FCIC Releases Report on Financial Crisis - Places Much Blame on Unenforced Regulations

February 4, 2011 - The Financial Crisis Inquiry Commission - a US government commission looking into the root causes of the banking and credit crisis that hit at the end of 2008 - has released its report. Among its conclusions, it determined that the crisis was foreseeable and that government regulators were asleep at the wheel. And of all the agencies that the report takes a shot at, it reserves the largest punch for the FED saying, "Federal Reserveâ€™s pivotal failure to stem the flow of toxic mortgages, which it could have done by setting prudent mortgage-lending standards. The Federal Reserve was the one entity empowered to do so and it did not."

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The report is more than 500 pages in length and is available for download. The commission also provides a much shorter online paper that just goes over the commissions conclusions. This section is quite enlightening.

In one area it states, "More than 30 years of deregulation and reliance on self-regulation by financial institutions, championed by former Federal Reserve chairman Alan Greenspan and others, supported by successive administrations and Congresses, and actively pushed by the powerful financial industry at every turn, had stripped away key safeguards, which could have helped avoid catastrophe." This is no great surprise. As late as 200t, we told you that Greenspan said in congressional testimony, "Innovation has brought about a multitude of new products, such as subprime loans and niche credit programs for immigrants. . . . With these advances in technology, lenders have taken advantage of credit-scoring models and other techniques for efficiently extending credit to a broader spectrum of consumers. . . . "What he was actually doing here is praising lenders for offering subprime lending products. These are the very products that led to the crisis.

But the commission didn't simply single out the FED. The report very clearly names a number of other problems with regulators, at one point saying, "we do not accept the view that regulators lacked the power to protect the financial system. They had ample power in many arenas and they chose not to use it. To give just three examples: the Securities and Exchange Commission could have required more capital and halted risky practices at the big investment banks. It did not. The Federal Reserve Bank of New York and other regulators could have clamped down on Citigroupâ€™s excesses in the run-up to the crisis. They did not. Policy makers and regulators could have stopped the runaway mortgage securitization train. They did not. In case after case after case, regulators continued to rate the institutions they oversaw as safe and sound even in the face of mounting troubles, often downgrading them just before their collapse. And where regulators lacked authority, they could have sought it. Too often, they lacked the political willâ€”in a political and ideological environment that constrained itâ€”as well as the fortitude to critically challenge the institutions and the entire system they were entrusted to oversee."
Other determinations include:

Â· "We conclude dramatic failures of corporate governance and risk management at many systemically important financial institutions were a key cause of this crisis."

Â· "We conclude a combination of excessive borrowing, risky investments, and lack of transparency put the financial

system on a collision course with crisis."

Â· " We conclude the government was ill prepared for the crisis, and its inconsistent response added to the uncertainty and panic in the financial markets"

Â· "We conclude there was a systemic breakdown in accountability and ethics."

One of the more interesting conclusions was that "over-the-counter derivatives contributed significantly to this crisis." These derivatives had been illegal in almost every state because they violated state gambling laws. These laws had been known as "bucket shop laws". But in 2000, Congress and the Clinton administration passed and enacted legislation that prevented either federal or state regulators from overseeing derivatives trading. That legislation specifically forbid the states from enforcing laws that had been on their books for nearly the past 100 years. And those laws had been put on the books specifically because near the turn of the last century there had been almost exactly the same kind of trading taking place. That trading also led to a financial crisis. Proof that if you don't know history, you are doomed to repeat it.

The commission didn't have any authority to prosecute anyone for legal violations. But where they found areas of the law that they think were violated, they were charged to turn over their information and conclusions to the Department of Justice for further investigation. It is very likely that the commission's work will lead to some individuals being prosecuted. Unfortunately, it is highly unlikely that it will have much impact at all with regard to regulatory enforcement.

byJim Malmberg
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