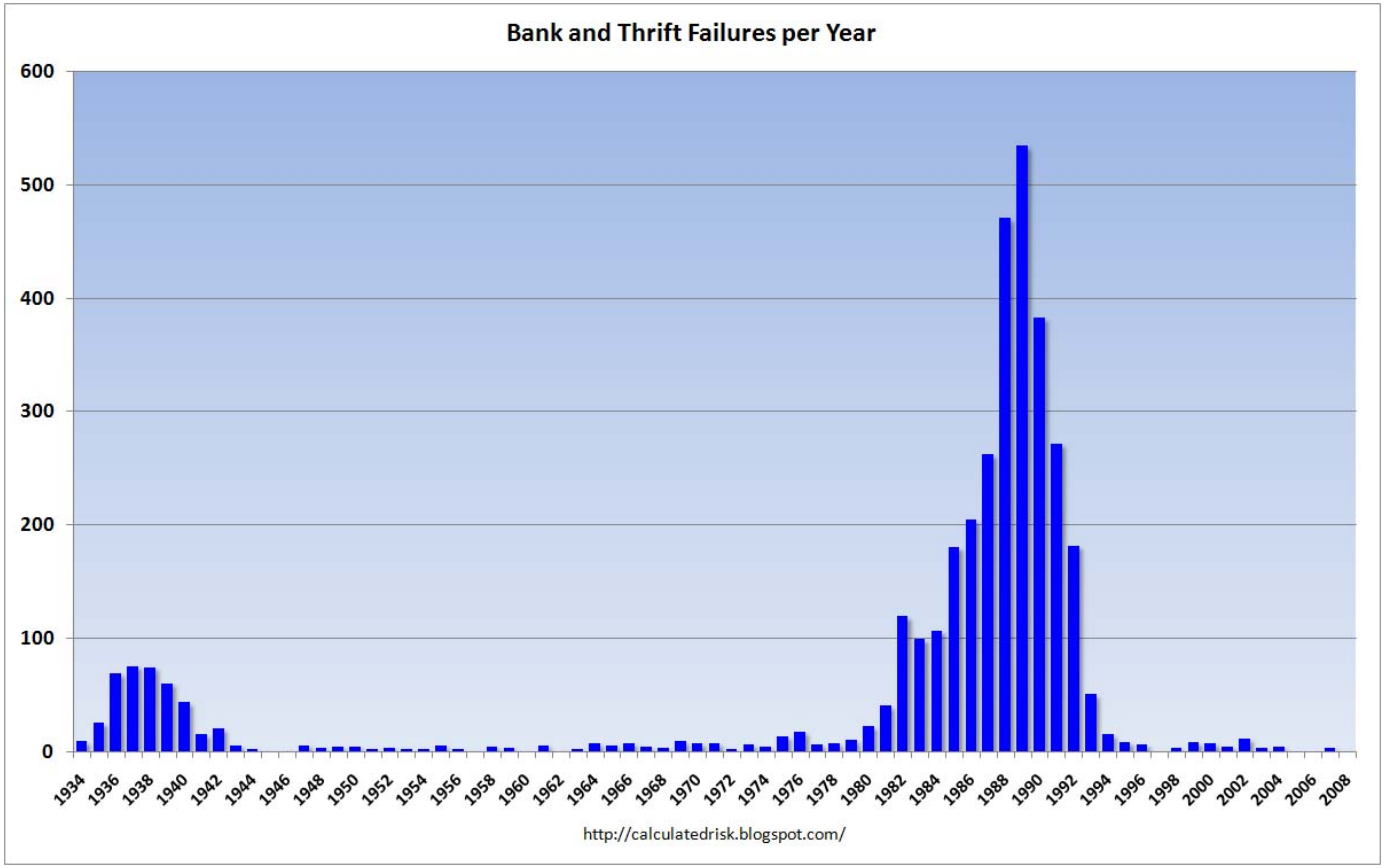
Final Exam Details

- The final exam will be posted on Blackboard by 7am on April 26th
- It will be similar in style and length to the midterm
- You will have two hours to complete the exam from the time that you open it
- The exam is open book, open notes
- Your completed exam should be emailed to me no later than 48 hours before the relevant grading deadline:
  - 2L and graduating law students: May 11 at noon
  - Other law students: May 27 at noon
  - Graduating MPP students: May 11 at noon
  - Other MPP students: May 18 at 9am

Final Exam Details

- The final is not cumulative except to the extent that some ideas presented in the first half of the semester are relevant for the more recent material
- The final covers environmental regulation, valuing non-monetary benefits (life, health, environment), product safety, workplace safety, and financial regulation
- The required readings (ones with a $\diamondsuit$ in the reading list) are the following:
  - Stavins (1998) on SO_2 allowance trading
  - Carson et al. (2003) on contingent valuation and the Exxon Valdez
- Note that the book chapters on product and workplace safety (Chapters 22 and 23) are quite useful

Modern Financial Regulation Put to the Test



Lessons Learned?

