NATIONAL PRESS CLUB LUNCHEON WITH CONGRESSMAN BARNEY FRANK

SUBJECT: CURRENT ECONOMIC CONDITIONS

MODERATOR: ALAN BJERGA, VICE PRESIDENT, NATIONAL PRESS CLUB

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ALAN BJERGA: (Sounds gavel.) Good afternoon, and welcome to the National Press Club for our speaker's luncheon. My name is Alan Bjerga. I'm a reporter with Bloomberg News, and the Vice President of the National Press Club. We're the world's leading professional organization for journalists and are committed to the future of journalism by providing informative programming and journalism education and fostering a free press worldwide. For more information about the Press Club, please visit our website at www.press.org.

And on behalf of our members worldwide, I'd like to welcome our speaker and our guests in the audience today, as well as those who are watching on C-SPAN. We're looking forward to today's speech. And afterwards, I will ask as many questions from the audience as time permits. Please hold your applause during the speech so that we have time for as many questions as possible. For our broadcast audience, I'd like to explain that if you hear applause, it's not the journalists. It may be from the guests and members of the general public who attend our luncheons, not the members of the working press.

I'd now like to introduce our head table guests and ask them to stand briefly when their names are called. From your right, Ralph Winnie of the Eurasian Business Coalition; Steve Geimann, a financial editor at *Bloomberg News*; Cheyenne Hopkins from American Banker; Jeanne Roslanowik, Staff Director and Chief Counsel for the House Financial Services Committee and a guest of the speaker; Jerry Zremski, Washington Bureau Chief of the *Buffalo News*; Jim Ready, Mr. Frank's partner; Angela Greiling Keane from *Bloomberg News* and Chair of the National Press Club's Speaker's Committee; Marilyn Geewax, Senior Business Editor for National Public Radio and the

Speakers Committee member who helped coordinate today's event; Steve Adamske, Communications Director for the House Financial Services Committee; Mark Hamrick, Business Editor for AP Broadcast; Kevin McCormally, who oversees Kiplinger's *Personal Finance Magazine*; and finally, Kevin Drawbaugh, Chief Regulation Correspondent for Reuters.

As Chairman of the House Financial Services Committee, Congressman Barney Frank has been at the center of the government's efforts to tame the nation's financial crisis. His committee is now trying to write new regulations for the 21st century. The Democrat from Massachusetts is often described as a creative dealmaker, a skill necessary when attempting to unite pro-regulatory reform liberals with free market conservatives. His committee overseas the Federal Reserve and the Securities and Exchange Commission. It also sets federal policy for the banking, securities and housing industries.

Whether question involves restraints on compensation for top executives or new protections for average consumers, Frank's committee is at the center of Capitol Hill debate. Frank was educated at Harvard College and received his law degree from Harvard Law School. He taught at several Boston area universities and also served as a Massachusetts State Representative. A member of Congress since 1981, in 1987 Barney Frank became the second openly gay member of the U.S. House of Representatives. Ladies and gentlemen, please welcome Congressman Barney Frank. (Applause)

CONGRESSMAN FRANK: Thank you. I very much appreciate the forum that the Press Club offers for these kinds of discussions and let me reinforce what may have been an entirely unnecessary admonition. No one who has been familiar with the media in America could ever think hearing applause that it came from members of the media. (Laughter)

I want to first address an issue about financial reform that puts it in context. One question that has been raised about President Obama is whether or not he is asking Congress to do too much, a refreshing change, I think, from the past. And the answer is no. And in particular, there is no validity to any suggestion that because maybe my colleagues are so deeply engaged now in trying to deal with health care or were earlier dealing with cap in trade, or are dealing with other very important issues, like labor law reform, to make real the fight of men and women to bargain collectively about their own job situation, which they have lost, unfortunately, or to improve education. These are not conflicting, and nothing in what is being done elsewhere is in any way retarding our efforts to deal with the financial system.

Those efforts are essential. We are in the midst of a debate about who is responsible for what in the past, and I will touch on that because having some sense of that is important in deciding what to do in the future. But our primary goal is not to try to undo the past, but to prevent its recurrence. The role of the Congress today, with our committee having a major piece of it, is to try to prevent things from recurring, the financial crisis that we have had.

Our general view, and by that I mean the members of our committee and the people who work with me on the staff, and members of the House in general and our Senate counterparts, is that the problem was non-regulation. And it's very important to stress that it's non-regulation, not deregulation. There was some deregulation, there was the passage of the Graham-Leach-Bliley Act in 2000, a bipartisan product of the Clinton Administration and a Republican Congress. I voted against it. But I do not think that was the major cause of our problem. Our problem was, rather, that of non-regulation. We have a very healthy phenomenon in this free enterprise country in which the private sector innovates, and the innovation is very important. And by definition, only those innovations which provide value added are going to survive because it's voluntary. If someone comes up with a new idea that doesn't work, it doesn't work, it goes away. The only innovations that thrive are those that attract people's money in a free enterprise society. And that's a constant process.

But there are periods when innovation reaches critical mass, when there is such a combination of new things, it often means new technology combined with new ideas, that the existing regulatory framework is left behind. And the role of the public sector is to come up with regulations that allow the society the benefit of those innovations in the private sector while curtailing some of the abuses. The problem with the current situation, I believe, is that we had for too long a dominant ideological viewpoint that rejected that, which rejected the notion that innovation of a very, very substantial sort, innovation that just was turning around a whole lot of previous assumptions, and that very much changed existing patterns, that that did not require new regulation.

