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Sunday, July 18, 2010

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429
Attention: Comments

Dear Mr. Feldman,

I am writing to provide comments for the July 19, 2010 CRA hearings. Our comments follow a series of warnings we have issued since 1998:

In October 1998, in a petition to the United States Court of Appeals for the District of Columbia Circuit[a], we cited evidence that growing financial market malfeasance greatly exacerbated risks in financial markets, reducing the safety and soundness of large financial institutions. We went on to note that:

"The nature of financial market activities is such that significant dislocations can and do occur quickly, with great force. These dislocations strike across institutional lines. That is, they affect both banks and securities firms. The financial institution regulatory structure is not in place to effectively evaluate these risks, however. Given this, the public is at risk."

On June 15, 2000, we testified before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (GSE's) of the US Congress. We suggested that the GSE's (Fannie Mae and Freddie Mac) be subject to a thorough "Social Audit." A Social Audit is an examination of the performance of an enterprise relative to certain social objectives. It also includes a review of ethical practices at the firm. Had they been subject to this audit, certain flaws in their operation, including ethical shortcomings, may have been revealed earlier and in a better market in which to make corrections.

On December 22, 2003, statistical models created by the firm using the Fully Adjusted Return ®Methodology signaled the probability of system-wide economic and market failure. See page 6: http://www.sec.gov/rules/proposed/s71903/wmccir122203.pdf

On Monday, April 11, 2005, we testified before Judge William H. Pauley III in the U.S. District Court for the Southern District of New York on behalf of investors at a fairness hearing regarding the $1.4 billion dollar Global Research Analyst Settlement.

In 2005, we served as an expert witness for homeowners in a case against PMI Group, Credit Suisse First Boston, Moody's, Standard and Poor's, Fairbanks Capital Corporation, Select Portfolio Servicing, US Bank National Association, as Trustee of CSFB ABS Series 2002-HEI, et. al., in the New Jersey Superior Court Law Division - Monmouth County. Our testimony sought to hold corporate parties responsible for facilitating predatory lending practices.

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[a] Cunningham v. The Federal Reserve Board of Governors. Case Number 98-1459.

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On February 6, 2006, statistical models using the Fully Adjusted Return® Methodology confirmed that system-wide economic and market failure was a growing possibility. See page 2: http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf

On Sunday, September 28, 2008, we wrote to US Senator Richard Shelby to comment on the financial rescue plan then under consideration by the US House and the US Senate. In the appendix to that letter, we provided a four step plan for dealing with the crisis. See: http://www.ethicalmarkets.com//wp-content/uploads/2008/12/financialbailoutcomment1.pdf

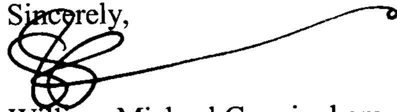
Also see: http://www.usnews.com/articles/business/economy/2008/01/28/the-first-bank-failure-of-2008

On June 18, 2010, we released a comment letter sent to Mr. Phil Angelides, Chairman, Financial Crisis Inquiry Commission, outlining our Transaction Cost Theory of the Financial Crisis. A portion of the letter is attached. Also see: http://www.prlog.org/10746429-firm-releases-transaction-cost-theory-of-the-financial-crisis.html

We incorporate these comments by reference.

Thank you.

Sincerely,



William Michael Cunningham , Social Investing Adviser

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Geographic coverage.

What are the best approaches to evaluating the geographic scope of depository institution lending, investment and/or deposit-taking activities under CRA?

We seek open and market based CRA performance evaluation standards. We believe the FDIC should define minimum standards for the geographic scope of depository institution lending, investment and/or deposit-taking activities under CRA and let the marketplace determine whether the performance of an institution is credible. Under this market based model, penalties for CRA non compliance must increase significantly, however, to provide an incentive for increased scrutiny. In this way, users will determine the extent to which CRA performance is reasonable.

Should geographic scope differ for institutions that are traditional branch based retail institutions compared to institutions with limited or no physical deposit-taking facilities?

Yes.

Should it differ for small local institutions compared to institutions with a nationwide customer base?

Yes.

If so, how?

We suggest you conduct a "credit needs" based review, subject to financial institution lending and service capabilities. In other words, we suggest you look at total credit needs in areas served by small institutions, calculate the potential impact that the small institution has in meeting those needs, calculate the actual impact (number and dollar amount of loans provided), and use this metric as part of the CRA review process. For nationwide banks, we suggest a similar review: calculate total credit needs in all areas served, calculate the performance of the institution in meeting those needs (number and dollar amount of loans provided), and base your performance evaluation on this metric.

As the financial services industry continues to evolve and uses new technologies to serve customers, how should the agencies adapt their CRA evaluations of urban and rural communities?

We suggest you conduct a credit needs based evaluation, subject to capacity limitations and constraints at the institution being reviewed. New technologies are irrelevant. What matters is performance in meeting credit needs in a nondiscriminatory manner.

CRA performance tests, asset thresholds and designations.

Should the agencies revise the criteria used to assess performance under the current CRA tests: Small institution; intermediate small institution; large institution; wholesale and limited purpose institution or strategic plan?

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Yes.

Are the current asset thresholds that apply to institutions and tests appropriate?

No.

Affiliate activities.

Currently, the agencies consider affiliate activities only at the request of the related depository institution. Should the agencies revise the regulation and, instead, require that examiners routinely consider activities by affiliates?

