Center for National Policy

THE CENTER FOR NATIONAL POLICY

"FOUR YEARS AFTER THE MELTDOWN: THE GLOBAL ECONOMY AND FINANCIAL SYSTEM STILL AT RISK"

FEATURED SPEAKER:

PHIL ANGELIDES, CHAIR,
FINANCIAL CRISIS INQUIRY COMMISSION

12:00 PM – 1:00 PM
THURSDAY, MAY 31, 2012

EDITED TRANSCRIPT OF REMARKS

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MR. SCOTT BATES: Well, how many of you are from California today? Oh, a few.

Thank you very much. My name is Scott Bates and I'm president here at the Center for National Policy and on behalf of our chairman, Peter Kovler, whose birthday it is today, thank you for coming.

You know, folks, four years ago, a financial crisis on Wall Street sent shockwaves around the world and brought economic devastation here at home. And as a result of the great recession which was triggered by the financial crisis of 2008, trillions of dollars in savings and investment was destroyed, billions in revenue at every level of government from Capitol Hill to school boards was wiped out and millions of Americans lost their jobs.

The repercussions of the financial crisis of 2008 are still being felt in families and communities across the United States. And four years on from that economic catastrophe, markets remain jittery, some financial institutions continue to issue reports of shocking losses from speculative bets going bust and too many people are struggling to make ends meet.

Four years on, what have we learned? What has been done and what must be done to rebuild the American economy on a strong and sustainable foundation? And could a financial crisis happen again? And if so what can we do to prevent that eventuality?

Well, to help us explore these questions today, we have a man with us who is well suited to that challenging task. Phil Angelides has served as chairman of the Financial Crisis Inquiry Commission, a 10-member bipartisan panel created by federal law and charged with conducting the nation's official inquiry into the causes of the financial and economic crisis. The commission presented its report to the president and Congress in January, 2011, and concluded – it's important to hear this I think – that the crisis was avoidable and was caused by widespread failures of regulation, dramatic breakdowns in corporate governance, and excessive risks taken in Wall Street. And government leaders also are ill prepared for the crisis and there were also systemic breaches in accountability and ethics.

The report made the *New York Times* and *Washington Post* best seller list. *The New York Book of Reviews* held is as the most comprehensive indictment of the American financial failure that has yet been made in the definitive history of this period.

In 2010, Mr. Angelides was named by *Worth Magazine* as seventh among the 100 most powerful people in global finance. Wow.

MR. PHIL ANGELIDES: I've fallen to 290. (Laughter.)

MR. BATES: Mr. Angelides is currently president of Riverview Capital Investments, which focuses on clean energy projects and sustainable urban development. From 1999 to 2007, he served as California State Treasurer. The Associated Press reported that he made the sleepy Treasurer's Office a policy powerhouse. And *The Sacramento Bee* praised Treasurer Angelides as the most effective and dynamic state treasurer in California history.

During his eight years in elected office, Mr. Angelides put the weight of the state's pension funds behind investment in clean energy and the fight against global warming. He helped lead the green tech investment revolution.

He was a consistent and forceful voice against California's deficit spending and excess of borrowing. And as early as 2002, he warned of excesses in the nation's financial markets, mobilizing pension funds and investors across the country to push for needed reforms.

As treasurer, Mr. Angelides served as trustee for California two major pension funds, managed $57 billion in the investment fund, financed over 100,000 units of affordable housing and $150 billion in schools, transportation, parks, and other public projects, and earned record returns on state investments.

Since '07, Mr. Angelides has served as chairman of the Apollo Alliance, a national coalition of business, labor, environmental, and community leaders committed to building a clean energy future for America.

I could go on. He's – (laughter) – he's also got a great history of civic engagement and was chairman of the California Democratic Party, but without further ado, Mr. Phil Angelides. Thank you very much.

MR. ANGELIDES: Thank you. (Applause.) Thank you. I accept your nomination – (laughter.) Thank you for coming here today. I want to thank the Center for National Policy for having me here today and I greatly appreciate the work that you do to enrich the civic and political debate in our country.

I see my friend Peter Kadzik, who's here today, who is an attorney who worked very closely with the Financial Crisis Inquiry Commission after we went out of existence, when the House Committee on Oversight and Government Reform decided to take a look at our activities. And I just wanted to say that the last time I was invited to speak in Washington about the work of the Commission was when Darrell Issa and Patrick McHenry invited me – and that's a loose term – (laughter) – to come before the committee. And I just want to say that I consider today's invitation a step up. (Laughter.)

I do want to talk briefly – I got my watch out here just to police myself so we have as much time for questions as possible. I want to talk about where we stand four

years after the near collapse of our financial system that left our economy in tatters. I want to talk a little bit about the risk that we still face in the wake of the financial cataclysm that we have endured and finally, about the critical choices I believe we must make now to repair our broken financial system and to rebuild and to remake our economy.

As was mentioned, some 16 months ago, the Financial Crisis Inquiry Commission issued its final report. And I want to say that I see some members of our team who are here today who did a phenomenal job, day and night, to try to put together this report for the American people.

Over the course of a year and a half, we looked at millions of pages of documents. We interviewed over 700 witnesses. We held 19 days of public hearings across this country. And before I start today, I want to, by way of preface, just make a few observations about my work in the area of financial reform through the commission and beyond. And just to make a couple of observations about how it has helped evolve my thinking about what we need to do.

The first is a very personal note. When I was – I see my director of research here today too, also. When I was appointed to this position, in July of 2009, by Speaker Pelosi and then made chairman by Speaker Pelosi and Majority Leader Reid, I thought I knew something about the financial system in this country. After all, I had been treasurer of the largest state in the country. I'd sat on two pension boards that were the first and second largest in this nation with some $400 billion of assets. In my own two decades in business, I had raised over $1 billion in debt and equity for a variety of projects. But I will tell you that for me the year and a half being at the commission and what I've seen since has been a journey of revelation that fascinated me, surprised me, shocked me, and disgusted me. And I will tell you these are feelings that many of my fellow commissioners shared.

