



**Russell Goldsmith**  
**Chairman & Chief Executive Officer**  
**City National Bank**  
**Remarks at the Orange County Forum**  
**“How Do We Get Out of This Mess?”**  
**Irvine Hyatt Regency**  
**February 26, 2009**

I want to thank the Orange County Forum, not only for inviting me to join you, but, more importantly, for all that it does to make such an important and continuing contribution to the life and dialogue of this community.

City National Bank is also committed to Orange County – and has been for more than 30 years. Today our company has seven offices in the county, which for us – as a private and business bank – is considerable and our largest and longest commitment outside of L.A. County.

That’s appropriate since Orange County is the fourth largest county in the nation, a region of 3 million people.

If this county were a nation, its \$130 billion economy would rank 31st among the nearly 200 countries in the world, larger than Israel or Ireland.

In my view, Orange County deserves two U.S. senators of its own, but getting Washington to see things that way will take more time than any of us have.

With all eyes on America’s economy and financial system, this afternoon I’d like to discuss three things:

1. Where are we today?
2. How did we get here?
3. And, as the topic of this afternoon’s remarks suggests ... How do we get out of this mess?

## **1. WHERE ARE WE TODAY?**

To say that 2008 was an extraordinary year would be an understatement. For the first time in our generation, the credit markets stopped working. Home mortgage rates went through the roof. Blue-chip companies couldn't get the cash they needed to meet payroll and continue their day-to-day operations. The stock market plummeted as investors fled equities for the safety of government T-bills that were paying virtually nothing.

In 2008, we saw Bear Stearns and Lehman Brothers disappear, along with Countrywide, IndyMac, Wamu and Wachovia. All have failed and been absorbed. AIG has effectively been nationalized. Goldman Sachs and Morgan Stanley have retreated somewhat and become bank holding companies.

In the fourth quarter of 2008, America's GDP fell preliminarily 3.8 percent, and when that number is finalized, it will be lower, I believe.

Unemployment now stands at 7.6 percent, and on February 18 the Chairman of the Federal Reserve, Ben Bernanke, said it will go higher than 8 percent "for sure." By the end of December, California's unemployment rate had reached 9.3 percent, and unfortunately it too is headed higher.

In 2008, the nation lost more than 2.5 million jobs, making 2008 the worst year for unemployment since World War II.

Even worse is the fact that the downturn has recently been accelerating. Half of the jobs lost last year came in the fourth quarter.

Not surprisingly, consumer confidence has fallen to its lowest level in nearly 20 years.

In this decade, our economy grew on a toxic brew of easy credit and inflated values, inadequate regulation and excessive optimism, greed and errors in the public and private sectors, both by consumers and corporations.

It was an economy on credit steroids that is now going through a painful detox, and while it will ultimately emerge leaner, meaner and healthier, getting there won't be easy – or quick.

The typical recession post-World War II has lasted 11 months. This one is already two years old, and I think it's fair to say that most believe it will endure through 2009. Just this week, Mr. Bernanke stated that while 2010 will likely begin the turnaround, things will get worse in 2009 before they get better. That would make this the longest and probably the steepest downturn in over 60 years.

Last week the Federal Reserve released the minutes of its Open Markets Committee, which sets key U.S. interest rates. They said, "All participants anticipated that unemployment would remain substantially above its longer-run sustainable rate at the end of 2011."

Declining home prices and falling equity values have dealt an unprecedented blow to household wealth as everyone here who owns a home and/or stocks can testify to. That means lower consumer spending as we are seeing. That, too, will continue in the months ahead as families set out to rebuild their savings and worry about job security and in far too many cases lose their jobs altogether.

In short, this is not just another recession. It is a fundamental economic realignment.

## **2. HOW DID WE GET HERE?**

How did we get here? Many would like the answer to that question, and of course hindsight is always 20/20. John Kennedy once said "Victory has a thousand fathers; defeat is an orphan." Today's economic realignment has turned that saying on its head: In this case, defeat has a thousand fathers, and they all have varying degrees of responsibility:

- Wall Street: Greed, untethered leverage and failure to understand a wide variety of complex financial instruments (combined with a "don't smell it; sell it" mentality and compensation structure). In the end, ironically, the financial manipulators were, in part, "hoisted on their own petards." They invented these peculiar instruments, peddled them like snake-oil salesmen, leveraged them 30-to-1 and then wound up owning too much of them, like Bear Stearns, or insuring them with credit default swaps that generated huge losses, like AIG.

