

# ***Exploring Shakespeare:***

***A Modern Day Economic Tragic Comedy***

**UMB**



Michael Hagedorn  
Vice Chairman  
Chief Financial Officer  
Chief Administrative Officer  
UMB Financial Corporation

# Agenda



## Act I

What led up to the financial crisis and who were the players?

## Act II

What really caused the financial crisis?

## Act III

What do the possible solutions look like and what is the best solution for America?

A stage with red curtains and a spotlight on the floor. The text "Act I" is centered in a white box with a black border.

# Act I



“Something is rotten  
in the state of  
Denmark”

– Marcellus, from Shakespeare’s Hamlet, Act 1

The Washington Post

Forbes.com

MONEY MARKETS-Dlr 3-mth Libor rates up on global concerns

REAL TIME ECONOMICS  
Economic insight and analysis from The Wall Street Journal.

Obama Proposes Package To Stave Off Foreclosures  
Multibillion-Dollar Plan Aims to Help Modify Mortgages

CFOs See Recession Lasting 14 More Months

abc NEWS  
start here

Bloomberg.com

Stocks Rise Around the World; Commodities Gain, Treasuries Fall

REUTERS

Stocks Jump After 5 Days of Heavy Selling

Newsweek The World According To TARP

MarketWatch

Near-term outlook for U.S. darkening: Fed officials

InvestmentNews

Even the rich have the economy blues

Dollar down as risk appetite returns

U.S. currency earlier hits four-month high against yen

SmartMoney Nothing Shines Like Gold

Bloomberg.com

Economy: Manufacturing Still Slumped in February

THE WALL STREET JOURNAL.

FOX BUSINESS

The Washington Post

Panicked Investors, Go Slow and Steady

Triple-Digit Rebound for Dow Despite Data

Reports Show Troubles Throughout U.S. Economy

Forbes.com

Loan Modification Plan Gets Sweeter

CNN Money.com  
A Service of CNN, Fortune & Money

Stimulus money hits the street

U.S. government releases \$26.6 billion for highway, bridge construction. Maryland road project among first recipients, creating 60 jobs.

BusinessWeek

TheStreet.com

Report: 1 in 5 Mortgages Are Underwater  
In Nevada, more than half of all mortgage borrowers are upside down

Hedge Fund Investors Are Increasingly Institutions

## ***Main Themes***



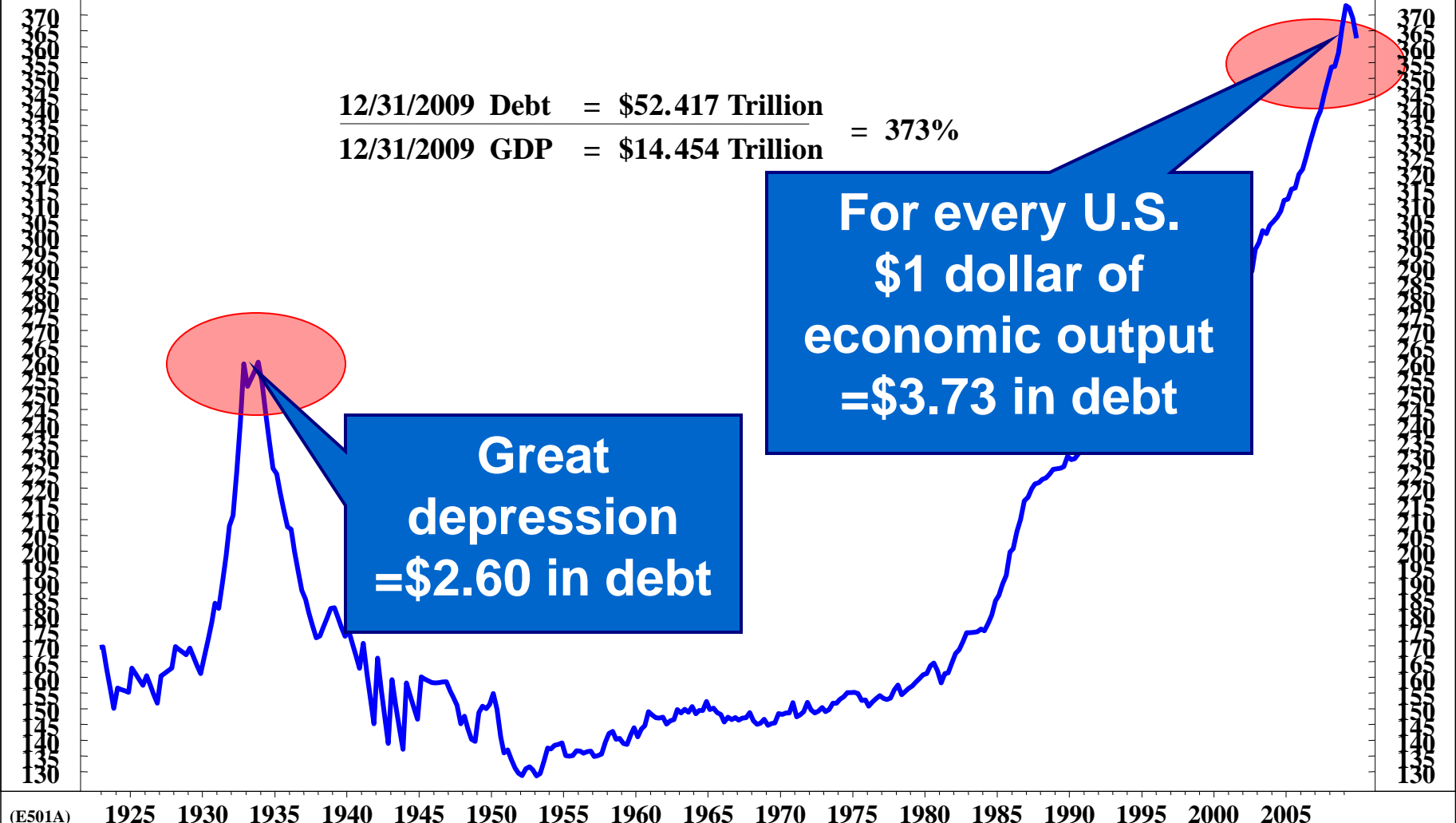
- Sustained period of low interest rates
- Abundance of cheap capital
- Too much leverage
- Financial engineering
- Passive regulatory environment
- Focus on short term results
- Development of complex financial instruments
- Consumer mindset shift from “debt load” to “monthly payments”



