TESTIMONY OF
ORIM GRAVES, CFA
EXECUTIVE DIRECTOR,
NATIONAL ASSOCIATION OF SECURITIES PROFESSIONALS

BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEES ON OVERSIGHT AND INVESTIGATIONS AND
HOUSING AND COMMUNITY OPPORTUNITY

"MINORITIES AND WOMEN IN FINANCIAL REGULATORY REFORM: THE NEED FOR INCREASING PARTICIPATION AND OPPORTUNITIES FOR QUALIFIED PERSONS AND BUSINESSES"

MAY 12, 2010

Good Afternoon Chairwoman Waters, Chairman Moore, Ranking Member Capito, Ranking Member Biggert and Members of the Subcommittees;

I appreciate the invitation to appear before you today representing the National Association of Securities Professionals or NASP. My name is Orim Graves and my career has spanned more than two decades in the financial services industry before becoming the Executive Director of NASP. Prior to joining NASP, I was a commercial banker servicing Wall Street, a fixed-income trader, a high yield analyst, a chief investment officer for a major municipal pension plan, portfolio strategist and an investment consultant to municipal, Taft-Hartley, corporate, and endowment pools of capital or pension plans.

BACKGROUND & HISTORY OF NASP

The National Association of Securities Professionals (NASP), representing more than 100 firms, is the premier trade organization supporting minorities and women in leveling the playing field in the financial services industry. We connect members to industry leaders and business opportunities; advocate for policies that create equal representation and inclusion; provide educational opportunities; and work to build awareness about the value of ensuring that people of color and women are included in all aspects of the financial services industry. Founded in 1985, NASP is based in Washington, D.C. with 10 chapters in major financial centers throughout the United States. Our members include asset managers, broker-dealers, pension fund consultants, public finance professionals, investment bankers, securities/bond counsel, commercial bank underwriters, institutional investors, pension and endowment plan sponsors and other professionals in the financial services industry.

NASP has been asked to testify today about the representation of minorities and women in the financial services industry, the ability of minority- and women-owned businesses (MWOB) to access government contracting opportunities in the areas of housing and financial services and the extent to which minority- and women-owned businesses obtain capital and credit. Specifically, we have been asked to respond to a series of questions as follows;

How would you describe the level of access of minority and women securities professionals to contracting and professional development opportunities with the federal government?

In the past three years, unprecedented events have reshaped the financial services industry. During this economic upheaval, it has been widely reported that the United States Government implemented over $12.6 trillion of direct financial intervention into our economy. This massive mobilization of taxpayer funds required the rapid hiring of numerous government contractors by the Treasury Department, the FDIC and the Federal Reserve Bank of New York to name a few. In the early days of the crisis, lawyers, accountants, consultants and asset managers were hired with an extremely limited RFP process, in some instances using expedited contracting or no process at all. The RFPs that were widely circulated had barriers to inclusion for minority- and women-owned firms that were arbitrary and capricious. For example, the initial RFPs for the Legacy Securities and Legacy Whole Loan Programs of the Treasury Department required minimum assets under management of $100 billion and $25 billion respectively. The initial RFP for the Public Private Investment Program or "PPIP" likewise contained a minimum $10 billion dollars in eligible assets under management and a demonstrated capacity to raise at least $500 million. Despite Section 107b of the Emergency Economic Stabilization Act of 2008, minorities and women and entities owned by them were NOT included to the "maximum extent practicable."

These requirements falsely presuppose that large is equated with best and as a result, opportunities to work with many of the best and the brightest entrepreneurs and professionals in the financial services industry were and are missed. The resulting absence of diversity in service providers creates a glaring lack of diverse ideas, leading to concentration of risk in alarming proportions, particularly considering some of the same firms who contributed to the crisis were allowed to bid on opportunities for efforts to stabilize the economy.

Another example of the lack of access to contracting opportunities with the Federal government in financial services was the $1.2 trillion agency mortgage backed security (MBS) purchase program undertaken by the Federal Reserve. In this instance, four firms were selected to manage the mortgage backed securities assets in a closed RFP process. NASP compared minority- and women-owned MBS money managers' aggregate performance in one, three, and five years to the larger majority firms selected. The minority firms performed better than three of the four firms selected according to third party independent performance evaluations. These firms have been managing mortgage backed securities and other fixed income instruments for public and corporate pension plans, foundations and endowments for ten years or more in some instances. Their assets under management range from $100 million to more than $20 billion. It should also be noted that many of the principals at minority-owned firms spent much of their professional development in large majority firms. Once again, the federal government's failure to solicit the entire universe of qualified financial services firms resulted in sub-optimal solutions for the American taxpayer. Lastly, the most egregious example of a large contract awarded without an RFP process is Blackrock's management of the $165 billion Maiden Lane funds on behalf of the Federal Reserve Bank of New York. The Wall Street Journal reported that Blackrock earned $71 million in one year as their asset management fee for this assignment. Today the crisis has subsided yet Blackrock still manages these assets. Numerous qualified minority firms have repeatedly requested an opportunity to compete for this business through an open RFP process. While we understand the expediency of Blackrock's initial appointment two years ago, NASP feels that the Federal Reserve Bank of New York can now afford the time necessary to carefully consider a wider universe of qualified candidates, including women- and minority-owned firms through an open RFP process.

