CONCLUSIONS OF THE FINANCIAL CRISIS INQUIRY COMMISSION

The Financial Crisis Inquiry Commission has been called upon to examine the financial and economic crisis that has gripped our country and explain its causes to the American people. We are keenly aware of the significance of our charge, given the economic damage that America has suffered in the wake of the greatest financial crisis since the Great Depression.

Our task was first to determine what happened and how it happened so that we could understand why it happened. Here we present our conclusions. We encourage the American people to join us in making their own assessments based on the evidence gathered in our inquiry. If we do not learn from history, we are unlikely to fully recover from it. Some on Wall Street and in Washington with a stake in the status quo may be tempted to wipe from memory the events of this crisis, or to suggest that no one could have foreseen or prevented them. This report endeavors to expose the facts, identify responsibility, unravel myths, and help us understand how the crisis could have been avoided. It is an attempt to record history, not to rewrite it, nor allow it to be rewritten.

To help our fellow citizens better understand this crisis and its causes, we also present specific conclusions at the end of chapters in Parts III, IV, and V of this report.

The subject of this report is of no small consequence to this nation. The profound events of 2007 and 2008 were neither bumps in the road nor an accentuated dip in the financial and business cycles we have come to expect in a free market economic system. This was a fundamental disruption—a financial upheaval, if you will—that wreaked havoc in communities and neighborhoods across this country.

As this report goes to print, there are more than 26 million Americans who are out of work, cannot find full-time work, or have given up looking for work. About four million families have lost their homes to foreclosure and another four and a half million have slipped into the foreclosure process or are seriously behind on their mortgage payments. Nearly $11 trillion in household wealth has vanished, with retirement accounts and life savings swept away. Businesses, large and small, have felt the sting of a deep recession. There is much anger about what has transpired, and justifiably so. Many people who abided by all the rules now find themselves out of work and uncertain about their future prospects. The collateral damage of this crisis has been real people and real communities. The impacts of this crisis are likely to be felt for a generation. And the nation faces no easy path to renewed economic strength.

Like so many Americans, we began our exploration with our own views and some preliminary knowledge about how the world's strongest financial system came to the brink of collapse. Even at the time of our appointment to this independent panel, much had already been written and said about the crisis. Yet all of us have been deeply affected by what we have learned in the course of our inquiry. We have been at various times fascinated, surprised, and even shocked by what we saw, heard, and read. Ours has been a journey of revelation.

Much attention over the past two years has been focused on the decisions by the federal government to provide massive financial assistance to stabilize the financial system and rescue large financial institutions that were deemed too systemically important to fail. Those decisions—and the deep emotions surrounding them—will be debated long into the future. But our mission was to ask and answer this central question: *how did it come to pass that in 2008 our nation was forced to choose between two stark and painful alternatives*—either risk the total collapse of our financial system and economy or inject trillions of taxpayer dollars into the financial system and an array of companies, as millions of Americans still lost their jobs, their savings, and their homes?

In this report, we detail the events of the crisis. But a simple summary, as we see it, is useful at the outset. While the vulnerabilities that created the potential for crisis were years in the making, it was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages—that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008. Trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world. When the bubble burst, hundreds of billions of dollars in losses in mortgages and mortgage-related securities shook markets as well as financial institutions that had significant exposures to those mortgages and had borrowed heavily against them. This happened not just in the United States but around the world. The losses were magnified by derivatives such as synthetic securities.

The crisis reached seismic proportions in September 2008 with the failure of Lehman Brothers and the impending collapse of the insurance giant American International Group (AIG). Panic fanned by a lack of transparency of the balance sheets of major financial institutions, coupled with a tangle of interconnections among institutions perceived to be "too big to fail," caused the credit markets to seize up. Trading ground to a halt. The stock market plummeted. The economy plunged into a deep recession.

