Unlike many books to date, THE END OF WALL STREET is the only comprehensive and fully interpretive work on the how and the why of Wall Street’s woes as well as the what and the when.

Other books on the banking crisis have been mostly reportorial. Roger Lowenstein takes the reporting to a different level and tells this story through the prism of the values and worldview he has been writing with for the past 20 years, which include:

Lowenstein’s worldview:

- Excess leverage leads to peril
- Markets are subject to speculation, and mass speculation can lead to bubbles
- Virtue resides in those who evaluate securities and markets for themselves, independent of the judgments of the crowd
- Markets make mistakes, so there is role and a need for government to be a robust cop on the Wall Street beat
- When Wall Street peddles overly complex securities (i.e., CDOs), it’s a sure sign of a trouble afoot
- Executives are entitled to fair compensation for their performance, but not to excessive or piggish rewards pegged to every short-term blip in the stock price
These values constitute the theological backbone of THE END OF WALL STREET. The crash of 2008 is a sort of ultimate corroboration of the ideas Lowenstein expressed in his previous bestselling books such as _When Genius Failed_ and _Buffet_.

Telling the full story of how we got into trouble, THE END OF WALL STREET is not just a compendium of conversations between bankers during the week that Lehman failed. It’s a narrative of an entire era, beginning in the heady Greenspan days of ultra-low interest rates and continuing through the first signs of trouble and into the crisis of 2008 and beyond. The story is not just a series of bank failures in September/October ’08, but the failure of an entire system.

ABOUT THE BOOK:

The crisis was a slowly brewing collapse that began to unfold as early as mid-2006. Housing was in a slump for _more than two years_ prior to Lehman. The default rate on mortgages had tripled. Home foreclosures had _quadrupled_ (from 75,000 a month to 300,000). Mortgage firms were folding throughout 2007. Even the job market had shrunk for 8 straight months _before_ September ‘08. The extent of the advance warning chronicled in THE END OF WALL STREET is mind-boggling.

Since the causes of the crash _predated_ Lehman, the arguments over whether it was right or wrong to let Lehman fail miss the point. The market panicked when the government failed to save Lehman, but it continued to panic when AIG (two days later) _was_ rescued. Neither approach worked, but by then, it was too late; the crash was already in motion.

THE END OF WALL STREET identifies, in arresting detail, the causes of the crash as follows:

- Bubble in home mortgages
- Faulty system of rating and distributing mortgage securities
- Wall street firms betting on mortgages & amplifying risks with leverage
• Lax government regulation
• Lax central banking (too easy credit)

Lowenstein gives a full accounting of:

• The history of how Fannie and Freddie got into trouble. (Chapter 1)

• How Congress refused to regulate, and preferred to use Fannie and Freddie to provide mortgages to people irrespective of their incomes (Chapter 1)

• How Fannie and Freddie were squeezed between the need to earn profits for shareholders and the need to deliver low-income mortgages to satisfy congressional allies such as Barney Frank. (Chapter 1). With the need to generate profits, they ramped up subprime loans and weakened loan criteria. Lowenstein details that Fannie knew of the risks -- see the memos discussed on pages 13 & 14-- and that Congress also knew. Barney Frank was warned that if Fannie and Freddie kept adding to the total of mortgages a bailout might be necessary. Frank assured skeptics that, regardless, he would never approve a bailout. This was in 2005

• How, over time, the subprime business changed. In the beginning, lenders made exceptions to accept the best subprime customers (i.e., those with low credit scores). Over time, however, they began to seek out such borrowers, ended up taking everybody, allowing loan quality to deteriorate fast

• Why new-style lenders such as Countrywide focused on subprime

• A revelatory portrait of Angelo Mozilo, Countrywide’ co-founder, the Johnny Appleseed of subprime, who wanted to plant a mortgage in every yard. Mozilo preached the gospel that everyone should have a mortgage, even those without capital. This was an error analogous to that of
Michael Milken in the junk bond era – “issue a junk loan to every company”