I said this often that I felt in some ways like I'd walked into my local community bank. I opened the wrong door and what I saw behind that door was a casino floor as big as New York, New York. But unlike Claude Rains in Casablanca, I was truly shocked at the level of gambling that I saw going on.

I will also tell you that in the course of our commission's work and thereafter, I was taken aback at the immense political power of the financial industry. Now, this may sound odd from someone who's run four statewide races in California, served as chairman of California Democratic Party, run for governor of the state of California. I don't consider myself a political naif, but I will tell you that I have been stunned at the raw and crude exercise of power by Wall Street to achieve its means over the public interest.

And finally, I want to say that I was deeply affected by what I saw in the year and a half of my work as commission chairman. For while we did much of our work here in Washington, we traveled across the country, hearing from hundreds of people who, in

previous recessions, had been knocked down and gotten back up, but who, in the context of what had happened in this economic downturn had really seen their lives and their aspirations shattered and crushed. And it's an experience I have not forgotten.

Scott said when we issued our report in January of 2011, we concluded first and foremost that the financial crisis was avoidable. There was a kind of reigning line of rhetoric that came out of Wall Street and in Washington that this crisis was a result of powerful and uncontrollable forces that came together in a perfect storm, a matter of Mother Nature, risk models gone haywire. But in fact, what we found is there were many warnings, warnings ignored, and this was a result of human action and inaction, not Mother Nature.

There were widespread reports for years of egregious predatory lending. As early as 2004, the FBI had warned of a pandemic of mortgage fraud that was so extensive that if it was left unchecked, it would leave us with losses bigger than we experienced in the savings and loan crisis.

There were growing risks all throughout the financial system, financial institutions who were levering themselves up 40 to one, for every $1 of capital borrowing $40. A dramatic rise in risky trading saw institutions like Goldman Sachs going from making about 39 percent of their revenues from trading in the 1990s up to about 68 percent by 2007. There was the unsustainable rise in housing prices and of course, there was that very small matter of the creation of $13 trillion of mortgage securities and the doubling of mortgage debt in this country from 2000 to 2007.

Perhaps the best example of the failure, the avoidability of this crisis is what didn't happen at the Federal Reserve under Alan Greenspan. Despite overwhelming evidence beginning in the 1990s, despite opportunity after opportunity, the Federal Reserve, the one entity that had the ability to control mortgage lending in this country by all financial institutions - federally chartered banks, state chartered banks, non-bank financial institutions - time and time again they failed to act. In 2001, in the wake of information about spreading predatory lending, they adopted a set of rules supposedly designed to cover some 38 percent of subprime lending. In the end, the rules were so weak, they covered 1 percent. It wasn't until July of 2008, when the horse was out of the barn that the Federal Reserve finally adopted a simple rule that said that lenders could not make loans to people who could not afford to pay them back.

We found, as was noted, dramatic failures in regulation, the result really of a three-decade long effort to strip away public protections, the public bulwarks that protected our financial system and our economy in the public interest. Somehow we were led down the path and many people bought into it that somehow the self preservation instincts of private institutions would, in the end, result in the protection of the public interest. And what we found was that the genius of financial modeling did in the end have severe limits.

But time and time again, when regulators had the chance to clamp down even with their existing authority, they didn't do it. The SEC could have pulled back on the reckless practices in the investment banks. They did not do it.

The Federal Reserve Bank of New York, headed by Tim Geithner, could have pulled the reins in on Citigroup and they did not do it.

The OCC and the OTS, the Office of the Comptroller of the Currency and the Office of Thrift Supervision, tied the hands of the states who were going after predatory lending and then sat on their own hands.

We found recklessness on Wall Street and by the executives who led their companies and our economy over the cliff in case after case reported in our final report. AIG that builds up an $80 billion exposure to credit default swaps without their management knowing the full implications of the risk. In the end of the day, a $182 billion bailout by the U.S. government. Of course, that didn't affect Martin Sullivan's compensation as CEO. He walked out with $107 million. At Citigroup, we catalogued how they built up $50 billion in losses in their collateralized debt obligation portfolio and in the end of the day, received $45 billion of direct assistance, $300 billion of guarantees from the taxpayers. And Robert Rubin, the chairman of the executive committee of the board of directors, walked away with $100 million plus.

We saw it again at Merrill, tens of billions of dollars in losses, massive government assistance in the takeover by B of A and Stanley O'Neal leaves having made $91 million in 2006, with a $161 million severance package when he is let go.

And finally, we did see widespread breaches of accountability and ethics. We saw borrowers being steered into loans they could not afford. We saw companies like Countrywide making loans they knew could not be paid back. A series of emails where Angelo Mozilo himself writes about the loans that are toxic, that will bring financial and reputational disaster to their company, which they did. And we saw countless instances of millions of mortgages being packaged and sold to investors throughout this world without disclosure and when there were disclosures, with misleading disclosures. And of course, we fulfilled our obligation as a commission to make referrals of potential violations of law to the Department of Justice, as was our statutory mandate.

So after all of this, after this dramatic breakdown in our financial system, the very heart of our economy, where are we today? Sadly, I think it's fair to say that in many respects the financial crisis in this country and globally never ended. We are still in the midst of it. As we gather today, 23 million Americans are out of work, can't find full time work. American households have had $9 trillion of wealth wiped away as in a day trade gone bad. Four million Americans have lost their homes to foreclosure and estimates are that it could go as high as eight to 13 million.

Now, let me add just for a moment, in my hometown of Sacramento, as of the end of last year, 81,000 Sacramentans had lost their homes on the courthouse steps - that

doesn't even count short sales - about 16 percent of the people in that community with the annual rate of foreclosure filings still running about 30,000 there.

