ECOFIN

APL MUN 2024 ECOFIN BACKGROUND GUIDE

Housing Crisis in the United States with Special Emphasis on Financial Institutions and the EURO Market Crash

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Letter from the Executive Board

Greetings, Delegates!

We, the Executive Board of the Economic and Financial Committee (ECOFIN) at APL MUN 2024, extend a hearty welcome to all the delegates and thank you for participating in this conference**.**

MUN is a platform for discussing pressing global issues and an opportunity for personal growth and forging lasting friendships. Our commitment to high-quality debate stems from a belief that rigorous and insightful discussions are needed to reach comprehensive solutions to the pressing challenges we face as a global community.

Thus, understanding both the importance and complexity of this agenda, we strongly recommend you to be prepared and well-researched in committee, Though this guide will help all the delegates comprehend the agenda in detail, however, this does not promise to address all issues related to the agenda; rather, it merely provides background information. Your true research goes beyond this manual.

If this is your first time attending a MUN conference, we ask that you familiarize yourself with the UNA-USA Rules of Procedure that the committee follows. You still have the same responsibilities as a delegate when it comes to researching the agenda, your foreign policy, and any relevant laws. Please take the initiative and research accordingly.

We, as the EB, are committed to making this conference inclusive, welcoming, and memorable for everyone, encouraging you to seize the opportunity to build connections, collaborate with fellow delegates, and create lasting memories.

Wishing you the best of luck,

Warmest Regards,
The Executive Board

About the Committee

The second committee of the United Nations General Assembly is called ECOFIN, or the Economic and Financial Committee. It is in charge of handling matters about international finance, economic expansion, and development.

It was established during the UN's inception together with the other principal General Assembly entities. Since ECOFIN distributes funds to committees and programs, it is seen as a vital instrument of the UN; without it, the UN and its affiliated institutions could not continue to exist. The committee's responsibilities include creating procedures for resolving ongoing economic inequality and handling new issues in global finance. All 193 UN members make up ECOFIN, and they all have equal voting rights.

Thus making it the essential body that formulates policies related to economics, international finance, and economic expansion. Similar to other UN entities, ECOFIN can create policies and develop recommendations, but it is unable to enforce them. As a result, the committee needs support and collaboration from all parties as well as properly considered incentive programs to encourage countries to willingly sign on to the resolutions that this organization produces.

MANDATE OF THE COMMITTEE

The functions and powers of the Economic and Financial Committee as defined in the United Nations Charter (Chapter X, Articles 62-66) are, primarily, to;

- Make or initiate studies and reports concerning international economic, social, cultural, educational, health, and related matters and make recommendations concerning any such matters to the General Assembly, to the Members of the United Nations, and the Specialized Agencies concerned.

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- It may call, by the rules prescribed by the United Nations, international conferences on matters falling within its competence.

- It may enter into agreements with any of the agencies referred to in Article 57, defining the terms on which the agency concerned shall be brought into relationship with the United Nations. Such agreements shall be subject to approval by the General Assembly.

- It may coordinate the activities of the specialized agencies through consultation with and recommendations to such agencies and through recommendations to the General Assembly and to the Members of the United Nations.

- It may communicate its observations on these reports to the General Assembly.

- Furnish information to the Security Council and assist the Security Council upon its request

Introduction to the Agenda

The American Subprime Mortgage Crisis was a multinational financial crisis that occurred between 2007 and 2010 which contributed to the 2007-2008 global financial crisis. It was triggered by a large decline in US home prices after the collapse of a housing bubble (sharp run up and subsequent collapse of house asset prices), leading to mortgage delinquencies, foreclosures, and the devaluation of housing-related securities. Declines in residential investment preceded the Great Recession and were followed by reductions in household spending and then business investment. Spending reductions were more significant in areas with a combination of high household debt and larger housing price declines.