Yes. In a letter to the Federal Reserve Board dated May 16, 1996, we protested the approval of a merger application submitted by Morgan Guaranty Trust. The Board approved the merger on April 29, 1996. On May 6, 2010, we filed a complaint with the Federal Reserve against the Goldman Sachs Group, Inc. ("Goldman") and Goldman Sachs Bank USA Holdings LLC ("Goldman Holdings"), (collectively referred to as Goldman) under the Community Reinvestment Act (12 U.S.C. 2901 et seq., Pub.L. 95-128, Title VII of the Housing and Community Development Act). Affiliate activities form the basis for both protests.

In 1996, we suggested that certain exemptions granted to banks and bank holding companies require Board staff to more broadly analyze activities of banking organizations in meeting the credit needs of the community. We feel this includes reviewing the social and community impact of securities activities. Advancements in information technology make this a reasonable suggestion. The creation of an Investment test under Community Reinvestment Act guidelines suggested that the Board agreed this can be done efficiently. Our research indicated that tools to conduct this type of "social and financial return analysis" can be readily developed. (See, for example, the Creative Investment Research Fully Adjusted Return® methodology.)

Our 1996 protest described our belief that the grant of a securities market (section 20) exemption does not relieve the Board from an obligation to review and uncover any discriminatory business lending practices on the part of these firms. This includes inspecting the gender and ethnic makeup of firms using the following services provided by subsidiaries active in the following areas:

a. Municipal Revenue Bonds/Securities
b. Mortgage related securities
c. Commercial Paper
d. Consumer - receivable related securities ("CRR's")

Activities in at least one of the above functional areas have been defined by the Federal Reserve Board (in An Order Approving Application to Engage in Commercial Paper Placement to a Limited Extent (Federal Reserve Bulletin, Feb. 1987, p. 148)) as "so functionally and operationally similar to the role of a bank that arranges a loan participation or syndication that banking organizations are particularly well suited to perform the commercial paper placement function."

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In our view, banking organizations should be required to provide all credit services in a nondiscriminatory manner.

If so, what affiliates or activities should be reviewed?

All securities market related activity. See our comment above. On May 6, 2010, we filed a complaint with the Federal Reserve Board (the Fed) against the Goldman Sachs Group, Inc. ("Goldman") and Goldman Sachs Bank USA Holdings LLC ("Goldman Holdings"), (collectively referred to as Goldman) under the Community Reinvestment Act (12 U.S.C. 2901 et seq., Pub.L. 95-128, Title VII of the Housing and Community Development Act). Goldman, effective September 21, 2008, was granted "approval under section 3 of the Bank Holding Company Act ('BHC Act') (12 U.S.C. § 1842) to become a bank holding company on conversion of Goldman Sachs Bank USA, Salt Lake City, Utah ('Goldman Bank'), to a state-chartered bank."

Congress passed CRA in 1977 "to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low and moderate income neighborhoods, consistent with safe and sound operations." A lawsuit filed by the US Securities and Exchange Commission on April 16, 2010 reveals that actions of affiliates to Goldman Sachs Bank USA Holdings LLC (the CRA-relevant entity) damaged the credit markets and were not consistent with safe and sound banking practices. These actions were specifically designed allow a client to profit from actions that did not to meet the credit needs of communities served by the firm. The suit reveals that the firm is not now and has never been in compliance with CRA.

How should consideration of affiliates affect the geographic coverage of CRA assessments?

We suggest you conduct a "credit needs" based review, subject to financial institution lending and service capabilities. In other words, we suggest you look at total credit needs in areas served by small institutions, calculate the potential impact that the small institution has in meeting those needs, calculate the actual impact (number and dollar amount of loans provided), and use this metric as part of the CRA review process. For nationwide banks, we suggest a similar review: calculate total credit needs in all areas served, calculate the performance of the institution in meeting those needs (number and dollar amount of loans provided), and base your performance evaluation on this metric.

Small business and consumer lending evaluations and data.

Should the agencies revise the evaluation of and/or data requirements for small business and small farm lending activities or for consumer lending activities, including activities or products designed to meet the needs of low- and moderate-income consumers?

Yes.

If so, what changes are needed?

Review loans to women and minority-owned businesses. This data should be detailed by gender and race.

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Access to banking services.

How should access to financial services be considered under CRA?

Access to financial services is irrelevant. What matters is performance in meeting credit needs in a nondiscriminatory manner.

What changes would encourage financial institutions to expand access to un-banked and under-banked consumers in a safe and sound manner and to promote affordable, safe transaction and savings accounts?

Monetary incentives for doing so. These can take the form of regulatory forbearances.

Should the agencies revise CRA to include additional regulatory incentives to provide access to services for historically underserved and distressed areas?

Yes.

Community development.

What are the opportunities to better encourage community development loans, investments and services to support projects that have a significant impact on a neighborhood?

Green investing. As an 8(a) firm, we submitted an unsolicited proposal to Department of Housing and Urban Development (HUD) on April 7, 2006. In our proposal, we offered to research and create a collaborative, market-based approach to increase participation in HUD 's Energy Efficient Mortgage (EEM) Program. The proposal was submitted to the Senior Energy Management Officer in the Office of Environment and Energy, US Department of Housing and Urban Development, Washington, DC. Our proposal offered to help build the EEM infrastructure. We set up a method and process to create green investments, starting with a minority-owned financial institution serving an area of high social need and older housing stock, and ending with the creation of a Green MBS security, which we proposed to manage on behalf of a pension fund.

The proposal was rejected by HUD.

Should the agencies consider revisions to the Community Development Test or to the definition of community development?

Yes.

How could the rules most effectively balance support for community development organizations of different sizes, varying geographic scope, and in diverse rural and urban communities?

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The geographic scope, size and location of a given community development organization is irrelevant. What matters is performance in meeting credit needs in a nondiscriminatory manner.

