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# WILLIAM DONALDSON

*Transcript of the Maxwell School / Public Agenda Policy Breakfast Discussion with William Donaldson, Former Chairman of the U.S. Securities and Exchange Commission, Former President of the New York Stock Exchange . Discussion moderated by Robert Siegel, host of National Public Radio's All Things Considered.*

**"Making Sense of the World Financial System: Bailouts, Regulations, and the Future of American Economic Influence"**

MAXWELL SCHOOL / PUBLIC AGENDA  
POLICY BREAKFAST

## Maxwell School/Public Agenda Policy Breakfast

"Making Sense of the World Financial System"  
Bailouts, Regulations and the Future of American Economic Influence

With William H. Donaldson

*Maxwell School / Public Agenda Policy Breakfast Discussion William H. Donaldson. Discussion moderated by Robert Siegel, host of National Public Radio's All Things Considered.*

*[The speakers were welcomed and introduced by Public Agenda's President Ruth Wooden and by Maxwell School Dean Mitchel Wallerstein.]*



**Robert Siegel:** Let me ask you more narrowly about what Secretary Paulson said last week among other venues in an interview on our program with me that—the Treasury has now given up, as I understand it, on trying to evaluate and buy the so-called toxic assets, and instead is relying on the strategy of infusing capital into banks, and becoming a preferred stockholders in the largest healthy banks. Are you hopeful about that strategy? Does it make sense to you?

**William Donaldson:** I think it was unfortunate that the first strategy was enunciated by Secretary Paulson. I think that in addition to being the wrong strategy, I think it was presented wrongly, if in the sense of giving the Congress a two or three page memo, and saying, "Give me 750 billion dollars, and I don't want any oversight, and I'll take care of it." I'm being a little bit unfair to Hank Paulson because I must preface the fact that I think he is a—he's a terrific person, and he's under tremendous pressure, but I think the idea of buying these so-called toxic assets was not the correct solution to begin with, and in effect, our good friends across the ocean in the U.K., Prime Minister Brown showed us the right way.

The U.K. government was ahead of the United States in saying that the first solution to this problem is to re-equitize, if you will, for putting money into the equity of our banking system. By doing that, we created the capability for the

banking system to once again start to lend, so it was the equity base that was needed. That, of course, is what Paulson has, and the Treasury Department have come around to now. Again, the problem with attempting to buy the so-called toxic assets is, among other things, how do you price them? I mean, and if you pay too much, you're subsidizing the banks. If you take too little, you may destroy the banking system. It's a tough thought to begin with.

**Robert Siegel:** Here's what I don't understand about it, though. If I'm a bank, and I have these securities on my books, which I can't figure out what they're worth, what is it about the arrival of more capital from the Treasury that gets me closer to a solution of what those securities are worth? Or are we simply deferring the date at which I will come to grips with the fact that I've got a lot of really dicey securities in my (talk over)?

**William Donaldson:** Let me use as an example what Warren Buffet did when he invested in Goldman Sachs. I mean Warren Buffet came along, and gave Goldman Sachs an equity capital. By the way, he got very handsomely paid for that preferred stock with a very high dividend, and so forth, but in effect, he gave Goldman the equity capital, and he furthermore was saying, "Now you guys bought all this toxic stuff. You're the best people to figure out how to get out of it, and you now have the capital to get

out of some of it, to stay with some of it, etc., etc., but you're in the best position to offload this stuff as opposed to some government agency."

**Robert Siegel:** The point here isn't simply flotation with money, throwing dollars in the top, and hoping it moves things. It's the government is now in the position to tell the banks, "You do this now. It's your job to do that."

**William Donaldson:** The government, the equity that's being put into the banks is non-voting equity, and in that sense, the government doesn't have anything to say. However, the government has a lot to say before they put it in. I think one of the problems with what we're going through right now is that there's some doubt, some opaqueness, if you will, as to what demands the government has made on the banking system for putting the money in.

