

# Index

- A
- AARP. *See* American Association of Retired Persons (AARP)
- ABSS. *See* asset backed securities (ABSs)
- AIG
- CDS exposure and insufficient collateral, 39
  - credit default swaps, 5
  - Federal Reserve, 29, 39
  - government bailout of, 25
  - liquidity crisis was tipping point for, 39
  - performance pay, government bailout money for, 48
  - taxpayers' funds collateralized, 39
- American Association of Retired Persons (AARP), 105
- American Bankers Association, 58, 61–62
- Anti-Trust Division of Justice, 17–18
- Asian financial crisis, 16
- asset backed securities (ABSs), 32–33, 36, 181
- Associated Press, 87, 171
- Australia, 97, 136
- B
- Bank for International Settlements, 38, 43, 185
- Bank of America, 16–17, 77
- Basel Committee for Banking Supervision (BCBS), 140
- BCBS. *See* Basel Committee for Banking Supervision (BCBS)
- Bear Stearns
- collapse of, 21, 38
  - government bailout of, 25, 134
  - investment banks and bad asset classes, 14
  - J.P. Morgan, force fed by, 77
  - rating agency downgrade and tipping point, 5, 92
  - repos, 13–14
  - residential mortgage-backed securities (RMBSs), 3, 13–14
  - SEC as holding company for, 180
  - systemic risk, 2–6, 10, 13–14
  - toxic assets, difficult-to-price, 6
- Berkshire Hathaway, 89
- Bernanke, Chairman Benjamin, 29, 60, 78–79
- Bernie Madoff scandal, xxi, xxiii, 110, 112, 147, 176
- British East India Company, xvi
- brokerage firms, 107, 116
- Buffet, Warren, 89
- C
- CCO. *See* Chief Compliance Officer (CCO)
- CDOs. *See* collateralized debt obligations (CDOs)
- CDSs. *See* credit default swaps (CDSs)
- Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce, 130
- Center for Economic and Policy Research (CEPR), 87–88
- CEPR. *See* Center for Economic and Policy Research (CEPR)
- Certified Regulatory and Compliance Professional [FINRA], 151
- CFPA. *See* Consumer Financial Protection Agency (CFPA)
- CFTC. *See* Commodity Futures Trading Commission (CFTC)
- Chief Compliance Officer (CCO), 110, 114, 151–52
- civil liability, 27–28, 30, 92
- CMBSS. *See* commercial mortgage-backed securities (CMBSSs)
- Code of Conduct Fundamentals for Credit Rating Agencies, 140
- collateralized debt obligations (CDOs), 11, 31, 42, 95–96

## 188 ■ Index

- commercial mortgage-backed securities (CMBSs), 31–32, 37, 40, 42. *See also* residential mortgage-backed securities (RMBSs)
- Commodity Futures Trading Commission (CFTC), xvi, 38–39, 64, 75, 80, 129, 149, 178, 182
- Community Reinvestment Act* (1977), 60, 183
- conclusions and recommendations
  - about, 142, 154–55
  - capital requirements for risky activities, higher, 144
  - chief compliance officer reporting to Board of Directors, 152
  - clawbacks and other malus provisions, 153
  - compliance profession, elevating the, 151–52
  - crisis, planning for the next, 144–46
  - decisions are made by individuals not organizations, 152–53
  - failing firms should be left to their own fate, 144
  - federal regulatory service, creating a, 148–51
  - Financial Regulation Service Institute, 149
  - firms receiving government support to repay every penny, 145
  - Foreign Service Institute, 148, 150
  - Foreign Service Officers (FSOs), 148
  - haircut for firms holding failing securities, 145
  - Inspector General (OIG), 112, 116, 147, 151
  - modern markets and self-regulation, 143–44
  - penalties for senior managers, 145
  - performance goals as part of regulatory examinations, 153
  - performance goals for analysts, 153
  - pitchforks, put down the, 154
  - power to dismiss senior managers and board of directors, 146
  - pre-funding the pool, 145–46
  - rating organizations, keep them on a short leash, 153–54
  - regulation to bolster oversight of markets, 143
  - regulatory service, need for a professionalized, 146–48
  - salary capping to prevent another crisis, 153
  - SEC, staff reforms by, 148
  - systemic risk and complexity of the market, 143
  - systemic risk regulator for failing firms, 146
  - Volcker Rule on size of firms, 144
- conflict of interest, 63, 72, 89, 97, 173–74
- Congressional Oversight Panel for the TARP program, 68
- Consumer Financial Protection Agency (CFPA), 57, 62, 64–65, 182–83
- consumer protection
  - about, 57–58
  - agency, politically sensitive issue, 64
  - agency powers, what are they?, 65–67
  - American Bankers objection to, 61–62
  - bad loans and regulation of financial service providers, 67
- Community Reinvestment Act* (1977), 60, 183
- conclusion, 68
- conflict of interest, 63
- Congressional Oversight Panel for the TARP program, 68
- Consumer Financial Protection Agency (CFPA), 57, 62, 64–66, 182–83
- consumer regulator for consumer financial products, 61–65
- credit card industry, xxviii, 32, 59, 61, 64, 70, 91, 161, 180, 6459
- federal regulators to coordinate, 61
- Federal Reserve, 63
- “for protection from unfair and deceptive practices,” 65
- Government Accountability Office (GAO), 57–58
- non-banks, 61, 63–64, 66
- Office of the Comptroller of the Currency, 63, 75–76, 79, 149
- Office of Thrift Supervision, 63, 75–76, 79, 149
- regulations, effectiveness of existing, 59–61
- regulations are overly burdensome, 60–61
- self-interest on part of lender, 67
- sub-prime securitization problem and rise in interest rates, 67
- systemic risk and, 67–68
- three arguments for, 62