The financial system we examined bears little resemblance to that of our parents' generation. The changes in the past three decades alone have been remarkable. The financial markets have become increasingly globalized. Technology has transformed the efficiency, speed, and complexity of financial instruments and transactions. There is broader access to and lower costs of financing than ever before. And the financial sector itself has become a much more dominant force in our economy.

From 1978 to 2007, the amount of debt held by the financial sector soared from $3 trillion to $36 trillion, more than doubling as a share of gross domestic product. The very nature of many Wall Street firms changed—from relatively staid private partnerships to publicly traded corporations taking greater and more diverse kinds of risks. By 2005, the 10 largest U.S. commercial banks held 55% of the industry's assets, more than double the level held in 1990. On the eve of the crisis in 2006, financial sector profits constituted 27% of all corporate profits in the United States, up from 15% in 1980. Understanding this transformation has been critical to the Commission's analysis.

Now to our major findings and conclusions, which are based on the facts contained in this report: they are offered with the hope that lessons may be learned to help avoid future catastrophe.

- **We conclude this financial crisis was avoidable.** The crisis was the result of human action and inaction, not of Mother Nature or computer models gone haywire. The captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks within a system essential to the well-being of the American public. Theirs was a big miss, not a stumble. While the business cycle cannot be repealed, a crisis of this magnitude need not have occurred. To paraphrase Shakespeare, the fault lies not in the stars, but in us.

Despite the expressed view of many on Wall Street and in Washington that the crisis could not have been foreseen or avoided, there were warning signs. The tragedy was that they were ignored or discounted. There was an explosion in risky subprime lending and securitization, an unsustainable rise in housing prices, widespread reports of egregious and predatory lending practices, dramatic increases in household mortgage debt, and exponential growth in financial firms' trading activities, unregulated derivatives, and short-term "repo" lending markets, among many other red flags. Yet there was pervasive permissiveness; little meaningful action was taken to quell the threats in a timely manner.

The prime example is the Federal Reserve'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. The record of our examination is replete with evidence of other failures: financial institutions made, bought, and sold mortgage securities they never examined, did not care to examine, or knew to be defective; firms depended on tens of billions of dollars of borrowing that had to be renewed each and every night, secured by subprime mortgage securities; and major firms and investors blindly relied on credit rating agencies as their arbiters of risk. What else could one expect on a highway where there were neither speed limits nor neatly painted lines?

• **We conclude widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets.** The sentries were not at their posts, in no small part due to the widely accepted faith in the self-correcting nature of the markets and the ability of financial institutions to effectively police themselves. 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 approach had opened up gaps in oversight of critical areas with trillions of dollars at risk, such as the shadow banking system and over-the-counter derivatives markets. In addition, the government permitted financial firms to pick their preferred regulators in what became a race to the weakest supervisor.

Yet 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 Citigroup'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 will—in a political and ideological environment that constrained it—as well as the fortitude to critically challenge the institutions and the entire system they were entrusted to oversee.

Changes in the regulatory system occurred in many instances as financial markets evolved. But as the report will show, the financial industry itself played a key role in weakening regulatory constraints on institutions, markets, and products. It did not surprise the Commission that an industry of such wealth and power would exert pressure on policy makers and regulators. From 1999 to 2008, the financial sector expended $2.7 billion in reported federal lobbying expenses; individuals and political action committees in the sector made more than $1 billion in campaign contributions. What troubled us was the extent to which the nation was deprived of the necessary strength and independence of the oversight necessary to safeguard financial stability.

• **We conclude dramatic failures of corporate governance and risk management at many systemically important financial institutions were a key cause of this crisis.** There was a view that instincts for self-preservation inside major financial firms would shield them from fatal risk-taking without the need for a steady regulatory hand, which, the firms argued, would stifle innovation. Too many of these institutions acted recklessly, taking on too much risk, with too little capital, and with too much dependence on short-term funding. In many respects, this reflected a fundamental change in these institutions, particularly the large investment banks and bank holding companies, which focused their activities increasingly on risky trading activities that produced hefty profits. They took on enormous exposures in acquiring and supporting subprime lenders and creating, packaging, repackaging, and selling trillions of dollars in mortgage-related securities, including synthetic financial products. Like Icarus, they never feared flying ever closer to the sun.

