AAA-rated securities, 85
AAA-rated tranches, 21, 59
AAA tranche pricing, 22
Abbey National, 331
ABCP conduits. See asset-backed commercial paper (ABCP) conduits
ABX index, 234
accurate prices, 26
action plan for mortgages and households, 344–348
fiscal and accounting framework creation, 345–346
legal obstacles posed by securitization, 347–348
simplify secondary default, 348
terms of debt-for-equity swaps, 345–346
viability of debt-for-equity swaps demonstration, 346–347
adjustable rate mortgages (ARMs), 15, 57
adjusted mark-to-market values, 217
adverse feedback effects and systemic risk, 226
aftermath of the financial crisis, 357–178
group risk. See also systemic risk component of transfer vehicles, 86
exposure and effective leverage, 84
vs. institution-level risk, 29
vs. specific risk, 296
aggregate risk charges, 98
aggregate risk contribution, 98
allocation of real resources, 1
Alt-A mortgages, 8, 62, 77
Altman, Edward, 58
Altman Z-Score model, 358–359
Ambac, 88
A.M. Best, 103
American International Group (AIG)
AIG Financial Products, 200
bailout of, 6, 10, 241
CDS spreads, 237
counterparty credit risk concerns, 230
credit default swaps (CDSs) premiums, 240
credit rating, 258
derivatives positions of, 236
downgrading of, 112
Federal Reserve Board (Fed) handling of, 319
governance and compensation, 201, 202
rescue packages, 327
systemic risk in the current crisis, 299–300
taxpayer guarantees, 198
amortized cost accounting, 218–219
Asian crisis, 372
Asset-Backed Alert, 58
asset-backed commercial paper (ABCP), 4, 90, 267, 337
asset-backed commercial paper (ABCP) conduits, 23, 86–94. See also
off-balance-sheet asset-backed commercial paper (ABCP) conduits
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), 36
asset-backed conduits, off balance sheet assets in, 27
asset-backed securities (ABSs), 2, 57, 58
asset-backed securities’ exposure concentrations, 97
asymmetric bets, 300n6
in real estate markets, 21
risky, 23, 34, 73
securitization and, 205
average debt-to-income ratio of households, 66
Bagehot, Walter, 306–308
bailout guarantees, broadening of, 146–147
bailout insurance, 35
INDEX

bailout limits, 46, 353–362
about, 353–354
debtor-in-possession financing, 355–356
proper use of chapter 11, 354–355
proposed solution for automakers, 356–361
bailouts
about, 323–325
appeals for, 272
costs of, 300n5
of financial sector, 327–339
to non-financial sector, 45
overview of the since September 2008, 40
United States vs. United Kingdom terms, 367
bailout stages, 41
balance sheets, recourse to, 87
balloon payments, 2
bank balance sheets
conduit access to, 92
full recourse to, 91
and risk-weighted assets, 94–98
bank equity price change and exposure to
ABCP conduits, 94
Bank for International Settlements (BIS), 50,
374
Banking Act of 1933. See Glass-Steagall Act
banklike runs, 173–175
Bank of America, 93, 97
canceled line of credit to Republic
Windows and Doors, 320n3
conduit organizations, 357
purchase of Countrywide, 8, 67
purchase of Merrill Lynch, 6, 8
recapitalization, 335
Bank of England, 48, 148, 227n4, 305, 308
Bank of New York, 305
Bank of New York Mellon, 335
Bank of Scotland (BOS), 91, 92
bank recapitalization, 327
bank regulation tiering, 338
bank runs, 10, 98, 170, 301n19, 307
bankruptcy. See also Chapter 11 of the
Bankruptcy Code
bankruptcy-remote companies, 87
debtor-in-possession (DIP) loan to GM,
56n5
of Enron, 103
of Lehman Brothers, 5, 6, 90, 165, 241,
257, 283
in market economy, 24
of Ownit Mortgage Solutions, 2
resulting from subprime mortgages, 2
banks
asset types, 21
equity stake in, 327
hoarding of liquidity by, 10
loan quality, impact to, 73
loans into investments, 83
NRSRO obligations of, 105
banks, leveraging, 83–99
asset-backed commercial paper conduits,
86–94
bank balance sheets and risk-weighted
assets, 94–98
credit risk transfer and bank leverage,
84–86
ways to counter regulatory arbitrage and
aggregate risk shifting, 98–99
banks and financial institutions, risk-taking
incentives at, 26
bank stock performance and regulatory
leverage, 96
Barclays, 93, 331, 333–334, 336, 337
barriers to entry in credit rating business, 103
Basel Accord of 1988, 373
Basel capital requirements
gaming of, 97
regulatory failure in, 98
Basel I capital regulation, 89, 95
Basel II, 50
Basel II capital regulation, 89, 95
Basel III approach to systemic risk, 35
Basel III capital requirements style, 292–293
basis spread points, 21
bear raid, 272
Bear Stearns, 327
actions prior to failure of, 2–3
bailout, 256–257
CDS spreads of, 241
collapse of, 36, 167
credit default swaps (CDSs) premiums,
240
failure of, 230
Federal Reserve Bank of New York loans
to, 42
governance and compensation, 201
hedge funds managed by, 2
JPMorgan Chase purchase of, 5, 297
Index