• The outrageous details of Countrywide loans (Chapter 3): loan officers refused to check information on borrowers; refused to investigate apparent evidence of borrower fraud; how loan officers, lacking real info on borrowers, cut and pasted “borrower profiles” from the Internet (Washington Mutual for instance, urged loan officers to keep only “thin” files on borrowers and pressured appraisers to inflate home values)

• The history of securitized mortgages, beginning with Lew Ranieri, pioneer at Salomon Brothers, who found a way for Wall Street to invest in home mortgages, effectively joining Wall Street to Main Street

• How a new distribution system was born, where mortgages are carved up and sold to thousands of investors (unlike old-fashioned door-to-door lenders, these dispersed investors had no knowledge of individual mortgage quality and thus had to rely on the rating of the mortgage securities)

• Inside Moody’s: Chapter 4 details how an actual mortgage security was stuffed with subprime loans; thousands of loans packaged in a day, most from same geographic area, with borrowers with little or no equity, and many of whom did not provide documentation. Nonetheless, securities were rated triple (Lowenstein documents how Moody’s was conflicted. It was paid by the firm seeking the rating). Moody’s was supposed to set capital requirements, but given the conflict, small wonder that its ratings proved overly generous. One employee of S&P quipped in an email, “Let’s hope we are wealthy and retired before this house of cards falters.” (Pg. 78)

Lowenstein goes deeper than anyone else into the personalities involved in the collapse:
• Dick Fuld at Lehman: had a tribal devotion to the firm, was wary of outsiders, and refused to consider selling even as storm clouds appeared. Fuld kept doubling down and refused to temper bets—“like a gambler who thinks he will always get to play the last card.” (Chapter 5)

• Stan O’Neal of Merrill Lynch: an autoworker’s son who remained a perpetual outsider on Wall Street, O’Neal golfed alone, was envious of Goldman Sachs, and pursued the mortgage business late in the cycle. O’Neal pushed underlings to buy a subprime issuer (Chapter 6 has a description of Merrill Lynch’s visit to New Century—a mortgage company similar to Countrywide—in California, where buttoned down Merrill bankers were horrified by New Century’s free-wheeling ways. Against his bankers’ advice, O’Neal moved into subprime anyway. The aloof CEO did not realize extent of Merrill exposure until mid 2007, at which point he was stunned and tried to sell firm (this is a revelation: Merrill didn’t disclose its interest in being acquired until a year later))

• Morgan Stanley’s hard-hitting Jamie Dimon (whose bank survived and thrived) and Chuck Prince, of Citigroup. Chapter 7 contrasts through the vehicle of their annual letters that Dimon astutely saw trouble ahead and talked to his shareholders, even estimating the size of Morgan’s losses in each of nine different business lines if credit markets worsened. Prince wasn’t even thinking about subprime, didn’t mention risks to Citigroup and didn’t show any sign that he anticipated a credit market slowdown

• Citigroup’s Bob Rubin, who burnished his reputation as a cautious strategist but failed to heed his own advice. A weak executive, Rubin was good at listening but failed to speak up when he should have

THE END OF WALL STREET also gives a full accounting of regulatory failings:

• Going behind scenes of the mortgage regulators, Lowenstein details the problem of too many agencies, each with different agendas and authority over different slices of mortgage industry
• The book profiles one of those regulator, John Dugan, the U.S. comptroller of currency, who realized early that mortgage lending was in a bubble. Dugan tried to set limits on mortgages while other agencies—including Greenspan at the Fed—stopped him. (Pages 34 & 35)

• Lowenstein includes a gripping account of how, in the late ‘90s, Greenspan, Summers, Rubin and Levitt—the four top regulators in Washington—shouted down Brooksley Born, head of a small federal agency, and prevented her from regulating derivatives. (Pages 58 - 60)

THE END OF WALL STREET pinpoints where the Fed went wrong:

• Bernanke did not believe central banks should “prick” bubbles; incredibly, he stated this in 1999, during height of dot.com mania

• Bernanke and Greenspan bought into theory that markets were self-regulating and self-correcting. Bernanke justified unparalleled U.S. borrowing from overseas, principally Asia, in 2005, even though he knew such borrowing was inflating U.S. housing prices (Chapter 2)

