

Regional and National Financial Crises: Roots, Results, and Responses



POLICY RESEARCH INSTITUTE
FOR THE REGION

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Regional and National Financial Crises: Roots, Results, and Responses

November 7, 2008

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This Executive Summary of the proceedings offers an overview of the symposium. A complete report on the conference will be published at a later date.

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The Policy Research Institute for the Region was established by Princeton University and the Woodrow Wilson School of Public and International Affairs to bring the resources of the University community to bear on solving the increasingly interdependent public policy challenges facing New Jersey, metropolitan New York, and southeastern Pennsylvania.

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Preface

2008 was the worst year for the financial markets since the Great Depression. Stock prices vacillated back and forth by the hour, and every day seemed to bring another crisis, including the demise of institutions previously deemed “too big to fail.” The U.S. unemployment rate surged in December 2008 to 7.2 percent, ending a year in which employers eliminated 2.6 million jobs. Consumer bankruptcy filings were up nearly 33 percent in 2008, reaching almost 1.1 million. Home foreclosures rose to record highs, and projections are for even more foreclosures and job losses in 2009.

Adding to all of these financial woes, it has come to light that formerly well-respected financiers have stolen billions of dollars in clients’ investments, while politicians are being investigated for ethics violations stemming from “pay to play” contributions. It is difficult to imagine a more challenging situation for an incoming President and the Congress.

Dealing with the financial crisis that has spread across the United States and the globe is the top priority of the new Obama administration as it takes the reins in January 2009. Both Republican and Democratic legislators agree that the crises require bold action, but there is substantial disagreement about what that action should entail. Some people say that the Obama plan is too ambitious; others opine that it is not ambitious enough. There are myriad ideas of how to spend the stimulus money and, at the same time, dire warnings about increasing the national debt.

The incoming Obama administration has proposed a \$775 billion stimulus package that combines tax credits, business refunds and spending incentives to jump-start the economy and stabilize the financial markets. He is also considering how to spend the remainder of the \$700 billion bailout fund, half of which has already been used to rescue troubled financial institutions. One suggestion is that the government use a large portion of the remaining funds to help homeowners avoid foreclosure, to spur consumer borrowing and to assist local governments in obtaining bond financing.

A key component in Obama’s plan is to overhaul the financial markets with a major restructuring of the regulatory agencies. He proposes combining the SEC and the Commodities Futures Trading Commission into a “super-regulator,” stating that “Wall

Street has not worked” and that “We’re going to have better enforcement, better oversight, better disclosure, increased transparency.”

It is obvious that these deep financial crises are not easily fixed and that the nation and the world are a long way from solutions.

These topics and others were discussed on November 7, 2008, at the Policy Institute for the Region’s (PRIOR) forum titled “Regional and National Financial Crises: Roots, Results and Responses,” to analyze the causes of the financial crises and to present possible solutions to the economic turmoil, bringing together experts from the region and the nation to address these pressing issues.

Former Congressman James A. Leach delivered the opening address, discussing financial regulation and the responsibility of the Congress. Congressman Leach was a former Chairman of the House Banking and Financial Services Committee, making him uniquely qualified to discuss the financial crisis and the role that government should play in its resolution. His recommendations to increase regulatory capacity at the SEC and CFTC are compatible with Obama’s plan to create a new, stronger regulatory agency to ensure compliance and transparency. Congressman Leach also discussed the abuse of subprime mortgages and the pyramid structure that finally collapsed and precipitated the financial crisis in the housing market. He criticized the enormous amount of leverage Fannie Mae and Freddie Mac were allowed to incur and voiced concern for homeowners now faced with foreclosures on houses they cannot afford.

The first panel, “Anatomy of the Mortgage Crisis,” analyzed the factors that led to the crisis. Panelists discussed the shift in ownership of mortgage assets from traditional banks to other institutions that borrowed so heavily against their assets that they were left with massive debt and declining assets when the housing market collapsed. Mortgages were issued with little regard for the mortgagees’ ability to pay once the initial teaser rates expired, counting on the continued rise in house prices to insure payoff of the loan even if the homeowner was forced to sell. When housing prices began to unexpectedly fall, people found themselves in the unfamiliar position of owing more money than the house was worth, and lenders found themselves with a surfeit of houses that they did not want and could not sell. Panelists offered suggestions to increase government spending to assist homeowners in keeping their houses and to institute mortgage counseling and direct contact between lenders and mortgagees to work out plans for affordable payments. It was suggested that another



PRIOR Director Richard F. Keevey, Congressman Rush Holt, and former Congressman Jim Leach

large stimulus package would be required to help troubled homeowners, and that is part of Obama's proposed plan.

The second panel focused on "Looming Threats in the Public Finance Arena," and began with an overview of

the state and local bond markets, and some of the problems connected with swaps and derivatives. Panelists, particularly Kit Taylor, the former executive Director of the Municipal Securities Rule Making Board, discussed the investigations currently underway in this market, and today's headlines concerning prominent political figures and questionable campaign contributions by underwriters underscore the problem of too little regulation and reduced competition among bond issuers. Subsequent to the formal panel discussion, Dr. Taylor recommended that negotiated deals be banned and that all bond sales be competitively bid at auction – which, in his judgment, would go a long way toward addressing 'pay to play' and reduce cost to state and local government.

The 1986 Tax Reform Act was also discussed. The Act has created a disincentive for banks to lend to municipalities, resulting in an increased role for hedge funds. Since these hedge funds are now losing assets, the ability for municipalities to borrow money from them is decreased. If municipalities are not able to issue bonds for infrastructure improvements, then needed projects will not be addressed or will be curtailed without federal assistance.

Professor Alan Blinder, Co-Director of Princeton's Center for Economic Policy Studies and former Vice Chairman of the Federal Reserve Board, delivered the luncheon address, starting with the assertion that the present crises can be dated to the failure of Lehman Brothers. His description of the financial crises likened the failure to dominos falling- the mortgage finance sector, the money market funds, banks, and finally European institutions - all toppled as the government scrambled to do damage

control. Although TARP was meant to buy and refinance mortgages, so far none of the \$700 billion has been spent for that purpose. It was also supposed to buy troubled, mortgage-related assets, but Treasury has not done that as yet, either. The third purpose was to buy any financial instrument that the Treasury Secretary and Federal Reserve Chair deem necessary to promote financial stability, and that is where the money has been spent so far, including the recent loan to the auto industry. Professor Blinder suggested that the government may decide to regulate hedge funds in the future, as he predicted that they will play an increasingly large part of the financial environment.