Some of the key problems in the S & L crisis:

- Partial regulation with relaxed deposit restrictions but no variable-rate mortgages (reminiscent of CA electricity crisis)
- Unforeseen shifts in demand (also reminiscent of CA electricity crisis)
- Overswinging the regulatory pendulum (recall cable television regulation)
- Moral hazard from federal and state insurance
- Over-leveraged firms (aided by Wall Street)
- Misperception of risk by managers (also aided by Wall Street)
- Lack of regulatory oversight led to both bad decisions and fraud

Lessons Learned?

- To fix these problems we get the Financial Institutions Reform Recovery and Enforcement Act in 1989
- Bailed out the industry
- Created the Office of Thrift Supervision (abolishing the Federal Home Loan Bank Board)
- Ended the FSLIC, switching insurance role to FDIC
- Higher net worth standards, had to hold at least 70 percent of assets in residential real estate

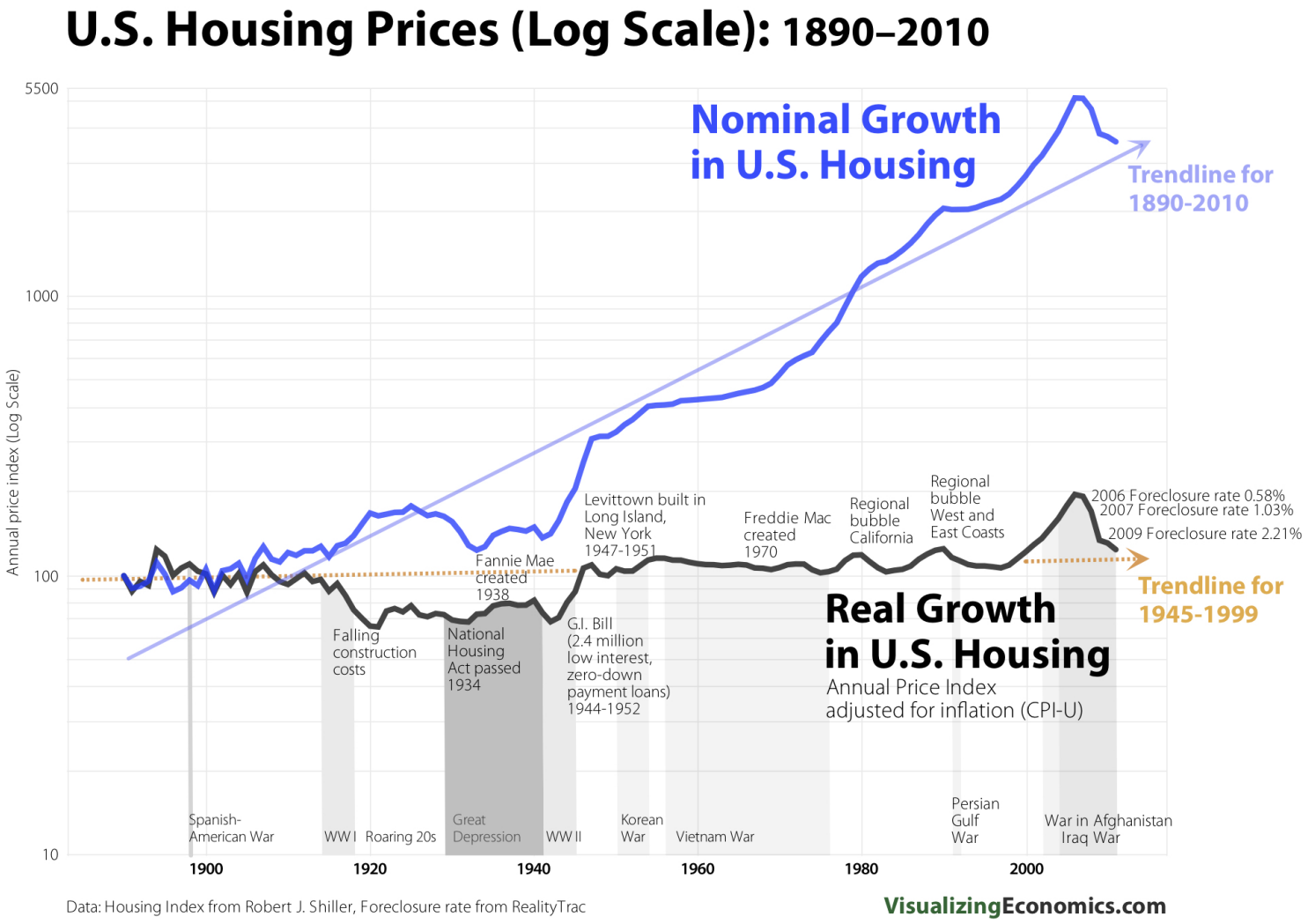
Lessons Learned?

