

MA Monitor: Focus on Managed Accounts

This edition: A recap of the MMI's 2009 Annual Convention, March 26th & 27th in Philadelphia, PA.



CONTENTS

PAGE 1

Key Trends in the MAS Channel

PAGE 2

Preparing for the Future of the Financial Services Industry

PAGE 4

The Crisis - Lessons for Money Management

PAGE 5

The Managed Solutions Communications Standards

PAGE 6

Advisor Distribution Models and the New Reality

PAGE 7

Ways to Increase Operating Effectiveness

PAGE 8

Rebuilding Trust - William Hambrecht

ABOUT EZRA GROUP

Launched by Craig Iskowitz in 2005, Ezra Group is a consulting firm providing technology and business strategy advice. Our focus is in the financial services industry, with expertise in wealth management, retail brokerage and equity and fixed income trading.

MMI 2009 Annual Convention

2008: A Year to be Both Forgotten and Remembered

This edition of Ezra Group's MA Monitor is focused on the MMI's 2009 annual convention, which was held in Philadelphia. Of course, the country's financial crisis was everyone's number one topic, and many of the distinguished speakers gave their analysis of the economic events of 2008 along with their proposals for turning things around.

In the following pages, we provide summaries from most of the conference sessions and include answers to some critical questions such as: What's next for asset managers? What's the impact of the upcoming U.S. budget deficit? What were the key issues that got us into the current financial crisis? What are some ways to fix the problems?

Opening Remarks

Key Trends in the MAS Channel

The speakers in this session were Marc Brookman, Managing Director, Director of Product Development, Smith Barney and Daniel O'Lear, Executive Vice President, Director of Sales, Franklin Templeton Distributors, Inc. Marc and Daniel were also the conference co-chairs.

Marc Brookman

"Was the advice and guidance we gave wrong?", Marc rhetorically asked everyone. He then reported that in his recent meetings, advisors said they've lost faith in this business. They feel they've let down their clients, even though their advice most likely minimized their losses. This was illustrated by stats Marc presented showing the average SMA beat the S&P500 by 5%, while the average MFW outperformed it by 9%.

He then quoted from a recent study by the CFA Institute about diversification. "Diversification works best in up markets when investors could use a little less of it, and fails to protect you in down markets when it's needed most."

Marc's Questions for the Future:

- Did people take on more risk than they should have?
- Will the markets ever come back?

- Does asset allocation, manager selection and portfolio construction truly add value?
- Did we fail our clients or did the markets fail us?

Daniel O'Lear

Daniel then followed up by asking some questions of his own:

Are we seeing a structural shift in the risk tolerance of investors?

The US has been a market that is driven by returns, Daniel commented. Was this change due to Generation X experiencing the second significant downturn of their lifetime, the first being post-1999? What about their parents, the baby boomers, who have seen the value of their investments decline significantly? If risk tolerance does shift, will the US become more like Asia and the EU where risk tolerance is substantially lower and holding periods are shorter?

What does growing risk aversion among investors mean for us?

We've seen this particularly in the proliferation of the ETF marketplace. How do active managers address this trend? Do they look to offer low tracking error products in the core spaces? Or will that confine the investment managers to mediocre performance? Does that defeat the purpose of active management?

How do investors feel about their advisors' performance?

A recent Cerulli survey of advisory clients reported that their returns beat the S&P by 16% over the last six months, Daniel stated. However, reviews that clients gave of their advisors' performance was mixed. In other words, they beat the market, but were unaware of it.

**Opening Keynote Session
Preparing for the Future of the Financial Services Industry**

The speakers were Robert C. Doll, Vice Chairman, Global Chief Investment Officer - Equity, BlackRock and Dr. Robert D. Hormats, Vice Chairman, Goldman Sachs (International).

Robert C. Doll

Bob's first slide was titled, "2008: a year to be both forgotten and remembered". At the beginning of the year, the consensus was that decoupling would "save the world" (and markets).

What's next for asset managers?

The asset management business is simplifying, Bob said. Future winners will have scale, global investment platforms, distribution depth and breadth.