A most particular opaqueness is what seems to be going on right now, which is the banks are sitting on that capital, and not investing it, not loaning it. That was not the reason that they've been re-liquified, and so there's a question as to not only what the deal was, in terms of putting it in, what the deal was or is, in terms of let's say compensation of executive officers of the bank, a whole series of conditions. One of the problems, I believe, with the situation now is it's very opaque. There is not much sunlight in terms of exactly what is going on, in terms of these huge sums of money being put out there.

**Robert Siegel:** That the behavior of the institutions that are receiving this capital, it will be very hard to measure as to whether they're acting and keeping with the intent of the government, since we're not getting a clear picture of what the intent of the government is.

**William Donaldson:** I mean to take an extreme case, I mean if this money is taken and used to acquire another bank, and to build a bank, that's not what the money's been put in there for. I don't think that anybody understands exactly what the conditions have been, and are right now for putting this money out.

**Robert Siegel:** I want to come back conditions in a moment when I'm going to ask you about the American auto industry, and what do you

*"There is some opaqueness as to what demands the government has made on the banking system for putting the money in. The banks are sitting on that capital and not investing it, not loaning it. There is not much sunlight in terms of exactly what is going on."*

think about that, but first I want to look back for a moment. There's a story in the front page of the New York Times this morning about Phil Graham, former Texas senator, who insists that the fault of deregulation has been grossly exaggerated, and there wasn't whatever we've seen happening isn't the fault of a—an ideology of deregulation. Is he wrong? Is he right?

**William Donaldson:** I think he's absolutely wrong, to put it mildly. I think we—if you go back to 1929, the Crash, and so forth, along came lots of remedial legislation, the formation of the SEC, the Securities Act, and so forth, as well as the law that said that banks, commercial banks, could not be in the investment business; separation, which again, was one of the big problems in 1929, using depositors' money to make equity kinds of investments.

If you fast forward to, not the current period, the Graham-Leach-Bliley Law was passed by—it was sponsored by Phil Graham, which in effect obviated the prior prohibition, and let everybody get into everybody else's business. In other words, the banks which had been proscribed from being in the investment banking business now were able to go into that business, and the banks got into all businesses. The effect of that, the fallout from that was that our regulatory institutions, I mean whether it be the SEC, or the Federal Reserve originally, we're structured for being responsible for certain industries, and with Graham-Leach-Bliley, everybody's in everybody

else's business. That left huge gaps out there of un-regulated businesses.

The most notorious being the mortgage business. There was—nobody was in charge of the mortgage business, totally unregulated. In addition to that, and the *New York Times* this morning covers that, there was another law passed, which had to do with the commodities futures trading operation, and specifically derivatives were taken out of that jurisdiction, so that we had this new instrument, or instruments, which nobody had oversight of. The SEC was proscribed from doing anything about it. The Federal Reserve was proscribed. The CFTC was proscribed, so here again opened up this Pandora's Box of derivative instruments including, but not limited to, the most notorious credit swap derivatives.

**Robert Siegel:** We don't get a chance to rewind the movie, and do it over again. This is what happens, so looking forward, is there—are there some obvious silver bullet regulations that can be put in place, that either prevent a recurrence of what happened, or more important, prevent the inevitably different thing that threatens us, that isn't quite like what's just hit, but might be the next big problem?

**William Donaldson:** That's a very good question, and the bottom line is, "No." In my view, there is no silver bullet. I think you have to go back a step, and not to get too technical, but the Federal Reserve is a prudential regulator. What that means is that they are charged with making sure that the banking system is sound, and solid, and functioning. If they go into a bank that they're regulating, and they find things going wrong, their job is to correct those things, and they do it quietly behind the scenes, less a scandal erupt, and you can have a run on the bank, and so forth, and so on.

The SEC is a—basically, a police agency. I mean it is an agency that is [a] investor protection oriented. It does that by disclosure. In other words, by having an oversight on accounting systems, by forcing corporate America to disclose all the facts about the issuance of any security, and it has strict rules that are in place, and if those rules are broken, the SEC has the power of finding and binding people from the industry, and so forth. They're two totally different missions out there.