# Where the Market Stands—Total Credit Market Debt as a Percentage of GDP

Total Credit Market Debt as a % of GDP

Quarterly Data 12/31/1922 - 12/31/2009

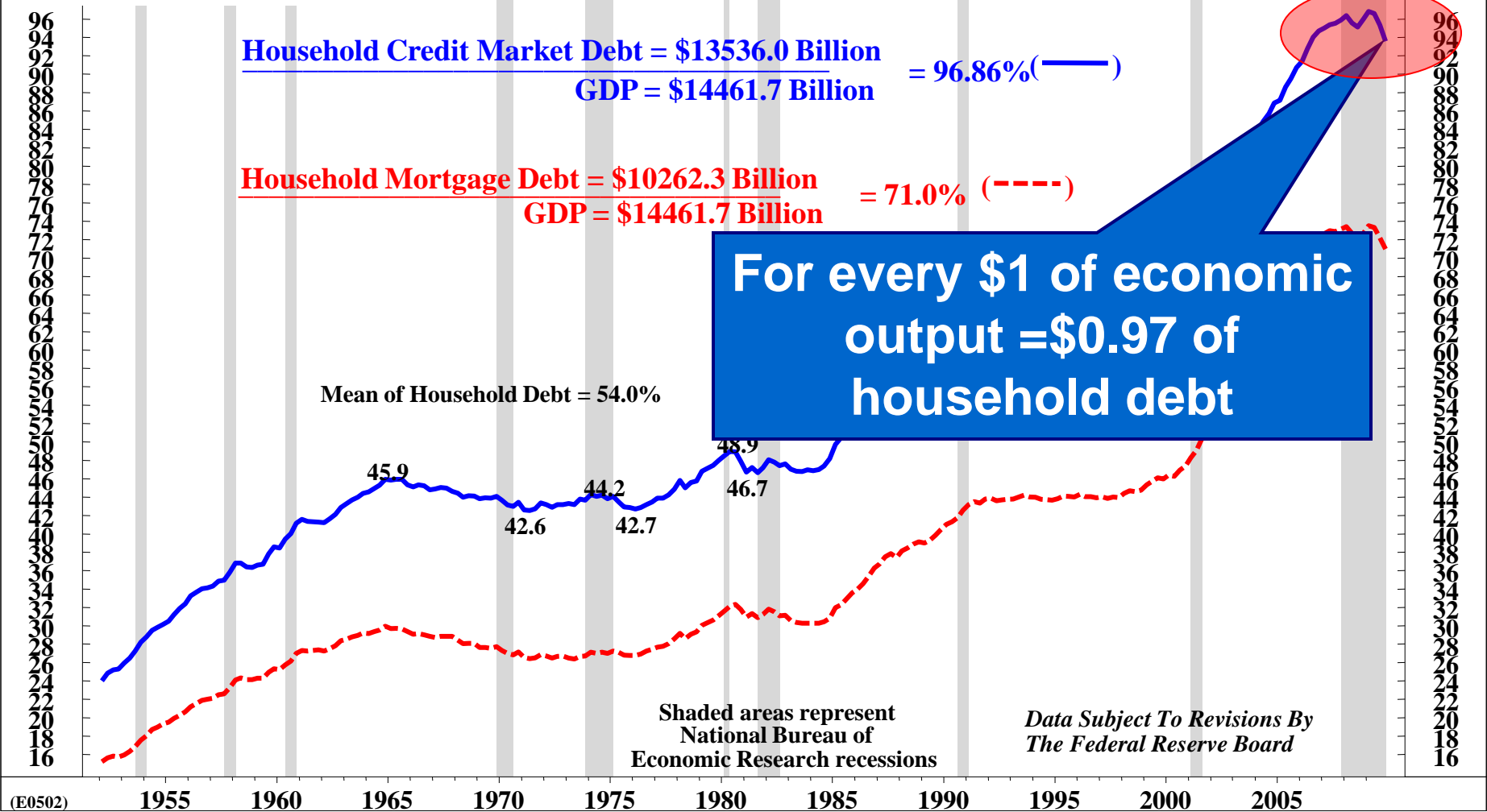




# Where the Market Stands—Total Household Debt as a Percentage of GDP

## Household Debt as a % of GDP

Quarterly Data 3/31/1952 - 12/31/2009

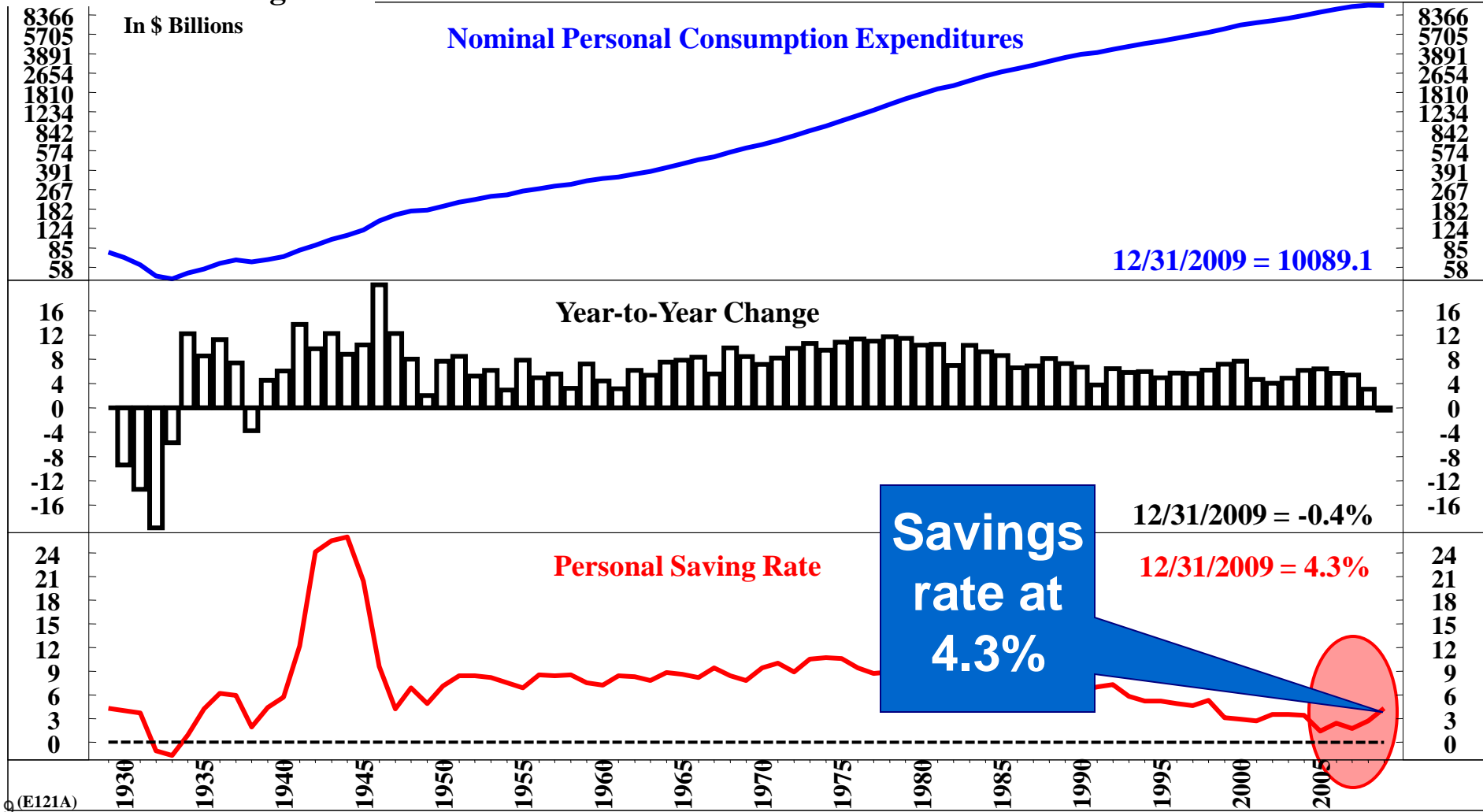




# Long-Term Savings and Investment Trend

## PCE and the Saving Rate

Yearly Data 12/31/1929 - 12/31/2009 (Log Scale)





# Cast of Thousands



***Cast of Thousands—Who are the players?***



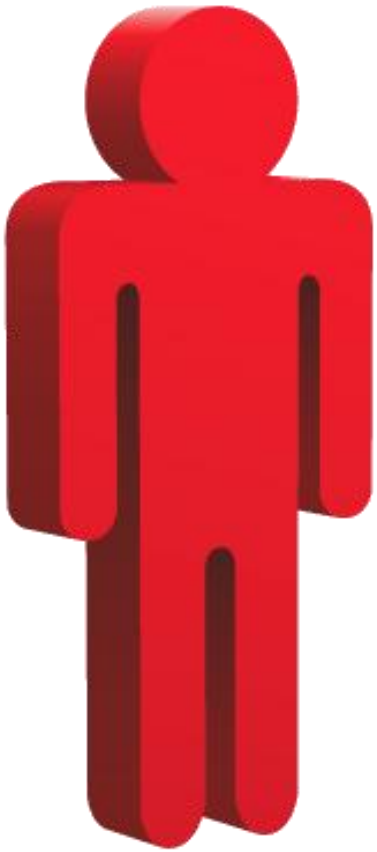
**HELLO**  
my name is. . .

**US Government**

- Wanted home ownership to increase nationally



# *Cast of Thousands—Who are the players?*



**HELLO**  
my name is. . .

**Mortgage Borrower**

- Took out the loan and bears the ultimate responsibility