rescue of, 5
systemic risk in the current crisis, 297–298
systemic risk of, 285
wholesale runs on, 28
beneficiaries from short sales, 270–271
benefits
of centralized clearing, 258–259
of credit derivatives market and the financial crisis, 238–240
of derivatives, 233–235
Bernanke, Ben, 280
big balance sheet business model, 143–145
BNP Paribas, 4, 89, 182
boards, 26
Boeing, 308, 310–311
bond spreads, 12
bonus/malus approach to compensation, 30, 211–212
breaking the buck, 9, 299
Bretton Woods conference, 371
British banks, 333, 367
British recapitalization scheme, 336, 337
Brown, Gordon, 373
bubble prices, 222–223, 227n4
Buffett, Warren, 211
Bundesbank, 305
business model of securitization, failure to follow, 71
business models, alternative, 110–111
capital erosion, 242
capital gains tax, 346
capital injection scheme, 335–337
capital insurance scheme, 296
capital issuance and losses incurred by all financial firms, 308
capital-light, liquidity enhancement as, 85
Capital Markets Safety Board (CMSB), 175
capital requirements, 89
car czar, 361
car loans, 58
carry trade, 3–4, 167–168
Case-Shiller house price index, 66
cash settlement vs. physical settlement, 255–256
Cassano, Joseph, 200
CDS (credit default swaps). See credit default swaps (CDSs)
CDX contracts, 292
central bank lending facilities, 309, 319–320
central banks, 305
duties of, 307
proposed role and actions of, 50
vs. shadow banks, 7–8
centralized clearing for credit derivatives, 251–260
about, 251–252
benefits of centralized clearing, 258–259
clearinghouse, 261
desirable levels of transparency, 264–266
exchange, 261
implications for other markets, 267–268
OTC credit derivatives, 252–254
possible solutions and relative merits, 259–264
recent proposals and prognosis, 266–267
registry, 259, 261
weaknesses in the CDS trading infrastructure, 254–258
centralized clearinghouse, 231
regulation of derivatives suggestions, 244–245
centralized clearing mechanism for collateralized debt obligations (CDOs), 31
centralized counterparties trading for credit default swap (CDS) market, 31
centralized counterparty risk, 261
centralized registry, 244
centralized trading, 266
CEO compensation
in the financial, insurance, and real estate sectors, 208
and optimal investment policy, 193–194
CEO wealth across sectors, 207
and changes in shareholder value, 210
defined, 206–207
certificates of deposit (CDs), 36
Chapter 11 of the Bankruptcy Code, 46, 325, 354–355
Chapter 22, 362n5
cheap loans, 58
Chicago Board of Trade (CBOT), 234
| Chicago Mercantile Exchange (CME), 235, 266 |
| China, 368, 373 |
| choice, 75 |
| Chrysler, 355 |
| Circuit City, 356 |
| Citadel (hedge fund), 266 |
| Coitigroup, 93, 200 |
| bailout of, 241, 329 |
| conduit organizations, 357 |
| credit default swaps (CDSs) premiums, 240 |
| loan restructuring, 349 |
| recapitalization, 336 |
| rescue packages, 327 |
| clawbacks of bonuses, 211 |
| clearinghouse, 261 |
| Collateralized Debt Obligation issuance, 238 |
| collateralized debt obligations (CDOs), 2, 62, 267 |
| AAA-rated tranches of, 59 |
| centralized clearing mechanism for, 31 |
| in credit crisis, 237 |
| issuers of, 68 |
| mortgage market size, 128 |
| problems with, 242 |
| risk of, 254 |
| collateralized loan obligations (CLOs) |
| AAA-rated tranches of, 59 |
| centralized clearing mechanism for, 31 |
| collateralized mortgage obligation (CMO) issuance, 133 |
| collateralized mortgage obligations (CMOs), 62 |
| collateral requirements, 263 |
| combined loan-to-value (CLTV) ratio, 64 |
| commercial banks, 369 |
| commercial mortgage-backed securities (CMBSs), 237 |
| Commercial Paper Funding Facility (CPFF), 328, 337–338 |
| creation of, 36 |
| Federal Reserve Board (Fed), 327 |
| commodities, 234 |
| commodity, defined, 247–248 |
| Commodity Exchange Act (CEA) of 1936, 247 |
| Commodity Futures Modernization Act of 2000 (CFMA), 236, 248 |
| Commodity Futures Trading Commission (CFTC), 247–248 |
| derivatives regulation, 236 |
| regulatory jurisdiction, 267 |
| and Securities and Exchange Commission (SEC), 248 |
| compensating high-performance employees in banking and finance, 203–206 |
| compensation |
| bonus/malus approach to, 30 |
| long-term contracts for, 187 |
| total value maximization principle, 193 |
| compensation at financial firms, 197–214 |
| about, 197–198 |
| CEO compensation and optimal investment policy, 193–194 |
| compensating high-performance employees in banking and finance, 203–206 |
| compensation of traders and perverse incentives, 194–195 |
| corporate governance in the modern financial sector, 193–196 |
| financial services sector vs. others, 206–210 |
| misaligned approaches, 198–201 |
| proposals, 195–196 |
| seeking change, 210–213 |
| senior management compensation, 201–203 |
| compensation caps, fixed, 202 |
| compensation conflicts, 23 |
| compensation in the financial, insurance, and real estate sector, 209 |
| compensation of traders and perverse incentives, 194–195 |
| compensation packages |
| code of best practices for, 33 |
| design of, 181 |
| disclosure of, 30 |
| improvements to, 30 |
| short-term, 26 |
| compensation preferences, short-termism in, 204 |
| compensation structure, 187 |
| competitive rating structure vs. monopoly rating structure, 107 |
| component (ES), 289 |
| component value at risk (VaR), 289 |
| compound options modeling, 106 |
Index

concentration risk, 291

collections
  hedge funds, 175
  lender of last resort (LOLR) facilities, 112–113
  proposed solution for automakers, 361
  rating agencies, 112–113
  short selling, 274–275
  conditionality, 367
  conditional lines of credit, 306
  conduit administrators, 93
  conduit market, 4
  conduit organizations, 357
  conduits
    access to bank balance sheet recourse, 92
    CP/equity ratio of, 94
    creation of, 89
conforming loans, 61
Constitutional stipulation, 348
consumer protection, 76–77
contingent capital, 296
contract netting, 261–262
convoy approach, 181
coordination complications among national regulators, 48
coordination vs. centralization, 373–374

corporate bond delinquencies, 58

corporate governance
  governance failure, 190–193
  at large, complex financial institutions (LCFIs), 188–190

corporate governance in the modern financial sector, 185–196
  about, 185–188
  compensation at financial firms, 193–196
  governance failure, 190–193
  at large, complex financial institutions (LCFIs), 188–190