- So we get some reform out of the savings and loan crisis
- But it turns out we have incredibly short memories
- The financial industry keeps pushing for deregulation and keeps getting it
- Alan Greenspan is a particularly sympathetic chairman of the Fed (1987-2006)
- In 1999, Glass-Steagal is repealed with the Gramm-Leach-Bliley Act
- So what could go wrong? Everything bad about the S&L's and then some

Modern Financial Regulation Put to the Test, Again

Otters, the cause of the Great Recession?

Modern Financial Regulation Put to the Test, Again

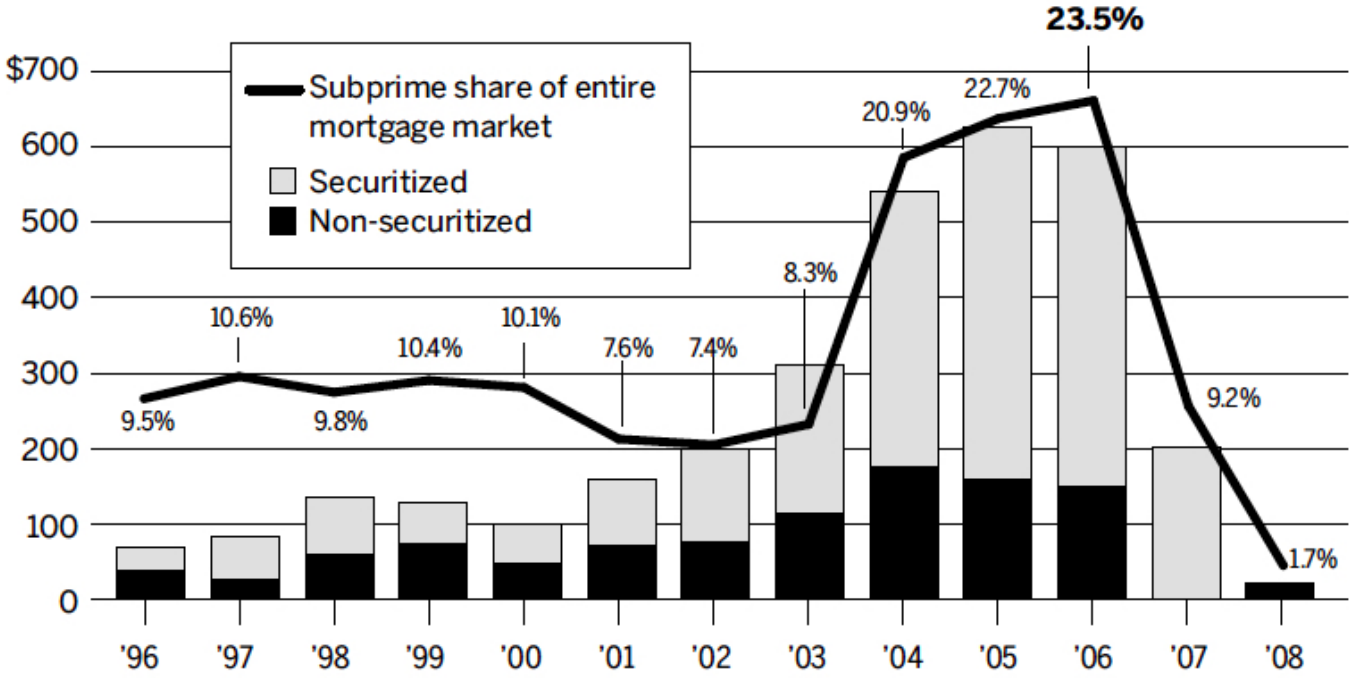


Modern Financial Regulation Put to the Test, Again

Subprime Mortgage Originations

In 2006, $600 billion of subprime loans were originated, most of which were securitized. That year, subprime lending accounted for 23.5% of all mortgage originations.