One of the arguments we have today is, from some people, "Well, was the cause of the problem--" Assuming that there were things that should have been regulated that weren't-- Was the cause of the problem regulators who are ideologically opposed to regulating, or an inadequacy of regulatory structures? And the answer is very clear: yes. It was both. It was both people who did not believe in regulator, and a regulatory structure that facilitated their ability not to regulate.

And it's true, there were two extreme cases. You can have the most complete regulatory powers given to individuals who simply do not believe regulation is ever useful, and it won't work. And frankly, Alan Greenspan, as he has acknowledged, came close to that by flatly refusing many of the regulatory powers given to the Federal Reserve. That was in the old days. The Federal Reserve led other bank regulators into becoming born-again consumer advocates. It's been one of the most interesting conversions we have seen recently in the United States.

But, it is made easier for those who believe firmly in never regulating, never to regulate, when no responsibility is fixed on who should do it. The more you disperse responsibility, the harder it is to overcome that aversion. On the other hand, it is true. If you had wonderful regulators firmly committed to trying to propose rules that would stop the bad things, or minimize the bad and let the good go, they could overcome regulatory inefficiency. But, we can't legislate on the assumption that we're going to either have people totally opposed or wonderful super regulators. We need to regulate for normal human beings, and that's what we hope to do because we think it is important, both that it be regulatory structures that provide focused responsibility for the right side of regulation, and the appointment of individuals to do it. It's best to have both, but it is better to have at least one than to have neither. And we think, as we say, we can structure it so you do get both, at least for the near term.

Because it is very important when you get new regulations, and this is something that we shouldn't lose sight of, by definition the political process, the new regulation is going to come under the aegis of people who believe in it and the first set of regulators will be good ones. And that's very important.

Franklin Roosevelt led the United States into a new set of regulations for finance capitalism, and then appointed people who were going to-- By the way, for those who have criticized the Obama Administration because there are people in the administration who had participated in the financial system we are now trying to change and improve and regulate, think of the example that was set by Franklin Roosevelt, when having established the Securities and Exchange Commission, he appointed as its first chair someone who knew what he had to regulate, Joseph P. Kennedy. And Joseph P. Kennedy was a very effective Chair of the SEC precisely because he knew what had been legal, what was no longer legal, what was no longer approved. So, we will be going forward with setting up that kind of a structure.

Now, I mentioned the New Deal. To me, we are in the third iteration of this phenomenon of innovation that is qualitatively different than what had been before in terms of a system, and the need for regulation to catch up. The first example came in the late 19th century when American business created the large industrial enterprises, far outstripping what had been before. If we hadn't had that, we never would have had the wealth created and spread the way it was. So the late 19th century was a time of large enterprises, people who did it in the financial and manufacturing area, in finance and steel and railroads, et cetera.

And then came Theodore Roosevelt, Woodrow Wilson, who spent their time coming up with regulation not to cancel out the innovation, but to try to contain its excesses. And you got the antitrust laws, you got the establishment of the Federal Trade Commission, you got the establishment of the Federal Reserve. And I think that was a very good system.

Then years later, decades later, Franklin Roosevelt confronts the need to do that again and create a framework for mutual funds, a Securities and Exchange Commission, the Federal Deposit Insurance Commission. By the way, for those who want to combine history and current events, if you want to read predictions that efforts to regulate innovation, efforts to rein in abuse are foredoomed and will, in fact, deny us the benefits of the innovation and curtail the ability of the financial system to provide benefits, you could either read today's *Congressional Record,* come to my markup session tomorrow when we will hear my conservative colleagues say that. Or, you could read what they said about Theodore Roosevelt and Woodrow Wilson, or what they said about Franklin Roosevelt. There is a pattern in which some people argue that any attempt seriously to set rules for these innovations will destroy the economy. We reject that. We think that, in fact, the most pro-market thing Franklin Roosevelt could have done is what he did do; the setting up the SEC and setting up rules for mutual funds and setting up the FDIC, in fact, saved capitalism and allowed it to go forward. And we plan to do the same thing if we are successful, to set rules which provide a framework in which this wonderful, vigorous, capitalist system can go forward.

We have several things that we need to do. And by the way, in that, we do reject one argument, and it comes from many conservatives. And by the way, there's an element of partisanship here. Can I say I do not understand why partisan is always a bad word, or at least it’s always been a bad word since the end of World War II when the partisans in Yugoslavia fought the Nazis. But in every other context, if you Google partisan, it’s a bad thing. Political parties are necessary for democracy. They have not, in my view, been successful self-governing polities where you won't have parties. Partisanship becomes a problem if it is excessive because there are issues in any democracy which are going to be legitimately partisan where two different parties have two different viewpoints. Remember, the parties are not, particularly in America today, sides randomly picked for a color war at camp. They are not one ones and twos. They are people who have different viewpoints.

And in particular on this central issue of whether or not there should be an appropriate regulatory intervention not to cancel out innovation, but to channel it, there are different viewpoints. There were those who thought that Theodore Roosevelt and Woodrow Wilson got it wrong, that Franklin Roosevelt got it wrong, and that we're getting it wrong today. That the best thing to do is to simply leave it at free enterprise with all of the goods and bads (sic). And others of us think that if you do this right, it's tough and it's difficult and you have to be careful and you have to have humility about how you do it and fully listen to everybody, but you can make the system better by reducing the bad while not in any way diminishing the good things.

And the parties differ on that. The Republican Party in the House has a very different view, and the Democratic Party has a different view. And that's called democracy. And we had an election. Look, we had elections in 2002 and 2004 in which the people who did not believe in regulation won, and they did not give any regulation. Nothing was done in that general area. And then we had elections in 2006 and in 2008 which were different.