Finally, Dr. Susan Wachter, Wharton School Professor and former Assistant Secretary for Policy and Research at the U.S. Department of Housing and Urban Development, addressed “Understanding the Sources of the Ongoing Financial Upheaval.” Dr. Wachter talked about the housing crisis and the change in the way that loans were packaged and re-sold to investors; a system that delivered profits from the transaction fees that encouraged short-term gain and ignored long-term perils. This was a major change from loans issued by local banks that serviced mortgages in their community and looked closely at the borrower’s ability to pay. The spread of these risky subprime mortgages ultimately led to spiraling prices and the eventual collapse of the housing bubble.

Although the financial crises in the United States are obviously not able to be solved in a one day forum, the experts who gathered at the Woodrow Wilson School offered insights on the current financial environment analyzed the events that led to the crises, and recommended new policies to avoid making similar mistakes in the future.

The following agenda and executive summary of the proceedings offer an overview of the symposium—a complete report on the conference will be published at a later date.

Special thanks are offered to Thomas Hale for his work on this publication.

Sincerely,

A handwritten signature in black ink that reads "Richard F. Keevey". The signature is written in a cursive, flowing style with a large, prominent 'R' at the beginning and a long, sweeping tail that extends to the right.

Richard F. Keevey, Director

Regional and National Financial Crises: Roots, Results, and Responses

November 7, 2008

Summary of Panel Discussions

This one-day conference on “Regional and National Financial Crises: Roots, Results, and Responses” was distinguished both by the expertise of the presenters and the timeliness of the topic. The conference was thus able to make a significant contribution to an issue appearing in the daily headlines. Such insight was especially important, as Richard Keevey, the Director of PRIOR, noted at the outset:

One day the solution is buying up toxic mortgages. The next day it is investing billions of dollars in a selected number of banks. One day the administration's proposal consisted of a 2-page document from the Secretary of the Treasury; the next week there's a 435-page document from Congress. The stock market seesaws back and forth between huge losses, huge gains, and sometimes only within hours, and no one seems to be able to pinpoint exactly why.

The panelists covered a range of pertinent topics. First, Congressman James Leach gave a detailed account of the regulatory failures that contributed to the crisis and how they might be fixed. Second, a panel discussion parsed the exact dimensions of the mortgage crisis and the response of the Federal Reserve and the U.S. Treasury through the \$700 billion Troubled Asset Relief Program (TARP). Another panel considered the impact of the crises on the ability of states and local governments to finance their operations by issuing bonds. Over lunch, Princeton's Alan Blinder explained the crisis in lucid and stark terms, warning of significant economic difficulties ahead. Last, the conference concluded with Professor Susan Wachter of the Wharton School explaining what exactly happened in the subprime meltdown and how it might be avoided in the future.

While the panelists identified many unanswered questions and engaged in detailed debates over certain issues, they found broad agreement on a number of points. First, the “innovative” financial instruments through which mortgages were



Session I:

Financial Regulation and the Responsibility of the United States Congress

Honorable James A. Leach

Former Chairman, Banking and Financial Services Committee, United States Congress, and currently John L. Weinberg/Goldman Sachs & Co. Visiting Professor, Woodrow Wilson School, Princeton University

securitized, packaged, and resold should have been regulated much more rigorously. Such financial slight-of-hand will need to be controlled in the future. Second, the \$700 billion TARP, as it has been executed to date, is inadequate to the gravity of the crisis. Of particular concern is the lack of a plan to use the money to rescue homeowners defaulting on their mortgages. Third, the incentive of short-term profit can lead financial entities to make poor decision with drastic consequences for both themselves and the economy as a whole. In other words, to paraphrase the recent testimony of former Federal Reserve Chairman Alan Greenspan before Congress, greed must be properly controlled.

Congressman Leach opened the proceedings with a broad but detailed overview of the regulatory landscape, the regulatory failures that led to the present crisis and how they might be fixed. In general terms, the economic crisis can be traced to the lack of savings and the twin fiscal and trade deficits, he argued. He also cited the war in Iraq, “the first war in human history to be financed with tax cuts,” as a strain on the financial system. But the proximate cause Congressman Leach identified was of course “the pyramidal subprime dilemma:”

Put simply, for more than a decade home prices in much of the country increased faster than household income or inflation, with buyers, some of whom lacked the financial capacity to commit to a long-term investment, choosing mortgage products with low down payments and escalating future payment clauses. As the economy weakened, wages stagnated, and job creation sputtered, then declined, the housing market stumbled.

The key enabler of this excessive borrowing and lending was a set of complex financial instruments that insured, disaggregated, and exchanged the mortgage contracts offered to

home-buyers. Congressman Leach noted that the value of these and other credit derivative contracts—what Warren Buffet has referred to as “instruments of financial destruction”—now have a notional value (meaning the total value of their leveraged assets) that exceeds the GNP of all the economies in the world.

Congressman Leach highlighted the role of the government-backed lenders Fannie Mae and Freddie Mac in the abuse of subprime lending. He noted that according to their regulator these agencies maintained one dollar for every \$60 in liabilities, but that the actual ratio may have been as high as several hundred dollars in liabilities for every dollar in reserve. “To the degree that a role of regulators is to keep leverage in check, it is preposterous that Fannie and Freddie were allowed such enormous leveraging,” he argued.

Turning to what should be done, Congressman Leach identified two issues that the government and the President-elect’s transition team must now consider. First, the social issue of “whether it is fair to attempt to right a system from the top-down, and not deal with the mortgage challenge from the bottom-up, that is, from the homeowner’s perspective.” And second, the regulatory issue of how to protect against systemic risk. He then listed several detailed proposals for how to proceed.

First, Congressman Leach argued for increased regulatory capacity at the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). He argued these two entities should merge and hire new staff with economics training. The CFTC in particular, he noted, is too small, with too much responsibility for too sophisticated a market. The revitalized agency should be mandated to work with the



Honorable James A. Leach noted that the economic crisis can be traced to the lack of savings and the twin fiscal and trade deficits, as well as the war in Iraq, “the first war in human history to be financed with tax cuts,” as a strain on the financial system. But, he identified the proximate cause as “the pyramidal subprime dilemma.”

Treasury and the Fed, particularly the latter, as it reviews leveraging regulations and develops coordinated financial rules.

Second, Congressman Leach argued for an expanded regulatory role for the Federal Reserve, noting that the Fed “has the greatest discretionary resources of any part of the government.” He noted that both the legal and economist professions are critical to oversee markets, but because financial regulation is “principally about the right, not the left, side of the brain,” the more numerically backgrounded Fed with its stable of economists should have a heightened regulatory role. Its purview should be broadened to oversee and serve as the umbrella ‘stability regulator’ for all systemically important firms, including currently non-federally regulated entities such as hedge funds and insurance companies. Similarly, the agencies that regulate government-sponsored enterprises like Fannie Mae and Freddie Mac should be consolidated and strengthened to prevent firms from arbitraging regulators.

