selling aluminum siding went into selling mortgages.

When you looked at the setup of what was happening, a mortgage originator got a huge commission on originating a mortgage. 87 The mortgage originator just sold those mortgages to a bank in a warehouse loan until there were enough of those mortgages put together so you could do a securitization. 88 So the originator really didn’t care whether the mortgagor could ever afford to service the mortgage. 89 He got his commission or she got her commission right up front. 90 You put it into the warehouse loan, and as soon as you had enough of these securities, you did a securitization.

What we have done is we have sped up the complexity of the

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85. George W. Bush, President of the United States of America, Remarks at the National Federation of Independent Businesses at the J.W. Marriott Hotel (June 17, 2004) (“We want people owning their own business, we want people owning their own homes . . . if you own something, you have a vital stake in the future of our country. The more ownership there is in America, the more vitality there is in America, and the more people have a vital stake in the future of this country.”); see also Jackie Calmes, *Bush Aides Strive for a Domestic Agenda*, WALL ST. J., July 21, 2004, at A4.

86. DAVID MAMET, *GLENGARRY GLEN ROSS* (Grove Press 1984).


88. See Engel & McCoy, *supra* note 54, at 2060-61 (discussing recent developments prompting investment banks, loan aggregators, and investors to intensify due diligence on subprime residential mortgage-backed securities).

89. See *id.* at 2043 (“Predatory lending is a syndrome of loan abuses . . . A major example is asset-based lending, which consists of loans to borrowers whom the lender knows cannot afford the monthly payments.”).

90. See *id.* at 2080 (discussing unfair advantage of lenders in subprime loans).
market so that you can’t really tell what is in there.91 And people stopped doing risk analysis.92 There was a company in California where for $55 they would confirm that you were an independent contractor.93 For another $25, they would answer telephone inquiries.94 So all you had to do was fill out your mortgage application, pay the $55, and a salesman would help you fill out the mortgage application.

Everybody just forgot about risk analysis. You had a matrix. The theory was that if you [put] enough mortgages into the securitization, you were spreading the risk.95

Then, when they started taking that same rating and creating out of the securitization collateral debt obligations (CDOs)96, you had tranches from AAA down to B.97 What you bought depended on the risk involved. I don’t know who determined that risk except by a matrix. Then you took the bottom tranche, the Bs, put them into a CDO, and suddenly the Bs became AAAs.98 Now, I don’t know how you do that.

91. See id. at 2049 (describing that there is an information asymmetry—mortgage lenders have more information than investors as to the risk associated with these securities.).

92. See id. at 2040, 2049 (discussing turning a blind eye to securitization and risk analysis of subprime loans).


94. See id.

95. See Engel & McCoy, supra note 54, at 2056-57 (discussing how diversification of the loan pool in terms of geography, credit risk, prepayment risk, and legal risk can protect investors from loss).


97. See Engel & McCoy, supra note 54, at 2047.

The tranches are arrayed from the most senior to the most junior, with ‘as many as five mezzanine or subordinated tranches going down the ratings ladder’ from AAA to B. The senior class is the AAA tranche, the mezzanine class consists of the AA and A tranches, and the BBB, BB, B, and unrated classes take the junior position. Any rating of BBB-/Baa3 or above is deemed investment-grade and serves to assuage investors’ concerns about the credit quality of the mortgages backing the securities. Id. (internal citations omitted); see also Moody’s Investor Services, Moody’s Rating Symbols and Definitions, Aug. 2003, available at http://www.rfcpa.com/Moody’s_ratings_and_definitions.pdf (explaining Moody’s nine symbols [Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C] used to designate least credit risk to greatest credit risk).

98. This refers to CDOs-Squared, a certain aspect of securitization. See, e.g.,
In medieval times, that was an alchemist who took a stone and said, “I’m creating gold.”

I can remember being on a panel at the end of June 2007 that was made up of two [representatives of] hedge funds, myself, and a senior vice president from Moody’s. The two hedge fund [representatives] said: “There’s a ‘Perfect Storm’ forming. We can see this because the prices that are being paid are so out of whack with the values concerned.” The gentleman from Moody’s said: “Oh no. This is a contained situation. It will never expand beyond 4.6 percent of the GDP.”

But everybody was investing in this. I had a client who heard about how easy it was to borrow money. He wanted to do a project. We went to Morgan Stanley and we made a loan application. We went up there. We got into this conference room. The bankers came in and they said, “Here’s a proposed term sheet.” My client read the term sheet. Suddenly I saw he got all red. He said, “Excuse me. I have to go to the men’s room.” I was worried about what happened. I followed him into the men’s room and I said, “Bud, what happened?” He said, “I looked at the term sheet, and they gave us so much more than I could possibly ask for, I didn’t know what to do.”

That was the environment that you were in. Everybody thought this real estate boom (if you want to call it that), [and] the home equity prices would continue to increase. That never happens in history.

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100. See, e.g., Mark Whitehouse & Sarah Lueck, Subprime Fears Spread, Sending Dow Down 1.97%, WALL ST. J., Mar. 14, 2007, at A1 (quoting Treasury Secretary Henry Paulson who states that the subprime mortgage crisis is largely contained).

101. Engel & McCoy, supra note 42, at 2045 (stating that today, lenders securitize almost 80% of subprime mortgages).


Although poor underwriting, and, in some cases, fraud and abusive practices contributed to the high rates of delinquency that we are now seeing in the subprime ARM market, the more fundamental reason for the sharp deterioration in credit quality was the flawed premise on which much subprime ARM lending was based:
When it started to fall apart, nobody was aware that all over the world people were investing in these derivatives.\textsuperscript{103} Once that started to happen, you could not contain it anymore. So the subprime crisis has now leaked into other areas.\textsuperscript{104}

As we get more conservative, it begins to be almost like cannibalizing because the banks start to pull back.\textsuperscript{105} Ms. Morgenson wrote an article on Sunday about home equity loans disappearing.\textsuperscript{106} I paid a lot of money to get a home equity loan. I never drew on it because I didn’t need the money. Now I get a notice from my bank that I can’t draw on it. I don’t know if [the bank] can do that legally, but [it is] trying to do it.

You have an environment now where, if you look at the bottom of the feeding chain – the consumer – the consumer’s discretionary income is contracting.\textsuperscript{107} And if you look at it, the consumer today is paying more than 30 percent of his discretionary income for necessities, which means that [he] [is] not using [his] discretionary income to buy other things.\textsuperscript{108} It’s fuel and it’s food. [In addition], the University of

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\textsuperscript{103} Aaron Unterman, \textit{Exporting Risk: Global Implications of the Securitization of U.S. Housing Debt}, 4 HASTINGS BUS. L.J. 77, 86 (2008) (stating that the business of securitizing mortgages has a huge global demand and a seemingly endless supply).

\textsuperscript{104} Bernanke Speech, \textit{supra} note 102 ("[T]he losses in the subprime mortgage market also triggered a substantial reaction in other financial markets.").

\textsuperscript{105} Id. ("We also see considerable evidence that banks have become more restrictive in their lending to firms and households.").