Where you get in trouble, let me give an example. Where you get in trouble is the commercial banking system has huge amounts of money under management for investment clients. They have custodian accounts, and they give advice on some of those custodian accounts. If the Fed is in there, they're not concerned about the investors. They're concerned about the impact of that business on the system. Whereas the SEC is concerned about investor information, and so there's a conflict here, and of course, that has been one of the problems as between the Fed and the SEC. I mean whose jurisdiction is this now? It's further compounded by the arrival of all these new sorts of institutions: hedge funds, and all sorts of financial entities which are performing in many instances like a bank. I mean—and so the ability for the Fed to reach beyond the commercial banking system into these quasi banks is very much inhibited.

**Robert Siegel:** One of the principles of good governance that with [advice], there shouldn't be conflicts of interest, and we think revolving doors are a bad idea. There seems to be a problem with regulating the financial system, which just for example, who would know how to unpack a complex derivative security that's based on all kinds of loans? Who would know how to do that better than somebody who packs these things? We're not talking about millions of people in the economy who create complex securities. Who can regulate an increasingly complex industry other than people who are from the industry?

As a new administration starts combing through people to take jobs, what principle should they have about the line between responsibility, and leaving the firm that is about to get billions from the Treasury, to go to the Treasury and put billions in firms. What's a good principle we could apply?

**William Donaldson:** The financial industry, it is rent with conflict. It used to be, I mean, the honest broker used to be someone who could mediate between the commercial interests of the issuing underwriting, and between the protection of the investor. That was a role of integrity and judgment, or refereeing, if you will, the conflicts inherent in that. Of course, that's long gone, and we now have very direct conflicts between the mortgage broker who wants to put the money

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out there, and wants to issue the mortgage, and so forth.

You have a further conflict now, just to carry that one step further, with the arrival of the packaging of mortgages into pools. It used to be that an issuer of a mortgage retained the responsibility if something went wrong on the mortgage, so that the issuer was very careful to examine the credit rating of the person that was taking on the mortgage, their ability to pay, etc., etc., because if they made a mistake, the issuer, or the bank, or mortgage company was going to—it's going to come back on them.

We had the institution, however, in recent years of the packaging of these mortgages into so called CMOs. I don't mean to get too technical, but the—a consolidated mortgage instrument where the bank would take all of these mortgages, and package them up, or the mortgage issuer would, the mortgage broker, package them up, and put them inside a security, and created a new security that was—had inside of it these mortgages. By doing that, this package of securities was sold throughout the world, and it had—it was secured by the underlying mortgages, but it had an interest rate, if you will, that was superior to other instruments.

This went further by slicing and dicing these mortgages, so the people that were packaging them took a little bit of this, and a little bit of this,

in terms of the different mortgages they put in the pool, and lo and behold, they came up with a triple A rating for that security. That meant that people could buy, institutions around the world could buy this mortgage package. Now what that did is take the bank, or the mortgage issuing company off the hook. Once they package up the mortgage, and floated it out to sea, they could go back and issue new mortgages, so we started this process.

The result of that was a total demoralization of concern for the ability to carry the mortgage, and that went into, first of all, regular mortgages, then into sub—so called sub-prime mortgages. We got to the point where a person could come in and get a mortgage, and nobody paid much attention to what their ability was to carry the mortgage. The mortgage broker wanted to sell the mortgage. They gave a huge percentage of the value of the home in the mortgage, 100% financing, ridiculous, and 100% financing for someone who did not have even the hope of being able to pay the interest on a mortgage.

Now that went along just fine as long as housing prices were going up, and as long as the house price was going up, that person who couldn't afford to pay the interest could go in, refinance the mortgage, and to use the house like a piggybank. Refinance the mortgage, take the money out, spend it, and this was a game that went along just fine until all of a sudden, as in most bubbles, the housing bubble burst. Then you've got the reverse process.

