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REBUILD FINANCIAL INSTITUTIONS AND CONFIDENCE

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P R O C E E D I N G S

MR. SLOAN: Well, it's only ten minutes late, so I guess that's early by Washington standards, so if you don't mind, we'll start. I'm glad to see everyone has made it through the rain, good to see such devotion. I'm Allan Sloan, I'm a writer at *Fortune* magazine. I'm being lent to Brookings today at no charge. I have no idea what I'm doing, as you've just seen, but that's what journalists do.

This is the sixth in a series of 12 memos that Brookings is sending, or hoping that somebody sends to the Obama people. I'm sure they're waiting with bated breath to hear what we have to say. But this stuff actually, the financial stuff, is actually important for actually three reasons; one is that it gives me, since I'm an editor at *Fortune*, it gives me something to write about and assures my continued employment. Unlike people who are, you know, just getting killed for business writers, this is actually good.

The second thing is, we had been worried about people retiring too early, but we've now solved that problem, because if you look at the numbers, you'll see that the only time most of us can afford to retire now is six years after we've died, so we've solved that with the market crash. And finally, it gives all of us up here on the podium a reason to have you hear us, because what's going on, as usual in Washington, is addressing the crisis of the moment, but not too many people are thinking of the long term implications or even the implications more than two days from now of what's been going on.

So what we're going to do here is, Martin Baily has graciously written a note to Obama, which is in your materials, which he will discuss for a few minutes. Alice, who's one of the foremost people in budget finance, will talk about the budget and implications of that.

And Don Powell, who, like me, is sort of an alien to this place, is a banker with a soul, I know, an usual combination, and he's going to talk about the practicalities of a lot of the things that the three of us talk about in generalities. Then we will, you know, set them at each other, I'll throw in a snotty question, but at least half of this is going to be Q and A. So you better have some Q's, because if you don't, you're going to have to listen to all of us, and anything has got to be better than that. So anyway, Martin, if you would lead off, please.

MR. BAILY: Thank you, Allan. That was a heck of an introduction.

MR. SLOAN: Well, I'm sorry.

MR. BAILY: Thank you. It's a pleasure to be here and to be talking about this. I know President-elect Obama is, as Allan said, waiting with bated breath. I haven't managed to catch his phone call yet, but I'm sure once he sees it, he will.

He is facing, as he assumes office, perhaps the most difficult economic situation of any president coming in since World War II. In 1982, we had a very severe recession. President Reagan came into office with a very difficult economy and a lot of inflation. This situation I think is more uncertain and harder to sort of predict what's happening, harder to formulate a response.

In previous U.S. recessions, it has been primarily the Federal Reserve raising interest rates to slow the economy down because of inflation, or in the case of the '82 recession, banging the economy on the head to really end the inflationary spiral, but once the Fed eased off, the economy sort of recovered again. I think this is more uncertain because policy is very strongly expansionary, but we don't yet know how that's going to play out in terms of the real economy. Certainly the quarter we're in looks to be very negative, the first quarter of '09, and we just hope there's a recovery coming up.

Now, I did think I was looking at some of the forecasts from macroeconomic advisors last night, and I did think actually there was a silver lining if you were President Obama, because if the forecast of macro advisors turns out to be correct, he's going to get a heck of a nice boom as he comes up for re-election. So it's actually not a bad thing if you're an incoming president to have a recession right there, because then you can grow out of it.

However, most of the content of this particular memo is about a couple of longer-run issues, one on the fixing finance side and the other on the budget side. Now, in the short space that was allotted either for me to talk now or in the memo itself, you can't possibly cover a lot of the sort of long run financial sector reform issues.

I want to plug the fact that we have a project going on at Brookings, including myself and Bob Lighten, that's really trying to look at some of those long run issues. It's been an interesting and frustrating project so far because we kind of propose something, and then we write it up, and then the Treasury does it before we've proposed it, so we have to throw away what we said. But I guess that's better than the alternative of feeling like it was the wrong thing to do.

Okay. Let me talk a little bit about dealing with the financial meltdown that we're now facing. With some reservations, I would give the Federal Reserve a very good grade for its handling of the crisis. That's not to say it gets a good grade for what happened before the crisis. I think the things that the Federal Reserve could and should have done that would have led to a milder crisis or maybe not a crisis at all. But since the crisis has hit, I think Bernanke and his colleagues have acted very aggressively, and, by and large, done the right things.

Now, they made mistakes along the way, but this is a real crisis situation. I think it's very hard to say someone else would have done a lot better. So one thing I would urge on President-elect Obama is that he make clear, as he has in the past, his support for Bernanke and the Fed, that they should remain on the job. I think the Treasury side of it has been a little bit more hit and miss. As you know, they started on the top proposal for buying distressed assets. There was a rationale for that; that was not a stupid thing to do, but it wasn't, as it turned out, the right thing to do. The idea was to have price discovery on the assets held by the banks. As a result of that, outside investors in the capital market would know where the bank stood and they would be willing to put capital into the banks and recapitalize the banking system in the face of the losses that had been taken.

It didn't work, A, because that price discovery process was always a little bit uncertain, the assets themselves were very idiosyncratic, so it wasn't so easy to establish a market for certain kinds of assets and get this price discovery process going. And it didn't work because the capital markets just were not willing, they were frozen up, with some exceptions. Obviously, Warren Buffet put in some money, some Middle eastern money came in, but, by and large, there wasn't anything like enough private capital wiling to come into the banking system. So the Treasury changed course and is putting in the 700 billion.

One thing I would say to President-elect Obama is that I think that 700 billion and maybe even more is needed to recapitalize the banking system. There's a lot of pressure now to use that money as direct help for homeowners. Now, as I'll say in a minute, I think there's a good case for helping homeowners, but the 700 billion is needed I think in – to bail out the banks, if that's the right phrase, or to recapitalize the banking system. Unless we get the banking system recapitalized, we're not going to hope they decline the economy or get back on track.

This is not a question of fairness, it's not a question of, gee, it's nice to spend 700 billion bailing out the banks, it's just that it's an essential part of the solution.

Let me turn now to the mortgage problem. And we're going to get some further discussion of that, which I'll be interested to hear about. My perception is that the plans to help mortgages directly have turned out to be very difficult to do. Sheila Bair is either a hero, a heroine, or a villain depending on who you talk to. I give her a lot of credit for being out front and trying to find a way of resolving some of these homeowner problems. But it doesn't seem like her plan, the Bair Plan, has worked that well. As you know, the *Wall Street Journal* has been after her and others in terms of the fact that the IndyMac Plan, first of all, didn't resolve all that many mortgages, and the ones that it did resolve maybe seem to have redefaulted, so that plan doesn't seem to have worked that well. As we know, there was a plan out of Congress, the Frank Bill some time back, again, it doesn't seem to have been on a very substantial scale.