At the same time, continued sizable increases in the prices of food, energy, and other commodities have raised inflation. To some extent, those increases have resulted from strong demand in rapidly growing emerging-market economies, like China and India. But the increases likely also reflect conditions such as adverse weather in some parts of the world, the use of agricultural commodities to produce energy, and geopolitical developments that threaten supplies in some petroleum-producing centers. The higher prices have eroded the purchasing power of household income, adding to restraint on spending.

\textsuperscript{108} Aaron Smith, \textit{Retailers Struggle as Stimulus Money Dries Up}, CNNMONEY,
Michigan just came out with a report that estimates that 5,800 retail stores will disappear this year because consumer confidence is basically gone.109

The whole concept in June and July that we could contain this crisis has really disappeared.110 We still have a situation where major financial institutions are undercapitalized.111 The projection was that the subprime crisis would cost the banks – correct me if I’m wrong, Gretchen – $250 billion in charges.112

MS. MORGENSON: It just keeps going up. That’s what I understand. Now it’s a trillion dollars.113

MR. MILLER: Okay. The other day in the Financial Times it was a trillion dollars.114 But U.S. banks will be $250-280 billion.115 They haven’t taken all those charges yet. Wachovia announced that they have to raise another $7 billion of capital.116 So we have a situation where our financial institutions are under-capitalized, the credit has stopped. And then you think back: Where were the rating agencies in all this?117

MR. KASWELL: Do others agree? Do others feel that this is a good diagnosis of where we are?

MR. COHEN: I probably have the distinction of being the least-

111. See, e.g., Greg Ip, Study Finds Wider Impact of Mortgage Losses, WALL ST. J., Mar. 1, 2008, at A2 (revealing that many highly leveraged institutions hold capital that only amounts to 4 to 10 percent of their total assets).
114. Id.
115. See Mollenkamp & Whitehouse, supra note 113.
117. See Engel & McCoy, supra note 54, at 2060-61, 2068-69 (explaining that due diligence is both the job of rating agencies and something that would help manage risk, yet it is often conducted by rating agencies in a cursory manner since their interest in the investment is not so high and is limited to legal compliance).
sophisticated person and least-credentialed person on the panel. The analysis is perfectly right.

When you take a step back and look at it, from my perspective, which is as a prosecutor [and] you try to understand what happened, there is a simple analysis: it used to be that people sold homes. At some point, the industry changed and what really was happening was the business became selling mortgages, not selling homes. Once it was the sale of the mortgage that began driving the market, things began to change.118

I remember as a kid – I grew up in the Midwest – there was a little town bank where my parents banked. You knew that bank was going to hold the mortgage.

MR. KASWELL: Was Jimmy Stewart the guy? [Laughter]

MR. COHEN: There is an interesting issue as to where Bedford Falls, [the mythic town in It’s A Wonderful Life], was actually located. But it’s exactly right. The Jimmy Stewart bank was the Bedford Building and Loan. There’s that great scene where there’s the run on the bank (I’ll keep it brief, but it’s worth seeing It’s a Wonderful Life119) and the Jimmy Stewart character explains, “Your money isn’t with me. It’s not here behind the counter. It’s in Harvey’s home. That’s where your money is. And Harvey’s money is in Gretchen’s home.” That model ceased to exist. I don’t know when it ceased to exist, but at some point it did.

The very structure of what most lay people understood to be the foundations of a mortgage system changed. So the risk moved away from the people who [and institutions that] were providing the mortgages.120 The mortgage providers began selling mortgages. They had an interest in selling as many mortgages as possible.121 They didn’t have to worry about the risk.

That is the simple analysis of how this whole thing began. If you think about it from that perspective, that paradigm (and it’s easy to do after the fact) you understand where this is going to lead you, which is to a situation in which there is no real foundation for the value of those mortgages.

118. Id. at 2045 (outlining the advent and expansion of subprime securitization into a $525.7 billion industry by 2005).
119. IT’S A WONDERFUL LIFE (Liberty Films (II) 1946).
120. See Engel & McCoy, supra note 54, at 2041.
121. See id. at 2043-44.
MR. KASWELL: When I first learned about this, I thought it was a good thing to encourage people to buy their first house, and we were going to help them, because they didn’t have enough money [for a down payment].

MR. MILLER: If they can service the mortgage.

MR. KASWELL: I understand.

MR. MILLER: If you’re going to do financing at 120 percent of value, then I think you have a problem.

MS. MORGENSON: These homes were sold, I think, on the basis of ever-rising home prices. That is a very important part of the analysis. That has stopped, as we all know.

I would certainly second what Harvey said, which is that everyone along the way in each step of this process basically had an interest in looking the other way.

First of all, you had the loan originator or the mortgage broker. They got paid more in commission for the riskier loans that they would make. So if you were going to do an FHA loan, which is an old standby government-ensured-to-a-degree loan for a fixed mortgage for a thirty-year period, you got paid far less than if you did a two-year ARM that would adjust after two years to a skyrocketing interest rate that virtually no one could withstand, and with a hard prepay penalty, which means that you cannot prepay, you can’t get out of it somehow. Those kinds of loans, which were toxic loans to most people (I don’t care if you’re low-income or high-income; nobody can withstand a huge interest rate increase like these loans were creating) – those kinds of

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123. Mara Der Hovanesian, Nightmare Mortgages, BUS. WEEK, Sept. 11, 2006, at 70.
124. See id.
125. An ARM is an adjustable rate mortgage. See id.
126. See id. (“[B]orrowers who jumped into so-called option ARM loans have another, more urgent problem: payments that are about to skyrocket.”).
127. See id.

With its temptingly low minimum payments, the option ARM brought a whole new group of buyers into the housing market, extending the boom longer than it could have otherwise lasted, especially in the hottest markets. Suddenly, almost anyone could afford a home – or so they thought. The option ARM’s low payments are only temporary. And the less a borrower chooses to pay now, the more is tacked onto the balance.

Id.
loans paid more. Wall Street paid more for those loans to put them into the securitization pools. The mortgage brokers received more to write the loans. Every step of the way, people were paid to look the other way, including the rating agencies. I think that is a very important explanation, or at least part of the puzzle of why we got here.

MR. NEIMAN: I like to characterize it as [a situation] where risk controls and best practices and regulatory supervision did not keep pace with innovation. Innovation at the center of this is really the securitization process.

When you think back on the S&L crisis, one of the things about the S&L crisis is you did know where the risk lay. It lay in the institutions that were making those commercial development loans. The development of the securitization process really was a dispersal of risk. If you had asked anybody back then, “Is that a good thing?” of course it has benefits. Part of the challenges that we are seeing now is that you don’t know where all the risk lies, so you don’t know where to focus your attention and where the risks are in the system.

The other thing the securitization process provided was an opportunity for global investors seeking higher yield. It provided a great opportunity for mortgage loan originators to go out and create with these misaligned incentives products that could be sold through that process to global investors seeking higher yield around the world.