- Mortgage originators: Companies like World Savings and WaMu, as well as New Century and Ameriquest, which used to be headquartered only a few minutes from here, were lightly regulated, to say the least. These companies inflated the country's appetite for subprime lending, in many cases by misleading people into mortgages they couldn't afford and helping to feed the securitization packaging that contributed to the credit and housing bubble.
- The SEC: It was asleep at the switch when it came to things like mortgage backed securities, credit default swaps, hedge funds and ponzi schemes and too eager to push accounting principles and theories over prudent management.
- Alan Greenspan: His failure to have the Federal Reserve regulate all mortgages – not just those held by banks – and his remarks encouraging the use of option ARMs poured liquor into the punch bowl instead of doing what the Fed usually does – take the punch bowl away before the party gets out of hand. This clearly contributed to the crisis.
- Regulators: In fact, many bank and thrift regulators – as well as Congress – often focused too much of the attention and energy of those they regulated on some things that weren't that critical and too little attention on some things that were mission-critical. The Bush administration's rigid ideology and its reflexive assumption that all regulation is bad left too many things – especially new things like credit default swaps, aggressive mortgage originators and huge hedge funds – largely unregulated.
- Ratings agencies: They failed to spotlight the lack of proper risk management or to accurately gauge the actual amount of risk when issuing their ratings. Putting their AAA ratings wrapper on mortgage-backed securities, they encouraged investors into buying these with a false sense of safety.
- Ill-advised consumers and housing speculators acting on the premise that home prices would always go up, leverage was always manageable and you could re-fi your house to cover debts you couldn't otherwise pay.

- Congress and the President: A strong and even commendable public policy to increase home ownership in the U.S. was pushed too far by President Bush (who used to bill himself as the “homeowner president”) and both political parties in Congress and Fannie and Freddie and, as a result, too many people purchased homes they couldn’t afford – popping the housing bubble.

And the list goes on from there.

### **3. HOW DO WE GET OUT OF THIS MESS?**

Recovery will require time and a concerted set of strategies that work together: forceful monetary policy, a stable financial system and smart fiscal stimulus. It also demands aggressive efforts to halt the foreclosure crisis. Fortunately, these steps are being taken in a variety of ways. Let’s take them one at a time, starting with monetary policy.

#### **A Forceful Monetary Policy**

Extraordinary times call for extraordinary measures, and that’s just what we have seen from the Federal Reserve during the last 18 months. Their key interest rate has dropped from 5.25 percent in August of 2007 to between zero and one quarter of 1 percent today. Record low interest rates have helped make credit and home mortgage rates much more affordable.

The Fed also deserves a lot of credit for a series of bold, innovative and even unprecedented initiatives. At last count, it has rolled out at least 15 programs aimed at alleviating this credit and capital markets crisis – many of which will require time to make a meaningful difference.

Between the Fed, the Treasury Department, the FDIC, the FHA and the Department of Energy, by several estimates the United States government has already committed an incredible \$3 trillion to alleviate the credit crisis.

#### **A Stable Financial System**

While the battle to restore America’s prosperity is being fought on a number of fronts, the most important and fundamental necessity is the effort to restore the

stability and full functionality of our financial system – not just in banks, but in the capital markets.

In fact, functioning credit markets are not just important; they are imperative.

Treasury Secretary Tim Geithner recently pointed out that “banks and the credit markets transform the earnings and savings of American workers into the loans that finance a first home, a new car or a college education.”

Credit is the lifeblood of our economy, and we need to get it flowing again. Otherwise, people will continue to lose their homes, parents won't be able to afford college, businesses will fail and jobs will continue to disappear.

Ben Bernanke has stated plainly that the \$800 billion stimulus package just signed into law won't lead to a sustained recovery unless the financial system is fully stabilized.

That's what the Troubled Asset Relief Program was originally designed to do.

To date, the U.S. Treasury Department has invested more than \$250 billion in nearly 450 banks.

Its \$400 million investment in City National was a strong vote of confidence in a well-capitalized bank that is vigorously supporting economic activity in the communities it serves.