## *Cast of Thousands—Who are the players?*



# HELLO

my name is. . .

### **Mortgage Broker**

- “Sold” customers loans they could never repay

## *Cast of Thousands—Who are the players?*



# HELLO

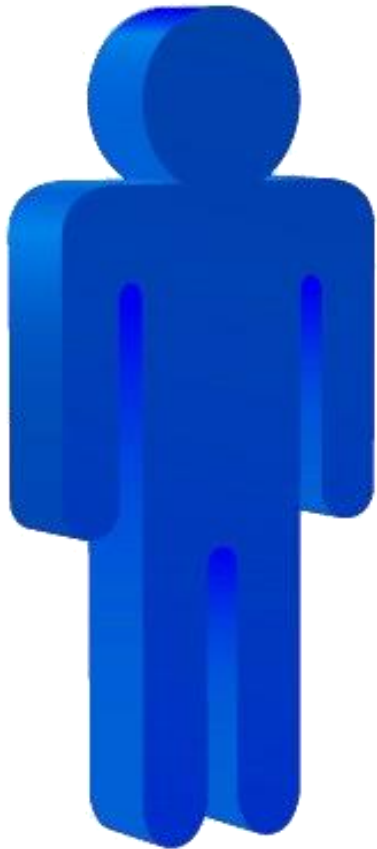
my name is. . .

### **Mortgage Company**

- Created an endless array of aggressive products and services



## *Cast of Thousands—Who are the players?*



# HELLO

my name is. . .

### **Appraisers**

- Valued houses beyond their real value, assuming prices would always go up



## *Cast of Thousands—Who are the players?*



# HELLO

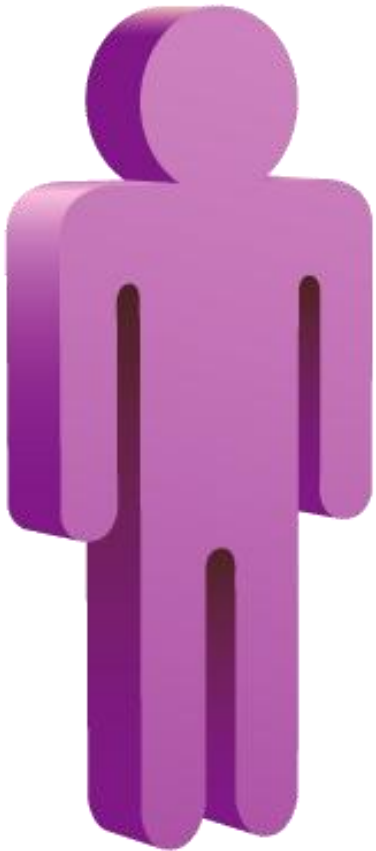
my name is. . .

### **Wall Street Investment Banks**

- Securitized and sold these loans



# *Cast of Thousands—Who are the players?*



**HELLO**  
my name is. . .

**Rating Agencies**

- Rated these securities AAA

## *Cast of Thousands—Who are the players?*



# HELLO

my name is. . .