Clients want relative performance when markets go up, but expect absolute performance when they're going down.

Winners & Losers

Bob Doll reported that institutional clients are shifting gears; a survey of pension consultants shows significant changes in winning and losing categories:

Winners	Losers
Liability-Driven Investments	Single-Manager Funds
Global Mandates	I30/30 Funds
Absolute Return	Quantitative Equities
TAA	Hedge Fund of Funds

Shifts in Distribution

Bob reported that the number of brokers employed by wirehouses was flat this decade, while the population of independent financial planners doubled. Wirehouses accounted for less than 25% of sales of large mutual fund complexes.

Notwithstanding these shifts in distribution, BlackRock expects "professionally managed" assets will continue to expand at ~7% rate vs. 5-6% for advised and self-managed assets and 6% for all financial assets. The primary reason for the higher growth in managed assets is the continued reduction in equities owned individually and not through a managed account (from 30% to 22%). Most investors have realized it's difficult to outperformed the pros.

Mutual Fund Flows Reflect Investor Sentiment

"The equity ETF has been a gatherer of assets in a way that exceeded even the purveyors of those products wildest dreams," Bob commented. "As folks look for cheap beta it's become the vehicle for that to happen." "With current valuations spread so

wide, it's probably not the right time to move to passive strategies. The ensuing period will show the breadth and width of the alpha between those who generate good returns and those who don't."

Wealth Management Landscape Consolidation

The new landscape:

- Bank of America + Merrill Lynch = \$2.0 trn assets, 20,000 FAs
- Morgan Stanley + Smith Barney = \$1.7 trn assets, 21,600 FAs
- Wells Fargo + Wachovia = \$1.4 trn assets, 16,000 FAs.

Consultant Landscape – Consolidation & Evolution

In the US, Mercer, Watson Wyatt, Callan, Wilshire, Russell & Cambridge have been the largest players in what has been a highly fragmented market. Post merger, Mercer will dominate with a much broader client base, more field consultants and a larger manager research group, Bob reported.

Consultants are moving away from a "pure advice" model, with many launching more traditional consulting services. They are converging on the same territory as asset managers and competing for the same mandates.

Some consultants are conflicted as they are both rating asset managers for fiduciary services, in addition to offering their own fiduciary management solutions.

Co-opetition is the new model.

Shifting Investor Preferences

Daniel O'Lear added his comments to this table from the MMI 2009 Factbook that identifies how investor preferences have shifted from the prior decade:

1990s	Post-2000	Daniel's Comments
Benchmarks	Outcomes	Seen recent flows into target date funds
Style Box	Core & Satellite	Slower, evolutionary change
Relative Returns	Absolute Returns	Can absolute returns be consistently delivered? What role will guaranteed products play?
Philosophy-Driven	Needs-Driven	Advisor and wholesaler training are key to success.
Active Core	Index Core	Validated by proliferation of ETF market.

Profits Will be Squeezed

Profit margins this year will be more than a third below their 2007 peak, Bob predicted. The industry's cost cutting campaign will be the most aggressive in its history as the asset management business adapts to the new landscape.

“Clients want relative performance when markets are going up, but expect absolute performance when they're going down.”

-- Robert C. Doll, BlackRock

The average firm is planning to reduce costs by 20-25% and headcount by more than 10%. Bob explained that there are essentially three ways for asset managers to cut cost:

- Squeeze costs - only save ~ 7%
- Structural changes - the business model stays intact, but only save 5-15%
- Strategic changes - includes simplifying the portfolio of products, refocusing on only the most profitable distribution channels, and consolidation within and across platforms. These changes can save more than 20%.

Do you see anything going right in the U.S. economy?

“There are a number of things that indicate to us that risk assets and equities in particular are in a bottoming process,” Bob stated. Even in the real economy we're seeing some ‘green shoots’, if you'll accept that ‘less bad’ is good news. Retail sales were better than expected the last couple of months. Excess inventory that built up in the fourth quarter is being taken down. There is a vast amount of cash on the sidelines that's waiting for some excuse to come back in.”

