EXPLORING TODAY THROUGH THE LENS OF THE PAST

THE 2008 FINANCIAL CRISIS: A TIMELINE

Timeline Theatre Company

INSTITUTION
LEHMAN BROTHERS
An American global financial services firm. In 2008, before it filed for bankruptcy, it was the fourth largest investment bank in the United States.

THE COLLAPSE OF LEHMAN BROTHERS HAPPENED DURING THE 2007–2008 SUBPRIME MORTGAGE CRISIS IN THE UNITED STATES. In 2008, the global investment bank declared bankruptcy. This event would play a significant role in causing the Great Recession of 2008–2009, one of the worst economic downturns in U.S. history. *The Lehman Trilogy* focuses mainly on the Lehmans, but the firm's collapse took place within a complex financial ecosystem characterized by decreasing regulatory oversight, imperfect government policy, and growing fiscal irresponsibility. In hindsight, these golden years of investment banking were a ticking time bomb that would be inevitably set off by the industry's hubristic belief in its banking institutions as "too big to fail."

1992 Congress establishes the "affordable housing goals" to encourage homeownership for all Americans. Fannie Mae and Freddie Mac, two government-sponsored enterprises that buy mortgages from banks, are now required to devote a percentage of their lending to low-income and minority borrowers.

FANNIE MAE AND FREDDIE MAC would package mortgages they bought from banks into complicated financial products, such as mortgage-based securities (MBSes), and resell those packages to other financial institutions for profit.

1994 Homeownership in the United States is 64.2%—consistent with the rate through the 1980s.

1994 JPMorgan Chase introduces a financial contract called the credit default swap (CDS), which quickly becomes a popular product.

WHAT'S THIS?
CREDIT DEFAULT SWAP (CDS)
If a lender wants insurance against a borrower defaulting, the lender may buy a CDS from another investor, who agrees to reimburse them if the borrower defaults.

A mixed-use development built in a former dust bowl in Marin City, California, as a result of the Community Reinvestment Act. (Getty Images)

1995 The Community Reinvestment Act (CRA) is reformed. To meet affordable housing goals, mortgage lenders may now buy subprime assets.

September 1999 Fannie Mae eases credit requirements for loans, which encourages banks to issue more subprime loans.

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FEDERAL RESERVE SYSTEM ("FED")
The central bank of the United States, which is in charge of taking actions that control money supply, in order to achieve stable prices and maximum employment. There are 12 Federal Reserve banks, each representing a separate district; one of them is the New York Fed.

WHAT'S THIS?
SUBPRIME LOAN
A loan is considered subprime if it is provided to a borrower with bad credit, i.e. the risk that the borrower cannot pay back the loan is very high.

Alan Greenspan, 13th Chairman of the U.S. Federal Reserve, from 1987 to 2006. (Cassuto Herald Tribune)

November 1999 The Clinton administration partially repeals the Glass-Steagall Act, which had forced banks to choose between commercial and investment banking.

2000 Homeownership in the United States suddenly increases to 67.5%—a 3.3% increase from the 1994 rate. This spurt happens because the standards for granting a mortgage have lowered, and the amount of low-cost funding available for mortgages has increased.

2000 Congress passes the Commodity Futures Modernization Act, which exempts financial products like CDSes from regulation.

INVESTORS BEGIN TO HEAVILY SPECULATE on mortgage-based financial products. Eventually, the products become so widespread that the entire financial system itself becomes increasingly complex, interconnected, and opaque—exposing it to the housing market and subprime mortgages.

2000–2001 The dot-com bubble bursts and 9/11 happens, all of which contribute to a recession. In response, the Fed dramatically lowers its benchmark interest rate to 1%, making it easier than ever for people—even those with bad credit—to take out loans.

April 2004 The SEC loosens the net capital rule, which had limited firms' leverage on investments. The change applies to firms with more than $5 billion in assets—including all five of the nation's major banks at the time.

WHAT'S THIS?
LEVERAGE
Investing in something using borrowed capital, with the expectation that the investment will lead to greater profits—built on the idea of spending money to make money.

INSTITUTION
SECURITIES AND EXCHANGE COMMISSION ("SEC")
An independent government agency that enforces laws against market manipulation.

June 2004 – June 2006 In response to skyrocketing housing prices, the Fed raises interest rates. By June 2006, the interest rate hits 5.25%.

This will cause demand for homes to fall, which impacts the market value of those homes. Homeowners begin to owe more than what their homes are worth. At the same time, monthly payments due on subprime loans rise, and homeowners become unable to make monthly payments.

September 25, 2006 Home prices fall for the first time in 11 years.

2007 The market sees the largest single-year drop in U.S. home sales in more than two decades.

LULLED INTO COMPLACENCY by the economic growth of the previous decades, the nation's five largest banks—Bear Stearns, Lehman Brothers, Morgan Stanley, Goldman Sachs, and Merrill Lynch—take advantage of the new rules. None of the five will survive the 2008 financial crisis as intact investment banks. The more money they borrow, the less money they have available to cushion unexpected losses.