**Banks, Governments, Municipalities, etc.**

- Bought these securitized loans without fully understanding what they were purchasing



## *Cast of Thousands—Who are the players?*



# HELLO

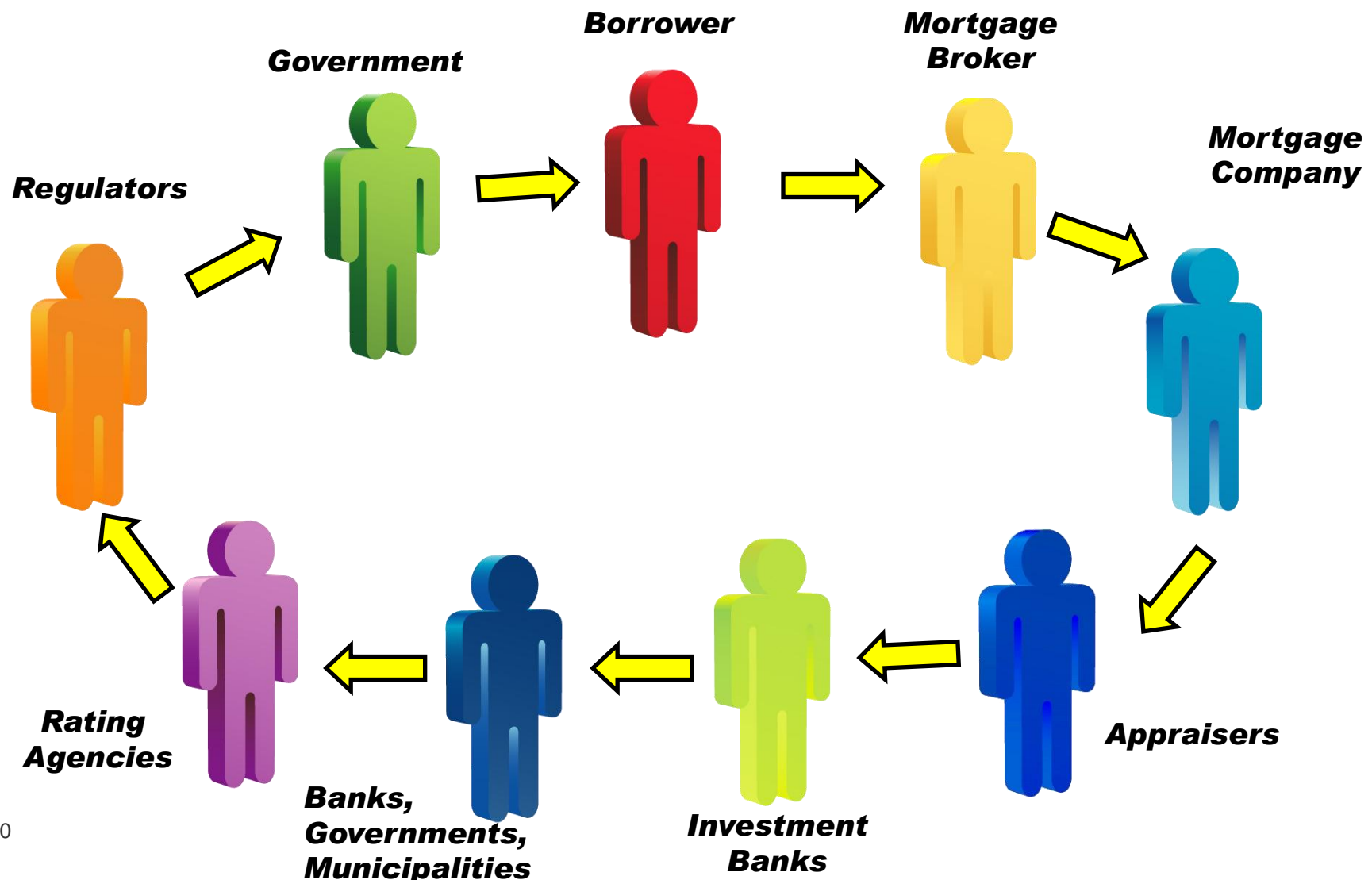
my name is. . .

### **Regulators**

- Largely stood by while this went on...



# Cast of Thousands — Shared Responsibility





“All the world’s a stage, and all  
the men and women merely  
players. They have their exits  
and their entrances;  
And one man in his time  
plays many parts”

– Quote from Shakespeare’s *As You Like it*, Act II

A stage with red curtains and a spotlight on the floor. The text "Act III" is centered in a white box with a black border.

Act III



“Can one desire too much of  
a good thing?”

– Quote from Shakespeare’s *As You Like it*, Act IV



# The Noble Cause



## ***Noble Cause***

- In 1994, the Government established a goal to raise national home ownership to 67.5 percent of households by 2000.



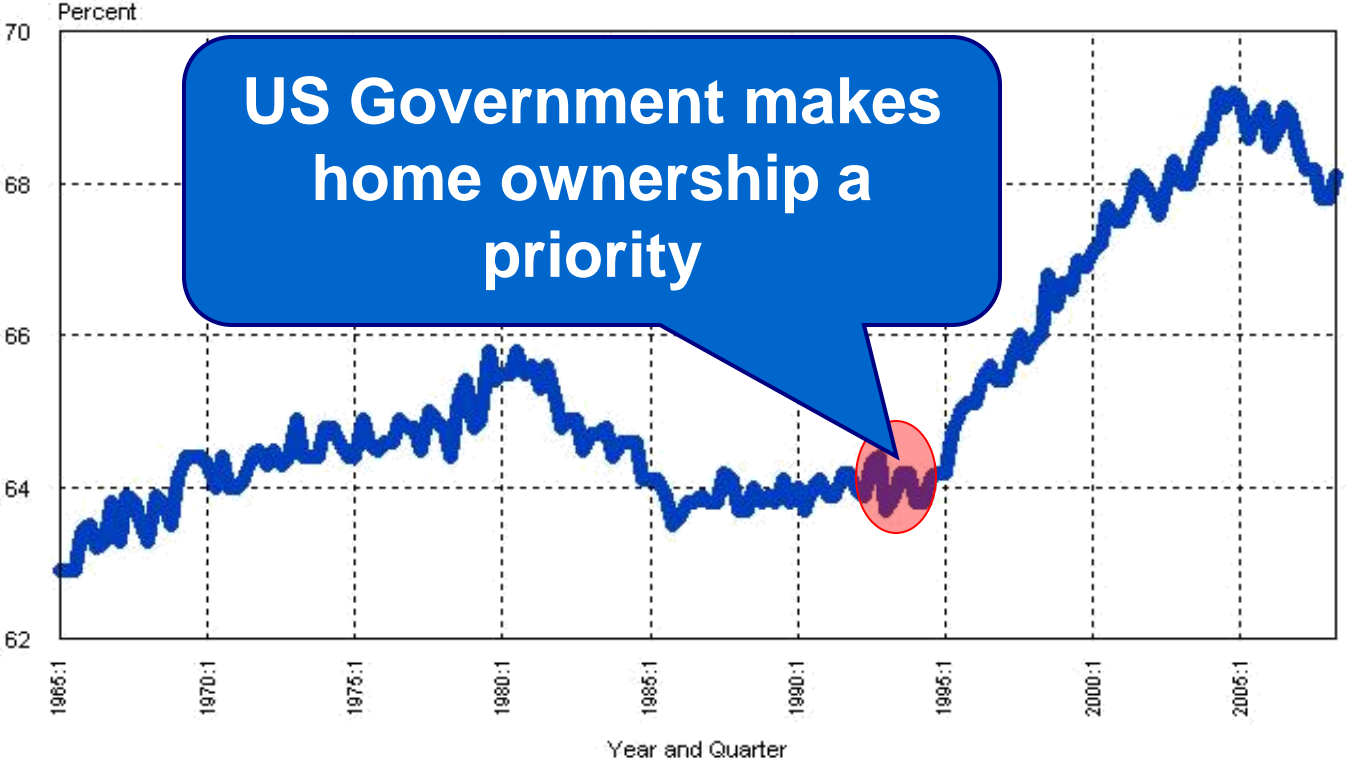
- Set the stage for the mortgage industry to get creative with programs and underwriting standards