So my view on this, and I think it's now moving towards where Treasury and the Fed, is to try to get mortgage interest rates down. Glenn Hubbard, former CEA Chair, wrote an – with a colleague that I'm forgetting suggesting this was an essential part of stabilizing housing market, I think he was right about that. The question is, how do you do it. At the moment, the Fed is buying assets, buying some of the mortgage assets.

I think the easiest way to do it really -- I mean the problem is that there's a substantial gap between the interest rate on mortgages and the interest rate on ten year treasuries. Now, obviously there's always a gap there, there has to be a gap there, but it's widened, and that's because the interest rate that Fannie and Freddie are paying, the gap between that interest rate and treasuries has widened a lot, so that we're not seeing the sort of usual market equilibrium where Fannie and Freddie debt are trading at only a small number of basis points above treasuries allowing them to issue mortgage interest at relatively low rates. Now, the mortgage interest rate has come down. In the memo I say it's 6.08, and it's actually now, looking at the Freddie Mac web page, it's now 5.53, so it has come down, but the gap actually to treasuries has not come down, and they still have this problem of a sort of risk spread associated with Fannie and Freddie debt.

I think there's some kind of – there's got to be a way of bringing that down, and therefore, bringing mortgage interest rates down. Either you're going to give an explicit guarantee and make it very solid at least on the past debt and the debt that's going to be issued over the next 18 months, or you may even have to roll over some of that debt directly into treasuries in order to – the GSE debt directly into treasuries.

But bringing mortgage interest rates down to a level that, as Glenn Hubbard said, may be closer to the equilibrium level in sort of normal times given the weak demand in the economy would be a way of allowing people to get out of some of these mortgages that they're in without necessarily rewarding or without rewarding people who are going to default on their mortgages. The last point in the paper is around the fiscal challenge that Alice Rivlin is also going to talk about. We are spending money like it's going out of style. I mean we're putting the 700 billion into the banks, and we get assets in exchange, so it's an asset exchange.

But assuming that we lose money on that, which we don't always do on those kind of bail outs, but we may lose a substantial amount of money, and then we're going to have a stimulus package, which I support, to try to get the real economy going again, and we're going to end up – this comes on top of what was a $455 billion deficit already last year, so those are just huge numbers we're talking about.

Now, one possibility is that this would mean the federal government would be in danger of defaulting and people would fly from treasury securities, that does not seem to be the case. If anything, we've had a flight to treasury securities and some rise in the dollar at least since its low point.

So I don't think any of the things that are being done now have the immediate effect of undermining the value of treasury securities. But if we keep going, and we have the Medicare and social security spending rising, as it will, then that becomes a significant danger. And if we put it off until the markets are signaling we have a default, a significant default probability on treasuries, that's too late, that's something we need to do now. Now, the actual policy you follow is a little hard, because if you announce we're going to do a stimulus package, we're going to give you tax cuts, but next year or two years from now we're going to raise your taxes, then that tends to limit the effectiveness of the stimulus package.

So I think this has to be done sort of subtly, to try to say the first priority is to get the economy back on track. Once the economy is back on track, we have to have – reimpose some fiscal discipline.

I was in a web exchange yesterday, and someone said, do you want to balance the budget four years from now, probably not. I don't think you should aim to balance the budget four years from now, but I do think you should aim to maybe eight years from now or over some clearly laid out time horizon, get targets for the deficit to come down, not obviously to put you in a straight jacket if there are more cyclical ups and downs, but the budget adjusted for the business cycle should be on a track to decline. I think that's essential and that involves a lot of stuff around the entitlements, which I'm not – I don't have a solution to, but there has to be some approach to. All right, let me stop there. Thank you.

MS. RIVLIN: I think Martin's memo is excellent. I hope the President-elect and his advisors read it. Clearly, they are inheriting a financial crisis and an economic meltdown. The meltdown may have been mitigated, but it's certainly not fixed. Financial institutions still have toxic assets on their books and are understandably extremely averse, they're not lending, and the real economy is in freefall due to a combination of lack of credit and plunging consumer confidence.

I am not as optimistic as the forecast that Martin quoted. I don't think we can count on a boom any time soon. One reason is that the origins of this crisis make it especially difficult to recover from, because we do not aspire and should not aspire to getting back to what seemed normal in recent years.

The crisis was a consequence of general over spending, over borrowing, and that also means over lending at all levels. We have to get back to a different normal, one in which Americans spend less out of their income and save more. We need more domestic investment coming from domestic saving, and this will mean a slower recovery and wrenching adjustments for many parts of the economy, especially retail and financial services. Now, the Fed and the Treasury have been improvising in damage control mode. We will never know how much worse things would have been if they hadn't thrown so much money at a collapsing financial sector, but I suspect both would do some parts differently if they had it to do over.

The original idea of the TARP, the Troubled Asset Recovery Program, was not a bad one, get the troubled assets off the books of the financial institutions at some price between fire sale and the original value, some price that will resolve the uncertainty about their value without causing a cascade of financial institution bankruptcies.

This was very hard to figure out, and the Treasury didn't figure out how they were going to do it or explain it adequately to the Congress, and so they opted, I think rightly, for the simpler task of injecting capital directly into the banks.

We do need to recapitalize the banks. We also need to downsize the financial services sector drastically, and that's not going to be easy. It got way out of kilter with the rest of the economy. So they need to carry on that task and to find a way of mitigating the foreclosure crisis. Lower mortgage rates may, as Martin suggests, be the simplest, most straight forward approach. But we should remember that we can't save everyone. Some people bought houses that they could not afford at any interest rate absent rising prices of houses and we're not going to see that any time soon.

The biggest challenge for the new team is now what to do about fiscal policy, the budget, and it seems to me the key is being able to focus on two problems at once and take action on two fronts at once, not just having a plan, but actually working on two problems at once.

The immediate problem of damage control and recovery, which requires big increases in spending and an increasing deficit, and the not so distant need to restore fiscal responsibility and the confidence of the world credit markets that we're putting our fiscal house in order.

Now, liberal economists like Paul Krugman and others have invade against the deficit hawks, and I guess Martin and I qualify as deficit hawks who they fear are just wimps who don't understand the need to spend now to avoid a deeper recession. They say forget the deficit, go for a big stimulus. That's not right, or it's only half right. We need to go for a big stimulus over the next several years, and at the same time, take actions that will bring down the long run deficit. I believe that we're smart enough to do that.

The stimulus is important, it's got to include immediate help to those who are most effected, food stamps would be high on my list. Aid to the states to keep them from cutting back on Medicaid and other programs would also be high on my list. And some shovel in the ground infrastructure, as they say, should be included, but there is a huge risk of getting carried away on infrastructure. Good investments and modern infrastructure take careful planning and engineering.

