

- Billionaire Science Projects
- Futurists Through The Ages
- Nine Great Books About The Future

Commentary

Subprime Market Debacle

Mark T. Williams 02.26.08, 6:00 AM ET

Mark T. Williams



Related Stories

- [Credit Crisis: Where Was The SEC?](#)
- [It Takes A Village To Fix Citigroup Help The Shareholders. Cut The Dividend](#)
- [Wall Street: Refueled But Not Recharged](#)
- [Bonus Time](#)

BOSTON There are clear lessons to be learned from the massive losses by the big investment banks - stemming from the subprime mortgage lending crisis, as well as from those firms that have been able to use superior risk controls to sidestep this calamity. The recent market shocks--with losses in excess of \$100 billion and growing--have provided a real-life test of risk controls. Unfortunately, many firms have scored failing grades.

Without a doubt, having a strong board and risk-management control culture is a necessity. This is especially the case as the level of sophisticated trading products expands and capital markets continue to become more complex and interconnected. This growing trend, coupled with the need to ensure a healthy balance in risk taking, requires strong firm-wide risk controls. On Wall Street, it is true that you have to take risks to make money, but excessive risk-taking can also turn into financial dynamite.

Examples of firms with strong risk-control cultures include **Goldman Sachs** (nyse: [GS](#) - news - people), **Lehman Brothers** (nyse: [LEH](#) - news - people) and **Credit Suisse** (nyse: [CS](#) - news - people). They were able to minimize their financial exposure to this subprime market debacle. The common characteristics of these risk-focused firms include board participation in setting corporate risk appetite and tolerance, committee participation and active involvement in risk-related questions and concerns. These firms all require adherence to company-stated risk-management policies, procedures and controls. Such risk policies and controls are also frequently updated to reflect changes within the companies and to insure that policies are not easily circumvented.

Risk managers at these firms are not viewed as traffic cops who are asked only to show up at the accident scene. Their risk concerns are never just dismissed. These risk-focused firms view risk management as a senior-level function with vested authority and power to fully perform their important role. Risk controls in such firms are built on the principle that risk management can provide valuable insights prior to taking on risk, and accurate monitoring once bets have been taken. These firms understand that effective risk management requires that risks be evaluated and understood prior to deciding whether to take them.

Firms that have not been able to fully understand the risks that they are taking on have experienced devastating financial losses. Many of these investment firms (e.g., **Merrill Lynch** (nyse: [MER](#) - news - people), Citicorp, **UBS AG** (nyse: [UBS](#) - news - people), **Bear Stearns** (nyse: [BSC](#) - news - people) and **Morgan Stanley** (nyse: [MS](#) - news - people)) shared a common characteristic--they had weak or lax risk controls. They also pursued a chancy mortgage-based strategy to structure, sell and/or hold these securities on their books.

Many of these firms entered into the mortgage derivatives business without a full understanding of the level of risk actually being taken, or if they did understand it, they simply ignored the risk in the pursuit of lucrative bonuses. For such firms, these actions were a deliberate failure to adequately control risk--from the board level on down.

Until these investment banks fix these fundamental risk-control problems, including the lack of strong board and risk-management oversight, many remain vulnerable to future losses. Several of these firms have already begun to overhaul their risk-management functions, but this is only a first step.

As more information about the level and types of control failures come to light, we can reasonably expect that shareholder and regulatory pressure will also help to make sure that these lax firms move swiftly to correct their control deficiencies.

News by E-mail
Get stories by E-Mail on this topic **FREE**

Companies

- Merrill Lynch
- Lehman Brothers
- Goldman Sachs
- Morgan Stanley

Topics

- Subprime
- Banks
- Lending
- Board of Directors

[Become a member FREE](#)
Already a Member? [Log In](#)

Receive Special Offers?

[FAQ](#) | [Privacy Policy](#)
[Terms, Conditions and Notices](#)

Also available:
[E-Mail Newsletters](#)

[Make Forbes.com My Home Page](#)

[Bookmark This Page](#)

Fake Steve Jobs Blog

Read it now >>

Now in leading online bookstores

the secret life of steve jobs
a parody by the oPtion\$ crew

ADVERTISEMENT

Mark T. Williams, a former Federal Reserve Bank examiner, is a finance professor at the Boston University School of Management.