Many of these institutions grew aggressively through poorly executed acquisition and integration strategies that made effective management more challenging. The CEO of Citigroup told the Commission that a $40 billion position in highly rated mortgage securities would "not in any way have excited my attention," and the co-head of Citigroup's investment bank said he spent "a small fraction of 1%" of his time on those securities. In this instance, too big to fail meant too big to manage.

Financial institutions and credit rating agencies embraced mathematical models as reliable predictors of risks, replacing judgment in too many instances. Too often, risk management became risk justification.

Compensation systems—designed in an environment of cheap money, intense competition, and light regulation—too often rewarded the quick deal, the short-term gain—without proper consideration of long-term consequences. Often, those systems encouraged the big bet—where the payoff on the upside could be huge and the downside limited. This was the case up and down the line—from the corporate boardroom to the mortgage broker on the street.

Our examination revealed stunning instances of governance breakdowns and irresponsibility. You will read, among other things, about AIG senior management's ignorance of the terms and risks of the company's $79 billion derivatives exposure to mortgage-related securities; Fannie Mae's quest for bigger market share, profits, and bonuses, which led it to ramp up its exposure to risky loans and securities as the housing market was peaking; and the costly surprise when Merrill Lynch's top management realized that the company held $55 billion in "super-senior" and supposedly "super-safe" mortgage-related securities that resulted in billions of dollars in losses.

- **We conclude a combination of excessive borrowing, risky investments, and lack of transparency put the financial system on a collision course with crisis.** Clearly, this vulnerability was related to failures of corporate governance and regulation, but it is significant enough by itself to warrant our attention here.

In the years leading up to the crisis, too many financial institutions, as well as too many households, borrowed to the hilt, leaving them vulnerable to financial distress or ruin if the value of their investments declined even modestly. For example, as of 2007, the five major investment banks—Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley—were operating with extraordinarily thin capital. By one measure, their leverage ratios were as high as 40 to 1, meaning for every $40 in assets, there was only $1 in capital to cover losses. Less than a 3% drop in asset values could wipe out a firm. To make matters worse, much of their borrowing was short-term, in the overnight market—meaning the borrowing had to be renewed each and every day. For example, at the end of 2007, Bear Stearns had $11.8 billion in equity and $383.6 billion in liabilities and was borrowing as much as $70 billion in the overnight market. It was the equivalent of a small business with $50,000 in equity borrowing $1.6 million, with $296,750 of that due each and every day. One can't really ask "What were they thinking?" when it seems that too many of them were thinking alike.

And the leverage was often hidden—in derivatives positions, in off-balance-sheet entities, and through "window dressing" of financial reports available to the investing public.

The kings of leverage were Fannie Mae and Freddie Mac, the two behemoth government-sponsored enterprises (GSEs). For example, by the end of 2007, Fannie's and Freddie's combined leverage ratio, including loans they owned and guaranteed, stood at 75 to 1.

But financial firms were not alone in the borrowing spree: from 2001 to 2007, national mortgage debt almost doubled, and the amount of mortgage debt per household rose more than 63% from $91,500 to $149,500, even while wages were essentially stagnant. When the housing downturn hit, heavily indebted financial firms and families alike were walloped.

The heavy debt taken on by some financial institutions was exacerbated by the risky assets they were acquiring with that debt. As the mortgage and real estate markets churned out riskier and riskier loans and securities, many financial institutions loaded up on them. By the end of 2007, Lehman had amassed $111 billion in commercial and residential real estate holdings and securities, which was almost twice what it held just two years before, and more than four times its total equity. And again, the risk wasn't being taken on just by the big financial firms, but by families, too. Nearly one in 10 mortgage borrowers in 2005 and 2006 took out "option ARM" loans, which meant they could choose to make payments so low that their mortgage balances rose every month.

