The 2008 financial crisis or "**The Great Recession**", was a severe 1930s style worldwide economic crisis which led to a global financial meltdown and had catastrophic implications. It not only put global financial markets on the verge of crash, but also put a question mark against the prevailing notions in the economic and financial domains. While the vulnerabilities that created the potential for crisis were years in the making, it was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages— that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008.

Before getting into the crisis, we first need to understand the key terms and the role-players.

**Mortgage,** according to textbook definitions, basically refers to the loans that are taken out to purchase a real-estate property, while keeping the house as the collateral. Every month, the home-owner has to pay back a portion of the principle borrowed, plus interest on the loan back to whoever holds the property's papers. If the home-owner fails to pay the said amount for a particular month, it is called **default** and whoever holds the paper becomes the owner of the house. Often, banks, the original lenders, sell these mortgages to a third party. Traditionally, it is pretty difficult to get a mortgage if the loaner has a bad credit or doesn't have stable sources of financial income streams. Lenders usually avoid the risk of giving out risky loans from the fear of default on the loan.

However, this gets changed in the early 2000s as investors in the US and abroad looking for a low risk and high return investments and in turns started throwing money in the US housing market. They figured that they could get better returns from mortgages than they could from other then-offered investments like treasury bonds, which were paying very low interests. Big global investors were more interested in buying mortgage-backed securities from banks than having to deal with the individual customers.

**Securitisation** refers to a process in which a pool of loans/illiquid assets is grouped together and broken into smaller investable units and sold to investors.

**Asset-backed security** is is a security whose income payments, and hence value, are derived from and collateralised by a specified pool of underlying assets.

**Mortgage-backed securities** are a type of asset-backed security, which is created when large bundles of mortgages are pooled and their shares are sold to investors as securities.

Mortgage-backed securities looked like extremely safe bets at the moment as the prices of real estate went high and more number of people were buying housing-related loans. Even for a worst-case scenario, the lenders could sell the house for more money if the borrower defaulted. Credit-rating agencies claimed these mortgage-backed securities were safe and gave them a AAA-rating. At the time when mortgages were only for borrowers with good credit ratings, Mortgage-backed securities were a good investment. Overtime, as more number of investors were looking for more of these securities to invest in, the spiral started churning negatively as banks started lending to people with low income and poor credit, called **subprime mortgages**, to create more of these securities. Eventually, lenders started engaging in predatory lending practices as they made loans without verifying income and offered "adjustable-rate" mortgages. By the end of 2007, Lehman, a big US financial institution had amassed $111 billion in commercial and residential real estate holdings and securities, which was almost twice what it held just two years before, and more than four times its total equity. And again, the risk wasn’t being taken on just by the big financial firms, but by families too. Nearly one in in 10 mortgage borrowers in 2005 and 2006 took out “option ARM” loans, which meant they could choose to make payments so low that their mortgage balances rose every month and started spiralling out of their payment capabilities. Trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world. Historical data pointed to these securities still as safe bets, even as they were becoming less trustworthy overtime. As the mortgage and real estate markets churned out riskier and riskier loans and securities, many financial institutions loaded up on them. Traders also started selling CDOs, or Collateralized debt obligations, which were even riskier financial products backed by a pool of loans and assets, as these underlying assets served as a collateral if the loan went into default.

As the lending requirements laxed and interest rates dropped, the housing prices drove even higher which only made these mortgage-backed securities and CDOs seem like a great investments. However, these factors drove into the negative direction as borrowers could not pay for their expensive houses or pay for their ballooning mortgage payments. Borrowers stared defaulting and more and more houses went back on the market. As the supply for houses increased and the demand fell, the prices for real-estate started collapsing. Moreover, a lot of home-owners had mortgages worth more than what their houses were worth and stopped paying, putting more houses on the market and driving the prices down further. This created housing bubble. As this was happening, big financial institutions stopped buying subprime mortgages and subprime lenders were stuck with bad loans.

Unregulated derivatives, especially Credit default swaps, which basically sold as insurance against mortgage backed securities. Big firms like AIG let these insurances out without the money to back them up when time needed. These credit default swaps were also turned into other securities which allowed traders to bet huge amounts of money on the value of these mortgage backed securities going up or down.

All of this created a complicated net of assets, liabilities and risks and when the net collapsed, it hurt the entire financial system. Despite the expressed view of many claiming the crisis to be unavoidable, there were warning signs. The tragedy was that they were ignored or discounted. Risky subprime lending and securitisation, an unsustainable rise in housing prices, widespread reports of predatory lending practices, dramatic increases in household mortgage debt, and exponential growth in financial firms’ trading activities, unregulated derivatives, and short-term “repo” lending markets, among many other red flags. Yet, little meaningful action was taken to quell the threats in a timely manner.

Federal reserve bank came out with emergency loans to provide bailouts to big, sound financial institutions and prevent them from collapsing just because the lenders were panicking Government enacted TARP, or troubled assets relief program and spent $250 Billion dollars to bail out the banks, and later other sectors. This helped cascade the panic that had set in.

ultimately, the US congress passed the Dodd-Frank law, which took to increasing transparency and prevent banks from taking too much risk. It set up consumer protection bureau to protect borrowers from predatory lending practices and required financial derivatives to be traded in exchanges where all market participants could observe.

In the years leading up to the crisis, too many financial institutions, as well as too many households, borrowed to the hilt, leaving them vulnerable to financial distress or ruin if the value of their investments declined even modestly. For example, as of 2007, the five major investment banks—Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley—were operating with extraordinarily thin capital. By one measure, their leverage ratios were as high as 40 to 1, and to make the matters worse, much of their borrowing was short-term, in the overnight market—meaning the borrowing had to be renewed each and every day. or example, at the end of 2007, Bear Stearns had $ 11.8 billion in equity and $ 383.6 billion in liabilities and was borrowing as much as $70 billion in the overnight market. It can also be concluded the government was ill prepared for the crisis, and its inconsistent response added to the uncertainty and panic in the financial markets. The Treasury Department, the Federal Reserve Board, and the Federal Reserve Bank of New York—who were best positioned to watch over the markets were ill prepared for the 2007-2008 crisis. While there was some awareness of, or at least a debate about, the housing bubble, the financial crisis inquiry committee noted that the records do not reflect the recognition that a bursting of the bubble could threaten the entire financial system. Many people who abided by all the rules now found themselves out of work and uncertain about their future prospects. The collateral damage of this crisis has been real people and real communities.