KNOPF Q&A

A Conversation with

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authors of

13 BANKERS

THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN

Q: Who are the 13 Bankers of the title? Are they the individuals at the heart of the crisis or are they a symbol for something more?
A: The "13 bankers" are the thirteen bank CEOs who met with President Obama during the depths of the crisis in March 2009, in a meeting that demonstrated the solidarity of the administration with Wall Street. But in another sense, they symbolize the political influence of Wall Street and the ideology of finance. In 1998, Deputy Treasury Secretary Larry Summers tried to convince Brooksley Born not to regulate derivatives by saying, according to the Washington Post, "I have thirteen bankers in my office, and they say if you go forward with this you will cause the worst financial crisis since World War II." The access that bankers enjoyed to the halls of power was and remains a major challenge to our political system.

Q: You write that President Obama defended Wall Street against broad public outrage, despite the major role that these banks played in causing the financial crisis. Why did he rally to Wall Street's defense? Why does his administration seem more aligned with bankers than consumers?
A: The Obama administration believes, as we do, that a healthy financial sector is necessary for a healthy economy. Where we differ is that they believe that a healthy financial sector requires these big banks, in their current form, with their current management, doing essentially the same things they have been doing for the past decade. Perhaps in the heat of the crisis they thought that anything else would be too great a risk. The result has been policies that are, quite frankly, very generous to Wall Street. The administration seems more aligned with bankers than consumers because they are more aligned with bankers than consumers. That's not because they like bankers more than ordinary people; it's because in their conception of the world, bankers are more important to the economy.

Q: There are other industries that wield power in Washington. Why should we be especially concerned about the financial industry?
A: Finance is special because it has the ability to hold the economy hostage. Without a functioning financial system, the economy could collapse quickly, as we almost saw in September 2008. No other industry has this degree of leverage over public policy. The auto industry is also important, because of the number of people it employs, but we say last year that the government had the ability to call the shots in restructuring the industry. The same was emphatically not true with the financial sector.

Q: What agencies are responsible for policing the banking industry, and how have they failed us?
A: The main agencies are the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation. During the last decade, to varying degrees, these agencies became cheerleaders for the financial sector rather than its overseers. They swallowed the idea championed by Alan Greenspan that the financial markets could self-regulate, and therefore the job of regulators was to let market forces work. The OCC and the OTS even went out of their way to prevent state governments from attempting to regulate the financial sector. This was a classic example of regulatory agencies being captured by and adopting the interests of the companies they were supposed to regulate.

Q: Is there a way to strike a balance between regulation and deregulation so that grave economic situations can be avoided and we can still earn money in our 401Ks?
A: Absolutely. Financial crises are bad for us as savers and investors; look what happened to the stock market this time. Beyond that, look at what happened to the national debt; that's a cost that will show up in the future either as higher taxes or as reduced government services or payments. Reducing the size of our financial sector would not only reduce the frequency and size of damaging financial crises, but it would also encourage growth in the real economy, which is what our long-term financial health depends on.

Q: What kind of policy is needed to make the relationship between our financial and political systems more equal?
A: There is no magic bullet. As long as Wall Street remains politically powerful, any new legislation or new regulations can be undone by the financial lobby. Breaking up the big banks will help, because it will reduce their political and economic power. But in the long run, we need to reverse the consensus among the political establishment that what is good for Wall Street is good for America. Leadership from the president would help, but ultimately this will take years of public debate, like we saw a century ago when the conventional wisdom shifted against the big industrial trusts.

Q: Should banks be held accountable for their breaches on behalf of consumers? What are some of the breaches that contributed to the housing bubble? Apart from the ethics involved, were regulations disregarded during the mortgage meltdown? Were laws broken? What kind of regulations are needed to prevent this from happening in the future?
A: There was an almost complete breakdown of consumer protection vis-à-vis mortgages and other financial products. This breakdown was not accidental – the rules were left deliberately vague by Congress and regulators who believed that finance was good, unregulated finance was better, and unfettered finance run amok was best. The laws were not, in large part, broken because the laws and supporting rules were so weak. We need to completely revamp consumer protection in this area.

