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VIA E-MAIL

Gary J. Cohen, Esq.
General Counsel
Financial Crisis Inquiry Commission
1717 Pennsylvania Avenue, N.W.
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Washington, D.C. 20006-4614

Re: FCIC Interview of former Treasury Secretary John W. Snow

Dear Mr. Cohen:

At the request of Secretary Snow, I am responding to your December 14, 2010, letter to him concerning the FCIC's potential use, in the Commission's forthcoming Report, of two quotes from, and/or paraphrases of, statements he made during his October 7, 2010 FCIC interview. As noted in my December 15, 2010 e-mail to you, I wanted to compare the quotes/paraphrases in your December 14 letter with the audio tape of Secretary Snow's interview, in order to resolve my initial concerns about the accuracy and context of the two quotes/paraphrases. Having completed that process, I believe that both quotes/paraphrases need to be revised, or placed in better context, to more fairly present Secretary Snow's statements.

1. <u>Proposed Quote</u>: "Nobody had a full 360-degree view. The basic reaction was, 'Well, there may be a problem. But it's not in my field of view,'" Snow told the FCIC. "Our default rate is very low. Our institutions are very well capitalized. Our institutions [have] very low delinquencies. So we don't see any real big problem."

The way in which quotation marks are used in this proposed quote mistakenly attributes to Secretary Snow certain views about financial institutions and markets during his tenure that, in fact, he was attributing to others—primarily financial regulators. The portion of his interview from which this proposed quote is drawn makes this quite clear. A transcription of the relevant portion of the interview (beginning at minute 26:06 of the audio tape) is as follows:

> **Secretary Snow**: I recognized that our financial regulatory system really wasn't up to the task of a modern world. We had these pigeon holes, we had these bifurcations, we had lack of a 360 degree regulator. We had, we

compartmentalized oversight of the financial market. The bill [Dodd-Frank] has made a little progress there, not as much as I'd like to see. But at least, you know, there's an effort to get a systemic regulator. Which was something that we were working on here at Treasury back in, I guess '05, '04/'05 through the Office of Finance -- the Undersecretary for Financial Policy. Because it was pretty clear that the architecture of our financial regulatory system wasn't up to the modern developments in financial markets. And we had to, we should be. We should be thinking about a new financial regulatory system and commissioned the Undersecretary for Financial Policy, Randy Quarles, and his very able deputy, Emil Henry to put together a blue print. What should the financial regulation look like? So we moved on that. We recognized that there wasn't a systemic regulator. We'd get together with the various regulators from time to time and talk about issues in the financial system. But there was nobody really overseeing systemic risks. As I've said before, it was like the elephant and the blind people. They each felt a piece of it but nobody saw the whole thing. So we saw the need for modernization of financial regulation with a systemic risk regulator. Also, in probably '05, we saw signs that there was troubling developments in debt markets, mortgage markets. The growth of subprime, growth of Alt A, growth of, expansion of, what they then called exotic, I don't think we called them "ninja loans" or "liar loans" then. But there was a feeling, you could get a sense. That's what the... Treasury is not a regulator but Treasury has responsibilities to provide some oversight of the financial system and to propose policies.

W. Edelberg: Do you recall when you....this first came on your radar.

Secretary Snow: I do indeed. I think it was probably early '05, maybe late '04. I remember concern and inviting all the regulators. The Fed, the OCC, the FDIC, the credit union oversight body, OTS, the whole range. Filled a room. We couldn't do it in this room; we had to do it in a much bigger room. And you'll recall of course, that after the savings & loan bust up, that collapse, the Congress wanted to make sure that Treasury didn't get involved in regulation of financial institutions and in effect put out an edict that Treasury was to keep their hands off the regulatory agencies. Even though some of them are housed in Treasury, that Treasury was not to be directly involved in the decisions the regulators made. But we did have an oversight responsibility, so exercising the oversight responsibility, I probably came up as close to that line as you can go without going over it by calling in all the regulators and saying: "Let's have a discussion about

> what you're seeing in the debt markets. We're seeing some troubling things, some things that at least things raise concerns. Try and put a spotlight on it and get your reaction." There ensued a number of meetings between the Treasury Department and the regulators. And out of that came, gradually, some new guidance on subprime and other things. But back then the issue was simpler things like balloon payments, and no interest loans, negative amortization I think, sort of loans. I remember talking to Alan Greenspan and other regulators about it and there was a general sense that something we needed to be on top of was going on in the debt markets.
>
> **W. Edelberg:** And do you feel like, did they share your sense? Alan Greenspan and others?
>
> **Secretary Snow:** Well, I was struck by that meeting. Again, confirmed my view, ***nobody had a full 360 degree view. The basic reaction was: "Well there may be a problem but it's not in my field of view. There may be a problem but we don't really see it. Our default rates are very low; our institutions are very well capitalized. Our institutions, very low delinquencies, so we don't see any real big problems."*** This was early '05. Well, they were all looking at different… nobody saw the whole picture. And everybody tends to think the things they regulate are being regulated well and are healthy and strong and so on. I think that's just the way it goes. But it confirmed my view we needed to redouble our efforts on a blueprint for the financial system and on a systemic regulator. But, and some good came from those discussions, because as I say, new guidance was issued.
>
> **W. Edelberg:** That's right.
>
> **Secretary Snow:** New guidance was issued. …

[Excerpt ends at minute 32:55] [Emphasis added].