How might they balance incentives for meeting local needs as well as the needs of very distressed areas or those with emergency conditions?

We have done so via the Creative Investment Research Fully Adjusted Return® methodology.

Ratings and incentives.

Is there an opportunity to improve the rules governing CRA ratings to differentiate strong, mediocre, and inadequate CRA performance more consistently and effectively?

Yes.

Are there more effective measures to assess the qualitative elements of an institution's performance?

Yes. See the Creative Investment Research Fully Adjusted Return® methodology.

Are there regulatory incentives that could be considered to encourage and recognize those institutions with superior CRA performance?

Yes. Banking institutions with superior performance in granting access to un-banked and under-banked consumers in a safe and sound manner and those that promote affordable, safe transaction and savings accounts should be grated relief from certain CRA reporting tasks.

Effect of evidence of discriminatory or other illegal credit practices on CRA Performance Evaluations.

Currently, the agencies' evaluations of CRA performance are adversely affected by evidence of discriminatory or other illegal credit practices as outlined in the CRA rules. Are the existing standards adequate?

No.

Should the regulations require the agencies to consider violations of additional consumer laws, such as the Truth in Savings Act, the Electronic Fund Transfer Act, and the Fair Credit Reporting Act?

Yes.

Should the regulations be revised to more specifically address how evidence of unsafe and unsound lending practices adversely affects CRA ratings?

As we noted above, the actions of affiliates to Goldman Sachs Bank USA Holdings LLC (the CRA-relevant entity) damaged the credit markets and were not consistent with safe and sound banking

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practices, according to the US Securities and Exchange Commission. The Bank received a Satisfactory CRA rating on 9/1/2006.

Further, according to **Best On-line Banks for Women and Minorities** (online at: http://www.minorityfinance.com/banks.html), "(Wells Fargo)..set up a special sales office to steer risky subprime loans to residents in Prince George's County, Baltimore city and other predominantly black communities..Wells Fargo Bank employees allege in a lawsuit. According to the sworn statements by two former loan officers filed June 1 in U.S. District Court of Maryland as part of a lawsuit being pursued by the city of Baltimore against Wells Fargo alleging discriminatory and predatory lending, bank employees targeted black neighborhoods and churches for the escalating-interest mortgages, which some in the office called 'ghetto loans.' This problem was not limited to Maryland: In August, 2009, the State of Illinois filed a lawsuit against Wells Fargo & Co. accusing it of discriminating against black and Latino homeowners by employing racially biased lending practices. The bank's CRA rating is listed below:

Bank	City	State	Evaluation Date	**Rating**	Examination
Wells Fargo Bank, N.A.	Sioux Falls	SD	12/1/2009	**Outstanding**	Large Bank

Clearly, the CRA rating system is, like much of the bank regulatory apparatus, broken.

CRA disclosures and Performance Evaluations.

Should the agencies consider changes to data collection, reporting, and disclosure requirements, for example, on community development loans and investments?

Yes.

What changes to public Performance Evaluations would streamline the reports, simplify compliance, improve consistency and enhance clarity?

A single online access point for CRA ratings, HMDA and small business data, accessible online, covering all regulated financial institutions and all affiliates, across regulatory agencies (OCC, OTS, FDIC, FRB, SEC, CFTC, etc.).

Should the agencies consider changes to how Performance Evaluations incorporate information from community contacts or public comments?

Yes. We have been online since November 16, 1995. Consider the social networking (Facebook, Linked-In, etc) media model.

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Transaction Cost Theory of the Financial Crisis

William Michael Cunningham, Social Investing Advisor

Conventional Wisdom

Most theories on the cause of the recent financial crisis[b] lay the blame for the upheaval on subprime lending, as exemplified by the testimony of Dr. Alan Greenspan, former Chairman of the Federal Reserve Board of Governors, before the Financial Crisis Inquiry Commission on April 7, 2010. He stated that:

"It was the global proliferation of securitized U.S. subprime mortgages that was the immediate trigger of the current crisis. But its roots reach back, as best I can judge, to 1989, when the fall of the Berlin Wall exposed the economic ruin produced by the Soviet system. Central planning, in one form or another, was discredited and widely displaced by competitive markets."

While valuation in the subprime mortgage market was a trigger of the crisis, it was not its true cause. Revised mortgage market financial instrument valuations led to downward pricing volatility, but a focus on this sector alone is too narrow. It does not explain several critical elements of the crisis, including the behavior of key market participants: insurance companies, rating agencies, commercial and investment banks, regulators, and institutional buyers.

More importantly, subprime lending is a short hand way of denoting home mortgage lending activities targeting low to moderate income minorities, specifically African Americans. This explanation ignores what we believe are the true reasons for the crisis, and has the added disadvantage that it does nothing to help policymakers prevent a reoccurrence of the crisis.

To be useful, any relevant theory of the crisis must be comprehensive, that is, it must explain most of the critical features of the crisis. A relevant explanation must also be rational, that is, it must explain events as they actually happened, truthfully capturing what went wrong. Finally, it must predictive, that is, it must explain the crisis in a way that can be used to prevent or limit a reoccurrence.

In the pages below, we outline a general theory of the crisis, focusing on what actually took place in an unbiased manner, in an effort to provide guidance for policymakers as they attempt to prevent a crisis of similar magnitude from happening again. Our theory explains the actions of a broad set of market participants, truthfully and in a racially neutral way. It explains actual observed behavior pre and post crisis.

[b] See: Global Market Turmoil Graphic and Financial Crisis Calendar Graphic. November, 2009, Creative Investment Research, Inc.