We have the lowest ratio of wages to GDP since the Great Depression. And since the recession officially ended in May of 2009, through the middle of 2011, over 90 percent of the growth in national income had gone to corporate profits and zero to wages, helping to lead to the greatest levels of income inequality since the 1920s.

Who would have imagined that in the wake of this crisis we would have come out with the economic playing field more tilted to power and money than ever before? And while this administration's economic policies have shown marked progress, the creation of four million new private sector jobs after an avalanche of losses, let's be clear that the headwinds against sustained economic progress, those headwinds which emanated from this financial crisis remain very stiff today.

Homeowners are still straining under enormous debt, one in five American homeowners underwater. Again, back to my hometown, 40 percent of the homeowners have negative equity and on the national basis, the cumulative negative equity of underwater homeowners is now $700 billion.

Student loan debt for a population with extraordinarily high unemployment now exceeds $1 trillion. De facto austerity policies - while Europe has had a very concerted policy of austerity that's driven the continent to the brink of depression - we have had de facto policies here that have resulted in the loss of hundreds of thousands of jobs at the state and local level. In fact, there's a recent report out that had we been able to maintain public employment, the unemployment rate in this country would be more like 7 percent. And of course, Europe remains on the precipice. They are saddled with enormous debt, but being driven into an economic depression by ill conceived austerity measures that have been pursued with the vigor, I might add ironically, of post-World War I reparations, leaving Greece with unemployment of 20 percent plus, Spain in the same situation, youth unemployment of 50 percent, and even Ireland, the poster child of the success of austerity, of course now slipping into the abyss with 15 percent unemployment.

Despite all of this, despite everything we've been through, I think what shocks me most is the world has changed, but Wall Street has not. There seems to be no correlation between those who drove the crisis and who is paying the price. It's as if there was an earthquake where the gleaming skyscrapers at the epicenter were left intact and rubble was strewn all about with everyone else left to dig out. And while this country and the world have suffered, Wall Street has rebounded quite nicely and has resumed business as usual - and I believe largely because it was spared any real consequences of its actions and therefore any real critical rethinking of what it has done and must do.

You know, people often focus on the TARP program, the $700 billion program that was the hallmark of the bailout, but as we all know, there were 24 separate programs of trillions of dollars that saved the financial system and saved individual institutions.

So by 2010, compensation at publicly traded Wall Street firms was back to record levels of $135 billion. The profits of the 10 biggest banks in this country had reached a record $62 billion. And with the $3 billion and climbing in trading losses that we have now seen at JPMorgan, we are reminded that the practices which brought Wall Street and the country to its knees are still very much alive in this nation's behemoth financial institutions.

I want to say something that's important at this point. Despite all the efforts at historical rewrite, no one should have any questions here that but for the tremendous assistance of the U.S. taxpayers every major Wall Street firm was circling the drain and on its way to collapse in September of 2008. Ben Bernanke told us 12 of the 13 major financial institutions would have collapsed. Tim Geithner said all of them. And I want to say even Goldman Sachs that trots around now talking about how they weathered the storm, I want to remind people that they saw their cash reserves in the week after Lehman fall from $120 billion to $57 billion in a matter of five days. But they've forgotten all that and emboldened by their assisted escape from disaster and with their hubris reinvigorated, Wall Street and their political allies in Congress have mounted a fierce frontal assault to destroy the efforts to reform the financial system, to bring greater security, spending hundreds of millions of dollars to distort our democracy for their financial interests. And, sadly they have been stunningly successful.

Think about it for a minute. Here we are, four years after the deluge, and a $600 trillion derivatives market is still in the shadows - unknown, unregulated, untransparent. We learn about it when there's an explosion that peaks out and lightens that darkness. We may learn about it when we find out which American banks have made what kind of bets on European sovereign debt. Here we are, two years after Dodd-Frank, there's still no Volcker Rule after a voracious and sustained attack to eviscerate it by financial institutions. And of course those efforts have been bolstered, I want to be blunt, by the Republican allies of Wall Street in Congress who have tirelessly tried to strip funding from the SEC, from the Commodities Future Trading Commission, and have made an art form of blocking appointments to key regulatory positions that oversee our financial system. And I want to say that every day change is successfully resisted, we remain at risk.

All this reminds me some things never change. I just want to recall something Will Rogers said in the wake of the 1929 debacle, he said "Those old Wall Street boys are putting up an awful fight to keep the government from putting a cop on their corner" and that's still true today.

So what is to be done? Let me just line out some steps that I believe we need to undertake to really complete the process of financial reform that will give us greater security and greater stability so we can focus on growing this economy.

First, let me say there's the matter of justice. One of the questions I get asked most frequently is why has no one paid a legal price for the injustices and the wrongdoing

that led to this crisis? And I want to say that we're not a country that should want or should seek revenge. We're not a country that wants hangman justice, but first and foremost I will say that we need to right the wrongs that were committed. We need to make sure the American people know there's one system of justice for all, not one for some who violate the law, but another one for those of immense power and wealth. And finally, it's important that we have a full scale, vigorous pursuit of justice for the purpose of deterrence because after all, that is the purpose of law, so that we know where the line is, and that these wrongdoings, if they were committed will not be repeated.

And let's be blunt about it. You look at these settlements from our regulatory entities where big corporations settle for pennies on the dollar, ridiculously low sums of no deterrent value. And I'll just give you this analogy. If someone robbed the 7-Eleven and they took $1,000 and they could settle for $25 the next day with no admission of wrongdoing, you think they'd be back at it? Of course they would.

So first, we need justice.

Second, we need a renewed offensive to put in place the essential reforms that are needed to safeguard our financial system. And make no mistake about it - because the avalanche of money and power that's been thrown at the implementation of the Dodd-Frank law, we are now at a place of paralysis in terms of getting true financial reform. I mean, there are soldiers out there working each and every day for reform. I see – as I pointed out earlier, my colleague Greg Feldberg, who is on the frontlines with many other public servants trying to push the ball forward, but there is enormous pressure from Wall Street to make sure nothing changes until they can achieve change at the political level.

