

## PERSPECTIVES ON THE FINANCIAL CRISIS\*

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It's a pleasure for me to be here tonight. I spent many years in the great state of Indiana, first attending graduate school, and then actually starting my banking career at Merchants National Bank in Indianapolis. It's always good to be back.

Before I get started on my prepared remarks, I first want to thank Chancellor Bantz; professor and incoming dean of the school of law, Andy Klein; and Justice Sullivan for the invitation to speak. I also want to take a moment to thank Nancy Huber, our Central Indiana President, for accompanying me here this evening.

I've been asked to provide you with my perspectives on the financial crisis. And while I will try to paint an objective picture, I must be honest—I have more than a little bit of a regional bank bias, but I'll do my best to hide it.

First, let me give you a nugget of background, which will help you put the timing in perspective. I became CEO of Fifth Third Bank in April 2007. Some say the actual start of the crisis began a short ninety days later with the liquidation by Bear Stearns of two hedge funds that invested in various types of mortgage-backed securities. Timing is everything, I guess. It's been more than four years, and I still cringe when I remember those times.

Over the years, I've gotten the question many times “who's to blame for the financial meltdown and subsequent recession,” and the best answer I can give is that everyone is to blame—government, unregulated lenders, investment banks, regulators, borrowers, and, yes, traditional commercial banks like Fifth Third all played a role—although some more so than others.

Shortly after the technology bubble and in the aftermath of 9/11, the Federal Reserve significantly reduced interest rates in order to mitigate the negative impact of recent events on the economy.<sup>1</sup> Low bond rates, low interest rates, and skepticism of the stock market significantly increased the attractiveness of real estate as an investment vehicle. This factor—coupled with government-sponsored enterprises that had a congressional mandate to increase home ownership—led to rapidly increasing real estate prices in many parts of the country.<sup>2</sup>

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1. GAIL MAKINEN, CONG. RESEARCH SERV., RL 31617, THE ECONOMIC EFFECTS OF 9/11: A RETROSPECTIVE ASSESSMENT 15-16 (2002), *available at* <http://www.fas.org/irp/crs/RL31617.pdf>.

2. FIN. CRISIS INQUIRY COMM'N, FINAL REPORT OF THE NAT'L COMM'N ON THE CAUSES OF THE FIN. AND ECON. CRISIS OF THE UNITED STATES 5-10 (2011) [hereinafter FIN. CRISIS INQUIRY COMM'N], *available at* <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

As property values rose, so did the availability of credit.<sup>3</sup> The “shadow banking” system that was comprised of unregulated lenders and securitization markets began to account for more and more lending activity—peaking at over seventy percent of all credit extended between 2003 and 2006.<sup>4</sup> This was further exacerbated by the emergence of new loan products that increased availability of credit, but were often done at teaser rates that would reset, required little money down, or completely circumvented most of the traditional underwriting process.<sup>5</sup> Pressure from the regulatory bodies responsible to Congress for the Community Reinvestment Act,<sup>6</sup> fair lending, and comparing “standard” lending practices to alternative lending offers only compounded the problem.<sup>7</sup>

The majority of toxic loan products, such as option-ARMs, subprime loans, and exotic mortgages, were created by lenders completely outside of the traditional regulatory authority of agencies like the Federal Reserve, FDIC, and the Office of the Comptroller of the Currency.<sup>8</sup> Investment banks with their exotic products, such as collateralized debt obligations, served to make matters worse.<sup>9</sup> I note that many traditional banks like Fifth Third did not originate these types of products, but we did continue to compete in more vanilla categories that were being underwritten based on grossly inflated property values. Don’t misinterpret my message. Traditional banks played a role. Our risk management processes were not developed enough to help us avoid the forthcoming problems and the industry should have had a better understanding of the interconnectedness of our business to all that was to ensue.

The rest, as you know, is history. Teaser rates began to expire, property values began to decline, and we began to see more and more borrowers unable to pay their mortgages.<sup>10</sup> Given that consumer savings in America were at the lowest levels since the government began tracking the statistic in the 1950s, many people had little, if any, contingency funds to fall back on.<sup>11</sup> With the fall of large

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3. *Id.* at 83-84.

4. Saskia Sassen, *Expanding the Terrain for Global Capital: When Local Housing Becomes an Electronic Instrument*, in *SUBPRIME CITIES: THE POLITICAL ECONOMY OF MORTGAGE MARKETS* 80 (Manuel B. Aalbers ed., 2012).

5. FIN. CRISIS INQUIRY COMM’N, *supra* note 2, at 104-05.

6. Community Reinvestment Act of 1977, Pub. L. No. 95-128, tit. 8, § 802, 91 Stat. 1147 (1977).

7. U.S. DEP’T OF HOUSING & URBAN DEV., *RECENT HOUSE PRICE TRENDS & HOMEOWNERSHIP AFFORDABILITY* 85 (2005), available at <http://www.huduser.org/Publications/pdf/RecentHousePrice.pdf>.