Within the financial system, the dangers of this debt were magnified because transparency was not required or desired. Massive, short-term borrowing, combined with obligations unseen by others in the market, heightened the chances the system could rapidly unravel. In the early part of the 20th century, we erected a series of protections—the Federal Reserve as a lender of last resort, federal deposit insurance, ample regulations—to provide a bulwark against the panics that had regularly plagued America's banking system in the 19th century. Yet, over the past 30-plus years, we permitted the growth of a shadow banking system—opaque and laden with short-term debt—that rivaled the size of the traditional banking system. Key components of the market—for example, the multitrillion-dollar repo lending market, off-balance-sheet entities, and the use of over-the-counter derivatives—were hidden from view, without the protections we had constructed to prevent financial meltdowns. We had a 21st-century financial system with 19th-century safeguards.

When the housing and mortgage markets cratered, the lack of transparency, the extraordinary debt loads, the short-term loans, and the risky assets all came home to roost. What resulted was panic. We had reaped what we had sown.

- **We conclude the government was ill prepared for the crisis, and its inconsistent response added to the uncertainty and panic in the financial markets.** As part of our charge, it was appropriate to review government actions taken in response to the developing crisis, not just those policies or actions that preceded it, to determine if any of those responses contributed to or exacerbated the crisis.

As our report shows, key policy makers—the Treasury Department, the Federal Reserve Board, and the Federal Reserve Bank of New York—who were best positioned to watch over our markets were ill prepared for the events of 2007 and 2008. Other agencies were also behind the curve. They were hampered because they did not have a clear grasp of the financial system they were charged with overseeing, particularly as it had evolved in the years leading up to the crisis. This was in no small measure due to the lack of transparency in key markets. They thought risk had been diversified when, in fact, it had been concentrated. Time and again, from the spring of 2007 on, policy makers and regulators were caught off guard as the contagion spread, responding on an ad hoc basis with specific programs to put fingers in the dike. There was no comprehensive and strategic plan for containment, because they lacked a full understanding of the risks and interconnections in the financial markets. Some regulators have conceded this error. We had allowed the system to race ahead of our ability to protect it.

While there was some awareness of, or at least a debate about, the housing bubble, the record reflects that senior public officials did not recognize that a bursting of the bubble could threaten the entire financial system. Throughout the summer of 2007, both Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson offered public assurances that the turmoil in the subprime mortgage markets would be contained. When Bear Stearns's hedge funds, which were heavily invested in mortgage-related securities, imploded in June 2007, the Federal Reserve discussed the implications of the collapse. Despite the fact that so many other funds were exposed to the same risks as those hedge funds, the Bear Stearns funds were thought to be "relatively unique." Days before the collapse of Bear Stearns in March 2008, SEC Chairman Christopher Cox expressed "comfort about the capital cushions" at the big investment banks. It was not until August 2008, just weeks before the government takeover of Fannie Mae and Freddie Mac, that the Treasury Department understood the full measure of the dire financial conditions of those two institutions. And just a month before Lehman's collapse, the Federal Reserve Bank of New York was still seeking information on the exposures created by Lehman's more than 900,000 derivatives contracts.

In addition, the government's inconsistent handling of major financial institutions during the crisis—the decision to rescue Bear Stearns and then to place Fannie Mae and Freddie Mac into conservatorship, followed by its decision not to save Lehman Brothers and then to save AIG—increased uncertainty and panic in the market.

In making these observations, we deeply respect and appreciate the efforts made by Secretary Paulson, Chairman Bernanke, and Timothy Geithner, formerly president of the Federal Reserve Bank of New York and now treasury secretary, and so many others who labored to stabilize our financial system and our economy in the most chaotic and challenging of circumstances.