“Positive convergences will continue. The important lows of October 10, November 21 and March 6, each successive low had fewer new lows and that indicates a change in pattern. We have been of the view since the

November 21 low, that the character of the market changed from down to sideways. It's in a multi-month, base-building process, from which if we get an economic recovery, which we're expecting in 2010, then risk assets will go higher.”

What's next for investment management?

- Scale players will be winners
- Shift to low-cost beta to continue
- Demand for low volatility and absolute return products will increase
- Alternative alpha still growing
- Industry consolidation continues
- Global players will be winners

When should advisors tell their clients to get back into the market?

“I would say now,” proclaimed Bob. “I don't mean putting it all in,” he cautioned. “None of us can call a bottom, but it's a lot easier analytically to identify a bottoming process. Investing is a process, not an event. To the extent you can get some money dollar cost averaged back into something that should give them an expected rate of return.”

Dr. Robert D. Hormats

The fundamentals of global diversification may have received a setback, but over the longer term, it's not something to give up on, Bob asserted. This is the first global downturn with negative growth since World War II.

“The era of big government is back,” exclaimed Bob. “When the consumer is in retreat and withholding discretionary spending, the government has to be the investor of last resort. This is a legitimate, positive role for the government to play unless one wants to see the economy completely collapse.”

Tim Geitner said that he won't do what the Japanese did, which was to cut back on the stimulus too quickly or what Roosevelt did in 1937 when he thought the economy was coming out of the depression and raised taxes, Bob said.

The government is going to play a role in the financial services industry for a very long time. This means not only regulatory scrutiny at a much higher

level, but Congress will also be playing a very pro-active role aside from the traditional regulatory processes of the Fed, FDIC and SEC.

If you look at the Wall Street Journal or the New York Times, the major financial stories are no longer coming from Wall Street, they're coming from Washington.

We have to understand that the regulatory environment will change, and then try to reduce the uncertainties for our clients. It's not sufficient to know the market outlook. It's just as important to understand the regulatory changes and how they will affect our clients.

What is the impact of the upcoming, huge budget deficits?

There are two reasons why the economy is capable of financing the kind of spending the government is talking about; 1) Publicly held debt is not at historically high levels yet. It's currently at 40% of GDP and will probably go up over the next two years to around 65%. In World War II, the publicly held debt went up to 110% of GDP.

“[T]he major financial stories are no longer coming from Wall Street, they're coming from Washington.”

-- Dr. Robert D. Hormats, Goldman Sachs (International)

2) It's relatively easy to finance this debt, since the domestic savings pool is considerably higher, because the average consumer is saving their money. This provides the government with a larger pool from which to borrow. Also, the interest rate on the Treasury's borrowing is very low. The amount of interest as a portion of GDP is about 1.5%, which is below the historic average of 2.0%.

After the emergency is over, the Congress and Administration have to demonstrate that they're committed to bringing the country back to fiscal responsibility, which is something that they've had a hard time doing in the past.

General Session

The Crisis - Lessons for Money Management

The speaker was Dr. Richard Marston, James Guy Professor of Finance, The Wharton School of Business, University of Pennsylvania.

Dr. Marston discussed four of the issues that he believes were at the roots of the current financial crisis.

1. The Real Estate Sector

The government had a role in the crisis, and in Marston's opinion, the way they handled Fannie Mae and Freddie Mac was disgraceful.

Are we at the bottom of the real estate market? House prices move at different rates across the country, Marston said. The last time we had a boom, it was nowhere near what we had this time (see chart). California reached a peak in 1989 and didn't hit bottom until 1996. New York reached a peak in 1988 and didn't hit bottom until 1995.

There was a study of all the financial crisis over the past 35 years. How long does it take for house prices to come back? An average of 5 years. How long does it take equity prices to reach bottom? 3 years on average. It's a bit unsettling to see how long it takes for these asset prices to adjust. And this is only to reach bottom! It's not gaining back what we lost. To err on the side of caution we should realize that this isn't going to turn around too quickly.