We need to do it. We've been under investing in the public sector, but we need to do it carefully and not just say anything goes in the name of stimulus.

The important point is simultaneously with stimulus we need to take action to reduce future liabilities of the government. This can be done in ways that do not reduce spending now. The best example is social security. We need to take steps to reduce the promised increase in benefits, especially for higher income people, and increase the revenue in the future so that the future shortfall is eliminated. This should, I think, include future increases in the retirement age, although the President-elect campaigned against that, and indexing it to longevity. It's not very complex to fix social security now that the private accounts argument has disappeared with the market, and we should just do it.

Mounting Medicare and Medicaid spending are the biggest threats to future budgets, but they have to be fixed in the context of broader health reform. So my final point is this, remarkably, 2009 is the ideal moment for comprehensive health reform. We should not put it off in the name of recession or fiscal crisis, because this is the best possible moment to move ahead.

The essence of comprehensive health reform is, it requires up front investment to accomplish future slowing in the rate of growth of spending, and covering more people will cost more money. We need to invest now in the infrastructure needed to slow cost growth, and that will take time. We need smart investments in health information technology, and institution, call it what you will, a health quality institute that has the mandate to collect and analyze information about treatments and outcomes that will enable us to formulate practice guidelines and change reimbursement rates. It will not be easy to move health delivery to more efficient and effective practices based on solid evidence of what works, but we need to start doing that, and the time to start is now.

In contrast to '93/'94, when we attempted health reform in a period when we were trying to get immediate reduction in the budget deficit, this is the time to do it. We couldn't do it in '93/'94 because we had to do it on the cheap, we couldn't make those up front investments. Now I think the fiscal climate is the right time to do comprehensive health reform. Thanks.

MR. SLOAN: Mr. Powell, you're at the podium.

MR. POWELL: Thank you. I could not help but think as I was listening to Martin and Alice about how intimidating this thing is for me, because I'm not a scholar, and they have presented to you very detailed and very excellent presentations as it relates to what should be done, not only from the monetary, but the fiscal side of this economy.

I'm a practitioner. I spent 38, almost 40 years in the banking business and then came to Washington as a regulator, and some of my people back home thought I had gone to the other side, and there was very difficult days during those period of time. So I'm going to speak to you just primarily from a practical standpoint about where we are today and what caused it today. And I will tell you, I struggle with some of this, because if we – the purpose of this meeting was, we were going to organize a bank, and part of our business plan, we discovered that we need to determine what we're going to do with this money.

We're going to obviously attempt to secure core deposits, but what are we going to do? Three or four – one person would say, let's make agricultural loans, and I come from agricultural accounts and we say those are high risk loans, let's don't do it. Another person would say, why don't we make just general working capital loans, receivables, equipment loans to businesses, and someone said, well, you know, that has a high degree of risk.

And then someone said, let's make the safest loan we can make, owner occupied, single family mortgages, and guess what, that's the root of the crisis. What happened? I think there's two fundamental things that we should focus on, and there's enough blame to go around everywhere. One is basically, we have been – we have rewarded innovation for many, many years. Securitization came along, and that was a wonderful – wonderful to provide liquidity in the market place. I come from an independent community bank; we learned from the crisis in the late ‘80’s and ‘90’s that you don’t loan long term and fund short term. So what was the answer to that? Provide liquidity, sell them to the GSE’s, securitize the mortgages, and get them out in the market place.

One fundamental thing that we did not do, and it’s terribly important when reviewing this crisis, we, as the originators, banks, had no risk associated with that, or as we say in Texas, no skin in the game. We would originate the loan and sell 100 percent to the market place, non-recourse. If it went bad, so what, that was somebody else’s issue.

Therefore, fundamental underwriting was – and also, we all had an attitude in this country that the safe loan was a single family, unoccupied mortgage, and home prices will always go up.

Well, everybody should have lived in Texas in the late ‘80’s and ‘90’s, when we said the price of oil and gas will always go up, and it doesn’t always go up, and I would suggest to you, home prices do not always go up. The second thing is, fundamentally we lost underwriting that we always knew – underwriting criteria that we always knew that was very, very important. One hundred percent loans, even though they were insured by private insurers, no one should make a 100 percent loan. Even government policies encouraged through FHA, 100 percent financing, if you didn’t have the payment, they had an agency that would give you the money. You had no equity into it. The borrowers had no recourse.

One of the issues, as it relates to the continued default in mortgage loans, Larry Lindsey is a proponent, as is Glenn Hubbard, and as others have talked about, is how we deal with the troubled borrower. Larry Lindsey's proposal is, we need to make these loans, should we recast them at a lower rate where there is recourse to the borrower? Now, not just recourse when you say that, but deep seeded recourse, IRS recourse, garnishment of wages.

So people – I think we went through a trend when – and I look at – I live my life through my boys and my mom, my boys have understood that when you sign the mortgage, there was no recourse, if you don't make the mortgage, you give it back to the lender. There was no stigma of defaulting on a mortgage loan. We made it very, very easy, no equity, no stigma about defaulting on a mortgage loan, and no skin in the games. Accountability and responsibility of borrowing money was not there, very fundamental, these are very fundamental things, I lived it in the banking business and I was part of the problems.

We made the loan, we retained other business, deposit business, we sold them other products, but we got rid of any responsibility or any recourse as it relates to the loan, very fundamental.

The second issue is that, how do we deal with this problem. I will tell you, I'm very sympathetic with the folks at Treasury, at the

Federal Reserve, and so forth. This was incredible. I worked, in my most recent life, as it relates to the tragedy caused by Katrina, it was overwhelming to the people along the Gulf states. This has been overwhelming.

The facts changed, changed constantly. An idea comes, it's hit back. The market place is very dynamic. I'm sympathetic to those issues. But in my view, one should have focused on the true cancer. And we should have circled those assets and institutions and had a good bank or a bad bank issue and circled those assets and said, they belong outside the market place, we're going to make sure that the burden of those assets are not on the balance sheet of these financial institutions. The second issue, and they did a very good job at it, and I will give them high marks, very high marks, we were all panicking, I was. I think we moved from the panic stage to the crisis stage.

Most Americans 120 days ago, 106 days ago, maybe even 90 days ago, had two thoughts on their mind when they woke up every morning, and I think you will agree with me, is my money safe.

The second issue is, if I need to borrow money, can I borrow money. The first one that was answered, when we insured 100 percent of all the transaction accounts and insured FDIC institutions, that brought stability in the market place. No more thoughts of runs on banks, no more liquidity crisis, my money is safe.