A good place to start, as I said, is the derivatives markets. It is disgraceful and dangerous that that market is still in the dark corners of our financial system. Tougher and simpler capital standards, particularly for the largest banks, and at least until we get more fundamental restructuring, a tough and effective Volcker Rule. JPMorgan did us all a favor. It reminded us that that eviscerated rule would be of no use and no good, should be discarded, and we should start over with a tougher rule and get it in place.

Thirdly, we need to reset the clock in the wake of an enormous period of debt accumulation. I think it's quite striking that since 2008, almost everything has been done for the lenders and almost nothing for the borrowers. People seem to have forgotten that it takes two to tango and that when a lending institution extends credit to a borrower, particularly on a non-recourse basis, they take that risk. But whether it's European lenders on the sovereign debt side or whether it's American lenders who lent to homeowners, lenders are being held harmless, while borrowers are being strangled by a boat load of debt that they cannot sustain.

So I think it's fundamentally important that here at home we embark upon a sweeping program of mortgage principal reductions so that we can relieve the burden on homeowners, we can help millions stay in their home. We would recognize the true

value of the debt that was extended and we can stop the freefall in the housing market. It's time that there'd be some fairness in the way in which we apportion the losses.

Fourth, we need not just to rebuild our economy, but to remake it, so it serves the interests of the nation and not just the titans of finance. And we need to bring an end to the economy of speculation and financial engineering that's come to dominate our financial markets.

In 1980, 15 percent of corporate profits in this country came from the financial sector. By mid-2000s, that was 33 percent. In 1978, for every $100 borrowed by non-financial companies in this country, $13 was borrowed by the financial sector. By 2007, for every $100 borrowed by non-financial companies, $51was borrowed by the financial sector.

The greatest tragedy, I believe, of the run up to the financial crisis is that we squandered so much wealth on phony mortgage securities instead of investing in education, technology, renewable energy, infrastructure, all the human and physical capital needs that can move this economy forward. And if we're going to recover in any real sense, we've got to reject the economy of speculation, turn away from the policies of austerity that are now sinking Europe and embark upon a course of vigorous reform and investment.

In essence, replacing an economy that's about money making money with an economy where capital is deployed to create jobs and wealth broadly defined for our society.

But I want to say something very clearly right now. What I have laid out is a good policy agenda, but given the power of the banks in our country, it has no chance of survival. And I want to say something here today that I never said before because it's something that I've come to over time, through my work at the commission and watching the aftermath of this crisis and something that I come to because I believe it's fundamentally important. And that is I believe that none of the things I have outlined, particularly the changes in the financial system and the re-contouring of our economy can occur unless we take decisive and dramatic reform efforts that go beyond Dodd-Frank and specifically actions to break up the country's biggest banks, to break the stranglehold that they now have on our financial system, our economy, and our democracy.

This is the conclusion, as I said, I've come to recently and not lightly. But the banks themselves, through their continued pursuit of the practices and culture that brought on the crisis of 2008, their fierce resistance to any kind of reasonable change, the unrestrained use of their enormous political power and their willingness to use whatever means necessary to bend the political system to their self-interest without respect to the public interest, have provided in my mind the conclusive evidence that a modern era of trust busting is now essential.

Their unrelenting, no resources spared lobbying against financial reforms, from derivatives to capital standards to the Volcker Rule, are proof in and of themselves that they have not changed, nor do they have any intention to change.

If you look at the conduct of this industry in the wake of this crisis that should have been life changing, you see kind of a curious financial and intellectual inbreeding that has precluded the kind of rethinking required in the wake of this kind of crisis. It's the kind of intellectual and financial inbreeding that will lead, I believe, to reckless recidivism that will bring harm to our country.

I concur with people like Richard Fisher at the Dallas Fed that the continued existence of too-big-to-fail banks is, quote, "a perversion of capitalism," and that it is resulting in, "an erosion of faith in American capitalism."

And I find myself increasingly seeing the wisdom of Thomas Jefferson's statement in 1816 that, "banking establishments are more dangerous than standing armies."

By 2011, the top 10 banks in this country held 77 percent of the nation's banking assets. The top five banks – JPMorgan, Citi, Bank of America, Goldman, Morgan Stanley – held $7.9 trillion in assets and 95 percent of the $304 billion in over-the-counter derivatives held by U.S. bank holding companies.

These banks are too big to fail. They're too big to manage. They're too big to regulate. They're too complex to understand and they're too risky to exist. And the bottom line is they offer very little benefit.

There's a recent study out of NYU that shows that efficiency in the financial sector, the cost of intermediation, is actually higher now than it was a century ago, despite all the claims we've had over the last two decades that scale and innovation would change the playing field and lives for each and every one of us. In fact, the concentration of power of these big banks has made our financial system less competitive, not more.

But perhaps as important as anything else, these banks need to be broken up for reasons beyond just market impacts. Simply stated, they have become a clear and present danger to our economy and democracy and must now go the way of the trusts that were dismantled at the turn of the last century.

Some will ask how do you do this? Now, let me just say that the first decision is to break them up, to have the will to do it. How it's done - more tightly limiting their size relative to the overall market, tearing away over-the-counter derivatives activities, stripping away the ability to underwrite securities - in many respects, those are the least difficult of the challenges. I suspect when Standard Oil was broken up, more than a century ago, the primary decision was to break up the behemoth because it was

inimicable to competitive capitalism. To then do it geographically was the how we got there.

