Submission Number: **1**

Group Number: **28**

Group Members: Yash Garara, Trung Hai Nguyen, Harshil Sumra

Full Legal Name	**Location (Country)**	**E-Mail Address**	**Non-Contributing Member (X)**
Yash Garara	UK	yash.garara@sky.com	
Trung Hai Nguyen	Canada	haint504@gmail.com	
Harshil Sumra	India	harshilsumra1997@gmail.com	

Statement of integrity: By typing the names of all group members in the text box below, you confirm that the assignment submitted is original work produced by the group (*excluding any non-contributing members identified with an "X" above*).

Yash Garara
Trung Hai Nguyen
Harshil Sumra

Use the box below to explain any attempts to reach out to a non-contributing member. Type (N/A) if all members contributed.

N/A

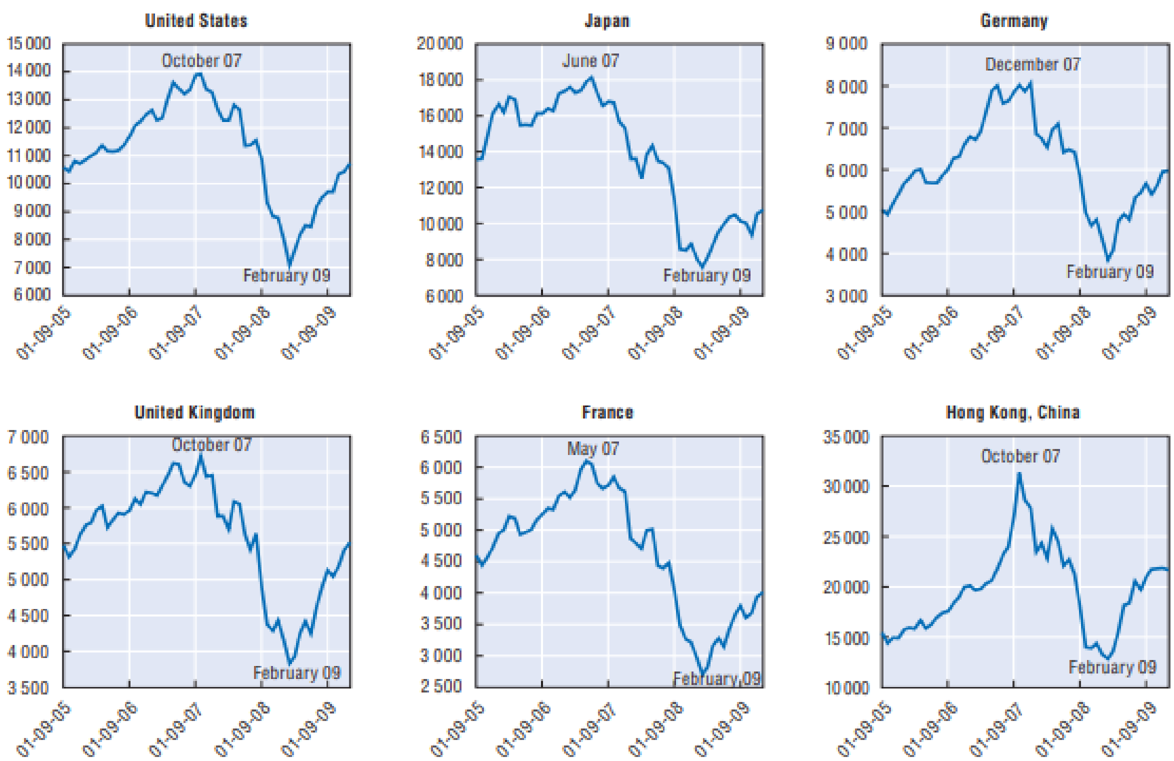
** Note, you may be required to provide proof of your outreach to non-contributing members upon request.*

The Global Financial Crisis

Introduction

Financial crises are defined by asset prices experiencing sharp declines, debts spiraling out of control and institutions experiencing liquidity shortages. Often, they also include speculative financial bubbles and may either be limited to a single sector, or much like the 2008 Global Financial Crisis, can ripple through global economies. Other market features that presented themselves during the GFC include huge government bailouts, the introduction of more stringent regulation (e.g. Dodd-Frank) and the failure of many large financial institutions, such as Lehman Brothers. Market conditions also drastically changed during the GFC with global equity markets reversing their up trends (*Figure 1*), major liquidity issues for the banking sector and a sudden, sharp reduction in the amount of money/credit available from lenders. Here we explore the potential causes, mechanics and responses to the GFC.