8. See *Fair Lending*, U.S. DEP’T OF HOUSING & URBAN DEV., [http://portal.hud.gov/hudportal/HUD?src=/topics/fair\\_lending](http://portal.hud.gov/hudportal/HUD?src=/topics/fair_lending) (last visited Jan. 24, 2014) (“[S]ubprime lenders are largely unregulated by the federal government.”).

9. FIN. CRISIS INQUIRY COMM’N, *supra* note 2, at 155.

10. *Id.* at 107-09.

11. See C. Alan Garner, *Should the Decline in the Personal Saving Rate be a Cause for Concern?*, FED. RES. BANK OF KANSAS CITY 8-9 (2006), available at <http://www.kc.frb.org/publicat/econrev/PDF/2Q06garn.pdf>.

banks, such as IndyMac and Lehman Brothers, liquidity dried up and panic ensued. Ultimately, lack of effective oversight of the shadow banking system and congressional meddling in housing policy played a large role in the crisis, but so too did banks continuing to compete for loans well past the point where it made economic sense.<sup>12</sup>

It's important to remember that, at this time, fear was rampant that the banking system would collapse and all banks would be nationalized. It seemed that the world was teetering on the brink of disaster. Even to me, it seems hard to believe the severity of the events and the negative sentiment that was pervasive at the time. But it was real—I know, I was there.

As a result of the impending crisis, the Bush Administration and Congress implemented the Emergency Economic Stabilization Act in early October 2008.<sup>13</sup> This bill was designed to restore liquidity and consumer confidence in the financial markets.<sup>14</sup> The most well-known component of this bill was the Troubled Asset Relief Program (TARP), which was designed to enable the U.S. Treasury to purchase preferred shares in healthy U.S. banks.<sup>15</sup>

While we at Fifth Third were initially relieved about our participation in the program, we soon learned TARP carried quite a stigma for the participating banks. It was common to hear the word “bailout” associated with the program.

Truth is, TARP was never a bailout. It was an investment made by the government in banks of all sizes to shore up their capital positions and encourage them to make loans to help spur the U.S. economy.<sup>16</sup>

Under TARP, the government invested \$245 billion in banks, and, as of September 2012, banks repaid the government \$267 billion through principal and interest.<sup>17</sup> That's a \$21 billion profit to taxpayers. Specifically, Fifth Third Bank paid back more than \$170 million per year—a total of \$346 million in preferred dividends.<sup>18</sup>

In theory, the concept of TARP was a good one—it was all about restoring confidence in the system. In reality, it became, as one of my colleagues deemed it, a scarlet letter.

Was TARP necessary? I could make arguments on both sides. When the

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12. FIN. CRISIS INQUIRY COMM'N, *supra* note 2, at 444-45.

13. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

14. *Id.* § 2.

15. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, tit. 1, § 101, 122 Stat. 3765 (2008).

16. *Why TARP Was Necessary*, U.S. DEP'T OF THE TREASURY, <http://www.treasury.gov/initiatives/financial-stability/about-tarp/Pages/Why-TARP-was-Necessary.aspx> (last visited Jan. 24, 2014).

17. AGENCY FIN. REPORT, DEP'T OF THE TREASURY, OFFICE OF FIN. STABILITY—TROUBLED ASSET RELIEF PROGRAM, at viii (2012), *available at* [http://www.treasury.gov/initiatives/financial-stability/reports/Documents/2012\\_OFS\\_AFR\\_Final\\_11-9-12.pdf](http://www.treasury.gov/initiatives/financial-stability/reports/Documents/2012_OFS_AFR_Final_11-9-12.pdf).

18. ANNUAL REPORT 2011, FIFTH THIRD BANKCORP 17 (2011), *available at* <http://ir.53.com/phoenix.zhtml?c=72735&p=quarterlyearnings>.

goal of legislation and government intervention is to protect consumers or achieve a shared goal, we willingly accept certain limitations on our business model. However, there are situations when legislation is specifically designed to hamper efforts to provide the best service to our customers or in delivering value to our shareholders.

So how did Fifth Third survive the meltdown? I believe it's because we reacted quickly and decisively—well ahead of our peers. In the beginning we took some heat for those actions. We raised more than a billion dollars of capital. We sold non-core assets and cut our dividends. We refined our credit and oversight practices. We took these actions certainly not because they were the easy or popular things to do—far from it. We took these actions because they were the right things to do. And, as I said during the height of the crisis and I continued to say years later, making the decisions we did made Fifth Third a better, stronger, and smarter bank. And now we are seeing the financial benefits of those decisions.

In 2012, Fifth Third's net income was \$1.6 billion, the second highest in the company's 155-year history. And earnings per share were up forty-one percent. The operating environment continues to be challenging, but if 2012 is any indication, there are many better days ahead.

As I wrap up my remarks, I would like to say in closing that the financial crisis of 2008 and 2009 was without a doubt the most challenging time in my career, and I hope, my lifetime. As hard as it was though, I am deeply proud of the outcome. We're looking forward to a bright future.