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Hon. Bill Thomas
Vice Chairman

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Commissioner

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Commissioner

Keith Hennessey
Commissioner

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Commissioner

Heather H. Murren, CFA
Commissioner

John W. Thompson
Commissioner

Peter J. Wallison
Commissioner

Thomas Greene
Executive Director

January 27, 2010

Via FedEx

Mr. Michael C. Mayo
US Banking and Financial Analyst
Calyon Securities (USA) Inc
1301 Avenue of the Americas
New York, NY 10019

Re: Financial Crisis Inquiry Commission Hearing on January 13, 2010

Dear Mr. Mayo:

On January 20, 2010, Chairman Angelides and Vice Chairman Thomas sent you a letter thanking you for testifying at the January 13, 2010 hearing and informing you that the staff of the FCIC might be contacting you to follow up on certain areas of your testimony and to submit written questions and requests for information related to your testimony. During the hearing, some of the Commissioners asked you to answer certain questions in writing, which are listed below. Please provide your answers and any additional information requested by February 26, 2010.

1. What questions would you suggest that the Commission ask the CEOs of the banks, government regulators, or any other public or private entity related to the causes of the financial crisis?

2. Given the complexity of banks' financial statements, e.g. derivative off-balance sheet positions, are investors and analysts able to determine banks' capital adequacy and risk profile? Are current SEC disclosures sufficient? In your opinion, did the lack of disclosure contribute to the crisis or delay the ability to diagnose the problems at the financial institutions?

3. During the hearing you testified that externalities and significant systemic risk justified some type of regulatory oversight. Do you believe there needs to be regulatory oversight or a resolution mechanism other than bankruptcy for institutions that do not pose significant systemic risk or impose contingent liabilities (e.g. deposit insurance) on the government?

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The Commissioners and staff of the FCIC sincerely appreciate your continued cooperation with this inquiry. If you have any questions or concerns, please do not hesitate to contact Chris Seefer at (202) 292-2799, or cseefer@fcic.gov.

Sincerely,

Thomas Greene
Executive Director

cc: Phil Angelides, Chairman, Financial Crisis Inquiry Commission

Bill Thomas, Vice Chairman, Financial Crisis Inquiry Commission

January 29, 2010

Mr. Thomas Greene

Executive Director

Financial Crisis Inquiry Commission

1717 Pennsylvania Av. NW

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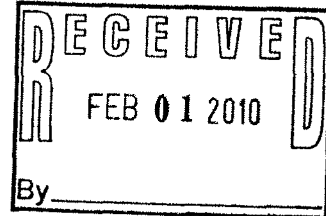
Washington, DC 20006-4614



RE: Financial Crisis Inquiry Commission Hearing on January 13, 2010

Dear Mr. Greene:

On January 27, 2010, you sent me a letter mentioning that, during the hearing, some of the Commissioners asked for answers to certain questions in writing, which were included in the letter. Attached are answers to the three questions that were asked.

As with my testimony, the views and opinions expressed in this reply are solely my own and do not necessarily reflect the views of my employer or any other institution or person I am currently affiliated with or have been in the past.

Please feel free to contact me if you have additional questions at mike.mayo@clsa.com or (212)-261-4000.

Regards,

Mike Mayo

CC: Phil Angelides, Chairman, Financial Crisis Inquiry Commission

Bill Thomas, Vice Chairman, Financial Crisis Inquiry Commission

QUESTION 1: What questions would you suggest that the Commission ask the CEOs of the banks, government regulators, or any other public or private entity related to the causes of the financial crisis?

ANSWER: Below are ten questions that relate directly to the ten ways that the banking industry was on the equivalent of steroids, as outlined in my January 13, 2010 testimony:

(1) Excessive growth

Bankers: What were the competitive pressures, firm-specific performance targets, and other pressures that caused the company to pursue growth even when it meant taking on more risk than was prudent?

Regulators: What were the early warning signals that the industry was pursuing excessive growth and why or why not were these cause for a change in regulatory oversight?