I actually had people calling me telling me that, these were bankers, that people were coming into their institution, not wanting a cashier's check, wanting currency. They wanted to withdraw cash, not cashier's checks, and that was occurring. Stability as it relates to that occur. I think the issue of liquidity, we haven't answered that yet, and it has a lot to do with this mark to market accounting issue. As I've already admitted to you, I'm not a scholar, I haven't studied – I haven't studied all those issues, I'm a practitioner. I will tell you that, as a banker, when you mark to market liquid assets, it doesn't necessarily show the true meaning of those assets, the true value of those assets.

I will also tell you, it bothers me, and I struggle with this, I think the investing public, depositors and investors, should be able to believe a balance sheet when it's published, it's critically important.

I don't think we've answered that question yet. I struggle with this, I struggle with I think we should do away with the mark to market, and then I struggle with, wait a minute, we've got to deal with making sure transparency, making sure the integrity of a balance sheet is what it says it is.

Now, I remind you that banks don't mark their assets to market. Loans are not mark to market. Loan loss reserve is judgment – loan loss reserves are judgment. So most of the balance sheet – most of the assets on a balance sheet of a bank are someone's opinion, they're not necessarily mark to market. And so the characteristic, it changes when it becomes a securitized asset, but it still is basically a loan, so why should we mark those to market and not mark just the loan we have on our balance sheet to market. That's an issue we've got to deal with, and I have some other thoughts about that and I'll go through those a moment later.

Going forward, where were the regulators, the market place. I think there's going to be a lot, and Martin talks a little bit about this in his paper, and I read some of his other stuff about the regulatory regime going forward. There are bills and legislation now pending in Congress about how to do that. So President-elect Obama, he's got to obviously get into this very quickly.

Ever since I can remember as a banker, we've always talked about how we're going to restructure the regulatory regime. I think it's very important that we have certain guiding principals and we not lose these guiding principals in the height of this crisis.

My guiding principals are real simple. I think it serves all very well to have these three to four guiding principals, competition. I do not believe there should be a single regulator. I think it's important that there is competition, that people seeking a charter have a choice, state charter, federal charter. There would be those that would question whether the federal reserve should be in bank supervision. Are they not charged with monetary policy? Is bank supervision very important to assist and help them with that issue or is it not? But competition is fundamental and should be.

The second issue, independence, and I'm talking about independence from any political, and maybe that's impossible, any political influence. It's very important that a regulator be independent.

The third is, it's very important that a regulator be transparent and have in place due process to those that they regulate. And I will tell you as a former banker, they don't believe that the due process is there.

And we're in a period of time where -- that there will be perhaps an overreaction by regulators as it relates to regulating those institutions that they regulate. It's very important that they be transparent, everybody understands what their decision making process is, and that there is due process going forward.

I think this word integrity –- we talk a lot, integrity of the system needs to be very much in place. So – oh, and one other thing as it would relate to this, and it's a bias I have because of my former role at the FDIC, the FDIC is charged with – has three missions, the receivership of failed institutions, the insurance of deposits, and the third is supervision. The FDIC, if they are the insurer, they have to have access into all insured institutions.

This concept of backup authority has lost its way, and the FDIC must have the ability to go into every institution that's insured in America to look at the issues. Thank you.

MR. SLOAN: We're almost on schedule, we're doing well. I just have one question I'd like to indulge myself in in asking the panel, and then it will be Q and A time and possibly I'll set the panel on itself.

But I think collectively, the four of us have probably been watching markets in government that always, for close to 140 years, and I'm assuming that they're younger than me, and I have never – this credit crunch or whatever it is has lasted now 16 months, and you know, it's starting to really, you know, hurt the real economy, I have never seen anything that lasts this long before.

I think part of it has to do with the fact that in a previous crisis, somebody would get up and mumble something and everyone would bow and say yes, and there was confidence, but now there is no confidence, and I'd just like to get your – any of you who would like to talk about this, why you think this is going on and what would actually fix it, again, in very short simple terms that I'm capable of understanding because I'm only a journalist.

MS. RIVLIN: Shall I start?

MR. SLOAN: Please.

MS. RIVLIN: I think you're absolutely right, this is very much a crisis of confidence, and there are several levels of confidence, most worried about the consumer at the moment, but the consumer is rationally not spending. It is – if you are a consumer, and you think you may lose your job, and you may not be able to get a loan on whatever it is you want to do, your automobile or so forth, then you don't spend. And we're seeing an overreaction on the part of consumers. But consumers were spending too much, and they know it.

How to restore confidence, very hard. We're going to have rising unemployment rates, and we can get money out to people who need it, who will spend it, but I am not confident that we will have rising consumer confidence any time soon. The other piece of confidence that we need to worry about, and this is why Martin and I have stressed the long run deficit, is the confidence of the people who have to lend us money, and a lot of them live overseas, and they've been lending us money, and they have ratified their belief that they will – that treasuries are a good investment, but we can't press our luck. Eventually we've got to show the world that we are fiscally responsible and we're moving in that direction.

MR. SLOAN: Martin, do you have the 90 second confidence cure?

MR. BAILY: I don't have the 90 second confidence cure. I was mulling an answer to your question as to why has this gone on longer. Well, it has gone on longer, the Great Depression lasted a long time, well, it was '29 it started, and '33 was when it sort of bottomed out, so I hope we don't last that long, although we may.

I think financial crisis tend to last longer than a traditional business cycle, which was often inventory driven. So – boom, there was sort of over production, inventories accumulated, then production was cut sharply, and then you worked off the inventories, and then you got back. We don't have that kind of business cycle. We do have an inventory of housing, and that's going to take a lot longer to work through, so that's one reason this is lasting longer. We are now seeing housing inventories begin to go down, but it's taken quite a while and will take a while longer before we work off the housing inventory. And then the interaction between the real sector and the financial sector, so the financial sector crisis has, in part, triggered the decline in the real economy, but now as the real economy goes down, and as Alice says, we get more unemployment, and people losing their jobs, that means we're going to get defaults on credit card assets and other kind of assets. So we still have to play out over time that financial part to restore confidence there.

Now, do I have a 90 second cure? No, I don't. I do think that President-elect Obama, he has appointed a very high powered, competent economic team, so I think that's a good start. That is one thing that presidents can do, is sort of help people through confidence. That's something that Franklin Roosevelt did at the time of the Great Depression. So I hope that President-elect Obama, just by virtue of his communication with the American people, can ease some of the fear that still remains.

MR. SLOAN: Don, do you have any thoughts? I mean you've lived through, you know, personally much more cycles than us because you actually lost money; for us it was academic.

MR. POWELL: I couldn't help but say this has gone on longer; in Texas, it went on a long time. I mean it took Texas, Oklahoma, Louisiana, the Northeast and the Northwest; it went on for an extended period of time. I think it relates back to jobs. I think Martin said it well, I think you've got this banking crisis, and then you have the economy crisis.

