[Journal of Financial Crises](https://elischolar.library.yale.edu/journal-of-financial-crises)

Volume 2 | Issue 4

2020

Lessons Learned: Ron Borzekowski

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Ron Borzekowski

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Ron Borzekowski was a senior economist at the Federal Reserve Board when he was detailed to join the Financial Crisis Inquiry Commission (FCIC) as a senior researcher and later became deputy to research director Greg Feldberg. The ten-member bipartisan commission, charged with investigating and determining the causes of the crisis, held more than 19 hearings, and interviewed more than 700 people from September 2009 to Jan. 2011. It issued a 662-page report explaining why the crisis came about and the roles of financial institutions, government, and the public. This "Lessons Learned" is based on an interview with Mr. Borzekowski.

Pay attention to unusual activity and new patterns, even if you think they are innocuous.

One of Borzekowski's roles at the FCIC was to author a chapter of the report, *The Story of a Mortgage Security: Inside CMLTI 2006-NC2*, which meticulously tracks an individual mortgage through to securitization in a mortgage-backed security and then a collateralized debt security (CDO). The result is a step-by-step history showing how the developments in the mortgage market, such as changes in underwriting standards, and securitization, contributed greatly to the crisis.

When asked to comment on the significance of *The Story of a Mortgage Security* and what it revealed, Borzekowski described how consumer groups had been raising red flags, pointing to warning signs in the sub-prime mortgage market, years before the market hit crisis stage. *The Story of a Mortgage Security* reveals exactly how this product and market developed in detail that may not have been fully understood at the time, explained Borzekowski.

Borzekowski continued by saying that it can be difficult for regulators to see some early warning signs because they do not always emerge in the large data sets that are usually examined by state or national regulators. "From the point of view of regulators who are often looking at the aggregate statistics, some of those harms—some of those warning flags—are going to get lost," he said. By looking more closely at large data sets, Borzekowski suggested, regulators may be able to spot developing problems.

In order to avoid being caught unprepared for the next crisis, he further urged regulators to pay closer attention to what starts as anecdotal evidence, because doing so can help to identify issues and looming risks that could snowball into real problems, but which may not be easily detected from data sets. Borzekowski also suggested that regulators should exercise some level of skepticism and curiosity around what generates such anecdotes and whether they might be evidence of a developing systemic issue that might require regulatory or statutory action.

Borzekowski believes that regulators should also focus on identifying anomalous developments—such as a particular instrument becoming a major source of credit for particular markets—and digging deeper into understanding such developments. This might require going against a natural inclination to accept that everything is okay because the markets are doing well, he said. But he firmly believes that regulators "should distrust [their] instincts to say 'everything's okay' in the good times, and dig deeper."

Incorporating lessons learned from the commission's report and the crisis into ongoing practices will better prepare us for the future.

Implementing lessons learned from the crisis is critical to future preparation, Borzekowski shared. One of the findings that the Commission's report cited that contributed to the crisis was the fragmentation of the financial regulatory system and the lack of interagency coordination regarding large institutions. Borzekowski views the development since the crisis of new entities that facilitate information-sharing within and among agencies as very valuable to addressing this issue:

> Organizations such as the Financial Stability Oversight Council and Office of Financial Research are necessary and useful to maintain interagency information sharing. They can foster an environment of vigilance in order to spot red flags and prevent future meltdowns.

Borzekowski also viewed these structural developments as particularly important to maintaining continuity of perspective and organizational memory as new generations of regulators who "had not been there that Friday night when a bank failed" take over. He pointed out that regulators who have lived through crises might tend to be more willing to look carefully at a firm and may be more willing to use supervisory authorities and other tools at their disposal. However, Borzekowski explained, with the passing of time, later regulators, who did not share this experience, may not have the same sense of urgency, which could lead them to different judgments.

Borzekowski also pointed to the Consumer Financial Protection Bureau (CFPB), a new agency created after the crisis by the Dodd-Frank Act in 2010, as an example of how lessons from the crisis can be implemented.

Borzekowski, who joined the CFPB as Deputy Assistant Director for the Office of Research in 2011, described how the CFPB learned to build communications channels between supervisory functions and enforcement functions, and research and policy functions. The commission "had a very open door to anybody," he said. "I worked very hard to build a pretty porous border between our research office and the academic community that was working on consumer finance so we could share ideas, data, and research findings." He also shared that Director Richard Cordray met with industry groups, industry participants, consumer advocates, consumer groups, and other research organizations.

> A lot of those institutional aspects of the bureau, I think we got very right. The notion that you can bring information and facts that the agency is learning to the public, and then, also across divisions within the agency, is a really strong model.

Information sharing must be done carefully in this regulatory framework to respect the agencies' supervisory process and industry confidentiality, pointed out Borzekowski. But he added that such constraints can be successfully negotiated while still building useful relationships.

Dated: January 2021
YPFS Lessons Learned No: 2019-32