- transparency, 68
- über-regulator for consumer protection, 58
- cost-benefit analysis
  - about, 121–22
  - assumptions, variable/wide ranging, 124
  - backward looking data for future projections, 126
  - basics of, 122–27
  - bell curve, fallacy of using middle of, 127
  - benefits of, 128–29
  - conclusion, 132
  - Federal agencies and, 129
  - government use of, 129–30
  - Homeland Security regulations, 122
  - illusion of accuracy, 125
  - as imprecise estimate, 124
  - measurement, problems in, 124–25
  - monetizing costs and benefits, 123, 125
  - as negotiating tactic, 130–31
  - political factors prevent regulation, 127
  - problems, other, 125–27
  - third party not necessarily an independent party, 131
  - time-horizon of, 126
  - as tool for ultimate decisions, 127
- CRA. *See Credit Rating Agency Reform Act (CRA)*
- CRA Reform Act, 84–85, 89, 95
- credit card industry, xxviii, 32, 59, 61, 64, 70, 91, 161, 180
- credit default swaps (CDSs), xxiv, 5, 37–39, 42–44, 73, 181–82
- credit derivatives, 70–71, 102, 140, 158–59, 184
- credit rating agencies
  - AAA, diluting the meaning of, xxi
  - AAA mortgage securities, defaulting, 84
  - AAA ratings slashed to junk levels, 86
  - about, 83–84
  - bell curve for agency models, 9, 35, 38, 86, 96, 126–27
  - bond ratings, corporate and municipal, 89–91
  - capital adequacy rules, 94
  - civil liability, 27–28, 30, 92
  - collateralized debt obligations (CDOs), 11, 31, 42, 95–96
  - conclusion, 98–99
  - CRA Reform Act, 84–85, 89, 95
  - Credit Rating Agency Reform Act (CRA), 84, 140
  - federal bailout of mortgage market, 87–88
  - First Amendment, 93, 154
  - issuer-pays model, 85, 88, 97–98, 154
  - maximizing profits by management, 88
  - mortgage-backed securities deals, 98
  - Nationally Recognized Statistical Rating Organization (NRSRO), 84–89, 94–97, 154
  - point-in-time ratings, 96
  - rating blunders, 93
  - ratings, how they are made, 89–92
  - ratings and bankruptcy, 90
  - ratings distorted by conflict of interest or outright greed, 89
  - residential mortgage-backed securities (RMBSs), 13–14, 31–34, 36–37, 39, 49, 84–85, 88, 93, 95
  - Sarbanes-Oxley Act, 83, 100–101, 107
  - SEC to study, 83
  - special-purpose vehicle (SPV), 32–33, 35, 91
  - structured finance products, 35–37
  - structured finance ratings, 91–92
  - subprime mortgage ratings, downgrading, xvii–xix, 88, 93
  - tighten oversight of, 186
  - toxic assets, role played by, 34
  - user-pays model and conflict of interest, 97
  - as utilities, 97–98
  - “voluntary regulation does not work,” 95
  - what keeps them up at night?, 92–93
- Credit Rating Agency Reform Act (CRA), 84, 140
- customer complaints, 107, 110–11, 116
- D
- Depository Trust Clearing Corporation (DTCC), 5
- disclosure, 68, 71–73, 117, 141, 159, 174, 183
- Dodd, Senator Chris, 78
- DTCC. *See* Depository Trust Clearing Corporation (DTCC)
- Dutch East India Company, xvi
- E
- Efficient Market Hypothesis, xix, 70
- Enron, 83–84, 93, 98
- European Union, 92, 97, 135–39