corporate sector, working capital requirements of, 11

correlated risks, 265
correlated trades by hedge funds, 170
costs
  credit derivatives market and the financial crisis, 241–242
  of derivatives, 235–236
Countrywide Bank of America purchase of, 8, 67
loan restructuring, 349
write-downs, 70
covenant-lite corporate loans, 58
covenant-lite leveraged loans, 19
credit boom, 2, 12
credit bubble, 280
credit card debt, 58
credit crunch, 222–226
credit default swap (CDS) market, 6, 31
credit default swaps (CDSs), 19, 331
  described, 236
  information telegraphed by, 239
  market operations of, 253
  net notional values, 265
  notional amount of outstanding, 237
  premium level as credit rating, 240
  premiums and ratings of financial institutions, 240
  risk of, 254
  weaknesses in trading infrastructure, 254–258
credit default swaps (CDSs) spreads, 254, 257
five-year senior unsecured, 286
credit derivatives market and the financial crisis, 236–242
  benefits of, 238–240
  costs, 241–242
  of derivatives, 236–242
credit enhancement, 83, 89
credit instruments restructuring, 3
credit insurance, 87
Credit Lyonnais, 372
credit rating agencies. See rating agencies
Credit Rating Agency Reform Act (CRARA), 103, 109
credit record, 80
credit risk, failure to transfer, 24
credit risk indicators, 254
credit risk sharing, 28
credit risk transfer
  and bank leverage, 84–86
  in mortgage markets, 21
credit risk transfer mechanisms, 83, 84
credit score (FICO), 61, 62, 64
credit swap premium, 236
crisis timeline, 51–56
criticisms of fair value accounting, 222–226
cyclical risk taking, 291
Dallas, TX, 66
deadweight costs of foreclosure, 76
debt and regulatory governance, 192–193
debt-for-equity swaps, 342, 343
debt leverage ratios, 19
debtor-in-possession (DIP) lender of last resort, 356
debtor-in-possession (DIP) loan, 56n5
debtor-in-possession (DIP) market, 46, 325, 354
debtor-in-possession financing, 355–356
de facto on-balance sheet vehicles, 8
defaults, 14. See also secondary default
credit record of, 80 and loan originator incentives, 70
occurrences of, 290
reasons for, 81
deferred compensation, preferential tax
treatment for, 195, 196
de jure off-balance sheet vehicles, 8
delinquencies, 67
Delphi, 255
Delta Airlines, 356
deposit insurance, 7, 27, 293
expansion of, 10
pricing of, 366
derivatives
about, 233
benefits of, 233–235
costs, 235–236
credit derivatives market and the financial
crisis, 236–242
general background and cost-benefit
analysis of derivatives, 233–236
as hedge to market makers, 234
liquidity enhancement, 234
oversight of, 247–248
principles of regulating derivatives, 242–243
problems with, 235
regulation of derivatives suggestions, 243–248
short selling and transparency, 229–232
deteriorating credit quality of subprime
mortgages, 20
Dillon Read Capital Management, 199
Dimon, Jamie, 292
disclosures, 218, 219
of compensation packages, 30
of market participants, 252
discount window, 277
Dojima rice futures, 234
Dominion Bond Rating Services, 103
down payments, 66
downside risk decompositions, 290
DTTC (New York), 267
"economic catastrophe bonds," 86
effective leverage, 83, 84
efficient regulation, 26–27
principles and proposals for, 25–35
principles for repairing the financial
architecture, 29–35
regulation focus individual institution vs.
institution level, 29
risk-taking incentives at banks and
financial institutions, 26
Egan-Jones, 103
Emergency Economic Stabilization Act of
2008, 40
employee compensation, 197
Enron, 236
Enron bankruptcy, 103
equity governance, 190–192
European Central Bank, 308, 320
European Union, 372
exchange, 261
exchange-traded derivatives, 233
exchange-traded funds, 234
exchange-traded options, 261–262
executive pay, 328
exit financing, 356
exit strategy, 328, 338
exit value, 220
expected shortfall (ES), 289, 291
explicit guarantees (Deposit Institutions,
GSEs), 34, 73, 78
external governance of financial institutions,
26
externalities, 25
internalization of, 76
sources of, 290
systemic financial risk regulation needs,
286–287
Index