I think people have to feel confident in their job. And we live in a world where we have instant news. I mean I find myself looking at the market every day. My mood goes up and down based upon what the Dow Jones does. And I think we have to – I think it's a lot of pieces, a lot of moving pieces, but I think the core of it is two things, jobs, and then I think the financial crisis, we've got to make sure, and we've got to stabilize the banking industry, and I think we're moving toward that way.

I think, again, repeating myself, we've moved from a panic to a crisis mode, and somehow we've got to get – we're going to be in the crisis for an extended period of time, but jobs, jobs, jobs.

MR. SLOAN: Okay. Now it's Q and A time. Oh, great, we're in business, we don't have to do anymore work. And, you know, if I call on you, if you'd just get up and say who you are so we know how to address you, please. You're in the front row, you've got to get something for that.

SPEAKER: Okay. I'm – Voice and Noise Foundation, it's called. Just a couple of weeks ago on this same stage, someone asked a Brookings fellow that comes from Argentina why they trusted so much the dollar within the circumstances, and his answer was, oh, we do trust the American taxpayer. It is sort of a little bit, you know, sit down, a little bit are they supposed to, so it's a very important issue that you have been raising on the whole thing, the fiscal sustainability in the long term.

But with respect to that, I would like to ask -- comment on something that we have heard lately of these efforts of trying to reduce the long term rates by going short and buying up long term bonds. That really changes the profile, the maturity profile of the whole fiscal system. So it's not only as much as how much you owe, but how you owe it, too. So that is opening up a very dangerous misfunding. I would also – this was the first time I heard about regulatory competition in the last 20 years, because we have always been talking that we should get out of regulatory competition and all obey the committee rules, and that was the stability, which is a crazy thing, because we know we're supposed to diversify our portfolios, and what we have been doing is to correlate everything to the same committee and the same credit rating edges, so that's why we have this explosion.

And finally, just a word on distrust, because I think that the reason we completely lost trust this moment was because we had never before been told to trust someone so much as we were told to trust the credit rating agencies. So we really got such a let down, so now, after we've been told that these are the guys who knows, and now we don't know anything about it, that is a very big shake up for trust, and to rebuild that, it's very – it's going to be a long time.

MR. SLOAN: Does anybody want to take any aspect of this?

MR. BAILY: I'll comment a little bit on regulatory competition. We have regulatory competition really at the national level. One of the main concerns before this crisis hit was that New York and U.S. financial institutions or the New York hub was sort of losing out to London or even to other financial hubs, and that was actually driving a program of deregulation, and that was the thing that – was concerned about.

Well, things haven't worked out so well. I think the regulatory competition within the U.S., in other words, we have state regulators, we have the FDIC. Now, I wasn't quite sure of your position, because at one point you said you wanted the FDIC to regulate all banks, but at the moment we have the state regulated, the fed regulated, and the FDIC, the Office of Control of the currency. I don't think we're getting the benefits of competition by having this sort of strangely fragmented structure of regulation. I don't think it's working to improve efficiency in regulation.

So we've got to redesign our regulatory system. Whether it involves some competition or not, I'm not sure. It's got to be better at what it does. And as we've seen from the Basal – the Basal rules haven't worked very well, so I don't think we can rely necessarily on international cooperation. I think we have to have greater skills, I think we have to pay regulators better, and we have to get a more effective regulatory system. We have two ways of trying to get stability in the financial sector; one is skinning the game. People have to have their own money at risk, and other people have to know what the risks are so they can make decisions. That didn't work very well. A, there wasn't enough transparency, B, even the people who should have known seemed to take on all these crazy risks and lose their own shirt, so that didn't work very well.

We have to somehow make that mechanism work better. And then we have a regulatory mechanism, we have to make that work better, too; easier said than done.

MR. SLOAN: Alice.

MS. RIVLIN: Let me jump in and then let Don, who really knows about regulation, because he's done it, respond. I'm also a little skeptical of regulatory competition, because I think it leads to regulatory arbitrage, seeking the weakest regulatory, and the evidence of that was what happened in mortgage lending.

Most of the predatory practices and bad stuff that Don has mentioned, the 100 percent loans and so forth, weren't going on at federally regulated banks, they were going on at mortgage lenders who weren't even banks and who were loosely regulated by the states, if at all. I'm not against state charters, but I think we have to have common standards for mortgage lending, and they've got to be higher than they were in the recent period or we're in deep trouble.

That's one regulatory failure; the other I think was that the regulators in charge, and this goes back even to the Clinton Administration, fought regulation of derivatives. And we have to know more about what's going on in the derivatives market, which just took off and credit the – or the big example, those have to be, if not regulated, at least transparent and traded on some kind of exchange.

MR. POWELL: A lot of things are going through my mind. What was going through my mind was, monopolies are not good, power corrupts, checks and balances are very, very important. If it's a competence issue, that's a different issue, and I want to be sure and make myself clear about the backup authority and also the international regulatory. The backup authority is because of their insurance. I mean I don't know of an insurance company in America that would say I'm going to insure a product, but I can't examine the patient, excuse me, examine the proposed insurer, or I can't go in and look at the balance sheet of what I'm insuring. I mean I just don't know that. So I'm just saying not the primary regulator, but have backup authority, the word backup, not the primary regulator, of having general oversight of all institutions.

Internationally, I think Basal was a mistake, I don't think there's any question. We at the FDIC, again, we didn't understand it. I'm a guy who does – I'm a guy who – I've never seen a model that can predict the future. I think models are important, I think they're very important, but I think they're just one tool.

And that gets me back to my thing I wanted to mention a moment ago. We've lost our way as it relates to capital. We have called – coordinated debt, trust – all those issues, we've said they're capital. We've got to go back to financial institutions where leverage capital, minimum regulatory leverage capital, not tier one, not tier two, not tier three, the American people don't understand that.

We've got to make sure that these institutions are well, well capitalized. If they had been well capitalized, again, this comes from my experience in Texas, we led the nation in failed institutions.

MR. SLOAN: You're always the Lone Star State.

MR. POWELL: Yeah, we're the Lone Star State, yeah, and so it's because it didn't have adequate capital and some other theories.

MR. SLOAN: Okay. The gentleman on the aisle with no tie, I feel a kinship.

SPEAKER: My name is Dan – I guess a specific question about mortgage interest rates. And I agree with the goal of helping homeowners, and it feels like that's good for homeowners and good for lenders and positive externalities for the communities, but if there was a housing bubble and prices are too high, I would think another goal would be also to try and help engineer a structured lowering of prices that doesn't hurt anyone too, too much, but gets them down to some sort of equilibrium.