## 190 ■ Index

## F

Fannie Mae, 25, 181  
*Federal Deposit Insurance Act*, 184  
 Federal Deposit Insurance Corporation (FDIC), 75–76  
 Federal Reserve, 29, 39, 53–56, 63, 75–79, 184  
 Federal Savings and Loan Insurance Corporation, 76  
 Federal Trade Commission (FTC), 75, 183  
 financial crisis, xxiii, 9, 11, 16, 50, 150–52, 156, 163, 172–76  
 Financial Industry Regulatory Authority (FINRA), 106, 109, 111–13, 138, 151–52, 168–69  
   Certified Regulatory and Compliance Professional, 151  
 financial institutions, 8, 16, 24, 53, 78, 87, 91, 94, 140, 144  
 Financial Service Authority (UK), 121  
 Financial Services Committee, 68, 70, 78, 101–2  
 Financial Stability Board (FSB), 54, 139, 184–85  
 FINRA. *See* Financial Industry Regulatory Authority (FINRA)  
 First Amendment, 93, 154  
 Fitch, 84, 86, 88  
 foreign regulators, 133  
 Foreign Service Institute, 148, 150  
 Foreign Service Officers (FSOs), 148  
 Freddie Mac, 25, 181  
 FSOs. *See* Foreign Service Officers (FSOs)  
 FTC. *See* Federal Trade Commission (FTC)

## G

G-20. *See* Group of 20 (G-20)  
*Glass-Steagall Act*, 18–19, 76–77  
 GLB Act. *See* Gramm-Leach-Bliley Act (GLB Act)  
 Goldman Sachs, 4, 17, 77, 87, 104, 160  
 Government Accountability Office (GAO), 57–58  
 government-sponsored enterprises (GSEs), 25  
*Gramm-Leach-Bliley Act* (GLB Act), 77–78, 178  
 Great Crash, 76, 112  
 Great Recession, 3  
 Greece, 134–35  
 Greenberg, Chairman Ace, 4, 10  
 Greenspan, Alan, 42, 62, 64, 70  
 Group of 20 (G-20), 139–40, 184–86

GSEs. *See* government-sponsored enterprises (GSEs)

## H

hedge funds, 6, 102, 105, 157–58, 180, 185  
 Homeland Security regulations, 122  
*Home Ownership and Equity Protection Act* (HOEP), 62  
 House Committee on Energy and Commerce, 57  
 House Committee on Oversight and Government Reform, 88, 101  
 House Financial Services Committee, 68, 70, 101–2

## I

IAIS. *See* International Association of Insurance Supervisors (IAIS)  
 Icelandic banks, 93  
 incentives and compensation  
   about, 46–47  
   Adam Smith, what he right?, 56  
   AIG performance pay, government bailout money for, 48  
   bank's program, three principles for assessing, 55–56  
   bonus calculations, 51  
   clawback of incentive pay, 50, 52  
   compensation at TARP institutions, 53  
   compensation reform, 47  
   compliance and risk management staff, 56  
   disincentives to discourage excessive risky behavior, 50  
   executives and huge pay packages, 47  
   Federal Reserve guidance (2009), 53–56  
   financial services restructuring debate, 46  
   Financial Stability Board and “sound compensation practices,” 54  
   government regulation of financial services industry, 47  
   incentive compensation, 29, 48–51, 55–56, 153  
   incentives encourage inordinate risk, 50, 53  
 Keynesian stimulus packages and nationalization of U.S. automaker, 47  
 long-term policy, 47  
 malus schemes, 50, 52–53  
 mortgage environment as first domino of financial crisis, 50  
 non-cash compensation for executives, vesting of, 51

