

***NOTES FROM INTERVIEW WITH HANK PAULSON AT SCHWAB IMPACT CONFERENCE  
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I attended an October 2010 conference at which Hank Paulson spoke. Most of the comments were from his excellent book "On the Brink" although he said Ben Bernanke joked that a better title for the book would have been "Before Asia Opens" or "Getting to the Weekend" as they faced crisis after crisis with each having to be resolved during weekends before the markets opened in Asia. Here are a few more tidbits from his talk:

-Paulson declined the request to serve as Treasury Secretary twice because he knew very few people who had gone to Washington and come back with a reputation better than when they left.

-His Mom cried on the news that he finally accepted the position, lamenting, "You started with Richard Nixon and now you are ending with George Bush. You should be ashamed of yourself!"

-He said Bush was a good boss. Bush understood the financial issues. He didn't want to intervene in the market, but he did want to do what was needed to save the economy.

-"Few bubbles burst as spectacularly as this one."

We were long overdue for a crisis. How did we miss seeing the housing bubble was about to burst?

We thought the problem was contained. Never before had we experienced a geographically-broad decline in housing prices. Mortgage-backed securities issuers and investors were worried about prepayments. The models all began with the same basic assumption that there would not be a broad housing price decline. Subprime was not a big part of the equation.

-Once Paulson got inside Fannie Mae and Freddie Mac, he found a significant capital hole, which was much bigger than anyone realized at the time. He not only had to take out his bazooka, but also a bomb when he had to nationalize them. He needed to stabilize FNM and FRE, or we would have had a global meltdown. Just think how much worse the crisis would have been if financing for housing had not been available throughout the crisis.

-The regulatory system was broken and outdated and hadn't grown to accommodate the financial market as it grew. There were multiple regulatory overlaps plus huge gaps.

-OTC derivatives had very low transparency and great complexity.

-A systemic risk regulator was needed.

-With the liquidity run on Bear Stearns, we learned how vulnerable the investment banks were. Thursday night we were told Bear would file for bankruptcy unless the government stepped into it. Bear was too

interconnected to fail, not too big to fail. We were lucky that J.P. Morgan stepped in to buy Bear and guaranteed Bear's trading book with the assistance of Fed loans.

-Difference between Bear and Lehman is that the government didn't have the authority to save Lehman as no buyer could be found. While Barclays had expressed interest, the U.K. regulators wouldn't approve the deal. Barclays didn't say "No", they just didn't say "Yes."

-On Bear & AIG versus Lehman...Bear had a strong buyer. There was a much bigger capital problem at Lehman.

-AIG's problem was at the holding company which was acting like a hedge fund with a liquidity problem. The underlying businesses still had good assets so the Fed could make a loan-secured by the assets of the underlying insurance business.

-There was a collision of political and market forces weeks before a national election. After the Reserve fund broke the buck, there were 5-6 other money market funds ready to follow, which led to the government guarantee of money market funds which helped to stabilize things. They never debated moral hazard during this period although they were concerned about it.

-When many industrial companies, including GE, called to say they couldn't roll over their commercial paper, Paulson thought economic Armageddon was upon us. If these companies couldn't meet their payrolls and pay their suppliers, the resulting layoffs and the impact on the economy would have been at least as bad as the Great Depression.

-He described the TARP vote, noting everyone who voted for it knew that it was a politically unpopular vote. The Republicans didn't want to intervene in the markets, but the alternative would have been worse.

-He described the "Circus Meeting" in the Oval Office when McCain suspended his campaign and called for a meeting with the President. Obama also attended the meeting, and a shouting match ensued between the Republicans and the Democrats. The Democrats stormed out of the room, surrounding Obama. To break the tension, Paulson followed them out of the room and got down on one knee to Pelosi, pleading with her "Please, don't blow this up." In the end, there was great restraint on both sides of the political aisle.

-After finally getting the TARP vote passed, a poll was taken among the American people: 93% of Americans said they were against TARP. In the same survey, 63% of Americans said they were against torture. The conclusion: bailouts were worse than torture. However, Paulson believes TARP prevented a depression, and that taxpayers will get all their money back.

-On FINREG, Paulson admitted he hasn't read the thousands of pages of the document. He joked that he hopes someone has. However, he is much more positive on all the new regulations than negative.

He outlined the reasons why:

-We will have a new systemic risk regulator which will have the authority to intervene in a crisis.

- Wind-down authorities are now in place with high hurdles to avoid moral hazard.
- No institution will be too big to fail as it can now be wound down and liquidated to protect the economy.
- All complex institutions will have a common regulator with the Fed.
- We need big financial institutions, but if they fail, they can be broken up as they now have to provide a "living will" in case they fail.
- With banks better regulated and with greater liquidity cushions, we should have greater and more consistent long-term growth.
- Paulson said he did the best he could under difficult circumstances. When you encounter a big, ugly messy problem, you never find a neat, elegant solution. When he looks back, he thinks the major decisions he made were the right decisions. However, he will leave history to the historians.