When we talk about rating agencies not being able to keep track of issues – How do you value those instruments? How do regulators assess the risk? [What about] risk managers within those institutions? [What about] compliance and regulators globally? It really is a case where

128. See Engel & McCoy, supra note 54, at 2060.
129. See Der Hovanesian, supra note 123.
130. See Engel & McCoy, supra note 54, at 2055-56, 2068.
132. See Engel & McCoy, supra note 54, at 2056-57.
133. See id.
134. See, e.g., Holly Sraeel, Analytics of The Future? A Question Not Easily Answered, BANK TECHNOLOGY NEWS, Sept. 1, 2008, http://www.americanbanker.com/printhis.html?id=20080828N5GYOMHS&btn=true (discussing the fact that the industry became overly reliant on credit-risk-scoring models that did not give a 360-degree view of borrowers, or adequately address the ‘full range of risk factors in the market’).
innovation was well ahead of supervision.\textsuperscript{135}

MR. KASWELL: Giovanni and Mickie, do you have some thoughts here too?

MR. PREZIOSO: I think my view is probably closer to Richard’s than to some of the others.

I think it is important here to step back and think about incentives and structure. While greed probably played a part in all of this, to the extent people broke laws, which is a distinct issue from greed, we ought to be punishing those people aggressively.

As much as I admire being part of the tail-end of the Baby Boom generation (and we like to believe we exceeded everyone who came before us in every way), I don’t actually think we are setting new all-time records for greed in this generation of human beings. I think it’s something that has been around for a while.

And even the process of securitization is not something new.\textsuperscript{136} In my misspent youth as an associate at Cleary Gottlieb in the 1980s, I did a lot of securitization of mortgages. We didn’t invent securitization three or four years ago. This is not a new thing.

The old world of thrifts, as Richard has pointed out, had its own imperfections that really were what led, not only to a lot of expensive mortgages for people and unavailability of mortgage money in key times when people needed it, but also to the S&L crisis ultimately.\textsuperscript{137}

So I think it is important to step back. A lot of you probably have had a similar kind of experience. I happened to go to grade school with nuns. Whenever you got in trouble with the nuns, if you said, “I didn’t do it,” after the nun is whacking your hand with the ruler, the nun would say something like, “It doesn’t matter. I’m sure you did something else just as bad.” That was true, it was always true, but it didn’t create...


incentives to good conduct and it didn’t change the way you behaved.

I think it is awfully important here to try to be very realistic about what is different as opposed to the things that are with us always.

In thinking about that, what captured some of this for me was a report that the IMF did that just came out last week. They do an annual or semi-annual Global Stability Report. They talked in this report – and they were criticizing their own report of a year ago when they said this – about a collective failure to appreciate and anticipate the breadth of what was happening in the mortgage market.

There are two parts to that I would emphasize: (1) the collective element, and (2) the breadth element.

The collective element is pretty astounding, when you look back. Not only the IMF when it was writing this report a year ago, but [also] Chairman Bernanke as late as June was giving testimony saying that the risk was confined, looked like it wouldn’t spill over into the general economy. If you look at the rating agencies, they weren’t seeing this.

If you look at the investment banks – this is something that is alluded to in the IMF report – it wasn’t that they weren’t doing risk analysis. [Rather], it’s that when they were doing the risk analysis on terms that the IMF refers to as “even assuming unprecedented deterioration of the market,” they weren’t coming up with these numbers, these kinds of losses.


139. See id. at ix.


For the most part, financial markets have remained supportive of economic growth. However, conditions in the subprime mortgage sector have deteriorated significantly, reflecting mounting delinquency rates on adjustable-rate loans. In recent weeks, we have also seen increased concerns among investors about credit risk on some other types of financial instruments. Credit spreads on lower-quality corporate debt have widened somewhat, and terms for some leveraged business loans have tightened. Even after their recent rise, however, credit spreads remain near the low end of their historical ranges, and financing activity in the bond and business loan markets has remained fairly brisk.

Id.

141. See GLOBAL FINANCIAL STABILITY REPORT, supra note 138, at xv-xvi.
You have read about these stories of an investment bank that took a very big loss in the fall as part of what was in fact a bearish bet. They took a very bearish position. They bet that the market was going to go down. They still ended up losing a lot of money, because the way they set up their hedges was structured, [based on their belief that the market] was going to go down. They thought it was going to go down a lot, but they just didn’t think it was going to go down this much.

I think it is interesting to focus on that second element. It’s not that people didn’t see that there were going to be problems in subprime. There were a lot of people who thought there were going to be problems in subprime.\textsuperscript{142} What nobody saw, [however], was how bad they were going to be.

It’s the difference between the ten-year flood and the hundred-year flood. The way you prepare for those is very different. Sometimes in preparing for the ten-year flood you may do things that are actually worse for you when you get to the hundred-year flood.

So I think that focusing a little bit on how it is that so many institutions in so many different positions – admittedly, many with conflicts of interest, which compromise our whole system – depend on people having self-interest driving them and regulators having a broader picture. No one saw this. Why didn’t they see it?

I’m focusing a little bit on the question of transparency in the marketplace, because what we really count on in our markets is signaling from the marketplace about losses, [and] about potential risk. We all watched the central planning model in the Soviet Union and a lot of other countries.\textsuperscript{143} Trying to assemble all the data about risk is a useful thing to do, and indeed I think as we look forward, when we get to that later, we can talk a little about how that would play out in our federal system, getting that information together.

But I also think it is worth talking about how it is that the market – with so many people who I believe were no more or less greedy, no more or less intelligent, no more or less focused on trying to reduce risk than any of our ancestors in other eras of financial ups and downs – got it wrong, and what that says about the [significance of the] lack of transparency and illiquidity in this market as we go forward.


MR. KASWELL: Mickie, what do you think? Is there nothing new under the sun here?

MS. SIEBERT: I think, first of all, [that] all you had to do was to go out to the country. If you went to Southampton, a lot of the old-line stores were replaced by real estate companies. They were either selling or they were mortgage companies. You could see that all over the country.

I think the money was too vast and too fast.

I looked at some of this because I had been asked to testify in Enron, which I did when Enron was going on. I was totally shocked. The loan that I had been asked to go into by Enron was a totally different kind of loan, but it involved out-of-the-country, off-balance-sheet items. I called it “total moral bankruptcy” to the Senate, because it needed the permission and the blessings of the lawyers, the accountants, the Wall Street firms, and the Wall Street banks. Without any of those four the Enron loan that I had been asked to look at would not have been in existence.

I looked at the individuals who were speculating in Florida, in Miami. They would buy apartments they had no intention of living in. They were buying them and they were flipping them. It was so prevalent that some of the builders made people sign a paper that they couldn’t sell it for a year. But it was there, and it was obvious. And these people were getting mortgages.

I just cannot see why some of the people didn’t speak up. When I read about one of our banks bringing the subprime back on to their balance sheet, back into the country, and they needed X billions of dollars to do this – where were the regulators? Where were the accountants? We have to ask these questions.


Enron, in my opinion, represents a total moral bankruptcy. It took more than the officers and the directors of the company. It required the participation of accountants, lawyers, and investment and commercial banks. As we all know, the investing public and employees paid dearly, many of whom will never be able to recoup their losses. It is imperative that this does not happen again.

Id.
I wasn’t smart enough to see the depth of it because it’s not my business. I was shocked as I saw the growth of it and I saw the way it was so totally prevalent.

