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Lessons Learned: Christopher Seefer

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Yale Program on Financial Stability Lessons Learned

Christopher Seefer

By Mercedes Cardona

Christopher Seefer was recruited to the Financial Crisis Inquiry Commission (FCIC) to serve as the commission's director of investigations. The ten-member bipartisan commission was charged with investigating and determining the cause of the global financial crisis of 2007-09 (GFC). The commission held over 19 hearings and interviewed more than 700 people from September 2010 to January 2011 and produced a 662-page report that attempted to explain why the crisis came about and what roles government and private enterprise played in the crisis. This "Lessons Learned" is based on an interview with Mr. Seefer.

A crisis is widespread, and in looking for the root causes there will be many opinions and viewpoints; it is critical to gather a multitude of viewpoints.

The commission's charge was broad, and Seefer said that in order to get to the root of the causes of the crisis, the commission set out to interview a wide range of companies and individuals. They knew from the beginning that they wanted to interview all types of market participants in order to build a full picture of what had happened and why. He described the commission's scope of inquiry this way:

> Essentially, you're going to look at the banks or the insurance companies that failed or received government assistance to figure out what happened with them, to the best of your ability. An important part of that requires that you are not only talking to the company's executives and looking at their internal documents, but also going to the folks whose work is adjacent to theirs. Whether it was the rating agencies giving AAA ratings to the subprime securities firms were issuing, the auditors certifying financial statements with questionable accounting practices, or the regulators who were, supposedly, on a periodic basis making sure everything was "safe and sound." And so, that's the scope of who we investigated.
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> Then, of course, you had outside investors, market participants and just people that were on the other side. We interviewed the folks that thought they recognized the problems early on and took the short side of the security investments, the Michael Berrys of the world, the John Paulsons of the world.
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> We cast a wide net to talk to as many people as possible about, one, the specific companies that we were looking at, and two, more generally what they saw as the causes of the crisis. And I actually think that's one of the things that's a nice legacy of the FCIC on [its] website. Most, if not all, of those interviews were recorded and are on that site. And you've got a lot of opinions from folks that went through it about what they saw as the causes or the various contributors to the crisis.

To get to the bottom of things, you will need subpoena power.

Because of the high profile of the commission, Seefer said most parties cooperated with its requests for documents and interviews. But after losses as widespread and severe as those in the GFC, litigation often follows, which complicates efforts to get to the root cause. Many of those involved resisted speaking with the commission or would limit the areas that they would speak about on advice of counsel.

In such circumstances, often the threat of a subpoena was enough to compel reluctant parties, said Seefer:

> I don't think we had to use the subpoena a lot, because the threat of the subpoena was good enough. I mean, you essentially tell people, "Look, we want you to talk to us and you can say yes or no, but if you say no, then we're going to subpoena you." And the same thing on documents: "We're going to send you a letter asking for documents related to these areas. If you say no, we're going to subpoena you."

However, Seefer recalls, even some parties who wanted to cooperate "needed to be subpoenaed" for coverage with their shareholders and any possible legal action:

> My recollection is that very rarely did we have to issue subpoenas. I think we had to issue one or two to Goldman Sachs because they were dragging their feet on providing documents. At least, in my opinion, they were dragging their feet—I think trying to run out the clock. Some people didn't want to talk for us and asked for a subpoena. Warren Buffett wanted a subpoena before he would talk to us. And so, we gave him one. It was kind of interesting, really, because he was very cordial and nice when we did go out there and talk to him, but I think he just wanted it to show that he was compelled to talk to us.

In the case of Goldman Sachs, Seefer said commission chairman Phil Angelides used a radio interview to pressure Goldman Sachs to stop dragging its feet and produce documents the commission requested. Sometimes, Seefer continued, the threat of bad publicity, of being seen as avoiding the investigators, was enough to convince a party to provide documents and agree to an interview.

Don't let panic send the market into a tailspin. Transparency helps.

When asked to identify an element of the commission's report that he thought was particularly valuable, Seefer pointed to its findings about corporate transparency. He noted that during the GFC, the lack of transparency had severe effects since the entire economy was experiencing the results of the housing market collapse. "It was very difficult to tell just from public reports the level of derivatives that a company had and what their counterparty exposure was," said Seefer. The lack of transparency made matters worse in the early months of the crisis, September and October 2008, said Seefer:

> Lehman went down, and nobody knew for sure what impact they were going to have on other financial institutions. That lack of transparency contributed

> to more and more panic and more and more declining asset values and stock values and bond values. It was like a vicious circle, just spiraling lower and lower and lower in terms of asset values.

Seefer urged, "Again, lesson learned or policies to follow is: Make sure these companies provide more transparency on the assets and liabilities that are on their balance sheets and their exposure to other counterparties that they're doing business with."

Better regulation, and coordination between agencies is a must to avoid a new crisis.

Another area of the commission's report that Seefer pointed to as valuable was the fragmented scope of financial regulation. "It's not necessarily the case that there are too many regulators in different agencies, but that there was not much appetite for enforcing oversight," said Seefer. "I don't know that you need that multiple-headed monster," said Seefer, referring to how some countries have fewer regulators with broader authorities. He continued:

> The bigger issue is that the staff in those regulatory agencies largely saw the looming problems and didn't act, for whatever reason—whether it was conflicts, political pressure, or just the lack of appetite to take on a multi-trillion-dollar company with high-priced lawyers that were going to fight.

However politically difficult it may be to achieve, regulators have to take a stronger position, Seefer insisted:

> Gatekeepers need to do their job and auditors need to take a closer look at financials and make sure they're legit. Rating agencies need to do a better in rating securities. Regulators need to do a better job in regulating the institutions they're charged to regulate. [Those], to me, are the lessons learned; but that's been known, I would like to say, at least since the Great Depression.

Seefer said some of the actions that regulators could take to address issues uncovered by the commission are common-sense measures such as higher capital requirements, higher liquidity requirements, better ratings of securitizations, and more transparency regarding derivatives. Also, said Seefer, "[c]ompanies need to put together a plan on how to have an orderly bankruptcy, if nothing else, if you get in trouble and you're not going to be able to survive it, or at least [prepare to] survive it without substantial government assistance." He noted that the Dodd-Frank Act does require certain large companies to create this type of "living will."

It all could happen again. Individual consequences were not severe enough.

Seefer pointed out that many of the failings the commission uncovered have not been addressed in the decade since the crisis and that few individuals were prosecuted. Seefer believes that this lack of prosecution created little disincentive to moderate the behaviors that led to the crisis. He reflected further:

> You hope that the executives of the financial institutions learned, that the regulators learned, that the other gatekeepers learned, and that they're running a safer and sounder business that can react to unexpected economic events or financial events. But I can't say I have a lot of confidence in that, because there's always the financial incentive to push it.
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> I mean, people make money by generating profits for their company, even if the profits that are reflected on the financial statement may not really be there, because of either accounting shenanigans or other things. And not a lot of people, if anyone, were really, personally, held accountable for any of this.

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