Third, the Congressman suggested that an obscure charter authorizing industrial loan companies, an instrument used by investment banks to escape oversight, should be abolished.

Fourth, ratings agencies should be more comprehensively regulated both by the SEC and Congress, which should bring them before committees under the Humphrey-Hawkins review process.

Fifth, Congressman Leach proposed the creation of a federally regulated clearinghouse for multi-party swaps and derivatives. Such a body would not only make the engine of finance work more fluidly, but would also provide a hook to bring governmental oversight and U.S. standards to market participants, including non-banks and foreign firms. Indeed, statutory authority for such an approach already exists in the Commodity Futures Modernization Act of 2000, but has not yet been effectively implemented by regulators. That is unfortunate, because had clearinghouses been established and appropriately regulated, “the systemic consequences of the current crisis might have been considerably softened.”

Still, some progress is being made, the Congressman noted. In New York a trust company has been chartered under Fed oversight to serve as clearinghouse for swaps. The CME Group of Chicago is also developing a CFTC-regulated clearinghouse, as are some European regulators. However, uncertainty remains as to how exactly these new clearinghouses will be regulated. It is thus essential, Congressman Leach argued, that the Fed plays a lead role in developing and enforcing standards.

Sixth, the Congressman noted the problem of regulators allowing numerous exemptions to certain rules on a case-by-case basis. Such exemptions should be reduced, he argued, and only ever applied under short-term, crisis conditions.

Seventh, while public funds may be required to prop-up certain firms in times of crisis, tax-payer dollars should always come with enhanced public oversight. These measures should include placing public representatives on the boards of the institutions receiving funds, to serve as “implicit overseers of public resources and stewards of the public interest.”

Eighth, regulators should question the assumption that large international institutions should be subject to less stringent capital requirements than smaller community banks. “As events of the past year have shown, it is our larger institutions which are most likely to precipitate taxpayer bail-outs and, more consequentially, jeopardize the financial system if they make market mistakes.” Moreover, “Laxness in regulation appears to have been in direct proportion to size of institution regulated, with the most sophisticated of our national and international regulatory bodies having the most disappointing track records in the new century.”

Ninth, the Congressman questioned the wisdom of a quantitative risk-based modeling approach to regulation. Regulators have increasingly accepted long-term debt, the value of which was determined by complex mathematical models of future risks, as assets large financial institutions can leverage. However, “what seemed like a “smart,” modern approach – use of risk-based modeling tools – was used to rationalize less than wise standards,” he argued. Traditional capital

adequacy requirements seem to have been much safer. “In unprecedented circumstances where the human factor – market psychology -- plays a role and where international politics and economics are so intertwined, risk models themselves are risky.”

Finally, Congressman Leach argued that better regulation could have substantially ameliorated the present crisis:

... if banks and large insurance companies had come under more restrictive leveraging guidelines in the trading of derivatives products, based on powers that could have been exercised by state insurance authorities, the CFTC, SEC and Treasury; and, if a swaps clearing facility had been created and vigilantly regulated and mortgage fraud more diligently pursued by either the Fed or Treasury, the depth and consequences of the current financial crisis could have been substantially lessened.

The good news, according to Congressman Leach, is that government is better equipped today to deal with the financial crises than it was in the 1930s. He made an analogy to the military doctrine of overwhelming force: “The government in Washington is trying to muster overwhelming financial capacity. It may be too little, too late, but the intent is to re-establish confidence by making it clear that any and all steps will be taken.” The other bright spot the Congressman identified was “the majority of American banks -- the non-money center financial institutions -- are well regulated, community-centric and by-and-large shielded away from purchasing sophisticated derivatives products.” It is these institutions that will “have a significant effect on whether the mortgage

market rebounds and the economy can be kept on an even keel.”

He concluded by noting that “financial markets are not only operating in dangerous times but in unprecedented circumstances with techniques never used before. With each passing year private sector finance becomes increasingly sophisticated relative to government regulatory capacities.” The regulatory challenges are thus severe, and will take an enormous amount of political will and governmental ingenuity to surmount.

Session II:

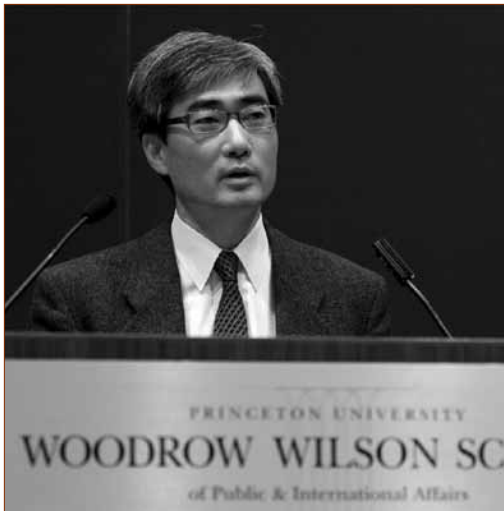
Anatomy of the Mortgage Crisis

Hyun Song Shin, Ph.D.

Hughes-Rogers Professor of Economics, and Associate Chair of the Economics Department, Princeton University

Professor Shin began the session with a descriptive overview of the economic crisis. First, he demonstrated the enormous growth of the financial industry. Dividing the economy into four sectors--the non-financial corporate sector, the household sector, the commercial bank sector and the broker-dealer sector—he demonstrated that since 1952 the first three sectors have grown at about the same pace, expanding to 80 times their previous size. The broker-dealer sector, in contrast, has grown 800 times, meaning that the role of the financial industry relative to other sectors of the economy has increased enormously. The greatest growth, moreover, occurred after 1980.

Second, Professor Shin showed the shifting ownership of mortgage assets. In the early



Professor Hyun Song Shin of the Princeton University Department of Economics opened the session with a descriptive overview of the economic crisis.

1980s, mortgages were held almost entirely by traditional savings banks. However, over time other intuitions began holding a larger and larger share of mortgages or mortgage-backed assets, including government-sponsored enterprises like Fannie Mae and Freddie Mac. Around 1990 traditional banks were overtaken by other institutions. This shift toward securitization of mortgages was made possible, Professor Shin argued, by access to non-deposit funds, including investment from abroad.

Third, Professor Shin noted a peculiarity of the broker-dealer sector that makes it exceptionally vulnerable to bubbles. For most of the economy, growth in assets decreases the amount of leverage; that is, the better off an entity is financially the less debt they tend to hold. This tendency is reversed for the broker-dealer sector, meaning that the more assets these firms have the more they borrow against them. While this characteristic can lead to great gains when times are good, it can also lead to what Professor Shin called a “double whammy” of massive debt and declining assets when the bubble bursts.