And I say that because I want to raise the stakes for myself and my colleagues. We now have for the first time since 1993 a Democratic President, a Democratic House and a Democratic Senate. We have the responsibility as Democrats to come up with a system of rules that allow the free enterprise system to flourish and provide all the benefits it can provide while diminishing the abuses, while protecting consumers, while encouraging investors to feel safe about investing, and basically to give us the benefits of the function of the financial system. And it’s up to us.

I will tell you that I believe that my Republican colleagues had that responsibility and failed. They had four years, 2003, ’04, ’05 and ’06, when they had the Presidency and both houses of Congress and nothing was done in the regulatory area. Now, I understand there was a theory that says that was my fault, and Chris Dodd’s and some others. Apparently, that view is that I had a secret hold on Tom DeLay that I wish I knew about. If I were to have made a list of things I would have deterred him from doing, it would have been a lot larger than simply derivatives. (Laughter)

But in fact, we had a difference of viewpoint. There were some who thought the problem was that we had been too good to poor people, that the problem was a democratic approach that said, “Let’s try to help low income people.” Let me be very clear, and measured and balanced. Utter nonsense. The Community Reinvestment Act is what they blame. And in fact, talk to the community bankers, the people who run the smaller, locally-based banks who justifiably object when people denounce banks and they get swept in, getting blamed for things that they were not guilty of doing.

If only financial institutions subject to the Community Reinvestment Act had made mortgage loans, we would not be in the crisis we are in today. The overwhelming majority of those loans were made by institutions not covered by the Community Reinvestment Act, and there was not a regulator who served under the Bush Administration, the Clinton Administration who will tell you that the CRA-- Well, you never know, could be one-- But there's this consensus, it clearly didn't happen. Again, look at the loans. What happened was an explosion of loans being made outside of the regular banking system. And by the way, that ties in with my thesis because the banks covered by the Community Reinvestment Act who did not cause the sub prime crisis were the regulated ones. It was largely the unregulated sector of the lending industry and the under-regulated and the lightly regulated that did that.

We now have our responsibility, and here's what we believe needs to be done. We want to make it very clear that the financial sector is an essential intermediary in our economy. The phrase intermediary is an important one. In fact, in periods when cash has disappeared from the-- Or credit has disappeared from the system, it’s called, when it happens to the banks, disintermediation. Disintermediation means that the financial sector no longer performs its important intermediary function. What's that function? To gather up money in fairly small amounts from large numbers of people, bundle it, a good word, bundling in this context, I thought it might-- And making it available to people who will use it for productive purposes. That's the financial function.

Financial activity is not an end in itself, it is a means to an end. It is a means by which we gather up the savings of individuals and their need to invest and provide for their own personal income and make it available to those who will invest it in large amounts and productive activities. And frankly, I believe one of the problems is that over the past 20 years in particular, a certain amount of financial activity became the end rather than the means. Let me be very clear. I do not expect anybody in this society to do very important work for nothing. Obviously, enterprises have to make a profit. Financial activity has to have a profit. But the purpose of that profit is to enable them to be the intermediary. So, I have had people come to us and complain, “Well, if you do that, I can’t make any money.” The answer is, “That's not our job. We're not here to help you make money.” We are here to help have a system in which you will make money as an incident of your providing funds to those who would use to productively.

And to some extent, there's been financial activity that was an end in itself. That's what's behind the denunciation of speculation. Sure, risk-taking is there, and people can call anything that they don’t like speculation, but there is an element in which people have been doing things solely to make money on them. And to the extent that is curtailed, the society is no worse off other than the handful of people there who were doing it, and they can go out and get real jobs and it won't be any loss to anybody else. (Laughter)

We believe, first of all, a large part of this came from innovation, a good thing, securitization. Thirty years ago, most loans were made by people who expected to be paid back by the borrower. And that meant you had to wait until the borrower paid you back to re-lend that money. Securitization comes, and it means money that's outside the deposit-taking system because there are new sources of liquidity, and it means that you don't wait to be paid back. You sell the right to be paid back by other people. And we then had a whole range of instruments involved that took those rights to be paid back and magnified them and cut them up into a whole range of very innovative financial devices.

Now, basically this securitization is a good thing because it means the money turns over more quickly. If I have to wait for everybody to pay me back, I can’t make as many loans. So if they're good loans, let’s put it this way, the more good loans that are made, the better. The problem is, securitization had two impacts: it allowed more good loans to be made, and it allowed more bad loans to be made. It turns out a very simple human truth got lost. If I lend you money and I expect to be paid back, I'm going to be more careful than if I lend you money and you're going to pay back somebody else. And securitization has weakened that borrower/lender relationship and the discipline.

And while I think the rating agencies have done, on the whole, a rather poor job, and today it seems to me the rating agencies are trying to overcompensate for weakness by excess and let me say on behalf of the working press, they may enjoy this phrase, but I'm reminded of a great phrase by one of the great editorial writers of all time, Murray Kempton, who said as an editorial writer, his job was to come down from the hills after the battle was over and shoot the wounded. (Laughter) I think you see some of that with the rating agencies. But in fact, rating agencies, when millions of loans are made by people who don’t have the discipline of expecting to be paid back, I don't know how anybody could rate those.

Anyway, here's the lineup we think you need to do. We think you need to put some limits on securitization. People should not be able to lend money without having any risk retention. We think that there needs to be somewhere in the system an ability to limit and leverage, to put maximum leverage rules in place so that people do not wind up owing not only much more money than they have, sometimes I think we have in this society as a whole people owing much more money than there is. You have to limit leverage.