So in standing here today, we clearly have very significant challenges and very significant decisions to make. And over the last year and a half, I've always talked about this financial crisis in purely policy terms, but I want to add one more dimension today. It's impossible to talk about this issue and to have the debate we need to have in this country without talking about it in the context of the November 2012 election. And while I have been forthright and outspoken in my views of this administration, when they've been deficient, in my view, in pushing forward financial reforms or in vigorously pursuing prosecution of potential wrongdoing, I want to be clear about one thing: if Mitt Romney were to win this election, we will forgo any real opportunity to debate these issues, let alone resolve them in the public interest. His two-headed monster of an economic agenda is absolutely clear, and that is deregulation of the financial system and a pursuit of European style austerity. And if those two agendas are made reality, they will likely push this country and perhaps the global economy into an economic crisis and depression.

And look, no one should have any doubts about what Mitt Romney intends to do in both these regards. He's been outspoken repeatedly and clearly on these subjects. Now, occasionally, he'll slip. He'll call for common sense regulation, after having called for the repeal of all new financial regulations or he'll admit in a moment of rare candor that if you make severe and draconian cuts in the budget, that would push us back in the recession. But he's reiterated his policies time and time again, so we should not be unclear.

With respect to the history of the crisis, he's absolved Wall Street of primary culpability, laying the blame on the old saws of government housing policies, Fannie Mae, Freddie Mac, the Community Reinvestment Act. I might add, positions that nine of the 10 members of our commission rejected, including three of the Republicans who saw the evidence and once they saw the evidence could no longer stomach nor spout those claims. He's made it clear that he's going to repeal all new financial regulations and has offered nothing in their place. And he's endorsed the Ryan budget and I just want to say, if you like what austerity is doing to Europe, you will love Mitt Romney's economic and financial policies. And I will just say that electing Mitt Romney in 2012 would be akin to electing Herbert Hoover in 1932, maybe a good and decent man, but with the wrong policies for the times we are in.

I want to conclude with this thought. We need to make our voices heard now. We need to make our voices heard in November. But no matter who prevails in November, we need to renew the push for financial reform in this country and the remaking of our economy so that we have a genuine chance in the United States of America to having a broad based economy of growth, progress, and broadly shared gains. Thank you very much for having me. (Applause.)

MR. BATES: Well, thank you very much. You just called for a new progressive era. That's what you just did. Boy, I had a few questions. I'll just stick to one and it's a bit philosophical. What you're talking about is a question of failed regulation, failed laws, or the ability to legislate. Is there also a kind of failure in ethics? Do you sense that things have slipped somehow, this concept that there is accountability responsibility is something beyond immediate shareholder value in corporate America? Can this be fixed through regulation alone if in fact we're primed for another kind of crisis in the days ahead?

MR. ANGELIDES: It cannot be fixed through regulation alone, but of course, public policies are a reflection of a value set of a society. So you know, for some perspective here, in my own career and life – I'm 40 years out of college almost –I've spent about half in the public sector, half in the private sector. And the half in the private sector has been in business as a risk taker, as an entrepreneur, and so I come at this – I actually come at this as a participant in the real economy.

I do think, when you look at the scale of the financial system, the extent to which it has become a driver of our economy, the ethical culture in that sector is fundamentally important. And I think it's fair to say that the private sector is about profitability, but it also should be, can be – should be not divorced from the values of the society. I mean there are people in the investment world who say our job is to focus on money and money alone, but you really can't divorce their activities for the consequential effects they have on society. And so I have seen, particularly over the last two decades and in recent years, a sole focus on money without regard to consequences that I think is very troubling.

I've also seen in the wake of this crisis a clear lack of accountability. I mean, look at – you know, we tend to learn from the consequences of our mistakes, but in this instance, because of the decision to wade in full-bore to save the financial system, Wall Street was really spared any kind of consequence of note. And I think it's reinforced a lack of accountability.

So I don't believe regulation can do it all. I do believe there's a culture and a value set that has to be embraced. A lot of the work I did as Treasurer of the State was focusing very hard on getting risk adjusted returns for our investments, but also, you know, reminding people that it was possible to make money but also add value to society. And I do think that's a very important – a very important kind of value set that I don't think holds sway today. And by the way, financial sector, more than any, tends to try to build a wall in my experience. And I saw this as treasurer, which is leave us alone, you should only care about our investment results, not about the consequences of how we may act for the larger society. But you really can't separate the two.

MR. BATES: Thank you. Questions and comments from our assembled audience. And please identify yourself. Yes, sir.

Q: My name is Lloyd Andrew (sp) – (inaudible) – once I ran for lieutenant governor of California, back before your time.

MR. ANGELIDES: Were you –

(Cross talk.)

Q: – your predecessors, Jesse Unruh. I normally don't talk about that because I lost. (Laughter.)

MR. ANGELIDES: I understand the feeling. I got to ask you, what year did you run?

Q: Nineteen sixty six, that was the year of Reagan – (inaudible).

MR. ANGELIDES: And Tom Braden ran that year too.

Q: He was an opponent of mine in the Democratic Party. Glenn Anderson won.

MR. ANGELIDES: Right, Glenn Anderson, yes.

Q: But that's ancient history. But it does – it's not totally unrelated to my question. What I've run in the 40-50 years, I've been around in politics and government, is that incumbency is the highest priority of most, not all, but most people who serve in the elected office. And I think unlike those earlier years, when people came here or in Sacramento and went back home, seeking reelection because of what they achieved for their state or in the case of Congress, the country. Today, that's not the case. Today, as you were saying earlier in response to the question, the public policy seems to reflect the values of the people. And I believe it's because there are so ideologically driven that today it is not what's in the best interest of the country, but how I can get reelected by not compromising. And with that kind of context, we are now going to be faced in the next few months with a train wreck. CRS came out with a report – you probably saw it –a week before last that shows that if nothing is done, our growth rate, the first quarter of 2013 will be 0.5 percent. I think it's 2.5 to 3 percent, 3.5. We need to just stay even with unemployment.

So – and with countries like Greece, Spain, Ireland, Iceland, others teetering on the brink of default and the U.S. vulnerable, what do you think is the likelihood of members of Congress coming together, putting aside their ideological differences and reaching a compromise that will avoid taking the U.S. over the cliff within next year or two?