Q: In what ways can financial innovation be utilized to help rather than harm consumers?
A: There are many "innovative" financial services that can help ordinary people, but they have already been "innovated;" the challenge now is making them accessible to more people. Index funds, inflation-indexed bonds, annuities--these are all products that have been around for decades, but that not enough people use. Part of the challenge is education. Part of it is that financial services firms make more money selling expensive products, like actively-managed mutual funds, whether or not they provide any additional value to the customer. Part of the challenge is simply making good products available to more people. In some poor neighborhoods the only way to get a loan is from a payday lender at astronomical interest rates; what those

neighborhoods need is an old-fashioned bank.

Q: What could the government have done differently in dealing with the financial sector when the economic crisis began? What are the next steps that need to be taken in order to avoid another—and even worse—economic disaster in the future?
A: The government had to take extreme steps to prevent the financial sector from collapsing in late 2008. But at the same time, the government should have made fundamental reform the price of its rescue efforts. The most sick banks should have been taken over, cleaned up, and sold off in pieces. By helping the banks recover, and waiting for them to recover, the administration made the task of reform that much harder. New regulations should now be dictated by Congress (not left to regulators), and they should be broad and simple--like setting a hard cap on the size of banks, limiting their size relative to the economy. The simpler the rule, the harder it will be for banks to getting around it, and the harder it will be for friendly regulators to overlook it. The big banks will fight tooth and nail against such proposals but, as they fight, they will reveal their power and undermine their support.

Q: Will it ever be possible for the interests of the financial sector to align with the majority of U.S. citizens?
A: The interests of the financial sector were moderately well-aligned with those of most citizens for several decades following the Great Depression and World War II. Banks made money if their borrowers paid back their loans. (There was plenty of ugliness such as racial redlining, but the basic banking model was sound.) The problem is that in the past few decades, the individual rewards for bankers have become increasingly detached from their contributions to the real economy. But if we tighten oversight of those more speculative activities, such as trading in credit default swaps, we can force bankers to make money the old-fashioned way--by supplying capital to people and companies that have a good use for it.

Q: Don't the banks owe me—the taxpayer—a share of those bonus pools? Instead of using their bailout money for accruing large profits and paying out large bonuses, shouldn't the banks be helping pay off the Federal debt? How were they able to accumulate such profits so quickly? As a lender, were the terms set forth by the government too lenient?
A: The terms set by the government in the initial TARP investments and later were definitely lenient, but that was the point--the plan was to be generous to banks because we needed them to get back on their feet. That's also why the Federal Reserve provided so much liquidity to the financial system--in order to make banks more profitable. Now that the good times are back, the banks have no obligation to help out the government, and some would argue they have a duty to their shareholders that prevents them from helping the government. But still, there's no good reason for record bonuses. Those bonuses are just a transfer of wealth from bank shareholders to bank employees, and it's disturbing that the employees continue to take home most of the profits.

Q: What's it going to take—and cost—to radically change our financial system?
A: It will take a real political battle. The fight could be led by Barack Obama, just like Teddy Roosevelt led the charge against the big trusts a century ago. Or it could come from a change in the conventional wisdom, which could take a decade or more. Given how hard the banking industry has fought even minor proposals, like the paltry bank tax proposed by Obama in January, it will take more political muscle than we have seen so far.

What will it cost? Nothing. We're talking about curbing some of the excesses of the financial system, which caused a misallocation of resources in the economy and also caused many of our

brightest young people to go work on Wall Street instead of making real products or starting real companies. Changing the financial system will only be good for our nation's economy and for our government's tax revenues.

Q: You write that economic reform is necessary but "It is ultimately a question of politics – whether the long march of Wall Street on Washington can be halted and reversed." How did Wall Street's capture of Washington come to pass?
A: Three ways, in increasing order of importance: First, major banks influenced Congress through old-fashioned campaign contributions and lobbying expenses. Second, the revolving door between the private sector and government gave Wall Street powerful friends in Washington. Third, Washington became captivated by the ideology of finance--the idea that financial innovation was always good and financial regulation was always bad.

Q: What can individuals (not Congress, the Senate, or the President) do to help improve and change the current state of our economy?
A: First and foremost, we have to break the political power of banks that are "too big to fail." This is an issue on which both left and right can agree. The consensus on this issue must change and must change fast if we are to avoid another crisis. Everyone can make a difference – turn this into the leading topic of conversation at your workplace, around the dinner table, and whenever you meet your in-laws. Become a complete bore on the paramount importance of breaking up the biggest banks. And listen to your voice amplify as it spreads throughout society and breaks down the glass walls that surround our politicians.

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