Main stock market indices[1] between 2005 and 2009



1. United States: Dow Jones Industrial Average; Japan: Nikkei 225; Germany: DAX; United Kingdom: FTSE 100; France: CAC 40; Hong Kong, China: Hang Seng.

StatLink http://dx.doi.org/10.1787/837733674302

Figure 1. Source: OECD (2010), "Global economic crisis: stock market trends", in Measuring Globalisation: OECD Economic Globalisation Indicators 2010, OECD Publishing, Paris, https://doi.org/10.1787/9789264084360-5-en.

Stakeholders and Mechanics

To delve deeper into the GFC, we need to understand who was involved, what their role was and how they all link together (*Table 1)*.

Stakeholder	**Role & Motivation**	**Impact of increasing house prices**
Homebuilders	To build houses that sell for more than their cost to build	Increased income per property
Mortgage Lenders	Earn money through interest rate payments	Little impact, as benefit of higher notional mortgages may be offset with a decrease in demand
Mortgage-Backed Securities (MBS) Structurers	Securitize a pool or mortgages and sell tranches to investors	Little impact, more dependent on demand for mortgages
Realtors/Real Estate Appraisers	Earn commissions on selling houses/fees on valuing houses	Increased commissions
Townships collecting local real estate taxes	Collect fees based on the value of properties in the town	Increased tax income
Homeowners using a mortgage	Pay regular interest payments in the hope of eventually paying off their mortgage	Possibly more reluctant to take out mortgages

Table 1

It is also useful to know some of the mechanics as to how these stakeholders are affected in different scenarios. For example, if the borrowers default on their mortgages it is easy to see the direct impacts such as homeowners being repossessed and losing their homes. However, this would also impact the banks selling the mortgages as if the house is not worth enough to cover their losses they would also be at risk of loss. Further to this, the end investors of MBS' would also be affected as their pass-through income could also be at risk.

Causes and Responses

Although there is much debate regarding the causes of the GFC, factors such as deregulation, securitization, and the growth of the popularity of subprime mortgages clearly had a massive part to play. Firstly, the Gramm–Leach–Bliley Act, which repealed the Glass-Steagall Act, helped to remove restrictions on how banks could use people's deposits. This allowed them to use deposits to invest in riskier assets such as derivatives. Secondly, banks began increasingly utilizing securitization, pooling together various types of debt, such as mortgages, and selling their related cash flows on, concealing underlying risks in the process. Finally, the Financial Institutions Reform, Recovery, and Enforcement Act helped enforce the Community Reinvestment Act, which encouraged banks to lend to lower income neighborhoods, by publicly ranking banks based on this, leading to a boom of subprime mortgages. As the adjustable rates on these started to increase, homeowners were hit with obligations they could not afford. This along with falling home prices meant homes were not good enough collateral for the mortgages either, leading to the housing bubble ultimately bursting.

In response, policymakers and regulators reformed regulation and passed acts into legislation to both control the damage and prevent future similar crises. In early 2008, President Bush signed the Economic Stimulus Act which provided tax rebates of more than $150 million in the hope of reducing financial pressure on business and averting an economic recession. Shortly after, the Fed reduced their nominal rate to 0% to encourage borrowing and ease the liquidity issues constraining financial markets at the time. In terms of regulation, the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed into legislation, which we shall cover in more detail soon.

