Too Big To Fail:

**The Financial Crisis of 2008 and its International Repercussions**

Elizabeth Colby, Heather Mitchell, Mark Villalba, Connor Finch, Jacob Wall

REAL ESTATE FUNDAMENTALS (RE3381-001)

Prof. Julie Lynch

March 24th 2014

The bailout of the banks on Wall Street, as they approached economic ruin in the fall of 2008, by the Federal Reserve had many implications on the financial health of the United Sates of America. Bailing out Bear Stearns in the early part of the 2008 sent a disturbing message to large banks, “if you make a mistake, don’t worry, the tax payers will bail you out.” People all over the world worried that the message the Federal Reserve sent would set the world up for an even bigger mess in the future. Americans, and those abroad, perceived the reaction by the government in bailing out the banks out as encouraging investments banks to engage in risky behavior or rather that they could behave in this way and know they were protected. The profit potential was unlimited with the downside risk low knowing that the government was giving them money to gamble with. This was the key factor in the cause of the crisis. The reckless lending from deregulated financial institutions ultimately led to the worst financial crisis in American history since the Great Depression of the 1930s.

The crash of September 2008 was the beginning of the largest bankruptcy in world history as over 30 million people became unemployed. Chairman Phil Angelides searched to find the cause of the meltdown. The key trigger was the easy lending of the housing market, because virtually anyone could be approved for a loan. John Dewey, one of America’s greatest philosophers, said that the deepest urge in human nature is “the desire to be important.” The desire to be important led to an egregious amount of greed that went so far as to not do any due diligence by either party. There was no concern for whether the buyer could pay back the loan, no concern to verify their income, no concern to the effects of originating the loan as the bankers simply focused on their “desire to be important” that was indexed to the number of zeros in their bank account. Sub-prime loans became the next move, for people who couldn’t pay back the money. Recent Federal Reserve Chairman Alan Greenspan made the mistake of not stopping the sub-prime loans. In poor and minority neighborhoods, the unqualified buyers were given the most complex of loans. Elderly people on a set income were even given huge loans that they could not possibly pay back. These loans were said to be, “downright criminal”, says Maxime Walters.

The FCC charged mortgage lender, Angelo Mozilo with insider trading and security fraud. One of Mozilo’s companies, IndyMac Bank, fell with the crumble of his dishonesty as Bank Of America came to the rescue. Mozilo didn’t care how things looked, because they didn’t stay on his record. It was all a way to get money without a thought to whom his behavior may affect. Toxic assets were passed to the broker, the lender, the securitizer, the market maker, and no one seemed to realize what they were passing along. This is what grew the “financial cancer”, says The Global Financial Crisis.

In regard to the housing market crisis, questions arose concerning Fannie Mae and Freddie Mac being stabilized by Congress. The concern was, would this heal the housing market and in the long tern create another crisis? The banks made loans that they couldn’t recover and this led to even more of a financial mess.

In the meltdown of our financial well-being, many different companies were intertwined and involved. The upside to deposit insurance was that the depositor is covered and protected by the government. The down side to deposit insurance is moral hazard. The depositors never take their money out and the banks are forced to loan to riskier people. With the downside, there ends up being more risk than there would normally be. The bankers were bundling up risky loans and selling them off to capital markets and assumed the investors understood the toxic risk in their hands. The risk was passed onto someone else and this continued the process of moral hazard. Ratings agencies like Fitch Ratings and Standard and Poor’s were additional protection agencies. The investors were covered twice, with insurance and protection agencies, or so they thought. Americans, and those abroad, had Fitch Ratings, Standard and Poor’s, and Moody’s in their scope. They felt betrayed that a rating agency would provide an AAA rating to junk-rated securities. To put it in perspective, tens of thousands of mortgage-related securities were rated; nearly half were given AAA ratings whereby at this moment in time only six American companies had a AAA rating. By the collapse of Lehman Brothers in September 2008 $523 billion was written down, within two years of the collapse of Lehman Brothers over $1.9 trillion was written down. At the collapse of Lehman Brothers, Morgan Stanley was selling their collateralized debt obligations at 22 cents on a dollar. This false sense of security gave the loaded guns into the hands of trigger-happy shooters.

