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Bailout bonanza

Dodd's new bank-reform dud

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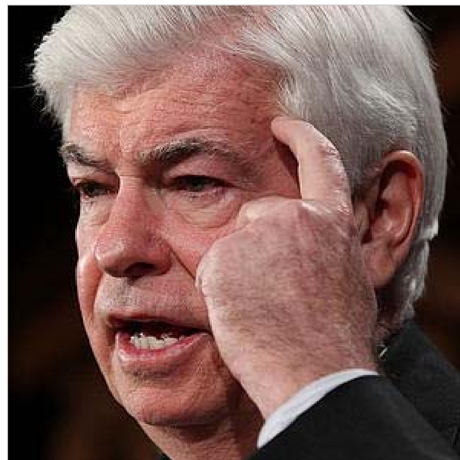
Mark A. Calabria

Sen. Chris Dodd's latest bill to fix the financial system is another failure. After months of negotiation, he's produced a "reform" of the regulatory system that simply fails to deal with the causes of the 2008 crisis -- which nearly saw the collapse of the US banking system.

Reform is urgently needed, but the senator has proved incapable of significantly improving on the widely criticized plan he presented in November. With Dodd retiring after this year, the best course is probably to start over in January, under new leadership.

What's wrong with the new effort? The central flaw is that Dodd's bill continues bailouts as federal policy, despite his claim that he's ending "too big to fail."



Dodd: Utterly fails to address the roots of the 2008 crisis.

Under the bill, debt holders can still be, and will likely be, bailed out. And debt is usually around 90 percent of the funding for a financial institution, so protecting it from loss eliminates any market discipline on these companies.

While shareholders and management might take a hit, Dodd, of course, will argue that creditors will take losses. But even a casual read of the various exceptions he allows (listed on pages 188 and 189 of his bill) indicates that debt *will* be bailed out in most cases.

A bill that essentially says, "No more bailouts -- except under conditions A, B, C and D," is *not* a bill that ends bailouts.

Even Dodd's claim to shut down companies is full of holes. On page 145, the bill clearly states that the FDIC "may" liquidate and wind up a failing company. That means the FDIC "may" also decide *not* to.

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In short, Dodd's bill wouldn't see failed firms put out of business in the next crisis, but instead produce *ad hoc* bailouts like those of 2008.

To function properly, capital markets need certainty about how the government will respond in crisis situations. The Dodd bill doesn't provide that clarity: Instead, it massively delegates power -- allowing regulators to decide who gets rescued and who doesn't.

Dodd has decried the greed of Wall Street -- yet his bill is a triumph for the oversight status quo. His proposed consumer-protection agency would lack any authority over Wall Street, leaving oversight largely with the (failed) **Securities and Exchange Commission**.

Indeed, the provisions Dodd sells as "anti-Wall Street" are actually aimed at nonbank lenders, such as payday lenders and check-cashiers, who had absolutely nothing to do with the financial crisis.

Even where Dodd correctly identifies failings, he at best punts. The best example may be the credit-ratings system -- whose colossal failings did so much to permit the 2008 crisis.

Rather than ending the ratings agencies' government-created monopoly status, Dodd merely says the **Government Accountability Office** "will study the issue."

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And despite all the new powers and discretions that the bill gives to the bank regulators, it still allows these same regulators to outsource much of their jobs to the rating agencies.

Perhaps the greatest of Dodd's sins are ones of omission. Nowhere does his bill address the actual practice that caused the crisis: permitting widespread writing of mortgages where the borrowers had little or no equity. The Dodd bill keeps in place the same federal incentives for homebuyers to treat our housing markets as casinos.

And the only time **Fannie Mae** and **Freddie Mac** get mentioned in the bill is to continue their favored treatment. Notably, banks can still engage in proprietary trading in Fannie and Freddie securities -- even though that practice was responsible for much of Bear Stearns' catastrophic losses.

The American public has a lot to be angry about, but the spark for that rage was the bank bailouts. Yet Dodd's bill makes bailouts into permanent policy. It wouldn't bring stability to our financial system, but further erode market discipline -- while asking us to put all our faith in the same regulators who have failed repeatedly.

Mark A. Calabria is the Cato Institute's director of financial- regulation studies.

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What a surprise, a failure linked to Dodd.

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