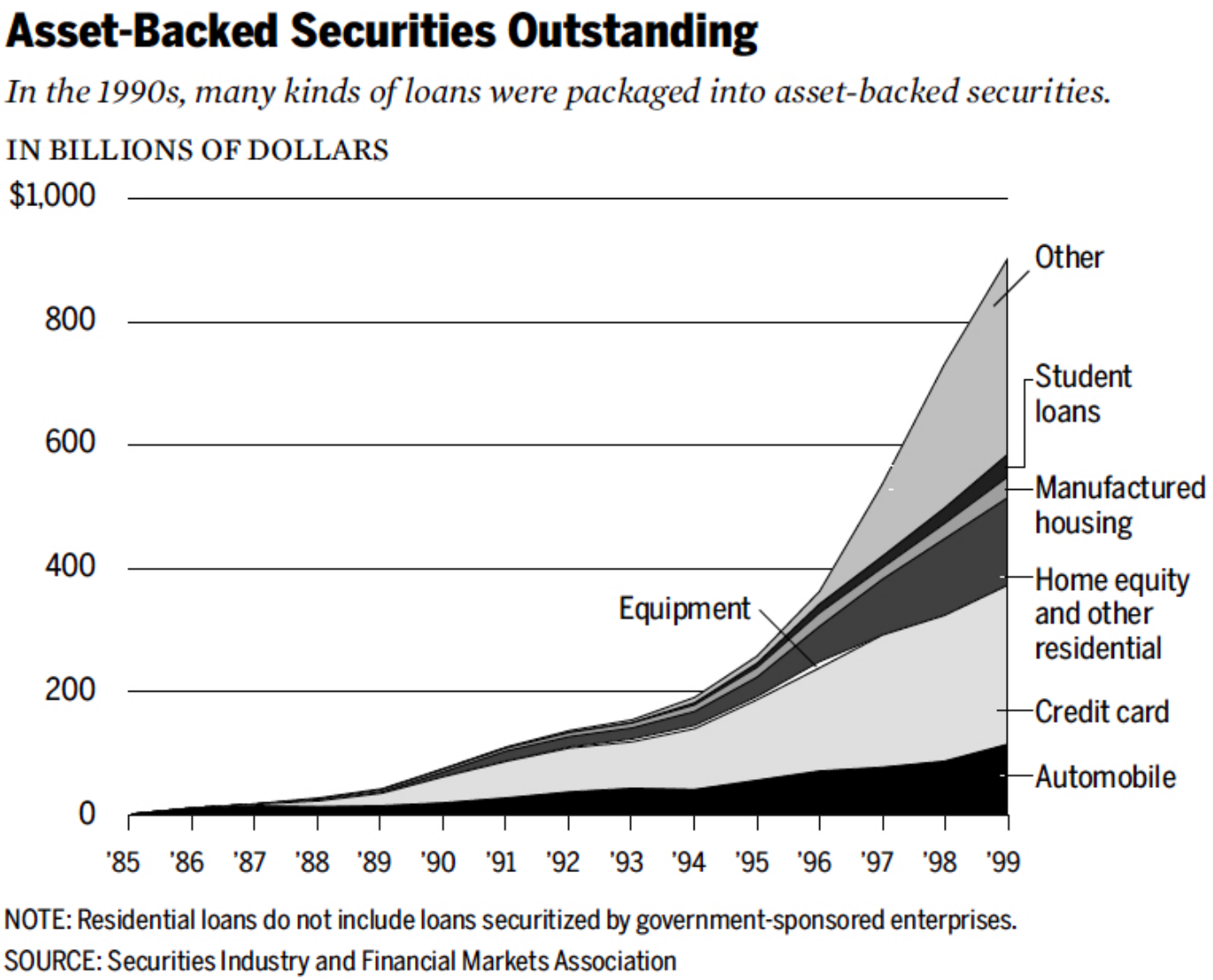
IN BILLIONS OF DOLLARS



NOTE: Percent securitized is defined as subprime securities issued divided by originations in a given year. In 2007, securities issued exceeded originations.