# Noble Cause—National Homeownership Rates

Homeownership Rates for the US and Regions: 1965 to Present

Source: Current Population Survey/Housing Vacancy Survey, Series H-111 Reports, Bureau of the Census





“All that glisters  
is not gold”

– Quote from Shakespeare’s Merchant of Venice, Act II



# Foreshadowing

The New York Times  
nytimes.com

September 30, 1999

## Fannie Mae Eases Credit

By STEVEN A. HOLMES

In a move that could help increase home ownership, the Fannie Mae Corporation is easing the credit requirements and other lenders.

The action, which will begin as a pilot program in the New York metropolitan region -- will encourage those whose credit is generally not good enough to qualify for a loan to make it a nationwide program by next spring.

Fannie Mae, the nation's biggest underwriter of home mortgages, from the Clinton Administration to expand mortgage lending. Fannie Mae felt pressure from stock holders to maintain its profitability.

In addition, banks, thrift institutions, credit unions and other lenders make more loans to subprime borrowers. These companies charge much higher interest rates than conventional loans.

"Fannie Mae has expanded home ownership by easing payment requirements," said Franklin D. Roosevelt. "Yet there remain too many borrowers whose credit is required who have been relegated to paying significant interest in the subprime market."

Demographic information on these borrowers is sketchy. Most of the loans in the subprime market went to black borrowers in the conventional loan market.

“Fannie Mae, the nation’s biggest underwriter of home mortgages, has been under increasing pressure from the Clinton Administration to expand mortgage loans among low and moderate income people and felt pressure from stock holders to maintain its phenomenal growth in profits.”

## Foreshadowing

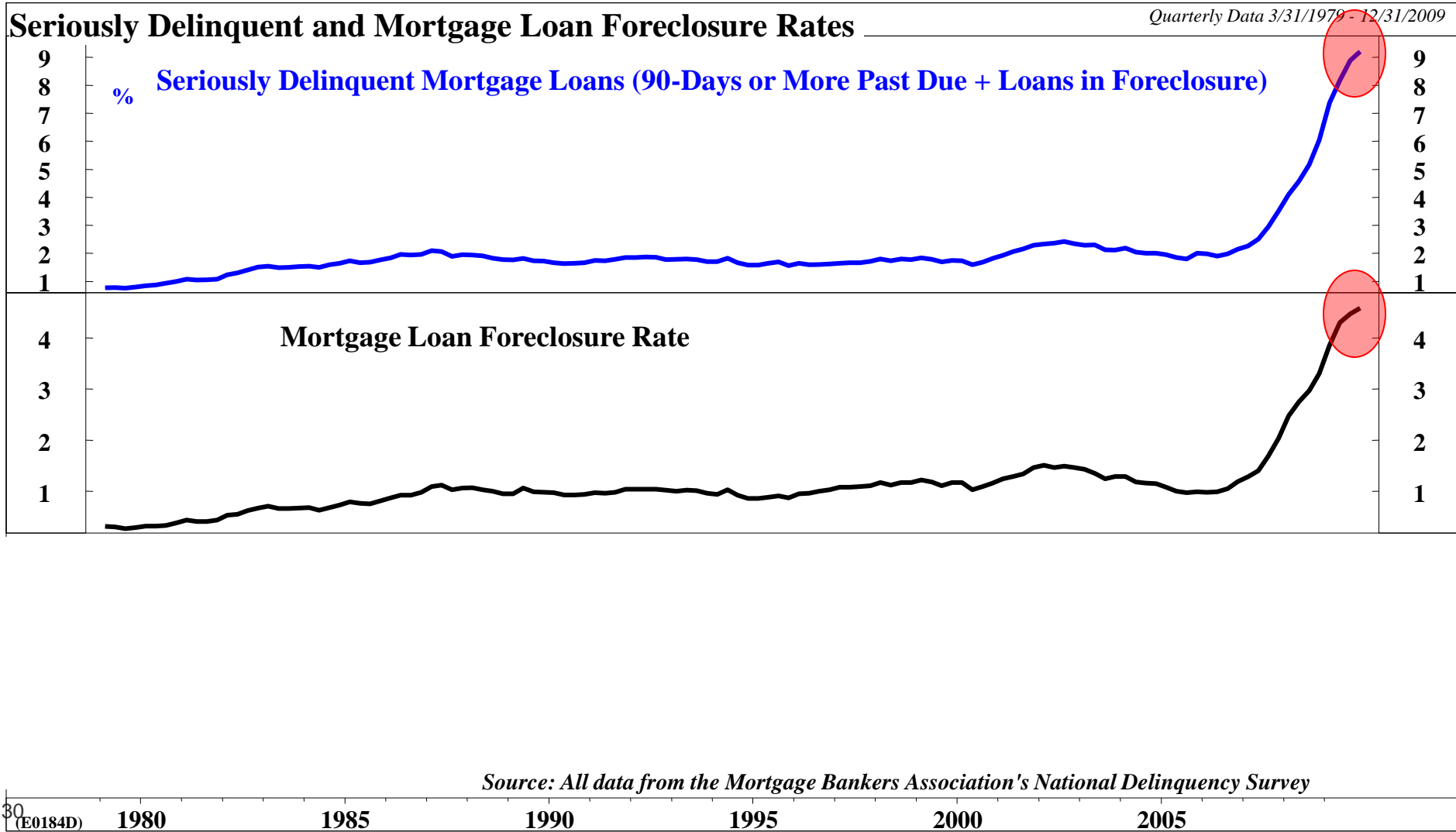


*“Fannie Mae has expanded home ownership for millions of families in the 1990’s by reducing down payment requirements. Yet there remain too many borrowers whose credit is just a notch below what our underwriting has required who have been relegated to paying significantly higher mortgage rates in the so-called subprime market.”*

