*Derivatives:* [***No way to lose***](file:///C:\Users\taxi1\OneDrive\Documents\economics%20comments\Derivitive%20Collapse.html)

*Why Derivatives eventually collapsed and had to be bailed out by the US Federal Reserve Bank and European Banks or To Big To Fail.?*

***Before 1913 the US Gold reserve decided to allow 40% Gold Reserves plus Taxes and Bonds Gilts to make up the reserves of the United States Treasury. In 1948 after the Bretton Woods agreement, it was decided by the world governments, that Gold would still be held, but this time backed up by the US dollar, now the major reserve currency. Fast forward to 2012, governments in the main, do not hold large reserves of gold, guarantees on debt loans to other countries is provided mainly by taxation, bonds, and gilts. In today’s economies the new boy on block are credit derivatives. This new one, it might be argued is fraught with unknowns and would prove a decidedly risky investment.***

**AIGs begins to fail.**

*Hank Paulson Chairman of the US Federal Reserve Bank and Timothy Geiter secretary of the Federal Reserve Bank or (Fed) came up with an explanation of how the crash happened.* [*AIG*](http://www.time.com/time/business/article/0,8599,1841699,00.html) *was a major insurer in the U.S and* [*Leman*](http://en.wikipedia.org/wiki/Lehman_Brothers) *was a major bank. Leman started bundling up home loans with mortgages backed by securities, selling slices of loans to investors and making large amounts of money. So, they started pushing more to lenders of credit, small banks etc saying come on we need more loans to people with good credit, as less and less of these good credit customers were available they lowered the credit score rating and went bottom feeding a term used to describe individuals with a low credit score. Before, an individual would have needed a high credit score or search to obtain a loan with a down payments of 20%, but now the bank would accept lower credit scores without a deposit. The regular guy in the street assumes the banks know what they are doing, so if they are willing to loan me, then I must be able to afford it. So, he reaches for the American dream, he buys a house, the banks know these mortgages are a risk,so they started to insure themselves against a conceivable mortgage default, this moved the risk from their books to the insurers, they can now invest more money give out more mortgages and make more money. One of the companies that took on a whole lot of these insurance policies was AIG.*

*Why would they do this? The answer is fees hundreds of millions of fees. They thought the house prices would go up and up, but they do go down, typical of these mortgages is a person who buys a house, they are offered a teaser rate (lower rate) at the time of purchase, this looked tremendously attractive but rates do go up, when they did the individual cannot find the payments and defaults, AIG now has to make a payment to the bank for the Swap (If the reference contract defaults, the protection seller pays par value of the contract to the buyer and transfers ownership to the seller) this was happening all over the world, AIG cannot pay and go under every bank begins to book massive losses on the same day they all begin to go under.*

*Question. Why was it not regulated?*

*Answer. No one wanted it they were all making too much money.*

*:updated 28/07/25*