fairness and efficiency, 270
fair pricing of explicit government guarantees, 30–31
fair value, defined, 220–221
fair value accounting, 182
about, 215–217
versus the alternatives, 217–220
as a cause of the financial crisis, 33
FAS 157’s measurement guidance, 220–222
overview of, 217–218
fair value accounting criticisms adverse feedback effects and systemic risk, 226
bubble prices, 223–224
credit crunch, 222–226
criticisms of, 216
market illiquidity, 224–225
potential criticisms of, 222–226
skewed distributions of future cash flows, 224
unrealized gains and losses reverse, 222–223
fake alpha, 26, 180, 193, 204–205
Fannie Mae (Federal National Mortgage Association) into conservatorship by Federal Housing Finance Agency (FHFA), 40
Fed purchases obligations from, 40
governance and compensation, 201
rescue packages, 327
securitization by, 345
taxpayer guarantees, 198
FDIC Improvement Act of 1991, 195, 216
Federal Deposit Insurance Corporation (FDIC)
correct premium pricing, 195
deposit guarantee, 188, 189
loan guarantee scheme, 327, 329
loan restructuring, 349
origins of, 301n19, 368
payments to, 27
pricing for, 30
Federal Deposit Insurance Corporation (FDIC)-insured institutions, 10
Federal Home Loan Bank (FHLB) system
Fed purchases obligations from, 40
securitization by, 63
Federal Home Loan Mortgage Corporation (Freddie Mac), See Freddie Mac (Federal Home Loan Mortgage Corporation)
Federal Housing Administration (FHFA), 45
Federal Housing Finance Agency (FHFA)
Fannie Mae into conservatorship by, 40
Freddie Mac into conservatorship by, 40
guarantees by, 345
shared appreciation mortgages, 324
Federal National Mortgage Association (Fannie Mae). See Fannie Mae (Federal National Mortgage Association)
Federal Reserve Bank of New York, 42, 337
Federal Reserve Board (Fed) actions of, 308
actions of, post Bear Stearns, 8
asset-backed commercial paper (ABCP) repurchase, 337
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), 36
Bear Stearns bailout, 256–257
Commercial Paper Funding Facility (CPFF), 36, 327
commercial paper purchase of, 11
deposit insurance on money market funds, 9
derivatives regulation, 236
federal funds rate, 13
handling of American International Group (AIG), 319
as lender of first and only resort, 11
lender of last resort (LOLR), 277
lender of last resort (LOLR) expansion, 10–11
lender of last resort (LOLR) to foreign banks, 10
lender of last resort (LOLR) to primary dealers, 10
lender of last resort facilities, 279
lending operations overview, 36–40
liquidity stage response, 42–43
liquidity tools employed by, 37–39
Long-Term Capital Management (LTCM) bailout, 167
monetary policy, 280–282
money market mutual funds guarantee, 90
new liquidity facility opened by, 90
Federal Reserve Board (Fed) (continued)
pricing scheme, 337
Primary Dealer Credit Facility (PDCF), 8, 36
purchases obligations from GSEs, 40
Regulation Z (Truth in Lending) amendments, 76
regulatory jurisdiction, 267
role of, 277–282
systemic risk, 278–279
Term Asset-Backed Securities Loan Facility (TALF), 36
Term Auction Facility (TAF), 36
Term Securities Lending Facility (TSLF), 36
TSLF Options Program (TOP), 36
fee structure, 330
FHA/VA loans, 61–62
FICO (credit score).
See credit score (FICO)
Financial Accounting Standards Board (FASB), 215
financial crises
impact of, 24
pervasiveness of, 24
financial crisis of 2007–2009
about, 1–7
banks, leveraging by, 83–99
efficient regulations, principles and proposals for, 25–35
government-sponsored enterprises (GSEs), 128–130
international coordination needs, 47–51
origins of, 2
public interventions to stabilize the financial system and efficacy assessment, 35–47
reasons for, 81
regulatory response to, 36
shadow banking sector, 7–12
timeline of crisis, 51–56
about, 57–60
banks and the leverage game, 83–99
explicit guarantees (Deposit Institutions, GSEs) as, 34
fair value accounting as, 33
governance as, 33
implicit guarantees (Too-Big-to-Fail LCFIs) as, 34
leverage game as, 33
loan originations as, 33
mortgage origination and securitization, 61–82
over-the-counter (OTC) derivatives as, 34
rating agencies, regulation of, 101–115
rating agencies as, 33
root cause of, 24
securitization of loans as, 33
short selling as, 34
unregulated managed funds (hedge funds) as, 34
financial firm, described, 284
Financial Industry Regulatory Authority (FINRA), 271–272, 274
financial institutions
about, 117–120
complex and opaque activities of, 26
counterparty risk externality internalization failure, 29
external governance of, 26
gambles taken by, 73
as investors, 71
Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 216
financial report disclosures, 219
financial risk, 323
financial sector
mispriced guarantees awarded to, 26–27
and resulting counterparty risk externality, 27–29
Financial Sector Assessment Program (FSAP), 372
financial sector bailout
about, 327–329
capital injection scheme, 335–337
commercial paper funding facility, 337–338
implications of contrasting structures, 330–335
loan guarantee scheme, 329–330
policy recommendations, 338–339
rescue package, 329–330
UK loan guarantee scheme, 330
financial sector regulation, 364–376
financial services sector vs. others, 206–210
financial stability, 24
financial stability and monetary policy, 280
Financial Stability Form, 50
financial stability regulator, 294
financial system components, 41
Financial Times, 191
fiscal and accounting framework creation, 345–346
Fitch
dominance of, 104
grandfathered as NRSRO, 103
history of, 102, 113n5
role in housing bubble and subprime
mortgage debacle, 101
fixed compensation caps, 202
fixing the issuer pay model, 108–109
foreclosure activity, 341
foreclosures, 324
credit record of, 80
deadweight costs of, 76
reasons for, 81
foreign capital growth, 13
Fortis, 93
forward-looking information, 234
forward-looking scenarios, 291
forwards/futures market, 233, 234
France, 372
Freddie Mac (Federal Home Loan Mortgage
Corporation)
into conservatorship by Federal Housing
Finance Agency (FHFA), 40
Fed purchases obligations from, 40
governance and compensation, 201
rescue packages, 327
securitization by, 63
systemic risk in the current crisis,
298–299
taxpayer guarantees, 198
full documentation loans, 64
fully supported conduits, 91
future cash flows, 218
gambling for redemption, 23
GE Capital, 332
General Agreement on Tariffs and Trade
(GATT), 372
general background and cost-benefit analysis
of derivatives, 233–236
General Electric, 332, 357
generally accepted accounting principles
(GAAP), 215, 219, 366
General Motors (GM)
action regarding, 56n5
government intervention for, 325
losses of, 357
unencumbered assets of, 355
General Motors Acceptance Corporation
(GMAC), 343
Germany, 271
Glass-Steagall Act, 48, 117, 140, 368–370
global dimensions, 155
global financial institutions, 365
global pricing of guarantees and bailouts
fairly, 49
Goldman Sachs, 6
bailout of, 241
CDS spreads, 257, 285, 338
clawback position, 211
compensation restructuring, 193
credit default swaps (CDSs) premiums,
240
five-year senior unsecured CDS spread for,
286
private preferred stock payments, 336
recapitalization, 335
relative behavior of CDS spread and
equity-implied CDS spread, 257
share price behavior of, 287
Gorton, Gary, 70
governance
as causes of the financial crisis, 33
failures of, 23
improvements to, 30
governance, incentives, and fair value
accounting overview, 179–183
governance failure
corporate governance in the modern
financial sector, 190–193
debt and regulatory governance, 192–193
equity governance, 190–192
government bailout or rescue packages, 36
government bailout package, 43–45
government guarantees
fair pricing of explicit, 30–31
implications of, 27
moral hazard of, 23, 24
pricing of, 49, 366–367
reliance on, 45
government intervention, 342
reasons for, 78
recommendations for, 47
government-sponsored enterprises (GSEs), 23
holdings of financial derivatives, 129
investor function of, 31
retained mortgage portfolios, 126
role of, 63
government-sponsored enterprises (GSEs), actions regarding
about, 121–122
mortgage investment strategy of, 124–128
on regulatory reform of, 130–134
securitization, 122–124
specific proposals regarding, 134–136
Gramm-Leach-Bliley Act, 369
Grampian Funding, 91, 92
Greenspan, Alan, 280
guaranteed liability, 330
guarantees. See also explicit guarantees
(Deposit Institutions, GSEs);
government guarantees; implicit guarantees (Too-Big-to-Fail LCFIs)
bailout guarantees, 146–147
deposit guarantee, 188, 189
explicit guarantees (Deposit Institutions, GSEs), 73
impact of, 98
loan constraints connected to, 78*-79
mispriced, 26–27
money market mutual funds guarantee, 90
regulatory, 26
reliance on, 324
HBOS, 93
hedge funds
in aftermath of the financial crisis, 157–178
asset value of, 159
carry trade losses, 4
conclusions, 175
correlated trades by, 170
described, 157–161
hedge fund interconnectedness, 163
interconnectiveness of, 173
as liquidity provider, 161
number of, 159
principles, 170–171
problems associated with, 162–170
redemptions, 166
regulation of, in the aftermath of the crisis, 171–175
systemic risk with leverage, 165
transparency, lack of, 165, 169
transparency requirements, 34
value creation of, 161–162
hierarchy of fair value measurement inputs, 221–222
higher-priced mortgage loans, 76
high-loan-to-value subprime mortgages, 19
high-tech bubble, 14
historical distributions, 289
historical high yield bond spreads, 12
holders of mortgage debt, 72
home equity line of credit (HELOC), 62
home equity loan (HEL), 62
Home Mortgage Disclosure Act, 67
homeowner equity restoration, 345
home ownership, 75
Hope for Homeowners, 45, 349, 350
household assets, 15
household debt/home values, 16
households, average debt-to-income ratio of, 66
house prices, 66
house price to rent ratio, 13
Housing and Economic Recovery Act of 2008 (HERA), 79
housing bubble, 12, 98
housing bubble vs. Internet bubble, 14–15
housing crisis, 324
housing loan modification, 45
housing market, 45–46
housing prices, 14, 343
housing wealth/total household assets, 15
HSBC Holdings PLC, 87, 88, 93, 331, 336
hybrid ARMs, 33
illiquidity problem, 33, 42–43
illiquidity vs. insolvency, 307
implications of contrasting structures
financial sector bailout, 330–335
optionalities, pricing, and economic implications, 333–335
postscript, 335
pricing implications, 331–333
implicit deposit insurance, 366
implicit guarantees (Too-Big-to-Fail LCFIs), 73, 78–79
as causes of the financial crisis, 34
systemic financial risk regulation needs, 288
too-big-to-fail (TBTF) guarantee, 26, 27
improved governance and compensation practices to curb excessive leverage and risk taking, 30
incentive system, 336
incomplete contracts and debt-for-equity swaps, 342–344
increasing opaqueness of the financial sector and resulting counterparty risk externality, 27–29
industry-wide coordination, 181
IndyMac, 10, 67
ING Bank, 93
initial margins, 264
insider trading, 31
insolvency vs. illiquidity, 307
instability of financial sector, 12–25
institutional linkages, 28
institution-level risk vs. aggregate or systemic risk, 29
institution specific pricing, 330
insurance companies, 10
interbank lending changes, 5
interbank lending rates, 90
interconnectiveness, 284
Intercontinental Exchange (ICE), 266
internal governance, 187
Internal Revenue Code, 196
international alignment of financial sector regulation, 364–376
addressing regulatory externality, 370–371
case for, 365–370
coordination vs. centralization, 373–374
history of international coordination efforts, 371–374
lender of last resort policies, 367–368
pricing of government guarantees, 366–367
recommended steps to achieve international coordination, 374–375
regulating bank scope: demise of the Glass-Steagall Act, 368–370
regulation of systemic risk due to large, complex financial institutions, 368
treatment of off-balance-sheet leverage, 366
treatment of over-the-counter derivatives, 367
international coordination, 368–376
international coordination efforts history, 371–374
international coordination needs, 47–51
International Financial Reporting Standards (IFRS), 96
International Monetary Fund (IMF), 371
International Swaps and Derivatives Association (ISDA) agreement, 262
Internet bubble, 14
Internet bubble vs. housing bubble, 14–15
investment banks, 369
Investment Company Act of 1940, 157
investor pays model, 102, 107
issue-level optionality, 335
issuer pays model, 102, 107
Japan, 234, 306, 368
Japan Credit Rating Agency and Rating and Information, Inc., 103
Japanese banks, 373
job losses and externalities, 360
JPMorgan Chase, 93, 97
CDS spreads, 332
collateralized debt obligations (CDOs), 239
conduit organizations, 357
Federal Reserve Bank of New York brokers Bear Stearns to, 42
loan restructuring, 349
purchase of Bear Stearns, 5
purchase of Washington Mutual, 67
recapitalization, 333–336
taxpayer guarantees, 198
judicial foreclosure, 348
jumbo loans, 79
described, 61
standardization of, 77
KBC Bank, 93
Keynes, John Maynard, 371
Kmart, 356
kurtosis, 234
Lace Financial, 103
large, complex financial institutions (LCFIs)
big balance sheet business model, 143–145
broadening of bailout guarantees, 146–147
complexity of, 145
large, complex financial institutions (LCFIs) (continued)
corporate governance, 188–190
current corporate governance of, 186
described, 139
determination, 152–154
enhanced regulation of, 139–155
examples of, 154
global dimensions, 155
ingcentive to adopt, 27
internal governance, 30
origins of, 140–143
regulation of, 32
regulatory challenge, 147–154
regulatory governance of, 183
risk profile, 180
specific enhanced regulation system framework, 149–152
too-big-to-fail (TBTF) guarantee, 26
value critique, 146
Las Vegas, NV, 66
LCDX pricing, 18
LCH.Clearnet Group (London), 267
legal barriers to modifying securitized loans, 45
legal obstacles posed by securitization, 347–348
Lehman Brothers
on AAA-rated tranches, 21
bailout of, 6
bank costs of, 355
bankruptcy of, 5, 6, 90, 165, 241, 257, 285
CDS spreads, 257, 297
counterparty risk of, 7
credit default swaps (CDSs) premiums, 240
European Central Bank borrowings, 368
failure of, 36, 230
governance and compensation, 201
impact of failure by, 44
interconnectiveness of, 299
run on, 8
suitor for, 320
systemic risk in the current crisis, 298
systemic risk of, 285
as too-big-to-fail, 6
wholesale runs on, 28
lender of last resort (LOLR), 7, 41
Index

