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# Managerial Myopia and the Mortgage Meltdown<sup>☆</sup>

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## Abstract

Prominent policy makers assert that managerial short-termism was at the root of the subprime crisis of 2007–2009. Prior scholarly research, however, largely rejects this assertion. Using a more comprehensive measure of Chief Executive Officer (CEO) incentives for short-termism, we uncover evidence that short-termism indeed played a role. Firms whose CEOs were contractually allowed to sell or exercise more of their stock and options holdings sooner had more subprime exposure, a higher probability of financial distress, and lower risk-adjusted stock returns during the crisis, as well as higher fines and settlements for subprime-related fraud.

*Keywords:* Financial crisis, Subprime mortgages, Financial fraud, CEO incentives, CEO pay

JEL classification: G01, G21, G23, G24, G28, G34, M12

## 1. Introduction

This study empirically examines whether CEO short-termism played a role in the subprime mortgage crisis of 2007–2009. Some prominent policy makers are convinced that incentives for short-termism were a major contributor to the crisis. For example, the US government's Financial Crisis Inquiry Commission asserts the following:

Compensation systems... too often rewarded the quick deal, the short-term gain—without proper consideration of long-term consequences... This was the case up and down the line—from the corporate boardroom to the mortgage broker.<sup>1</sup>

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<sup>1</sup>The Financial Crisis Inquiry Report (2011), p. xix.

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