- pay packages, 47–48, 53
- performance goals and risk, 49–50, 153
- performance management and bonus programs, 56
- rating agency analysts and bank's senior management, 49
- regulators and issues of justice and revenge, 46
- revised compensation for individual traders, research or credit analysts, 53
- revised compensation for officers and employees, 53
- revised compensation for top management, 53
- reward with risk, aligning, 50–52
- RMBS shares and performance goals, 49–50
- self-interest, competing, 56
- Senate bill on financial reform (2009) and excessive compensation plans, 47
- TARP-based guidance for groups creating risk for the firm, 54
- insider trading, 107, 113, 116, 137, 157, 172
- Inspector General (OIG), 112, 116, 147, 151
- institutions are “too big to fail.” *See also*
  - Troubled Asset Relief Program (TARP)
  - accountability of senior management and boards, 22
  - Anti-Trust Division of Justice and phone market, 17–18
  - anti-trust powers/legislation, 18
  - assets weighted by level of risk, 16
  - banks, keep them small, 17–18
  - bonds, arbitrage between prices of, 16
  - capital cushion requirements, 17
  - capital requirements, increase, 19–20
  - commercial vs. investment banking activities, 18
  - conclusion, 22–23
  - do nothing, 22
  - financial disclosures, mandatory, 19
  - Glass-Steagall Act*, bring back, 18–19
  - government intervention vs. free market principles, 17, 21
  - government support is swiftest, 23
  - hedge funds, 16, 19, 102, 105, 157–58
  - highly leveraged firm, 16
  - Long Term Capital Management, 16
  - market capitalization, 16
  - moral hazard encourages inordinate risks, 22
  - pay limits for officers, 20
  - Plan B, 10, 20, 22, 30, 81, 144
  - policy options, 17–22
  - proprietary trading by commercial banks, 19
  - Resolution Authority, 20–22
  - risk of unknown loss, 21
  - Sherman Anti-Trust Act*, 18
  - systemic risk, identify, 22
  - too-big-to-fail concept, 15–17
  - Volcker, Fed Chairman Paul, 18–19
  - Volcker Rule, 19
- Insurance Core Principles, 140
- International Association of Insurance Supervisors (IAIS), 140–41
- International Organization of Securities Commissioners (IOSCO), 140
- international regulations
  - Asia, regulatory initiatives in, 136
  - Basel Committee for Banking Supervision (BCBS), 140
  - Code of Conduct Fundamentals for Credit Rating Agencies, 140
  - conclusion, 141
  - EU privacy laws, 137, 141
  - Europe, stock exchanges in, 135
  - The European Union, 136–38
  - Financial Stability Board (FSB), 54, 139–40, 184–85
  - FSA's Handbook of regulations, 138
  - global markets, interconnectedness of, 134
  - herd mentality (short-term market movements), 134
  - Insurance Core Principles, 140
  - International Association of Insurance Supervisors (IAIS), 140–41
  - International Organization of Securities Commissioners (IOSCO), 140
  - international organizations, 139–41
  - Markets in Financial Instruments Directive (MiFID), 136
  - overseas regulators, 135–39
  - privacy laws, 134–35, 137, 141
  - Prospectus Directive governs filing requirements, 137
  - regulation, principles based vs. rules-based, 138–39
  - SEC and shift toward principles-based regulation, 138
  - Sunday is the new Monday, 133–35
  - U.S. Credit Rating Reform Act*, 140
  - investment advisers, 107, 109, 115, 131, 160, 173, 180, 183

## 192 ■ Index

- investment banking, 4, 18–19, 47, 76–77, 180
- Investment Company Act of 1940*, 107
- IOSCO. *See* International Organization of Securities Commissioners (IOSCO)
- issuer-pays model, 85, 88, 97–98, 154
- J
- Joint (House and Senate) Economic Committee, 101
- K
- Kanjorski, Paul, 98–99
- King, Governor Mervyn, 19
- L
- Lehman Brothers, 8, 22, 25, 38, 77, 87, 134
- leverage, 6, 16, 147, 159, 177–78, 184
- lobbying, 92, 99–100, 104, 126, 131, 171
- Long Term Capital hedge fund collapse, 11
- Long Term Capital Management (LTCM), 16
- M
- Madoff Investment Securities, 109
- Malthus, Ricardo, xvii
- malus schemes, 50, 52, 153
- margin call, 6
- market abuse, 107, 113, 181
- Markets in Financial Instruments Directive (MiFID), 136
- Merrill Lynch, 4, 77, 87
- MMFs. *See* Money Market Mutual Funds (MMFs)
- money laundering activity, 119, 151, 185–86
- money market fund, 7–9, 11, 92
- Money Market Mutual Funds (MMFs), 180
- Moody's, xi, 84, 86, 88–89, 94, 98
- moral hazard
  - AAA ratings of riskiest assets, 26
  - about, xxiv, 24–25
  - of businesses associated with the irresponsible firms, 28
  - clawback of previous compensation, 29
  - conclusion, 30
  - creditors as the other, 28–30
  - creditors should not be made whole, 30
  - as deciding factor in risk decisions, 26
  - emergency pool of funds trigger clawback in compensation and civil liability, 28
  - emergency pool of funds trigger government to dismiss any or all senior management or Board, 27
  - failures, provisions for, 29–30
  - federally insured deposits of individuals, 24
  - firms extending credit to irresponsible firms stand to lose their investment, 28
  - government bailout of AIG and Bear Stearns, 25
  - government bailout of financial institutions, 24
  - government can create, 27
  - government-sponsored enterprises (GSEs), 25
  - government support of failing banks prevents uncertainty, 28
  - government support of important institutions, 30
  - as life insurance, 26
  - moral suasion alone will not carry the day, 29
  - Plan B, 30
  - practice of, 26
  - punish or reward firm vs. the individual, 27
  - “punish the leaders, not the organization,” 27–28
  - regulatory debate on, 30
  - “risks are fully understood to be risky,” 26
  - risky behavior by firms too big to fail, 26
  - salary and incentive compensation, forfeiture of, 29
  - sanctions against senior management, 29–30
  - sanctions for individuals making risk-taking decisions, 27
  - self-interest, 30
  - short-term funding contracts and exemption from haircuts, 28–29
  - systemic risk, need for new rules for, 25
  - theory of, 25–26
  - third-party, 28, 30
- Morgan Stanley, 17, 78, 92, 104, 160, 175
- N
- NASDAQ stock market, 113, 160, 168
- National Bank Supervisor (NBS), 179
- Nationally Recognized Statistical Rating Organization (NRSRO), 84–89, 94–97, 154
- NBS. *See* National Bank Supervisor (NBS)
- New York Stock Exchange (NYSE), 113, 168
- New York Times*, 27, 89, 98–99, 104, 138
- Nightly Business Report*, 43
- non-banks, 61, 63–64, 66