Professor Shin concluded by putting the present crises into context, noting it will lead to losses of about ten percent of GDP according to current estimates. This makes it larger than the savings and loan crises, but still smaller than the Japanese crisis or the East Asian crisis. However, current estimates may be overly conservative, Professor Shin warned, given the ongoing stream of pessimistic economic indicators.

Mark Zandi, Ph.D.

Chief Economist and co-founder Moody's Economy.com

Dr. Zandi began his remarks with a discussion of “how we got into this mess.” It began, he argued, with the housing boom and bust. Housing prices doubled in the first half of the decade, reaching their peak in the first quarter of 2006. This bubble provided the fuel for the crisis. Additionally, the process of securitization, through which credit was made available for many of the mortgages financing the housing bubble, is flawed, Dr. Zandi argued. No one “was responsible for making sure that the mortgage loans that were being made were good loans.” This hubris led to a spectacular collapse, with housing prices now 20 percent down from their peak and still falling.

Dr. Zandi next identified three waves of foreclosures in the present crisis. The first was 2006, right as home prices reached their peak. “This was the flipper who got into the market looking for a quick buck,” Dr. Zandi explained. As soon as it became clear that the market was starting to fall these speculators began defaulting on their mortgages. The second wave was 2007, when many of the subprime mortgages that had been taken out in previous years on very favorable terms



Economist Mark Zandi noted that since no one "was responsible for making sure that the mortgage loans that were being made were good loans" in the early part of the decade, this led to the spectacular collapse of the housing market.

saw a sudden increase in rates. The average monthly payment for such loans increased \$350, Dr. Zandi showed, causing numerous foreclosures. The third wave is going

on now, as rising unemployment and the worsening economy force homeowners to default on their mortgages.

Dr. Zandi then offered some estimates of the future extent of the crisis, which roughly aligned with the IMF projections, he noted. He estimated a total loss of \$1.3 trillion, with housing prices falling 30 percent off their peak (i.e. ten percent more than at present), commercial real estate falling 15 percent, and unemployment rising to a peak of 7.8 percent in the fourth quarter of 2009. If true, these estimates would place the current recession on par with the worst of the postwar years. More encouragingly, Dr. Zandi argued that panic has likely peaked already, and that while confidence will take a while to strengthen, it will not get much worse.

There are three primary links between the financial industry and the real economy, according to Dr. Zandi. First is credit. With the banking system in "survival mode," lending standards have tightened significantly and it is much harder for businesses and individuals to obtain financing. Second, financial markets affect confidence in the real economy. When catastrophic economic news

regularly appears in the headlines, consumer and businesses become less willing to spend. Third, the financial crisis has destroyed wealth. While the connection between wealth and growth is complicated, Dr. Zandi argued it was unquestionably deleterious for individuals to watch their assets evaporate.

Dr. Zandi concluded with some thoughts on policy. The Fed is now coming to the end of what it can do, he argued. Now empowered to lend money to whomever it deems appropriate and even buy whomever it deems appropriate, the Fed is as powerful as it can be. The onus, then, shifts to the new President, for whom Dr. Zandi had three suggestions. First, the TARP should continue to make equity investments, including in the mortgage market. Second, there needs to be a much broader foreclosure mitigation plan to prevent the housing market from "overshooting" in its downward correction. Dr. Zandi estimates there to be 12 million homeowners at risk at present, which, combined with rising unemployment, is a pending disaster. Third, this will require another large stimulus package, perhaps around \$300 billion, or two percent of GDP.

Erica Groshen, Ph.D.

Vice President and Director of Regional Outreach, the Federal Reserve Bank of New York

Dr. Groshen's remarks focused on the subprime crisis in the region and specifically in New Jersey. New York and New Jersey have roughly tracked each other economically since the 1980s, but New Jersey has been a bit more stable. The state's economy is now in decline, however, and the collapse of the financial sector is likely to make things worse in the future. Dr. Groshen also noted

that though the present crisis started in the subprime market, she is seeing contagion to other mortgages and to consumer credit in general. As of March 2008 there were 6.7 million subprime loans with a balance of \$1.2 trillion, and as of September 2008 the foreclosure rate was around 11 percent.

New Jersey has generally avoided the rapid boom-bust cycle of fast-growing regions like California and Florida, as well as the general decline of areas like Ohio and Detroit. New Jersey and New York thus have a lower than average rate of subprime mortgages, though a higher than average rate of foreclosures. However, this last fact is likely due in large part to the relatively long period of time required to foreclose a house in the region. Within the state, subprime mortgages are highly concentrated in a few areas.

Dr. Groshen highlighted the role of servicers—companies that actually hold the securitized mortgages and interact with homeowners directly—in the crisis. Because these companies are paid a flat rate per loan, whether it is in foreclosure or behaving normally, these companies are “squeezed between rising costs per loans and static revenue per loan.” This situation gives servicers incentives to pursue reimbursable activities such as foreclosing non-performing mortgages over non-reimbursable activities like loan modification—i.e. working out a feasible payment plan with the borrower.

A further challenge for servicers is getting in touch with borrowers who are defaulting on their payments. Such individuals may be stressed, or feel embarrassed to speak with mortgage holders. Dr. Groshen noted one estimate that half of homes go into foreclosure with no contact between the borrower and servicer.



New Jersey has generally avoided the rapid boom-bust cycle of fast-growing regions like California and Florida, and thus has a lower than average rate of subprime mortgages, though a higher than average rate of foreclosures, said Erica Groshen, vice president of the Federal Reserve Bank of New York.

Servicers have taken some steps to try to resolve these issues, through such programs as the HOPE NOW initiative and the American Securitization Forum. Outreach to borrowers, counseling, and loan modification can all help to

ease the impact of the crisis on home-owners.

David Wilcox, Ph.D.

Deputy Director, Division of Research and Statistics, the Federal Reserve Board, Washington D.C.

Dr. Wilcox offered a perspective from the frontline of the Fed’s efforts to avert the financial crisis. He kept his remarks brief because, he quipped, “The less that I say today, the less will change tomorrow.”

The TARP is not striving to cure all that ails the economy but rather “to restore market functioning and to support viable financial institutions.” Several mechanisms are available to accomplish this goal. One is injecting capital into financial institutions. A second is buying financial assets, providing guarantees or insurance for them, or providing incentives for mortgage modification. Congress gave the Treasury and the Fed enormous discretion to purchase assets under the TARP, and \$700 billion worth of capacity with which to do it.