February–March 2007 More than 25 subprime lending firms declare bankruptcy.

April 3, 2007 New Century Financial Corporation, the largest U.S. subprime lender, files for bankruptcy.

April 17, 2007 The Fed encourages lenders to work out loan arrangements, rather than foreclosing on mortgage holders who aren't making their payments. Fannie Mae and Freddie Mac launch new programs to help subprime borrowers keep their homes. However, these programs cannot help people who owe more than their homes are worth—which, by this point, is most people.

FINANCIAL PRODUCTS LIKE MBSes AND CDSes derive a good part of their value from subprime mortgages, which means that the rise in mortgage defaults seriously undermines their value. As a result, many institutions that use these financial products in their asset portfolios—and, thanks to how interconnected the system has become, even institutions that don't —will suffer catastrophic losses.

WHAT'S THIS?
SHAREHOLDER EQUITY
The total dollar amount that would be returned to the shareholders if the company is liquidated and all its debts are paid off.

July 2007 Two hedge funds at Bear Stearns lose almost all of their investor capital and file for bankruptcy.

August 23, 2007 Lehman Brothers closes one of its subprime lender units, BNC Mortgage, and lays off 1,200 employees.

September 10, 2007 Lehman Brothers reports a loss of nearly $4 billion—its worst quarterly loss since going public in 1994.

September 18, 2007 Trying to restore confidence, the Fed makes the first in a series of interest rate cuts, from 5.25% to 4.75%. It is the first time since 2003 it has lowered rates.

October 30, 2007 Merrill Lynch reports an $8 billion loss on risky investments in subprime mortgages—the biggest loss in its 93-year history. CEO Stan O'Neal resigns.

Former Merrill Lynch CEO Stan O'Neal, who had said in July 2007 that "we go about managing risk and market activity every day at this company." (Mike Morgan/Bloomberg News)

December 6, 2007 President George W. Bush announces plans to help more than a million homeowners facing foreclosure by offering them a five-year mortgage freeze.

December 11–20, 2007 Five leading central banks around the world coordinate an action to make billions of dollars in loans available to commercial banks.

January 22, 2008 The Fed cuts rates by three quarters of a percentage point to 3.5%—its biggest cut in 25 years—trying to prevent the economy from slumping into recession.

March 7, 2008 In its biggest intervention yet, the Fed makes $200 billion in funding available to banks and other institutions.

March 13, 2008 Bear Stearns announces major liquidity problems, prompting a sharp decline in its share price and a market-wide loss of confidence in the company.

WHAT'S THIS?
ILLIQUID ASSETS
High-risk assets that cannot be quickly or easily converted to cash for their fair market value, such as real estate, mutual funds, artworks, collectibles.

March 16, 2008 JPMorgan Chase buys Bear Stearns for $2 per share—well under market value—facilitated by $30 billion in financing from the Fed. After some backlash, JPMorgan Chase increases its bid to about $10 per share, and agrees to assume the risks for the first $1 billion in potential losses.

PEOPLE
BEN BERNANKE
14th Chairman of the U.S. Federal Reserve, from 2006 to 2014.

(Karen Bleier/AFP/Getty Images)

TIMOTHY "TIM" GEITHNER
President of the Federal Reserve Bank of New York, from 2003 to January 2009.

(Saul Loeb/AFP/Getty)

Bear Stearns, one of the world's largest investment banks in 2008. (Mark Lennihan/Associated Press)

A demonstrator outside Bear Stearns headquarters, protesting the Fed's decision to assist with bailing out the company. (Jin Lee/Bloomberg/Getty Images)

April 3, 2008 Facing intense criticism for bailing out Bear Stearns, Ben Bernanke defends his decision, saying, "Given the exceptional pressures on the global economy and financial system, the damage caused by a default by Bear Stearns could have been severe and extremely difficult to contain."

June 2008 Lehman Brothers announces that it has lost almost $3 billion in the last three months, and begins looking for a buyer.

June 19, 2008 The FBI arrests 406 people, including brokers and housing developers, as part of a crackdown on alleged mortgage frauds worth $1 billion.

July 11, 2008 Federal regulators seize IndyMac, a California bank that specialized in risky mortgage lending, after it runs out of money. Some of the loans IndyMac granted did not require borrowers to show proof of income.

Customers line up in front of an IndyMac Bank branch in Santa Monica, California, trying to get their money back after the bank announces its failure. (AP/Getty Images)

July 14, 2008 Federal regulators step in to assist Fannie Mae and Freddie Mac. The two companies are owners or guarantors of half the nation's home loans (valued at $5 trillion), and authorities fear that their collapse will severely damage the economy.

September 7, 2008 The U.S. government rescues Fannie Mae and Freddie Mac in one of the largest bailouts in U.S. history.