I did some checking when this happened. I called some people I hadn’t talked to in years. They told me about the way mortgage applications were totally falsified.\textsuperscript{146} They would create an application and create an income.\textsuperscript{147} So it wasn’t a matter of people just buying a larger home than they could afford. It also got into lack of knowledge of some of the people who were buying homes. I heard of one couple in Cleveland. (I’m from Cleveland originally). I did a little checking. They were going to buy a house for $150,000. A working couple. Good history of work. The mortgage broker said, “With rates this low, you can buy a house for $250,000.” So they bought a house for $250,000 and they’re now being foreclosed. Where were our ethics? They seem to have been on a long vacation.

MR. KASWELL: What we hear in different points of view is sometimes the incentives were there and people forgot their morals. Other times people had incentives perhaps only for one part of the transaction but it didn’t apply across the board, and so the system failed. In other cases, it may just have been abuses and people doing the wrong thing. As Giovanni said, that’s another problem.

MR. MILLER: But when you say “doing the wrong thing,” I don’t think you can excuse things by saying “greed has always been here, and therefore it’s not any different than any other situation.” I think greed probably preceded the 1929 collapse. But the 1929 collapse and the Depression resulted in some corrective legislation. We moved into a world of laissez-faire. If you are going to say laissez-faire, greed is going to come to the forefront.

If you take the Carlisle Capital Fund, which goes public in Amsterdam, and a $29 billion fund that leverages up thirty-three times\textsuperscript{148} – this is an overwhelming thing.

\textsuperscript{146} See Kenneth R. Harney, \textit{New Report: Housing Boom Stimulating Mortgage Application Fraud Boom}, \textit{REALTYTIMES}, Aug. 1, 2005, http://realtymag.com/rtpages/20050801_applicationfraud.htm (“What sort of games are people playing with mortgage applications? You name it – everything from little white lies about income or assets all the way up to what the FBI calls ‘air loans’ that are based on completely fabricated information.”).

\textsuperscript{147} See id.

I don’t want to get into politics, but we had a national policy in favor of laissez-faire.\textsuperscript{149} Greed is a great driver, as I said, and people are going to take more risks.

And where did the hedge funds fit into all of this? Where did the private equity funds fit into all of this? That added to it.\textsuperscript{150}

MR. KASWELL: One of the things we all agreed we would do is talk about the issues, as you’ve done, Harvey, but not talk about the politics, which is fine. I think that works us into where we are now. We are in this situation, which I don’t think anybody anticipated. I think we’ve got ourselves in this situation now where [many] people are in terrible shape personally. You read about the stories of the foreclosures rates.\textsuperscript{151} The stories even [show that] people’s pets are being abandoned in homes. The human element of this is really very tragic. And again, some people got into it for all the wrong reasons. Some people were just naïve.

But where are we now? What do people think? Gretchen, what do you think?

MS. MORGENSON: I was talking with one of my sources yesterday who is a very high-level executive in fixed income at a major firm.

I said, “Okay, what inning are we in?” That’s the metaphor everyone wants to use.

He said, “We’re in the seventh inning.”

I said, “Oh, great, that’s great.”

He said, “Except it’s a double-header.” [Laughter]

Every time we seem to think that we’ve gotten to a point where we can start to feel maybe that’s the last shoe to drop, we get another big huge announcement from a firm or bank that needs to be recapitalized or that needs to raise capital, that coughs up some massive loss or other, or has to bring something back onto their balance sheet.\textsuperscript{152}

I truly want to be bullish. I am tired. I have been writing about this


\textsuperscript{152} See, e.g., Eric Dash, Surprise Loss at Wachovia Stirs Profit-Season Unease, N.Y. Times, Apr. 15, 2008, at C1.
for more than a year now. I would love to move on to something else. But I really feel like the way this has leached into the entire financial system means that it is going to be with us for quite a while, I think, throughout this year and into 2009.

One of the reasons is that a lot of the exotic mortgages that were created in the midst of the boom have not yet even reset to high levels. Now, the low rates that the Fed has pushed have helped that and [have] helped to ameliorate that situation. But I think we have a whole raft of loans that were made where people did not have to pay down any principal. These were negative-amortization loans. They only would have to start paying the principal down when the loan became 125 percent of the value of the property. That whole group of loans I think is still out there, possibly waiting to be a problem that hits the system. So I would have to agree with my Wall Street source.

MR. NEIMAN: There is a lot of focus on the impact on the financial institutions and the continued write-downs and the pullback on credit and how that is going to put downward pressure you can’t lose sight of the impact on communities. As a state regulator, it is clear [to me]. In New York it’s interesting because New York as a state certainly hasn’t been impacted as much as the nation. New York’s foreclosure filings are up 10 percent 2007 over 2006. The nation is up 75 percent. States like Ohio, California, and Nevada are up over 200 percent.

But having said that, [some] areas of New York are being disproportionately impacted. Concentrated areas within Brooklyn and Queens

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154. See, e.g., Norm Alster, Some Banks (Yes, Banks) May Be Back in Favor, N.Y. TIMES, Mar. 23, 2008, at BU5 (“[S]ome financial companies . . . [are] positioned to benefit from the flurry of recent Federal Reserve moves to cut interest rates and restore market liquidity. . . . [A]lso, some regional banks are now poised to benefit from plunging short-term rates.”).
158. Id.
159. Id.
account for almost 40 percent of those foreclosure filings, Suffolk and Nassau over 20 percent.\textsuperscript{160} Those are areas – particularly Long Island, where escalating home prices really drove people with a very high-pressure sales force, and provided opportunities for people to purchase homes, particularly using products like these Option ARMs, where the majority of those individuals [were] paying minimum payments.

We are doing a lot of outreach into communities, trying to bring borrowers together with lenders.\textsuperscript{161} One woman I met with recently was facing the loss of her home, a single mother with four children. She said the most disturbing thing that upsets her is not the fact that she is losing her home, but [rather] the fact that there are four or five other people on her very block that are ashamed and embarrassed to come seek help because they really feel that they put themselves into this position. So I think the impact on communities, even in New York, should not be underestimated.

MR. KASWELL: You see at the institutional level [that] debt markets in some cases have just frozen up.\textsuperscript{162} Different institutions have securities in their portfolio that they can’t price. They know they’re worth something, but they don’t know [precisely how much] they are worth. You see lenders trying to borrow money. There are lenders and borrowers out there, but the transactions just don’t seem to be working. The markets seem to have seized. It is a very difficult situation for people who are in business right now.

Harvey, I don’t think you are going to see that situation where your client gets offered more money than he could ever dream of again for some time.

MR. MILLER: I think what we are missing is [that] this has leached over into the commercial area.\textsuperscript{163} The drop in liquidity is affecting commercial transactions; transactions have commitments from financial institutions to close, and suddenly the financial institution or

\textsuperscript{160} See N.Y.S. Banking Dep’t, \textit{New York State Foreclosure Filings by County of One-to-Four Family Homes: First Quarter 2008}, http://www.banking.state.ny.us/pr080529.pdf.


\textsuperscript{162} See, e.g., Leonhardt, \textit{supra} note 80.

the syndicate says, “Oh no, we’re not ready to close.” You see that in 
situations like when] Finish Line and Genesco were supposed to merge 
[and abandoned the deal].\footnote{See Reuters, Footwear Retailers End Plans to Merge, N.Y. TIMES, Mar. 4, 2008, at C4.}

You see it happening in Chapter 11 cases, where suddenly the exit 

Solutia for a long while wasn’t able to get exit financing.\footnote{See Jeffrey McCracken & John D. Stoll, Delphi’s Bankruptcy Exit Hits a Snag, WALL ST. J., Feb. 13, 2008, at C1.} There’s this retrenchment.