While TARP has become a four-letter word in some quarters, and some investment bankers have abused their companies' cash, I would argue that the program has gone a long way toward meeting its goal of restoring public confidence in the traditional banking system.

There's no doubt in my mind that TARP has helped to reassure clients and depositors who, understandably, had grown concerned by the newspaper headlines and long lines of depositors surrounding bank failures like IndyMac, Downey Savings and First Heritage.

- There was a climate of fear last fall, but that changed after TARP was approved and FDIC deposit insurance was enhanced.

- Critics of TARP – and there are many – argue that banks are not lending.
- But that’s not true. The U.S. Treasury recently announced that bank lending was up in December 2008. In fact, it pointed out that “loan activity was resilient in the face of the worst economic downturn in decades.”
- At City National, our loans grew 9 percent in 2008, or about \$1 billion more in loans than one year earlier. In the fourth quarter alone, City National renewed \$1 billion in loans and made \$340 million of new loans as compared – erroneously – to \$400 million in TARP investment in mid-November.
- TARP is often called a bailout, but that’s not the case. It is an investment. The government should – and does – expect to receive a fair return. This year, for example, City National will pay the Treasury Department a dividend of almost \$22 million after tax.

“Facts,” John Adams once said, “are stubborn things.” And it is a fact that the credit crisis is rooted not in the banking industry, but in the capital markets.

- By one estimate in The New York Times last Friday, as much as \$1.9 trillion of lending capacity – the rough equivalent of half of all the money borrowed by businesses and consumers in 2007, before the recession struck – has been sucked out of the system by the collapse of the securitization markets.

Banks fund only one-third of all consumer credit in the United States and just one-fifth of residential mortgage credit. They cannot replace all of the nation’s private capital and long-term syndicated debt. That’s why the government and private sectors must unlock the capital markets as soon as possible.

It is something the Obama administration acknowledged in the financial stabilization plan that Tim Geithner announced a couple weeks ago.

The details of that plan are very important and do need to be hammered out soon. But contrary to most talking heads on TV, I believe there’s a lot to like in the outline of the new proposal.

It includes measures to strengthen the capital resources of financial institutions and broaden access to credit. It supports housing and foreclosure prevention and streamlines small business lending backed by the federal government.

The proposal acknowledges that a way has to be found to dispose of bad financial assets held by some banks. But it's also clear that pricing these assets will present a challenge.

I'll be particularly interested to see the details of the administration's plan to "stress test" the nation's largest banks. Just the idea has made banks and Wall Street nervous about the administration's intent and skill. To a point, the concept sounds reasonable – it may provide clients and investors with better information – but we will need to see how Treasury intends to implement it.

I do hope the administration will resist calls and rumors to nationalize private banks and other financial companies. They have effectively done that already with AIG, which, according to news reports, is expected to announce an additional \$60 billion in losses.

However this plays out, there's no doubt that the financial services industry is changing fast in order to restore full confidence and functionality in a stable financial system.

Gretchen Morgenson, a columnist for The New York Times, recently wrote that the behemoth, all-things-to-all-people financial supermarket approach to banking has failed. She called for a return to the basics – to things like strong client relationships, stable deposit funding and sound credit standard.

Well, lost in the media hysteria is the fact that many banks never left those standards. At City National, for example, we've never made any subprime loans or sold any of our clients' loans through Wall Street. We never bought or sold credit default swaps or leveraged up our balance sheet 30 to 1. We don't even have any auto loans or consumer credit card debt to worry about.

### **A Smart Fiscal Stimulus Package**

- Like the one announced this past week. No, it's not perfect. But it is a huge step in the right direction. It may not be big enough, but at \$800 billion it's certainly big. It has a mix of tax cuts and spending that won't all be immediate, or fully effective, but it should work like a time release capsule, largely over the next 18 months.
- The plan will both stimulate jobs and economic growth and also support many constructive investments in technology and healthcare, clean energy and transportation.
- It will help to rebuild our country's neglected infrastructure.
- It is expected to provide California with \$65 billion in much needed support for things like education and healthcare. (Source: Los Angeles Times)
- The new stimulus package also will lower payroll and other taxes paid by small businesses that create 90 percent of America's jobs.

