Team 9 Executive Summary

The goal of this document is to understand and provide recommendations following the 2008 US financial crisis, a major collapse of the US banking sector, followed by a major US and world recession. Bank structures, regulation, and design of the financial systems are analyzed to determine the cause of the crisis. Contrary to popular belief, greedy bankers were not the cause of the collapse, but rather the incentives within and organizational design of 21st century banks.

Through research, our team was able to determine the major likely causes of the crisis. A short history of US banking and deregulation is also provided, each item setting the stage for the US financial crisis. Through our research, we determined that the 2008 US financial crisis was caused by a mass deregulation of commercial and investment banking institutions driving incentives for bankers to take on perpetually riskier investments to improve their yearly growth. As US banking regulation decreased and become obsolete, banks created perverse incentives for investment bankers so that they could continue to be competitive and grow. Quickly, the organizational design of banks ensured that the best interest of the bank's customers and own agents were no longer aligned. To ensure continued growth, bankers working for commercial banks were incentivized to act as investment bankers and take on high risk investments using bank assets. In other words, principal-agents began acting contrary to their client's own interest as the financial incentives ensured this misalignment. To compound this, bankers were rewarded for making large profits on any investment, whereas were often not penalized for large losses, ensuring each individual would be willing to take on larger risk investments. Unfortunately, the final safeguard to prevent the global crisis was removed in the 1980s. At this time, mass deregulation known as the 'Big Bang' allowed British banks to restructure and improve profit margins, but also made them susceptible to fallout from the US crisis, which likely resulted the global recession.

After the 2008 crisis, the US government issued the Dodd-Frank Wall Street Reform and Consumer Protection Act which was designed to correct the issues which caused the crisis. An explanation Dodd-Frank act is provided in this document, as well as criticisms against it. This document also provides our own conclusions, recommendations, and deliverable actions which we suggest would be the major steps required to ensure another future financial crisis is avoided.