- **We conclude there was a systemic breakdown in accountability and ethics.** The integrity of our financial markets and the public's trust in those markets are essential to the economic well-being of our nation. The soundness and the sustained prosperity of the financial system and our economy rely on the notions of fair dealing, responsibility, and transparency. In our economy, we expect businesses and individuals to pursue profits, at the same time that they produce products and services of quality and conduct themselves well.

Unfortunately—as has been the case in past speculative booms and busts—we witnessed an erosion of standards of responsibility and ethics that exacerbated the financial crisis. This was not universal, but these breaches stretched from the ground level to the corporate suites. They resulted not only in significant financial consequences but also in damage to the trust of investors, businesses, and the public in the financial system.

For example, our examination found, according to one measure, that the percentage of borrowers who defaulted on their mortgages within just a matter of months after taking a loan nearly doubled from the summer of 2006 to late 2007. This data indicates they likely took out mortgages that they never had the capacity or intention to pay. You will read about mortgage brokers who were paid "yield spread premiums" by lenders to put borrowers into higher-cost loans so they would get bigger fees, often never disclosed to borrowers. The report catalogues the rising incidence of mortgage fraud, which flourished in an environment of collapsing lending standards and lax regulation. The number of suspicious activity reports—reports of possible financial crimes filed by depository banks and their affiliates—related to mortgage fraud grew 20-fold between 1996 and 2005 and then more than doubled again between 2005 and 2009. One study places the losses resulting from fraud on mortgage loans made between 2005 and 2007 at $112 billion.

Lenders made loans that they knew borrowers could not afford and that could cause massive losses to investors in mortgage securities. As early as September 2004, Countrywide executives recognized that many of the loans they were originating could result in "catastrophic consequences." Less than a year later, they noted that certain high-risk loans they were making could result not only in foreclosures but also in "financial and reputational catastrophe" for the firm. But they did not stop.

And the report documents that major financial institutions ineffectively sampled loans they were purchasing to package and sell to investors. They knew a significant percentage of the sampled loans did not meet their own underwriting standards or those of the originators. Nonetheless, they sold those securities to investors. The Commission's review of many prospectuses provided to investors found that this critical information was not disclosed.

THESE CONCLUSIONS must be viewed in the context of human nature and individual and societal responsibility. First, to pin this crisis on mortal flaws like greed and hubris would be simplistic. It was the failure to account for human weakness that is relevant to this crisis.

Second, we clearly believe the crisis was a result of human mistakes, misjudgments, and misdeeds that resulted in systemic failures for which our nation has paid dearly. As you read this report, you will see that specific firms and individuals acted irresponsibly. Yet a crisis of this magnitude cannot be the work of a few bad actors, and such was not the case here. At the same time, the breadth of this crisis does not mean that "everyone is at fault"; many firms and individuals did not participate in the excesses that spawned disaster.

We do place special responsibility with the public leaders charged with protecting our financial system, those entrusted to run our regulatory agencies, and the chief executives of companies whose failures drove us to crisis. These individuals sought and accepted positions of significant responsibility and obligation. Tone at the top does matter and, in this instance, we were let down. No one said "no."

But as a nation, we must also accept responsibility for what we permitted to occur. Collectively, but certainly not unanimously, we acquiesced to or embraced a system, a set of policies and actions, that gave rise to our present predicament.

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THIS REPORT DESCRIBES THE EVENTS and the system that propelled our nation toward crisis. The complex machinery of our financial markets has many essential gears—some of which played a critical role as the crisis developed and deepened. Here we render our conclusions about specific components of the system that we believe contributed significantly to the financial meltdown.

- **We conclude collapsing mortgage-lending standards and the mortgage securitization pipeline lit and spread the flame of contagion and crisis.** When housing prices fell and mortgage borrowers defaulted, the lights began to dim on Wall Street. This report catalogues the corrosion of mortgage-lending standards and the securitization pipeline that transported toxic mortgages from neighborhoods across America to investors around the globe.