OTHER FEDERAL RESERVE PROGRAMS

The Federal Reserve began several programs to provide liquidity to markets in late 2008 and early 2009. Two examples of these programs include: the aforementioned MBS purchase program, wherein the Federal Reserve purchased $1.2 trillion dollars of Fannie Mae and Freddie Mac mortgage-backed securities; and the Term Asset-Backed Loan Facility (TALF), which provided purchasers of asset-backed securities access to Federal Reserve funds for the purpose of making such purchases. In both instances, qualified minority- and women-owned broker-dealers were excluded from the process, despite their experience in this field. The MBS purchase program required broker-dealers to purchase MBS and deliver them to the Federal Reserve's custodian. Many minority- and women-owned broker-dealers provide this service daily to their own clients. Despite the Federal Reserve Bank's awareness of this opportunity to include more, qualified broker-dealers, MWOB broker-dealers were still excluded.

Though three MWOB broker-dealers were eventually admitted into the Term Asset-Backed Loan Facilities (TALF) program, the program's design prevented their meaningful participation. One barrier was the requirement that MWOB firms guarantee the loans of their substantially larger clients. It is therefore upsetting, but not surprising that of the many minority firms allowed into the program, none of them completed a single transaction as a TALF agent before the program ended in March of 2010.

Section 116H of the Emergency Economic Stabilization Act of 2008 directs the Comptroller General to report to Congress the total dollars spent with all contractors as well as the amount spent solely with minority- and women-owned firms. **To our knowledge, such a report has never been received by Congress.** Likewise, Section 1116 of the Housing and Economic Recovery Act of 2008 requires regular reporting of the dollar amounts paid to minority- and women- owned firms juxtaposed against payments made to all firms for contract services. Despite the prudence of complying with Congressional directives, Fannie Mae, Freddie Mac and The Federal Home Loan Banks have similarly not reported their contractual relationships with minority- and women-owned firms.

How would you describe the level of professional development opportunities afforded to women and minorities within financial services firms?

Women and minorities face many barriers to professional development in the financial services industry. They are seldom invited to join boards, and other professional or even informal networking organizations. This prevents them from developing relationships with influential decision makers. It prevents them from bringing in as many clients as their non-minority peers. It prevents them from fully realizing their potential in the industry. Though they do not enjoy equal access to business networking organizations, surely minorities and women deserve equal access to their government's financial services.

Many of these firms are qualified and eager for a chance to prove their abilities but they are excluded from deal flow, access to capital and investment assets. This is why access to these government programs is vital. Without the opportunity to exhibit their talent, MWOBs, and women and minorities, cannot progress America's financial industry.

I will now turn my remarks towards the lack or minimum levels of participation of minority- and women-owned firms in the area of asset sales. The transfer of hundreds of billions of dollars in assets through the FDIC's receivership and structured asset sales is a historic opportunity for the federal government to encourage the participation of small, women- and minority-owned investors. Inclusive policies for these programs should be adopted by the FDIC considering its use of debt is backed by the "full faith and credit of the United States". While the FDIC does not receive taxpayers' dollars directly, the Agency's ability to resolve failed banks depends on taxpayers who are ultimately financially responsible for the FDIC. The Agency's operations should fulfill public policies beyond insuring the nation's banking deposits. They should reflect the values of the people who hold the ultimate financial responsibility for its actions. Moreover, it is absolutely vital for the future economic and political stability of our nation that the investment decisions are made by a more diverse group than the one that created the economic crisis today and in the 1980s.