loan guarantees, 323, 328
loan guarantee scheme, 327, 329–330
loan limits, 80
loan origination fees, 78
loan originations, 67
loan originations as a cause of the financial crisis, 33
loan originator incentives and defaults, 70
loan quality, 73
loan repackaging, 20–21
loan risk opacity, 20
loans
  maximum dollar caps on, 80
  renegotiation and reorganization of, 76
loan-to-value ratios, 64, 77
lockup periods, 169, 174
Lombard Street (Bagehot), 306
London Interbank Offered Rate (LIBOR) spreads, 10
Long-Term Capital Management (LTCM), 166–167, 236
long-term solutions, 41
long-term stabilization, 41
low-doc mortgages, 14
managed funds, wholesale runs on, 28
management control, 308
management replacement, 328, 354
managerial compensation, 336
marginal expected shortfall (ES), 289
marginal value at risk (VaR), 289
margin calls, 263, 272
margin requirements, 262
market-based system, 294–296
market economy, bankruptcy in, 24
market illiquidity, 224–225, 243
market makers
derivatives as hedge, 234
exemptions for, 273
market manipulation, 230
market manipulation and regulatory response, 271–274
market manipulation practices, 31
market participants, 221
market prices, 223, 271
Markit’s indexes, 227n4
mark-to-model values, 217
material adverse charges (MAC) clause, 43, 279, 306, 308, 320
measurement date, 221
measuring systemic risk contribution, 289–292
about, 289
based on value at risk and expected shortfall, 289–290
pricing systemic risk, 292
stress tests and aggregate risk scenarios, 291–292
systemic risk regulation, 289–292
medium-term notes (MTNs), 91
Merrill Lynch, 2
Bank of America purchase of, 6, 8, 285, 298
and Bear Stearns failure, 167
CDO mortgage market size, 200
credit default swaps (CDSs) premiums, 240
governance and compensation, 201, 202
recapitalization, 335
subprime mortgage bets, 170
Metallgesellschaft case, 235
Miami, FL, 66
misaligned approaches, 198–201
mispriced guarantees awarded to financial sector, 26–27
mispricing in capital markets, 13
mixed-attribute accounting model for financial instruments, 219–220
mixed-attribute model, 219
momentum return, 273
monetary policy
Federal Reserve Board (Fed), 280–282
and financial stability, 280
money market funds, 5, 9
monoline insurers, 265
AAA ratings loss, 10
distress of, 5
monopoly rating structure vs. competitive rating structure, 107
Moody’s dominance of, 104
grandfathered as NRSRO, 103
history of, 102, 113n3
role in housing bubble and subprime mortgage debacle, 101
moral hazard
of explicit and implicit guarantees, 34
of government guarantees, 23
linked to aggregate risk, 296
moral hazard (continued)
minimization of, 354
proposed solution for automakers, 361
of rewarding bad management, 46
strengthening of, 286
Morgan Stanley, 6
bailout of, 241
CDS spreads, 285, 331, 332, 338
clawbacks of bonuses, 211
credit default swaps (CDSs) premiums, 240
five-year senior unsecured CDS spread for, 286
governance and compensation, 202
private preferred stock payments, 336
recapitalization, 335
share price behavior of, 287
subprime mortgage bets, 170
mortgage-backed securities (MBSs), 61, 62, 267, 298–299
mortgage-backed securities market and government-sponsored enterprises, 122
Mortgage Bankers Association, 67
mortgage contracts, barriers to modification of, 345
mortgage default losses, 324
mortgage defaults, 341
mortgage delinquencies and defaults, 67
mortgage investment strategy of government-sponsored enterprises (GSEs), 124–128
mortgage market originations, 65
mortgage markets
credit risk transfer in, 21
underwriting standards of, 14
mortgage origination and securitization, 61–82
mortgage facts, 63–69
principles for regulatory reform, 75–76
proposals for regulatory reform, 76–81
U.S. mortgage market, 61–63
what went wrong, 69–74
mortgage origination business consolidation, 67
mortgage originators, servicing obligations of, 78
mortgage path, 131
mortgage portfolio, 136
mortgage products, systemic risk and, 71
mortgage-related securities, opacity of, 105
mortgages
categories of, 61
quality of, 64
types of, 61
mortgages and households, 341–351
about, 341–342
action plan for, 344–348
comparison with alternative policies, 348–350
incomplete contracts and debt-for-equity swaps, 342–344
shared appreciation example, 344
mortgage servicing, 70
mortgage servicing rights, 78
mortgages facts, 63–69
mortgage markets, 65–67
securitization, 68–69
naked short sales (naked shorts), 269, 272–273
National Association of Realtors survey, 66
nationally recognized statistical rating organization (NRSRO), 102–103
category as barrier to entry, 109
deconstruction of, 110
Enron bankruptcy, 103
expansion of, 103
list of, 104
national regulators
coordination between, 370
coordination complications among, 48
Nationwide, 331
negative externality, 293
net capital rule, 23
net positions, 253, 256
New Century Financial, 2
New York Stock Exchange, 263
New York Times, 200
NINJA (no income, job, or assets) mortgages, 14
no-doc mortgages, 14, 19
nonagency securitized mortgage issuance, 63
nonbank mortgage lenders, 8
nongovernment U.S. debt, 17
nonguaranteed long-term debt, 329
nonprime mortgages growth, 65
nonstandard contracts, 81–82
Norway, 306
NRSRO. See nationally recognized statistical rating organization (NRSRO)
Occam’s razor, 270
off-balance-sheet activities reporting, 31
off-balance-sheet asset-backed commercial paper (ABCP) conduits, 59, 83, 85
off balance sheet assets, 27
off-balance-sheet leverage, treatment of, 366
Office of the Comptroller of the Currency (OCC), 102
100 percent margin, 264
one-size-fits-all approach, 337, 338
opacity. See also transparency, lack of
of institutional linkages, 28
in loan risk, 20
of mortgage-related securities, 105
operational risks, 252
option-adjusted ARMs, 70
optionalities, pricing, and economic implications of contrasting structures, 333–335
optionality in participation, 328, 329, 334, 378n4
options, 233. See also derivatives
Options Clearing Corporation (OCC), 235, 261–262
orderly transaction, 221
originate-to-distribute model of securitization, 57, 69
overnight index swap (OIS) rate, 337
over-the-counter (OTC) contracts
counterparty and operational risks, 252
transparency, lack of, 252
over-the-counter (OTC) credit derivatives, 252–254
over-the-counter (OTC) derivatives, 72, 233
as a cause of the financial crisis, 34
treatment of, 367
over-the-counter (OTC) markets
changes to, 31
need for, 244
shortcomings of, 251–252
transparency enforcement in, 31
transparency in, 231, 265
over-the-counter market versus central clearinghouse, 245
Ownit Mortgage Solutions’ bankruptcy, 2
partially supported conduits, crisis impact by, 91
pay and performance, 197
payment in kind (PIK) toggle leveraged loans, 9, 19
penalty rate, 307
performance-based compensation, 204
performance metric of banks, 84, 86
performance metrics, 99
physical settlement vs. cash settlement, 255–256
Pilgrim’s Pride, 356
Plaza Agreement, 373
policy recommendations, 231, 338–339
pooling outcome, 334
Porsche, 255, 271
position limit, 258
predatory lending, 70–71
predatory lending, protection from, 75
preferential tax treatment for deferred compensation, 195, 196
prepayment penalties, 77
price discovery, 233, 234, 270
pricing guarantees and bailouts fairly, 49
pricing implications of contrasting structures, 331–333
pricing of government guarantees, 366–367
pricing systemic risk, 292
Primary Dealer Credit Facility (PDCF), 8, 36
primary dealers, 56n1
primary mortgages, 61
Prince, Chuck, 191
principles
essentials of, 354
for government intervention, 325
hedge funds, 170–171
importance of, 353
overarching, 371
and proposals for efficient regulations, 25–35
rating agencies, 107–112
for regulators in direct government intervention, 47
principles for repairing the financial architecture, 29–35
fair pricing of explicit government guarantees, 30–31
improved governance and compensation practices to curb excessive leverage and risk taking, 30
regulation of large, complex financial institutions based on systemic risk contribution, 32, 35
INDEX