2. Securitization Spreads the Pain

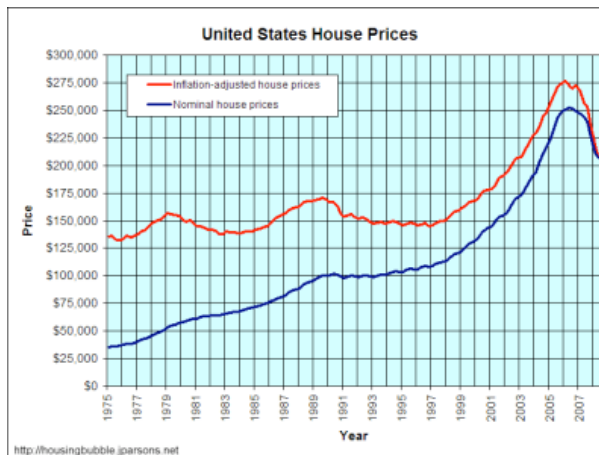
Banks changed their model from taking deposits and making loans to one based on securitization. Securities were sold and then spread amongst the hedge funds, insurance companies, investment banks and pension plans. That meant we were all holding the same paper!

We had a test of this crisis in 1998 with the failure of Long Term Capital Management (LTCM), but the industry didn't learn from it. LTCM ran into trouble in the summer of 1998. The reason that

Wall Street bailed them out was due to securitization. They were all holding the same paper! So, they put up a combined \$300 mm to buy LTCM and then closed it down in an orderly fashion.

Then we asked the prime brokers to watch over hedge funds. The problem was that, in the meantime, the prime brokers became hedge funds via their proprietary trading units, which is just a hedge fund inside of an investment bank.

Is there a point at which hedge funds threaten the system because we're all securitized? This is an issue that Obama and Geitner have to worry about as they try and re-establish regulation.



3. Black Swans

When new instruments are created, we never really understand what the risks are, Marston asserted. This is an old story. People try to pretend that every crisis is a "black swan" event so that no one has to take responsibility.

An example of a prior black swan event was caused by a similar instrument in the 80's -- syndicated loans.

To give you an idea of how perilous it was, Manufacturer's Hannover, which was one of the money center banks, had



250% of its capital tied up in Latin America! If they had to price down their loans by 50 basis points, they'd have been insolvent. We've been through this before. Only the names have changed.

4. Credit Assessment Cycles

Credit assessment goes through cycles. Shortly after a disaster we over-price risk. After things calm down, we under-price risk.

There's something called "disaster myopia," which means the further you get from a disaster the less you believe there'll be another in the future.

Emerging markets bonds are a perfect example. After Russia defaulted in 1998, the spread between emerging markets debt and Treasuries exploded to over 12% (see chart). It then fell to 6% until Argentina defaulted in 2002. By July 2007 the spread had collapsed to 1.6%! Disaster myopia had firmly set in.

Fed Actions are a Disaster

Dr. Marston praised Ben Bernake and the the Fed for quieting down the short-term securities markets. The Fed was innovative and broke the rules when

necessary. They did this by selling \$300 bil from their inventory of Treasury securities and used the proceeds to buy commercial paper.

However, when the Fed started buying Treasury bonds, Dr. Marston said he stopped praising them. He believes this move was a disaster and they should have focused on credit spreads, not creating future inflation. The problem, according to Dr. Marston is illiquidity.

The Fed needs to intervened directly in order to revive the long-term securities markets and since they haven't, the banks are still in distress. It's too early to see what will happen with the Geitner program, but it's a good start, Dr. Marston argued. It's a sensibly designed program, but we don't know whether it's going to work and the private sector can be induced to start buying some of these assets, he said.

Morgan Stanley Considers Spinning Off Prop Trading Unit

Dr. Richard Marston said that one cause of the crisis was the failure of prime brokers to monitor hedge fund's activity when they became hedge funds themselves via their proprietary trading units. Bill Hambrecht suggested that investment banks that became hedge funds are going to have to split their businesses.

Their opinions may be confirmed according to a recent [article](#) in the Wall Street Journal, which reports that Morgan Stanley is looking to spin out their prop trading operation into its own hedge fund in order to avoid government restrictions on pay at firms receiving government aid. Morgan likely would keep its current investment in the fund and maintain a significant ownership stake. Since 1993, the prop trading unit has churned out \$6.5 billion in pretax income.

