What if you could talk to President Franklin Delano Roosevelt or Joseph P. Kennedy, the first Chairman of the SEC? What would they say if you told them:

1) **In November 1999, Congress repealed the Glass – Stegall Act.**
2) **In the summer of 2007, SEC Chairman Cox canceled the Uptick Rule.**

Causes of the Panic

Uptick rule –The government concluded during the Great Depression that short-selling exacerbated the market collapse. A so-called uptick rule was implemented in 1938 to regulate bearish traders to only shorting a stock on the uptick – when the price has increased. SEC Chairman Cox canceled the rule in the summer of 2007.

Mark – to - Market (FASB 157) – FASB statement 157 was implemented in 2007 to change the definition of fair value – the measure of the worth of an asset on a company's books. Let me give you an example of how stupid this rule was. Let's say that all the homes in your neighborhood are worth $200,000, but the house down the street goes into foreclosure and sells for $100,000. If houses were valued according to FASB 157, all the homes in your neighborhood would now be valued at $100,000. But, it gets worse. If your house was collateral for any loans, loan covenants would be breached and you might be forced to immediately repay the loans or sell your house.

This utter stupidity of this rule is what forced Merrill Lynch to sell itself to Bank of America and Wachovia to be taken over by Wells Fargo.

Paulson – Pelosi Panic – In Paulson own words "Last night (September 18, 2008) Federal Reserve Chairman Ben Bernanke, SEC Chairman Chris Cox and I had a lengthy and productive working session with Congressional leaders." Paulson proposed the Troubled Asset Relief Program (TARP), which I like to call the Bad Asset Relief Fund (BARF). Somehow, Paulson managed to scare the Congressional leaders and the whole country at the same time. And then, on September 29, 2008, in a shock to the whole world, Speaker of the House Nancy Pelosi brought the TARP plan up for a vote without having enough votes to secure passage. With no Uptick Rule, the stupidity of FASB 157 and the failure of that September 29 vote, the Panic began.

By Harvey Helman, CFP

Those who do not remember the past are condemned to repeat it.
George Santayana

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Causes of the Great Recession

Increasing home ownership was a goal of the Clinton and Bush administrations. There is evidence that the Federal government leaned on the mortgage industry, including Fannie Mae and Freddie Mac (the GSE) to lower lending standards. Also, the U.S. Department of Housing and Urban Development's (HUD) mortgage policies fueled the trend towards issuing risky loans.

In 1995, the GSE began receiving government incentive payments for purchasing mortgage backed securities which included loans to low income borrowers. In 1996, HUD directed the GSE that at least 42% of the mortgages they purchased should have been issued to borrowers whose household income was below the median in their area. This target was increased to 50% in 2000 and 52% in 2005.

Amendments to the Community Reinvestment Act (CRA) in the mid-1990s raised the amount of mortgages issued to otherwise unqualified low-income borrowers, and also allowed for the first time the securitization of CRA-regulated mortgages, even though some of these were subprime.

Glass – Stegall (GSA) – In 1933, this act separated investment and commercial banking activities. In 1956, an extension of the Glass – Stegall Act, the Bank Holding Company Act, further separated financial activities by creating a (*partial*) wall between insurance and banking.

In November 1999, Congress repealed the GSA with the establishment of the Gramm – Leach - Bliley Act which eliminated the GSA restrictions against affiliations between commercial and investment banks. Furthermore, the Gramm – Leach – Bliley Act allows banking institutions to provide a broader range of services, including underwriting and other dealer activities.

These political decisions were the catalysts that fed the subprime mortgage crisis, but, in my opinion, they didn't create the panic.

Mortgage brokers talked buyers with poor credit into accepting housing mortgages with little or no down payment and without proper tax documentation and credit checks.

Banks and financial institutions repackaged these mortgages; creating financial instruments called CDOs (collateralized debt obligations) or MBS (mortgage backed securities).

Credit rating agencies, in a monstrous failure, gave AAA ratings to these securitized transactions (CDOs and MBSs) based on subprime mortgage loans. This allowed them to be sold to pension plans, insurance companies and banks worldwide.

At the same time, banks were increasing their leverage to 30-1 or more. Low interest rates, low margin requirements and excess liquidity led to even more speculation in housing, commodities and stocks. Hedge funds were becoming more powerful and continued to be unregulated. The serious subprime crisis began in June of 2007 when two Bear Stearns hedge funds collapsed. And so the groundwork was established for the coming panic.

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Oh, by the way, the SEC is now considering reinstating the "Uptick Rule".

On April 2, 2009 the Financial Accounting Standards Board voted in favor of a proposal that will give institutions more flexibility in how they use fair value, of mark – to market accounting rules.