principles of regulating derivatives, 242–243
prisoner’s dilemma, 181
private financial markets, needs of, 5
private guarantors, 135–136
private lines of credit, 279, 306, 308–309, 310–311
private-public insurance scheme, 295
problems associated with hedge funds, 162–170
faced by hedge fund investors, 168–170
generating systemic risk, 166
quant meltdown, 167–168
systemic risk lessons, 168–169
systemic risk within the financial system, 162–169
problems with rating agencies, 104–107
procyclical behavior, 291–292
proposals
Chicago Mercantile Exchange (CME) and Citadel, 266
compensation at financial firms, 195–196
Intercontinental Exchange (ICE), 266
regulating systemic risk, 296–297
proposals for regulatory reform, 33–34
conclusions, 81–82
conforming loan limits, 79–80
fixing the issuer pay model, 108–109
households, 80–81
loan agreements, 81
mortgage brokers, 80
predatory lending, 76–77
rating agencies, 107–112
securitization, 77–79
standardization, 77
timing question, 111–112
proposed solution for automakers, 356–361
bailout limits, 356–361
conclusions, 361
economic sense vs. alternatives, 357–360
job losses and externalities, 360
moral hazard, 361
public interventions to stabilize the financial system and efficacy assessment, 35–47
bailout limits, 46
bailout overview of the since September 2008, 40
Fed’s lending operations overview, 36–40
Fed’s liquidity stage response, 42–43
government bailout package, 43–45
housing market, 45–46
recommendations for future interventions, 46–47
regulatory interventions, framework to assess, 40–42
public transparency, 171
put options, 234
quality of mortgages, 64
quality of new debt issuance, 18
quant meltdown, 167–168
rate of economic growth, 1
rating agencies, 57, 88, 101–120
about, 101–104
adjustment speed criticism, 106
advertiser pays model, 111
alternative business models, 110–111
barriers to entry in, 103
business model conflicts, 107
business model of, 104
as a cause of the financial crisis, 33
centralized clearing platform for, 108–109
competition problem, 112
conclusion, 112–113
failure by, 242
free rider problems, 108, 111
grandfathered as NRSROs, 103
history of, 102
hybrid model, 110
joint venture model, 111
limits of compensation to, 108
loss leader model, 111
principles, 107–112
problems with, 104–107
proposals for regulatory reform, 107–112
role of, 59
standard business model of, 102
ratings calculations, 114n13, 114n14, 114n16
ratings failures, 85
ratings scale, 101
rating through the cycle, 106, 112
Realpoint, 103
recapitalization, 306, 323
Bank of America, 335
Bank of New York Mellon, 335
Barclays, 336, 337
British scheme, 336
Citigroup, 336
Index