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A General Theory of the Financial Crisis

According to our theory, a significant increase in transaction costs[c] caused the financial market crisis. We define transaction costs as the value, over and above the price paid, required to complete an exchange for items of worth. Transaction costs are generally denominated in money, but also involve nonmonetary resources.

The Role of Transaction Costs

To understand the role transaction costs played in the financial crisis, it helps to definite them as *institutional costs*, or as exchange-related costs "that arise due to the existence of institutions."[d]

Our theory states that as marketplace ethics decreased, transaction costs increased. Eventually, transaction costs rose to a level that caused general market failure, or the financial crisis. General market failure is defined as an inefficient allocation of liquidity in the global financial marketplace.

Decline in Ethical Standards

Widespread fraud in the marketplace revealed a generalized, deep and pervasive decline in ethical standards of business behavior. Between 2003 and 2006, the U.S. Securities and Exchange Commission reported multiple, overlapping violations of U.S. securities laws:

- On April 28, 2003, every major US investment bank, including Merrill Lynch, Goldman Sachs, Morgan Stanley, Citigroup, Credit Suisse First Boston, Lehman Brothers Holdings, J.P. Morgan Chase, UBS Warburg, and U.S. Bancorp Piper Jaffray, were found to have aided and abetted efforts to defraud investors. The firms were fined a total of $1.4 billion dollars by the SEC, triggering the creation of a Global Research Analyst Settlement Fund.

- In May, 2003, the SEC disclosed that several "brokerage firms paid rivals that agreed to publish positive reports on companies whose shares..they issued to the public. This practice made it appear

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[c] According to Wikipedia (online at http://en.wikipedia.org/wiki/Transaction_cost),

> "In economics and related disciplines, a transaction cost is a cost incurred in making an economic exchange (restated: the cost of participating in a market). For example, most people, when buying or selling a stock, must pay a commission to their broker; that commission is a transaction cost of doing the stock deal. Or consider buying a banana from a store; to purchase the banana, your costs will be not only the price of the banana itself, but also the energy and effort it requires to find out which of the various banana products you prefer, where to get them and at what price, the cost of traveling from your house to the store and back, the time waiting in line, and the effort of the paying itself; the costs above and beyond the cost of the banana are the transaction costs. When rationally evaluating a potential transaction, it is important to consider transaction costs that might prove significant."

[d] See: Steven N.S. Cheung, *On the New Institutional Economics.* Discussion Paper No. 118, Department of Economics, University of Hong Kong, 1990. Also in Contract Economics. Werin, Lars, Ingemar Stahl, Eds, Blackwell Publishers, Oxford, UK. See also Coase, Ronald, (1937) *"The Nature of the Firm".* Economica 4 (16): 386-405.

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that a throng of believers were recommending these companies' shares." This was false. "From 1999 through 2001, for example, one firm paid about $2.7 million to approximately 25 other investment banks for these so-called research guarantees, regulators said. Nevertheless, the same firm boasted in its annual report to shareholders that it had come through investigations of analyst conflicts of interest with its 'reputation for integrity' maintained."

- On September 3, 2003, the New York State Attorney General announced he has "obtained evidence of widespread illegal trading schemes, 'late trading' and 'market timing,' that potentially cost mutual fund shareholders billions of dollars annually. This, according to the Attorney General, "is like allowing betting on a horse race after the horses have crossed the finish line."

- On September 4, 2003, a major investment bank, Goldman Sachs, admitted that it had violated anti-fraud laws. Specifically, the firm misused material, nonpublic information that the US Treasury would suspend issuance of the 30-year bond. The firm agreed to "pay over $9.3 million in penalties." On April 28, 2003, the same firm was found to have "issued research reports that were not based on principles of fair dealing and good faith .. contained exaggerated or unwarranted claims.. and/or contained opinions for which there were no reasonable bases." The firm was fined $110 million dollars, for a total of $119.3 million dollars in fines in six months.

- On December 18, 2003, the Securities and Exchange Commission "announced an enforcement action against Alliance Capital Management L.P. (Alliance Capital) for defrauding mutual fund investors. The Commission ordered Alliance Capital to pay $250 million. The Commission also ordered Alliance Capital to undertake certain compliance and fund governance reforms designed to prevent a recurrence of the kind of conduct described in the Commission's Order. Finally, the Commission found that "Alliance Capital breached its fiduciary duty to (it's) funds and misled those who invested in them."

- On October 8, 2004, the Securities and Exchange Commission "announced..enforcement actions against Invesco Funds Group, Inc. (IFG), AIM Advisors, Inc. (AIM Advisors), and AIM Distributors, Inc. (ADI). The Commission issued an order finding that IFG, AIM Advisors, and ADI violated the federal securities laws by facilitating widespread market timing trading in mutual funds with which each entity was affiliated. The settlements require IFG to pay $215 million in disgorgement and $110 million in civil penalties, and require AIM Advisors and ADI to pay, jointly and severally, $20 million in disgorgement and an aggregate $30 million in civil penalties."

- On November 4, 2004, the Securities and Exchange Commission "filed a settled civil action in the United States District Court for the District of Columbia against Wachovia Corporation (Wachovia) for violations of proxy disclosure and other reporting requirements in connection with the 2001 merger between First Union Corporation (First Union) and Old Wachovia Corporation (Old Wachovia). Under the settlement, Wachovia must pay a $37 million penalty and is to be enjoined from future violations of the federal securities laws."