September 10, 2008 South Korea's Korean Development Bank declines to bail out Lehman Brothers. Lehman Brothers reports a loss of $3.9 billion.

The New York headquarters of Lehman Brothers. (Peter Foley/Shutterstock)

September 12, 2008 Bank of America will not bail out Lehman Brothers unless the government agrees to cover $65 billion to $70 billion in anticipated losses. Hank Paulson will not agree; instead, he sponsors a weekend retreat with the nation's top bankers to try and find a different solution.

September 13, 2008 Barclays agrees to bail out Lehman, so long as Wall Street takes over some of the assets.

September 14, 2008 U.K. regulators will not approve the Barclays deal. The Fed rejects a last-minute deal to provide Lehman Brothers with additional assistance; Paulson says there will be no further Wall Street bailouts.

Bank of America says it will buy Merrill Lynch for $29 per share.

Lehman Brothers headquarters on the day of its bankruptcy. (Mark Lennihan/Associated Press)

September 15, 2008 Lehman Brothers files for the largest bankruptcy in U.S. history: $639 billion.

Bank of America agrees to a $50 billion rescue package for Merrill Lynch.

Share prices for American International Group (AIG), the nation's largest insurance company, drop 61%.

Merrill Lynch's headquarters in New York, prior to its acquisition by Bank of America. (The New York Times)

PEOPLE
RICHARD S. "DICK" FULD
Chairman and CEO of Lehman Brothers in 2008.

(Doug Mills/The New York Times)

PEOPLE
HENRY "HANK" PAULSON
U.S. Treasury Secretary from 2006 to 2009.

(Chip Somodevilla/Getty Images)

September 16, 2008 Just a day after Lehman Brothers collapses, the Fed deems AIG systemically important to the global financial system and offers the company an $85 billion, two-year loan.

September 21, 2008 Goldman Sachs and Morgan Stanley, the last of the big independent financial banks on Wall Street, announce they will convert to bank holding companies. This move gives them access to more loans from the Fed, in exchange for greater regulatory oversight. This move marks a turning point in the era of high finance that has defined the late 20th century.

September 25, 2008 The Federal Deposit Insurance Corporation (FDIC) takes over the bank Washington Mutual (WaMu), and sells it to JPMorgan Chase for $1.9 billion.

September 26, 2008 WaMu declares bankruptcy. With some $307 billion in assets when it fails, it is the largest bank failure in U.S. history.

October 3, 2008 President George W. Bush signs the Emergency Economic Stabilization Act, which authorizes the Treasury Secretary to buy up to $700 billion of troubled assets. (Eventually this figure will be reduced to $475 billion.) Detractors criticize the legislation as a "bank bailout bill."

President George W. Bush signs the Emergency Economic Stabilization Act of 2008 in the Oval Office. (Charles Dharapak/AP)

WHY DIDN'T THE FED BAIL OUT LEHMAN BROTHERS?

In March 2008, the New York Fed bailed out investment bank Bear Stearns when it was on the verge of bankruptcy due to its high exposure to subprime mortgages. Just six months later, the New York Fed declined to step in to save Lehman Brothers. Why?

LEGALITIES Lehman Brothers had sustained massive financial losses and did not have enough collateral. The Fed may not have had the legal authority to loan out the amount of money that Lehman Brothers needed.

FUTURE UNCERTAINTY Even if bailed out now, it was unclear whether Lehman Brothers could actually survive long-term.

POLITICS Hank Paulson, who had endured intense public criticism for bailing out Bear Stearns, said on a conference call that he did not want to be known as "Mr. Bailout."

IN HINDSIGHT ... SHOULD THE FED HAVE SAVED LEHMAN BROTHERS?

YES *NOT* SAVING LEHMAN BROTHERS WAS ...

A MISJUDGMENT The collapse of Lehman Brothers was one of the main catalysts for the 2007-2008 global financial crisis, which sparked the Great Recession. Saving the company might have shielded the global economy from a devastating blow.

CONTRADICTORY The Fed would not save Lehman Brothers, but stepped in to save institutions like Bear Stearns and the insurance giant AIG.

POLITICALLY MOTIVATED It is possible that, contrary to their claims, the Fed actually had the authority to bail out Lehman Brothers—making their decision political instead of practical.

NO *NOT* SAVING LEHMAN BROTHERS WAS ...

NECESSARY Saving Lehman Brothers was truly beyond the Fed's legal authority.

INCIDENTAL Saving Lehman Brothers would not have resolved the housing market crash caused by the subprime mortgage crisis. No matter what, the economy was already heading toward recession—and maybe a different company would have failed instead.

HOWEVER ... without the ensuing panic from the fall of Lehman Brothers, the economic downturn could have been smaller, more predictable, and more manageable.

VOTE

Place a sticker in the area below the line between "YES" or "NO" to cast your vote on this question:

CAN A BANK BE "TOO BIG TO FAIL"?

YES — NO

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THE LEHMAN TRILOGY