With the easy lending of the U.S. housing market the high rolling bankers were enjoying the power. The billionaire mortgage sellers were fooling everyone. Whenever people touched mortgages, they made money. Greed was obviously the driving force behind this. There was a competition between New York and London to become the number one financial center of the world. The bankers were given loose regulations around the time of the New York and London race to the top.

Hank Paulson ran the economic decisions for the United States that affected the entire world. However, many people came to play with the economic meltdown, including executives from other countries. The effects on the global economy were disastrous in their own right. David Oddsson changed Iceland through his free market principles. He wanted to privatize everything. The largest banks in the country were strangely and suspiciously auctioned off to Oddsson’s friends (father and son from Russia). These people knew nothing of banking and this is what started the problems. The country was flooded with easy credit because the banks lowered interest rates. Bankers sold securities back and forth to each other, and this caused false inflation. Iceland was headed for ruin and bankruptcy. Iceland convinced people in London to bring over their money, claiming it was bullet proof. Then the Iceland banks crumbled and were taken over by the government. The Iceland bank was then categorized as a terrorist by Britain.

Dubai was full of companies building new buildings and this competition brought people to buy and re-sell with no intention of ever living or working in these homes or buildings.  “The state-owned conglomerate in the United Arab Emirates asked for a delay in repaying some of the 60 billion U.S. dollars it owed to creditors, causing panic and concerns across the world”, says *China View*. A race to the highest building was the beginning of the global real-estate burst.

Sub-prime loans were being questioned about their worth and how they became toxic due to many investors solely wanting more investments regardless of risks. BNP Paribas in Paris were the first ones to question the toxic loans. Upon finding toxic U.S. securities, Paris terminated all funds. The crisis meetings began in Paris regarding the cracks in the global economy as the corrupt spiral continued.

The Britisher Adam Applegarth, CEO of the Northern Rock Bank in London, formed a very unstable model and customers lined up to get their money back. Applegarth couldn’t even admit that his model was shaky when he was asked.

New York didn’t feel the international crisis until one of their biggest banks was at crisis. Bear Stearn’s Jimmy Cayne (CEO), the richest and highest-risk taker on Wall Street was blind to the US crisis. Bear Stearns was the 5th largest bank in the US with an unengaged CEO. The company had more toxicity than anyone on Wall Street and Cayne was forced out of position. JP Morgan took over Bear Stearns for an embarrassing $2 a share assisted by the US Government in a matter of days. Cayne used the excuse that it was, “a self fulfilling prophecy”. The idea that the government would never let such a huge company fall was a false belief that was dangerously floating through the air after Stearn’s rescue.

The next domino was the Lehman Brothers, ran by Richard Fuld. Sept 11, 2008 was the date of fall in Fuld’s company. Paulson brought together a secret crisis meeting to try and save Lehman Brothers without a government bailout. Lehman Brothers was believed to be immortal until the British government chose not to help. The liabilities to the British taxpayers would never be understood. With the fall of Lehman Brothers, it was felt around the globe. “The financial tsunami flooded the world”, says The Global Financial Crisis. The largest bankruptcy in the US was by Lehman Brothers, the greatest fall in history. All banks stopped lending money and accepting collateral and the New York stock exchange dropped.