Efficiency & Innovation

The Managed Solutions Communications Standards

Account Origination & Maintenance Sub-Committee

Today marked a very important milestone when the MMI Board of Governors voted to approve the release of the first standards for account origination and maintenance (AOM). According to Heeren Pathak, CTO, Vestmark and AOM committee co-chair, the committee is looking at adding new features such as:

- improved restriction management
- manager-sponsor messaging
- message cancels

Model Maintenance Sub-Committee

The model sub-committee has made significant progress recently, explained Renee Bowen, senior VP at Advisorport and model sub-committee co-chair. They've created a list of core fields needed to send/receive model updates and are ready to put the model standards out for internal comment to MMI. The goal is to have the standards ready to be adopted by the summer 2009. The standards are in good enough form for firms to begin implementing the defined data points in non-automated processes.

Billing Sub-Committee

Seth Johnson, president of Redi2 and billing sub-committee co-chair, began with research from the Tower Group that shows 1.7% of gross fees are lost annually to slippage, representing between \$221 mm - \$306 mm.

The sub-committee recently updated the standards and have published them for internal review. Two messages that are being focused on in

particular are fee summary and fee detail.

Work is also ongoing to develop a specification for uploading flat files.

Three sponsors currently participating in the billing standards development: Merrill Lynch, UBS and Morgan Stanley. Also, several service providers: AdvisorPort and Prudential Wealth Management Solutions; and overlay managers: Delaware Investments, Invesco, and AIM. Special recognition was given to Jim Penman from Penman Consulting for his help in pushing the schema forward from the technical side.

Firms Using the Standards

Brett Ginter, a consultant to DTCC, explained that as an at-cost industry provider, DTCC is always looking for cost reductions, straight through processing and operational efficiencies. For example, FUNDSERV prices have gone down by 90% since it was launched in 1993. As more participants come onto the platform, the cost of providing infrastructure between sponsors, managers and service providers will be reduced.

Gib Veconi, president of Peridrome, said that the industry needs infrastructure that doesn't currently exist. Also important to the processes are value-added networks like DTCC and message-oriented interfaces. Firms are looking to leverage message content and develop exception-based processing.

Peridrome provides a layer that enables firms to quickly integrate messages to drive their account origination and maintenance processes.

Smaller managers don't have the resources to support the infrastructure needed to run SMA or UMA programs. We see firms that work with 30 different

sponsors and custodians and it's very difficult for them to work on 30 different platforms, noted Gib.

Jonathan Flitt, a director at Citi/GTS, provided an outsourcer's point of view. How do we approach this from an industry perspective? Citi projects a 52% increase in efficiency from using these standards in new account processing.

Cheryl Nash, senior VP of strategic marketing at FiServ, announced that they just launched their Message Workflow Manager, which allows managers to send and receive MMI-standard messages.

They plan on converting sponsor data into MMI-standard data to save the sponsors from having to do it.

Gary Jones, President, Jones & Jones Consulting, noted that technology doesn't always translate to efficiency, mainly due to a lack of consistency from a technology perspective.

What's coming in the rest of 2009?

Brett noted that the biggest release coming is UMA v3.0, which is being promoted to their test environment in May. They have commitments from UBS and SmithBarney to participate. They're also looking for a pilot group of 15-20 managers to join the test.

DTCC is releasing Manager User Interface Light, which is a GUI built for managers to enable them to pull down and respond to messages, as well as uploading files to send to other systems.

What we've heard from UBS and SmithBarney is "give me more sponsors and give me ways to hook up with managers." We think this release does both of these, said Brett.

For more information please go to www.mass-committee.org

General Session

Advisor Distribution Models and the New Reality

The moderator was Neil Bathon, Managing Director, FUSE Research Networks. The panelists were Steve Dunlap, COO, Pershing Managed Account Solutions (PMAS), Barnaby Grist, Sr. Managing Director, Strategic Business Development, Schwab Institutional and James Tracey, Director of Investment Advisory Services, Citi.