Many of the institutions are scared to death that if somebody starts 
liquidating these securities, they are all going to have to mark-to- 
market.\footnote{See John Berlau, Maybe the Banks Are Just Counting Wrong, WALL ST. J., Sept. 20, 2008, at A15; Arthur Levitt Jr. & Lynn Turner, How to Restore Trust in Wall Street, WALL ST. J., Sept. 26, 2008, at A17.} If they have to mark-to-market, what is it going to do to their 
balance sheets? On one hand, if you are a real pessimist, you could say we’re on the edge of a “Perfect Storm.” Then, if you want to say it’s the 
seventh inning and it is only a single game, everything is going to work 
out. [On the other hand], I think there is a real problem about it working 
out. I think the liquidity crisis is very serious for the commercial world. And it has leached right through subprime.

MR. KASWELL: Just because I’m physically removed from the 
folks at the other end, please chime in.

MR. PREZIOSO: I would just add to the point you were making 
about the seizing up and spilling over – [the fact that] a lot of people did 
not forecast this means that a lot of people don’t have confidence in 
what the future is going to bring.

There are a couple of interesting ways in which there has been a 
negative feedback loop that people have commented on here. To the 
extent the markets have seized up and institutions have had to mark to 
model instead of marking to actual market prices, they have to make 
predictions about the future at precisely a time when they have the least 
market information available to them to make those predictions.\footnote{See Ethan Penner, Of Markets and Mortgages, WALL ST. J., Mar. 25, 2008, at}
is a challenge not only to those institutions, but also to regulators.

It creates a dynamic where, if you project losses higher than ever before (let’s say suddenly going to 10 percent loss assumptions) you write down a lot of assets. Those announcements come out. People think the situation is going to get worse. The projections go down even further. So people who were projecting cumulative losses of 10 percent in October, in terms of the rating agencies, were at 19 percent in January, I think. So everybody writes down their assets even more.

The more this goes on, you also begin to see – and this is an inevitable and unfortunately cyclically-enhancing part of the regulatory system – that when times are good, regulators are hard-pressed to actually get people to tighten up capital and lending standards, which is precisely when they should be [doing so], of course. When times are bad (like right now) you have everyone very acutely aware of the scrutiny they are under, in terms of every extension of credit they make. As they go through that exercise, [people] become more sensitive to the way regulators are going to look at what they are doing. [At the same time], regulators are very sensitive to being criticized for not adequately overseeing folks.

I think there is an element that grows out of the lack of ability to see prices in real-time – that is not just at the financial institution level or the instruments themselves, but rather at the level of the real estate market itself, which is one of the less liquid markets out there, and one in which we all know home sellers don’t like to (as they say in the stock market) capitulate to a bear market. Everyone believes their home should only go up in value.

I think that is an element that makes it quite difficult to know when


[According to a] second-quarter survey . . . 62% of the 1,361 homeowners who responded said they believe the value of their home increased over the previous year. But . . . that high level of optimism is out of sync with reality. [D]ata show[s] that 77% of U.S. homes depreciated in value over the past year, while only 19% appreciated.

this is going to end; all those factors, if the market started to turn, would tend by the same token to reinforce pretty quickly a positive feedback loop.

I think the regulators are making a clear effort to show that they want things to succeed.\footnote{See Greg Hitt, Damian Paletta, & Deborah Solomon, \textit{Bailout Negotiations in Disarray}, \textit{Wall St. J.}, Sept. 26, 2008, at A1; see also Karen Richardson & Damian Paletta, \textit{Spitzer Warns Bond Insurers}, \textit{Wall St. J.}, Feb. 15, 2008, at A1.} But I am no prognosticator of the future. In terms of where we are now, I just think not very many people know.

MS. SIEBERT: I think that we have to look towards the accountants. I’m sorry that this panel is not in two weeks, because we would have had all the earnings out by the major banks. The auditors are not going to allow banks just to tell them, “Oh, don’t worry about this.” They are forcing them to bring the assets back. They are forcing them to mark them to market to the best of their ability.\footnote{See Jon Hilsenrath et al., \textit{Goldman, Morgan Scrap Wall Street Model, Become Banks in Bid to Ride Out Crisis}, \textit{Wall St. J.}, Sept. 22, 2008, at A1.}

We had Wachovia out yesterday.\footnote{See Eric Dash, \textit{Wachovia Is Said To Raise Billions Amid Rising Credit Losses}, \textit{N.Y. Times}, Apr. 14, 2008, at A16.} In the next week we are going to have a half-a-dozen of other major banks out, plus a lot of small banks. Then we’ll get an idea. No auditor is going to bend over backwards when they can become the next Arthur Andersen.

I think that we are going to have to look at some of these earnings that are coming out. We are going to have to see whether these loans were brought back to the country or are they still sitting somewhere. I believe that the accountants will have a tendency to be extremely conservative. We will have information on the rest of a lot of financial institutions within a couple weeks.

MR. KASWELL: One of the things I remember from the Sarbanes-
Oxley experience was – and I can’t remember the sequence anymore – this feeling of “well, there were a couple of big companies that failed,” and then it seemed like it was one after the other. If it hadn’t been that sort of succession of problems, I don’t think in Washington we would be talking about Sarbanes-Oxley today. It just seems like [everyone is asking], “Is there any end in sight?” I think that is what crystallized the political consensus in Washington to say, “Yes, it’s time to pass something.” I am not sure where we are in that spectrum right now, but I pretty clearly remember that.

MS. MORGENSON: I think that part of the problem that we are having with a resolution is just from the standpoint of the free market; i.e., vulture funds, people who have an interest in distressed properties, should be starting to tiptoe into some of these markets. But I think that one of the reasons we are not seeing more of that is the complexity of the securitization pools, which create difficulty in even finding out who owns which part of the note. Now you are starting to see bankruptcy judges actually stopping lenders from foreclosing because they don’t prove standing because the note has not been assigned properly. These are all sort of boring little details that get sloughed off during a boom, and certainly did in this case.

This is now making it extremely complicated to extricate good loans from bad in these pools so that people can step in and say, “Look, I’ll buy that piece and this piece and the other piece.” The securitization, I think, contributed to the problem on the up-side and now it is contributing to the problem on the down-side as well.

MR. MILLER: And it’s more complex because in 2005 the Bankruptcy Code was amended so that bankruptcy judges don’t have any discretion anymore to stop repo securitizations from creditors fore-
closing and taking their collateral.\textsuperscript{177} So you have a much diminished Bankruptcy Court.

If you look at \textit{American Home Mortgage} and similar pending cases, the secured lender goes in and says, “You have no authority to stop me from foreclosing,” and [takes its] collateral and [runs]. And then you don’t know who the counter-party is. You really don’t know in half the cases.

MR. COHEN: The other thing that has happened here is that because of the complexity, unlike in past versions of these kinds of crises, there aren’t yet the big bumper-sticker law enforcement cases. We don’t have an Enron. Oftentimes, when you get those big cases, rightly or wrongly (you can argue that you get a skewed perception from looking at the worst examples) they do tend to sharpen the issues.