You have to come up with a way to put ailing financial entities out of our misery. It's called the resolving power, which is a strange word; it means dissolving. We have a way to do that with banks. We did not have a decent way to do that with AIG or Lehman Brothers or Merrill Lynch, and all of them caused problems as the Bush Administration legitimately, people of good will, Ben Bernanke and Hank Paulson, tried to avoid terrible financial harm from what would happen.

We need to contain derivatives. Yes, they play a very important role, but they have gotten out of hand and we need to do something about it. We need to protect consumers because protection of consumers now has dissipated in ways that result in a lack of activity because there is no way to focus responsibility.

And we need to deal with executive compensation. The problem with executive compensation is essentially from the systemic standpoint, that it gives perverse incentives. That if you are a top decision maker, or maybe even somebody else down the chain, you may have a system in which you are incentivized to take a risk because if the risk pays off, you make money. And if the risk pays off, you suffer no penalty. Heads you win, tails you break even. It’s like selling lottery tickets that only cost you money if they pay off. We’d sell a lot of tickets, we wouldn't raise much money. That's part of it.

Now, there's also a problem with salaries being excessive. Our view is, and we will be working on this tomorrow, that the regulators, the Securities and Exchange Commission, should prevent there from being systems that give perverse incentives. As to the amounts, we think that's up to the shareholders. We have the radical notion on the Democratic side that the shareholders who own the company ought to be able to set outer limits on pay. Because the notion that it will be done by the board of directors, I think, is fruitless because boards of directors and CEOs are inevitably the closest of collaborators. There is not, and should not be an adversarial relationship between the CEO and the boards of directors. I think it's impossible to structure one in a well functioning organization. But given that it’s a mistake to think that one day a year, they'll go to arm’s length and be labor and management, so we want the shareholders to be involved in setting the pay. That's our package.

Now, I have a challenge to make. And let me tell you, that package has broad support in the Congress, I believe. And I accepted a challenge. I believe as Democrats we have the responsibility to put a systemic risk regulation regime in place that will limit the kind of leverage that got us into trouble with people being overextended. That will allow us in the future to deal with an AIG or Lehman Brothers and put them out of business in an orderly way without either shocking the system or having enormous public funds have to go into them as went into AIG.

I believe we can curtail speculation in derivatives that is excessive without reducing the real economic function that they provide in society. I think we can impose risk retention rules on originators of loans so that we still get the benefit of the higher turnover, but don't lose the lender/borrower discipline. I believe we can protect consumers from abuses without endangering the system. Indeed, if we had protected consumers better from sub prime mortgages they shouldn't have gotten, we'd have a sounder system, not a less sound system.

We're going to do those. There is a commitment, as I said, it's a responsibility for us as Democrats to do them. We are convinced that this is the way to prevent these abuses. And I invite the judgment of failure if we are not able to deliver that. And I will tell you, I am not politically inclined to take on responsibility I don't think I can handle. I am giving us this responsibility because I am confident we are going to meet it. I believe you are going to see during this Congress, I believe by the end of this year, a package that does it.

One last point I want to make, and I want to offer advice, unpaid, to my friends in the financial community, and to the rest of the financial community because that first category-- That first category, it's actually-- It's kind of cyclical, maybe. I think I didn't have that many a few years ago. Then I became chairman of the committee, I made a lot of new friends without getting any nicer. And, we've worked together. We worked together last year. When Ben Bernanke and Hank Paulson came to us on behalf of the Bush Administration and said, "We face serious financial collapse if you can't collaborate," none of us thought this was going to be the most popular thing to do, but we did it in a very bipartisan way. The Democrats in the House and Republicans and Democrats in the Senate worked very closely with the Bush Administration. And yes, there were many in the financial community who were grateful for our help.

But I think some of them have forgotten that. Not everybody, but there are some in the financial community who call to mind what was said of the Bourbons, the restored monarchy in France after Napoleon. "They have forgotten nothing because they learned nothing." And I do think, and let me go back to my youth and to the days when radio had a function other than the spewing of venom, and when fiction on the radio was labeled as fiction, and there were people who in the financial want, some of the older people here will catch the reference, they want to revert, return, they want to return, to the thrilling days of yesteryear. And let me make one amendment. They want to return to the thrilling days of yesteryear when the loan arrangers will ride again. (Laughter) And in this view, the loan arrangers will be accompanied by their faithful and submissive companion, government.

And that's not going to happen. We are going to put these rules into effect. (Applause) And in fact, if they want to stick with that analogy-- They don't, I do, but let me just say for the sake of my own metaphorical consistency-- There was an old unpleasant joke when I was a kid, and it may be relevant now. WE may have to give them a new definition in that context of Kemo Sabe. Older people will explain to younger people what I mean by that.

But, I am making this response to the financial community. I want them to work with us. They need to understand, what I talked about, restricting leverage, having a systemic risk regulator, curtailing the excesses in derivatives, some risk retention, protection of consumers in a single, effective agency, those are all going to happen, I can guarantee you that the votes are there not because I want them to be, but because I have had a series of conversations with people and I know that is what is going to happen. And I know if the financial community, or people who believe in total deregulation, if they want to make that a national debate, I welcome it. They will lose that debate, it’s a good debate to have. I believe just as we had that debate in the early part of the 20th century and in the New Deal, we will have it again and we will win it. We will prove that the best thing you can do for capitalism is to have rules that give investors the confidence to get back into the system, that protect the great majority of decent people from abuses.

