The Causes of the Financial Crisis 2008

Reading Test

Student

Time: *Approximately 1hour*

Two types of lesson

Lesson#1: [Easy] ***** [B2/C1]
1. Try to predict the content of text / write down key terms / ideas
2. Read text – check words and meanings with a dictionary
3. Answer questions
4. Check answers (pass mark is 70%)

Lesson #2: [Hard] ***** [C1]
1. Read text – no dictionary
2. Answer questions
3. Check answers (pass mark is 70%)

Teacher

Two types of lesson

Lesson#1: [easy] ***** [B2/C1]
1. Give out text a week before the test – students read, check vocabulary and meaning.
2. Test day – give out a new copy of text and the questions (no dictionary or notes)
3. Set 1 hour to read text and answer the questions
4. Take in and correct or go through answers in class (pass mark is 70%)
5. Extra activity – students write the summary* (add 30 minutes to test)

Lesson #2: [hard] ***** [C1]
1. Test day – give out text and questions
2. Set 1 hour to read text and answer the questions
3. Take in and correct or go through answers in class (pass mark is 70%)
5. Extra activity – students write the summary* (add 30 minutes to test)

Summary writing
Link: www.academic-englishuk/summary

The Causes of the 2008 Financial Crisis

C. Wilson [2017]

1) In 2008 the world experienced the worst financial crisis since the Great Depression (1930s). The severe **magnitude** of the financial disaster became [redacted] the end of 2007. It had, however, begun years earlier through what many claimed to be the main factor in the crash; [redacted]. The financial crisis of 2007-08 and the aftershocks of the US subprime mortgage crisis of 2007-09 is now considered to be 'The Great Recession'. The US [redacted] Commission [FCIC] (2011) reported [redacted] was caused from widespread failures in regulation of financial institutions and the reckless actions in risk and borrowing. It concluded that key [redacted] were ill-prepared and lacked understanding and accountability in the financial systems they oversaw. This article will examine how [redacted] to the Great Recession.

2) Towards the end of the 1990s property purchases began to rise. With such growth, lending money for house buying became a profitable business in [redacted]. Traditionally, the house buyer saves up a deposit (down payment – usually between 10% of the house cost) and [redacted], who connects them to a lender, who in turn provides a mortgage based on the grounds of specific criteria (permanent employment, [redacted] **defaults** (a positive credit-score), and the [redacted] being achievable).

3) Throughout 2000 as home ownership became more popular and house prices rose significantly (1997 – 2006 house prices rose by [redacted] in the UK (US Spindices, 2016)), lenders began to securitise these mortgages into mortgage-backed securities (MBS) and Collateralized Debt Obligations (CDOs) and then sold [redacted] banking sector. These [redacted] credit agencies into three areas, 'safe', 'ok' and 'risky', and then sold on to the Shadow Banking Sector or investors, [redacted], and hedge funds respectively. However, the prime mortgage market began to become **saturated** due to those who [redacted].

4) Therefore, sub-prime mortgage lending was introduced in 2002/3 based on the presumption that as house prices continued to rise, if a [redacted] the lender would reprocess the house as equity. Lenders began to add risk to these new mortgages in that no deposit, no proof of income, or no documents were required to obtain a mortgage. An estimated $3.2 trillion loans were [redacted] with bad credit and undocumented incomes between 2002-2007 (FCIC, 2011), and with such a rise deregulation of [redacted] to include **fraudulent** automated underwriting processes and credit agencies' standards falling. At the same time 'predatory [redacted] at low interest rates or Adjustable Rate Mortgage (ARM) rates, where the consumer was unaware of the contract [redacted], 2009). The sub-prime mortgage process actively encouraged a rise in house prices and a phenomenon known as the **'housing bubble',** where [redacted] than wages making housing unaffordable or people borrowing more than they can repay.

5) The shadow banking sector of Investment bankers, hedge funds and insurance firms all bought into the highly profitable world of [redacted]. These highly profitable credit instruments (CDOs), were traded internationally through derivatives and foreign exchange trading [redacted] financial community. By 2006, 80% of U.S mortgages were subprime loans with an [redacted] (FCIC, 2011) Shadow banking often referred

to as **parallel** banking, were not subjected to the same banking regulatory controls. These institutions XXXXXXXXXXXXXXXXXXX short-term in liquid markets to purchase long term, illiquid and risky assets. This meant disruptions in XXXXXXXXXXXXXXXXXXX deleveraging, selling long term assets at depressed prices.

6) Interest rates began to rise in 2007, and this was the beginning of the end. The default rates began to increase with many borrowers unable to meet the XXXXXXXXXXXXXXXXXXX in turn meant that MBS and CDOs began to lose value with higher default rates. Concurrently, the housing bubble XXXXXXXXXXXXXXXXXXX 40% (FCIC, 2011), leaving many people in **negative equity**. However, the most serious effect was a crisis XXXXXXXXXXXXXXXXXXX across banks. Lehman Brothers went bankrupt and many more (Merrill Lynch, AIG, Freddie Mac, Fannie Mae, HBOS, Royal Bank of Scotland, Bradford & Bingley, Fortis, Hypo and Alliance & Leicester) were on the verge of XXXXXXXXXXXXXXXXXXX **bailed out** by Governments. In fact, 21 Banks and 61 hedge funds had been forced to declare bankruptcy in the US alone (Morris & XXXXXXXXXXXXXXXXXXX banks rose interest rates XXXXXXXXXXXXXXXXXXX which became known as the **'Credit Crunch'** and the led the world into 'The Great Recession'.