The crisis led to a severe economic recession, with millions of people losing their jobs and many businesses going bankrupt. The immediate cause of the crisis was the bursting of the United States housing bubble which peaked in approximately 2006. An increase in loan incentives such as easy initial terms and a long-term trend of rising housing prices had encouraged borrowers to assume risky mortgages in the anticipation that they would be able to quickly refinance at easier terms. However, once interest rates began to rise and housing prices started to drop moderately in 2006–2007 in many parts of the U.S., borrowers were unable to refinance. Defaults and foreclosure activity increased dramatically as easy initial terms expired, home prices fell, and adjustable-rate mortgage (ARM) interest rates reset higher. Banks and financial institutions that held Mortgage-Backed Securities (MBS) and Collateralized Debt Obligations (CDOs) tied to these subprime mortgages faced significant losses.

The housing market collapse triggered a broader economic recession in the U.S., unemployment rose, consumer spending declined, and GDP growth slowed significantly. In the aftermath of the financial crisis, several European countries, particularly those in Southern Europe like Greece, Portugal, and Spain, faced sovereign debt crises. These countries had high levels of public debt and struggled to finance their obligations amidst economic downturns and banking sector stress. European banks were also heavily exposed to toxic assets (assets that have lost value and are impossible to sell at any price) related to U.S. subprime mortgages. Many European financial institutions faced significant losses and struggled to maintain liquidity. Thus began the European Debt Crisis which erupted in the wake of the Great Recession around late 2009, and was characterized by an environment of overly high government structural deficits and accelerating debt levels. Now, due to significant losses in the banking sector, numerous European states had to provide financial assistance to their most affected banks through recapitalization loans.

This was crucial as the survival of these banks was closely tied to the overall stability of the economy. The European Debt Crisis caused economic downturns, high unemployment, and banking sector stress. Austerity measures fueled social unrest and political tensions. Sovereign debt contagion raised borrowing costs across borders. This strained EU relations and tested Eurozone cohesion, highlighting the need for deeper integration and reforms for economic stability.

US HOUSING CRISIS

The Great Depression (1929 - 1939): The Great Depression began with the Wall Street crash of 1929, leading to a massive decline in property values. Real estate prices fell dramatically, and bank lending decreased significantly. Markets such as Manhattan lost over half their value by the end of 1933. It took until the 1960s for prices to fully recover. During this period, the government created various institutions to support the housing market, such as the Federal Housing Administration (FHA) and the Federal National Mortgage Association (Fannie Mae) (New Silver) (RealWealth) (ACE).

Post-WWII Boom and Subsequent Declines: After World War II, returning veterans caused a housing shortage. The G.I. Bill provided mortgages at low interest rates, which helped stimulate the market. However, inflation in the 1970s led to rising home prices and other crises in the mid-1970s when the stock market hit a low. Despite this, the housing market experienced growth in the 1980s and 1990s, although issues such as the savings and loan crisis led to flat prices until the end of 1997 (New Silver).

The 2008 Housing Bubble: The most significant recent crisis was the 2008 housing bubble. Leading up to this, mortgage fraud increased, and lending standards were lax. From 2004 to 2006, the Federal Reserve increased interest rates significantly, making loans more expensive. This led to widespread defaults, starting with subprime borrowers and spreading to prime borrowers. The crash resulted in hundreds of thousands of foreclosures, the bankruptcy of major lenders, and a global financial crises. The market required government bailouts and significant regulatory changes, such as the Dodd-Frank Act, to prevent future crises (New Silver) (RealWealth) (Wikipedia).

Post-2008 Recovery: The housing market began to recover around 2013, aided by government stimulus and low-interest rates. The COVID-19 pandemic surprisingly boosted the market further due to low supply and high demand, along with record-low interest rates. However, by 2022, the market began to stabilize as interest rates increased and inventory levels rose, leading to a more balanced market (New Silver) (RealWealth).