From a prosecutor’s standpoint, these are very difficult cases to wade into and to get your arms around, in part because, to the extent there was misconduct (and we can argue over whether or not a lot of this was driven by misconduct), it was a very broad, almost institutional, industry-wide accepted type of [mis]conduct.\textsuperscript{179} To the extent that these were broad practices, they ended up being very complex, involving all sorts of phases of transactions.\textsuperscript{180} So you don’t even have what is akin to the autopsy that is placed out there for everybody to look at.

MR. MILLER: Wait, Steve. Wait for Countrywide.\textsuperscript{181}

MR. COHEN: I think Countrywide will be the first big one. From


\textsuperscript{178} See Peg Brickley, \textit{American Home Creditors to Review Payment Plan}, WALL ST. J., Aug. 20, 2008, at B3D.


Federal officials heap much of the blame for the subprime mortgage mess on lenders, claiming they recklessly made too many high-cost home loans to borrowers who couldn’t afford them. It turns out that the U.S. government itself was one of the lenders giving out high-interest, subprime mortgages, some of them predatory. . . . \textsuperscript{Id.}; Ruth Simon, \textit{Investors Press Lenders on Bad Loans}, WALL ST. J., May 28, 2008, at C1.

\textsuperscript{180} See Maremont, supra note 179.

a law enforcement perspective, these are cases that have been harder to get traction on than some of the earlier ones.

MR. MILLER: But I think after Enron and after what happened to Arthur Andersen, and talking about auditors, you would have thought that the accounting profession, the auditors in particular, would have been very careful.

If you read the preliminary examiner’s report in *New Century* about some of the things that KPMG did, you ask, “Is this Enron all over again? Was KPMG more concerned about its fees than actually doing an audit?”

MR. COHEN: That gets back to your earlier point, which is: how much of this is driven by greed? How many of these fixes that they are going to look at and say, “Oh well, we can impose these solutions,” really were available years ago?

The simplest thing to understand is the liar loan. You [Ms. Morgenson] wrote a great piece on this a while ago, about how easy it would have been to spot. You can say, “Well, the person shouldn’t have lied on the loan application.” Well, how hard would it have been to do the due diligence on that loan application to find out that, in fact, the application was bogus? Those things didn’t happen.

MR. MILLER: Did anybody want to find out?

MR. COHEN: That’s exactly right. They didn’t want to know.

MR. KASWELL: One of my stories I tell young associates is Client A calls up – let’s say it’s a broker-dealer – and says, “We want to do X in the market. Everybody else is doing it but we can’t do it.”

I say, “You can’t do that.”

“Well, everybody else is doing it. Folks at Firm B are doing it.”

So you call up your friend at Firm B and say, “Are you doing X?”

He says, “What, are you crazy? We can’t do that.”

Unfortunately, that sounds like it didn’t go on in this setting.

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People maybe didn’t care what Firm B was doing. They did what they wanted to do.

MR. MILLER: I must tell you, Paul Volcker made a speech last week, on April 8, in which he talked about all these problems. If you get a chance, read it. He talked about all of these problems from his perspective. It’s really quite a speech.

MR. KASWELL: Mickie?

MS. SIEBERT: The government did have a precedent in helping companies. The government guaranteed Chrysler and made money on it. The government guaranteed Lockheed (I was involved in that; I was specializing in aviation stocks) and made money. So if the government can guarantee something, why can’t we create a way that the government will make money on this so it won’t be a gift? We don’t want to make it a gift. We can’t afford to make it a gift. But why can’t we create something, with all the brains in this country, where the government can guarantee and make some money on it when the time comes?

MR. KASWELL: This is a convenient segue to the last part of the discussion, which is: Where do we go from here? There are all these competing proposals in Washington now, with the Administration and the House and the Senate having different views. Everybody has something to say about whether or not this package is better than that package: does it go far enough? Does it go too far? Are we rewarding people for behavior that we shouldn’t reward them for?

I think there is certainly a political imperative to do something. The question is: What’s the right thing to do in this situation? I’m not sure

188. See Allan Sloan, On the Brink of DISASTER, 157(7) FORTUNE 78 (Apr. 14, 2008) (“[T]he government made $311 million from stock-purchase warrants it extracted for issuing the guarantee.”).
189. See John Cobbs, When Companies Get Too Big to Fail, BUS. WEEK, INDUS. ED., Jan. 27, 1975, at 16 (noting the government’s bailout of Lockheed Aircraft with a $250 million loan guarantee).
that we can ever pass a law that will always prevent failure from occurring, as Gus said a while back.

But what are the right steps to [take] and what are the wrong steps?

MS. MORGENSON: That’s a lot of territory. Certainly, I would say regulators who regulate would be on my wish list.

[Laughter]

MR. KASWELL: That would be a start in your judgment?

MS. MORGENSON: That would be number one on my wish list. I just feel like the regulators didn’t really have an appetite. There were rules they could have enforced that they did not, things as simple as HUD rules on violations of what you put on a mortgage and how much you are allowed to charge for certain fees in the mortgage. Those kinds of violations were never pursued.

Could we have regulators who have an appetite for regulating? I don’t know how you make that happen. But it just was such a failure this time around. To me that would be job one.

I [also] think disclosure has to be improved. I’m not sure that Stan O’Neal192 understands what a CDO193 is. I think that he got bounced (he took a lot of money with him,194 so I’m not crying for him) but I don’t think he understood what a collateralized debt obligation that was crammed with subprime mortgages was and how that was going to impact his company’s balance sheet. I would like him to try to explain that to me. I don’t think he could.

So how about having people who really ask the tough questions and push back on these things when you’re making money hand over fist? Who’s in the boardrooms saying, “What about that? Gee, that’s a huge increase in your derivatives book this year. Is that putting the firm at risk at all?” There didn’t seem to be any appetite for that either.

MR. NEIMAN: When we talk about regulators – I am in a law school, so I can use the term federal preemption195 – states like New

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191. See 24 C.F.R. § 203.27 (1971) (listing the charges, fees, or discounts a mortgagor may collect from a mortgagee).
192. Stan O’Neal was formerly the CEO of Merrill Lynch.
193. See Standard & Poor’s, Global Cash Flow and Synthetic CDO Criteria, supra note 96.
195. See Watters v. Wachovia Bank, N.A., 550 U.S. 1, 27 S. Ct. 1559, 1572 (2007) (holding that under the National Bank Act, a national bank’s mortgage business whether conducted by the national bank or its subsidiaries is subject to federal preemption).
York did take strong actions, both in the Attorney General’s Office and in the Banking Department, starting in 1999 with large actions against Household196 and Delta Funding197, highlighting and bringing significant actions against subprime lenders for predatory lending practices.198

What was needed was an additional effort at the federal level. Instead of welcoming that and pursuing it both in terms of national banks – not only to the extent that they originate, but also to the extent that they are participating in the securitization process – the response was: “Sorry, you cannot even investigate these types of unfair lending or other violations of national banks. In fact, we are going to expand our interpretations of federal preemption and prohibit you from bringing actions or investigating or supervising subsidiaries of national banks.”199

The federal regulators spent more time and effort thwarting the efforts of the states back in 1999, 2000, and 2001, which could have certainly made a difference.200 We’ve got to get beyond these federal regulatory turf wars and really look at how to recognize where state and federal regulators have to work together.