- On November 17, 2004, the Securities and Exchange Commission announced "charges concerning undisclosed market timing against Harold J. Baxter and Gary L. Pilgrim in the Commissions' pending action in federal district court in Philadelphia." Based on these charges,

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Baxter and Pilgrim agreed to "pay $80 million – $60 million in disgorgement and $20 million in civil penalties."

- On November 30, 2004, the Securities and Exchange Commission announced "the filing..of charges against American International Group, Inc. (AIG) arising out of AIG's offer and sale of an earnings management product." The company "agreed to pay a total of $126 million, consisting of a penalty of $80 million, and disgorgement and prejudgment interest of $46 million."

- On December 22, 2004, "the Securities and Exchange Commission, NASD and the New York Stock Exchange announced..enforcement proceedings against Edward D. Jones & Co., L.P., a registered broker-dealer headquartered in St. Louis, Missouri." According to the announcement, "Edward Jones failed to adequately disclose revenue sharing payments that it received from a select group of mutual fund families that Edward Jones recommended to its customers." The company agreed to "pay $75 million in disgorgement and civil penalties. All of that money will be placed in a Fair Fund for distribution to Edward Jones customers."

- On January 25, 2005, "the Securities and Exchange Commission announced the filing in federal district court of separate settled civil injunctive actions against Morgan Stanley & Co. Incorporated (Morgan Stanley) and Goldman, Sachs & Co. (Goldman Sachs) relating to the firms' allocations of stock to institutional customers in initial public offerings (IPOs) underwritten by the firms during 1999 and 2000."

- According to the Associated Press, on January 31, 2005, "the nation's largest insurance brokerage company, Marsh & McLennan Companies Inc., based in New York, will pay $850 million to policyholders hurt by" corporate practices that included "bid rigging, price fixing and the use of hidden incentive fees." The company will issue a public apology calling its conduct "unlawful" and "shameful," according to New York State Attorney General Elliott Spitzer. In addition, "the company will publicly promise to adopt reforms."

- On Feb. 9, 2005, the Securities and Exchange Commission "announced the settlement of an enforcement action against Columbia Management Advisors, Inc. (Columbia Advisors), Columbia Funds Distributor, Inc. (Columbia Distributor), and three former Columbia executives in connection with undisclosed market timing arrangements in the Columbia funds. In settling the matter, the Columbia entities will pay $140 million, all of which will be distributed to investors harmed by the conduct. The SEC also brought fraud charges against two additional former Columbia senior executives in federal court in Boston."

- On March 23, 2005, the Securities and Exchange Commission "announced that Putnam Investment Management, LLC (Putnam) will pay $40 million. The Commission issued an order that finds Putnam failed to adequately disclose to the Putnam Funds' Board of Trustees and the Putnam Funds' shareholders the conflicts of interest that arose from..arrangements for increased visibility within the broker-dealers' distribution systems."

- On March 23, 2005, the Securities and Exchange Commission (Commission) "announced that it instituted and simultaneously settled an enforcement action against Citigroup Global Markets, Inc.

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(CGMI) for failing to provide customers with important information relating to their purchases of mutual fund shares."

- On April 19, 2005, the Securities and Exchange Commission "announced that KPMG LLP has agreed to settle the SEC's charges against it in connection with the audits of Xerox Corp. from 1997 through 2000." As part of the settlement, KPMG paid a fine totaling $22.475 million.

- On April 12, 2005, the Securities and Exchange Commission "instituted and simultaneously settled an enforcement action against the New York Stock Exchange, Inc., finding that the NYSE, over the course of nearly four years, failed to police specialists, who engaged in widespread and unlawful proprietary trading on the floor of the NYSE." As part of the settlement, the "NYSE agreed to an undertaking of $20 million to fund regulatory audits of the NYSE's regulatory program every two years through the year 2011." On that same date, the Commission "instituted administrative and cease-and-desist proceedings against 20 former New York Stock Exchange specialists for fraudulent and other improper trading practices."

- On April 19, 2005, the Securities and Exchange Commission announced "that KPMG LLP has agreed to settle the SEC's charges against it in connection with the audits of Xerox Corp. from 1997 through 2000. As part of the settlement, KPMG consented to the entry of a final judgment in the SEC's civil litigation against it pending in the U.S. District Court for the Southern District of New York. The final judgment..orders KPMG to pay disgorgement of $9,800,000 (representing its audit fees for the 1997-2000 Xerox audits), prejudgment interest thereon in the amount of $2,675,000, and a $10,000,000 civil penalty, for a total payment of $22.475 million."

- On April 28, 2005, the Securities and Exchange Commission announced "that it has instituted settled enforcement proceedings against Tyson Foods, Inc. and its former Chairman and CEO Donald "Don" Tyson. The SEC charged that in proxy statements filed with the Commission from 1997 to 2003, Tyson Foods made misleading disclosures of perquisites and personal benefits provided to Don Tyson both prior to and after his retirement as senior chairman in October 2001."

- On May 31, 2005, the Securities and Exchange Commission "announced settled fraud charges against two subsidiaries of Citigroup, Inc. relating to the creation and operation of an affiliated transfer agent that has served the Smith Barney family of mutual funds since 1999. Under the settlement, the respondents are ordered to pay $208 million in disgorgement and penalties and to comply with substantial remedial measures, including an undertaking to put out for competitive bidding certain contracts for transfer agency services for the mutual funds."

- On June 2, 2005, the Securities and Exchange Commission "filed securities fraud charges against Amerindo Investment Advisors, Inc., Alberto William Vilar and Gary Alan Tanaka, Amerindo's co-founders and principals, for misappropriating at least $5 million from an Amerindo client."