The first step, injecting capital into financial institutions, has already been accomplished, with \$250 billion given or made available

to targeted firms. Dr. Wilcox noted that the taxpayer will be receiving a five percent dividend yield on the acquired equity for five years, after which the yield will go up to nine percent. During the question and answer session, one audience member asked whether banks receiving money under the TARP should be required to lend it out, noting that some banks were simply using the bailout money to buy other banks. Dr. Wilcox argued that the purpose of the bailout was to restore investor confidence in the banks and bank's confidence in one another. He also noted the incentive to use the funds to support lending as one way of making money.

Dr. Wilcox concluded by discussing what the TARP should do with the \$450 billion that remains uncommitted. First, more capital could be injected into vulnerable financial institutions. A second round of bailouts could possibly encompass a broader range of institutions, Dr. Wilcox noted, to make it more effective. Another strategy would be for the Fed to directly purchase distressed assets, which are currently under-traded and thus opaque. Third, Dr. Wilcox suggested the TARP might be used to mitigate foreclosures. Whatever strategy is considered, Dr. Wilcox noted it will be up to the future administration to determine if the pool of resources needs to be expanded.

During the discussion period, Congressman Rush Holt questioned Dr. Wilcox about the vagueness of the rescue package and asked what limitations and restrictions were in place if Congress decided to revisit the plan and impose more guidelines. Dr. Wilcox quoted Keynes in saying that "When the facts change, I change my mind," and stated that if Congress revisited the plan, the key would be flexibility and trust between the executive and legislative branch.



Dr. David Wilcox offered a perspective from the frontline of the Fed's efforts to avert the financial crisis, noting that the TARP is not striving to cure all that ails the economy but rather "to restore market functioning and to support viable financial institutions."

Session III:

Looming Threats in the Public Finance Arena

Joseph Fichera

CEO and Senior Managing Partner, Saber Partners, LLC and Visiting Lecturer, Woodrow Wilson School, Princeton University

Mr. Fichera began the session with an overview of the state and local bond market and the threats currently facing it. He noted this market, at \$2.7 trillion, is small relative to the total bond market of \$30 billion. It is also very fragmented with over 50,000 issuers—everything from school districts to states—1.5 million bonds, and diverse sources of credits and assessments. Federalism is a key driver of this fragmentation, because the federal government is prevented from enforcing uniform regulation on the issuers, as it does in the corporate bond market.

Mr. Fichera then turned to the threats currently facing the local bond market. First, many bonds have been transformed into derivatives, but the lack of federal regulation

has meant that there is little transparency for these instruments. Second, Mr. Fichera noted there are numerous federal, civil, criminal, and regulatory investigations underway in this market, covering frauds ranging from bid-rigging to anti-competitive actions by dealers. Third, the collapse of several banks has led to a smaller market for local debt, raising the price and reducing the efficiency of the market, especially because of competition with corporate bonds. At the same time, local governments face an increased need to infrastructure expenditure and looming pension fund obligations.



Joseph Fichera, in his overview of the state and local bond market and the threats currently facing it, commented that many bonds have been transformed into derivatives, but the lack of federal regulation has meant that there is little transparency for these instruments.

Mr. Fichera closed his remarks with an extended quote from Arthur Levitt of the Securities and Exchange Commission on the dangers of bond underwriters selling their own products to too complacent issuers:

...it's clear what has, that too many issuers were left in the dark. Many had no independent advisors, and those that did hire advisors often found themselves receiving advice from parties that were conflicted since these advisors also worked as a banker in the auction securities market. ... Treasurers and CFOs displayed

a false trust in their underwriters and investment bankers seeing them as advisors instead of their competitors in the capital markets. ... State and local governments far too often practiced as almost an art form a go along-get along attitude of Wall Street. The sad reality in this case is that what they were doing is hardly in the issuer's best interest."

John L. Kraft

Bond Counsel, Lomurro, Davison, Eastman & Munoz, P.A.

Mr. Kraft spoke about the historical regulatory disputes over municipal bonds and the tax-incentives around them. He specifically identified the 1986 Tax Act and suggested that Congress repeal portions of the act because it prevents, as an example, banks from deducting "interest to carry" costs. These are the borrowing costs a bank incurs when it borrows money that it later lends back out; i.e., if it costs a bank three percent to borrow funds to purchase a municipal bond, the 1986 act prevents it from deducting the three percent cost. By contrast, the bank can deduct the three percent as a business expense if it lends the money to a private person. This provision of the 1986 Act has greatly reduced bank



John L. Kraft suggested that Congress repeal portions of the 1986 Tax Act because it prevents, as an example, banks from deducting "interest to carry" costs, which are the costs a bank incurs when it borrows money that it later lends back out.

participation in the municipal bond market, thus making it more difficult for local governments to obtain financing.

Christopher A. Taylor, Ph.D. & CFA

*Consultant and Former Executive Director,
Municipal Securities Rulemaking Board*

Dr. Taylor began his comments noting the gravity of the present crisis:

The market ... actually froze in September. There was no bond issuance...You can pick up The New York Times today...hospitals cannot obtain financing, student loans cannot get financing, state and local governments are having a tough time finding the money to build bridges.

Much of the blame for the crisis, Dr. Taylor argued, can be attributed to unsavory business practices. During the 1980s “dealers suddenly realized there was a thing called risk.” They thus sought to supplement long-term capital management with fee-based business, which provide a constant source of income and reduce the variability of profits. The result was a lot of bidding to underwrite state and local debt.

However, as competition increased, profits decreased. This led firms to ‘the other side of the pipeline,’ where they started purchasing bonds and leveraging them for investment. This shift reduced the incentive for underwriters to get the best possible deal for issuers.

Yet the problem of misaligned incentives was even more severe, Dr. Taylor argued, leading to outright fraud. In the late 1980s it was not uncommon for underwriters to make political

contributions to officials of state and local entities they wanted to do business with – Dr. Taylor observed:

It started out \$500 a pop. By the time we enacted a rule in 1993 to prevent political contributions to be given by dealers to issuer officials, the numbers were in the hundreds of thousands of dollars of political contributions flowing to the public officials for their campaigns.

After the 1993 rule banning campaign contributions of this kind, brokers began making contributions to charities aligned with politicians they wished to deal with. As Dr. Taylor noted, these “shocking” practices did not lead to an efficient market for state and local bonds.

A fundamental problem, according to Dr. Taylor, is that the bond market is a “dealer market,” in which fragmentation allows individual dealers to exercise effective monopsony over their products. Consolidation of the industry has also raised barriers to entry and reduced competition.

Dr. Taylor concluded with some ideas for regulatory reform. First, centralized price



Christopher A. Taylor, Ph.D. & CFA, Consultant and Former Executive Director, Municipal Securities Rulemaking Board, places much of the blame for the financial crisis on unsavory business practices.

discovery would increase competition in the market and allow for more effective oversight, along the same lines as the clearinghouses that Congressman Leach proposed. “Primary issuance by states and localities should be through some sort of transparent nationwide business rather than this negotiated sale, which is an invitation to fraud,” Mr. Taylor argued. Second, making state and local bonds available for sale to all dealers, not just the dealer who arranges the underwriting, would also increase competition and help guard against perverse incentives.