That doesn’t mean that there's no role for them. I believe we should be containing derivatives. There are a couple of ways to do it. On the table is banning naked credit default swaps; there are alternatives to that, a much tighter regime of openness and price discovery that comes from putting them on exchanges. We will talk to them, we hope to talk to them about that.

But there's some tests they have to meet. One, tomorrow there will be a meeting called by Secretaries Donovan and Geithner about one of the great failings of my friends in the financial community today: their unwillingness to help us reduce mortgage foreclosures. It's not in their own interests. The cascade of foreclosures-- And to make it worse, by the way, because I'm glad we did unemployment compensation as part of the Economic Recovery Bill, and I was very pleased when Ben Bernanke said in testimony last week, in response to a Republican question, that if it had not been for that bill, unemployment would be higher today. But, you cannot pay your mortgage in many cases out of unemployment compensation. So, we face a potential of more foreclosures with disastrous effects for individuals and communities and the whole economy.

The financial community was successful with the community banks and the credit unions in the lead in defeating a bankruptcy reform. Their argument was that we didn't need that to reduce mortgage foreclosures; but so far, that's not been proven right. We need much better cooperation in reducing foreclosures. We need people in the major financial institutions to understand how angry the American people are, that people who were in many cases collectively the causes of a crisis and the beneficiaries of serious economic activity on the part of the government to help them get out of the crisis, we didn't do the rescue plan or the TARP, and I long for the good old days when I thought that tarp is what you used to cover the infield when it was raining. But we're not there anymore.

We didn't do that to help the banks, but helping the banks was the inevitable byproduct of it. You could not restore the credit system of the United States from imminent danger of collapse, as Hank Paulson and Ben Bernanke, I think, accurately said. You could not have done that without helping some of the institutions there. You can't get a whole new set of institutions.

Having done that, though, for them to return to those thrilling days of yesteryear with the level of compensation is a great mistake. And by the way, I do have to say to my friends in the financial community, think about what you say about your character when you tell us that you have to have enormous bonuses to align your interests with those of the people who pay your salary. In other words, you get hired for this very prestigious job and you get a salary, and now we have to give you extra money for you to do your job right? I must say, that does not speak well of the character of the people there. I think they're unfair to themselves. To be honest with you, I'll be their compensation consultant. I think if you cut their bonuses by 90 percent, they'd work just as hard. But, that's not what they've done, so we will have to deal with this in legislation. Not to curtail the overall amount, but to restructure them.

But I am asking the financial community to cooperate with us. Help us figure out the best way to do derivatives. Follow Joseph Kennedy and accept the reality of this regulation and work with us. And that applies to the community banks. The community banks were not the ones who did sub prime mortgages, they are not the ones who do credit contributions (?). By the way, another example in the financial sector is salary increases, compensation increases going up, not helping in mortgages. And, we passed a credit card bill and we were told, "Oh, we need more time to work it out so we can do the pricing right." Well, that was the reason for the delay; not so they could jack things up in the interim. And they are inviting a much harsher response if they are not willing to cooperate with us on these. Again, TARP recipients who now tell us that we should not curtail the excessive use of derivatives because it might reduce their profits, they are putting themselves outside of the debate we're going to have. And I would much rather they be in it, because they need to understand they can't stop it.

And to the community banks, yes they have been unfairly traduced because they weren't the problem. But, they have to be careful not to allow themselves to be used by some of their big, big brothers who would like to have them shelter them. We can set up a consumer protection agency that will respect all of the community banks. They were not the perpetrators of the abuses, they will not be the subjects of the corrections. And they need to work with us to help us do that. So, we are ready to go forward with a set of regulations that respond to these innovations that we believe will give us the benefit of the innovations and diminish the abuses. And our models are Theodore Roosevelt, Woodrow Wilson and Franklin Roosevelt.

We invite the financial community to participate with us, given what we believe is necessary and how we do it. But it's going to happen one way or the other, and the debate will be, I believe, in terms of history, as important as the one in the early 20th century, as important as the New Deal, and I believe will end just as beneficially for the American economy. Thank you. (Applause)

MR. BJERGA: And thank you, Mr. Chairman. We have no shortage of questions this afternoon. And the first one comes from a person who says that as an executive in the banking industry, I agree that lack of regulation was key to the financial crisis. How do we now avoid regulations that hinder our country's ability to compete in the global economy and prevent bankers from serving their customers' needs effectively?

CONGRESSMAN FRANK: One point I forgot to mention, I was going to get to it until you gave me the note that said "Shut up," which was fair for you to do, we had the rules. He didn't say, "Shut up," he said, "You're going on a little long." We do face a problem of international cooperation. Nothing in the world is as mobile as capital. It can move anywhere in the world instantaneously. We are working very hard with our major financial competitors/partners, the European Union, United Kingdom, which is kind of a semi-independent entity there; Japan, Canada. We are determined, as is the Obama Administration, to make sure that what I talked about are rules that are adopted not identically and not by the same entity, but sufficiently similarly in all of those places so there won't be any competition.

And I have met with the EU's market commissioner, I've met with parliamentarians with the same jurisdiction that we have from the European Union and from the Canadians. I apologize to my constituents, they haven't seen as much of me as they have a right to expect in some cases, but we've been spending a lot of time to deal with exactly that; to make sure we have a harmonious set of regulations so that we don't have that international competition.