So lower mortgage rates help borrowers stretch and pay more, so could help inflate the housing prices, so I wonder – I mean I saw, you know, Chairman Bernanke was talking about that on Friday, it seems like it may be easier to implement, but it feels to me that if there is a way to restructure loans so that there is some principal forgiveness, in realizing that the FDIC's track record hasn't been so great, but maybe that's in the implementation of that specific program rather than in the concept of trying to just bring the prices down a bit.

MR. BAILY: Well, I've remarked on a previous occasion, as Alice said, to a considerable extent the crisis we're in has been caused by over borrowing and budget deficits and stuff like that, and now we're sort of like the alcoholic saying, just a couple more drinks and I'll be back on my feet.

You know, let's have a little more deficit spending this year, and let's lower interest mortgage interest rates and that will get us back going. But I think actually, paradoxically, that is the right answer, timing is everything. I think interest rates should have been higher in '06, '07, or maybe have increased a little earlier than they did to prevent or discourage this bubble from getting as over extended as it was.

Now we're in the opposite problem, which is that I think there's a danger we're going to overshoot, and housing prices are going to fall too low, and obviously the economy is sort of overshooting on the down side, so now is the time I think that we need low interest rates, and that's why I propose that, to prevent us from going too far in the other direction. Now, you raise an important point, which is that if the economy recovers, if the macro advisor's scenario turns out to be right, the Fed is going to have to scramble very hard to get rates back up again, to pull some of the liquidity back so that we don't just go right back into another housing boom, so your point is well taken.

MS. RIVLIN: But they know how to do that.

MR. SLOAN: Okay. Over here, yeah.

SPEAKER: -- free lance correspondent. I just ask question. How to change the culture of the – spending in all – for – to the domestic – as Doctor – told us. The second is, everywhere talk about this new regulatory regime, this will take time, and now we are in crisis. How about we just do what Mr. Powell told us, get to the fundamental, also, get back to what already in the regulation book? Thank you.

MR. SLOAN: All right. Don, you're eager –

MR. POWELL: It's a spending issue, and again, I'm not an economist, but there has to be – there has to be some type of punishment, and I'm talking about – I'm saying – what I'm saying is, if I spend more than I earn, I need to be damaged some way, there needs to be a cause and effect, and I think we've lost that in America. Accountability and responsibility have gone to the wayside. If I default on a mortgage, it needs to hurt me. I will think next time before I sign a note where it says I promise to pay. I mean I think we've lost our way. And we need to reward also those that say there needs to be incentive to save on the issue.

MR. SLOAN: Okay. I see a gentleman in the back had his –

MR. BAILY: Can I ask a follow-up question on that?

MR. SLOAN: Go ahead, yeah.

MR. BAILY: And that is, the bankers that I've talked to, and I know you're a banker, but saying we – to borrow doesn't do them any good, because they're a big bank, they go into court and go after a mortgage, the small mortgage owner that's defaulting on their mortgage, and that's just not a tenable position for them to be in. So having recourse wouldn't do anything as far as they're concerned.

MR. POWELL: Well, part of that is another issue about the court system, but I think it does. I think any time someone sues me, it gets my attention. And any time someone has the potential to have a deficiency against me, it gets my potential. As I mentioned, Larry Lindsey has it a little bit different, he wouldn't have to go through the courts, it would be like an IRS deal. Once you default and you prove that you're in default, they can garnish your wages, that's true recourse, because – I mean it would have made me stop and think about that I mean before I did that.

There has to be some accountability and responsibility to people who go in debt, I mean not only from equity into it, because if I have equity into it, I'm going to return the phone call much faster from a collector than if I don't have any equity in it, I've got something to lose.

MR. SLOAN: Let me – for a second. If –

MR. POWELL: Somehow I think these guys are picking on me.

MR. SLOAN: I'm not picking on you. I just, you know, not all of us grow up – you know. The minute this happens, your life is over, you know. If you're going to be garnished, your life is over, people aren't going to hire you if you're subject to garnishment. Do you think that lifetime ruin and destruction might be a little bit of an overreaction?

MR. POWELL: Absolutely, I do. And just like people that are barred from banking because they're unemployable, but here is – I mean I think it's more fundamentally this, because we don't want to get to that point, and that's the reason someone needs to have equity into it –

MR. SLOAN: Oh, sure.

MR. POWELL: -- that's the reason someone needs to have underwriting. And let me just make this, I don't know the banker who, when he or she originates a loan, says, man, I hope I get to foreclose, I don't know of a banker that says I want to foreclose, so bankers are going to do what's in his or her best interest, they're going to modify, amend, forgive mortgages if they think it's in their best interest. I did it, I know, I lived during the crisis. I modified a lot of loans I didn't want to do because it was the right thing and the best thing to do for my interest.

MR. SLOAN: In the back, yeah, you, yes, stand up, take a bow, ask a question.

SPEAKER: Good morning and thank you to everybody for being here. It's become pretty evident that –

MR. SLOAN: I'm sorry, who are you?

MR. COALS: I'm Febreeze Coles and I'm from New York.

MR. SLOAN: Okay.

MR. COALS: Nice to meet you. It's become pretty evidence that the government is going to become a partner in the next few years as far as revitalizing our economy. So my question, and you touched on it a bit, Ms. Rivlin, we're going to have some problems financing ourselves I think based on some recent events, you know. The decreased price of oil is going to keep the Petra dollars from recycling back into our economy, and also, there's been a lot of chatter about China and other Asian nations boosting domestic demand. So how are those events going to impact Treasury's ability to finance our spending in the next few years? Thank you.

MS. RIVLIN: I think that's a very real worry and it's why I think we have to take action now to bring down future deficits. I'm not sure we can squeak by. Some of the things you're suggesting may happen before we even get out of this recession. But the rest of the world, including China, does not have an interest in tanking the U.S. economy, and so they may hang in there fairly well. But we've got – we certainly will face higher interest rates in the future, and we've got to get our house in order as quickly as we can.

MR. SLOAN: Over here.

MR. BAILY: Let me just quick comment, she's got her hand up, a friend and colleague, Susan Lund, has studied this and can maybe chime in on this, but I think, when you talk about decline in the price of oil, when the price of oil comes down, U.S. imports go down, or the cost of U.S. imports, so from that point of view, it's actually a net benefit to the U.S. It's less money to finance our deficit, but the deficit itself is smaller. But, Susan, did you want to make any comment on that question or was it a different question?

MS. LUND: Well, I had a different question. I would say that our research does show, though, that oil exporters will have surplus funds to recycle into global capital markets even if oil falls to $30 a barrel, which we used to think was crazy, now it's looking more realistic. So, yeah, certainly there's a lot less oil money flowing into global capital markets, but the surpluses are still quite large.

MR. SLOAN: Okay. Over here, this gentleman.