- On June 9, 2005, the Commission announced that "Roys Poyiadjis, a former CEO of AremisSoft Corporation, which was a software company with offices in New Jersey, London, Cyprus, and India, agreed to final resolution of fraud charges brought against him by the Securities and Exchange Commission in October 2001. In documents filed with the federal district court in Manhattan,

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Poyiadjis consented to disgorge approximately $200 million of unlawful profit from his trading in AremisSoft stock -- among the largest recoveries the SEC has obtained from an individual."

- On July 20, 2005, the Securities and Exchange Commission "announced a settled administrative proceeding against Canadian Imperial Bank of Commerce's (CIBC) broker-dealer and financing subsidiaries for their role in facilitating deceptive market timing and late trading of mutual funds by certain customers. The Commission ordered the subsidiaries, CIBC World Markets Corp. (World Markets), a New York based broker-dealer, and Canadian Imperial Holdings Inc. (CIHI), to pay $125 million, consisting of $100 million in disgorgement and $25 million in penalties."

- On August 15, 2005, the Securities and Exchange Commission "charged four brokers and a day trader with cheating investors through a fraudulent scheme that used squawk boxes to eavesdrop on the confidential order flow of major brokerages so they could 'trade ahead' of large orders at better prices."

- On August 22, 2005, the Securities and Exchange Commission "filed civil fraud charges against two former officers of Bristol-Myers Squibb Company for orchestrating a fraudulent earnings management scheme that deceived investors about the true performance, profitability and growth trends of the company and its U.S. medicines business."

- On August 23, 2005, the Securities and Exchange Commission "filed charges against two former top Kmart executives for misleading investors about Kmart's financial condition in the months preceding the company's bankruptcy."

- On November 2, 2005, the Securities and Exchange Commission "filed enforcement actions against seven individuals alleging they aided and abetted a massive financial fraud by signing and returning materially false audit confirmations sent to them by the auditors of the U.S. Foodservice, Inc. subsidiary of Royal Ahold (Koninklijke Ahold N.V.)."

- On November 28, 2005, the Securities and Exchange Commission announced "that three affiliates of one of the country's largest mutual fund managers have agreed to pay $72 million to settle charges they harmed long-term mutual fund shareholders by allowing undisclosed market timing and late trading by favored clients and an employee."

- On December 1, 2005, the Securities and Exchange Commission "announced settled enforcement proceedings against American Express Financial Advisors Inc., now known as Ameriprise Financial Services, Inc. (AEFA), a registered broker-dealer headquartered in Minneapolis, Minn., related to allegations that AEFA failed to adequately disclose millions of dollars in revenue sharing payments that it received from a select group of mutual fund companies. As part of its settlement with the Commission, AEFA will pay $30 million in disgorgement and civil penalties, all of which will be placed in a Fair Fund for distribution to certain of AEFA's customers."

- On December 1, 2005, the Securities and Exchange Commission "announced a settled administrative proceeding against Millennium Partners, L.P., Millennium Management, L.L.C., Millennium International Management, L.L.C., Israel Englander, Terence Feeney, Fred Stone, and

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Kovan Pillai for their participation in a fraudulent scheme to market time mutual funds. The respondents will pay over $180 million in disgorgement and penalties and undertake various compliance reforms to prevent recurrence of similar conduct."

- On December 19, 2005, the Securities and Exchange Commission "announced that it filed and settled insider trading charges both against an accountant and a former executive of Sirius Satellite Radio, Inc. who illegally profited from advance knowledge of radio personality Howard Stern's $500 million contract with Sirius."

- On December 21, 2005, the Securities and Exchange Commission "sued top executives of National Century Financial Enterprises, Inc. (NCFE), alleging that they participated in a scheme to defraud investors in securities issued by the subsidiaries of the failed Dublin, Ohio company. NCFE, a private corporation, suddenly collapsed along with its subsidiaries in October 2002 when investors discovered that the companies had hidden massive cash and collateral shortfalls from investors and auditors. The collapse caused investor losses exceeding $2.6 billion and approximately 275 health-care providers were forced to file for bankruptcy protection."

- On January 3, 2006, the Securities and Exchange Commission announced "that it filed charges against six former officers of Putnam Fiduciary Trust Company (PFTC), a Boston-based registered transfer agent, for engaging in a scheme beginning in January 2001 by which the defendants defrauded a defined contribution plan client and group of Putnam mutual funds of approximately $4 million."

- On January 4, 2006, the Securities and Exchange Commission "filed securities fraud charges against McAfee, Inc., formerly known as Network Associates, Inc., a Santa Clara, California-based manufacturer and supplier of computer security and antivirus tools. McAfee consented, without admitting or denying the allegations of the complaint, to the entry of a Court order enjoining it from violating the antifraud, books and records, internal controls, and periodic reporting provisions of the federal securities laws. The order also requires that McAfee pay a $50 million civil penalty, which the Commission will seek to distribute to harmed investors pursuant to the Fair Funds provision of the Sarbanes-Oxley Act of 2002."

- On January 9, 2006, the Securities and Exchange Commission "announced that Daniel Calugar and his former registered broker-dealer, Security Brokerage, Inc. (SBI), agreed to settle the SEC's charges alleging that they defrauded mutual fund investors through improper late trading and market timing. As part of the settlement, Calugar will disgorge $103 million in ill-gotten gains and pay a civil penalty of $50 million."

- On February 2, 2006, the Securities and Exchange Commission "announced that it filed an enforcement action against five former senior executives of General Re Corporation (Gen Re) and American International Group, Inc. (AIG) for helping AIG mislead investors through the use of fraudulent reinsurance transactions."

