Dear Yves,

I am writing in response to your recent posting about the first two hours of "Money, Power and Wall Street." I produced and reported the first of those hours for FRONTLINE. Below I've also attached a response from Mike Wiser of the team that produced the second hour on April 24th. I appreciate your taking the time to critique our programs but I have to say, I was pretty surprised by some of your comments. I have long been a regular reader of your blog and admire your work. I have followed your telling of the Magnetar story (in "Econned") in particular.

It seems you have misunderstood our documentary. Let me try to explain.

<u>HOUR 1</u>

To begin with, you describe the hours as "remarkably bank-friendly." We wanted to direct your attention to the first few minutes of the first hour when we introduce the thesis statement of the film and say of Wall Street: "It is the industry that led America and the world into its worst economic crisis since the great depression." That from our perspective is hardly "bank-friendly." In any case, it is not our job to prosecute, but rather to investigate and explain so as to promote better understanding.

Second, you write that we cribbed from Gillian Tett's "Fool's Gold." That's a serious accusation to make and I don't think a fair characterization of what we have done. We were very clear in narration to credit Tett as the first journalist to tell the "full story" of the JP Morgan bankers. We also interviewed her (twice) and credited her book on screen several times. Tett does not feel that her work was "cribbed.

You go on to write:

> "The book at least explained that the reason for the creation of the CDS was to solve a rather big problem for JP Morgan, that it was carrying a ton of loan risk and could use a way to lay it off (the broadcast, by contrast, made it sound like this was a market just waiting to happen, as opposed to one JP Morgan, and later its competitors, cultivated)."

Yet, this point is made abundantly clear to our viewers. Winters, Brickell and later Masters both make this point explicitly as does the narration:

> Narration: **They were striving to address an age-old problem in banking: how to reduce risk.**
>
> **Bill Winters**: The defining problem was that banks were unable to adequately deal with their own credit risks.

Narration: **Over two days of meetings, they looked at whether they could find a way to make their loans less risky.**

Gillian Tett: They began to look for ways to enable financial institutions to pass risk between them. One way to do that was to sell loans another way though was to separate out the risk of a loan going bad from the loan itself. And out of that came this drive to develop credit default swaps.

And

Narration: **The first big credit swap was engineered by Blythe Masters and involved Exxon.**

Blythe Masters (JP Morgan, '91 – present): Exxon was the client at the bank and we had credit exposure associated with that relationship.

Narration: **In the wake of the Exxon Valdez oil spill and a rash of lawsuits, Exxon took out a multi-billion dollar letter of credit with J.P. Morgan.**

Blythe Masters: A letter of credit creates credit risk. If Exxon were to fail on their obligations, then J. P. Morgan would have to step in and make good on those obligations on their behalf. It was a large amount of exposure, and there was a significant amount of risk associated with that."

And that risk is a big drain on a bank."

And

Mark Brickell (JP Morgan, 1976–'01): The innovative element of swaps is that they allow companies, financial institutions, governments, to-shed the risks that they don't want to take and take on other risks that they would prefer to be exposed to.

Another point you make:

"CDS, by contrast, are the economic equivalent of unregulated insurance contracts. The pernicious feature of CDS is that the CDS protection writers (the guarantors) aren't regulated for capital adequacy, the way other insurers are. They instead are required to post collateral to reflect the current value of the contract. But that is no guarantee that the CDS protection writer will be able to pay out.

But this was again explicitly addressed in my interview with Dennis Kelleher:

> **Dennis Kelleher (Better Markets Inc.)**: One of the most heavily regulated products in the country are insurance products for all the obvious reasons. If you're gonna-- if you're gonna write insurance, you have to have enough money to pay off that insurance.
> **Martin Smith**: But if you write a credit default swap, you don't have to have that same amount of money on hand?
> **Dennis Kelleher**: Or anything else including, importantly, no disclosure.
> **Martin Smith:** So you're saying it's a kind of under-the-table insurance agreement that avoids regulation?
> **Dennis Kelleher**: It's an insurance product designed not to be regulated as an insurance product and designed to avoid regulation at all. And one thing we do know is that when a product of any type is designed with minimal regulation, capital and activity moves into that area. And it expands dramatically.

Later Satyajit Das makes the point that AIG couldn't pay its CDS contracts:

> **Satyajit Das (Author, Extreme Money)**: Remember an insurance contract is only as good as the credit quality of the insurer. They have to pay you. And if they can't pay you for whatever reason, then this whole process of risk transfer breaks down.

And both Daniel K. Tarullo and Christopher Whalen explain that it was because AIG hadn't been regulated for capital adequacy:

> **Daniel K. Tarullo (Federal Reserve Board Governor, 2009-present):** AIG could not conceivably have paid off all of those credit derivatives, because it had-- misunderstood the risks did not have what we'd call a balanced book or nearly enough capital to back their losses.
>
> **Martin Smith**: Didn't everybody know that AIG was holding a lot of CDSs?
> **Christopher Whelan (Tangent Capital Partners):** No. There was no disclosure. You haven't reported this to anyone else. The other banks don't know. But nobody knows. The banks turned this market into their own private game.