MR. ANGELIDES: I'm deeply troubled in the sense that I can sit here and say that I believe in the end that people will do the right thing to stabilize this financial system and the economy. There's obviously a great amount of political risk in this. I think that there are a set of people and to be blunt about it, on the Republican side in

particular, who are willing to risk things becoming worse for this country to achieve political gain, bluntly stated. And I think they undercalibrate the fragility of the world's financial system right now. How slack demand is, how tenuous our housing markets are, how if you go industry to industry to industry, how many industries are on the edge at this moment, and it's really quite unconscionable to think that people would have that in their equation that they would try to achieve gain politically in this kind of era of fragility, but it absolutely exists. And I think political risk is obviously a factor here. There's no question about it.

MR. BATES: Other questions, yes.

Q: Hi, my name is Dan Starkman (sp), I'm a student at Union College. My question is about –

MR. ANGELIDES: (Inaudible.)

Q: – how might a possible student debt crisis unfold within the context of the financial system. Student debt has reached $13 trillion recently and student debt can't be – you can't foreclose on education. You can't. My understanding is that you can't file bankruptcy and student debt is now being collateralized and traded as a commodity on the derivatives market and you know, in a similar way that mortgage backed securities were in the past, and so how might that unfold if – it seems unsustainable the situation.

MR. ANGELIDES: Well, given unemployment rates among young people, given wages among all workers and particularly young people, it's hard for me to imagine there are not going to be substantial losses in the student loan sector. Whether that metastasizes into a crisis of the scale we saw is yet to be seen, but I think there is one thing to remember in all these sectors. If you go back to the spring of 2007, you will see that in our report we talk about the slow-footed response of government leaders, the ill prepared nature of government leaders. There was a lack of understanding of the interconnection of markets. Bernanke and Paulson went out repeatedly all through 2007, assuring the American people that the subprime problem, which as a market itself was relatively small in the global scale, that it was contained and really had very little chance of there being spillover effects.

None of these markets are self contained. I guarantee you on all those student debt packages, there are derivative bets that have been placed on them. What I can't tell you, I don't know enough about the student loan market, as to whether – as in the mortgage market, there's not only credit default swaps there, but whether there are also synthetics that magnify the extent of the market impact. But each of these market sectors now have an amplification effect because of the interconnection between institutions, because of the side bets that are going on or hedging, depending on what they are, in the derivatives markets, so each of them has a greater potential to shake the market. And look, the truth is when Romney was asked about JPMorgan, he kind of had a boys will be boys comment and no one really got hurt. Someone lost $3 billion. Someone gained $3 billion. I mean, he forgot the essential fact, which is that, number one is because these

are dark markets, that's like saying when the Bear Stearns hedge funds blew up in 2007 – you remember that was one of the first warning signs of this financial crisis, July of 2007. The Federal Reserve meets in the Federal Open Market Committee. They assess the situation. It says, ah, just Bear Stearns, no one else has that position.

But in today's market, given the interconnections, any time we learn about a JPMorgan, it's really a warning shot that that practice is going on throughout the marketplace. And those practices tend to be undertaken by banks that have federally insured deposits and are systemically important. So all of these potential blow ups are things about which we should be concerned, but the other thing we should be concerned about is we don't know the depth and the extent of the market impact because, again, the derivatives market remains unregulated today.

We don't know, for example, what exposure what U.S. banks have to European sovereign debt. Could be $100 billion. Could be a trillion dollars. And we will learn about it when it blows up on us.

MR. BATES: Yes, in the back.

Q: Jeremy – (inaudible) – with Congresswoman Shelley Berkley's office. I think one of the things underlying the whole problem is debt and risk as you outline. And I think with the banks, you all know very well, how they took up too much risky debt. And I think it goes to other sectors of the society and all the way down to the individual level, you know, people who took on mortgages that they couldn't possibly afford, and the government saying, you know, well, we can just cut taxes and raise spending because we're grow ourselves out of this problem and we'll cover the debt that way. Has the last four years in any way transformed the national thinking on the individual or governmental level, leaving the bank aside, you already addressed that pretty clearly, but on the individual or governmental level, do you think there is a change in the psychology and particularly as the economy has been so slow to growth and people said, oh, well, maybe they I can't afford this house in five years because I'm not going to have a better job. Maybe we can't cover the government debt because we're not going to actually grow ourselves out of the problem.

MR. ANGELIDES: So a couple of things, yes, first by necessity, just income constraints, capacity, inability to borrow, tighter credit, so yes, you know, we are in that countercyclical moment now where credit as well as borrowing has ratcheted back. I mean, the real question would be, over time, what's the length of the lesson?

I was in real estate for two decades plus and there was always a joke that people would unlearn the lesson seven to 10 years after the trauma. So that at least by necessity now, both credit constriction and family capacity, yes, families aren't borrowing as much. In fact, they're struggling to meet their debt obligations as they are. Do I think that people have come to a recognition that you can't have a full boat of services without paying for it? That's been slow and painful in coming and I think it's at least being discussed today, but you know, not successfully addressed as yet. My own state of

California is a classic example. I made the mistake of running for governor in 2006, which was kind of like 1928, telling people that we're going to face a fiscal crisis because it didn't take a genius to see that housing prices were beginning to move down. Now, I don't say that I foresaw the magnitude of the downturn, but here was a state that was spending $7 to $8 billion more a year in the good times than it was taking in.

The biggest single factor in that was we cut taxes by $15 billion a year, since 1996, and maintained the same level of services. We are now in the seventh year of financial crisis and while there's a recognition that we've got to match revenues to what we want as a society, we have yet to accomplish that politically. And again, in California, there're a set of forces at work whose agenda is economic turbulence. It serves their purposes and also they're unwilling in a sense to come to a place where they meet the broader consensus about the level of public services we want, desire, and need in the society.

MR. BATES: Thank you. Yes, right over here.