Many mortgage lenders set the bar so low that lenders simply took eager borrowers' qualifications on faith, often with a willful disregard for a borrower's ability to pay. Nearly one-quarter of all mortgages made in the first half of 2005 were interest-only loans. During the same year, 68% of "option ARM" loans originated by Countrywide and Washington Mutual had low- or no-documentation requirements.

These trends were not secret. As irresponsible lending, including predatory and fraudulent practices, became more prevalent, the Federal Reserve and other regulators and authorities heard warnings from many quarters. Yet the Federal Reserve neglected its mission "to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers." It failed to build the retaining wall before it was too late. And the Office of the Comptroller of the Currency and the Office of Thrift Supervision, caught up in turf wars, preempted state regulators from reining in abuses.

While many of these mortgages were kept on banks' books, the bigger money came from global investors who clamored to put their cash into newly created mortgage-related securities. It appeared to financial institutions, investors, and regulators alike that risk had been conquered: the investors held highly rated securities they thought were sure to perform; the banks thought they had taken the riskiest loans off their books; and regulators saw firms making profits and borrowing costs reduced. But each step in the mortgage securitization pipeline depended on the next step to keep demand going. From the speculators who flipped houses to the mortgage brokers who scouted the loans, to the lenders who issued the mortgages, to the financial firms that created the mortgage-backed securities, collateralized debt obligations (CDOs), CDOs squared, and synthetic CDOs: no one in this pipeline of toxic mortgages had enough skin in the game. They all believed they could off-load their risks on a moment's notice to the next person in line. They were wrong. When borrowers stopped making mortgage payments, the losses—amplified by derivatives—rushed through the pipeline. As it turned out, these losses were concentrated in a set of systemically important financial institutions.

In the end, the system that created millions of mortgages so efficiently has proven to be difficult to unwind. Its complexity has erected barriers to modifying mortgages so families can stay in their homes and has created further uncertainty about the health of the housing market and financial institutions.

• **We conclude over-the-counter derivatives contributed significantly to this crisis.** The enactment of legislation in 2000 to ban the regulation by both the federal and state governments of over-the-counter (OTC) derivatives was a key turning point in the march toward the financial crisis.

From financial firms to corporations, to farmers, and to investors, derivatives have been used to hedge against, or speculate on, changes in prices, rates, or indices or even on events such as the potential defaults on debts. Yet, without any oversight, OTC derivatives rapidly spiraled out of control and out of sight, growing to $673 trillion in notional amount. This report explains the uncontrolled leverage; lack of transparency, capital, and collateral requirements; speculation; interconnections among firms; and concentrations of risk in this market.

OTC derivatives contributed to the crisis in three significant ways. First, one type of derivative—credit default swaps (CDS)—fueled the mortgage securitization pipeline. CDS were sold to investors to protect against the default or decline in value of mortgage-related securities backed by risky loans. Companies sold protection—to the tune of $79 billion, in AIG's case—to investors in these newfangled mortgage securities, helping to launch and expand the market and, in turn, to further fuel the housing bubble.

Second, CDS were essential to the creation of synthetic CDOs. These synthetic CDOs were merely bets on the performance of real mortgage-related securities. They amplified the losses from the collapse of the housing bubble by allowing multiple bets on the same securities and helped spread them throughout the financial system. Goldman Sachs alone packaged and sold $73 billion in synthetic CDOs from July 1, 2004, to May 31, 2007. Synthetic CDOs created by Goldman referenced more than 3,400 mortgage securities, and 610 of them were referenced at least twice. This is apart from how many times these securities may have been referenced in synthetic CDOs created by other firms.