As far as Brooksley Born is concerned you write:

> "Tellingly, there are clips of Brooksley Born, but no mention of her failed effort to regulate CDS."

Kelleher addresses this in his interview:

> **Dennis Kelleher:** Brooksley Born was absolutely right because what she said is, "If you don't have transparency and regulation of derivatives, the

risk is gonna build up and they're gonna lead to a financial crisis that's gonna cause massive taxpayer bailouts."

So does the narration:

> Narration: **Proposals circulated to rein in the banks and to regulate derivatives. The head of the Commodity Futures Trading Commission, Brooksley Born, led the charge…. The banks lobbied hard for no regulation.**

The website also references viewers to another FRONTLINE documentary, "The Warning," a one hour treatment of Brooksley Born's effort to regulate derivatives. Viewers of the program were alerted to this through an on-screen marker directing them to FRONTLINE's website for more on Born.

You speculate:

> "It's more accurate to say JP Morgan was once burned, twice shy. It took significant losses in the first test of the corporate CDS market, the bankruptcy of Delphi in 2005. That led it to pull its oars in just as the market for asset backed securities CDS was taking off. Fool's Gold makes a great deal of noise about how JP Morgan couldn't figure out how other banks were modeling the risks on mortgage-related CDS and presents that as the reason they were largely out of that market. That may be narrowly true, but I wonder if that sort of caution would have reigned had they not had to reassess the adequacy of their risk metrics in the wake of Delphi."

But you do not offer anything concrete to counter our reporting here.

You write:

> "Similarly, the account hews to conventional lines in making Goldman out to be the poster villain in the CDO market, yet merely in passing, has Deutsche Bank CEO Joseph Ackermann admitting to being one of the banks that stuffed Landesbanken like IKB full of toxic debt. Crisis junkies know that Deutsche Bank trader Greg Lippmann was the most aggressive middleman in helping subprime shorts like John Paulson create and sell CDOs designed to fail (and they had their own program, Start, which was a synthetic CDO series just like Goldman's better known Abacus trades)."

I discussed Lippman with Ackermann in our interview and we decided not to include this exchange. In the end, though Lippmann successfully shorted the market, Deutsche Bank as an institution lost millions of dollars on their CDOs. By contrast Goldman made millions. This, in my opinion, was worth reporting.

You assert:

> "The segment provides anecdotes of the crazed subprime lending, but fails to explain how mortgage backed securities and CDOs were linked to lending (or most important, that CDOs came to drive demand for RMBS, which in turn drove demand to the worst loans)."

But viewers heard several interviewees addressing this very issue:

> **Roy Barnes (Fmr. Governor of Georgia):** What really changed the appetite for subprime mortgages, was you could securitize. And you could sell it on Wall Street. They do it in tranches, and then they wrap it up so they could be packaged together and have an overall higher yield. And of course, Moody's says Triple A.
> So-- it was just a feeding frenzy. I mean, it was just an absolute feeding frenzy for sub-prime mortgages.

And later:

> **Chris Whalen (Tangent Capital Partners):** Let's say I have a pool of mortgages-- I have a thousand mortgages from California and I want to package these up. But I decide, "Well some of these mortgages may be subprime and I wanna buy a little bit of credit default insurance.
> **Martin Smith**: And by doing that, you improve the profile—
> **Chris Whalen**: In theory, yes.
> **Martin Smith**: --of your CDO—
> **Chris Whalen**: That's right.
> **Martin Smith:** So you can sell it better.
> **Chris Whalen**: And I can go get a rating for it, too. I could go to Moody's and say, "Look. I have laid off 2% of the risk on this portfolio. Shouldn't I get a better rating than if I just sold the pool as it was?"
> **Martin Smith**: So you take a lot of crap—
> **Chris Whalen**: That's right.
> **Martin Smith**:--a lot of mortgages that are—
> **Chris Whalen**: Hi-- hideous crap.
> **Martin Smith**: But you insure it and the credit agency says, "Hey. That's a good idea."
> **Chris Whalen:** Yes. Yes.
>
> **Gillian Tett*:*** And it seems that in the housing market many investors actually began to take more risks precisely because they thought that they had bought protection with the credit default swaps.

Finally you suggest that we are not hard enough on JP Morgan. We urge you to watch the second installment, airing May 1st, at 10PM. I don't think at the end of the day, most viewers would characterize the four hours as a "whitewash."

I'll concede that an hour is not a lot of time when the subject matter is so vast and at times so complex for a lay audience. Choices have to be made as to what to include. Yes, we were unable to get into some of the complexities you allude to in your blog, given our time constraints. But as to the points you have made above, I can't see where we made omissions as you are charging.

I think we should just agree to disagree. But, I hope we can remain in touch. You have a lot to offer when it comes to understanding the banking business and the economic crisis. Again, thanks for taking the time to critique the program.

Sincerely,

Martin Smith
Producer/Correspondent

Below is a response from Mike Wiser of the team that produced the second hour on April 24th, addressing points you raised about that program.