Finally, Dr. Taylor called for greater disclosure from issuers. Only with sufficient information about the bonds being offered can a consolidated national market be efficient.

Nancy Feldman

Director of Public Finance, Department of Treasury, State of New Jersey

Ms. Feldman began her comments by pointing to the worrying demise of bond insurers.

She then discussed ratings agencies and observed that they were a key component of the state and local bond market because they gave buyers information about which bonds were sound investments. This was crucial in a market with 50,000 issuers, many of which were small entities—e.g. school boards, utilities, etc.—about which buyers had very little information. However, the financial crisis revealed that many of the bonds insurers the rating agencies declared AAA were in fact unsound, leaving the future of the bond market in question. Large entities like states will be affected much less than

smaller entities like towns or school boards, Ms. Feldman argued. There are sufficient research analysts to study the states, but not necessarily the other 49,950 issuers.

Ms. Feldman then echoed comments by Mr. Kraft concerning the potential buyers

of state and local bonds. The 1986 Tax Act that prevented banks from deducting the interest-to-carry costs opened the gates to “creative financing,” according to Ms. Feldman. The result was that the largest new buyer of municipal bonds became hedge funds. But with hedge funds now losing assets, this vital source of finance for state and local governments is increasingly in danger. The result will be “more supply and more needs in this environment where capital and infrastructure demands are so high, our bridges, our roads, our water.” The result will be “that our interest rates will rise,” Ms. Feldman argued.

Given this grim picture, Ms. Feldman concluded by suggesting the TARP might be used to reinforce the credit of state and local governments:

... they bailed out AIG, but all the municipalities who had ever done



Nancy Feldman pointed out the worrying demise of bond insurers, noting that ratings agencies are a key component of the state and local bond market because they give buyers information about which bonds are sound investments.

any work or had any relationship with AIG, are now having financial penalties imposed upon them, because AIG is no longer a good credit. ... AIG is now okay, because they have federal support, but municipalities, and other levels of government, will have credit problems as a result of AIG's credit no longer being up to snuff. So, why should TARP or Treasury or the Fed bail out one part of the equation and not the rest?

Q & A

Mr. Fichera asked if the state of New Jersey has a risk management officer, or some way to look at counter-party risk. Ms. Feldman replied that the state has five staff members who manage the \$32 billion in outstanding bonded debt -- fewer than would typically be found in a corporate treasury of comparable size. However, Ms. Feldman noted that the state receives help from third parties, such as investment bankers, financial advisers, and others who want to do business with the state.

Mr. Kraft, picking up the topic of rating agencies, suggested that the federal government could take up the role of insuring state and local bonds. But, he also noted that such a proposal remained controversial.

The panelists all offered their opinion on what the greatest looming threat to state and local public finance was. Mr. Kraft singled out the coming pension obligation of many states. In New Jersey alone pension obligations add up to over \$50 billion, and there are also mounting post retirement health care benefits, Mr. Kraft noted.

Ms. Feldman, in turn, identified the demand for infrastructure as the greatest looming threat:

If we cannot sell bonds, because there is no investor or there is no market, we are going to have to pay for infrastructure improvements with cash. And, if we pay for capital improvements with cash, that means that funds will not be available for Medicaid, municipal aid, hospital assistance, or any of the other very important strategic and critical government functions. So, the competition for capital dollars and operating dollars is a significant, forward-looking challenge.

For Mr. Fichera the largest looming threat is a "government process that is not robust enough to respond quickly and evaluate risks properly and negotiate in its own self interest, but because of limited resources, relies on more outsourcing of financial analysis to people who have a direct conflict of interest." Because governments must rely for financial advice on the very firms that they do financial business with, the public interest is at risk, he argued.

Session IV:

Putting the Pieces back together Again

Alan Blinder, Ph.D.

Gordon S. Rentschler Memorial Professor of Economics and Public Affairs, Princeton University, and Co-Director of Princeton's Center for Economic Policy Studies, and former Vice Chairman, Federal Reserve Board

Professor Blinder began his remarks by noting that, unlike many economic events, the present crises can be dated to an exact hour. The prelude to the crisis began in perhaps August 2007, with the Fed and the Treasury devising creative ways to hold things together with “scotch tape and glue, bailing wire, pick your metaphor.” But the start of the crisis itself, Professor Blinder argued, can be pinpointed to the minute the decision was made on September 15th to let the investment bank Lehman Brothers go bankrupt. After this decision, according to Professor Blinder, “everything fell apart.”

The failure of Lehman Brothers and its aftermath demonstrated two economic principles very painfully, Professor Blinder explained. First, the “too big to fail” doctrine. Before Lehman came under threat, Bear Stearns, a smaller investment bank, was not allowed to fail, and was instead merged with JP Morgan. The assumption was thus that Lehman, which was far more important to the economy, would be propped up by the government. It was not. One immediate result was that “perceived counter-party risk just soared all over the world. If Lehman were a lousy counter-party, because it was not protected by ‘too big to fail,’ what about everything else?”

The second economic principle Professor Blinder identified might be called “too entangled to fail.” Bear Stearns was deemed, apparently, too entangled to fail, especially with hedge funds. This, at least, was the explicit justification given by the Fed for merging Bear Stearns into JP Morgan.

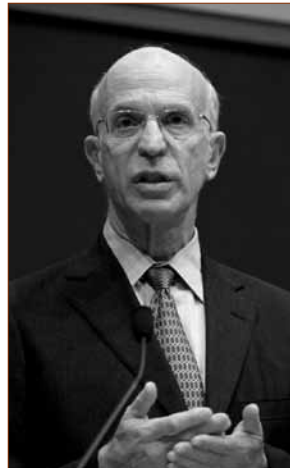
For reasons Professor Blinder said he “would never understand,” Lehman Brothers was not deemed too entangled to fail. “That was shown wrong within hours, because we had an immediate infection to the MMMFs – money market mutual funds,” with which Lehman was deeply involved. Thus the crisis spread from the mortgage finance sector, where it had been relatively contained up until September 15th, to the money market funds. Shares in some of these funds plummeted below a dollar, deeply shaking confidence and directly affecting the commercial paper market. Two unrelated sectors were thus plunged into crisis by the subprime difficulties. Lehman Brothers, Professor Blinder argued, was indeed too entangled to be allowed to fail.

