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)
1. **Great Moderation** (Doug)
* Failure of pricing risk
* Greenspan put
* The ultimate moral hazard
* Contributed to regulatory environment
* Bad business cycles became a distant memory
1. **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
1. **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* Outdated models with new risk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
1. **Loss of consequences for behavior** (Byron)
* Lack of capital
* No “skin in the game”
* Individuals borrowed too much
1. **Leverage** (Heather)
* At every level: household, corporate, systemic
1. **Hyper-sensitive short-term liquidity model** (Keith)
2. **Housing and commercial real estate bubble** (Doug)
* Should check other assets to see if there is parallel behavior
1. **Housing** (Bill)
* Broadly defined
* Explosion of subprime lending
	+ Including predatory lending and fraud
1. **GSEs** (Keith)
2. **Failure of regulation/regulatory reform** (Brooksley)
* Government failed to prevent excesses
* Failure to regulate derivates and other products
* Failure to regulate shadow banking/markets
* Regulations were insufficient
* Ineffective oversight of markets and institutions

|  |  |  |  |
| --- | --- | --- | --- |
|  | Markets | Products | Institutions |
| Regulations | X | X | X |
| Implementation | X | X | X |

* E.g. Glass-Steagall
* Regulatory arbitrage
1. **Mark-to-Market Accounting** (Peter)
* Writing down mortgage–related assets to current market prices made institutions appear weak
* Spreads the mortgage crisis
1. **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
1. **Complex and exotic products** (Phil)
* In housing
* In financial markets
* Opacity and leverage
* Betting and amplification
1. **Rating Agencies** (Bill)
* Gatekeepers
* How did this system evolve?
1. **Transparency** (Peter)
2. **Too big to fail and lack of resolution authority** (Keith)
* Policy makers believed they had to step in
* Moral hazard
* System not robust
1. **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
1. **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