SOURCE: Inside Mortgage Finance

Modern Financial Regulation Put to the Test, Again



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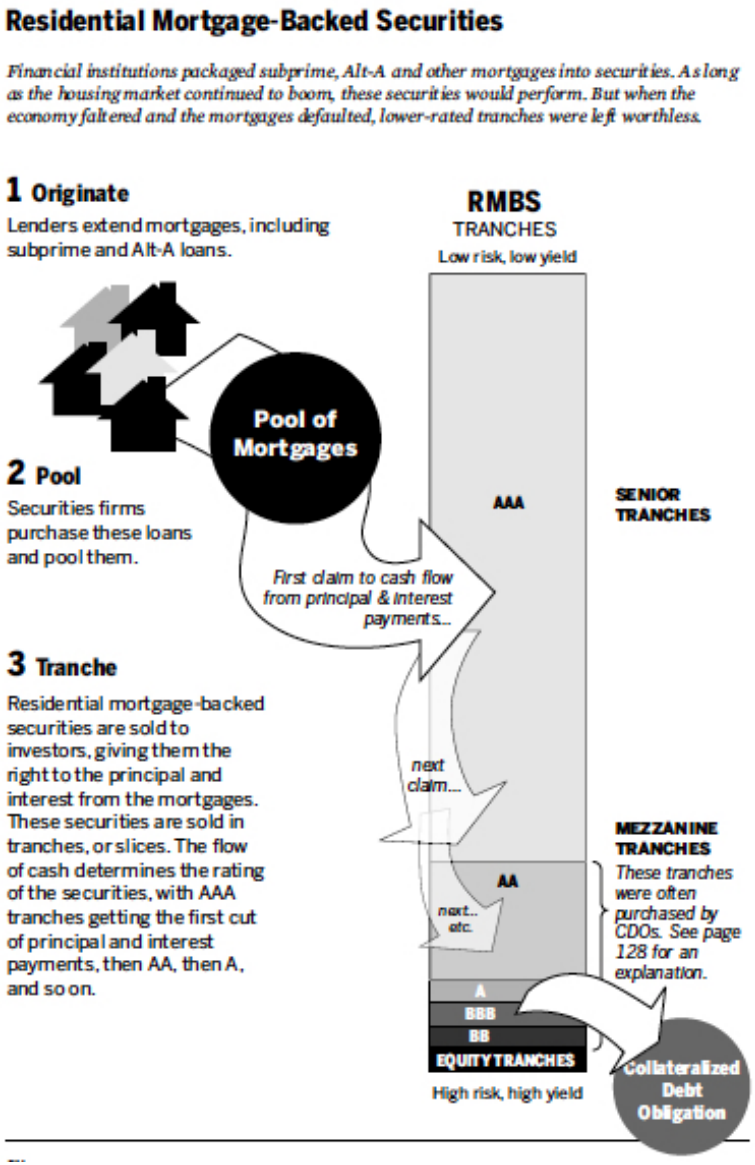