The dominoes continued falling. Next in line were many name-brand banks, such as Washington Mutual and Wachovia. The crisis thus became very real to the public at large, who up to that point may have written the crisis off as something “done by rich people that they had no understanding of whatsoever.” Seeing these institutions fail significantly damaged public confidence. The woes spread also to Europe. European institutions, which some had thought to be insulated from the subprime crisis, turned out to be holding a significant number of US subprime-backed assets on top of their own housing bubbles.

Professor Blinder then turned to the government's response to the crisis. First he noted that the Fed has not done very much besides set up an "alphabet soup" of lending facilities, including "essentially nationalizing" AIG. The Fed also coordinated an interest rate cut with a number of other central banks around the world on October 8th. While the "effort and cajoling it took Ben Bernanke to get these other central banks to go along" was a "barely believable achievement," "it had no effect on the markets at all," a result Professor Blinder dubbed "amazing." A future implication of the Fed's actions -- which Professor Blinder urged the audience to consider -- "is whether all this money pumping is creating the seeds of a future inflation problem."

Next, Professor Blinder turned to the Treasury and the TARP, explaining that Congress authorized the \$700 billion bailout for three purposes. First, buying and refinancing mortgages to avoid "a potential tsunami of foreclosures in America." This is wise because foreclosures "cause fire sales of prices of homes, which depress prices further, which lead to more foreclosures." However, thus far the TARP has spent exactly \$0 on this purpose.

Second, the TARP was meant to buy up troubled mortgage-related assets. This was, Professor Blinder noted, "the sales pitch that was made to the Congress to get them to pass this bill so that the money would be used for this purpose." However, none of the TARP money has yet been spent on this purpose either. "Something strange is going on here -- assuming we are a democracy," Professor Blinder noted.



During the luncheon keynote, Princeton University economist Alan Blinder argued that the beginning of the financial crisis could be pinpointed to the minute the decision was made on September 15, 2008 to allow the investment bank Lehman Brothers to go bankrupt; it was at this point, he noted, that "everything fell apart."

The third, "breathtaking, almost unbelievable" purpose was "to buy any other financial instrument that the [Treasury] Secretary, after consulting with the Chairman of the Board of governors of the Federal Reserve System, determines the purchase of which is

necessary to promote financial market stability." Professor Blinder stated his disbelief that a government official could be endowed with such broad discretion and authority. Unfortunately, he noted this is the only purpose that has attracted TARP money to date.

Another feature of this plan that Professor Blinder finds "remarkable," "is that the capital injections have had essentially no strings attached to them. I would have thought," he stated:

If the government hands out equity to private institutions, such as banks, automakers, etc. -- there would be some public purpose strings attached, because after all, the government is not just a hedge fund trying to make money on its investment, but is actually trying to fulfill some public purpose.

The good news in the crisis, Professor Blinder added optimistically, is the Federal

Deposit Insurance Corporation (FDIC). The deposit insurance provided by the FDIC has “really been only place to run to for safety in this storm.” Even so, the FDIC now finds itself having to raise premiums to maintain its minimum capital requirements because the failure of Lehman Brothers has put an enormous strain on its resources.

Professor Blinder then turned to the real economy, arguing that it “also looks like it fell off a cliff on Lehman Day.” With bad economic data reported for September and more bad news expected for October, Professor Blinder foresees significant difficulties ahead. Usually it is the real economy that drags the credit market down, Professor Blinder argued, by turning good loans into bad. This case is surprisingly the opposite, where the crash of the credit market has dragged the rest of the economy down with it.

Professor Blinder’s overall message was that the economy demanded financial triage. “We need to concentrate on that for now, or we are going to be in it for a while”, he argued. “Job number one is to stem the panic,” which means deciding what the TARP will do. “I think the TARP is off to a bad start and badly needs fixing,” he stated.

Once confidence has been restored, Professor Blinder suggested several longer term reforms. First, Fannie Mae and Freddie Mac should be made either entirely public or entirely private, he argued. The hybrid structure confused shareholders and allowed the entities to escape rigorous regulation. Second, Professor Blinder argued that firms like Goldman Sachs and Morgan Stanley must learn to operate like more conventional banks, which means less leverage and,

correspondingly, smaller profits.

Finally, a likely implication of the changes at the investment banks is that trading and other activities will migrate to hedge funds. Thus, the next big regulatory issue is whether or not to regulate hedge funds, many of which are incorporated in the Cayman Islands, a British territory. “The regulators are going to be forced to open their eyes to what is happening in hedge funds,” Professor Blinder stated.

Q & A

One questioner asked if Professor Blinder meant to imply that a significant portion of the crisis could have been avoided if Lehman Brothers had not been allowed to fail. Professor Blinder said that was not his point, because a confluence of factors lay at the heart of the present crisis. Still, he argued that the Lehman case highlighted the dangers of contagion. A crisis that started in the subprime sector traveled, in significant part through the failure of Lehman Brothers, to the rest of the economy.

Another questioner noted that Wells Fargo recently raised \$11 billion, giving it a high capital ratio that constituted, in the questioner’s view, hoarding. He asked Professor Blinder if the government should not force banks to lend if they received support from the TARP. Professor Blinder noted that hoarding is indeed an attractive strategy for banks to pursue at the moment, and that the government should have taken steps to prevent it. But he also stated that part of the problem was that the Treasury pressured banks to take funds they did not necessarily want because they could not lend them out effectively.

A third questioner asked Professor Blinder what advice he had for those trying to predict what would happen in the economy. Professor Blinder advised the audience to monitor the general health of the financial system—e.g. LIBOR rates, TED spread, and OIS spreads. He also suggested forecasters look for a large initiative in the first weeks of the Obama administration -- “sensible items in the package that will help shorten the recession,” he argued would be important. However, Professor Blinder also warned the audience to expect four to five quarters of negative growth.

Session V:

Understanding the Sources of the Ongoing Financial Upheaval

Susan M. Wachter, Ph.D.

Richard B. Worley Professor of Financial Management and Professor of Real Estate and Finance, Wharton School, University of Pennsylvania, and former Assistant Secretary for Policy and Research, U.S. Department of Housing and Urban Development

Professor Wachter began her remarks by asking if the crisis was avoidable. Knowing the answer to that question is crucial, she argued, because it would “point to what we need to do to prevent...similar or worse crises, and also how we respond now, because to understand the causes is to understand potential solutions.”

“The crisis could be summed up in few words,” Professor Wachter stated, “Loans were made that could not be paid.” A historic loosening of standards “beyond reasonable

limits” was followed by a historic curtailment of mortgage credit. Previously, U.S. housing prices had basically kept pace with inflation as far back as data is available, but after 2000 they doubled in just six years, Professor Wachter explained. They have now drooped back by 20 percent. Noting that some of her colleagues would argue that prices are likely to sink back all the way to the 2000 level, Professor Wachter declared herself “not that pessimistic.”

