The 2008 Financial Crisis Background Guide
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Introduction

Welcome Delegates to the King’s in House Model United Nations and the 2008 Financial Crisis Committee. The purpose of this guide will be to introduce you to the events leading up to the 2008 Financial Crisis and to prove just how devastating it was to the global economy. Not only will the preliminary events be discussed but we will also take an in-depth look at the chaos that ensued while the crisis was unfolding. Even now in 2015, seven years after the crisis began, we are only just beginning to crawl out of the economic recession that the 2008 Financial Crisis left in its wake.

Housing and Credit for Everyone

Early in his presidency, President George W. Bush made a promise to Americans to make it possible for every American to be able to own their own house, citing the ‘American Dream’¹. Little did Americans know that it was this promise that helped ramped up the events leading to the crisis. Using government sponsored mortgages agencies Fannie Mae and Freddie Mac, the American government was able to manipulate the mortgage market to make it more affordable for people to own a house. They did this by introducing Sub-Prime Mortgages, where sub-prime refers to a lower offering of interest rate relative to the Prime Rate offered by the Federal Reserve. This

effectively made it less expensive to have a sizable mortgage, thus Americans were
inclined to purchase larger houses which would normally be outside their price range.

In the late 1990s legislation was passed in the United States, under President
Clinton, that inherently made it easier to qualify for a mortgage by easing regulations on
credit lenders. These new regulations included the removal of down payments and
lowered the minimum income requirements to receive a mortgage. The combination of
sub-prime interest payments and the deregulation of the credit market is what
ultimately lead to the housing bubble.

The housing bubble refers to the gradual increase in demand for housing that
was bred by cheap and available credit. The bubble burst, however, when interest rates
started to climb. Most of the mortgages that were issued in during the early 2000s were
variable rather then fixed in rates; this meant that the interest payments on one’s
mortgages are subject to change depending on the prime interest rate set by the Central
Bank. As a result, when interest rates started to climb, so did people’s mortgage
payments. This caused many to file for bankruptcy and to default on their mortgages,
thus being forced to evict from their homes. Ironically, President Bush and President
Clinton’s efforts to improve home ownership in the United States actually made the
situation worse, as home ownership rates are at the lowest point in decades.

Insurance Crisis

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While the housing collapse was the primary ignition point of the crisis, there are many other factors that compounded the crisis to the point of bringing the world economy to its knees. Financial Institutions who issued sub-prime mortgages to unqualified individuals were well aware of the risk of people defaulting on their loans, which meant they effectively hedged their position by purchasing insurance. This insurance policy was primarily used to help offset the cost and loss of revenue from a defaulted mortgage. Large Insurance companies such as AIG and Lehman Brothers broke several of their own rules and issued policies on high-risk loans. When the dominos started to fall and the sudden wave of foreclosures started, Financial Institutions starting knocking on the doors of Insurance Companies to claim large amounts of money promised to them by their insurance policies. Insurance companies were soon overwhelmed and were not equipped to payout this unprecedented amount of claims, leading many to become at risk of bankruptcy. This is significant because the lending institutions were not able to collect from their defaulted loans and now they were unable to collect the insurance money. This left them with millions of dollars of bad loans with nothing to show for it. This devastation inspired lending institutions, such as banks, to restrict lending to the point where even clients with good credit would be hard pressed to get a loan. Lending institutions are the heart of any capitalist economy, so if these firms are unable to generate revenue they will restrict the amount they lend out, thus lowering the amount of capital available in the economy. While it is argued
that the credit market never truly froze, the restriction of capital would have (and almost did) killed the capital dependent economies of the capitalist Western world.

Realizing that the entire modern economic order was on the point of collapse, governments pumped large amounts of money into failing financial institutions to prevent mass bankruptcies of financial giants. The U.S. government in particular rolled out a massive bailout fund of six hundred and fourteen billion dollars. The amount of firms that received bailout funds is staggering, however to much controversy, Lehman Brothers was allowed to fail and become bankrupt as it did not receive any funding. AIG was one of the biggest receivers of funding as they were given over sixty seven billion dollars. While the general public fumed over their hard earned tax dollars being used to bailout firms like AIG, many saw it as necessary to do so. This is because AIG used their portion of the funding to pay out its insurance policies to lending institutions so that those firms would be once again able to fuel the economy with capital. Without the funding AIG would of went bankrupt this, combined with the closure of Lehman Brothers, would have left thousands of insurance policies nullified, thus putting the full burden on lending institutions who would in turn go bankrupt themselves.

Lastly the final nail in the coffin came in the form of AAA grade securities. Many of the bad mortgages were packaged with other safe investments and sold as Bonds in the financial market. Since these mortgage backed securities were packaged with safer

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investments the risk of defaulting was hidden from investors. When the mortgage crisis occurred and many people were unable to make their payments these AAA Bonds became worthless causing a massive decline in pricing and resulting in investors and retirement funds to suffer the cost. Those who held large amounts of these junk bonds suffered heavily losses and caused many financial institutions to require a portion of the government bailout.

**Concluding Remarks**

In 2015 we still feel the pain of the 2008 Financial Crisis and the amount of devastation that it caused cannot be overlooked. Not only economically was this crisis painful but it was also the psychological effects were present as well. Millions lost their jobs, countless others loss their house and retirement savings. While there were many factors that lead to the crisis and plenty of blame to distribute it is vital that we as a society learn from our mistakes so that a crisis such as this never occurs again. This has to come in balance, however, over regulation of capital markets can be just as harmful as no regulation and as a society we have not found this ideal set of rules yet.
Your Task:

In the post crisis economic order, there has been a lot debating concerning how much regulation should be put on capital markets. Also one could argue that it was Clinton/Bush meddling in the marketplace that caused the sub-prime mortgage crisis which lead to the events of 2008. Others have blamed the general American population for spending outside their means by buying houses that they know they could not afford and later defaulting on their mortgages. Your task will be to propose a plan that both governments and private firms can agree upon that will prevent another major financial crisis similar to the one experienced in 2008.
Character List for the 2008 Financial Crisis Committee

1) Bill Clinton
2) George W. Bush
3) American International Group (AIG) Lobbyist
4) Ben Bernanke
5) Janet Yellen
6) Stephen Poloz
7) Mark Carney
8) Fannie Mae Representative
9) Freddie Mac Representative
10) Citigroup Lobbyist
11) Goldman Sacs Lobbyist
12) Bank of America Lobbyist
13) Stephen Harper
14) Standards and Poor’s Representative
15) Henry Paulson
16) Morgan Stanly Lobbyist
17) Countrywide Lobbyist
18) Mario Draghi
19) Jean-Claude Trichet
20) Mary Jo White
21) Consumer Federation of America Representative
22) Joe Oliver