(2) Push for higher yield

Bankers: In what broad ways did the company increase the risk of loans, securities, and other assets on the balance sheet and what was the justification for these moves?

Regulators: Banks reduced the percentage of safer assets on their balance sheets, such as treasury securities, and increased the percentage of risky assets, such as real estate assets. These moves had the effect of increasing short-term profits via higher yields but with greater risk later on. Did regulators note and address these trends?

(3) Concentration in risky assets

Bankers: The crisis occurred later in the decade but imbalances were built for several years before this. Why did your strategic and tactical planning fail to fully address your company's exposure to the concentration of risky real estate and other assets at a time of excesses in the industry?

Regulators: The percentage of real estate assets in the industry increased to the highest level in history. How did regulators note and address these trends?

(4) Balance sheet leverage

Bankers: Almost all banks had historically high leverage until the crisis. Did you, your board, and/or risk committee consider reducing leverage or having less leverage than peer?

Banking regulators: On some measures, the banking industry had the highest leverage in a quarter of a century until shortly before the crisis. Why was this allowed to occur and how did regulators note and address the leverage issue?

Securities regulators - SEC: The balance sheet leverage in the securities industry from the 1980s, 1990s, and 2000s increased from around 20x to 30x to almost 40x until shortly before the crisis. The leverage occurred despite recent efforts by the SEC for consolidated supervision due to the fact a lot of the leverage within the group was outside the regulated entity. How did regulators note and address these leverage trends?

(5) Exotic securities

Bankers: What part of the risk management system failed to work as well as it should have to properly alert you about the severity of the exposure in risky assets and the crisis in general?

Regulators: Losses in areas such as CDOs and other exotic securities caused billions in dollars of losses. How did regulators note and address the risks in these securities, and what were the first warning signs that these securities existed and could cause such problems?

(6) Consumer risk and historic high consumer leverage

Bankers: Consumer debt increased steadily over the past decade. How did the company's risk management and loan underwriting systems take into account these increasingly high levels of consumer debt? What could have worked better?

Regulators: The level of consumer debt to GDP reached a record high shortly before the crisis. How did regulators note and address this issue, assuming that it was flagged?

(7) More lax accounting

Bankers: To bank CEO: Your stock is down XX% since 2007. Should investors have seen these risks given the quality of your disclosures back then? How have your disclosures improved over the last two years? Where did your accounting fail to reflect numbers that were as conservative as they should have been based on future losses? What could have improved the accuracy of reporting?

Regulators: Where did capital guidelines fail to address the risk on bank balance sheets? What lessons are there to be learned from the low risk ratings on mortgage assets given their perceived low risk?

SEC: Discuss the trade-off between requiring banks to properly reserve for future problems without setting aside "cookie jar reserves", as described by the SEC in the late 1990s? In hindsight, should the SEC have encouraged banks to have more adequate reserves at a time when they were originating more risky loans?

(8) More lax regulation

Bankers: In what ways did your company take advantage of less regulation when, in hindsight, it was not prudent to do so? Discuss the pressures to capitalize on reduced regulation given competitive pressures even when this causes risk to increase to levels that are not prudent.

Bank regulators - FDIC: Why were deposit insurance premiums reduced for most banks for almost a decade ending 2006? In what ways did the FDIC voice its concern to Congress?

FASB: Why were employees of industry allowed as part of the process that sets accounting standards?

All regulators: How do we avoid morale hazard when we socialize risks (such as with deposit insurance)?

(9) Government facilitated via GSEs

Bankers: How did the government role in stimulating the housing market encourage business practices at your company that turned out to be detrimental? To what degree did the government and the GSEs encourage these activities?

Regulators: Why were the GSEs allowed to grow so large with so much leverage at a time when housing prices continued to increase at unprecedented levels?

(10) Incentives not aligned

Bankers: Where did the company's compensation schemes fall short in incenting employees based on economic value created? In other words, to what degree did compensation programs encourage the sales of products due to revenue-based compensation even when the imprudent risks associated with these revenues may have led to future losses?