Part of the cause of these jump in house prices, according to Professor Wachter, was the new paradigm of financing that took over the market—eventually covering about half of the mortgage industry—in which mortgages were securitized, packaged, and otherwise manipulated. The result was “not standardized, not homogenous” mortgage assets that “could not be marked to market.” These “enablers,” as Professor Wachter termed them, did not exist before 1995. By 2001, they were only worth around \$10 billion, she argued. But just half a decade later they

“The crisis could be summed up in few words,” said Professor Susan Wachter. “Loans were made that could not be paid.”



stood around \$70 billion. These subprime products were also concentrated in certain parts of the country. It was these areas where home prices increased the most and these same areas where housing prices are now most in decline.

Borrowers borrowed at “teaser” rates they were not able or expected to repay. These were created by brokers who had no intention of holding them, but instead distributed them to a secondary market which securitized them, packaged them, and sold them to investors. This process left Professor Wachter “extraordinarily puzzled,” she said, because “we did point to this obvious bubble in 2005/2006... Why were the investors buying these highly risky mortgages?” Even though these products were backed with credit default swaps, a form of risk insurance, Professor Wachter struggled to understand why investors were buying risky mortgages.

The driver “making this circle go around,” she concluded, was the huge short-run profits. Brokers collected fees for selling and buying this product. The originators of the mortgages were also making large fees selling mortgages to the brokers. The insurance companies issuing credit default swaps—the largest of which was AIG—were also making substantial fees. Because all the players were benefiting in the short-run, no one had an incentive to manage the long-term risk. The result was disaster.

Q & A

One questioner worried that one consequence of the present crisis would be to ruin the credit scores of borrowers in the future. Individuals who might otherwise be creditworthy might see their records tarnished by the crisis. Dr. Wachter responded that this was indeed a potential risk that has not yet been addressed.

Another questioner asked why subprime loans were more common in places like California and Florida, which would seem to be important in determining the cause of the crisis. Dr. Wachter answered that regulation is generally more stringent in these places, which makes housing less affordable and the market less elastic. Demand is also very high in these fast-growing parts of the country, further pressuring a relatively tight market. Along these same lines, another audience member asked, given the drop in demand for houses, if bulldozing vacant houses was a possible outcome? Professor Wachter agreed that indeed it was, and that dealing with vacancies and abandonments is a crucial issue for many municipalities.

The last questioner asked Professor Wachter if she would recommend the TARP be used to shore-up existing mortgages, as was planned. Dr. Wachter agreed this was necessary, and that a number of proposals existed for it, but that it was extremely difficult to sort through the sub-prime mortgages to figure out how to make them work.

Appendix A

Conference Agenda

Regional and National Financial Crises: Roots, Results, and Responses

November 7, 2008

Sponsored by the Policy Research Institute for the Region at the Woodrow Wilson School of Public and International Affairs, Princeton University

Welcome and Opening Remarks

Richard F. Keevey, Director, Policy Research Institute for the Region,
Woodrow Wilson School, Princeton University

Session I—Financial Regulation and the Responsibility of the United States Congress

Honorable James A. Leach, Former Chairman, Banking and Financial Services Committee,
United States Congress, and currently John L. Weinberg/Goldman Sachs & Co. Visiting
Professor, Woodrow Wilson School, Princeton University

Session II—Anatomy of the Mortgage Crisis

With leading international banks, individual consumers and the economy as a whole suffering losses attributed to mortgage-related investments, this segment will explore the macro-level and micro-level motivations and decisions that triggered the deeply interconnected, widespread phenomena. Experts in the field will discuss the causes, the players, and the way forward with particular impact on the region.

Opening Comments and Moderator:

Hyun Song Shin, Ph.D., Hughes-Rogers Professor of Economics, and Associate Chair of the
Economics Department, Princeton University

Panelists:

Mark Zandi, Ph.D., Chief Economist and co-founder Moody's Economy.com

Erica Groshen, Ph.D., Vice President and Director of Regional Outreach, the Federal
Reserve Bank of New York

David Wilcox, Ph.D., Deputy Director, Division of Research and Statistics, the Federal
Reserve Board, Washington DC

Session III—Looming Threats in the Public Finance Arena

While less apparent to the wider population than outcomes related to mortgage-backed products, issues pertaining to taxpayer supported debt financings and public investment portfolios pose risks with potentially extensive impacts. The entrance by state and local governments into sophisticated trade agreements in the primary and secondary markets –auctions, derivatives, and interest rate swaps, etc. -- has created both opportunity and exposure, with the former perhaps not fully realized and the latter resulting in documented costs to taxpayers and potential costs in the future. Experts in the field will offer analyses of possible errors and recommendations on current and future practices.

Opening Comments and Moderator:

Joseph Fichera, CEO and Senior Managing Partner, Saber Partners, LLC and Visiting Lecturer, Woodrow Wilson School, Princeton University

Panelists:

Nancy Feldman, Director of Public Finance, Department of Treasury, State of New Jersey

John I. Kraft, Bond Counsel, Lomurro, Davison, Eastman & Munoz, P.A.

Christopher A. Taylor, Ph.D. & CFA, Consultant and Former Executive Director, Municipal Securities Rulemaking Board

Session IV Luncheon Speaker—Putting the Pieces Back Together Again

Alan Blinder, Ph.D., Gordon S. Rentschler Memorial Professor of Economics and Public Affairs, Princeton University, and Co-Director of Princeton's Center for Economic Policy Studies, and former Vice Chairman, Federal Reserve Board

Session V—Understanding the Sources of the Ongoing Financial Upheaval

Susan M. Wachter, Ph.D., Richard B. Worley Professor of Financial Management and Professor of Real Estate and Finance, Wharton School, University of Pennsylvania, and former Assistant Secretary for Policy and Research, U.S. Department of Housing and Urban Development

Closing Remarks

Richard F. Keevey, Director, Policy Research Institute for the Region, Woodrow Wilson School, Princeton University

Commentary sponsored by the Policy Research Institute for the Region at the Woodrow Wilson School of Public and International Affairs at Princeton University.

The Policy Research Institute for the Region was established by Princeton University and the Woodrow Wilson School of Public and International Affairs to bring the resources of the University community to bear on solving the increasingly interdependent public policy challenges facing New Jersey, metropolitan New York, and southeastern Pennsylvania.

With a full-time staff augmented by project coordinators and guided by faculty associates and an advisory board, the institute reflects and understanding that the issues facing our region cut across not only state and municipal borders, but also across a range of traditional academic disciplines. Our mission is to bring together the University's greatest resources—its faculty and students, its research expertise, and commitment to public service—to find solutions across boundaries that improve the quality of civic life in our dynamic, multi-state region.

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