



Geithner's Wrong: Dodd Bill Doesn't End Bailouts

Treasury Secretary Timothy Geithner has a recent op-edⁱ in The Washington Post titled “How to prevent America's next financial crisis.” The following provides a brief analysis of Secretary Geithner’s claims regarding the most important issue facing the financial regulation bill: preventing future bailouts of failing, large financial institutions – and the failure of the Dodd billⁱⁱ to address this critical concern.

GEITHNER CLAIM: “Crucially, if a major firm does mismanage itself into failure, the Senate bill gives the government the authority to wind down the firm with no exposure to the taxpayer. No more bailouts. Instead, we will have a bankruptcy-like regime where equityholders will be wiped out and the assets will be sold.”ⁱⁱⁱ

FACT: The Democrats’ bill creates bailout funds, authorizes bailouts, allows for “back door” bailouts from the FDIC, Treasury and the Fed, and expands the scope of bailouts.

Creates a New Permanent Bailout Fund Paid for by Taxpayers – The bill creates a new prepaid \$50 billion bailout fund,^{iv} signaling to creditors that the government stands ready to bail out large banks. This creates a slush fund for Treasury to use for unintended purposes, immediately drains \$50 billion away from productive investments, and will erode market discipline.

Authorizes Bailouts of Creditors – The bill does not require creditors of a firm to take a loss. In fact, the resolution authority allows the FDIC to pay creditors more than they would receive in bankruptcy (which defines a bailout)^v and lets the FDIC and Treasury pick and choose which creditors get bailed out.^{vi} This would allow the government to selectively bail out politically favored creditors.

Allows for “Back Door” Bailouts – The bill expands the ability of Treasury and regulators to conduct back door bailouts through extensions of Federal Reserve credit,^{vii} bridge loans,^{viii} and broad-based guarantees of bad debt.^{ix} These powers may be used to prop up and bail out firms that would otherwise have gone into bankruptcy. This perpetuates moral hazard and cements permanent bailout authority into law. The risk to taxpayers is underscored by the fact that more than \$1 *trillion* of taxpayer-financed assistance in the recent financial crisis came in the form of lending by the Federal Reserve.^x

Expands the Scope of the Bailouts – The bill authorizes a Financial Stability Oversight Council (“Council”) to designate non-bank financial institutions as potential threats to financial stability and, hence, too big to fail.^{xi} This gives such companies an undeserved funding advantage over competitors, leading to outsized profits and the extension of additional bailout risk for taxpayers. What determines whether a non-bank financial institution is a threat to stability? Among other possible considerations, “any other factors that the Council deems appropriate.”^{xii} Such broad authority would allow the Council to protect and promote, or to hamper, firms based on whatever it deems appropriate.

Fails to Fix Fannie/Freddie – Geithner’s op-ed^{xiii} states: “It is simply unacceptable to walk away from this recession without fixing the system’s basic flaws that helped create it.” Yet, amazingly, the Democrats’ bill does nothing to address the costly,^{xiv} risky flaws inherent in the mortgage giants, Fannie Mae and Freddie Mac.

ⁱ “How to prevent America’s next financial crisis,” by Timothy Geithner, Washington Post, April 13, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/04/12/AR2010041203341.html?nav=hcmoduletmv>

ⁱⁱ Text of the Dodd bill consists of the Chairman’s Mark combined with the Manager’s Amendment, as passed by the Senate Banking, Housing, and Urban Affairs Committee, both documents available at the committee’s website: http://banking.senate.gov/public/index.cfm?FuseAction=Issues.View&Issue_id=630c2b4a-ef2a-9ff3-5e79-bbe3c26422da and http://banking.senate.gov/public/index.cfm?FuseAction=Issues.View&Issue_id=8c36157a-e6cc-c6e6-1104-578079eb8ad6

ⁱⁱⁱ Supra note 1

^{iv} Section 210(n), page 272 of the Chairman’s Mark

^v Section 210(d)(4)(A), page 241 of the Chairman’s Mark

^{vi} Section 210(d)(4)(A), page 241 of the Chairman’s Mark; section 210(b)(4), page 188 of the Chairman’s Mark; section 210(h)(5)(E), page 254 of the Chairman’s Mark

^{vii} Section 1151, page 1302 of the Chairman’s Mark

^{viii} Section 210(h), page 244 of the Chairman’s Mark

^{ix} Section 1155, page 1316 of the Chairman’s Mark

^x Monthly Report on Credit and Liquidity Programs and the Balance Sheet, Board of Governors for the Federal Reserve System, March 2010, <http://www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport201003.pdf>

^{xi} Section 113, page 31 of the Chairman’s Mark

^{xii} Section 113(a)(2)(J), page 33 of the Chairman’s Mark

^{xiii} Supra note 1

^{xiv} CBO’s Budgetary Treatment of Fannie Mae and Freddie Mac, The Congressional Budget Office, January 2010, <http://www.cbo.gov/ftpdocs/108xx/doc10878/01-13-FannieFreddie.pdf>