**Robert Siegel:** Before I go into cars, one just quick question. Had one player in that scheme of events you described. The security got a triple A rating. It got it from a rating company. What's in store for the rating companies? How do you address the problem that you had raters that were in on the composition of the security, raters being paid by the people who were issuing the security, and would be rated by them. It's not a job that a federal agency can do, is it? Or is it? It's a market role to tell us what's safe, and what isn't safe. How do you solve that problem?

**William Donaldson:** Through time, the rating agencies have been unregulated. They're private businesses, and you're correct. They are paid by the issuer of the security, so clearly there's a conflict of interest there. It's further complicated by these very complex pooled

vehicles: the consolidated mortgage securities, which as I say, have slices in them of different mortgages with different ratings, so it's extremely complex for someone to get inside this, and understand what the overall rating should be.

Of course, there was great incentive to, with an explosion in the issuance of these securities. There was great incentive for the rating agencies to give ratings that were pleasing to the issuer. That's not entirely fair to the rating agency because clearly it was not that blatant, but it gradually got into being, in addition of being complex, it was a huge volume being done.

Now the solution to this is not as simple as it seems. You would say, "Well, if that's the case, then going forward, the rating agency should not work for the issuer. The rating agency should maybe work for the buyer." However, if I'm a buyer of these securities, and I pay the rating agency to give a rating, then I don't want to have that intelligence in the marketplace. I paid for it, so I'm not going to give it to everybody else who's going to buy these securities. You have a conflict there.

Maybe the rating agency should be federalized. Maybe they should be totally independent. Of course, that—there are arguments against that, so there's not a simple solution to this basic conflict. I will say that I think my knowledge of what's going on in the rating agencies is increasing transparency. They're trying to explain what their systems are, and how they get it. I think they admit that they made their share of mistakes along the way, and mis-rated the securities. I think if they want to have blame go around, there are an awful lot of analysts who didn't do their job, the purchasers of these securities. It was pretty easy just to take somebody else's rating, and not get inside, and do your own analysis, difficult as it was.

**Robert Siegel:** To me, one fundamental difference between the credit crisis and the automotive crisis is that while most of us wouldn't know a collateralized debt obligation. I think Graham actually is quoted in the paper saying, "Politicians don't know a credit default swap from a turnip," or something. I think that probably is true for a great many of us, but we all know a Toyota Camry from a Chevy Vega of

the past, or whatever, and so we are—we're perhaps the most knowledgeable public in the world when it comes to cars. Our auto industry is crashing, and the president-elect talks about there have to be conditions to avoid the collapse of Detroit. You said we suffer from an opacity in the bailout of the banks. When we deal with the car companies, what's a reasonable set of conditions that the government can ask of an industry to make better cars? Should we be able to examine the models they have—they'll roll out in 2011? Fuel efficiency standards, new management, what's a fair set of conditions?

**William Donaldson:** I want to come back to the credit default swaps in a minute, just because I think that's such a confusing [moniker], if you will, that maybe we might discuss that in terms of—but on the automotive industry, clearly our financial infrastructure is a unique entity, if you will, that makes everything else work. I mean you go nowhere as a nation, unless you have a financing capability, a financial infrastructure, banks, underwriting, and so forth. If that fails, the whole system fails, and that backs into the rest of the economy, and you're in deep trouble.

The political rhetoric that says, "We're bailing Wall Street out at the expense of Main Street," is catchy, but it really, when push comes to shove, it really is, it's not a good characterization of what's going on. Now when you get into the automotive industry, we're dealing with a totally different animal. We're dealing with a commercial operation, and we're dealing with a competitive industry that's competing on a world-wide basis with automotive manufacturers all over the world. I hope I don't insult any automotive executives sitting here, but we've had an industry here.

