The New York Times
Floyd Norris
Notions on High and Low Finance

OCTOBER 2, 2008, 11:57 AM

Causes of the Crash

By FLOYD NORRIS

Two pieces caught my eye today, one doing a fine job explaining a cause of the credit debacle and another mocking those who think the whole thing can be blamed on legislation that encouraged loans to poor people.

Writing in The Washington Post, James Rickards, who used to be general counsel for Long-Term Capital Management, the late hedge fund, does the best job I have seen of explaining why "value at risk" models that were beloved on Wall Street — and by regulators — were foolish.

"Financial systems overall have emergent properties that are not conspicuous in their individual components and that traditional risk management does not account for. When it comes to the markets, the aggregate risk is far greater than the sum of the individual risks; this is something that Long-Term Capital Management did not understand in the 1990s and that Wall Street seems not to comprehend now."

Barry Ritholtz, writing on his Big Picture blog, asks a series of questions to those who want to blame the whole thing on Fannie Mae, Freddie Mac and the Community Reinvestment Act.

A few of his questions:

"Did the 1977 legislation, or any other legislation since, require banks to not verify income or payment history of mortgage applicants?

"Did any federal legislation require real estate agents and mortgage writers to use the same corrupt appraisers again and again? How did they manage to always come in at exactly the purchase price, no matter what?"

"How exactly did legislation force Moody's, S&Ps and Fitch to rate junk paper as Triple AAA?"

Copyright 2008 The New York Times Company | Privacy Policy | NYTimes.com 620 Eighth Avenue New York, NY 10018