Finally, when the housing bubble popped and crisis followed, derivatives were in the center of the storm. AIG, which had not been required to put aside capital reserves as a cushion for the protection it was selling, was bailed out when it could not meet its obligations. The government ultimately committed more than $180 billion because of concerns that AIG's collapse would trigger cascading losses throughout the global financial system. In addition, the existence of millions of derivatives contracts of all types between systemically important financial institutions—unseen and unknown in this unregulated market—added to uncertainty and escalated panic, helping to precipitate government assistance to those institutions.

- **We conclude the failures of credit rating agencies were essential cogs in the wheel of financial destruction.** The three credit rating agencies were key enablers of the financial meltdown. The mortgage-related securities at the heart of the crisis could not have been marketed and sold without their seal of approval. Investors relied on them, often blindly. In some cases, they were obligated to use them, or regulatory capital standards were hinged on them. This crisis could not have happened without the rating agencies. Their ratings helped the market soar and their downgrades through 2007 and 2008 wreaked havoc across markets and firms.

In our report, you will read about the breakdowns at Moody's, examined by the Commission as a case study. From 2000 to 2007, Moody's rated nearly 45,000 mortgage-related securities as triple-A. This compares with six private-sector companies in the United States that carried this coveted rating in early 2010. In 2006 alone, Moody's put its triple-A stamp of approval on 30 mortgage-related securities every working day. The results were disastrous: 83% of the mortgage securities rated triple-A that year ultimately were downgraded.

You will also read about the forces at work behind the breakdowns at Moody's, including the flawed computer models, the pressure from financial firms that paid for the ratings, the relentless drive for market share, the lack of resources to do the job despite record profits, and the absence of meaningful public oversight. And you will see that without the active participation of the rating agencies, the market for mortgage-related securities could not have been what it became.

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THERE ARE MANY COMPETING VIEWS as to the causes of this crisis. In this regard, the Commission has endeavored to address key questions posed to us. Here we discuss three: capital availability and excess liquidity, the role of Fannie Mae and Freddie Mac (the GSEs), and government housing policy.

First, as to the matter of excess liquidity: in our report, we outline monetary policies and capital flows during the years leading up to the crisis. Low interest rates, widely available capital, and international investors seeking to put their money in real estate assets in the United States were prerequisites for the creation of a credit bubble. Those conditions created increased risks, which should have been recognized by market participants, policy makers, and regulators. However, it is the Commission's conclusion that excess liquidity did not need to cause a crisis. It was the failures outlined above—including the failure to effectively rein in excesses in the mortgage and financial markets—that were the principal causes of this crisis. Indeed, the availability of well-priced capital—both foreign and domestic—is an opportunity for economic expansion and growth if encouraged to flow in productive directions.

Second, we examined the role of the GSEs, with Fannie Mae serving as the Commission's case study in this area. These government-sponsored enterprises had a deeply flawed business model as publicly traded corporations with the implicit backing of and subsidies from the federal government and with a public mission. Their $5 trillion mortgage exposure and market position were significant. In 2005 and 2006, they decided to ramp up their purchase and guarantee of risky mortgages, just as the housing market was peaking. They used their political power for decades to ward off effective regulation and oversight—spending $164 million on lobbying from 1999 to 2008. They suffered from many of the same failures of corporate governance and risk management as the Commission discovered in other financial firms. Through the third quarter of 2010, the Treasury Department had provided $151 billion in financial support to keep them afloat.

We conclude that these two entities contributed to the crisis, but were not a primary cause. Importantly, GSE mortgage securities essentially maintained their value throughout the crisis and did not contribute to the significant financial firm losses that were central to the financial crisis.

The GSEs participated in the expansion of subprime and other risky mortgages, but they followed rather than led Wall Street and other lenders in the rush for fool's gold. They purchased the highest rated non-GSE mortgage-backed securities and their participation in this market added helium to the housing balloon, but their purchases never represented a majority of the market. Those purchases represented 10.5% of non-GSE subprime mortgage-backed securities in 2001, with the share rising to 40% in 2004, and falling back to 28% by 2008. They relaxed their underwriting standards to purchase or guarantee riskier loans and related securities in order to meet stock market analysts' and investors' expectations for growth, to regain market share, and to ensure generous compensation for their executives and employees—justifying their activities on the broad and sustained public policy support for homeownership.