-Franklin D. Raines, CEO Fannie Mae  
Fannie Mae Eases Credit to Aid Mortgage Lending  
The New York Times, September 30, 1999

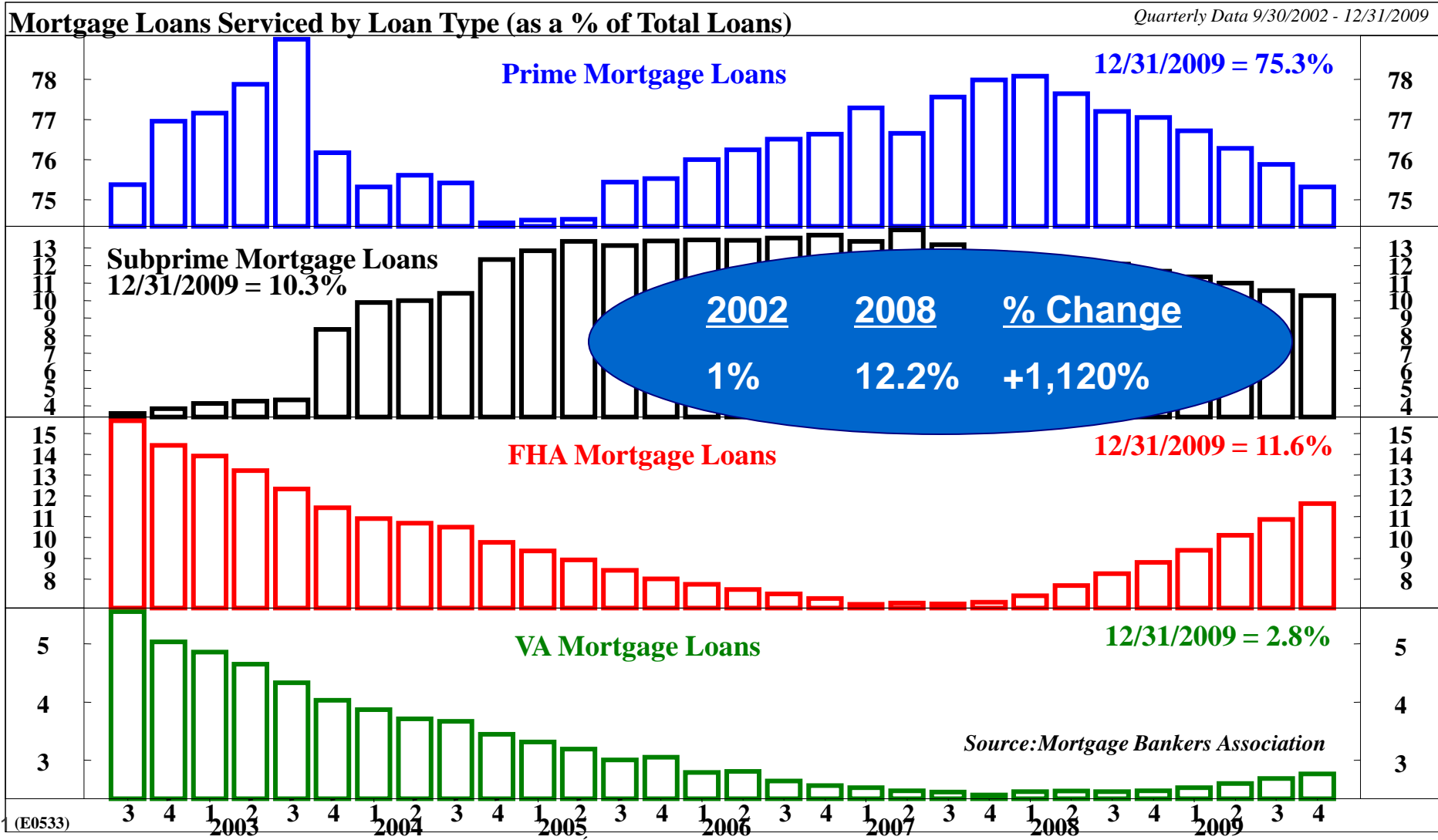


# Peak of the Plot





# Peak of the Plot—Prime vs. Subprime Loans



31 (E0533)



# The Plot Thickens

## **Foreshadowing**



*“From the perspective of many people, including me, this is another thrift industry growing up around us. If they fail, the government will have to step up and bail them out the way it stepped up and bailed out the thrift industry.”*

-Peter Wallison, American Enterprise Institute  
Fannie Mae Eases Credit to Aid Mortgage Lending  
The New York Times, September 30, 1999



## Plot Thickens

2005 2006 2007 2008 2009

- Lenders originated \$173 billion in subprime loans
  - Subprime market valued at \$600 billion
  - Mortgage industry begins to “sell loans” to consumers
  - Regulators watching the issues unfold remain off stage
  - Commercial banks, investment banks, world governments, etc. purchase large amounts of U.S. mortgage debt
    - New Century fails in July
    - Fannie Mae and Freddie Mac come under scrutiny
      - Bear Stearns, Lehman Brothers, Merrill Lynch, cease to exist
      - Goldman Sachs, Morgan Stanley commercial banks
      - WaMu to JP Morgan; Wachovia to Wells Fargo; Merrill to B of A
        - 140 FDIC bank failures reported
        - Record 2.8 million foreclosures reported, up 21% from 2008 and 120% from 2007.