General Motors Acceptance Corporation (GMAC), 343
Goldman Sachs, 335
HSBC Holdings PLC, 336
JPMorgan Chase, 335–336
Merrill Lynch, 335
Morgan Stanley, 335
State Street, 335–336
Wells Fargo, 335
recapitalization requirements, 296
recapitalization scheme, 328
recent proposals and prognosis, 266–267
recommendations for future interventions, 46–47
recourse to balance sheets, 87
redemptions, 166, 174
regional house price indexes, 80
registry, 259, 261
regulating bank scope, 368–370
regulating systemic risk, 292–297
alternative proposals, 296–297
“Basel III” capital requirements style, 292–293
examples of systemic risk in the current crisis, 297–300
market-based system, 294–296
systemic financial risk regulation needs, 292–297
taxing the externality (FDIC-style), 293–294
regulation. See also efficient regulation
balances of, 24
focus of, institution-level risk vs. aggregate or systemic risk, 29
by function or activity, 148
individual institution vs. institution level focus, 29
of large, complex financial institutions (LCFIs), 32
regulation of derivatives suggestions, 243–248
central clearinghouse, 244–245
derivatives, 243–248
oversight of derivatives, 247–248
transparency, 245–247
regulation of hedge funds in the aftermath of the crisis
banklike runs, 173–175
capital markets safety board, 175
systemic risk, 172–173
transparency, 171–172
regulation of large, complex financial institutions based on systemic risk contribution, 32, 35
regulation of systemic risk due to large, complex financial institutions, 368
Regulation Z (Truth in Lending) amendments, 33, 76
regulators’ performance in bank inspection, 32
regulatory alternatives for regulatory challenge of large, complex financial institutions (LCFIs), 147–149
regulatory arbitrage, 26, 84, 85
and aggregate risk shifting, 98–99
developments from, 96
at government-sponsored enterprises (GSEs), 31
regulatory assessment of systemic risk, 32
regulatory capital requirements, 89
regulatory challenge of large, complex financial institutions (LCFIs)
framework for LCFI-specific enhanced regulation system, 149–152
LCFI determination, 152–154
regulatory alternatives for, 147–149
regulatory externality, 370–371
regulatory failure in Basel capital requirements, 98
regulatory governance of large, complex financial institutions (LCFIs), 183
regulatory guarantees (ill-designed and mispriced), 26
regulatory interventions, framework to assess, 40–42
regulatory jurisdiction, 267
regulatory leverage and bank stock performance, 96
regulatory recommendations for government intervention, 47
regulatory reform
of government-sponsored enterprises (GSEs), 130–134
systemic risk causes and proposals for, 33–34
relative behavior of CDS spread and equity-implied CDS spread, 257
renegotiation, 344
renegotiation and reorganization of loans, 76
INDEX

rent extraction, 107
repo market, 5
required credit rating, 319
rescue packages, 327, 329–330
Reserve Primary Fund, 6, 9, 165
  bailout of, 241
  breaking the buck, 299
reserves, 307
residential mortgage-backed securities (RMBSs), 106, 237
residential wealth, 66
Resolution Trust Corporation, 216
restricted stock grants, 203
return correlations, 164
ring-fencing of guarantee access, 30
risk aversion, 5
risk controls, 26
risk incentives, 23
risk management, 233
risk management tools, 283
risk-taking fee, 189
risk-taking incentives at banks and financial institutions, 26
risky asymmetric bets, 23, 34, 73
Rubin, Robert, 205
runs, 293, 307
Russia, 167
Salomon Brothers, 167
Salomon Inc., 210–211
Santander, 97
Sarbanes-Oxley Act of 2002, 103
search for yield, 26
secondary default, 342, 345, 349
Section 20 subsidiaries, 369
Securities and Exchange Commission (SEC), 23, 102, 157
  banned short sales, 269
  and Commodity Futures Trading Commission (CFTC), 248
  credit agency report, 103
derivatives regulation, 236
Form 13F, 172
market manipulation, 271–272
on mixed-attribute model, 219
rating agencies rules, 108
regulatory jurisdiction, 267
Securities Exchange Act of 1934, 23, 59
securitization
  business model of, 71
  by government-sponsored enterprises (GSEs), 122–124
  of loans a cause of the financial crisis, 33
  originate-to-distribute model of, 57
  specific proposals regarding GSEs, 134–136
  of subprime mortgages, 68, 74, 105
  unintended problem with, 82n2
securitized credit, 20
securitized loans, legal barriers to modifying, 45
security spreads, 21
senior management compensation, 201–203
separating equilibrium, 334
severance packages, 201
severe crisis stages, 41
shadow banking sector, 7–12, 27
shared appreciation example, 344
shared appreciation mortgages, 45, 324.
  See also debt-for-equity swaps
shell companies, 86
shorting against the box, 269, 273
short sale ban
  impact of, 270
  by SEC, 269
short selling, 230, 269–275
  about, 269
  beneficiaries from short sales, 270–271
  as causes of the financial crisis, 34
  conclusions, 274–275
  fairness and efficiency, 270
  issues regarding, 269–270
  market manipulation and regulatory response, 271–274
  reporting of, 274
  vs. selling, 272
short-selling constraints, 274
short squeeze problem, 255–256
short-term debt, impairment of, 11
short-term markets, 5, 7
short-term stabilization, 41
simplify secondary default, 348
Single European Act, 372
SIVs. See structured investment vehicles (SIVs)
skewed distributions of future cash flows, 224
Index