By the way, when I first became Chairman in 2006, I was Chairman-in-Waiting there, I was told we had to deregulate in America because everybody in America was going to go to England to the Financial Service Authority to be subject to their light touch regulation. the head of the Financial Service Authority said a couple of months ago, explicitly, so many words, "The era of light touch regulation is over." Everything I have talked about, derivatives and compensation, securitization, is being talked about in very similar terms by all those entities.

And then we have to do one more thing, and I guarantee this will be written into the bill. We are talking about the U.K. and EU and Japan and Canada, we will write into the bill instructions, not authority, but instructions to the Secretary of the Treasury and the Federal Reserve, that any country anywhere in the world which holds itself out as an escape hatch for these regulations will be denied any access to the American financial system. And I believe we will be able to work with all the other allies to do this.

As far as the banks are concerned, they would not overreach in some of the consumer products. One proposal was that, well, people are going to have to offer a plain vanilla product. I don't think you can force people to offer a palatable product. Again going back to my youth, remember when there were bars that were told they couldn't just serve liquor, they had to serve food, and they served the most inedible food known to man. I can still remember the jars of pickled hardboiled eggs that sat on the counters of some bars. We're not going to make bankers offer people pickled hardboiled egg mortgages. I don't think that's going to be a problem.

I would say in particular to the community banks, they are very unlikely to see much change when this happens. You know, this is the argument. Well, do we need central regulation? Yes. Is there such a thing as stupid regulation? Yes. Can we avoid it? Also yes. Let me give you an example. I think it's very important that we register hedge funds, and I had a meeting with some hedge fund people last week. But hedge funds are not mutual funds and there was a fear that if we registered hedge funds, we would do it and they would have to register at the SEC the same as mutual funds. No, they won't. We are very capable and determined to come up with a form of registration for hedge funds the are suitable for hedge funds. And we will not treat them as mutual funds, and we'll follow that principle.

MR. BJERGA: Federal Reserve Chairman Ben Bernanke said Friday that about 25 companies would be deemed too big to fail under the President's bank regulation proposal. Should too big to fail exist? And if it did, does that change the competitive playing field for large versus small institutions?

CONGRESSMAN FRANK: It should not exist, and if we do this job right, it will not exist. Part of our major core set of principles here is, and legislation, first to set up a set of regulations that will keep people from getting too big to fail in part by severe limitations on leverage. There will be at several places in this system, at the systemic risk regulator and in the day to day prudential regulators, the ability to say to any entity, "You have to raise your capital, you're over-extended." And by the way, the requirement to raise capital will be disproportionate. That is, the biggest you get, the higher percentage of capital you'll have to have, not just amount. And I think that that could have kept AIG, for instance, for getting so over-extended.

Secondly, and this was the problem, Lehman Brothers failed and there was no mechanism for doing anything so it just went into regular bankruptcy. And then the judgment of the Bush Administration financial regulators brought the system nearly to a halt. Even the conservative Republican witness that they brought forward agreed that that would have been the effect of Lehman Brothers. He said it wasn't inherent, it was because people had different expectations.

But the Bush Administration believed that letting Lehman Brothers go bankrupt the way it did really brought the system almost to its knees. That's why they then rushed in to provide all the funding for AIG. Well, those are not choices we should have, either to pay off nobody and have a collapse, or pay off everybody. So, you will have in this where banks go under, we have a good system under the FDIC's leadership, I think Sheila Bair has done a very good job, of resolving the institutions, of putting them out of their misery with little systemic disturbance. We will have the same rules for other institutions.

By the way, one of the things I asked the financial community to work with us on, we're going to have a way to put these people to sleep, these institutions. One question is how sharp should the sanctions be automatically? Should it be the rule that any company that gets that, the CEO is gone, the board of directors is gone? Should there be some discretion? Because we want to make it very unpleasant to be an entity that has done that.

The second part of it is this; because we don't want to see too big to fail, there will not be that list. Yes, the administration has proposed that there be a list of systemically important companies. But general sense in Congress is that that would have the opposite effect. The administration sees it as a way to discipline the companies. But many people see it, as the questioner suggested, that it would be kind of a license to do well because people would think you couldn't fail. There will be no such list. The administration thinks, as I said, that creating that list of systemically important institutions would be a way of severely disciplining them. Other people think that the institutions would be Br'er Rabbit and the list would be the briar patch and that they would, in fact, be happy to be there. Yes, there will be restrictions on excessive leverage, et cetera, but not with a predetermined list precisely to avoid that problem.

MR. BJERGA: One of the big issues with derivatives right now is that concept of getting over the counter derivatives onto cleared exchanges. The White House's proposal assumes that once the Treasury Department defines what will be a standard derivative exchanges electronic platting forms, clearing houses, are going to step up and want to trade them. What happens if they don't want to do it? Does the federal government under what you envision have the authority to be able to make exchanges put over the counter the derivatives standardized that they don't want to do?

CONGRESSMAN FRANK: That's been raised. I talked to the NASDAQ about that. No, I don't think we will force them to do it. On the other hand, these exchanges are moneymaking operations so they will want to do it. We do recognize that there will be an occasional, I hope not much more than an occasional, derivative that can't be traded on an exchange. The people doing that will have to pay a price in much higher capital charges.

In other words, what we will say is we expect these to be on exchanges and clearing houses, and we understand the exchanges and clearing houses believe they are ready to do the great majority of them. They understand they may not be able to do a couple, or several. In those cases, the regulators will have the ability to require, will have the duty to require, much higher capital charges which means that those who want to engage in those derivatives will have an incentive to fit them onto the exchanges. Remember, there are two parties to a derivative contract, buyers and sellers. One of those parties has an incentive to make it more expensive, the other has one to make it less expensive, as any transaction, and there will be much higher capital charges. So, we believe that the likelihood will be there will be great market pressure, and we try to use market pressure wherever possible, to tailor these things so they will, in fact, go onto exchanges.

