

RELEASE IN PART B6

**From:** Gary Gensler [redacted]  
**Sent:** Friday, October 28, 2011 8:52 PM  
**To:** H  
**Subject:** Re: Europe

Hillary,

Im at [redacted]. I will send some further thoughts via e-mail tomorrow and am always available to speak.

Gary

-----Original message-----

**From:** H <HDR22@clintonemail.com>  
**To:** Gary Gensler [redacted]  
**Sent:** Sat, Oct 29, 2011 00:03:21 GMT+00:00  
**Subject:** Re: Europe

Dear Gary,

Thank you for your thoughtful memo which I shared w my staff. I'd be interested in knowing your views post the decisions made this week. All the best, H

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**From:** Gary Gensler [mailto:[redacted]]  
**Sent:** Monday, October 24, 2011 10:41 PM  
**To:** H  
**Subject:** Europe

Hillary,

I hope all is well with you and that your current overseas trip is successful.

I write on the current debt crisis enveloping Europe. Though I have every confidence that your staff, Treasury and others in the Administration have kept you well briefed, as a friend and former advisor I share some thoughts and am available if you wish.

In a nutshell, I believe that Europe's two critical challenges – that of the Euro and of excess debt - are not likely to be satisfactorily addressed by the upcoming European summit. Leaders may well have some success 'kicking the ball down the field' but negative market sentiment is likely to once again outpace political actors' ability to respond to deteriorating events. Furthermore, all of this is occurring in a slow growth environment, where-in Europe may have already dipped back into a recession.

The overriding structural issue of the Euro – a fundamental flaw of design – that of a currency union without a fiscal union or a true free flow of labor, is not readily solvable. European leaders, though now well aware of these structural issues, have not signaled any quick resolutions on this front. The leaders, even those who might wish to act in this regard, no doubt are constrained by public sentiment not yet readied for such dramatic steps towards integration.

The issue of excess debt – plagues both the sovereigns and the banks. This is both a liquidity problem – that of the market not being willing to fund – and a far more challenging structural problem. Unfortunately, though much is said of distinguishing liquidity and solvency issues, defaults and bankruptcies do not rely on such distinctions. Nearly every major collapse of a bank or sovereign has occurred when such bank or country loses access to funding. It's just the modern equivalent of the good citizens of Bedford Falls run on George Baily's Building and Loan in "It's a Wonderful Life."

Currently, the banks and sovereigns of Greece, Ireland and Portugal have been shut out of the private lending markets. Simply stated - they have no access to funding other than through official governmental sources. The same is coming close to reality for Spanish and Italian banks as they have largely been shut out of unsecured funding markets and barely have any access to international funding at this time. Spain and Italy have access to sovereign markets only given that the ECB is buying their debt in the secondary market. The five countries have different structural and competitive issues, but all are at serious risk.

Much has been written about the Greek and other sovereign debt problems and their knock-on effect on the European banks. I think, however, that a more proper diagnosis is that European banks are overly leveraged regardless of the sovereign problems. Europe's banks are far more leveraged (with nearly 24 euros of adjusted assets for each euro of capital) than US banks and far more reliant on short term wholesale funding. Europe's banks are also far greater as compared to their underlying economies (about 2 ½ to 3 euro of bank assets for every euro of GDP) than US banks. (less than 1 to 1\$ of GDP) This gives the governments less room to maneuver if and when government support is called upon. (So 'Too Big to Fail' changes to "Too Big to Save.")

It is quite discouraging, therefore, that European leaders are now only discussing capital infusions of approximately 100 billion euro for their banks. This represents only approximately a 10 % boost on the current capital base of 1.1 trillion Euro. (On at least 24 trillion in adjusted assets.) The IMF estimated 200 billion earlier last month and many Wall Street estimates are closer to 250 to 350 billion of needs. Even these figures might not do the trick long term. The markets have recent reasons to discredit European Banking regulators' stress tests and oversight. The recent collapse Dexia Bank (600 billion Euro assets), came just months after it had passed Europe's stress tests this summer.

With only France and Germany amongst the large countries standing with AAA government bond ratings, all eyes rest on them. Unfortunately, given France's own structural issues, (debt/GDP of 83% and a banking system of nearly 3 times their GDP) it is prone to losing its AAA rating. The 3 largest French banks alone (BNP Paribas, Societe Generale, & Credit Agricole) are leveraged on average 27 times their tangible equity and have combined assets twice the size of the French economy. Most market participants also believe that the French banks have significant mark-to-market losses on their exposures to sovereign debt. All of this may help explain Sarkozy's public desire to have bank recapitalizations come from the ECB or ESFS rather than from the country itself.

Which brings us to some of the possible solutions being debated amongst Europe's leaders. The drill in such situations is all too familiar. Everyone attests to wanting to do the ri