Subprime Plan Keeps Markets Afloat ▶

Bear Stearns Upbeat On Business ▶

Your Rating ☆☆☆☆☆ Overall Rating ★★★★★

Reader Comments

Post A Comment

More On This Topic

Companies: [GS](#) | [LEH](#) | [MER](#) | [UBS](#) | [BSC](#)

E-Mail Newsletters: [Sign Up Now To Stay Informed On A Range Of Topics](#)

Attaché: [Customize Forbes.com Now To Track This Author And Industry](#)

Article Controls

[E-Mail](#) | [Print](#) | [Request Reprints](#) | [E-Mail Newsletters](#)

[del.icio.us](#) | [Digg It!](#) | [My Yahoo!](#) | [Share](#) | [RSS](#)

Related Sections

[Home](#) > [News & Analysis](#)

Today On Forbes.com

Microsoft Gets Mammoth E.U. Fine

Parmy Olson

The \$1.35 billion charge is Europe's biggest ever on a single company.

- [Q&A: Microsoft's Multi-Billion Dollar EU Fine](#)
- [E.U.'s Hard Line Cows Microsoft](#)
- [Microsoft Has Soft Defense in Antitrust Case](#)



The \$2.5 Billion Question



States To Consumers: Pay Up



Dividends Do Double Duty



IMF Sees Need For Fiscal Stimulus

[News Headlines](#) | [More From Forbes.com](#) | [Special Reports](#)

Advertisement: [Related Business Topics](#) >

[800 Numbers](#) [Business Logo Design](#)

[Subscriptions](#) >

[Subscribe To Newsletters](#) [Subscriber Customer Service](#)

More From Forbes.com

- ➔ [Most Expensive Cities For Renters](#)
- ➔ [Least Expensive Cities For Renters](#)

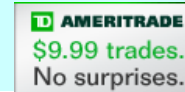
Related Business Topics

[Business Ethics](#)

[Communication Skills](#)

Trading Center

Brought to you by the sponsors below



ForbesAutos.com

World's Largest Luxury Showroom

Land Rover

ForbesTraveler.com

[more >](#)

STUNNING SUITES
ROMANTIC RESORTS
HOTTEST HOTELS



Investopedia.com

What Type of Money Personality Do You Have?



Test Your Personality at Investopedia.com

CEO Book Club

Book Review

James McBride



Book Review

Spirituels

Marisa Rindone

James McBride's second novel impresses and inspires.

- [How to Travel on a Weak Dollar](#)
- [Ultra-Exclusive Destination Wedding Spots](#)
- [How To Boost Your Business School Application](#)



[Sitemap](#)[Help](#)[Contact Us](#)[Investment Newsletters](#)[Forbes Conferences](#)[Forbes Magazines](#)[Forbes Autos](#)

[Ad Information](#) [Forbes.com Mobile](#) [RSS](#) [Reprints/Permissions](#) [Subscriber Services](#)

© 2008 Forbes.com LLC™ All Rights Reserved [Privacy Statement](#) [Terms, Conditions and Notices](#)

Tested By [Market Data By](#) [Market Data By](#) [Market Data By](#) [Investopedia](#) [Polska](#) [Luxury Cars](#) [Luxury Travel](#)

 A row of logos for various partners and data providers, including SPIRENT, HEMSCOTT, THOMSON, quotemedia, INVESTOPEDIA, Forbes, Forbes AUTOS, and Forbes TRAVELER.

Stock quotes are delayed at least 15 minutes for Nasdaq, at least 20 minutes for NYSE/AMEX.U.S. indexes are delayed at least 15 minutes with the exception of Nasdaq, Dow Jones Industrial Average and S&P 500 which are 2 minutes delayed.

Powered By [Oracle DBA by](#)

 Two logos for technology providers: at&t Intelligent Content Distribution System and The PYTHIAN GROUP REMOTE DBA Oracle • SQL • MySQL.