President Bush addressed the public on the countries catastrophic condition. Paulson played the leading role on the meltdown. He claimed it wasn’t the role of government to save companies. Millions lost pension plans and their life savings around the world. Even French lawyer and managing director of International Monetary Fund, Christine Madeleine Oddette Lagarde called Paulson’s plan ridiculous. People left their jobs with boxes and sadly just walked away. The circle of investors around the world having no access to cash or assets, had to sell down their own assets at astonishing low prices, in the single digits. International financial markets were full of uncertainty and panic continued to ripple. The blame was passed around and the bottom of the spiral was questioned. AIG was the next threatened to fall, the largest insurance company. Executive Joseph Cassano performed questionable dealings that threatened the world financial position. Cassano insured companies against the failing of their business partners, with a model he assumed to be bullet proof. This practice was banned in the US, which is why he moved to London. He believed the huge companies could never fall all at once so he never worried. However, no one knew what AIG was really up to. AIG was tied to so many other companies and Paulson had to bail it out with 85 billion dollars of taxpayer’s money. Joseph was fired from AIG but he walked away with 315 million dollars. Federal Reserve chairman Bernanke and Paulson asked congressional leaders for more money to prevent more financial catastrophes. Paulson came up with TARP to use taxpayer’s money to give banks to prevent the downfall. Congress eventually rejected the bill and felt Wall Street was trying to take advantage of the public sector. The next shock was the lowest drop in stocks in history. Economic depression came to the United States. Banks were taking homes, foreclosures skyrocketed and many people were out of work. Citizens were even dragged out of homes and many committed suicide. People slept in their cars and had nowhere to go since they had lost everything they had ever invested in.

Then, America’s top Bank CEOs was called together for a secret meeting. Paulson planned to involve the government into the banking situations. The CEOs were forced to accept the money from the government along with government interference. Protesters were everywhere opposing the bailouts of bankers. Paulson claimed that the best thing that happened to the taxpayers was that the downfall that “didn’t happen”. However, the meltdown was already happening all around the world. Violence and protests around the world began after the meltdown. Anger at the United States was what united Europe. It was unclear if the markets would stay frozen.

The moral hazard that tossed the world’s financial well being into a downward spin began as Wall Street decided to link the investors to mortgages in hopes for a massive profit. The bankers then divided the loans into three sections, safe ones protected by credit default swaps sold to investors, decent ones that were sold to other bankers, and riskier ones sold to hedge funds. Credit default swaps became involved so that the rating agencies would approve the loans. The investment bankers made millions and their greed made them want more CDO slices. Without being able to find more, they found sub-prime mortgages. Lenders decided to add more risk to new mortgages without required paperwork or down payments and extremely low teaser rates that only enticed the unqualified buyers. The homes were sold to irresponsible parties, who were quite literally financially unable to pay off the loans. No one was concerned, because massive cash was being made. The mortgage brokers linked the families with the lenders and mortgages, families bought homes, the lender sold the mortgages to the investment bankers and they turned them into collateralized debt obligations (CDOs) and sold slices. No one cared because they were selling off their risk to the next person. More and more of the monthly payments turned into houses and everything turned upside down. Default rates rose and then no investors wanted the toxic CDO’s. The investors have bought thousands of these bad CDO’s and the entire financial system froze as everyone went bankrupt. Lastly, is the message that moral hazard sends to us that large criminal corporations can make massive profits off the expense of the rest of the world and get away with it?

In conclusion the financial crisis of 2008 was caused by the lax regulatory environment for financial institutions and the subprime mortgages that they gave to millions of Americans. Six years after the crisis, the economy of the United States has recovered, however lending is still in low supply. Banks have learned their lesson from the crisis, which has forever made getting a loan harder.

Works Cited

*Crisis of Credit*. N.p., n.d. Web. 28 Mar. 2012.

*Financial Crisis, The Meltdown 2008*. N.p., n.d. Web. 25 Sept. 2011.

*LINGO:Moral Hazard*. N.p., n.d. Web. 16 Feb. 2010.

*PBS Newshour*. N.p., n.d. Web. 18 July 2008.

*Too Big to Fail*. Dir. Curtis Hanson. Perf. James Woods, John Heard, William Hurt. HBO Films, 2011. DVD.