Company Challenges

Jim stated that a big challenge is to remake financial advisors. Financial advisors built their practices around equity accumulation for the last forty years. The next thirty years will require a completely different skill set.

Steve mentioned that through Pershing, PMAS works with over 1,100 IBDs, 100,000 advisors and 5 million investors.

2008 was Schwab's best year ever for revenue and profit, Barnaby claimed. The RIA business represents 40% of their assets and more than half their growth. The top four wirehouses have 60,000 FAs yet only gathered \$6 bil in net new assets last year, while the top four custodians brought in over \$100 bil. Former wirehouse RIAs who turned independent brought \$15 bil to Schwab.

What are the lingering effects of the crisis on investors?

Schwab has seen advisory accounts move from previous levels of 7-8% cash to 20%, which is low when compared with retail accounts that are averaging 40% cash now. Advisors are keeping clients from over-reacting to recent market conditions, Barnaby claimed.

Steve reported the results of a Pershing survey of high net worth customers that showed 87% are considering switching advisors.

While surveys may show clients considering switching advisors, that hasn't happened, Jim asserted. What we're seeing is the return of relationship alpha. Stronger advisors are taking advantage of

the market and preparing their practices for future growth. The best advisors are obtaining new clients while the others are just trying to retain their current ones.

Advisors are shifting their money to outsourced discretionary products that allow them to free up their time for building their client relationships, according to Steve.

Barnaby countered that Schwab is seeing RIAs becoming more active in tactical investment decisions, not less.

Jim agreed that they're also seeing a big change as their advisory programs towards tactical solutions and away from auto-pilot asset allocation programs. Jim urged everyone to do more to allow advisors to take advantage of cash as an investment and facilitate increasing client's holdings of cash and cash equivalents when necessary.

"We're like a phoenix rising from the ashes."

-- Jim Tracey, Citi

Any new industry trends?

One major focus of PMAS is helping breakaway brokers to efficiently move their client's assets into customized programs, according to Steve. The PMAS portfolio construction team is spending about 1/3 of their time with former wirehouse advisors.

Jim sees a trend towards the use of discretion by advisors and their teams. Advisors are adding more investment expertise to their teams instead of relying on outsourcing or consultants. They're seeing a huge interest in clients wanting their advisors to take discretion.

In 2008, 40% of assets coming into Citi's UMA program were going into the discretionary component Jim noted. This indicates that advisors want more control and efficiency in their practice. There's also been very strong growth in their Rep as Portfolio Manager programs.

Close to 98% of Schwab's clients take discretion, Barnaby confirmed. Last year, Schwab's managed account assets

shrank by 15%, which dramatically outperformed the industry!

Steve said that managers should consider building out their own fully-discretionary UMA to allow advisors to focus more on building their business.

Jim noted that the wirehouses still control 65% of managed account assets. he addressed the many references to "breakaway brokers" by asserting that out of Citi's 13,000 FAs, they only lost 8 club-level advisors (\$750K+) to the independent channel last year.

What should managers emphasize when reaching out to RIAs?

Steve stated that our society is on the verge of redefining wealth, away from the current definition, which focused on the accumulation of assets. In the Victorian era, the perception of wealth was more focused on the amount of income your estate was able to generate. Our current society may be moving back towards this definition.

What is the future direction of programs for RIAs?

Citi uses the term "wealth advisors" instead of "investment advisors" as part of their goal to encourage RIAs to think holistically about their client's needs, Jim explained. RIAs must broaden their discussions with clients to include the sale of businesses, charitable giving, long-term care, and the transfer of assets to heirs. Advisors need to change and address their client's rotational shift away from just growing assets.

Steve stated that PMAS is seeing a demand for a middle solution that falls somewhere between providing pure manager connectivity and access to only a pre-screened manager universe. This solution is where advisors don't have to setup their own program, handle their own paperwork or be their own sponsor.

Jim said that the need for advice has never been greater than it is today. Our industry has hit bottom and we're expecting phenomenal growth ahead. There's never been a better time to be an advisor than right now. We're like a phoenix rising from the ashes.