**Robert Siegel:** I don't think—you can't say anything they haven't heard.

**William Donaldson:** I mean you have an industry which has, in my view, been shooting itself in the foot for many, many years. I say shooting itself in the foot. I think that we come year after year to negotiations with the labor unions, and generally speaking, the negotiation gets resolved by holding relatively constant on wages, and giving all the benefits that come in in the future giving that. The settlements are made, and the real cost of those settlements is pushed out in the future to a point where now, I think,

the figure is something like \$1,500 or \$2,000 a car is in health benefits.

Now that's all comes home to roost. You can also be critical of the design and motives, if you will, of our American automotive industry. Big money was made with the gas guzzlers, the SUVs, the trucks, etc., etc. That was where the money was made, so the industry went along, and continued to produce these products, even in the face of the oil situation.

Just as an aside, when I—you mentioned that I'd been in the State Department. I was. I was Under Secretary. The day I arrived, the Mid East War broke out, and Kissinger said, "You're in charge of international energy." "Thanks a lot." I went back to my office, by the way, and John Sawhill was on the phone, who was the Deputy Energy Administrator.

**Robert Siegel:** Yeah, but you didn't have an energy department yet.

**William Donaldson:** We did, under Bill Simon, and Sawhill says, "Just wanted to call you because Simon has just told me I'm in charge of the international side of energy." I said, "Well, that's interesting." But my point is that the going back into my files, and reading the information that we're coming up with, in terms of the energy crisis, the oil and gasoline popped up, and we were searching for solutions, alternative energy, wind power, oil shale, etc., etc.

You could take that, put it into today's environment, and exactly the same thing was being said. Okay? What happened back in 1973 that was that all this attention to the ultimate energy shortage, and oil shortage, that gave rise to Vice President Rockefeller put forth the concept of an industry independence authority that would basically subsidize alternative energy sources until the price got up high enough, so it could stand on its own. That all went by the wayside when oil prices came down, and everybody forgot about that. Everybody forgot about the—

**Robert Siegel:** Now the question is put to Washington. (1) Do you keep the automaker—I'll use plural, automakers afloat? Or let them fall, and if you're going to keep them afloat, what do they have to do? Then we'll take questions from our guests.

**William Donaldson:** I believe, personal view, is that if we temporize at this point in terms of "saving General Motors," we're only pushing the problem off further. What do you do? One alternative is bankruptcy, and of course, the horror of bankruptcy for General Motors is something that is really politically scary. It's emotionally scary for the American people to think that General Motors went bankrupt.

**Robert Siegel:** Because what's good for General Motors is good for America is what they say.

**William Donaldson:** The fact of the matter is that bankruptcy, the company doesn't disappear. It's in business the next day. It's in business with a changed management. It's in business with a changed board of directors. It's in business with somebody the bankruptcy mechanism has the power to abrogate the contracts, to basically tear the thing apart to get rid of all the layers of finance that are inefficient to get rid of a healthy, global, competitive labor rates, and so forth, and to emerge with a reduced product line, with an entity that works.

Now there are ways short of total bankruptcy to address that. There are so-called prepackaged bankruptcies. There are ways of negotiating with suppliers, and with labor, and with everybody to in effect get that modification that I'm talking about, but not through a Chapter 11 bankruptcy. Then all the way over here, there is the idea that you could put the management, and labor, and everybody concerned in a room, and smash them together to get that done.

I think we've learned that that's a pretty tough thing to do, so the president and the president-elect are faced with a real hot potato. In addition to that, there is underway an appropriation for 25 billion dollars to the automotive industry to help them convert to energy efficient automobiles, and the industry is now looking for another 25 billion on top of that. I'm not sure what's going to happen. I suspect that there will be an effort to push this forward into the next administration, to—

**Robert Siegel:** When in doubt, punt is what you're—

**William Donaldson:** Give just enough money, so to keep old General Motors limping along, and let the new president handle that.

**Robert Siegel:** There are some microphones in the hall, and they're for your questions.

**Audience Member:** Yes, good morning, Mr. Donaldson. When you look back at your tenure at the SEC, is there anything you might have done differently, or might not have done in retrospect?