There is also some concern, and we'll look into this, and this is one we invite people on, there are companies for whom the hedging is a major part of their business, people who are not in it for financial reasons purely, but because they have a business.

We will be talking about different versions. For them, for instance, collateral may not need to be cash in some of these ongoing operational businesses. But, the answer is no, they won't be forced to take derivatives they don't want. Those people engaging in the transactions will be under great financial pressure to design them so they can go onto exchanges.

MR. BJERGA: Financial regulatory overhaul is only one of several major initiatives on Congress's calendar this year. You have health care reform, you have climate change legislation. It's a pretty ambitious agenda. Given that, when is this legislation that you say will pass this year actually going to pass, if this year?

CONGRESSMAN FRANK: Yes, I wondered what was the effect of people writing out their questions before I talked. Now I see, they ask me a question that I answered. (Laughter) There is no conflict. Our work has not been slowed up in the slightest by the fact that we're working on climate and health care. There was some overlap between climate and health care because of the committees, but even that didn't turn out to be the case. I expect the House to pass this in September and October.

We have done a lot of work, we have focused on it, we have worked we're doing in August. Let me just say at this point, some members of my staff are here, I wish the American people understood what a bargain they get in the people who work for the Congress of the United States. They are the most talented, dedicated, under-paid people. And they have been working hard, and will continue to work hard ,and I believe we will get this to the Senate by the fall.

Now, what happens is this, with the Senate, we have done a number of things collaboratively; very tough regulation of Fannie Mae and Freddie Mac. Unfortunately, the Republicans couldn't do it when they were in power, we did it when we came to power. It took a little longer, year and a half. We've done some work on other areas. There are a certain number of disputes that are going to get resolved by the first body to deal with them. The House will begin this work. A number of issues, some of which I mentioned, are central and will never be resolved until both houses vote. Others are more specific and can get results. We will send the Senate a package, I believe, where we will have arrived at consensus on a number of issues. There will be some important issues. I think it is overwhelmingly likely that the Senate will get this bill on October and the President will sign the package I'm talking about before the end of the year.

MR. BJERGA: The federal budget deficit is rising at rates we haven't seen before. Where could you see cuts made in the federal budget that will actually slow down that pace a bit?

CONGRESSMAN FRANK: Well, let me give you a couple. First of all, I thought George Bush's plan to send people to Mars was very strange, given this budget deficit. Well, that's hundreds of billions of dollars they want to start spending, and I believe we should not be sending people to Mars. The problem, of course, is not sending people to Mars, it's bringing them back. You could send people to Mars fairly cheaply, but we care about human life. Frankly, I think we overdo manned space travel. Space is very important, and we should be spending a great deal of money on space because we can learn a lot from it. Most scientists I talk to would diminish, not abolish, manned space. I'm glad we had people up there to fix the Hubble.

I believe, though, and I thought the President was right in agriculture. It is striking to me that some of the most conservative people in the Congress, and they want to cut the budget and cut out subsidies and make people stand on their own two feet and keep their shoulders to the wheel and their noses to the grindstone and cut back on government intervention and let's be pro-consumer, let’s be free market. Apparently in the great free market techs, Hayek and Von Mises and Milton Friedman, there's a footnote that says, “Except agriculture.” Apparently, none of this applies to agriculture.

Now, my guess is, apparently in Hayek and Von Mises, the footnote may be in German, which is why it’s hard. German can be a difficult language for the uninitiated. But the President proposed cutting back on agriculture subsidies, and some of the great budget hawks in both parties killed that right away.

And finally, substantial savings in the military. Let me be very clear. If we had not waged what I think was a damaging war in Iraq, we would not be now worrying about how to pay for health care. Let’s be very clear. (Applause) The money spent on the war in Iraq could have paid for health care. In fact, sometimes when I'm asking where I'm going to find the money to do this or that, I say, “Well, I have one idea. I was in Congress on September 10th, 2001. There was no money in the budget at that time for a war in Iraq. So I am tempted to go to the guy who found the money for the war in Iraq and ask him to find me some. Apparently, he has sources none of the rest of us do.”

And it’s not just that. Look, a very important thing just happened, and I give the President a great deal of credit: the defeat of the F-22. The F-22 was conceived to defeat the Soviet Union in a Cold War atmosphere, if it ever got hot. It had no current military function. It has never fired a shot in anger, and almost certainly never will. Many of my Congressional colleagues, including a lot of budget hawks who were ready to cut back on medical care for children and who were ready to cut back on aid for the homeless, wanted to go ahead with the F-22. Why? Because of the job impact. See, the press missed something. The press has been doing stories about will there be a second stimulus. There was a second stimulus, it was the F-22, in the minds of many of my colleagues. It was a weapon whose sole justification was keeping people at work.

And it was very important for the President to defeat that. I believe America should be, by far, the strongest nation in the world. We could be by far the strongest nation in the world, far stronger than we have to be, with a significant reduction of over $100 billion a year in the military budget. And that includes providing a protection screen for everybody in the world.

Many of our allies have said, “You know, we're tired of the dollar being the reserve currency.” Well, I'm tired of the Pentagon being the reserve military. And they cannot tell us, “You're spending too much money. Oh, but by the way, we're not going to have much of a defense budget, you got to have the defense budget.” I think without in any way endangering the safety of the United States, we could substantially reduce the military budget.

