underpriced--and then load up on those risks. The solution, in addition, lies with more closely tying traders' compensation to the long-run performance of their portfolios. This internalization of the costs of risk-taking toward those most capable of understanding and measuring the risks should help blunt the buildup of excessive risk and leverage.

Long and complex chains present problems, importantly because of the incentive problems along the chain. Nevertheless, there may be sound economic reasons why long chains are desirable. For example, long chains of lending allow for some financial intermediaries to specialize in screening borrowers, others to specialize in arranging initial short-term financing, and others to focus on securitizing the assets and selling them to investors. Specialization lends itself to long chains, but such specialization comes with incentive problems at every step of the chain. These incentive problems need to be recognized and dealt with. Proposals that require intermediaries along the chain to maintain "more skin in the game" are worth considering, but that approach is not a panacea. Many institutions that had skin in the game got into trouble anyway--perhaps because it is hard to judge how much skin is enough to maintain proper incentives. In addition, it may be impossible to police whether an institution has chosen to keep its own skin in the game or whether its risk has been mitigated through hedging. In the end, no one can police the market better than the final investors, provided the instruments are simpler and more transparent.

Finally, our efforts to stabilize the system by guaranteeing much of the liabilities of systemically important institutions have further distorted the incentives of their counterparties. Offsetting the effects of this moral hazard is another reason to hold these institutions to higher standards and find better resolution mechanisms for them.

I want to close by reiterating the importance of Hyun's contributions. He has led the way in showing that the organization of financial structures is critical to the resiliency of the financial system. Going forward, we need to address not just the unstable structures that have become so evident in the recent crisis, but we also need to better understand why these sorts of structures emerge and take steps to prevent their reoccurrence in whatever forms they may take.