Q: Bill Goodfellow, Center for International Policy. Phil, one of the interesting things about your committee, you did all of these interviews. Here's something that I've always been curious. Around 2006, 2007, 2008 heads of these major banks, these titans, all like you, or at least half of them have Harvard MBAs, which leads us to believe they're pretty smart, did they know –

MR. ANGELIDES: I never went back for my MBA.

Q: Oh, you didn't. You're still Harvard – whatever. They –

MR. ANGELIDES: I haven't done my full degree culpability analysis, but go ahead.

Q: So here we are going, 2006, 2007, 2008, the head of these big banks have huge research departments, did they know that they – the trouble that they were getting their institution in and why didn't they know or when did they know. I mean that's – I've always – or was it just faith based banking, that they just sort of all marched over – they must have known –

MR. ANGELIDES: Some knew. There were voices. This notion that no one saw it coming is just a flawed notion. There were many people out there who were registering concerns at many different levels, I might add. If you read the beginning of our report, you see that in the late '90s, there's community based concerns – starting in the places like Cleveland – about the level of egregrious predatory lending and its effect on neighborhoods.

You do see people logging in throughout this period about fundamental flaws in the marketplace. I mean – and there were people who spoke up. Robert Shiller, who's highly respected – Case-Shiller Index – pointed out that there was something unlikely to

be sustainable, about 15 percent per year housing price increases. So information was on the table, but money was being made and on an immediate basis. Don't forget that. And that's one thing that's really never changed. It'll be interesting to see in the JPMorgan experience if there is true clawback of compensation. Take Ina Drew. She was the chief investment officer – her compensation in 2011 was $14 million. I don't know what the London Whale made, aka Voldemort, right, but the real question is will there be clawbacks? You know, in real private sector business, like the one I've been in, there are some years you did well, and then when a project lost money, you actually had to come out of pocket to pay project costs, to pay guarantees. It wasn't if things go well, I hit a home run, if things go badly, I still get a reasonable salary. And as long as the compensation incentives reward immediate activity, the making of the deal without respect to long-term performance, I think you had a whole culture there whose mindset was probably more of I got to jam as much of this in as I can before it's over.

I think there were a number of people who began to see the writing on the wall by early 2007, but I think it's fair to say that the cake was baked by that time. There were some institutions, i.e. Goldman, who were able to build somewhat of a fortress, but in the course of doing that, they may have also undermined others in the situation. What was really striking, though, is once you get into 2007, look at what's happened by then. Housing prices – first of all, the myth that this was done for homeownership. Homeownership in this country peaked in April of 2004. Now, this is not something we needed a staff of 80, a $10 million budget to find. But I always say, one of the things that I reflect when this is all over is that, think of that, homeownership, the very, quote, unquote, "supposed purpose" of all this, peaked in April of 2004, housing prices in the spring of 2006. By the end of the 2006, the beginning of 2007, almost every major subprime lender has gone out of business. They're collapsing.

By the first quarter of 2007, for the first time, banks have to reveal what are called their level one, their level two, and their level three assets, and the level three being the highly illiquid assets, and places like Bear Stearns and Lehman are reporting that they've got 200 percent plus illiquid assets versus their own capital. So by early 2007, the writing was on the wall, cake was baked, but a lot of the institutions kept moving, trying to get as many of the deals out the door as they could.

MR. BATES: Thank you. Yes, in the back.

MR. ANGELIDES: And by the way, there is one thing risk models can never anticipate, I think, you know, is that – it was Emanuel Derman – I'm trying to remember –the Columbia professor, who said, gravity is what gravity is. But in markets, there's herd instinct, there's human action, and none of the risk models, the variants of risk models these institutions had were ever equipped to pick up those kinds of human behaviors.

Yes, in the back.

Q: Peter Cocharis, international law and consulting firm. Phil, it seems to me there's a dilemma for those in the Democratic Party who have been most critical of the Dodd-Frank approach. They've been critical of the FSOC, the Financial Stability Committee – Oversight Committee and whether it could work, but on technical, or political level, or market level, they've been critical of too-big-to-fail or too big to exist, you know, all sorts of criticisms. But it seems to me they either have to say Dodd-Frank should be radically reformed, which is the message of the Republican Party, or they have to – (inaudible) – their teeth and say this may be fundamentally flawed, but it's better than nothing, and so we have to support it against the regulatory onslaught. What do the critics, like yourself – where's the political maneuvering room and strategy?

MR. ANGELIDES: Okay, so now that I'm not running for office, I have the luxury of not having to calibrate every political calculation. Peter, here's what I believe, and I want to be clear on this. The key big features of Dodd-Frank that are not yet in place, they've got to get in place and they've got to get in place soon. So there needs to be a concerted effort to get strong rules in place as quickly as possible, in a sense a counteroffensive. And in some respects the JPMorgan debacle has provided some fuel for this. And specifically big picture, getting the over-the-counter derivatives market on exchanges and getting that market regulated. It really can't wait for a long sustained political debate.

Getting a Volcker Rule with teeth needs to happen and actually I think we have some reasonable chance now, given the latest events – that may be a possibility.

The designation of systemically important financial institutions and the oversight and capital standards that come with them have got to be done.

My point today, though, is that given the risk profile we have today, we would be remiss in not, in a sense, reopening the debate and putting new items on the table that have to be accomplished in addition thereto. So I want to be clear. Dodd-Frank, particularly in the respects I've talked about, make the world better and need to happen, but in the end, I don't believe they're going to be enough. I believe particularly the scale and size of these institutions will mean that in the end they have inordinate market power. They have inordinate political power. They have a scale that's very hard for even the brightest regulator to get their arms around or the brightest manager. Look, I mean, Jamie Dimon was the wizard of Wall Street, but it turned out just like in Oz, as in real life, wizards have their limits, particularly when it comes to trading synthetic financial derivatives.