SPEAKER: My name – and I have two basic questions; number one, is it not – it is not hurricane, it's not natural disaster, it's human making disaster. Until you don't understand who is guilty, what was mistakes, you cannot improve situation. And from my point of view, concentration of mortgages is wrong. It's not the reason, it's –

And the second question is very simple, why no one from you mentioned the Wall Street behavior. It's a lame point in this crisis. It's this situation, it's spending. People cannot live quietly and to have calm decision because every day something unpredictable as in – honestly, something is wrong. My question is very simple, what's the basic reason why it's happen, who is guilty, and the third question is, what about Wall Street? Why we need to – of Wall Street?

MR. SLOAN: Okay.

SPEAKER: President, government, Congress, all those.

MR. SLOAN: Okay. Don, since you actually mentioned Wall Street, you're just too polite to name them, do you want to answer this? Because you were talking about securitization, that's Wall Street.

MR. POWELL: Yeah; you know, I don't know what to say other than I think there's enough blame for this, and I think we were all, again. I go back to underwriting, we lost our way, and because we lost our way, we had no skin in the games. We as mortgage lenders, originators, had no skin in the game.

But also, we, again, in this country, always, again, I think securitization did provide some liquidity, and I think that's a good thing.

But what's bad about it is that the fundamental underwriting of these loans were wrong, and also the rating agencies who rated these securitizations were in error, too.

So I think – and we were all wanting higher yields, and you know, whether it's a pension fund or whoever it may be, we bought into it.

MR. SLOAN: Alice, you look like you want to say something.

MS. RIVLIN: Well, I think punishing the guilty is always an attractive thing to do, but you have to think why people did what they did. We rely in a capitalist system on people making decisions that are in the best interest of their shareholders or themselves, that's the basic set of rules. But we need a regulatory system that channels that greed in the right direction, and it broke down. We did not regulate the mortgage originations properly, we didn't regulate derivatives, we had too much leverage and too little transparency. That's another way of saying we let these incentives get out of kilter.

Now, there was some malfeasants and some astonishing greed, but the real problem was that we didn't – our regulatory system had not caught up with the enormous innovation in the financial sector.

MR. SLOAN: Okay, back there.

MR. BAILY: Can I just plug a very good paper of which I just happen to be an author, which is on the Brookings web site called The Origins of the Financial Crisis that looks at some of these issues.

MR. SLOAN: Okay, yeah.

MR. REYNOLDS: Thank you; I'm – Reynolds, I used to be on the Board of the IMF, and until recently I was the representative of the European Central Bank here in Washington.

MR. SLOAN: Can you speak a little louder, please? My ears are old.

MR. REYNOLDS: Okay. – Reynolds; until recently I was with the European Central Bank as the representative here. I first want to say that I very much agree with Martin's recommendation and I hope they will be put in place. Secondly, I just want to come back to the regulatory aspect. I'm a little worried about this notion of competition among supervisors, and that's I think not the way the international community is thinking about that. Maybe there are pockets in the United States that feel this way.

And I agree with Ms. Rivlin that you will have, of course, the most – supervisor getting most of the business, so to speak, and I don't think that's a good thing.

There was some criticism of Basal, the Basal Committee. Yes, it's certainly not perfect, but it's an important body we have for international cooperation. And given globalization and given the large, complex financial institution who operate across border, I think nobody – no country, not the U.S. either, can just ignore what is going on internationally.

Basal, too, will be better, and we have to work on getting rid of the procyclicity there. And I would just remind you that in the G-20 financial summit that we had recently here in Washington, there's language about regulatory and supervisory reform which mentions colleges of supervisors, internationally constituted colleges of supervisors, which will look at the largest banks in the world, which, of course, operate globally, I think that's the way to go. Thank you.

MR. SLOAN: Anybody want to say anything?

MS. RIVLIN: I agree with that. I don't think we need a super regulator, but we do need more and more common standards and communication among the regulators and supervisors in different countries.

MR. BAILY: I think the Basil process did fail. There may be reasons why it failed. It took ten years and then the rules that it came out with didn't really work to prevent this crisis. In fact, they had real estate with very low reserves because it was considered so safe. I was surprised at how successful the G-20 meeting was. I would have said ahead of time this was a complete waste of time, but actually it was a surprisingly good meeting. There was a surprising amount of support for finding sort of market – oriented market friendly regulatory structures that would allow things to work better in the future, and I think it laid out some specific steps that needed to be done. I think this college of advisors or international cooperation, I think it was – that was Gordon Brown's suggestion and I think there's a lot to that. So that part of it was, you know, I guess – so my prior view was that international cooperation is great, but we haven't found our way to make it work. The G-20 maybe had a little bit of hope there and I hope it works better going forward.

MR. POWELL: Can I say something?

MR. SLOAN: Please.

MR. POWELL: I can think about the too big to fail issue and the – issues you were talking about, some things you were talking about. I'm not sure that a large institution, and I think it's proven, and we used to say this to some extent, are not nationalized. I hope not, and don't say I said that, but the too big to fail issue is an issue we've got to deal with.

MR. SLOAN: All right. Let me see, over here.

SPEAKER: Good morning; my name is B.J. – I'm a financial advisor in Tyson's Corner, Virginia. And I have two questions for the panel. The first one is, do you advocate – do you believe that some of the recent crisis situation has been caused because we don't adopt the gold standard anymore? And do you think that if we did return to the gold standard, why that would be painful, in the long term, that would actually be better for the world economy? And the second question is, with so much money in motion with all the stimulus, all the country – eventually that's got to be inflationary in our view, and so far we haven't seen any indication of that, and are we creating a bigger monster in due course of time with that inflationary – I'll give you a small example.

In the Roman Empire, you could buy a suit, a belt, and a pair of sandals for a one ounce gold coin. Today you can buy a suit, a pair of shoes, and a belt equal to a one ounce gold coin. It's just that the dollar has taken to buy that gold coin different today than back then.

So are we creating a problem, two questions. Thank you.

MR. SLOAN: Does anybody want to take the gold question? I mean if not, I –

MS. RIVLIN: I have a very simple answer to the gold standard, no, I don't think that would have helped.

MR. SLOAN: And why?

MS. RIVLIN: Why?

MR. SLOAN: Yeah.

MS. RIVLIN: Because it is such an arbitrary straight jacket on monetary authorities that we need much more flexibility in the ability to create money. It can't be abused, and your second question gets into that, have we created so much liquidity that we're in danger of inflation, not in the near term, but that's a real concern for the longer run. But, no, I don't think a gold standard would help us.

MR. SLOAN: Okay. Next question, in the back.

MR. RAFFERTY: Scott Rafferty, Erie Group. Crisis create a lot of opportunities for creative restructuring, and Chairman Powell mentioned the competition within the industry structure. I understand how compelling the logic of some of the emergency steps we've taken recently is, but stepping back for a moment, we're seeing a lot of horizontal concentration in both the retail and the investment banking sides which were never classically competitive.