• There are finely etched profiles of Paulson and Bernanke that suggest why neither official anticipated crisis (Paulson had spent his whole life in finance but had never dealt with, or thought much about, systemic issues. Bernanke, his polar opposite, had spent a career in academia immersed in theoretical issues but had never traded a bond, much less a CDO)

• Paulson, a former CEO, had unrealistically high expectations for what he could accomplish in government. As Secretary he was impulsive, like the trader he had always been. He expected a crisis but looked in the wrong place (hedge funds, not mortgages)

• Bernanke saw economic events in macro terms. He had a Fed-centric view that focused on monetary conditions only (and wrote an entire book on the Great Depression that did not mention individual bank failures or the unemployed). In 2007-08, he missed the trouble brewing at Citi, et.
al., because he had no feeling for analyzing specific institutions, balance sheets, etc., and his faith in models left him unprepared to question Wall Street forecasts and ratings

- The Fed made a major mistake (Greenspan as well as Bernanke) in refusing to “prick” asset bubbles before they got out of hand. Instead of checking market excesses, they reinforced market errors

- A central flaw of the period was the belief in the perfection of markets; the Fed bought into this—it refused to regulate derivatives, it trusted in the market models of rating agencies and banks, and it failed to raise rates to curb speculation (Lowenstein disagrees with Bernanke’s recently stated view that the Fed’s low-interest rate policy was not a factor in the bubble)

Mistakes, there were plenty of them:

- Wall Street’s fatal error was relying on liquidity. Banks figured they could always trade out of assets such as mortgage securities if they had to. In fact, during market convulsions liquidity always evaporates (during a panic there is no one to trade with)

- If liquidity won’t protect a bank, what will? Capital. Capital is the opposite of leverage. Banks with sufficient capital did not get into trouble. In a crisis, banks cannot rely on liquidity—only on capital

- Lenders assumed that homeowners who couldn’t afford their mortgages could always refinance them. They relied on the liquidity of the mortgage market

- Homeowners figured they could borrow new money to pay off the old.

- Wall Street firms such as Lehman believed they were in the “moving” business, not the “storage” business—i.e., that their mortgage securities
could always be unloaded (Chapter 5). Figuring they could always pawn them off, the banks were unconcerned with the *quality* of their holdings.

- The Fed made the same mistake. The Fed’s early moves were all about restoring liquidity--extending loans to banks and cutting interest rates for instance. These moves liquefied the system, but they didn’t stop the crisis. Why? The problem was not (primarily) a lack of liquidity, it was a lack of capital

- Since customers did not have equity in their homes and the banks were too leveraged, the many attempts by the Fed to extend loans didn’t work. Lending money to a bank that is undercapitalized does not make it solvent

The book treats the decision by Paulson to use Tarp to invest capital in banks as its climax. That is when Paulson finally got that only additional capital would save the banks. Paulson made his mind up in advance not to save Lehman, mostly for personal/philosophical reasons. Having bailed out Fannie and Freddie, he was opposed to more bailouts. This was consistent with his generally free-market approach, such as refusing help for underwater homeowners.

Lowenstein makes clear that Paulson declined to help in the case of Lehman and that Bernanke, weakly, let Paulson impose a “no-bailout” policy. Two days after Lehman’s failure, Paulson and Bernanke reversed their policy and saved AIG. This had nothing to do with saving Goldman Sachs (as many later alleged). Goldman at the time was not at risk. The figures in the book prove it (Chapter 14).

While it is fair to criticize Paulson as inconsistent, Lowenstein points out that this should be tempered in light of the fact that officials were working in unprecedented crisis conditions. Many Paulson critics were hypocritical. Before the Lehman failure, the country overwhelmingly opposed helping Lehman. Afterwards they faulted him for *not* saving it.
Lowenstein also offers a simpler and more intuitive explanation of the AIG rescue: the non-bailout policy adhered to in the case of Lehman wasn’t working, i.e., markets were imploding. So officials panicked and decided not to let AIG fail. Lowenstein quotes AIG CEO Bob Willumstad: “The reason we were saved is we came second.”