NRSRO. *See* Nationally Recognized  
Statistical Rating Organization  
NYSE. *See* New York Stock Exchange (NYSE)

## O

Obama's Financial Regulatory Reform  
accounting standards, improve, 186  
asset backed securities (ABS), 32, 36, 181  
bank regulation, close loopholes in,  
179–80  
banks and BHCs, strengthen capital and  
other prudential standards for, 179  
BHCs including Tier 1 FHCs, create  
resolution regime for failing, 184  
compensation practices, introduce better,  
185  
Consumer Financial Protection Agency  
(CFPA), 57, 62, 64–65, 182–83  
consumer protection, reform, 183  
credit rating agencies, tighten oversight  
of, 186  
crisis management and management  
authorities and procedures, reform,  
185  
Federal Reserve's Emergency Lending  
Authority, 184  
financial abuse, protect consumers and  
investors from, 182–84  
financial crisis, provide government with  
tools to manage, 184  
financial firms, promote robust  
supervision and regulation of,  
177–81  
financial markets, establish regulation of,  
181–82  
Financial Services Oversight Council,  
177–78  
Financial Stability Board, 184–85  
futures and securities regulation,  
harmonize, 182  
global financial markets, improve  
oversight of, 184  
government sponsored enterprises (GSEs),  
181  
*Gramm-Leach-Bliley Act (GLB Act)*,  
77–78, 178  
hedge funds and other private pools of  
capital, 180  
insurance sector, enhance oversight of,  
180–81  
interconnected financial firms,  
heightened supervision and regulation  
of all large, 178

international capital framework,  
strengthen, 184  
international cooperation, improve,  
184–86  
international financial firms, enhance  
supervision of, 184–85  
International Regulatory Standards, raise,  
184–86  
investor protection, strengthen, 183  
Money Market Mutual funds (MMFs), 180  
National Bank Supervisor (NBS), 179  
OTC Derivatives including Credit Default  
Swaps (CDS), comprehensive  
regulation of, 181–82  
payment clearing and settlement systems,  
strengthen, 182  
prudential regulation and money  
laundering/terrorist financing,  
stronger standards for, 185  
Prudential regulations, strengthen, 185  
recommendations, summary of,  
177–86  
regulation, expand scope of, 185  
SEC programs for consolidated  
supervision, eliminate, 180  
securitization markets, strengthen  
supervision and regulation of, 181  
tax information exchange, stronger  
standards in, 185  
OCC. *See* Office of the Comptroller of the  
Currency (OCC)  
Office of Compliance Inspections and  
Examinations (OCIE), 108–9  
Office of Information and Regulatory Affairs  
(OIRA), 130  
Office of Management and Budget, 130  
Office of the Comptroller of the Currency  
(OCC), 75–76  
Office of Thrift Supervision (OTS), 63,  
75–76, 79, 149  
OIG. *See* Inspector General (OIG)  
OIRA. *See* Office of Information and  
Regulatory Affairs (OIRA)  
over-the-counter market, 39, 71, 168

## P

Parmalat, 84  
Petrou, Karen, 43  
Plan B, 10, 20, 22, 30, 81, 144  
point-in-time ratings, 96  
political capture, 104  
privacy laws, 134–35, 137, 141  
private equity funds, 105, 180