HOUR 2

Your point that we treat Bear Stearns as where the crisis begins is just not true. Our chronology focuses on the events of 2008 but the previous hour goes into detail on the roots of the crisis.

You argue the second hour presents "pro-Obama propaganda" and claim that the McCain/Obama meeting bears "zero relevance" to the crisis. I would encourage you to watch night two for a more complete treatment of how the Obama administration has handled the financial crisis. We made the judgment that it was important to follow Barack Obama throughout the crisis, because it helps to inform an understanding of decisions that he would make later in his administration.

You say that there is "no mention" of the Federal Reserve's special credit rate facilities. Unfortunately, we cannot touch on every topic during a one-hour film, but the subject is covered in the second night.

You correctly point out that there are other topics we did not mention: the Fed's original loan to Bear Stearns and what you call the "bait and switch" of the Tarp Bill. However, both were covered in a previous FRONTLINE ("Inside the Meltdown"). As we seek to tell a story without unlimited time, we sometimes need to decide what to include. In our judgment those topics were not as important as they were when we first reported on them in 2009.

But your most important point on the second hour is that "the show defended the false dichotomy of bailout or disaster." I'm not sure how you reached this conclusion, but the very last word in the film is someone making exactly the opposite point:

> **PHIL ANGELIDES (Chmn., Financial Crisis Inquiry Comm.):** The real story of this financial crisis is probably not so much whether the bailout was the right thing to do or the wrong thing to do. The real question is, how did it come to be that this nation found itself with two stark, painful choices, one of which was to wade in and commit trillions of dollars to save the financial system, where we still end up losing millions of jobs, millions of people lose their homes, trillions of dollars of wealth is wiped away, and the other choice is to face the risk of total collapse. That's the real story. How did policy makers, our government leaders, the financial sector maneuver this country into that kind of corner?

Time and time again in the film we flag missed opportunities that might have prevented the choice between "bailout and disaster."

First, during Bear Stearns we make it clear that regulators were unprepared for the failure of Bear, because of a history of deregulation.

> **PHIL ANGELIDES (Chmn., Financial Crisis Inquiry Comm.):** What became clear, as you look at the record, is the extent to which the people who were charged with overseeing our financial system really didn't have a sense of the risks that were embedded in that system. They didn't see the fundamental rotting in the system that had manifested itself for years.
>
> NARRATOR: **A year later, Phil Angelides would chair the Financial Crisis Inquiry Commission. In their report, the commission concluded regulators at the Federal Reserve, the SEC and other agencies ignored evidence that Wall Street was flirting with disaster.**
>
> **PHIL ANGELIDES:** You would think that the people who were in charge of our financial system would have a grip on the key risks that were in it. And if they did, they would have moved, in a sense, to get a handle on those. They had deliberately turned a blind eye to those problems.
>
> NARRATOR: **For three decades, Washington had steadily moved to a hands-off attitude towards Wall Street. And with little oversight, inside these black boxes, Wall Street had created a host of complicated but lucrative financial products.**
>
> **BROOKSLEY BORN (Financial Crisis Inquiry Commission):** We had no regulation. No federal or state public official had any idea what was going on in those markets. It was a dark market. There was no transparency.

> **JOSEPH STIGLITZ (Economist, Columbia University):** They were making money, and they want to continue making money. It was generating fees. Transparency drives profits down, drives down transaction costs. The banks don't want that because they make their money from transaction costs, and they like lots of non-transparency.

During the section of the film on the summer of 2008, you quote Michele Davis but not the other voices in the film that were critical of policy makers' handling of the crisis.

> NARRATOR: **But there were strong warnings of what was to come.**
>
> **H. RODGIN COHEN (Wall Street Lawyer):** A bullet had been dodged with Bear, but I think the more analytical people on Wall Street recognized that there were still a lot of bullets coming. The prognosis for the near future was that there were still huge problems.
>
> NARRATOR: **That summer, as the financial crisis became increasingly obvious, there was no decisive action from those in charge.**
>
> **PHIL ANGELIDES (Chmn., Financial Crisis Inquiry Comm.):** That's one of the most striking parts of the story, is that, first of all, how little the people who were in charge of our system knew and/or did in the wake of this oncoming crisis. And secondly, once the evidence was clear that the system itself was shaky and unsound, how there wasn't definitive and strong action to try to curb what was becoming a disaster for the country.

You quote statements by Shelia Bair and Robert Reich as "throwaways." However, similar sentiments are expressed throughout the film. I am baffled how you would believe the film dismisses their viewpoints. I would encourage you to watch the film as a film (as opposed to merely reading the transcript) before you make a judgment about whether we took these perspectives seriously.

The film is not a polemic or an opinion piece. It's an attempt to provide an accurate and informative telling of the crisis. Of course, we provide an opportunity for the viewpoint of decision makers to be reflected in the film as well as a chance for critics to raise their objections about how the crisis was handled. We hope that having multiple perspectives reflected in the film ultimately will help viewers to make up their own mind about the material.

Sincerely,

Mike Wiser
Producer