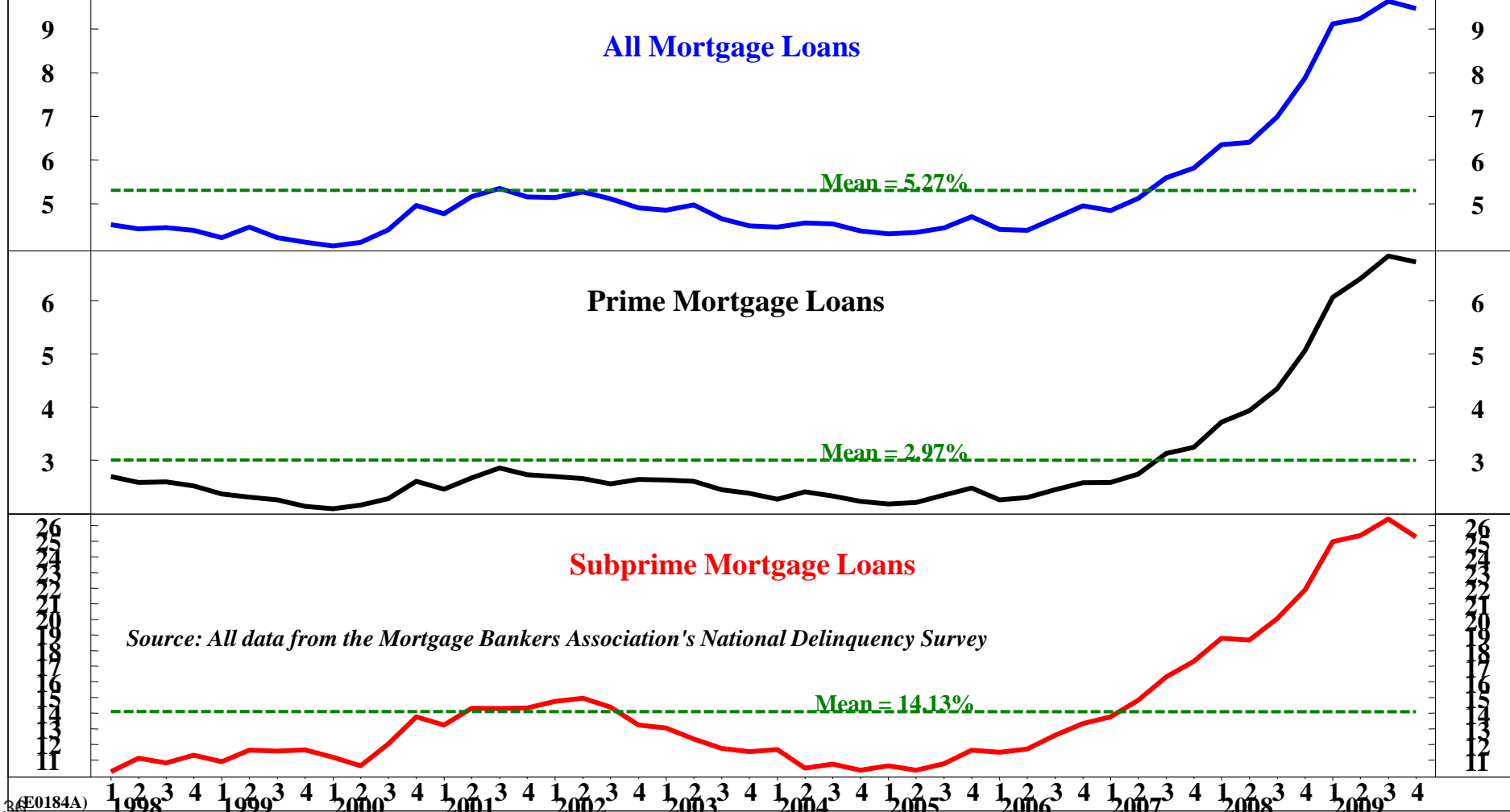
# Peak of the Plot

# Peak of the Plot— Prime vs. Subprime Loans



**Mortgage Delinquency Rates (Prime vs Subprime)**

Quarterly Data 3/31/1998 - 12/31/2009



36 (E0184A)



# Peak of the Plot

## Lending Standards for Residential Mortgages

Monthly Data 8/31/1990 - 4/30/2010 (Log Scale)

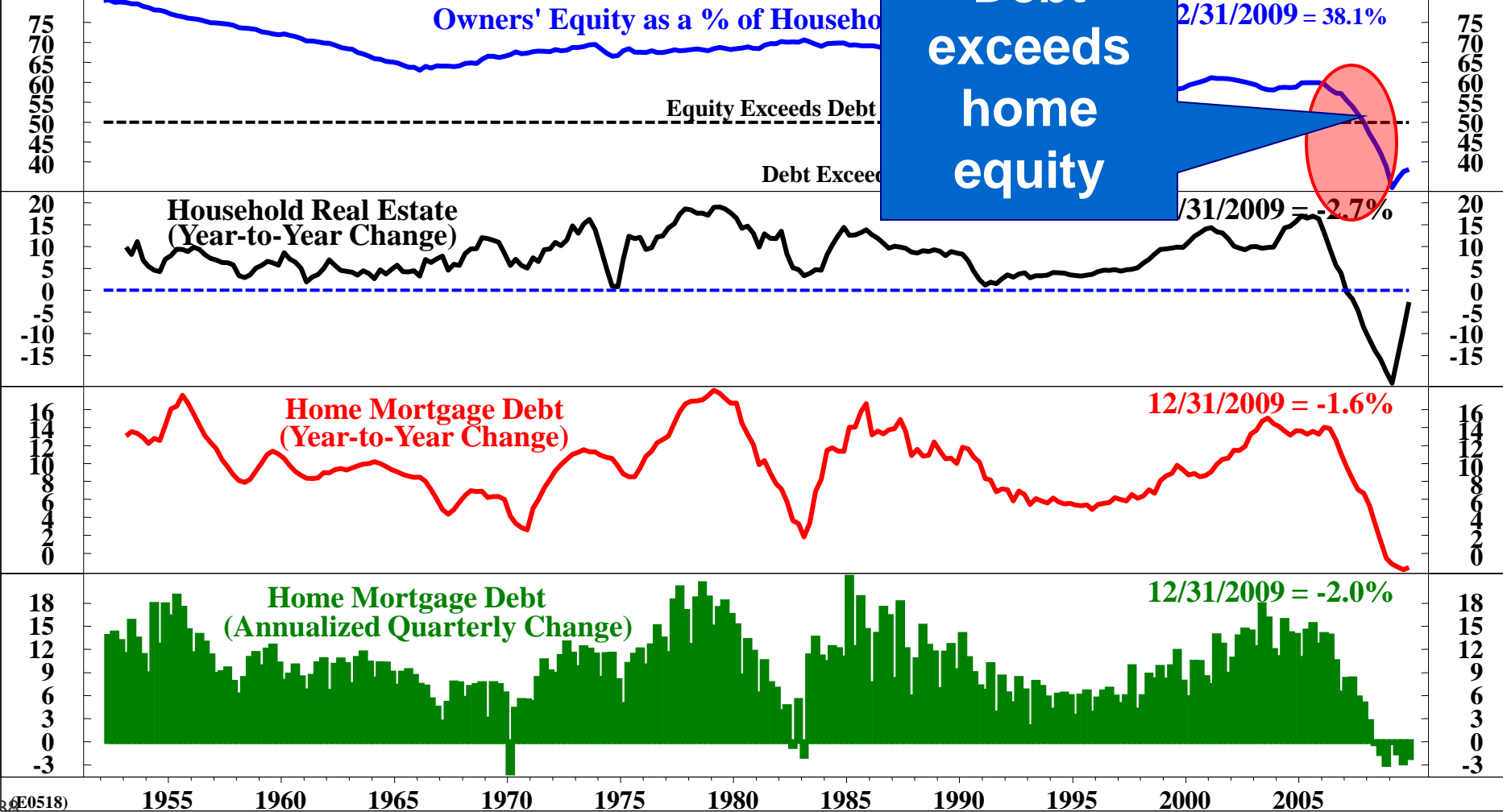


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# Plot Unravels—Where the Market Stands

