Opening Remarks of Phil Angelides
Chairman of the Financial Crisis Inquiry Commission
At the Hearing on "The Role of Derivatives in the Financial Crisis"
June 30, 2010
Washington, D.C.

Good morning. Welcome to this hearing of the Financial Crisis Inquiry Commission. As always, I'd like to thank Vice Chairman Thomas and my fellow commissioners. I particularly want to single out Commissioners Born, Hennessey, Thompson, and Wallison for taking the lead on this hearing.

Today we will be examining the role of derivatives in the financial crisis. I must say that despite 30 years in housing, finance, and investment--in both the public and private sectors--I had little appreciation of the tremendous leverage, risk, and speculation that was growing in the dark world of derivatives. Neither, apparently, did the captains of finance nor our leaders in Washington.

The sheer size of the derivatives market is as stunning as its growth. The notional value of over-the-counter derivatives grew from $88 trillion in 1999 to $684 trillion in 2008. That's more than ten times the size of the Gross Domestic Product of all nations. Credit derivatives grew from less than a trillion dollars at the beginning of this decade to a peak of $58 trillion in 2007. These derivatives multiplied throughout of our financial markets, unseen and unregulated. As I've explored this world, I feel like I have walked into a bank, opened a door, and seen a casino as big as New York, New York. Unlike Claude Raines in *Casablanca* we <u>should</u> be "shocked, shocked" that gambling is going on.

As the financial crisis came to a head in the fall of 2008, no one knew what kind of derivative-related liabilities the other guys had. Our free markets work when participants have good information. When clarity mattered most, Wall Street and Washington were flying blind.

To be fair, derivatives have a legitimate purpose: to help hedge against risk. But much of what has been traded in recent years--especially synthetic securities--is just bet upon bet upon bet. They don't build a factory. They don't start a business. They don't add a job. These securities may have been synthetic--but they destroyed real peoples' real-life savings.

One might think that financial reform legislation will take care of all of this. But it would be naïve to believe that a signature on a law--in and of itself--marks the completion of financial reform.

In fact, it is only the beginning. It took a good decade for New Deal reforms to be put into action. The real nitty-gritty of financial reform will be worked out in regulations. No wonder lobbyists are already lining up to help write the rules. Real reform depends on the will to make it happen—of regulators, of the public officials who appoint them, and of the financial leaders who must live by them. This commission has already seen plenty of instances of sensible regulations that went unenforced. Sadly, we know that while the soul may be willing, the flesh is often weak.

All of us who want to avoid another financial crisis need to understand how we got into this one. In the case of derivatives, my fellow commissioners and I are seeing something we've seen many times in our investigation: enormous risk, reckless leverage, and early warning signs being ignored. In this instance, there were the reddest of red flags:

- In 1994, Orange County, California goes bankrupt in a derivatives deal gone bad.
- In 1998, Long Term Capital Management causes a near financial crisis.
- And in 2001, Enron--knee deep in derivatives—explodes, causing what at the time was the largest bankruptcy in U.S. history.

It's not as if no one warned us. Back in the nineties, Commissioner Born, then chair of the Commodity Futures Trading Commission, saw the looming crisis and argued strenuously for transparency and common-sense regulation of derivatives. Her prescience and tenacity earned her the John F. Kennedy Profile in Courage Award. If she had prevailed, I believe we would have had a safer financial system.

And so today we'll look at derivatives and the financial crisis through the prism of two companies, Goldman Sachs and AIG. The two were linked through derivatives as, indeed, was all of Wall Street. In June 2008, Goldman's derivative book had a stunning notional value of $53 trillion. We'll ask Gary Cohn, Goldman's President and Chief Operating Officer, how his firm's derivatives dealings may have contributed to the financial crisis--and the economic crisis that followed. We'll ask how it came to be that AIG--a once-respected company that Americans looked to for traditional insurance needs--found itself on the losing side of many derivative transactions with Goldman and other companies and had to be bailed out with a commitment of $182 billion in taxpayer's assistance. We'll have questions for AIG's former CEO Martin Sullivan as well as the former head of its Financial Products group, Joseph Cassano, who is testifying for the first time since the crisis. And we will explore the Goldman-AIG connection—

a multi-billion-dollar strategic relationship that ultimately turned contentious. We'll examine how the two financial giants struggled over derivatives in the fateful weeks and months leading up to the financial crisis and whether their fight fueled the crisis.

Hopefully, over the next two days, we can shine a light on this dark world of derivatives. And with that I turn the microphone over to Vice Chairman Thomas.