Call for Proposals
NBER-Sloan Financial Crisis Project

Working group on the systemic causes and effects of the credit crisis

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In late 2008, the Sloan Foundation agreed to fund projects to be organized by the NBER to conduct research examining competing explanations for the financial crisis that began in 2007 and possible reforms. Our working group will investigate a wide range of issues broadly related to how interactions between financial institutions, markets, and regulations affected the crisis and how such interactions will (or should) change. Some of the project activity will involve presentation and discussion of research papers that are well along and some will support work on new papers. This is a call for proposals for new papers to be presented at a conference in the second half of 2010. Papers on the conference program will be considered for publication in a special issue of the *Journal of Financial Economics*. The project will provide some funding to the authors and will pay for the submission fee to JFE. Proposals for papers for the conference will be considered until November 15, 2009. An acceptable proposal would be one that outlines the paper to be written in three pages and has a timetable for completion. Authors of selected proposals submitted before April 24, 2009, will be invited to attend a meeting at the NBER Summer Institute on July 8 and 9 to discuss proposals. Proposals submitted before April 24 will have a better chance of being accepted for the 2010 conference.

The organizers will consider proposals on a wide range of topics. Some examples of topics we are interested in include:

- How and why were moderate prospective credit losses amplified into systemic problems?
- How important was uncertainty about the true value of bank assets? Why did this uncertainty seem to persist? What were the implications of this uncertainty for the financial system?
- Did financial innovations contribute to the crisis? If yes, how? For which type of innovations do long-term welfare gains exceed crisis-related welfare losses?
- How should financial institution liquidity postures be measured, managed and regulated?
- A primary stated rationale for the diversion of Bear Stearns from a Chapter 11 bankruptcy was the interconnectedness of major financial institutions caused by OTC derivative transactions, repo transactions, and other counterparty relationships. Why are large international financial institutions so interconnected? Why did market solutions not emerge to an extent that would have avoided concerns about this interconnectedness? Why did market forces fail to make Lehman less interconnected during the six months after Bear failed?
- Some have proposed that OTC interlinks be reduced by forcing derivatives into more standardized, exchange-traded forms with associated clearinghouse intermediation and risk management. Would that make the financial system more resilient, and what would be the efficiency costs? Why is it that these financial

instruments were not traded on exchanges? Why is it that there was no centralized clearing-counterparty? Did the absence of a central clearinghouse counterparty worsen the crisis?

- Was there a credit boom in the large corporate syndicated loan market that involved mispricing of credit and inefficient lending? If so, why did investors participate, given that such booms appear to occur repeatedly?
- Can central banks stop or "manage" credit booms? What would be the costs and benefits if they attempted to do so?
- Was there a global savings glut and did it play a role in the credit boom?
- What can we learn from similarities and differences in the performance of banks in different countries?
- Press accounts imply that failures of consumer protection were an element of the U.S. mortgage credit boom, in that many borrowers allegedly did not understand what they got themselves into. To what extent was that the case? To what extent should consumer protection policy be viewed as an element of effective promotion of financial stability?
- "Market discipline" is a commonly suggested method of promoting stability and efficiency. Many studies find evidence that it pushes prices and quantities in the "right" direction in the cross section.
    - Presumably it will be a long time before the authorities can credibly threaten to impose default losses on holders of large bank liabilities. How should policy change as a result? How should firms change their strategies?
    - Casual observation suggests that market discipline is "too weak" during credit booms and asset price bubbles, and "too strong" after crashes. True? If so, why? Is there a role for policy action? What are the implications for supervision and regulation?
- Did the participants in the securitization process have poor incentives to perform adequate due diligence? If so, why were arms-length investors willing to buy securitized debt? Why did issuers hold so much of the debt they securitized?
- What asset price relationships departed materially farther from frictionless ideals due to lessened arbitrage activity during the crisis? Why did arbitrage falter, and to what extent will arbitrage activity return to former intensities? For example, covered interest parity, a bedrock of international finance, failed throughout the crisis period in that interest rate and foreign exchange price relationships departed from longtime norms.
- A "parallel banking system" of off-balance-sheet vehicles and other entities depended on the conventional banking system through a web of liquidity-support and credit-support contracts and reputational links, and was a primary source of initial shocks to the conventional system during the crisis. Why did this parallel banking system develop? What would be the costs and benefits of extending regulation to the "parallel" system?
- Similarly, "maturity transformation" vehicles played a major role in the money market shock. What is the source of demand for such transformation, and how can it best be satisfied in the aggregate?

- To what extent did credit derivatives and other credit risk transfer mechanisms actually spread risks throughout the financial system versus making the locations of risk-bearing less transparent? Was stability enhanced or reduced?
- Many observers have suggested that mark-to-market accounting rules were a primary amplification mechanism. Were they? Why? What would be the costs and benefits of different accounting rules?
- What role should risk management play in corporate governance of financial institutions? What arrangements would promote effectiveness?
- Many observers have criticized financial institution disclosure practices. What constitutes "good" disclosure *ex ante*? If disclosure was inadequate, why?
- In spite of their recent failures, few have seriously suggested that rating agencies be outlawed. Instead they appear to be increasingly viewed as public utilities. Did they contribute to the crisis? Why? What is a proper view of their role? What regulation is implied?
- Market arrangements, such as margining, imply that procyclical leverage arises endogenously. Why? Do the efficiency gains outweigh the impact on stability?
- Money market investors appear to expend little effort in monitoring and pricing risk *ex ante*. Instead they run when risk begins to become more than *de minimus ex post*. Is this an efficient arrangement? What role did runs on money market funds play in the crisis?
- Recent official sector documents proposing various reforms, such as that produced by the Financial Stability Forum, include large numbers of recommendations for changes, each of which appears modest. Is such a patchwork approach to regulation and other official sector action likely to be effective? Or should fundamental approaches change?
- Did short-sales contribute to the crisis? Do they pose risks to financial institutions? If yes, what are they? How can they be measured?
- How should risk be measured in an environment characterized by infrequent very large systemic crises? Are there measures that would be more appropriate than stress tests?
- How important were risk management mistakes in the crisis as opposed to risk-taking decisions that worked out poorly? If risk management mistakes played an important role, why? Were resources devoted to risk management insufficient? Did risk managers have poor incentives?
- Was the crisis in part the product of a regulatory failure? If yes, was it because of poor regulations or poor regulators? Did regulators have the right incentives? Did they have enough independence from the political process? How should regulatory bodies be governed?
- Capital regulation did not work as intended. Why not, and how should it be changed?
- How important was the role of competition in the risk posture of firms before the crisis? Did competition lead them to take more risks?
- Did fire sales play a significant role in the crisis? Can their impact be measured?
- Why did the Lehman bankruptcy filing trigger severe stress in the financial markets? Could alternate resolution mechanisms have helped?

As noted previously, work on topics not on this list will be considered.

Please forward proposals for discussion at the Summer Institute and contact information by email to dice@cob.osu.edu by April 24, 2009. Authors of proposals will be informed of status by May 15, 2009.