



Many groups must share the blame for the precipitous downturn in the U.S. housing market – speculators, some mortgage brokers, ratings agencies and institutional buyers who dispensed with due diligence, along with home buyers

who assumed prices would never fall and appraisers unwilling to rain on the parade.

But some critics have railed against what they see as another culprit in America's current economic malaise: financial markets' enthusiasm for innovation. And that's missing the point. Innovations, notably the securitization of home mortgages, didn't cause global credit-market problems. The problems arose from the *misuse* of innovations – the very tools that have done so much to spur global economic growth over the last quarter-century.

Some skepticism about financial innovation is always healthy. The use of innovative financial products in recent years did, for instance, mask a slackening of attention to the creditworthiness of borrowers. The fallacy that any loan based on real estate is a good loan went unchallenged until the market finally realized that some loans were mispriced or should never have been approved.

To condemn securitization or other financial innovations because of these bad loans, however, is like condemning automobiles because they are sometimes piloted by bad drivers. (Read "Institute View" from the 2nd

Quarter 2008 issue of the *Milken Institute Review* for more on our perspective on the subprime mortgage market.)

Perspective, then, is needed here. Much of the increase in global prosperity in recent years can be traced to financial innovations that have allowed global markets to develop rapidly. Various forms of securitization have increased access to capital and homeownership, reduced interest rates and managed risk in companies that created millions of new jobs. Over the past several decades, financial innovations have created useful incentives in areas such as agriculture, property insurance, alternative energy and medical research that have benefited people worldwide.

The Milken Institute has been a proponent of a number of financial innovations to help solve social problems, such as bolstering research in life-saving drugs and, most recently, creating incentives that would expand the market for insurance against natural disasters such as hurricanes. By helping individuals and businesses to cope with risk at minimum cost, these innovations have improved our standards of living.

Yes, it will take further regulation, as well as market experience, to ensure that these instruments are used properly. But we will continue to focus on financial innovation at the Milken Institute while encouraging an informed discussion – in the pages of the *Review* and elsewhere – about what reforms may be needed.

A handwritten signature in black ink that reads "Michael Klowden". The signature is fluid and cursive.

Michael Klowden, President and CEO