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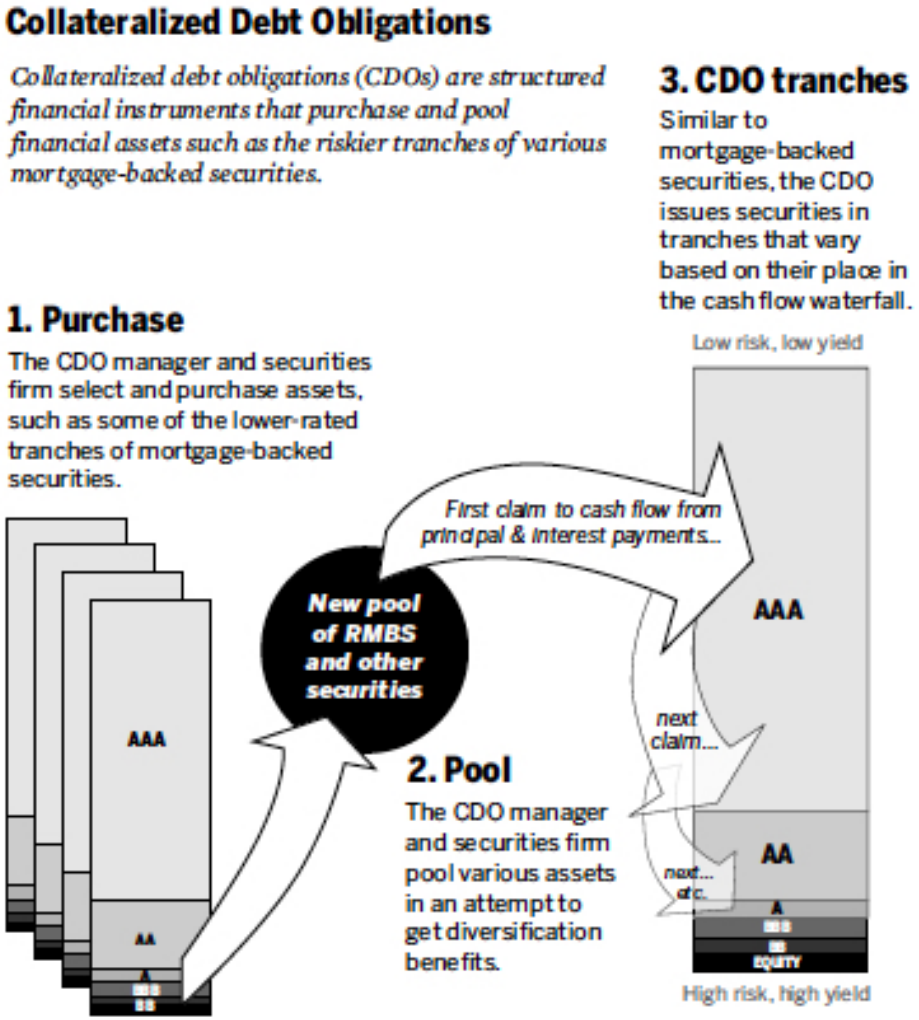

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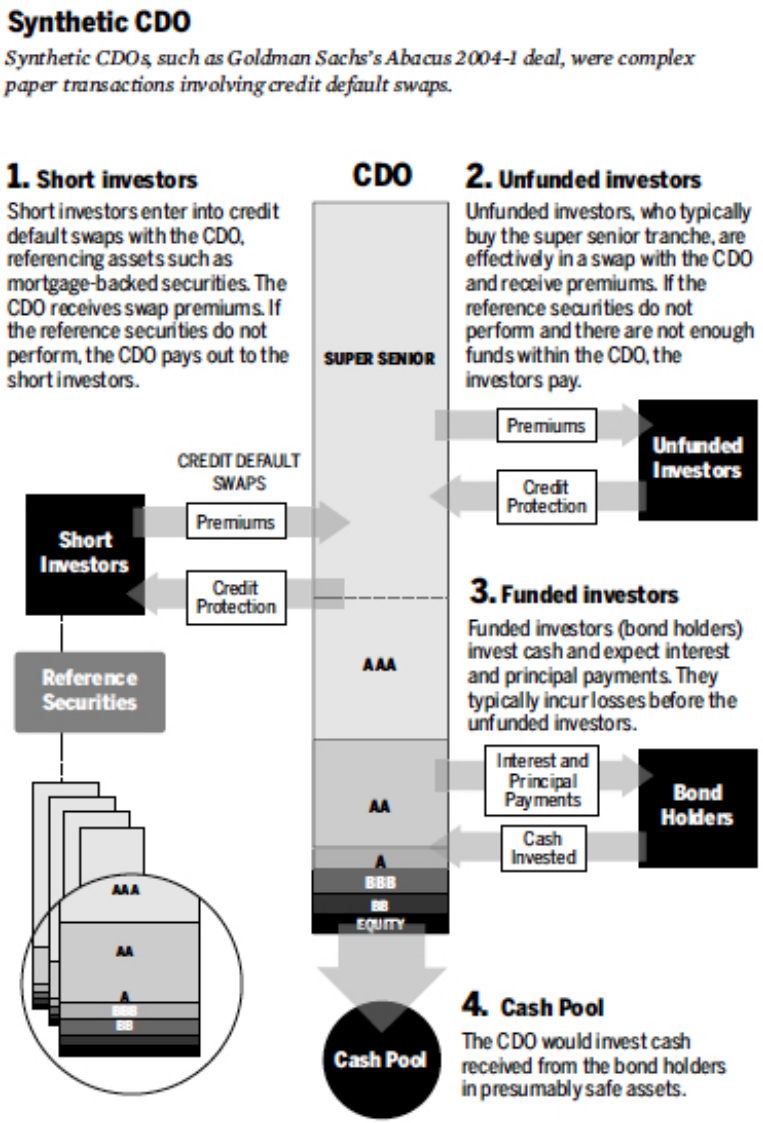