- On February 9, 2006, the Commission announced "the filing and settlement of charges that American International Group, Inc. (AIG) committed securities fraud. The settlement is part of a

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global resolution of federal and state actions under which AIG will pay in excess of $1.6 billion to resolve claims related to improper accounting, bid rigging and practices involving workers' compensation funds."

- On March 16, 2006, the Securities and Exchange Commission "announced a settled enforcement action against Bear, Stearns & Co., Inc. (BS&Co.) and Bear, Stearns Securities Corp. (BSSC) (collectively, Bear Stearns), charging Bear Stearns with securities fraud for facilitating unlawful late trading and deceptive market timing of mutual funds by its customers and customers of its introducing brokers. The Commission issued an Order finding that from 1999 through September 2003, Bear Stearns provided technology, advice and deceptive devices that enabled its market timing customers and introducing brokers to late trade and to evade detection by mutual funds. Pursuant to the Order, Bear Stearns will pay $250 million, consisting of $160 million in disgorgement and a $90 million penalty."

- On April 11, 2006, the Securities and Exchange Commission announced "charges against individuals involved in widespread and brazen international schemes of serial insider trading that yielded at least $6.7 million of illicit gains. The schemes were orchestrated by..a research analyst in the Fixed Income division of Goldman Sachs, and a former employee of Goldman Sachs."

- On September 27, 2006 CFO Magazine reported that:

  "A subcontractor hired on Monday by the Securities and Exchange Commission to work on its new, interactive regulatory filing system..is under formal investigation by the SEC because of the company's poor internal controls over financial reporting. BearingPoint, an international management and IT consulting company, was identified by SEC Chairman Christopher Cox on Monday, as being one of the subcontractors working on the technology project aimed at converting existing, and possibly future, regulatory filings from a static electronic format to an interactive XBRL format. XBRL, an Internet-language method of tagging financial data, has been championed by Cox, who has argued it would make the financial statements of public companies easier for investors to examine and compare."

In other cases, corporate management unfairly transferred value from outsider to insider shareholders at the following companies: Adlephia Communications, Alliance Capital Management, American Express Financial, American Funds, Arthur Andersen, AXA Advisors, Bank of America's Nations Funds, Bank One, Canadian Imperial Bank of Commerce, Canary Capital, Charles Schwab, Cresap, Inc., Empire Financial Holdings, Enron, Ernst & Young , Federated Investors, FleetBoston, Franklin Templeton, Fred Alger Management, Freemont Investment Advisors, Gateway, Inc., Global Crossing, H.D. Vest Investment Securities, Heartland Advisors, Homestore, Inc., ImClone, Interactive Data Corp., Invesco Funds Group Inc., Janus Capital Group Inc., Legg Mason, Limsco Private Ledger, Massachusetts Financial Services Co., Millennium Partners, Mutuals.com, PBHG Funds, Pilgrim Baxter, PIMCO, Prudential Securities, Putnam Investment Management LLC, Raymond James Financial, Samaritan Asset Management, Security Trust Company, N.A., State Street Research, Strong Mutual Funds, Tyco, UBS AG, Veras Investment Partners, Wachovia Corp., and WorldCom.

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Ethical Standards, Trust and Transaction Costs

The decline in ethical standards of behavior eventually led to a decline in trust. We define trust as:

"increasing ones' vulnerability to the risk of opportunistic behavior of one's transaction partner whose behavior is not under one's control in a situation in which the costs of violating the trust are smaller than the benefits of holding the trust. In the face of opportunism, contracts are designed with 'safe-guards' to protect against an opportunistic party. Such safe-guards include the costs of negotiating, drafting, monitoring contracts." [e]

As we see from the listing above, opportunistic behavior increased dramatically.

Declining trust increased transaction costs in three ways:

- First, opportunistic behavior on the part of key financial market participants, commercial and investment banks, led to higher security prices. They simply gouged customers.
- Second, these same institutions developed a set of racially biased[f], low added value, high cost financial practices and products, designed solely to maximize firm revenue and profit. They also concealed the fact that these products had limited value from both customers and regulators.[g]
- Financial market participants attempted to use imagination to deal with the ethics/trust/ transaction cost issue. They did so via derivatives and other financial market "innovations" designed as 'safe-guards' to protect parties vulnerable to opportunistic behavior in financial transactions. These contracts were supposed to eliminate the need to be concerned about the behavior of unscrupulous actors[h] and the impact that behavior might have on one's financial standing. Ratings on securities were supposed to serve as another type of insurance policy. Both sets of "insurance policies" proved ineffective, however, and only increased transaction costs.

These significantly increased transaction costs precipitated and caused global market failure in 2007 and 2008.

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[e] See: "Integrating Variables Risk Preference: Trust and Transaction Cost Economics" by Todd H. Chiles, John F. McMackin, University of Oregon, 1996, Academy of Management Review, 1996, Vol. 21, No. 1, 73-99.

[f] See: "Bank accused of predatory practices. Lawsuit alleges black neighborhood, churches targeted." Gazette.net. Online at: http://www.gazette.net/stories/06182009/collnew182411_32521.shtml

[g] See: Exhibits from the Hearing on Wall Street and the Financial Crisis: The Role of Investment Banks. United States Senate Permanent Subcommittee on Investigations. Committee on Homeland Security and Govenmental Affairs. April 27, 2010.

[h] Ibid.

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Why our theory is better

Our theory is a generalized explanation of the financial crisis. It explains actual and observed behavior of several market participants, including but not limited to insurance companies, rating agencies, commercial and investment banks, regulators, institutional buyers and other financial market participants. It also explains behavior across security markets, that is, it explains observed behavior in the equity market, the debt market and the derivatives market. Finally, our theory is racially neutral and unbiased. It does not attempt the statistically impossible task of blaming the global financial crisis on one small demographic group.

