owens: There have been a number of arguments about the causes of the current financial crisis, including the policy to promote home ownership, more or less regulation by the Federal Reserve, credit rating agencies, greedy consumers, greedy bankers, etc. Where do you see the causes of the crisis?

boisi: I think it’s a combination of a number of social policy decisions starting as far back as the late ‘30s—after the first Depression—including the creation of Fannie Mae (and later Freddie Mac), the Community Redevelopment Act of 1977, and a variety of tax policies that were enacted in the early ’90s that really spurred the housing market and the subprime market specifically. This was one type of activity that went on and built momentum over a period of time.

Another type of activity was that of investment and commercial banks, and the evolution of that industry, particularly as it related to moving away from traditional investment banking to a more trading environment. As traders became the leaders of those organizations, they argued for certain accounting rule changes, certain changes in the way that stocks, particularly, would be traded.

When the investment banks started to go public, that changed the dynamic of the need for those organizations to increase their quarterly earnings, which drove them to reach out for more creative types of securities. That spurred the securitization markets, which started to grow excessively, and fostered a mentality of short-term thinking, eventually unearthing a sense of greed in that community that impacted what was going on.

Then you also have the deficiency of regulatory policy: the Department of Housing and Urban Development and the Securities and Exchange Commission didn’t respond to certain things. The actual oversight of the mortgage industry was spotty at best. There were a number of policies that actually contributed to the issue. And then the Federal Reserve’s easing of monetary policy in the ’90s really created an environment for exaggerated trading.

All these factors started to come together around the year 2000, first when Fannie Mae had an accounting scandal, and then Freddie Mac had an accounting scandal, ironically, for absolutely opposite reasons. That shook the confidence of the stock market in those two companies, but those companies were under tremendous pressure by the government at that point to spur the growth in housing.

When these companies started to respond to pressures from government, certain decisions made it very difficult for them to finance their businesses. So when the bubble that had been created by the easy monetary policy—when the values of housing stock started to go down—it had a negative spiraling effect on the balance sheets of those companies.

Because the government didn’t work with these companies to help them finance this in regular public markets—and made the decision to take those companies into conservatorship—that was such a wrenching decision for the equity markets which is when the downward spiral really worsened.

I wouldn’t say there was one specific trigger, but I think the decision made by the
government and spurred by the Federal Reserve, to take those organizations into conservatorship was a major factor. It was like putting gasoline on a fire at that particular point in time.

**Owens:** Let’s talk about moral hazard, with regard to government bailouts as well as federal guarantees of bank deposits. Do you think the crisis in some sense is a simple case of misaligned incentives? Or is there something else at work?

**Boisi:** I think there are certain things that were happening culturally in terms of a “me-too” or “what’s-in-it-for-me” environment. It’s a cultural phenomenon that’s been going on for a number of years, which I would call a casino approach to even the consumer investment. The huge expansion of consumer credit and leverage (personal leverage as well as bank leverage) has contributed to this dramatically.

While all this was going on, you also had a 24-hour news cycle going on, speeding the hysteria that started to develop, particularly in the summer of 2007.

But at a fundamental level, I think that the governance structures of some major institutions veered away from their mission statements. I think that you had leaders that were not standing up to their responsibilities. I think that, as I said before, the cultural mores were breaking down in a way that we were getting away from a sort of a fundamentalist approach to making economic decisions.

**Owens:** What do you think we should do about the broad social and ethical issues that have played into the financial crisis? How does one address the casino mentality, the speculation, and the “me-too” mentality that you’ve just spoken about—this mentality that, as you said, reaches beyond the industry to the broader culture? What are the possibilities for change on that front?

**Boisi:** I think we’re going through a very wrenching experience right now and I think a major reset button has been pushed. From a financial standpoint, people at the individual family level are rethinking how they go about doing their business in terms of utilizing credit, and increasing savings. The last two years have been such a shock to the system that I’d like to think that people are really taking that seriously.