## 194 ■ Index

## R

Regan administration, xv

regulation and innovation

about, 41–44

conclusions, 45

credit default swaps (CDSs), 42–44

financial innovation and risk

management, 42

financial innovation pushes boundary of

complexity further, 43

financial regulators and regulatory lag on innovations, 43

internal risk controls, 44

legislation to reform markets after

near-collapse of financial system, 41

market complexity, 44

mortgage-backed securities, 42

policy implications, 44

regulation could stifle all innovation, 42

residential mortgage-backed securities, 44

transparency as regulatory tool, 44

regulation of free markets

about, xv–xvi

Bernie Madoff scandal, xxi

Commodities Future Trading Commission

and transparency to credit derivatives

market, xvi

conclusion, xx–xxi

credit rating agencies and subprime-loan

pools, xvii–xix, 88, 93

credit rating agencies diluted meaning of AAA, xxi

Efficient Market Theory, xix

market collapse is 2008, xx

markets, inefficiencies and imbalances of distorted, xvii

market self-regulation, xix–xx

perfect markets regulate themselves, xx

philosophy to math, the shift from,

xvii–xix

regulation, ideological legitimacy of,

xv

regulation is not separate from market,

xv

regulation vs. justice, xx

regulation vs. retribution, xx

self interest and free trade, xvii

selfish interest drives irresponsible,

inordinate risk-taking and fraud, xxi

Smith, Adam, xvi–xvii

subprime mortgages, xxi

transparency and market self-regulation,

xix

regulations

are there other ways to achieve the same aim?, 158

conclusion, 161

do the exemptions make sense?, 158

is the goal of regulation worthwhile?,

156–57

is the regulation likely to attain the goal?, 157

is the right agency responsible?, 159–60

transparency provisions, do the rules have the right level?, 159

unintended consequences, are there any?, 157

what exemptions exist?, 158

regulations, the politics of

about, 100–101

American Association of Retired Persons (AARP), 105

Black Caucus, 103–4

Center for Responsive Politics, 104

credit derivatives, 70–71, 102, 140, 158–59, 184

“Deficiency Letter,” 111

Enforcement Division, 111

government’s role in markets, ideological struggle over, 103

hedge funds, 6, 102, 105, 157–58, 180, 185

House committee, 100–101

House Committee on Oversight and Government Reform, 88, 101

House Financial Services Committee, 68, 70, 101–2

Joint (House and Senate) Economic Committee, 101

lobbying, 92, 99–100, 104, 126, 131, 171

political capture, 104

political process, 101–5

Ponzi scheme, multi-million dollar, 111

private equity funds and lobbying, 105

regulatory capture, 104, 169–71

Securities and Investments industry and lobbying, 104

Senate Banking Committee, 29, 58, 62, 77–79, 101–2

regulators and compliance officers

about, 106

advertising and marketing review, 117–18

anti-money laundering, 151

brokerage firms, 107, 116



- business unity compliance officers, 114–15
- Chief Compliance Officer (CCO), 110, 114, 151–52
- compliance departments, 113–19
- compliance systems, 118–19
- conclusions, 119–20
- conduct of examinations, 110–12
- customer complaints, 107, 110–11, 116
- due diligence process, 119
- examination, cause, 109
- examination, cyclical, 109
- examination, risk-focused, 109
- examination and reporting, 117
- examinations and inspections, 108–9
- Financial Industry Regulatory Authority (FINRA), 106, 109, 111–13, 138, 151–52, 168–69
- functions, other, 119
- insider trading, 107, 113, 116, 137, 157, 172
- Internet complicates marketing review process, 118
- investment advisers, 107, 109, 115, 131, 160, 173, 180, 183
- Investment Company Act of 1940*, 107
- market abuse, 107, 113, 181
- money laundering activity, 119, 151, 185–86
- monitoring, 115–16
- Office of Compliance Inspections and Examinations, 108–9
- risk identification and risk assessment methodology, 108
- SEC examination program, 108–9
- SEC rule making process, 107–8
- Securities Act of 1933*, 107
- Securities and Exchange Commission (SEC), 106–16
- Securities Exchange Act of 1934*, 107
- Self-Regulatory Organizations, 109, 111–12, 116, 138, 152, 160, 168–69
- trading activity, surveillance of, 118
- trading floor compliance officer, 115
- regulatory capture, 104, 169–71
- regulatory concepts and issues
  - conflict of interest, 173–74
  - consequences, unintended, 166–68
  - information asymmetries, 172–73
  - moral hazard, 163–65
  - one size fits all, 174–76
  - playing fields, unlevel, 165–66
  - regulatory capture, 169–71
  - self-regulation, 168–69
  - systemic risk, 163–65
  - too big to fail, 163–65
- regulatory reform matters, xxiii–xxv
- regulatory structure rebuilding
  - fifty50 state-level regulators for securities for banking, 75
- Commodity Futures Trading Commission (CFTC), 38–39, 64, 75, 80, 129, 149, 178, 182
- Consolidated Supervised Entity (CSE) program, 77
- consumer protection, 80
- consumer protection issues, consolidated body to handle, 79
- FDIC for safety of deposits, 76
- Federal Deposit Insurance Corporation (FDIC), 75–76
- federal regulator for insurance industry, 79
- Federal Reserve, 75–76, 78–79
- Federal Savings and Loan Insurance Corporation, 76
- Federal Trade Commission (FTC), 75
- Financial Services Committee, 68, 70, 78, 101–2
- Glass-Steagall Act*, 76–77
- the Great Crash, 76
- Municipal Securities Rulemaking Board, 76
- National Credit Union Administration, 76
- New Deal reforms of 1930s, 76
- Office of the Comptroller of the Currency (OCC), 63, 75–76, 79, 149
- Office of Thrift Supervision (OTS), 63, 75–76, 79, 149
- Ponzi scheme, 81
- proposed changes, other, 79–80
- regulatory agencies, why so many?, 76–77
- Savings and Loan crisis, 76
- SEC and the investment banks, 77–78
- SEC regulated big banks, 77
- systemic regulator, do we need, 80–81
- systemic responsibility, Feds vs. state, 82
- “to concentrate or not to concentrate,” 81–82
- voluntary regulation doesn’t work, 77
- repos. *See* repurchase agreements (repos)
- Republican lawmakers, 68
- Republicans, Senate, 61