7) Since 2008, a number of measures have been created in response **to rectify** the problems. These include XXXXXXXXXXXXXXXXXXX bank's monetary policies of lowering interest rates, and Governmental public **stimulus packages**. There are XXXXXXXXXXXXXXXXXXX and supervision, which have been met through the Dodd Frank Act (Krugman, 2009). This was the largest reform of the UXXXXXXXXXXXXXXXXXXX. In addition, a new global financial system regulated by the IMF, who should have a broader role in the regulatory XXXXXXXXXXXXXXXXXXX.

8) Overall, the financial crisis of 2008 was not just the XXXXXXXXXXXXXXXXXXX. There are a number of other contributing factors that this article has not discussed, but primarily fraudulent greedy XXXXXXXXXXXXXXXXXXX seems to lie at the heart of it. To identify who is exactly to blame is incredibly difficult because the results of **toxic assets** from fraudulent underwriting processes, easy credit conditions, predatory lending, XXXXXXXXXXXXXXXXXXX. It seems that everyone was responsible, from government's inability to regulate innovative banking practice, Economists unable to XXXXXXXXXXXXXXXXXXX, financial institutions exploiting the **complexity** of MBS and CDOs and even homeowners taking on loans they were unable to pay back. The questions that exist, however, are whether it will happen XXXXXXXXXXXXXXXXXXX.

[1003 words]

Reference List

Krugman, P. 2009). *The Return of Depression Economics and the Crisis of 2008*. W.W. Norton Company Limited.

XXXXXXXXXXXXXXXX (2009). Financial Regulation in a System Context. *Brookings Papers on Economic Activity*, 2008(2), pp.229-274. Available at XXXXXXXXXXXXXXXX [Accessed 24 Dec. 2016].

The financial crisis inquiry report [FCIR]: XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. (2011). *Choice Reviews Online*, [online] 48(12), pp.48-7034. Available at: …….

XXXXXXXXXXXXXXXX (2016). *S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index - S&P Dow Jones Indices*. [online] Available at: https://us.spindices.com/indices/real-estate/sp-corelogic-case-shiller-us-national-home-price-nsa-index [Accessed 24 Dec. 2016].

Comprehension Questions

1. Headings – *choose a subtitle for each paragraph*

1	**B**	*Background history*	**A**	Profitable Trading
2			**B**	~~**Background history**~~
3			**C**	mortgage
4			**D**	~~**Conclusion**~~
5			**E**	A Prime mortgage
6			**F**	A new regulatory system
7			**G**	Mortgage
8	**D**	*Conclusion*	**H**	The collapse

___ / 6

2. True / False / Not Given – one question per paragraph **T/F/NG**

i.	The financial crisis began in 2007	
ii.	Prime-mortgages are high-risk	
iii.	In 2000, mortgages into marketable products	
iv.	Credit Agencies were unqualified in underwriting processes	
v.	Shadow main reason for the financial crisis	
vi.	The government had to take over banks to save them from bankruptcy	
vii.	The rescue packages the banking sector	
viii.	The subprime mortgage sector was the main reason for the financial crisis	

___ / 8

3. Data - fill in box below– what do the numbers connect to?

10%	i)
186%	ii)
	iii)
80%	iv)
1.4	v)
	vi)

___ / 6

4. Acronyms: write the words for these acronyms

FCIC	
MBS	
ARM	

___ / 4

Academic English UK

Paragraph 1

5. What were the main causes of the crisis according to the FCIC? (2 key reasons)

1	
2	

___ / 2

Paragraph 2

6. Three key criteria for a traditional mortgage.

1	
2	
3	

___ / 3

Paragraph 3/4

7. Why did the sub-prime mortgage [redacted] rise?

1	
2	

___ / 2

Paragraph 4

8. What is 'predatory' lending?

___ / 1

Paragraph 5

9. How is shadow banking different from [redacted] banking?

___ / 1

Paragraph 6

10. What was the most [redacted] the financial crisis to the banks?

___ / 1

Paragraph 7

11. What are the two [redacted] being put in place after 2008?

1	
2	

___ / 2

Conclusion

12. What were the key problems associated with toxic assets?

i	
ii.	
iii.	
iv.	
v.	

___ / 5

Academic English UK

Conclusion

13. The overall key problems with these groups were:

Governments	i. *inability to regulate innovative banking practice*
Economists	ii.
	iii.
Homeowners	iv.

___ / 3

14. Key language – *explain these terms from the context / use synonyms (where appropriate)*

magnitude	*A great size / immense / vast*
i. Defaults	
ii. Saturated	
iii.	
iv. Fraudulent	
v. ‘housing bubble’	
vi.	
vii. Bail out	
viii. The ‘credit crunch’.	
ix. To rectify	
x.	
xi. toxic assets	

___ / 11

Overall Score: ____ / 55

Comprehension Questions ANSWERS

1. Headings – *write a subtitle for each paragraph*

1	B	~~**Background history**~~
2	**E**	A Prime mortgage
3	**G**	Mortgage securitization
4	**C**	Sub-prime mortgage
5	**A**	Profitable Trading
6	**H**	The collapse
7	**F**	A new regulatory system
8	D	~~**Conclusion**~~

___ / 6

2. True / false / not given – one question per paragraph

i.	The financial crisis began in 2007 [P1: begun years earlier]	**F**
ii.	Prime-mortgages are high-risk [P2: low risk]	**F**

ALL ANSWERS ARE INCLUDED IN THE PAID VERSION…