This recent Massachusetts election I think epitomizes this: people are tired of the polarization. We’ve lost an amazing amount of trust in the institutions of the United States and people are reacting to that... you’re going to see a more fundamentalist approach to people’s lives.”

United States and people are reacting to that. When the individual American has an opportunity to voice their views on that, they will do that. We’re going to go through a period of several years where you’re going to see a more fundamentalist approach to people’s lives.

**Owens:** Fundamentalist—do you mean a return to fundamentals of thrift?

**Boisi:** Right.

**Owens:** Speaking of thrift, the Great Depression created a generation with a certain view toward savings, thrift and economy. Do you think this financial crisis has been big enough to create the same sort of cultural shift?

**Boisi:** I think it has a shot at it. Certainly this current crisis is not quite as jarring as the Great Depression—and it has been pretty jarring. At the upper end of the socioeconomic scale, most people lost close to 30% of their net worth, which is the equivalent of wiping out 10 years of investment. That impacts the way people have to live, and thus they go through a process of soul searching. I think people are nervous. Particularly people of my generation are now worried about their retirement benefits. That has affected the way that they approach their lives, it affects the conversations that they have at the dinner table in terms of their own children. There are a lot of people who are not going to be able to go to colleges like Boston College and whatnot now because their financing is not available.

We have only really started to feel the pain. You have three million people out of their homes. The next several years are not going to be a walk in the park. It’s not back to normal business. This is going to be a slow, slow grind back. It will force people to think differently about things.

**Owens:** At the center of all of this, it seems to me, is the role of risk in the finance industry and our own lives as consumers. There is a traditional understanding of bankers as conservative, which has been overtaken by the recent view of banking as wildly speculative and aggressively risk-seeking. In your view, what’s the proper role of risk in the finance industry?

**Boisi:** Risk management has been the cornerstone of the financial services industry. In my opinion, it had gotten way out ahead of itself in terms of very theoretical modeling, as opposed to looking at the character of the person that’s borrowing the money, or the character of the person that’s running the business financed with equity. The smarter people are going to go back and start to look at...
those fundamental decisions because at the heart of all this is trust. And that trust has been broken.

Part of the reason for that is the trading mentality that has crept into the system. Today, you can place a commercial dollar bet on who the next president of the United States would be. You can find a market for just about anything. Twenty years ago, you didn’t have that kind of mentality. I think people are going to be much more cautious about the way that they conduct their financial affairs as a result of this.

**OWENS:** One last question. Are you persuaded by any of the arguments put forth in the past year to limit or heavily tax executive compensation, in the finance industry or more broadly, in the interest of justice?

**BOISI:** I’ve spent my life trying to figure out how to properly motivate people in the financial services sector. There has to be a common sense balance. Part of that balance is salary, cash compensation. But then you get into the question of pay for performance, which I think is critical to the success of any organization. When your own capital is at risk, as opposed to dealing with other people’s money, you think about it differently.

When a lot of private investment banks went public with the breakdown of the Glass-Steagall Act you started to see the dramatic growth of compensation. I think that we’re going to go through a redressing of that.

However, I personally don’t buy overly taxing people either. People are vilifying Goldman Sachs today, for example. Here’s a company that didn’t want the Troubled Assets Relief Program (TARP) money. They took it as part of the cooperative effort and paid it back sooner than anybody else, with a high degree of interest, yet they seem to be vilified. There’s a certain amount of anti-Americanism in that vilification. Some of the suggestions that have been made I wouldn’t endorse.

On the other hand, board of directors’ governance processes have been set up with the Sarbanes-Oxley Act. At one level it’s problematic for some people, but in general, I think it was a good thing. The system does work. If shareholders aren’t happy, they’ll vote out the directors, and the directors will vote out management. The current regulatory environment does need some tweaking. However, that regulatory environment should allow the boards of directors to do their jobs rather than having politicians—who have never had the responsibility of creating a system of paid compensation—get involved. This allows personal political needs to get in the way of commerce. I think it’s a very, very dangerous circumstance that we’re finding ourselves in right now. [END]