EURO MARKET CRASH

The European Union experienced a multi-year economic crisis from 2009 to mid-2010, which is commonly referred to as the Euro market Crash or the European Debt Crisis. Several members of the EU were unable to repay or even pay their government debt or refinance their indebted banks without third-party organizations like the International Monetary Fund and the European Central Bank. During the Euro market crash, the European Union faced significant challenges in maintaining debt sustainability levels across its member states.

BEFORE THE DEBT CRISIS

Upon the collapse of the US "housing bubble" in 2007, banks worldwide were flooded with "toxic" debt. Adjustable-rate mortgages are the primary type of mortgage that has contributed to the surge in home ownership in America. The initial interest rates on these loans were extremely low, but as time went on, they rose to double digits, which homeowners could not pay, ultimately resulting in bankruptcy. These bonds are typically sold to investment banks by mortgage lenders rather than being owned by them. These banks create "mortgage" loans by combining loans with thousands or even hundreds of other loans. These amounts of money were consequently absorbed into the global financial system, resulting in credit deficits and overpriced banks. When banks declined to lend, the housing market deteriorated. Land values dropped as a result of the bubble era's excesses and foreclosures flooding the market.

The first country outside the US to experience a budgetary crisis was Iceland. Following the 2003 independence of Iceland's managing account system, banks began to cede more authority to foreign investment. The main critic of these lessons is Landsbankinn, which promotes high-interest advances to through its online Icesave program, citizens of the Netherlands and the United Kingdom. Over time, Iceland's external debt exceeded 500% of GDP, while its monetary allocation of resources exceeded 1,000% of GDP. The execution of Icesave in October 2008 resulted in the collapse of Landsbankinn. The announcement by the Swedish government that it would support the investments made by domestic financial experts but not by outside speculators had an impact on Iceland, the Netherlands, and the UK's financial systems.

After Icesave's disappointment, Iceland's heavily leveraged banks nearly collapsed, the stock market plummeted 90%, the country missed its debt payments, and it entered self-liquidation. When Iceland's government collapsed in January 2009, Jóhanna Sigurðardóttir, the country's current prime minister, implemented a plan of extraordinary measures to obtain funding from the International Monetary Fund (IMF). Iceland's ability to deflate its currency set it apart from the subsequent obligation emergency. Iceland has allowed the value of its currency, the Krona, to virtually decline against the Euro because it is not a member of the Eurozone. This resulted in increased inflation and a significant decline in GDP, but actual costs began to rise again in 2009.

FACTORS THAT INDUCED THE DEBT CRISIS

Greece claimed in 2009 that the previous administration had manipulated politics and the economy to inflate the budget deficit, in violation of EU regulations and stoking fears of a euro collapse. 2010 saw the creation of the EFSF by 17 eurozone nations in response to and assistance with the crisis. The situation of European sovereign debt worsened.

From 2010 to 2012, lenders pushed for higher interest payments to fund budget shortfalls before these countries' collapse, particularly Greece, as concerns over a national debt crisis intensified. Investors were alarmed when international credit rating agencies downgraded the sovereign debt of several nations during the crisis, notably Greece, Portugal, and Ireland. Economic expansion. Their areas in 2010 and a lack of trust among the leaders of the eurozone, but their governments' efforts have been hindered by a significant debt and dollar burden.

RESPONSE FROM CONCERNED PARTIES AND ENTITIES

German Chancellor Angela Merkel, French President Nicolas Sarkozy, and President of the European Central Bank (ECB) Jean-Claude Trichet (Mario Draghi after October 2011) spearheaded the EU's response to this crisis. The greatest economy in Europe, Germany, has been hardest hit financially by a rescue plan approved by the EU, and Merkel's pledge to defend the EU has put her in political hot water at home. Ultimately, the eurozone economy was promised several billions of dollars in loans from the EU and the International Monetary Fund (IMF). However, the beneficiaries' readiness to carry out broad economic reforms governed when these amounts of money were released.