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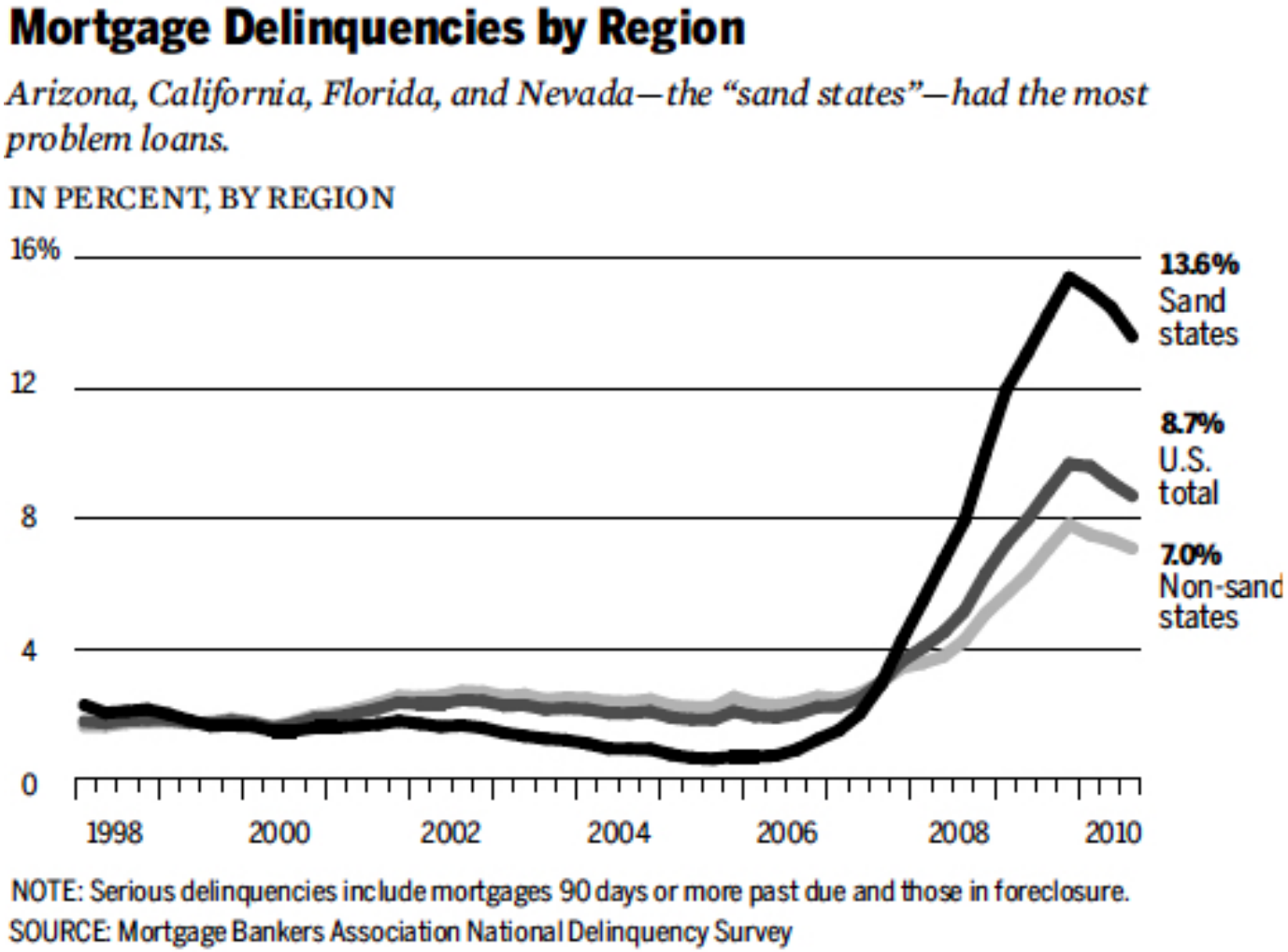