Suggested Policies

Given our focus on transaction costs, it is clear that policies that increase trust and thereby reduce transaction costs will help prevent a reoccurrence of the financial crisis. We support the Securities and Exchange Commission's efforts to modernize financial reporting technology and believe the eXtensible Business Reporting Language (XBRL) can reduce transaction costs by enhancing the flow of information to investors. This increased information flow should reduce the "risk of opportunistic behavior of one's transaction partner whose behavior is not under one's control in a situation in which the costs of violating the trust are greater than the benefits of holding the trust." We detail our reasons below.

Prior to the creation and adoption of high speed, massively networked public computer systems, providing a new method for financial reporting was a costly proposition, unfair to public companies and corporate management. This is, however, no longer the case. Many investors and shareholders currently use websites like www.google.com/finance/ to obtain corporate information. Internet technology was specifically designed for this type of problem.

Relevant XBRL-tagged information could be submitted using a secure, tamper resistant, management-independent website. Data would be tabulated in real time. We also believe public companies should be required to disclose executive and director compensation via the Internet.

Finally, we suggest using a fairness-enhanced, Dutch-auction style system to allocate and price initial and secondary debt obligations (CDO.) The network of prescreened buyers, already well known to Wall Street, could easily be moved to this system. The system would be designed to meet certain security and performance standards.

An Internet based, XBRL-enhanced, on-line system will significantly lower the cost of raising capital. We believe this lowered cost will result in more companies coming to market. More companies coming to market will result in, other things equal, higher levels of economic activity, lower unemployment and lower inflation.

Graphically, the system would look as follows:

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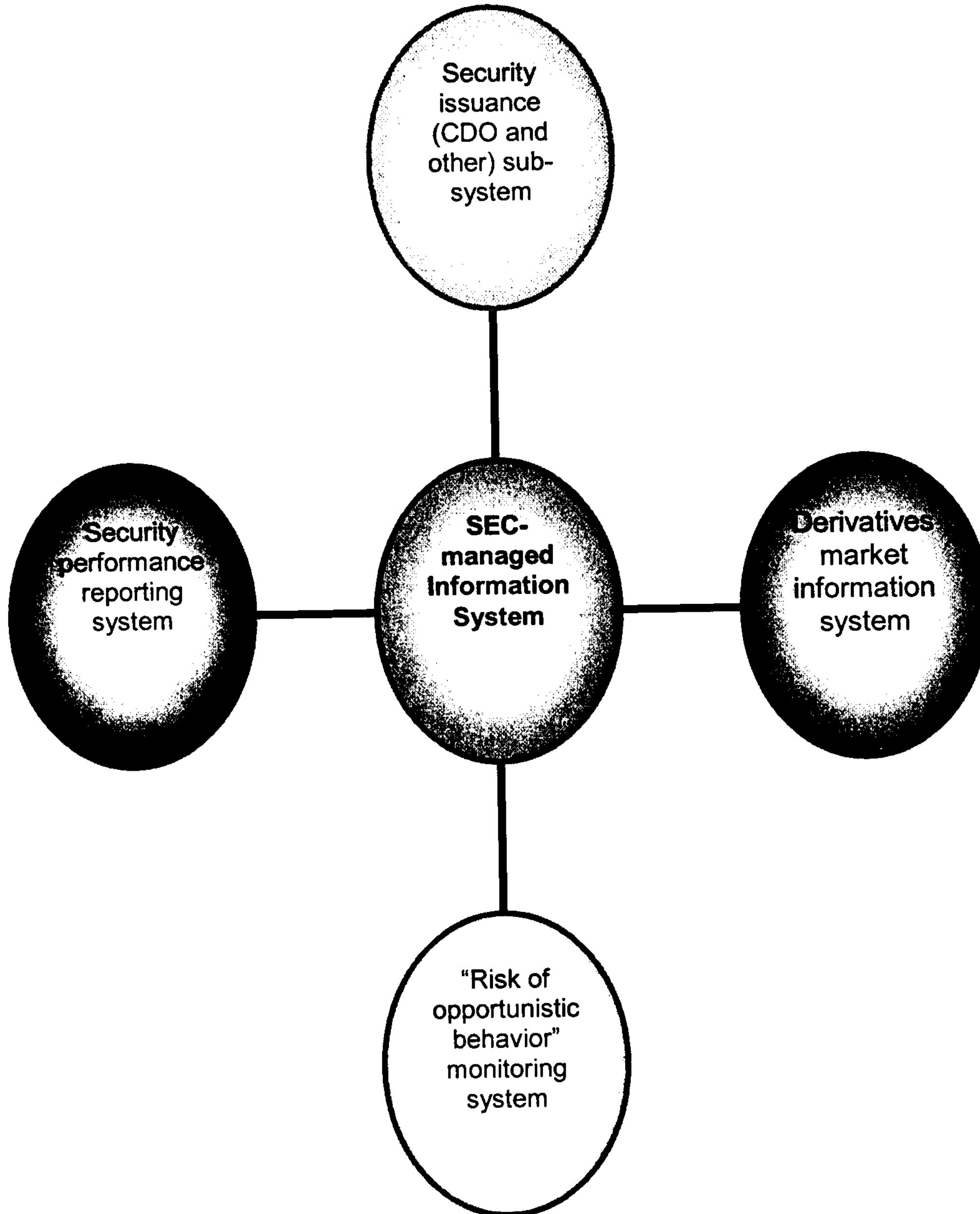

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