

**1. Too much liquidity chasing higher returns (John)**

- Money flowing into the system
- Caused “irrational” behavior
- Cheap money – huge bets and new higher levels of risk taking
- Interest rates (particularly long-term)

**2. Great Moderation (Doug)**

- Failure of pricing risk
- Greenspan put
- The ultimate moral hazard
- Contributed to regulatory environment
- Bad business cycles became a distant memory

**3. Why were warning signals ignored? (Bob)**

- No entities focusing on signals (not rating agencies)
- Key players want to ignore

- Early warning entities not capable (accounting, profession, rating agencies...)
- Example of signal: FBI warning in 2004

#### **4. Failure of corporate financial risk management and governance in the financial sector (John)**

- Outsized compensation packages – tied to equity markets that were soaring
- Outdated models with new risk
- Long-term consequences not collaborated to short-term risks

#### **5. Loss of consequences for behavior (Byron)**

- Lack of capital
- No “skin in the game”
- Individuals borrowed too much

#### **6. Leverage (Heather)**

- At every level: household, corporate, systemic

#### **7. Hyper-sensitive short-term liquidity model (Keith)**

**8. Housing and commercial real estate bubble (Doug)**

- Should check other assets to see if there is parallel behavior

**9. Housing (Bill)**

- Broadly defined
- Explosion of subprime lending
  - Including predatory lending and fraud

**10. GSEs (Keith)**

**11. Failure of regulation/regulatory reform (Brooksley)**

- Government failed to prevent excesses
- Failure to regulate derivatives and other products
- Failure to regulate shadow banking/markets
- Regulations were insufficient
- Ineffective oversight of markets and institutions

	<u>Markets</u>	<u>Products</u>	<u>Institutions</u>
Regulations	X	X	X
Implementation	X	X	X

- E.g. Glass-Steagall
- Regulatory arbitrage

## **12. Mark-to-Market Accounting (Peter)**

- Writing down mortgage-related assets to current market prices made institutions appear weak
- Spreads the mortgage crisis

## **13. Over-the-Counter derivatives (Brooksley)**

- Lack of federal regulations
- Role of CDS with respect to securitization (by AIG and others on AAA tranches)
- Use in synthetic CDOs
  - Including CDS
- Equally relevant: role of OTC derivatives (millions of contracts with trillions national value)
  - Counterparty risk

- Leverage
- Lack of transparency
- Added to panic and freezing of markets

#### **14. Complex and exotic products (Phil)**

- In housing
- In financial markets
- Opacity and leverage
- Betting and amplification

#### **15. Rating Agencies (Bill)**

- Gatekeepers
- How did this system evolve?

#### **16. Transparency (Peter)**

#### **17. Too big to fail and lack of resolution authority (Keith)**

- Policy makers believed they had to step in
- Moral hazard
- System not robust

## **18. Effectiveness of policy in face of globalization of financial system (Bob)**

- Large international institutions in certain countries buying toxic vs. assets
- International regulatory arbitrage
- Coordination of global financial policy
- International contagion
- Global financial markets
- Comparative analysis

## **19. Scale, size and power of financial sector (Phil)**

- By force and design?
- Outsized effect of financial crisis on economy
- Stop things? Make things happen? Change over time?
- Not a monolith
- Influence of GSEs
- Influence of biggest i-banks and biggest BHCs
  - Look at pivot points