Risk and Regulations

Other than default risk, the housing market also contained a plethora of systematic risks, which can be defined as risks inherent to the market or a sector as a whole and hence cannot be diversified. Systematic risks within the housing market are widely thought to be one of the major contributors to the GFC. As previously alluded to, the US governments policy on residential housing encouraged banks to give out low quality mortgages and regulation allowed banks to have minimal reserves in the case that borrowers defaulted. This caused great strain on the lending sector when they did. Also, the way these mortgages were securitized into MBS' led to a lack of transparency of the true risks inherent to these products and the further trade of exotic securities such as CDS' and CDO's between banks resulted in a large, interconnected web of dependencies within the financial system, meaning if one institution failed, it had massive ramifications on the system as a whole.

As mentioned before, one key regulation put in place to minimize these systematic risks was the Dodd-Frank Wall Street Reform and Consumer Protection Act. Its aim was to protect consumers by preventing financial institutions from taking on too much risk and creating agencies that oversaw Wall Street. For example, the Financial Stability Oversight Council identifies any institutions that have become "too big" and in turn the Fed can increase capital requirements for these businesses to mitigate the risk that they collapse like Lehman Brothers did. The act also seeks to make clear to consumers the risks and fees associated with credit cards, loans, and mortgages, helping increase transparency. Another key part of the regulation was the Volcker Rule, which eliminated proprietary trading in banks and enhanced provisions on the trading of risky derivatives such as credit default swaps, stopping banks from making speculative bets with their depositors' money.

Conclusion

To conclude, although there are many causes that can be linked to the GFC, we have identified deregulation, lack of transparency in exotic securities and the enablement of institutions to grow so large that when they fail, they are able to shake global markets as some of the primary causes for the GFC. We have also identified the main systematic risks inherent in the housing market that allowed such a collapse to occur and how the response from policymakers and regulators helped minimize the repercussions and mitigate these risks to prevent such a crisis from occurring again.

References

(GPO), U.S. Government Publishing Office. “GRAMM–LEACH–BLILEY ACT.” 1999. 2021. <https://www.govinfo.gov/content/pkg/PLAW-106publ102/pdf/PLAW-106publ102.pdf>.

“About the Community Reinvestment Act.” n.d. *St Louis Fed.* 2021. <https://www.stlouisfed.org/community-development/about-us/community-reinvestment-act>.

Amadeo, Kimberly. “2008 Financial Crisis.” 2020. *The Balance.* <https://www.thebalance.com/2008-financial-crisis-3305679>.

—. *Causes of the 2008 Global Financial Crisis*. 2020. <https://www.thebalance.com/what-caused-2008-global-financial-crisis-3306176>.

—. “What Is the Dodd-Frank Wall Street Reform Act?” 2020. *The Balance.* <https://www.thebalance.com/dodd-frank-wall-street-reform-act-3305688>.

Angelides, Phil, Bill Thomas, and Financial Crisis Inquiry Commission. *The financial crisis inquiry report: Final report of the National Commission on the Causes of the Financial and Economic Crisis in the United States.* Government Printing Office, 2010.

CARMASSI, J., GROS, D. and MICOSSI, S. “The Global Financial Crisis: Causes and Cures.” *JCMS: Journal of Common Market Studies* (2009): 977-996. https://doi.org/10.1111/j.1468-5965.2009.02031.x.

“DODD-FRANK WALL STREET REFORM AND.” 2010. *(GPO), U.S. Government Publishing Office.* <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf>.

Pelofsky, Jeremy. “Bush signs stimulus bill and cites economic resilience.” 2008. *Reuters.* <https://www.reuters.com/article/us-usa-economy-stimulus/bush-signs-stimulus-bill-and-cites-economic-resilience-idUSWAT00889920080214>.

Rimkus, Ron. *The Financial Crisis of 2008*. 2016. <https://www.econcrises.org/2016/08/17/the-financial-crisis-of-2008/>.

Spahr, Ronald W. “THE ROOT CAUSE OF THE CURRENT FINANCIAL CRISIS, EFFECTS ON CAPITAL MARKETS, AND LONG-TERM SOLUTIONS.” *Business Perspectives, vol. 19* (2009): 42-45. https://search.proquest.com/scholarly-journals/root-cause-current-financial-crisis-effects-on/docview/228718009/se-2?accountid=196966.

Systemic Risk. n.d. 2021. <https://corporatefinanceinstitute.com/resources/knowledge/finance/what-is-systemic-risk/>.