So – so my point is that we need to really be back on offensive because this crisis never really ended and there's unfinished work. I feel there's a consistent threat there to keep pushing the ball forward. And I might add that the post-New Deal reforms took years to put in place. They then served us well for decades. If you'd ask me eight weeks ago about the adequacy of the Volcker Rule, I would have said the legislation I think it's pretty clear. And by the way, Senator Levin and Senator Merkley, who wrote that provision, I think have been very foursquare in saying that the rule proposed to

implement it didn't comport with the statute. But if you would have asked me, like I said, a few weeks ago, I would have said I think the Volcker Rule is the right thing. I think it's the right thing, but I do not think it is enough. And I think the banks have made the case for my position.

They have so tortured that rule that they've proven that even nuanced changes are not accomplishable because they'll beat the hell out of them. And I do think that with respect to the scale of banks, we need to think about the ramping back. Just remember, this is about federally insured banks. They're enormously subsidized, in two ways. They have insured deposits – any business in the country would be thrilled to have a capital base that's insured by the government of the United States. They have access to all the lending from the Fed. They have an enormous competitive advantage over smaller regional banks in terms of their cost of borrowing. It's an enormously subsidized industry. There is no reason but for transaction specific hedges for them to be in the OTC derivatives business. But they command that business. It's wrong from a policy perspective and a risk perspective.

You know, people say we can't go back to Glass-Steagall. I don't know. What's the compelling case for a federally insured depository institution being in the business of underwriting securities? These are all pieces that can survive. Now, I know that Tim Geithner – he's never said this to me personally, but I know or at least I'm led to believe that he believes that it would be a mistake to break up these large institutions because they're one of America's competitive financial advantages in the global economy.

And first of all, I don't believe that because the pieces will still exist in a more competitive environment, number one. And number two, I'd like to see us develop competitive advantages in a few other places other than the financial sector.

MR. BATES: I think we have time for about two more questions. Mr. Mulloy.

Q: Thank you very much for your talk. You're very forthright on it. That's what the young people on the society need. I was general counsel of the Senate Banking Committee under Proxmire. I worked under Riegle and Sarbanes. And here's what I saw. Over the last number of years in this town, the power of money and the need to raise money to campaign and the Congress tried to protect itself from this by passing Campaign Limit.

MR. ANGELIDES: Right.

Q: And the Supreme Court kept striking them down, saying corporations are people. Money is speech. And so we've got a system now where the money interest have a complete run and control the political system of this country. So I think it's very difficult for us to get the kind of basic reforms that you think need to be done as opposed to where it was 60 years ago, after the Great –

MR. ANGELIDES: I agree with you.

Q: And do you have any thoughts on what we need to do –

MR. ANGELIDES: Supreme Court. Tony Kennedy was my neighbor, literally my neighbor for four or five years, but that was such an incredibly destructive decision to American democracy. But I have never allowed myself to become cynical. It is what it is. The playing field has always been tilted. I mean, perhaps worse today than before, but look, always in our country, even in Roosevelt's era, money and special interests had enormous power. Caucasians had inordinate power versus people of color. I mean there's always been a tilted playing field. So it falls to those of us engaged in the political process to always stand for what we believe. And every time, you know, someone says to me it's so polluted with money now, I'm exiting, I just remind them, good, the people with enormous money are thrilled today because we've lost another citizen who's engaged.

But I do believe there's an interesting phenomenon when it comes to these large financial institutions. Richard Fisher, by all accounts, is not a lefty radical. I did not come to the commission believing the banks should be broken up and I can't tell you the day I left I believed it. I believe it now because I've seen the conduct, which is unrepentant in the last year and a half. It's like we don't give a blank what happened to the country, the damage being done. We will resist any change that constrains our profitability.

I think there's a potential in this country to build a movement to break down some of the enormous concentration of wealth and power. We go through these cycles, even though I admit, it's a very steep climb, no question about it. You know, I even reflect on myself when people ask if ever think of running for office again. I'm highly conscious of the amount of money it takes and the type of money and the volumes of money that come in when you do speak candidly about where we need to go, but that's why we're here.

MR. BATES: Yes, thank you. Last question.

Q: As chairman of the board, I am so grateful to you and I know I speak on behalf of our board, chairman of the board here at CNP, and also as a board member for many years, I'm very comfortable saying this is arguably one of the most significant speeches ever presented at this organization. And I am really grateful to you.

MR. ANGELIDES: Thank you.

Q: One quick comment. There's been mention of Roosevelt and Harvard and what you're saying brings to mind the 1940 quote of Roosevelt's, where I have – if I have this right, I think he said, everything I'd learned about economics at Harvard turned out to be wrong. (Laughter.) So my question for you about the trust busting – about – the steep coal decline. I think it's such an important idea and such an idea that has to be circulated more and more. How you came to that theory? It's clearly –

MR. ANGELIDES: I just came – I came to the view, in the end, that as long as the banks exist in the form they do, their economic and political powers were such that it could constrain any kind of meaningful change. And you know, I watched the efforts of some, I think, very courageous peoples like Sherrod Brown, who has put forward a bill to begin the debate on limiting the size, and look, he got, I think, about 30 some members of the U.S. Senate. It's not 51 and I guess in this word it's not 60, but it's not inconsequential, not, you know, someone standing outside the Capitol, waving a couple of placards and screaming. I mean, there's a – I think there's an inherent, latent breadth of support out there.

I found that one of the most interesting things since I returned to my home town and have gotten back into business, which right now is focused on the clean tech sector and on delivering a set of large scale solar projects in California is the extent to which my colleagues in business, many of whom who do not share my political views, find themselves still very angry about what the financial centers of this country did to the economy and the amount of power the wield, the privileges they have that are not accorded to other people participating in this capitalist society. It is out of bounds. And so I think the banks have made an extraordinarily eloquent case by themselves for their demise in their current form.

Q: Thank you.

MR. BATES: Well, on that note, please join me in thanking Phil Angelides. (Applause.)

(END)