MR. COHEN: Let me pick up on that. That is one of the more curious points. You know the Chinese curse, “May you live in interesting times.”201 Federalism has been turned on its head, in a way. You have a federal government that is intent on enforcing its rights under preemption to keep the states out of various issues. If you think about

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196. See Michael Cooper, Spitzer Inquiries Net The State $786 Million, A Record Sum, N.Y. TIMES, Apr. 10, 2004, at B2 (discussing Household Finance’s $37 million settlement under accusations of predatory lending).


198. See id.


200. See id. at 1307 (“Recently, the federal government is thwarting efforts of state legislators to protect homeowners in their states by preempting state statutes regulating predatory lending abuses. Regulations preempt state predatory lending statutes applicable to national banks and savings associations . . . and proposed legislation would preempt the statutes altogether.”).

traditional notions of preemption (at least when I was in law school) preemption was always [invoked] so that the feds could dominate the field. Now we find – and this happens in real cases – that when there is a state effort to issue an investigatory subpoena to a banking entity . . . [the state] can’t even do that because it falls within the scope of federal jurisdiction.202 The bank will come in and litigate, with the assistance of the feds, [to seek] to keep the state regulators or state investigators out of the area.203

We had a curious [situation] in the AG’s Office not too long ago. We brought a lawsuit. Everybody thought it was against Washington Mutual. It wasn’t. It was against two appraisal companies that were doing business with Washington Mutual. At the middle of the case was basically an empty spot where WAMU would normally have sat because of the preemption issue. We knew litigating that issue, at least in the Second Circuit, would have been a fool’s errand because the Second Circuit has already spoken to this.204 But if you don’t have the feds willing to take the initiative, and instead [using preemption to] more or less keep[] other potential regulators out of the field, these are the kinds of issues you are going to run into.

MR. PREZIOSO: I think that the federalism point is awfully important. Maybe I just have too benign a view of the world, but I actually think all the regulators, more or less – and there are some exceptions – were trying to do what they thought was best in light of the way they saw their jobs.

202 See, e.g., Clearing House Ass’n, LLC v. Spitzer, 394 F. Supp. 2d 620 (S.D.N.Y. 2005). In this case, the plaintiff, Clearing House Association, sued the Attorney General of the State of New York to enjoin him from instituting enforcement actions or investigating plaintiff’s national bank members and their subsidiaries relating to their residential mortgage lending practices. At issue was whether the threatened Fair Housing Act (FHA) action was prohibited by § 484(a) of the National Bank Act’s, 12 U.S.C.S. § 484(a), limitation on states’ visitorial authority. In granting the plaintiff’s motion for an injunction, the court held that an action brought in the state’s parens patriae capacity to enforce the FHA’s fair lending provisions against plaintiff’s national bank members or their operating subsidiaries constituted a form of visitorial authority prohibited by § 484(a) of the National Bank Act, 12 U.S.C.S. § 484, and was not authorized by federal law. Therefore, the New York State Attorney General was enjoined from instituting any judicial action premised on the state’s parens patriae authority to enforce the FHA’s fair lending provisions against plaintiff’s national bank members or their operating subsidiaries. Id.

203 See id.

204 See Wachovia Bank, N.A. v. Burke, 414 F.3d 305, 321 (2d Cir. 2005).
But I think one of the things we face, if you think about where we are now in terms of accountability, is a system that has grown up with a history at the state level, a history at the federal level, and a division between regulation of banks and thrifts and broker-dealers and so forth. It isn’t very well suited to the kind of marketplace that we have today, the kinds of international institutions that we have.

I think it is important to strengthen all of the regulators and to think about ways to create a better integration. At the federal level, what the federal [government] can do best is pull together information from a lot of different sources. When I was talking earlier about how people didn’t foresee this, that includes at the federal level. I think there aren’t so many regulators, even at the federal level today, that have the kind of access across the board to banking institutions, securities firms, insurance companies, mortgage brokers, that would have been needed to really understand what was going on here. I think to some extent we don’t even have that information together today. So I think trying to figure out how to strengthen that is awfully important.

By the same token, I think that the point about the state regulators is very well taken. There is absolutely no reason that the system ought to be one in which states aren’t encouraged, obviously within the confines of a broader national and international economy, to be quite active in pursuing the kinds of interests that have always made state regulation so useful. Sometimes it is called a laboratory. There are all kinds of good ways to characterize it.

I think that debate is maybe starting now. Unfortunately, given our political cycle – and I am not trying to make a partisan comment – we happen to be in an election year. It is going to be quite difficult for people to implement broad, far-reaching changes until after we have our election, at least. That is a shame for all of us, because I think we are losing time that we don’t necessarily want to lose.

MS. SIEBERT: We all know that the products have become much more complicated. The derivatives have changed the entire industry.205 We are obviously going to have new regulation. I think we should have regulation by function. There is no reason that the same regulator can’t do the savings banks and the S&Ls and the commercial banks and the foreign banks if they are in that business. Otherwise it doesn’t work. There are too many different regulators and there is too much dupli-

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205. See Unterman, supra note 103, at 132.
cation.

MR. KASWELL: If you look at the Treasury blueprint\textsuperscript{206} that came out, I agree; I don’t think there is any likelihood that that is going to become law before the end of this Congress. [But] I think if you view it as the beginning of a process and a discussion, it is a very interesting document, whether you agree with it or not. It does take on functional regulation fairly directly and says that the problem with functional regulation as we now have it – and I have always been a fan of it – was that it doesn’t allow a more comprehensive view of a particular institution, because you have different regulators looking at the bank or the broker-dealer or the insurance, which would be at the state level.\textsuperscript{207} I’m not sure that is entirely accurate, but I think it is fair to ask: Is this really the right model that we have had?

We have a model that has grown up in many instances more as a response to a crisis; the 1929 crash, as Harvey mentioned before, created all the New Deal legislation.\textsuperscript{208} And we are now competing not just nationally, but [also] internationally. The Treasury has looked at the Australian model of the Twin Peaks\textsuperscript{209} regulator, and the U.K. model of the FSA.\textsuperscript{210}

This is something where intelligent people can and should disagree as to what the right prescription is. But I don’t think that anyone would invent the system that we’ve got now. It is an accident of history rather than of logic.

MR. MILLER: I think it is fair to say that the market has outpaced


\textsuperscript{207} Id. at 4.


the regulators. The complexity of the market, the derivatives and all of these other sophisticated securities . . . . [T]hink of the CDO market. You have $45 trillion of notional value which only deals with $5.9 trillion of debt.\footnote{See Bill McIntosh, Soros Urges Cleanup of CDS Market, HEDGEWORLD DAILY NEWS, Apr. 4, 2008, available at 2008 WLNR 6392996 (confirming estimated notional value of approximately $45 trillion as of April 2008).} So somebody is trading in these derivatives that has no attachment to the debt, and nobody knows who the counter-parties are.\footnote{See Nelson D. Schwartz & Julie Creswell, What Created This Monster?, N.Y. TIMES, Mar. 23, 2008, available at http://www.nytimes.com/2008/03/23/business/23how.html (discussing derivatives as a “stealth market”).}

I think there is a real issue as to whether the regulators can ever get up to speed on this. You have a market which is basically opaque. I don’t really know how any government is going to face up to that issue.