**William Donaldson:** Sure. When I became Chairman of the SEC, Enron, WorldCom, and all of the horrors of corporate malfeasance were front and center. The agency was demoralized in terms of people saying, "Well, where were you guys when all of this happened?" The Chairman of the SEC resigned under fire, and it was a pretty demoralized situation. We also had the new laws passed to address some of this malfeasance. We had to write the rules to implement that. It was a time when I felt very strongly, as did not all of my co-commissioners, but some of them that we needed to take some very swift action.

We took full advantage of the law to be able to administer very steep fines, and to do a number of other things that changed the way the stock exchanges were operating to become too much of a monopoly, and so forth. Now my own feeling was that we needed to be very firm in what we were doing, and we needed to because it was not just public disillusionment, not just investor disillusionment, but there's general public loss of confidence. Along with all of that, I felt that we needed to address certain specific areas: hedge funds.

This is a gigantic industry growing like a weed, which the SEC had no jurisdiction over. These are pools of capital, and so we passed a rule, a hedge fund rule, that brought them under the Investment Advisor's Act for the first time, and that rule was challenged by the courts. I'm getting now to the—you know, and it was thrown out. I regret that action was not taken to do it a different way. Now I regret, I guess, the fact that I wasn't there to do that, and that's a decision on my part to leave the SEC.

The president asked me—I'm being very direct. The president asked me to come. I said, "I'd

come for a period of time." I came for a period of time. I got done what I thought was necessary, and I said, "Now it's up to somebody else to take it the next step." In a way, I regret that because I think that what's happened since then has been unfortunate. I also, on another issue, and then I could go all day on things that I regret, but we had great malfeasance in the mutual fund industry, the so-called late trading and market timing scandals, which were perpetrated, not just by small mutual fund companies, but by some of the oldest and most revered mutual fund companies, and so we passed a whole series of rules to address the problem.

The culmination of which was a rule to have mutual fund management—mutual funds have independent directors, and most particularly, disallowing the manager, or the CEO of a management company from being the chairman of the fund. They were managing a total conflict of interest. You can't have fiduciary responsibility of your shareholders as a management company, and fiduciary responsibility to shareholders of the fund itself. We passed that rule, and once again, the court came back and said, "You have not analyzed the cost of doing this." In other words, if you have independent directors, and independent shares, it's going to cost you more money.

We had analyzed it, and we determined that it was fractions of pennies. I mean the tawdry for independent CEO, chairman for independent director, was nothing compared to the billions of dollars, and so we went back to the court, and said, "Here it is. You know, we've got to get this law underway, and here's what it does cost, and we've done that by statistical analysis that indicated that it was fractions of pennies, insignificant." Now at that time, we went back and said that to the court, and the court says, "No." I think probably—that probably I should have been more patient. I think probably I should have said, "Okay, we'll stop. We'll go out. We'll do this fancy analysis that will take us months and months and months to do it, and we'll come up with the same answer," but we didn't. We went back and said, "We've given you the analysis," and therefore, nothing has been done now. That's where it stands.

**Robert Siegel:** In these cases were you meeting with technical objections or

philosophical objections about attempting to regulate things that were (talk over)?

**William Donaldson:** I mean I guess I was addressing—let me give another statement on this that I regret, and that is that we set up a risk analysis department in the SEC. The SEC had never had a risk analysis. What I mean by that is that usually the SEC arrives on the scene of malfeasance, at the scene of the accident after it's happened, and they cleanup. They have no ill-developed anticipatory capability, so we set up a department of risk analysis, and tried to use this to look over the hill, and around a corner, and see what was going to happen, and see if we couldn't get some preventative medicine going.