Strategy Session

Ways to Increase Operating Effectiveness & Build Distribution

The speaker was Kip Gregory, Principal, The Gregory Group.

Kip shared a few ideas that could be implemented immediately to improve operative effectiveness.

Jotting

For people that aren't big computer users, who type slowly or want to make better use of travel time, Jotting is a perfect tool.

Jott.com (www.jott.com) is an inexpensive voice-to-text service that transcribes your voice from a phone call. Just call the Jott 800 number, speak for up to 30 seconds, and a few minutes later, Jott sends you an e-mail containing the transcript of your call. It's that simple!

You can use Jott anywhere you can make a phone call; from your car, from the airport or even from your office.

Jott will revolutionize the way you manage your information.

Blackberry Auto-Texting

Auto-texting is function built-in to every Blackberry that lets you insert words, phrases or entire paragraphs with just a few keystrokes. Kip demonstrated this function by auto-texting a sample MMI-related follow-up e-mail message in just a few seconds. (see Kip's website for step-by-step autotexting instructions)

Building Distribution

How can you make high tech work in a high touch environment? How can you become more effective in building networking relationships, qualifying prospects and closing new business?

One of Kip's recommendation is to use LinkedIn (www.linkedin.com), which allows you to confidentially share rolodexes with anyone in the world. Referrals are the best way to grow your business and LinkedIn is a great business networking tool.

For more information please go to:
www.kipgregory.com

Special Guest Speaker

Rebuilding Trust in the Financial Markets

The speaker was Bill Hambrecht, Chairman & CEO, WR Hambrecht.

Roots of the Financial Crisis

One of the problems was that the mortgage market had developed totally as a dealer market, which blocked transparency and third-party pricing, Bill explained. For almost a year and a half, even though the market was declining, the paper was being carried at abnormally high values by models or through some collusion among traders. The paper still looked good way after the economics had changed. "I don't think anyone truly understood the amount of leverage in the system," Bill said.

"There wasn't a CEO on Wall Street that really understood the risk inherent in these derivatives"

-- Bill Hambrecht quoting Professor Andrew Lo, MIT

Another problem was the firms that had a 30 times leverage ratio. Bill asked, "Who was foolish enough to give them a 97% loan on an asset that wasn't freely traded?" These firms took the entire left side of their balance sheet, which included customer deposits, and used these assets to leverage against. And this is why the government couldn't allow them to fail. Because it would have taken down the customer's assets as well.

Ways to Fix the Problem

Bill proposed three proposals to fix the private market banking system.

1. Reverse Auction for Toxic

Paper. Bill believes that the current market for toxic paper is around 30 cents bid and 70 cents offer. Secretary Geithner will probably be able to improve the bids a bit, but there's still the underlying problem of where to get the money to recapitalize the banks after the assets are purchased.

Bill made a proposal through a House committee to use a reverse auction. The auction variable would be the dollar amount of the equity in return for buying the assets at your markup. The discount the government would get, would in effect be re-invested in the equity of the banks.

2. **Debt-for-Equity Swap.** This targets the mortgage market. Bill has proposed a debt-for-equity swap between the banks and homeowners to convert a possible default into a sustainable mortgage.

3. **Government Match.** This option would require the government to match dollar for dollar any equity raise for any non-TARP bank. Barney Frank has strongly endorsed this proposal. These banks don't have any toxic paper problems, but they have to get through the recession. This proposal would magnify the bank's equity raises and would probably make money for the government.

Referring to another one of the underlying causes of the financial crisis, Bill quoted Professor Andrew Lo, director of the MIT Laboratory for Financial Engineering, "There wasn't a CEO on Wall Street that really understood the risk inherent in these derivatives." The big problem with these complex derivatives, Bill explained, is that they always work until they don't. And by the time they don't work, it's too late.

Bill suggested that the investment banks that became hedge funds are going to have to split their business.

In closing, Bill suggested that hedge funds should be regulated together with mutual funds and have the same level of transparency to avoid a future crisis.

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EZRA GROUP, LLC

Craig Iskovitz
Managing Director
craig@ezragroup.net