## Household Real Estate



38(E0518)



“Double, double toil and  
trouble; Fire burn, and  
cauldren bubble.”

– Macbeth, from Shakespeare’s Macbeth, Act IV

A stage with red curtains and a spotlight on the floor. The text "Act III" is centered in a white box with a black border.

Act III



“True nobility is  
exempt from fear”

– King Henry, from Shakespeare’s King Henry IV

## ***The Epilogue***



### **Short-Term**

- Tighter underwriting standards
- Access to credit constrained
- Additional failures, consolidations
- Additional charge-offs and write-downs
- Return to a more traditional lending approach?
- More government intervention

### **Long Term**

- Significant regulatory changes
- Possible consolidation of stronger players
- Different financial landscape
- New global accounting standards

## ***Re-Setting the Stage***



### **Taking Down ‘Too Big to Fail’**

If we choose to address ‘Too big to fail’  
with systemic remodeling...

### **Pursuing Nationalization**

If we choose to allow further nationalization  
of the financial services industry...

### **Modified Status Quo Approach**

If we choose to continue along the current path,  
maintaining status quo...



## Re-Setting the Stage

*“In short, we need an end to ‘too big to fail.’  
Because of their concentration of economic power and  
interconnections through the financial system, the  
management and supervision of institutions of this size  
and complexity has proven to be problematic.”*

—Sheila Bair,  
FDIC Chairman

# ***“Too Big to Fail”***



## **Scenario:**

- Restructure the banking system using the regional banking model that the OCC validates as highly effective, limiting total deposits one company can hold to 5 percent.
- Further distinguish between traditional banking and other financial services (investment, brokerage, etc.).
- Diversify risks by spreading the liability across a broader base.
- Create one super-regulator to supervise all financial institutions and/or provide oversight over other regulators.
- Improve and increase oversight of non-bank financial services companies and products.

# ***“Too Big to Fail”***



## **Considerations:**

- Does the regional banking model allow us to meet the credit needs of large domestic companies and allow us to effectively compete internationally?
- How do we allow for innovation in financial products and services without extraordinary risks?
- Which companies will fill the secondary market void?
- How do the largest banks shrink to achieve the 5% deposit cap?
- What consideration is given, if any, to states' rights to regulate financial institutions?
- What does the final regulatory structure look like...the current Federal Reserve System structure?



## ***Further Nationalization***

*“The days of light-touch regulation are over.”*

- Rep. Barney Frank (Mass.),  
Chairman of the House Financial Services Committee

# ***Further Nationalization***



## **Scenario:**

- Adds perceived stability to market, restores confidence.
- Government more aggressive in seizing control of failing institutions.
- Government actively involved in the strategic planning of nationalized banking system.
- More government involvement in oversight and operations of needs traditionally met by private financial sector.
- Equal playing field established by offering flat rates, standardized products, services, and regulation.
- Competitive internationally because of size and scope.
- Largest U.S. banks get even bigger due to U.S. government backing.

# ***Further Nationalization***



## **Considerations:**

- Are we allowing a broader, grander systemic risk to the overall health of the national economy?
- Where does innovation fit in with a 'one size fits all' approach to credit, rates, products, and services?
- How do we continue attracting and retaining the best and brightest talent?
- Do you regulate at the institution or product level?
- What would be the role of community banks and mid-sized regional banks?
- What would the U.S. population's reaction be to nationalization?
- What impact will the courts have on the outcome?
- Does nationalization last, or do we re-privatize?



## **Further Nationalization**

*“Leaving such institutions to go on with a failed management team will prove more costly in the long run, and less likely to restore public confidence and get us back on the path to recovery.”*

- Thomas Hoenig,  
President of Federal Reserve Bank of Kansas City

***So the question is...***



*What is the best solution given America's unique position in the world, the current state of our financial crisis, and our future needs?*

...Modified Status Quo Approach

# ***Modified Status Quo Approach***



## **Scenario:**

- Significant banking industry consolidation.
- Taxpayer support for so-called systemically important financial institutions continues.
- Existing regulatory structure essentially stays in place, with Fed taking on the additional role of systemic risk regulator.
- Four largest US banks get even bigger and control nearly 50 percent of US domestic deposits.
- Financial Accounting Standards Board (FASB) modifies accounting rules to accommodate current criticism.
- Competition for core deposits increases significantly, especially from various non-traditional competitors.
- Higher, risk-based FDIC assessments for many years needed to replenish the Deposit Insurance Fund.
- Large, mid-sized and smaller community banking structure essentially stays in place, albeit with fewer players, less loan type concentration, and reduced overall leverage.

# ***Modified Status Quo Approach***



## **Considerations:**

- How does the government get taxpayer investments out of banks in an orderly manner that does not cause other unforeseen problems?
- Does the government's unprecedented intrusion into the financial markets mask the root problems and ultimately prolong the crisis?
- How much inflation results from the many government programs and what is the impact on the value of the dollar?
- Does the dollar remain the world's reserve currency?
- Is the deposit concentration in a few large banks in the country's best interests?
- What influence do special interest groups have?

## ***Parting Considerations***



- It all starts with the right people doing the right things.
- Our shared values and principles should drive the decision-making.
- Regulations cannot make financial services risk-free.
- How much political influence should be allowed over regulators?
- The current failure is an opportunity to get it right and prepare for a different future.

## ***Our Desired Destiny***



Hope is not a plan—  
we need to know where we are going  
in order to get there.

After we have established a plan we need to be flexible  
because most things do not go according to plan.

One person can make a difference—we are all players and  
therefore need to positively influence the outcome.



“This above all: to thine own  
self be true”

– Hamlet, from Shakespeare’s Hamlet, Act I