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CAUSES OF THE FINANCIAL CRISIS

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ABSTRACT

Why did the popping of the housing bubble bring the financial system—rather than just the housing sector of the economy—to its knees? The answer lies in two methods by which banks had evaded regulatory capital requirements. First, they had temporarily placed a large portion of their assets in off-balance sheet vehicles, so that they did not count against the capital requirements. Second, they had used the capital against assets that remained on the balance sheet but were not rated, such as mortgage-backed securities. These choices will be signaled to our partners and will not affect browsing data. [Privacy Policy](#)

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Notes

1. Coval, Jurek, and Stafford [2009](#), therefore, calls these kinds of tranche products “economic catastrophe bonds.”
2. See Rajan [2008](#) for an early hint of this problem with bankers’ pay. Acharya and Volpin [2009](#) provides a model explaining why pay may have risen in the banking industry, and why at the same time risk-management (governance) quality deteriorated, due to greater mobility of risk-takers across financial institutions. Acharya and Richardson [2009](#) provides a detailed account of such governance failures (see, especially, chs. 7 and 8).
3. The following account is taken from UBS’s “Shareholder Report on UBS’s Write Downs,” prepared for the Swiss Federal Banking Commission, 18 April 2008.

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