FDIC CAPITAL ASSISTANCE TO MINORITY INSTITUTIONS SEEKING TO ACQUIRE FAILED BANKS

The first opportunity for the FDIC to encourage the utilization of minority investors is receivership where the agency holds a competitive process for financial institutions to acquire the assets and deposits of failed commercial banks. To date, the FDIC has encouraged minority-owned institutions to acquire failing banks. Asian-owned Mutual Bank in Harvey, IL failed in July 2009 and was acquired by Asian-owned United Central Bank in Garland, TX. African-American-owned Gateway Bank in St. Louis failed in November 2009 and was acquired by woman-owned Central Bank of Kansas City, MO. Legislation passed during the S&L crisis (1441a (u)) provided minority-owned businesses with a substantial competitive advantage by offering interim financing for up to two years at the agency's average cost of funds. The legislation only permitted such assistance when the agency had not received acceptable bids so the FDIC followed its legal mandate to pursue "least cost resolution." Of the 140 institutions that failed in 2009, only 90 were resolved as loss-share transactions where an acquiring bank purchased and assumed the entire institution. In many of the remaining cases, the FDIC had to create a bridge bank to operate the institution or directly paid off depositors. Instead, the FDIC could likely resolve these failed banks at a lower cost by encouraging minority-owned banks to use the federal capital assistance permitted under the statute. Since financial institutions can jointly bid for failed institutions with non-bank investors, this legislation could also benefit non-bank minority investors as well.

IMPROVED FDIC BIDDING INSTRUCTIONS

While the FDIC has changed its bidding instructions to include a questionnaire asking investors to voluntarily describe their race and gender, the language in the form naturally leads investors to question the FDIC's commitment to minority investors. Not only is the form optional, but the FDIC in bold print announces that minority status "will not affect the scoring of the application." The FDIC should include clear and affirmative language in all of its communications that the encouragement of minority-owned investors is a priority for the agency and will be among the non-price or best value considerations in determining bidder eligibility. A strong signal from the FDIC will encourage joint ventures between minority-owned investors and other firms. Joint ventures are a key to ensuring that a sufficient number of minority-owned investors participate in the FDIC's process and ultimately secure a proportionate share of the FDIC's assets.

CREATION OF AN FDIC BIDDERS' PREMIUM

One effective way to create incentives for majority-owned firms to partner with MWBEs would be to add a “bidders' premium" to bids which are submitted by (i) MWBE bidders or (ii) bids submitted by “combined groups” which consist of majority and MWBE owned bidders. The “bidders' premium” would be relatively small (say, 2 to 4%), and would be added to these bids solely to select the highest bidder. The bidders' premium would not affect the actual amount paid for the loan pool. For example, if there were two bidders for a pool of mortgage loans and Bidder A was a majority-owned investor which submitted a bid of $100 and Bidder B was a combined majority/MWBE-owned investor which submitted a bid of $100; a bidders' premium of 2% would then be added to Bidder B's bid to increase it to $102. While Bidder B would be deemed to have submitted the highest bid, the actual monetary price to be paid by Bidder B for the pool will be the original $100 bid amount submitted by Bidder B.

RESERVATION OF FDIC EQUITY INTEREST FOR MINORITY-OWNED INVESTORS

Typically acquiring banks assume only a portion of the failed banks' assets leaving the unwanted assets with the FDIC. In the case of the December 2009 failure of Amtrust, New York Community Bank acquired only $9 billion of the $12 billion in assets in the bank. The remaining assets were predominately troubled real estate loans and are currently being sold to investors in a structured asset sale. In these sales, the FDIC provides 50% financing at 0% interest for up to nine years to encourage investors to acquire the loans, foreclose and acquire the properties directly, then hold them until the real estate market recovers. The ownership of the portfolio is split 40% to the private investor who manages the portfolio and 60% to the FDIC with an equivalent share of future profits. Structured asset sales are competitively bid with large institutional investors undertaking extensive and expensive due diligence prior to bidding. The primary factor in selecting winners is purchase price. The FDIC can adjust the amount of retained ownership and could reserve a 5 to 10% equity interest that would be sold to qualified minority investors. Minority investors would benefit from the attractive leverage provided by the FDIC and the least cost resolution issue can be addressed by selling its interest to minority investors at the same price paid at the initial auction. Structured asset sales are performed under an LLC agreement proposed by the FDIC which bidders must be agreed to in whole. The FDIC has extensive oversight and asset management functions which flow to minority-owned investors who purchase a portion of the FDIC's interest. This would especially benefit those minority-owned investors. They would gain valuable experience and eventually create a new generation and pool of potential market participants.

RESERVATION OF SECURITIZED FDIC EQUITY INTERESTS FOR MINORITY-OWNED INVESTORS

A final opportunity for the FDIC to encourage minority investors comes from the securitization of the FDIC's equity interests. By pooling equity interests from multiple structured sales, the FDIC can create a diversified and attractive passive investment where investors receive cash flows from a number of the FDIC's asset sales. This investment would be more passive than the previous opportunities but because its diversification would be an attractive investment for public plans seeking to fulfill their minority manager requirements. Once again, the FDIC could avoid the least cost resolution issue by holding two auction rounds. A first round, open to all investors where the price would be established and a second round, only open to minority investors, where a material (5 to10%) portion of the securities would be sold at the established price.