MS. MORGENSON: I think one way to deal with the credit default swap market – which is what I think you’re talking about with the $45 trillion notional – would be to increase margin requirements.\footnote{See InvestorWords.com, http://www.investorwords.com/2959/margin_requirement.html (defining margin requirement as “the amount that an investor must deposit in a margin account before buying on margin or selling short, as required by the Federal Reserve Board’s Regulation T”).} Now, nobody ever wants to do that, including Alan Greenspan, who back in the Internet bubble was asked at an Economic Club of New York dinner, “Why don’t you raise margin requirements?”\footnote{Alan Greenspan, Chairman, Bd. of Governors of the Fed. Reserve Sys., Remarks to the Economic Club of New York (Jan. 13, 2000), http://fraser.stlouisfed.org/historicaldocs/ag00/download/29043/Greenspan_20000113.pdf.} This was in 1999, when Internet stocks only went up and individuals were flocking to the stock market. He said he didn’t believe in it, that raising margin requirements didn’t work.\footnote{See Patrice Hill, Fed Faces Pressure to Deflate Markets, WASH. TIMES, Apr. 4, 2000, at B8 (noting that Greenspan stated that increasing margin requirements has little effect on stock prices).} Well then why . . . is it in your arsenal of potential fixes or potential things to do?

I would say: Why not require greater margins? I think the margin requirements on credit default swaps are minuscule. That would at least make people focus on what their exposure is, if they had to put up considerably more money to trade these securities.

MR. MILLER: Also capital requirement rules that [require]
institutions to have a certain amount of capital on hand. Those went by the board. And was the repeal of Glass-Steagall a good thing? You have banks that have never been able to merge their investment banking facility with their banking facility. The banking facility is based on a balance sheet and a financial statement; the investment banking arm is fee-driven. So you have two different incentives in one institution. Sometimes the fee-driven part of the bank takes command and you get a . . . (I’m not going to name the bank).

MR. NEIMAN: I think this is going to be one of the largest challenges for [both] U.S. regulators [and] global regulators. How do you keep up with innovation? If you can keep up, is there a constraint? Even though I don’t have any teenagers, I think of it as: What’s your responsibility for supervision over a gifted teenager? I assume you’ve got to give [him or her] enough latitude. But as soon as [he or she] blows up the basement or drives the car off the road, you do have to exercise a degree of supervision.

Same with capital and margin. I think the two I would have highlighted would be to what extent can leverage be used, as well as assuring that there is a safety net to ensure no systemic problems arise out of any failures.

MS. SIEBERT: I think it is a great time to try to get international securities regulations, specifically margin; if a hedge fund can’t borrow in the States, it goes to London, where it can borrow and it’s between [the hedge fund] and the bank. Private equity – you can see deals being

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217. See Banking Act of 1933, supra note 50.
218. One of the main reasons for repealing the Glass-Steagall Act in the first place was to permit banks to engage in both investment and commercial banking. See John Steele Gordon, Manager’s Journal: May Glass-Steagall Rest in Peace, WALL ST. J., Oct. 26, 1999, at A26 (“Glass-Steagall’s most important provision required banks to choose between being depository banks and investment banks . . . .”).
220. See id.
done at six, seven, eight, nine, ten times to one. 221 It doesn’t give these buyers a time to have a regular poor quarter or two.

I asked the head of one of the large German banks six months ago. He said, “Oh no, we don’t want your regulations.” Well, they’re now talking, since they’ve had a few of their own institutions get into trouble because of the subprime. 222

I think it gives us a wonderful opportunity to set up international regulations on those kinds of things – leverage, margin. These are the things that break us so fast. All [the hedge funds] do is pick up and go abroad.

MR. PREZIOSO: I am a huge fan of enhanced international coordination for a lot of those same reasons. But I think it is important to come back here. I don’t think it is completely fair to all the regulators or the heads of these companies. I’m not sure the criticisms of people like Stan O’Neal and Alan are so merited.

You can have lots of margin and capital requirements. We have margin and capital requirements. There are a variety of reasons why, in the international context, those are not meaningful. There are a variety of reasons why, even without the international context, they are hard to apply. 223 But all of them depend – and this goes to what I think is the most important thing here – on being able to price instruments. You can write capital rules to your heart’s content. The banking regulators have been doing this for a long time.

Curiously, of all the areas in which there is the most international cooperation, bank capital standards are probably the most developed of all of the systems that we have. 224 It shows, I think, that even when you have a very good system, if you do not have markets that work in terms

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of pricing and transparency, it is very difficult for any regulator or businessperson to make decisions that ultimately will not entail very significant risk.\(^{225}\)

Risk is inherent in what financial institutions do. You can eliminate risk in financial institutions, but you can only do it by taking away the opportunity for profit. The only way you can be sure that the bank will always have the money when you come to withdraw it is for the bank to put it in a drawer in the back room and not lend it to the others on the panel for their mortgages or for any other purpose. We know that.

So to me, the focus on those items is, obviously, appropriate. We need to think about whether the capital standards are right, whether we have international coordination, which I think is critical here. But I do think that focusing a bit on how one could enhance transparency in these markets, [as well as] what the [state and federal] governments can do to enhance that transparency, and to create incentives toward liquidity and transparency in the way financial institutions look at what they are doing, is an important step.

We are never going to stop these crises. We are never going to stop the system from having losses that are not anticipated. What we see in the stock market (at least in the United States) [is that] when prices collapse, you know what they have collapsed to. I think that allows this kind of crisis to work itself through more quickly and more in tune with the kinds of tools for people (who I really think were acting in their own interest) to try to find these things. I don’t believe that people intentionally did things to embarrass themselves, to get themselves fired, etc. They just didn’t have the information because the market isn’t functioning in a way that delivers it.

MR. KASWELL: I think we are just about out of time.

MR. MILLER: I had a question. I came here to be educated. So let me ask a question. What the hell is a CDO?

MS. MORGENSON: A collateralized debt obligation, which is a pool of pools. A pool of mortgages, what’s called a residential mortgage-backed security (RMBS)\(^{226}\), that’s a pool of, say, thousands of


mortgages – your mortgage, my mortgage, everybody in this room’s mortgage. A CDO has different combinations of those kinds of pools in it. So it’s like an RMBS square essentially.\footnote{Collateralized Debt Obligation, Investopedia.com, \url{http://www.investopedia.com/terms/c/cdo.asp}.}

Then there’s [what is] called a CDO square,\footnote{Collateralized Debt Obligation Squared, Investopedia.com, \url{http://www.investopedia.com/terms/c/cdo2.asp}.} which is a square of a square. So you are talking about some rocket-science debt.

MR. MILLER: And when you finally know what a CDO is, they change the acronym to something else.

MS. MORGENSON: L-O-S-S. [Laughter]

MR. KASWELL: On that upbeat note, I do think we ought to remember that this is America. We will work through these problems. The markets will work together. The private sector and the public sector will sort it out. We will get through this.

With that, I want to thank the panelists for a great job.

PROF. FISCH: Please join us outside for the reception.

[Adjournment: 7:33 p.m.]