Part and parcel with that was we did a huge survey, sent out all our inspectors. We asked them to come back and tell us what was wrong in some of the companies that they were looking at, what—not what was on their checklist, but what they sensed was going on. They came back. We boiled this all down, and we developed a list of potential problems out there. One of those potential problems was derivatives. It was top of our list was the explosion in derivatives, and so we went to the Federal Reserve, and basically said, "Look, we've got this problem, and this derivative thing is falling in between us. You know, can we jointly do something about this?" "At the staff level? No, we're not going to get mixed up in that."

I regret that we didn't push it. It would have been pushing. It would have been very difficult. We did not have the authority, and yet, again, we could have undertaken a political battle to at least bring the thing into everybody's viewpoint.

**Robert Siegel:** There's a question over here.

**Audience Member:** There's a view that the collapse of natural services firms is primarily a governance failure. The argument being that directors didn't understand risk, and the argument further being that the running of a financial service firm is not very little more than risk management. I wonder if you agree with that, or what your view is about the role of directors, and whether the role of directors is going to change.

My second question, somewhat related, is the role of sovereign wealth funds in the current crisis is creating a lot of chatter and a lot of fear. I wonder what your view is of the role of sovereign wealth funds.

**William Donaldson:** If I understood your question, what's the role of directors in assessing risk, and have they failed to do that?

**Audience Member:** The two questions: did they fail, and are we going to redefine their job and responsibilities in the future, so that this doesn't happen again, and so that they are held more accountable?

**William Donaldson:** This gets into the whole concept of corporate governance. Excuse me, and the—basically, the breakdown in corporate governance that caused not just Enron, and WorldCom, and the gross malfeasance, but also the gradual erosion of integrity, and throughout much of corporate America, tied to short-termism, tied to this game that was being played of quarterly earnings, and to meet Wall Street's demand for quarterly earnings, and to keep the quarterly earnings growing quarter by quarter often times at the expense of making long term investments, and so forth, so that what I'm getting at is the new laws made a big change in the way corporate boards were organized.

It took the power away from the omni-powerful chief executive, and put it back on the board where it should have been in the first place. It eliminated its setup independent committees for (inaudible), etc., etc., and basically boards were functioning better, and many people who'd been directors of lots of companies self-policed themselves into taking the responsibility, the true responsibility. I think corporate governance is working better. However, there is a limit, I believe, to even what good corporate governance can do.

These are complex situations. Even if you're on an audit committee, the ability to question the meat of the audit, the ability to have independent advice coming in, it's tough, and yet, if you take a large bank, and it has so-called special investment vehicle off by the side here, and there are earnings pouring into the bank, but that special investment vehicle is not under the bank auspices, but it's been setup by the bank, I think somebody should ask the question where's

all this money coming from. Where's all this earning power coming from?

I guess what I'm saying is that it's not easy to provide the due diligence that's required. I think a lot more due diligence is being put forth now by boards of directors, but it's still got a long way to go.

**Robert Siegel:** In sovereign wealth funds, you—

**William Donaldson:** With the sovereign wealth funds issue is, again, I think that there are huge piles of money out there in different jurisdictions around the world, particularly in the Mid East, and the oil nations. That money is searching for places to invest. It's coming into this country. We rightly must question under what conditions it's coming in. I think the sovereign wealth nations who have invested here have been very careful of the public reaction to this, and have come in a very quiet way, no demands, etc., etc.

The question is how long will they stay like that? They're just another shareholder now, but again, as time goes on, are these funds going to be used to promote political goals? Are they going to be used to—for something other than just making money? Do they have an axe to grind, or will they have an axe to grind? I think we have to have—be very careful in terms of the guidelines under which this money is coming in. I believe that we must encourage the money to come. I think, again, to not—to close our borders to being in this global world would be a big mistake, but I think we have to be careful as we do it.

**Robert Siegel:** There's a question at the front table right here.

**Audience Member:** There are no more U.S. investment banks, so what's going to take their place? Will it be a European investment bank? Will it be a hedge fund like Citadel that comes in and is taking up market-making functions, or Blackstone? If it is a hedge fund, or a private equity firm, a large asset manager that starts taking away the—you know, taking over the functions of the U.S. investment banking industry, how will that be regulated because there is no regulation for them now?