We're seeing unprecedented integration, and we're also seeing entities that we don't normally think of as being banks coming into the – obtaining federal charters for the purpose of basically creating a more – insulation from the bankruptcy, an alternative regime to reorganize. Are these good things long terms? Are we scrambling eggs that, you know, do we have our eye on creating a structure post-crisis that is competitive and is up to speed with the fundamental changes in technology? I just want to park in back to what you said about the sort of pre-crisis world in which there used to be, you know, local retail banking, where there were bankers who did know you and who loaned you money and had your checking account and did underwriting, which is kind of the reason why real estate was so secure. Do we want to go back to that world, and if so, how?

MR. SLOAN: Do you want to take that?

MR. POWELL: I think part of the concern is, again, there's always going – consequences. The market place is starved for capital, and regulators understand that we've got to put a lot more capital into the system, so these non-traditional entities, private equity, et cetera and so forth, have capital.

And so I think because of we need so much capital, they may be looking the other way to some extent. I struggle with all that, I must say, because I'm a capital guy, I think banks have been undercapitalized, and I think we need to look at the whole capital structure of insured institutions who make the capital level higher. And there's limited capital, but I think there's always going to be in the market place room for a First National Bank of Anderson, Indiana that will compete with the Bank of America because of lots of other things. I mean Bank of America has a distinctive advantage, in my view, primarily because we're a mobile society, and people don't like to change bank accounts. But I think a local bank that understands the local community, that has local management, that has a local Board of Governors, will always have a distinct advantage also.

So I think there's going to be room for both of them. But I think what we should not compromise on is the balance sheet and the capital structure of those in it.

MR. BAILY: We had a friendly neighborhood S&L back in the 1980's and they didn't – that didn't work out too well either. So I think we – now, there were other reasons with the way the deregulation proceeded, but to say that the model of small local banks – the – bank in Germany had their troubles, too, so I don't know that the model of small local neighborhood banker has been proven to be effective in the long run.

The consolidation we're doing works in the opposite direction from the too big to fail problem, so I think we're actually going to be stuck with too big to fail for the indefinite future, and we need to address it directly.

MR. POWELL: Let me just say to Martin's point, the reason we're in a crisis is not because of small banks.

MR. SLOAN: Right, because they can be allowed to fail.

MR. POWELL: Yeah.

MR. SLOAN: Right; well, you survived, though, didn't you?

MR. POWELL: I did, fortunately.

MS. POPLIN: I'm a physician and an attorney from Georgetown, my name is Carolyn Poplin. Three quick points, one is that it seems to me there's a synchronization problem. We have to have the banks lending. At the same time we have to have people with money in their pockets spending, and if they're not together so that we have demand and we have businesses that produce, it's not going to work and we're going to slide further in that awful spiral.

People will spend because they have to. If the banks aren't lending the money that they've been given, then the money needs to be taken away and given to institutions that will lend it to the people who need it. Second, I don't think you're going to get anywhere with personal accountability for homeowners until there's personal accountability for bankers. Third point, how about the war bond solution? You see that personal savings accounts, IRA's, TSP, all of that hasn't worked.

I've lost 40 percent of my thrift savings plan, the government 401K, I'm 61, I can't make up that money anywhere. Perhaps people could save their money in federal accounts, war bonds accounts type things where the government pays a reasonable rate of interest and then recycles that money into the economy, in the stimulus plan, so we're borrowing from ourselves and not from China. Thanks.

MR. SLOAN: All I'll say is, I mean savings bonds exist. I mean you wouldn't know it, but they actually do exist. I own one. Anybody want –

MR. POWELL: I'll just make one comment about banks should be responsible, I couldn't agree with you more. I think, obviously, there was some abuse by lenders and by some other institutions. I mean I couldn't agree with you more. There has to be accountability and responsibility on both sides, the lender and the borrower.

MR. SLOAN: Okay.

MR. BAILY: We at Brookings like to think we're smarter than everyone else, but I will have to say that I've lost a ton out of my retirement account, too, so –

MR. SLOAN: All right. Now we should auction off the last question, shouldn't we? For Brookings, write your check. All right. This is a tough decision. All right, back over there, the gentleman, you, you win or lose as the case may be. We're simpatico clearly.

MR. SONICKSON: Ethan Sonickson with the National Association of Insurance Commissioners. And obviously you can tell my bias on regulation here. But to your point about the competition between regulators, you know, that's like having the cops on the beat competing against each other to make it more appealing to criminals, just in my humble opinion.

But is there some way to have more efficiency without compromising effectiveness? Whether that's a systemic regulator, you know, someone who can interact with the international community, but preserve the strength of, you know, having those cops on the beat and not putting all your eggs in one basket, where there's one single point of failure.

MS. RIVLIN: Yes, I think so. I mean I think the Fed has to be the systemic regulator. I'm not enamored of trying to pull all the boxes together under one. I think we need to strengthen the SEC, among other things. We need to figure out what we're going to do about insurance, which as you know, is not regulated at the federal level at all. And I think there is some case for federal regulation. But the one regulator does not make sense.

MR. SLOAN: All right. We have three minutes left. We need a short question that will elicit short answers; if not, you will have to pay. Anybody got a short question? You haven't gone, have you?

MR. LAWRENCE: No.

MR. SLOAN: Okay.

MR. LAWRENCE: John Lawrence from Dickinson Wright to follow up on Ms. Rivlin's last comment. If each of the panelists could give their prescription for how legislatively we would have a regulator who would supervise and worry about systemic issues, which probably would necessitate being able to, in a manner of speaking, review and have oversight of the activities of the subordinate regulators in each instance. So you could have a situation, if the Fed were the systemic regulator, it would supervise the activity of the FCID, the Office of the Comptroller and the Currency, the Office of Thrift Supervision, if it continues to exist, and the other entity agencies that are functional regulators and how you actually would accomplish that in a way that would both work and preserve harmony among the agencies.

MR. SLOAN: Gee, that's a simple question. Anybody got a 20 page proposal we can give him?

MS. RIVLIN: I didn't get all of that, but I think the framework is the one that we have, the bank holding company, and these big financial behemoths have various functions under them, and we need the functional regulators, and they need to all communicate. But that seems to me a workable model. The failure was not at that level, the failure was at – that we weren't regulating a lot of other things like the derivatives market, the credit swaps market, we didn't have consistent lending standards for mortgages, et cetera.

MR. SLOAN: All right. And it's now 11:30, that concludes our session. Thank you for coming. And I'm sure you'll all be back here for the seventh one, whenever that is. Thank you.

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

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in and for the
Commonwealth of Virginia
My Commission Expires:
November 30, 2008