Regulators: To what degree did regulators view the compensation and other incentive schemes at banks and brokers and highlight the potential detrimental impact on behavior that would encourage excessive risk taking? Could this happen again under current laws, rules, and guidelines?

Other regulators: Should bank debt investors have felt more of a loss than they did since many equity investors who bought bank stocks two years ago are still under water but debt investors have been essentially made whole?

QUESTION 2: Given the complexity of banks' financial statements, e.g. derivative off-balance sheet positions, are investors and analysts able to determine banks' capital adequacy and risk profile? Are current SEC disclosures sufficient? In your opinion, did the lack of disclosure contribute to the crisis or delay the ability to diagnose the problems at the financial institutions?

ANSWER: During my presentation, I gave the analogy of CDOs to "bad sangria" which has a lot of ingredients that are repackaged and sold at a premium. This product may taste good but it can cause headaches later, and few really know what's inside. To extend the analogy, the general problem is that analysts do not know which is good sangria from bad until after the fact. Analysts are always forced to make conclusions based on incomplete data, and this can never change. There are always competitive considerations for the companies that disclose the data. In hindsight, it is easy to say that the companies should have disclosed more data in the problem areas but, it seems, that the companies did not fully appreciate the problem areas.

Nevertheless, some parts seem clear. First, companies may have hid too much behind the "competitive considerations" argument for not disclosing data. Second, there is limited data about the quality of investment securities that are held on balance sheets. In most structured products, we do not know the quality of the underlying collateral/assets. There was no way that we, as analysts, could know of the actual subprime-backed CDO exposures at any of these banks before the fall of 2007 because this was not disclosed.

In short, SEC disclosures are not sufficient. We would like more granularity in loan exposures. This tends to improve during crisis periods and seems to go away during good times. The same seems to apply for country exposures, trading exposures, and other areas that at times has problems. (For instance, which banks have exposure to Dubai, Greece, or other regions that may have problems? The answer is not relevant until there are problems.) As a general observation, disclosures are too pro cyclical and sometimes really don't help analysts and investors anticipate the fallout from bubbles. During the recent crisis, there were times when we

had estimates of total industry exposure to areas such as subprime mortgage but had difficulty in determining which entities inside the country or outside held this exposure.

Lack of disclosure seems to have exacerbated the crisis but was not the cause. Problems were accelerating even in areas where there was much disclosure, such as mortgage loans in general and credit cards. More light always help and perhaps will reign in some of the risks, but certainly not all. For the surviving firms, improved disclosures did help the market price in the risks and consequences faster than expected though it took some time to digest the full magnitude of the problem given a once-in-a-lifetime decline in home prices.

QUESTION 3: During the hearing you testified that externalities and significant systemic risk justified some type of regulatory oversight. Do you believe there needs to be regulatory oversight or a resolution mechanism other than bankruptcy for institutions that do not pose significant system risk or impose contingent liabilities (e.g., deposit insurance) on the government?

With regard to a resolution mechanism, the short answer is "no', that is, if institutions do not pose significant system risk or contingent liabilities to the government, there does not need an additional resolution mechanism. For me, the issue is that the definition of which firms cause systemic risk gets broadened during the time of crisis. In my testimony, I mentioned the bail out of hedge fund Long Term Capital as having set a poor precedent for the subsequent decade, since a bailout of a hedge fund of this size would imply bailouts of many other types of institutions. During the recent crisis, firms were bailed out that in theory should not have been. If one decade ago firms that should have failed did not, and if recently other firms were saved that should have failed, then it seems likely that regulators a decade from now would allow firms to fail due solely to the perception versus the reality of systemic risk.

With regard to regulatory oversight, I support more effective supervision and application of existing regulations and the ongoing jurisdiction of those in accounting (the SEC), law (the FBI, etc.), enforcement, and elsewhere to ensure that laws are not getting broken and that business is conducted under fair practices.