**William Donaldson:** Clearly, I mean there still are American investment banks. The big five

have disappeared and become part of bank holding companies, and as such, they will have the advantage of access to the Fed window, and so forth, but they're going to be much

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constrained in what they do. There still are regional investment banks in the country that are not part of bank holding companies that perform that service in different parts of the country, but you're right. The great bulk of the investment banking power, and the investment banking business has been put into a new business, so what happens?

I think in terms of American ingenuity, you're going to find spin-offs. You're going to find boutique firms. That's already happened. There are a number of firms that have been setup in the last five to six to seventy years by spin-offs from major investment banking firms who become investment bankers in a more narrow sense, and in a less conflicted sense. Teams of people have put together, let's say, an invest—a boutique investment bank that gives merger and acquisition advice, but that's all it does. It's not underwriting securities, and it doesn't have the conflict of making markets, or all that stuff. It's just a pure advice giver without conflict.

I think you're going to see that sort of thing go on in all different phases of the investment banking business. I suspect that as time goes on, the banks that have gone into bank holding companies will gradually get back to performing many of the services they had before, but it's going to be a lot less profitable.

**Audience Member:** Will we remain competitive then? If we're looking at small boutique investment banks, how will they remain competitive with large European banks that have stayed intact? I mean will we fall behind?

**William Donaldson:** This brings up the whole subject that we haven't touched on, which is a major challenge that we have, and that is that we're no longer isolated. We can address some of these regulatory changes that I believe need to be made, and get our, "our house in order," but it will be meaningless unless we have a global approach, unless we have regulation around the world that is coordinated, and basically, prevents somebody from fleeing to a more highly regulated environment, and to the less regulated environment somewhere in the world.

Now that's going to be really tough to do. We have pretty good cooperation now with—in the enforcement area around the world. I mean we cooperate, and we exchange information, and we get after the bad guys, the really bad people holding hands with jurisdictions around the world, but when you get into different ideas and different entity—different nations around the world as to what is bad, and what is illegal, and what is bad—that's beauty is in the eye of the beholder. To attempt to get the world coordinated is one of the big challenges that's going forward now. We had the meeting this weekend, the group of 20 at 50,000 feet putting forward all sorts of ideas about task forces, and we'll come back together in April, and so forth, but to try and do this, it's going to be very tough.

My own judgment is that we're not going to come up with global rules from the top down. We're going to come up with principles, and judgments, and so forth, but we're not—we're going to have to build up from the bottom here in this country according to our own morals and concepts, and we're going to have, hopefully get

some coordination from the top down, but it's not going to be an easy process.

**Robert Siegel:** On that note, we're going to have to wrap up. I'll give you one, just very brief item to make us feel better about change. You told me about you've said a framed copy of the ad for which you raised capital for Donaldson, Lufkin, Jenrette not all that long ago.

**William Donaldson:** Right.

**Robert Siegel:** As you told me, all of the financiers who were involved in that ad but two?

**William Donaldson:** Yeah, I told Robert, we had the usual tombstone when DLJ went public for the first time. Actually, it was the first time that a stock exchange firm had sold its shares to the public, and I have the original tombstone with all these firms on it that underwrote us at the time, and as the years have gone by, I've put red crosses through all these firms. That tombstone now—

**Robert Siegel:** It's a tombstone now. It's a literal tombstone.

**William Donaldson:** Exactly, no. I mean it—there are probably two or three names that haven't been changed. I mean Goldman Sachs is still Goldman Sachs, but Merrill Lynch changed its—and they've gone out of business, and so forth. It's a process that's been ongoing for years.

**Robert Siegel:** Things do change.

**William Donaldson:** Things do change, and there's an amazing resuscitating—you know from the ashes arise entrepreneurs, and I think that's going to continue to go on in this country.

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