The Commission also probed the performance of the loans purchased or guaranteed by Fannie and Freddie. While they generated substantial losses, delinquency rates for GSE loans were substantially lower than loans securitized by other financial firms. For example, data compiled by the Commission for a subset of borrowers with similar credit scores—scores below 660—show that by the end of 2008, GSE mortgages were far less likely to be seriously delinquent than were non-GSE securitized mortgages: 6.2% versus 28.3%.

We also studied at length how the Department of Housing and Urban Development's (HUD's) affordable housing goals for the GSEs affected their investment in risky mortgages. Based on the evidence and interviews with dozens of individuals involved in this subject area, we determined these goals only contributed marginally to Fannie's and Freddie's participation in those mortgages.

Finally, as to the matter of whether government housing policies were a primary cause of the crisis: for decades, government policy has encouraged homeownership through a set of incentives, assistance programs, and mandates. These policies were put in place and promoted by several administrations and Congresses—indeed, both Presidents Bill Clinton and George W. Bush set aggressive goals to increase homeownership.

In conducting our inquiry, we took a careful look at HUD's affordable housing goals, as noted above, and the Community Reinvestment Act (CRA). The CRA was enacted in 1977 to combat "redlining" by banks—the practice of denying credit to individuals and businesses in certain neighborhoods without regard to their creditworthiness. The CRA requires banks and savings and loans to lend, invest, and provide services to the communities from which they take deposits, consistent with bank safety and soundness.

The Commission concludes the CRA was not a significant factor in subprime lending or the crisis. Many subprime lenders were not subject to the CRA. Research indicates only 6% of high-cost loans—a proxy for subprime loans—had any connection to the law. Loans made by CRA-regulated lenders in the neighborhoods in which they were required to lend were half as likely to default as similar loans made in the same neighborhoods by independent mortgage originators not subject to the law.

Nonetheless, we make the following observation about government housing policies—they failed in this respect: As a nation, we set aggressive homeownership goals with the desire to extend credit to families previously denied access to the financial markets. Yet the government failed to ensure that the philosophy of opportunity was being matched by the practical realities on the ground. Witness again the failure of the Federal Reserve and other regulators to rein in irresponsible lending. Homeownership peaked in the spring of 2004 and then began to decline. From that point on, the talk of opportunity was tragically at odds with the reality of a financial disaster in the making.

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WHEN THIS COMMISSION began its work 18 months ago, some imagined that the events of 2008 and their consequences would be well behind us by the time we issued this report. Yet more than two years after the federal government intervened in an unprecedented manner in our financial markets, our country finds itself still grappling with the aftereffects of the calamity. Our financial system is, in many respects, still unchanged from what existed on the eve of the crisis. Indeed, in the wake of the crisis, the U.S. financial sector is now more concentrated than ever in the hands of a few large, systemically significant institutions.

While we have not been charged with making policy recommendations, the very purpose of our report has been to take stock of what happened so we can plot a new course. In our inquiry, we found dramatic breakdowns of corporate governance, profound lapses in regulatory oversight, and near fatal flaws in our financial system. We also found that a series of choices and actions led us toward a catastrophe for which we were ill prepared. These are serious matters that must be addressed and resolved to restore faith in our financial markets, to avoid the next crisis, and to rebuild a system of capital that provides the foundation for a new era of broadly shared prosperity.

The greatest tragedy would be to accept the refrain that no one could have seen this coming and thus nothing could have been done. If we accept this notion, it will happen again.

This report should not be viewed as the end of the nation's examination of this crisis. There is still much to learn, much to investigate, and much to fix.

This is our collective responsibility. It falls to us to make different choices if we want different results.