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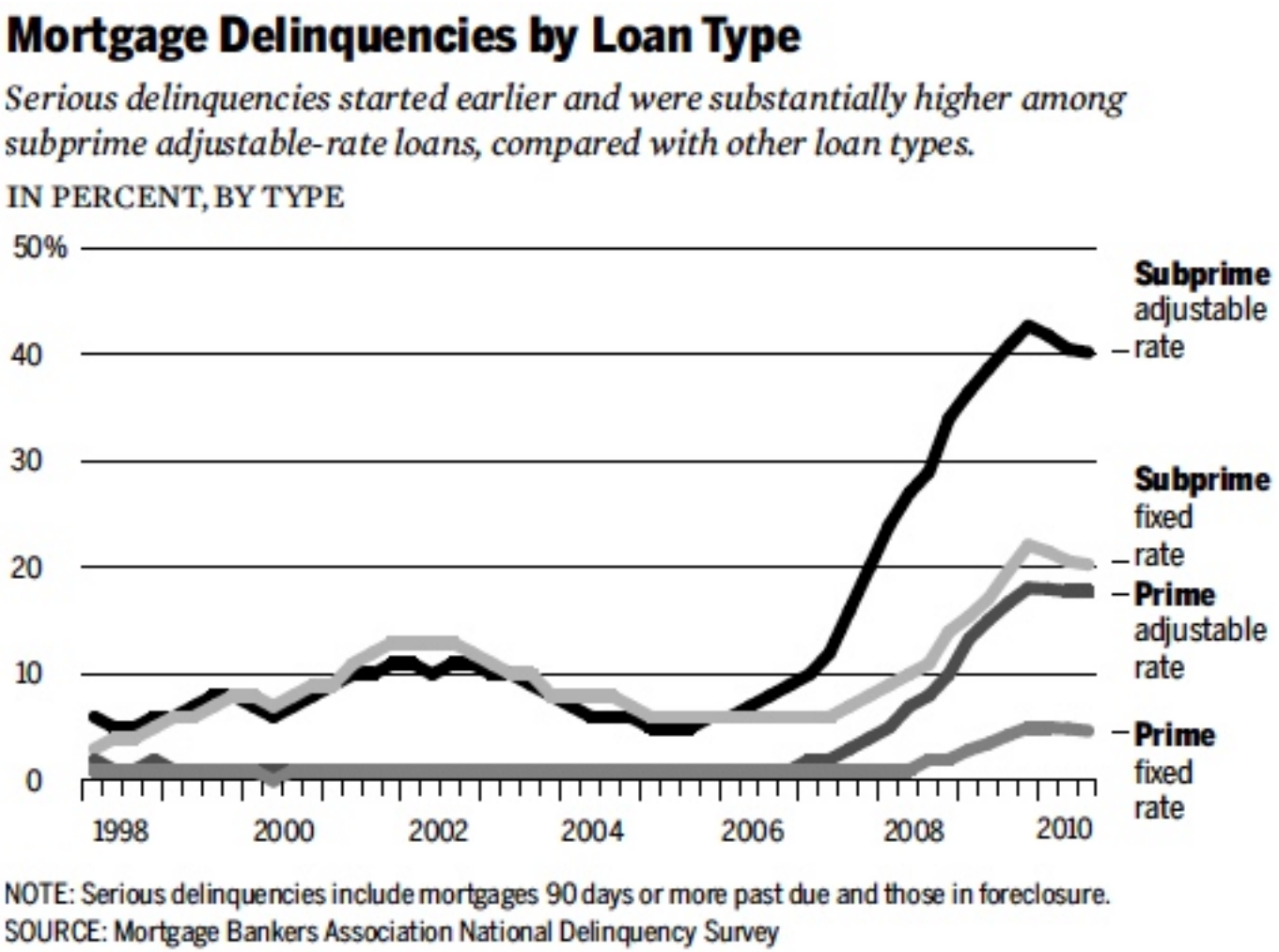

Modern Financial Regulation Put to the Test, Again

- There are many oddly familiar elements here:
  - Over-leveraged firms
  - Exotic assets that are hard to assess in terms of risk
  - Major moral hazard issues (credit rating agencies add a new wrinkle)
  - The role of housing policy
  - Lack of transparency
- Credit default swaps add a new dimension of complexity
- Systemic risk becomes a big concern
- We learned some new lessons and relearned some old ones