While there has been access granted to minority- and women- owned businesses in government programs such as PPIP, CPP and the TALF, minority- and women- owned firm participation has been minimal with respect to the total dollars generated from these programs. Moreover, their precarious success is due to the efforts of a few dedicated individuals. NASP would like to thank Gary Grippo at the Treasury, and Sandra Thompson, David McDermott and Mickey Collins at the FDIC who have championed the participation of minorities and women within their respective agencies. In appreciating the efforts of these dedicated individuals, we must all face the reality that programs where limited success hinges on a few people soon wither. NASP seeks more substantial, long-term policies to include minority- and women-owned firms in the nation's financial services.

Can NASP please comment on the provision within H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009, which would establish Offices of Minority and Women Inclusion at each to the major federal financial regulatory agencies?

With respect to H.R. 4173, Section 1801, Inclusion of Minorities, Women, and Diversity, we fully agree with and support the goals and intent of including this Section. This Section provides for an office of minority and women inclusion in each agency covered by H.R. 4173 which we believe will be helpful in broadening and monitoring the affirmative steps taken by various federal agencies to expand the inclusion of minority- and women-owned business in their business and contracting activities. Equally important are the new legislation's requirements that 1) the contracting review and proposal process includes a component that considers and weighs the diversity of the proposed agency contractor or vendor firm; and 2) each agency contractor provide a written assurance or certification that such agency vendor shall ensure, to the maximum extent possible, the inclusion of minorities and women in its workforce and its contractors.

In addition, we believe that the effectiveness and impact of this Section could also be significantly increased through directly tying the agency inclusion efforts and results to the performance measurement and compensation practices of each agency regarding its agency head and senior management. In prior written and oral testimony, our association has suggested this approach with respect to the private sector, and we believe such an incentive mechanism would materially encourage greater inclusion of minorities and women in contracting participation and the agency workforce.

There are three primary "key success drivers" in attracting and retaining a more diverse workforce: (1) workforce diversity efforts require a long-term, sustained commitment to be successful; (2) workforce diversity initiatives require a C-Level Executive commitment; and (3) workforce diversity efforts in recruiting and retention-which go hand in hand-should begin very early in an investment professional's career and be consistently supported and maintained by such professional's employing firm or company. Linked to various of these "key success drivers" are ten central best practices, including (i) development of a multi-year plan, (ii) long/short term measuring of success and progress made, (iii) tying workforce diversity goals to executive and managerial compensation, (iv) establishing mentor programs led by C-Level Executive participation, (v) providing ongoing internal training and position/career development opportunities that correspond to increasing business or position demands, and (vi) leverage the expertise of outside organizations, such as NASP which can help with recruitment of qualified minority and women professionals at all career levels. While investment firms surveyed have increased general accountability of managers for diversity performance and results by measuring managerial performance through both performance reviews and management-by-objectives, the majority of investment firms report that they still do not offer financial rewards for or tie compensation or monetary incentives to diversity performance at the managerial or executive levels. Investment firms and companies that do not in some way measure their managers' diversity performance are 2 ½ to 6 times more likely to fall below the median for representation of minority and women professionals in their respective workforces.

It is also a reasonable implication that those investment firms that do in fact measure and periodically assess their managers' and executives' diversity performance but do not tie-in or link compensation or other financial incentives to such managerial diversity performance are still more likely than not to fall below median levels for representation of minority and women professionals in their respective workforces. In totality across the various diversity studies and reports from the GAO, the USI and SIFMA above, what we see from our industry vantage point is a disappointing, woefully incremental and unacceptable picture of diversity in the U.S. financial services industry.

We firmly believe that the best way to impact the disappointing and incremental diversity metrics and fundamentally change and accelerate industry diversity implementation is to do business with minorities and women wherever they are found, either within majority-owned firms or minority- or women-owned firms. There must be both external and internal economic incentives to positively impact workforce diversity. As an internal economic incentive to achieve meaningful workforce diversity within majority institutions, managerial diversity performance should be measured periodically and incentivized by being tied to compensation or other economic or financial reward.

General Recommendations

The provisions already adopted by Congress have the potential for spurring more inclusion of minorities and women; however, Congress's policies are being ignored by the agencies compelled to abide by them. The Treasury Department and the GSEs, for example are not reporting their contracting activity with MWOB firms despite their Congressional directive to do so. In addition to questions about the details of their activity, this raises questions about their willingness to abide by inclusive policies. While we feel that reporting requirements can serve as a powerful mechanism for encouraging inclusion, it is only effective if it is actually practiced. We would even suggest that all Federal Agencies should be compelled to report their activity with minority- and women-owned firms and for the heads of these agencies to certify the agency's compliance with inclusive initiatives.