So we reduce manned space travel, we cut out agricultural subsidies to people who don’t nee different, and we reduce the military budget to what we need and you're saving well over, I think, $150 billion a year. (Applause)

MR. BJERGA: We had several questions about the proposal for a Consumer Financial Protection Agency. Would such an agency, which you're on record of supporting, what sort of jurisdictional issues would you see that having with other regulators, and what sort of person would you like to be in charge of it?

CONGRESSMAN FRANK: Jurisdictionally, I do think that the FDIC, the Controller of the Currency, and the Federal Reserve should lose their consumer protection jurisdiction to this agency. And I have to say that when any agency that inherits the consumer protection tools of the FDIC, the Controller of the Currency, and it would be the OTS, which will be part of the Controller, if you inherit the tools from the existing bank regulators for protecting consumers, you will be getting a very good set of tools. They will be almost new because they have rarely been used.

The difficult jurisdictional issue comes with the FTC, the Federal Trade Commission. And I do think we need to readjust that. I think we are talking about financial products that are to go to the consumer financial product entity. As I look at the administration bills, there were a couple of things they talked about taking from the FTC that I would leave back with the FTC and I would not have that competition.

The other one I said I would change, the Community Reinvestment Act is very important. But it's not an individual consumer function. I think we need to strengthen the Community Reinvestment Act, I think we need to extend its reach, but I wouldn't put it in the Consumer Protection Agency.

The other area where you could have some jurisdiction is with the states. In fact, from the standpoint of the community banks, they should welcome this Consumer Financial Protection Agency once they understand how we plan to do it. They are now suffering from unfair competition and reputational damage from a whole lot of unregulated people out there; check cashers and payday lenders, and remittance senders. We plan to give the consumer product agency authority over a number of currently unregulated entities; that is, it's not from the banks. Yes, there are things that banks regulate, but there are even greater abuses that come from thoroughly unregulated entities. And there, they would be sharing the jurisdiction with the states.

The basic model would be this: if the states are doing a good job, there's no need for us to intervene. But the states do an uneven job, some very good and some don’t, and they would have that jurisdiction as well.

MR. BJERGA: Is it time to get rid of don't ask, don't tell in the military?

CONGRESSMAN FRANK: Well, I can't say yes because that assumes there was ever a time to have it. It never made sense from the beginning and it's certainly time to get rid of it now. People in the American military who are unnerved at the thought at serving with people who, like me, are gay or lesbian, should, I suppose, have been given an exemption from service in Iraq and Afghanistan because we have military allies in both countries who allow gay and lesbian people to serve. Of course, one of the arguments was that having gay and lesbian people in the military, who are known, apparently are unsettling effect, is only clear if people know who we are despite the view that, "Oh, I can always tell," which some people claim but they obviously can't. I mean, if they could, then there would be no ask, don't tell rationale.

But the notion that this implodes the military coherence ranks, presumably, the Israeli defense forces as a wholly ineffective military since Israel has quite sensibly not tried to restrict it. Yeah, I think the average American 20-year-old, you could not argue anymore, that he or she will be freaked out by the notion that there will be somebody gay or lesbian. And, I believe not only that the time has come, I believe that in next year's Congressional session, we have the bill we're going to do this year, I believe, on employment nondiscrimination. But I believe we will get the bill through to repeal it. Sixty votes in the Senate is always an issue. There's no question in my mind there's a majority in the House, there's a majority in the Senate and a President committed to doing it. And I think we will be getting rid of don't ask, don't tell to the benefit of the American military some time next year.

MR. BJERGA: We are almost out of time. But before asking the last question, there are a couple of important matters to take care of. First of all, upcoming speakers. On July 29th, we'll have Senator John Kerry, a Democrat from Massachusetts, and the Chairman of the Senate Committee on Foreign Relations. On September 28th, we will have Ken Burns, documentary filmmaker.

Second, we'd like to present our guest with our coveted traditional National Press Club mug. (Applause)

CONGRESSMAN FRANK: Thank you. I appreciate it, and I will now be able to say, without contradiction, I've been mugged by the press. (Laughter)

MR. BJERGA: And we have one last question, and it's about this congressional timeline. President Obama would like Congress to take part of its August recess off to work on legislation. Does Congress really need to take a break in August?

CONGRESSMAN FRANK: Yes. One, we do spend a lot of time with our constituents, and I will be doing some of that. Two, people who do not take time to reflect, who get overworked, can get-- Their judgment isn't always the best. Third, there's a lot of studying to do. We've had a series of conversations. I've said there are people who work with me on my staff, and others, I will be spending a lot of my time, I won't be reading a lot of fiction this summer. In fact, as I kind of bide the time when I'm no longer in office and you'll miss something, one of the advantages is I will no longer have to spend a lot of my time learning about things that are very complicated and wholly boring. But that time hasn't come yet, so I will be learning a lot more in August about things that I never cared about as an individual than I should. So yeah, I think a reasonable work schedule is a good one and it will not retard the passage of legislation at all.

MR. BJERGA: Thank you for appearing with us today, Chairman Frank. We'd also like to thank National Press Club staff members Melinda Cooke, Pat Nelson, JoAnn Booz and Howard Rothman for organizing today's lunch. Also, thanks to the National Press Club Library for its research. The video archive of today's luncheon is provide by the National Press Club Broadcast Operation Center. Our events are available for free download on iTunes, as well as on our website. Nonmembers may purchase transcripts, audio and video tapes by calling 202-662-7598, or archives@press.org. For more information, check out our website at www.press.org. Thank you. This meeting is adjourned. (Sounds gavel.)

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