Lowenstein contends that a more trenchant criticism would be that, post-Lehman, Paulson, Bernanke and Geithner adopted a universally *pro*-bailout stance. Burned by the example of (and criticism over its handling of) Lehman, the regulators adopted a policy of bailing out every conceivable endangered large institution, some of them more than once, from the fall of 2008 and into 2009. *This was a mistake.* Once the panic was over, the government should not have been so quick to bail out failing banks. Lowenstein cites the rescue of Citigroup in November and the continuing bailouts of AIG, as well as the bailout of GM, as ill-conceived rescues.

In the end, THE END OF WALL STREET concludes that the “new finance” was fatally flawed. It relied on historical models of home foreclosures and such to predict the future. Models are great for predicting the odds in dice or cards, but history is more complex than dice. It is subject to uncertainties and cannot be modeled so precisely.

The “Golden Age” of Wall Street:

THE END OF WALL STREET gives rich historical context of Wall Street’s Golden Age that lends credence to the book’s title. Dubbed by Lowenstein “The Age of Market,” the Golden Age was roughly from the 1980s to the pre-crash period. In this period, markets ruled, characterized by less government and less regulation, more faith in markets and in the ability of market models to forecast future and to control risk. Characterized by low taxes and unemployment, and more faith on the part of public in Wall Street, the Golden Age had a higher proportions of investment directed to stocks, a low savings rate (people thought
appreciation in homes and portfolios would pay for retirement so no need to save), and a generalized belief that economic calamities were thing of past.

In 2008-’09, ALL THESE TRENDS WENT INTO REVERSE.

Regardless of whether we have another crash, our faith in Wall Street/models/markets/the Fed will not be what it was. The economic world is again seen as fraught with risk. And how has the landscape changed? Specifically:

- Leverage and risk levels at banks will be (and are) lower
- Capital requirements will be higher
- Deregulation is in retreat; Wall Street will have to contend with more rules
- Taxes will be higher
- The role of government in economic life will be (and is) greater. The government is, today, the main prop in housing, autos and consumer loans
- Economic thinking has returned to the Keynesian view espousing deficit spending during recessions
- Government spending and deficits have soared
- The dollar has been and will be under pressure
- The American model of super-laissez faire capitalism, in which Wall Street called the shots, is being challenged by the European view (more state control) and the Chinese model of centralized command and control
• New regulations are in force and legislation is in the works. Obama’s recent broadside to separate banks would be the most draconian financial reform since the New Deal.

Finally, what are Lowenstein policy suggestions?:

• The Fed must realize that refusing to prick asset bubbles was a huge mistake (the book offers a way for central bank to deal with bubbles)

• Derivatives should be regulated. Credit default swaps amount to gambling on whether companies will survive – there is no reason for such derivatives to exist

• Capital levels should be higher

• Government should end policy of ‘too big to fail’ by a), making it unattractive for banks to be “big” via a tax or premium or b) enact (as Obama proposes) a new Glass-Steagall Act that separates banks in two. Put the activities in which the public has a legitimate interest, such as making loans and issuing stocks and bonds, on one side, which would be regulated, and trading activities, which constitute the bulk of profits for firms such as Goldman, on the other half. That side would be allowed to fail. The government should not protect trading firms

• Restrain compensation at banks and other public corporations. Shareholders (not a federal pay czar) are the rightful party to exercise control because the money is theirs; thus, all CEO and executive bonuses over a certain threshold should be subject to shareholder vote

• One regulator should oversee all mortgages, whether written by state-chartered banks, federal banks, or non-banks. It should mandate that lenders approve only those mortgages that the borrower can service
from income, i.e.—issuers should not be allowed to approve mortgages on the mere hope that the borrower will be able to refinance them before the bill comes due

- Rating agencies: government should end the conflict of interest and end official recognition of rating agencies that charge the companies whose bonds they rate. If Moody’s wants issuers to pay for ratings, those ratings should be deemed unacceptable by the SEC, the Fed, and other federal agencies

- Capital requirements: the SEC and banking regulators should abandon the use of historical models of the type that Wall Street uses to measure risk. They should go back to reading balance sheets