skewness, 234
small banks, 338
Small Business Administration (SBA), 40
Solitaire Funding Limited, 86–89
specific proposals regarding GSEs, 134–136
  mortgage portfolio, 136
  private guarantors, 135–136
  securitization, 135–136
spillover risk, 287
SSW proposal, 149, 150, 151, 155
Standard & Poor’s
dominance of, 104
grandfathered as NRSRO, 103
history of, 102, 113n4
role in housing bubble and subprime mortgage debacle, 101
standardization
  of Alt-A mortgages, 77
  of jumbo loans, 77
  and liquidity in the mortgage-backed securities market, 75
  of subprime mortgages, 77
standardized contracts, 262
state insurance regulators, 102
Statement of Financial Accounting Standards
  No. 157, Fair Value Measurements (FAS 157), 215
definition of fair value, 220–221
hierarchy of fair value measurement inputs, 221–222
inputs from most to least reliable, 221
levels of input, 221–222, 224–225
measurement guidance, 220–222
requirements of, 217–218
State Street, 335–336
statistical measures, 289
stock holding periods and forfeiture rules, 30
stop-loss orders, 272
stress tests, 289
stress tests and aggregate risk scenarios, 291–292
structured investment vehicles (SIVs), 8, 59, 83
  of BNP Paribas, 4
contractions of, 90
crisis impact by, 91–92
off balance sheet assets in, 27
with recourse to balance sheet, 23
subordinated capital notes, 91
subordinated tranches exposure, 72
subprime-backed CDOs downgrading, 112
subprime defaults, 2
subprime loans as hybrid ARMs, 33
subprime mortgage crisis causes, 226
subprime mortgage defaults, outcomes from, 71
subprime mortgages, 8
  AAA-tranche pricing, 22
defaults and bankruptcies resulting from, 2
delinquencies of, 67
deteriorating credit quality of, 20
growth of, 57
market for, 16
securitization process of, 105
standardization of, 77
systemic structuring of, 58
subprime origination and securitization, 68
subprime securitization, 125
Sullivan and Cromwell, 335
swaps, 233
Sweden, 306
Swiss Federal Banking Commission (SFBC), 212
symmetry principle, 273
systemic capital charge (SCC), 293
systemic failure in United States, 1
systemic financial risk regulation needs, 284–288
  externalities, 286–287
  implicit guarantees, 288
  regulating systemic risk, 292–297
  systemic risk in the current crisis, 285
systemic fund, 35
systemic insurance, 60
systemic liquidity stage, 41
systemic risk
  and adverse feedback effects, 226
  Basel III approach to, 35
described, 1
  hedge funds, 172–173
  industry bailout, 272
  vs. institution-level risk, 29
  measuring, 278
  mortgage products and, 71
  spreads of, 241
taxation, 278
systemic risk assessments, 32, 35
market-based system for, 283
overall, 32–33
INDEX

systemic risk causes and proposals for regulatory reform, 33–34
systemic risk fee, 294
systemic risk generation, 166
systemic risk in the current crisis
  American International Group (AIG), 299–300
  Bear Stearns, 297–298
  Fannie Mae (Federal National Mortgage Association), 298–299
  Freddie Mac (Federal Home Loan Mortgage Corporation), 298–299
  Lehman Brothers, 298
regulating systemic risk, 297–300
systemic financial risk regulation needs, 285
systemic risk lessons, 168–169
systemic risk regulation
  about, 283–284
  Federal Reserve Board (Fed), 278–279
  measuring systemic risk contribution, 289–292
  need for, 284–288
systemic risk within the financial system, 162–169
systemic solvency stage, 41
systemic structuring of subprime mortgages, 58
takeovers, 26
taxation
  market risk, 98
  systemic fund through, 35
taxing the externality (FDIC-style), 293–294
taxpayer subsidies, 330
tax rules, 345, 346
  Term Asset-Backed Securities Loan Facility (TALF), 36
  Term Auction Facility (TAF), 36
  Term Securities Lending Facility (TSLF), 36
  terms of debt-for-equity swaps, 345–346
  Terrorism Risk Insurance Act (TRIA), 302n23
  thrift (savings and loan) crisis, 216
timeline of crisis, 51–56
timing question, 111–112
too-big-to-fail (TBTF) guarantee, 26, 27
too-big-to-fail (TBTF) institutions, 6, 23, 279. See also large, complex financial institutions (LCFI)
total assets and risk-weighted assets gap, 95
total value maximization principle, 193
toxic loans, 8
toxic waste (risk holding for bad loans), 5
Trade Reporting and Compliance Engine (TRACE), 246, 274
trading implications, 267
tranche structure, 238
transfer vehicles, aggregate risk component of, 86
transparency
  of compensation packages, 30
  desirable levels of, 264–266
  hedge funds, 171–172
  impact of, 243
  of OTC markets, 231
  of positions, 246
to reduce counterparty risk externality, 31
  regulation of derivatives suggestions, 245–247
transparency, lack of, 4
  about loan quality, 73
  in hedge funds, 165, 169
  impact of, 5, 6
OTC contracts and, 252
yields lack of trust and confidence, 73
transparency and reporting, 274
Treasury. See U.S. Treasury
Troubled Asset Relief Program (TARP), 40, 43–44, 329, 357
  TSLF Options Program (TOP), 36
turnaround management, 354
UBS, 97, 202
  compensation restructuring, 193
  compensation structure, 199
  Dillon Read Capital Management, 199
  residential mortgage-backed security (RMBS), 198
  subprime mortgage bets, 170
UK banks, 367
UK loan guarantee scheme, 328, 330, 333, 334
UK Treasury, 330, 331
underwater mortgages, 346
underwater mortgages, negotiation of, 342
underwriting standards, inadequacy of, 14
uninsured deposits, 10
United Airlines, 356
Index

United Kingdom, 366, 372
universal banks, 369
unrealized gains and losses reverse, 222–223
unregulated managed funds (hedge funds) as a cause of the financial crisis, 34
unwind hypothesis, 168
upstairs market, 263
uptick rule, 273
U.S. Department of Labor, 113n9
U.S. equity markets, 14
U.S. independent broker-dealers, 8
U.S. loan guarantee scheme, 328
U.S. mortgage market
nonprime mortgages, 62
prime mortgages, 61–62
securitization, 62–63
U.S. mortgage market originations, 65
U.S. Treasury, 256–257
actions of, 43
bank recapitalization, 327
confidence crisis in, 44
deposit insurance on money market funds, 9
one-size-fits-all giveaway approach of, 44
redesigning the financial regulatory architecture, 149
treasury proposals, regulation by type of charter, 150
Troubled Asset Relief Program (TARP), 40, 357
value at risk (VaR), 289
value creation of hedge funds, 161–162
value critique of large, complex financial institutions (LCFIs), 146
viability of debt-for-equity swaps demonstration, 346–347
volatility, 234
Volkswagen, 255, 271
Wachovia, 10, 67
Wall Street Journal, 336
Washington Mutual (WaMu), 10, 67
wealth shock, 71
welfare gains, 1
welfare policy, 79
Wells Fargo, 97
conduit organizations, 357
purchase of Wachovia, 67
recapitalization, 335
wild card option, 255
World Trade Organization (WTO), 372
wrong-way counterparty exposure, 265