## 196 ■ Index

- repurchase agreements (repos)
  - agreements, 7–8
  - Bear Stearns, 13–14
  - Lehman, 8
  - market, 6, 13
- Reserve Primary Fund, 8
- residential mortgage-backed securities (RMBSs), 13–14, 31–34, 36–37, 39, 49, 84–85, 88, 93, 95. *See also* commercial mortgage-backed securities (CMBSSs)
- RMBSs. *See* residential mortgage-backed securities (RMBSs)
- Russian financial crisis, 16
- S
- salary capping, 153
- Sarbanes-Oxley Act*, 83, 100–101, 107
- Savings and Loan crisis, 9, 11
- Securities Act of 1933*, 107
- Securities and Exchange Commission (SEC), 106–16
- Securities Exchange Act of 1934*, 107
- self-interest, xvii, xxi, 30, 56, 67, 157, 173
- self-regulation, xix–xx, 73, 143–44, 168–69
- Self-Regulatory Organizations (SROs), 109, 111–12, 116, 138, 152, 160, 168–69
- Senate Banking Committee, 29, 58, 62, 77–79, 101–2
- Sherman Anti-Trust Act*, 18
- six degrees of separation, 11
- Smith, Adam, xvi–xvii, 56
- Society of Corporate Compliance and Ethics' Certified Compliance and Ethics Professional, 151
- special-purpose vehicle (SPV), 32–33, 35, 91
- spoiler alert, 15
- SPV. *See* special-purpose vehicle (SPV)
- SROs. *See* Self-Regulatory Organizations (SROs)
- Standard & Poor (S&P), 84, 88, 94
- structured finance products, 32, 34–36, 73, 84, 88
- Stuart, John, xvii–xviii
- subprime mortgages
  - AAA rating for, 33–34
  - interest rates, rising, 86
  - investment bankers, xxi
  - mortgage payments and, 34
  - pooled risk, 33
  - ratings, downgrading, xvii–xix, 88, 93
  - structured investments backed by, 37
  - as toxic assets, 32–34, 37
- systemic risk and market meltdown
  - about, 1
  - AIG and credit default swaps, 5
  - Bear Stearns, 2–6, 10, 13–14
  - borrowed money, short vs. long-term, 2
  - “breaking the buck,” 8
  - collateral damage, 6–7
  - conclusion, 12
  - economy is about connections, 1
  - economy is not the sum of its parts, 1
  - funding, day-to-day, 2–3
  - government intervention, 9–10, 12
  - hedge fund redemption, 6
  - investment practice, legal covenants governing, 4
  - Lehman repos, 8
  - leverage, 6
  - Long Term Capital hedge fund collapse, 11
  - loss of confidence, 3
  - margin call, 6
  - money market fund, 7–9, 11, 92
  - regulation to focus on firms vs. system as a whole, 12
  - regulatory reform proposals, 2, 12
  - repurchase agreement (repo), 3, 6–8, 13
  - risk of fluctuation in the overnight price of an asset, 3
  - rumor control and market psychology, 4
  - rumors, at the mercy of, 4–6
  - rumors, self-fulfilling nature of, 9
  - rumors and bank runs, 4
  - rumors cause a crisis, 4
  - run on the bank, institutional, 6
  - SEC regulations restricting what money market fund for investment, 7
  - six degrees of separation, 11
  - speculative (junk) bond status, 4
  - system collapse, why not before?, 10–12
  - systemic, how a problems goes, 3–10
  - systemic risk, how it works, 2–9
  - systemic risk, macro/micro, 2
  - systemic risk and Bear Stearns, 13–14
  - system is complex and prone to uncertainty and rumor, 12
  - toxic assets, difficult-to-price, 6
- T
- TARP. *See* Troubled Asset Relief Program (TARP)
- Theory of Moral Sentiments* (Stuart), xvii–xviii
- Tier 1FHC, 177–79, 184–85