### **Help for the Housing Crisis**

The housing crisis assumed center stage with the administration's big proposal last week and again in the President's budget address Tuesday night. Real estate values and home foreclosure are at the heart of today's economic difficulties, as everyone in Orange County knows all too well.

An estimated 6 million U.S. households are facing possible foreclosure, and each foreclosed home lowers nearby property values by as much as 9 percent.

The administration's new plan is a step in the right direction.

Here in Orange County and throughout the United States, there are plenty of homeowners who are working hard to meet their mortgage obligations. Many of them will be upset – understandably upset – at the prospect of having to help out somebody who has defaulted on a similar obligation. It isn't right. It isn't fair.

But the fact is that today's foreclosure crisis threatens to weigh down our economy for years. We have to do something about it. This too isn't perfect – I'm particularly concerned about the process, precedents and terms of loan "cramdowns" – but something needs to be done to try to help and stop the continuing downward spiral in housing prices.

Monetary and fiscal policies such as these are what governments typically focus on, and there is no question that they are important. However, let's also not overlook some of the fundamental changes that we must all embrace moving forward. Things like ...

Regulating the unregulated. It's time to cast off shibboleths like "all regulation is bad." If today's economic challenges have taught us anything, it is that our society needs comprehensive and consistent regulation across the spectrum of not only financial products and institutions, but the systemic risks inherent in our entire financial system.

Living within our means. Not everyone can afford a home or an expensive car or a new flat-screen TV, and we shouldn't have policies that try to make that happen anyway.

Facing the hard truths. As Nietzsche said, "What doesn't kill us makes us stronger." As painful as it is, today's economic realignment won't kill us. Ultimately, as the President has said, it will make us stronger, but that means we need to face some hard truths. Using the motor vehicles industry as an example, the United States won't return to producing 17 million cars and light trucks a year. Right now the new rate is around 10 million units. If it levels off at 13 or 14 million units, that's 20 percent of the industry that is going away for a very long time. A 20 percent cut means fewer dealers, laid off UAW workers and closed factories. That means looking to new industries, like alternative energy, and reducing our dependence on oil resources that strengthen the very people – like Hugo Chavez – who detest us most. It also means leading with a more educated workforce. It means welcoming the aspiring entrepreneurs who apply for HIB visas – instead of turning them away after they graduate from U.S. colleges and universities. It means addressing the realities of our underfunded entitlement programs like Social Security and Medicare.

Becoming more politically active. The budget debacle in Sacramento illustrates once again just how dysfunctional the political process here in California has

become. Every one of us needs to take some responsibility. Let's demand more – from local government, from Sacramento and from Washington, D.C. Let's engage our elected officials and ask them to press for our fair share of government funds and services – and more efficient and productive government services – as well as for government efforts to expedite – not impede – public and private investments that will responsibly grow the economy and create good jobs.

We also urgently need policies that encourage private investment.

Government at every level must find ways to move faster and work in tandem with the private sector to make rational decisions more quickly and get things done.

Local, state and federal government agencies together must encourage private and public capital investments by expediting important projects – especially now when the federal government has allocated billions in stimulus dollars.

#### **4. CONCLUSION**

Alright, you've been a great audience, and now it's time to wrap things up.

This afternoon we've covered a complex subject at a very challenging time.

The message I'd like to leave with you today is that we appear to be slowly getting back on track. The right combination of financial stabilization, economic stimulus and housing relief combined with proactive policies that generate private investment will – I believe – eventually get us out of this mess.

This realignment of our economy won't be cheap, and it won't be easy. Ultimately, we need more factories producing things we can sell abroad and fewer malls as consumer spending declines; in other words more investment, less consumption and a leaner economy not pumped up artificially by so much debt.

The Obama administration is tackling this economic crisis with a broad arsenal of largely sensible and aggressive policies, in my view, but they have to be careful not to do unnecessary damage to consumer and investor confidence in banks and the financial system, and they need to ensure that federal dollars are spent wisely, rapidly and where the needs, and the benefits, are greatest.

We all need to press government at every level to be more effective and fair while managing our own financial affairs – carefully and conservatively – with quality companies and responsible investment advisors.

Thank you all for giving me this opportunity to share my views with you today.

I'd be happy to take questions.

###