As the excerpt makes clear, the statement that "nobody had a full 360 degree view" of systemic risk reflects Secretary Snow's assessment of the circumstances that existed at that point in his tenure. However, the remainder of the proposed quote summarizes what financial regulators expressed to him when they attended a meeting convened by Secretary Snow and others at Treasury, who were not financial regulators. The latter part of the proposed quote fails to use internal quotation marks to make this point clear, and thus mistakenly attributes to Secretary Snow the views that in fact were expressed to him by financial regulators.

Moreover, without knowing the context in which the FCIC Report may use this proposed quote, it is unclear whether the Report will explain, as it should, that these views were expressed by financial regulators in response to questions raised by Secretary Snow and others at Treasury about developments in the financial markets in late 2004 and early 2005.

2. <u>Proposed Paraphrase</u>: Reflecting on the role of the financial system in the American economy, former treasury secretary John Snow told the FCIC that while the financial sector must always play a "critical" role in allocating capital to its most productive uses, over the last 20 or 30 years it had become too large.

This proposed paraphrase omits important context that risks altering the meaning of what Secretary Snow said. This paraphrase is drawn from the following portion of Secretary Snow's interview (beginning at minute 1:30:34 of the audio tape):

> **W. Edelberg:** What in your mind, just very generally speaking, is the proper role of a financial system? What is it actually supposed to do? What is its role in society and did its role in society change over time? It's a 10,000 foot question.
>
> **Secretary Snow:** It's a good question. It's an excellent question. I think we overdid finance versus the real economy and got it a little lopsided as a result. Finance has a ***critically*** important role to play of course, in moving capital from savers to investors; from the originators of savings to people who can put it to better, higher use in terms of productivity for the economy. And that's absolutely essential. For any well functioning economy has to have a good finance system that takes capital from savers and puts it into people's hands who can use it well. And then it has to price it well. I always come back to that. It's got to price it right. So, capital gets allocated to the right people based on the marginal productivity of capital in A's hands, versus industry B's hands versus industry C's hands. That's the role of financial markets, allocating capital to the best uses. Now, over the last 20 years, 30 years or so, the financial sector has grown relative to the real economy, quite remarkably. And I guess that reflects an awful lot of things. But, one, it reflects is that banks make so many loans to each other and financing each other's trades. And, whatever verdict you come down on it, it's observable that the financial sector is much bigger and the growth of it is driven by loans from banks to other banks. Now, what to make of it, I'm not really sure, but it's observable.
>
> It's also observable that compensation levels in the financial sector have risen relative to compensation levels in virtually every other sector. It is

> observable that graduates of the best universities gravitate to Wall Street much more so today than they did 30 years ago because the returns on Wall Street are so much higher. And, is this healthy from society's overall point of view? Well, in that sort of value judgment, policy judgment, I don't think so. ***I think one can properly raise the question whether the financial sector hasn't grown larger than is socially efficacious.*** And in the process hasn't created substantial risks because it's grown by loans. And, going back to my earlier point, you can overdose on debt, and debt as a fraction of GDP all around the world has risen significantly. We have a lot more debt than we used to have which means we have a much bigger financial sector. There's a market correction going on here, it's sort of painful, but the financial sector is going to shrink, it's going to become smaller, it has to, because we are de-leveraging, paying down these debts, shrinking the debts, shrinking leverage, higher capital standards. ***So, did the financial sector get too big? Absolutely, that's what the market is telling us. It's shrinking it. This is a market reaction, this isn't just Dodd-Frank, and Basel rules, this is the marketplace saying too much risk.*** Too much risk, too much financial leverage, so we're getting a big correction which I think is a healthy and a good thing. ***Did the financial sector get too big, relative to everything? Absolutely! How do we know, the market is telling us.***

[Excerpt ends at minute 1:35:32] [Emphasis added].

In the quoted excerpt, Secretary Snow makes two separate points: (i) that "one can properly raise the question whether the financial sector hasn't grown larger than is socially efficacious"; and (ii) that "the market is telling us" that "the financial sector g[o]t too big." In contrast, the proposed paraphrase attempts to ascribe to Secretary Snow the view that the "role of the financial system in the American economy" had become "too large" "over the past 20 to 30 years. Any paraphrase of this portion of Secretary Snow's interview in the FCIC Report should more fairly and accurately distinguish between the two separate points that Secretary Snow made.

Secretary Snow was pleased to be able to participate in the important work of the FCIC. He has asked me to let you know that he would consider it beneficial if you and I could discuss and resolve his concerns about the proposed quote and paraphrase. Because at least one of the proposed quotes/paraphrases relates to Treasury Department matters, it also would help to include a representative of the Department in our conversation. Please let me know when it would be convenient for you to speak with me about these matters.

Very truly yours,

Mitchell R. Berger

cc: Hon. John W. Snow
Michael Gordon, Esq.