WASHINGTON BUSINESS JOURNAL

Panic in D.C.: Did regulators overhype the financial crisis?

By Mark Holan

April 10, 2014

Federal banking regulators used " a thick dose of overblown, panic-based rhetoric" and ignored their own standards to stick taxpayers with the burden of bailing out troubled institutions such as Citigroup, the Cato Institute says in a new report.

And it could happen again under the broad discretion of the Dodd-Frank Act, according to author Vern McKinley, who cites research from his 2012 book "Financing Failure: A Century of Bailouts."

"By late September 2008 and thereafter, panic had descended on the Treasury and the major financial agencies," he writes. "That resulted in the decision to backstop the full range of large institutions,as government officials feared a collapse of the entire financial system. However, serious analysis of the risks facing the financial sector was sorely lacking and outright misstatement of the facts was evident."

Dodd-Frank, signed by President Obama in 2010, was passed by Congress in response to the financial crisis. It aims to bring new oversight of increasingly complicated and interconnected financial institutions. It remains a work in progress, with many implementing rules still being written.

McKinley is a former regulator himself, having toiled at the Federal Reserve Board of Governors, the Federal Deposit Insurance Corp., the Resolution Trust Corp., and the Department of the Treasury’s Office of Thrift Supervision. Wednesday's release of the Cato report came two days after the Fed, FDIC and Controller of the Currency beefed up the capital buffer for the nation's largest banks.

"The Dodd-Frank legislation — with the expressed desire for a more thoughtful, coordinated funding of illiquid institutions on a systemwide basis — is a better approach for decision-making over the ad hoc, seat-of-the-pants, individual institution approach of 2008 and 2009," McKinley added. "Unfortunately, the discretion granted to authorities under Dodd-Frank to determine whether or not an institution is “solvent” and any lending is sup- ported by 'sufficient collateral' will allow those agencies to continue to make the results of those determinations match their desired resolution outcome."

The libertarian Cato Institute, based in D.C., espouses less government and free markets.