Financial Institutions

1. **Scion Capital -** The Scion Capital was a hedge fund founded by Michael Burry in 2000. It became famous for foreseeing the subprime mortgage crisis and making money from it. The company mainly looked for undervalued assets and used unusual investment strategies. The fund closed in 2008 after it was decided to return the capital of investors due to concerns about broader financial market conditions.

2. **Deutsche Bank -** The Deutsche Bank is a multinational investment bank and a global financial institution that provides financial services to companies, governments, institutional investors, and private individuals. Deutsche Bank's extensive investments in mortgage-backed securities worsened the subprime crisis and its exposure to risky assets heightened concerns during the Eurozone market crash.

3. **FrontPoint Partners -** FrontPoint Partners, a hedge fund based in Greenwich, Connecticut, known for betting against subprime mortgages, was acquired by Morgan Stanley for $400 million in 2006. However, the two split in 2011. FrontPoint Partners had offered absolute return investment products to institutional investors and high-net-worth individuals across multiple asset classes and strategies.

4. **S&P Global Ratings -** The S&P Global Ratings, an American credit rating agency (CRA) and a division of S&P Global publishes financial research and analysis on stocks, bonds, and commodities. S&P is considered the largest of the Big Three credit-rating agencies. S&P Global Ratings' high ratings for risky mortgage-backed securities worsened the subprime crisis, while its sovereign debt downgrades worsened the Eurozone crisis.

5. **Morgan Stanley -** Morgan Stanley is one of the largest financial institutions in the United States and is best known for its investment banking business. It advises on mergers and acquisitions (M&A), and initial public offerings (IPOs), and underwrites debt and equity offerings. Morgan Stanley's involvement in the subprime crisis included significant investments in mortgage-backed securities, while its role in the Eurozone crisis involved its exposure to European debt markets and financial instability.

6. **SEC -** The Securities and Exchange Commission (SEC) is the U.S. government agency in charge of the nation's securities industry. It monitors transactions, as well as the activities of financial professionals. The SEC's role during the subprime mortgage crisis included oversight of financial institutions and enforcement of securities laws to address misconduct and improve transparency in the mortgage market.

7. **Goldman Sachs -** The Goldman Sachs Group, Inc. is a leading global financial institution that delivers a broad range of financial services to a large and diversified client base that includes corporations, financial institutions, governments, and individuals. Goldman Sachs played a significant role in the subprime mortgage crisis through its involvement in creating and selling mortgage-backed securities, as well as its trading practices related to those securities.

8. **Bank of America-** Bank of America (BofA), founded in 1904 as Bank of Italy in San Francisco by Amadeo Giannini to serve underserved immigrants, rebranded as Bank of America in 1930. Through mergers and acquisitions, including the significant addition of Merrill Lynch in 2009, BofA has become one of the world's largest financial institutions, offering a wide array of banking, investing, asset management, and risk management products and services. During the subprime mortgage crisis, Bank of America expanded its mortgage operations through the acquisition of Countrywide Financial but faced significant losses and legal challenges due to defaults on risky mortgages, requiring government assistance to stabilize its financial position.

ROLE / PURPOSE OF REPRESENTATIVES OF INSTITUTES

A representative of each of these Financial institutions and an ex-employee of those institutions that have closed down are summoned to the ECOFIN committee as the executive board believes that their insight and analysis would be useful to predict, understand, and tackle the ongoing issue. However, these institutions cannot exercise their major powers as the ECOFIN is a recommendatory body, but the contributions made by these institutions will be highly valued.

Closing Remarks

Dear Delegates,

This marks the end of the background guide for this year's ECOFIN committee in APLMUN'24. This background guide is meant to be a comprehensive **starter** guide for you in your research and preparation for the agenda.

Please note that this agenda covers a vast range of topics, you the Executive Board recommend that your research go beyond the scope of this document.

For further inquiries, mail ecofinmun@apl.edu.in

Happy Debating!

Regards,
The Executive Board of ECOFIN