- too-big-to-fail concept, 15–17
- toxic assets
  - AAA rating for housing market, 34
  - AAA rating for senior tranches, 34
  - AAA rating for subprime mortgages, 33–34
  - AAA rating for tranches, 34, 36
  - AAA rating for U.S. Treasury bonds, 34
  - about, 31
  - asset-backed securities (ABSs), 32–33, 36
  - Bank for International Settlements, 38, 43, 185
  - cash reserves and firms selling CDSs, 38
  - CDS and 'over the counter' exchange of money, 38
  - CLO, 31
  - collateralized debt obligations (CDOs), 11, 31, 42, 95–96
  - commercial mortgage-backed securities (CMBSs), 31–32, 37, 40, 42
  - conclusion, 40
  - credit default swaps (CDSs), 31, 37–39
  - credit rating agencies, role played by, 34
  - credit rating agencies and structured finance products, 35–37
  - credit rating and conflicts of interest, 35
  - derivative products, 31
  - housing market and market for securitized products, 36
  - low-risk assets out of high-risk assets, building, 33–34
  - mortgage-backed securities, securitization concentrated the risk into, 40
  - mortgage-backed securities and credit default, 40
  - mortgage back securities, creditworthiness of, 33
  - PBS's *Nightly Business Report*, 38
  - rating process as an advisory service, 36
  - residential mortgage-backed securities (RMBSs), 13–14, 31–34, 36–37, 39, 49
  - special-purpose vehicle (SPV), 32–33, 35, 91
  - structured finance and pool of very large income stream, 32
  - structured finance products, 32, 34–36, 73, 84, 88
  - structured or securitized products, 31
  - subprime loans, senior tranche composed entirely of, 33–34
  - subprime mortgage, 32–34, 37
  - tranches, 33–37, 51
  - Volcker, Fed Chairman Paul, 42, 45
  - what are they?, 32–33
  - why are they toxic, 32–33
- trading floor compliance officer, 115
- tranches, 33–37, 51
- transparency
  - about, xv–xvi, xix, 39, 42, 44, 69–74, 98
  - conflict of interest within firms, 72
  - credit default swaps (CDSs), 73
  - credit derivatives, 70–71, 102, 140, 158–59
  - "default position" for information disclosure, 74
  - degrees of, 71–73
  - disclosure, 68, 71–73, 117, 141, 159, 174, 183
  - Efficient Market Hypothesis, 70
  - markets, growing complexity of, 70
  - market self-regulation, xix, 73
  - over-the-counter market, 39, 71, 168
  - as regulation, 69–71
  - regulatory filings, 73–74
  - as the remedy, what to consider, 73–74
  - reporting, 71–72, 74, 88, 115, 117, 119, 152
- Treasury bonds, 25, 34–35, 49
- Troubled Asset Relief Program (TARP)
  - Congressional Oversight Panel, 68
  - financial institutions, 53
  - firms, capping salaries in, 153
  - funded firms, 53
  - guidance and relative compensation, 54
  - money, 20
  - money paid back, 54
  - program money went in one door and out the other to influence legislation, 105
  - recipients, 20, 54
- U
- über-regulator for consumer protection, 58
- U.S. Chamber of Commerce, 58, 105, 130–31

**198** ■ Index

*U.S. Credit Rating Reform Act*, 140

U.S. Treasury bonds, 25, 34–35, 49

V

Volcker, Fed Chairman Paul, 18–19, 42, 45

Volcker Rule, 19

W

*Wall Street Journal*, 42, 52, 65, 93–94, 98–99

Warren, Elizabeth, 68

*The Wealth of Nations* (Smith), xvi–xvii

WorldCom, 84

<http://www.pbookshop.com>