

# A SENATOR'S RECOLLECTION OF THE FINANCIAL CRISIS

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I was privileged to serve as United States Senator from Indiana from 1999 to 2011. During those twelve years, our nation faced many challenges. Among the most severe was the financial crisis that began gathering force in 2007 and climaxed with the bankruptcy filing of the investment banking giant Lehman Brothers Holdings, Inc., on September 15, 2008.<sup>1</sup> As a senior member of the Senate Committee on Banking, Housing and Urban Affairs ("Banking Committee"), I was deeply involved in the policy debates and legislative response to the crisis.

In this Article, I set forth a few of my recollections on three aspects of the legislative response to the financial crisis: the Emergency Economic Stabilization Act; assistance for the American automobile industry; and the Dodd–Frank Wall Street Reform and Consumer Protection Act.

## I. EMERGENCY ECONOMIC STABILIZATION ACT (TARP)

The reaction to the Lehman Brothers' bankruptcy filing on Monday, September 15, 2008, was swift and severe. The very next day, the Federal Reserve (with the full support of the Treasury Department) approved a loan of \$85 billion to insurance giant American International Group (AIG) to prevent it from failing.<sup>2</sup> As the *Washington Post* reported at the time, a "massive disruption of the financial system" took place that day and the next:

The AIG rescue hadn't calmed nerves. In fact, there appeared to be a run developing on money-market mutual funds, a \$3.5 trillion pool of savings that was supposed to be nearly as safe as cash but lacks any government guarantee. If money-market funds failed, ordinary people stood to lose huge sums, stirring wider panic. Meanwhile, shares of Morgan Stanley and Goldman Sachs Group, the last two freestanding investment banks, sunk as investors bet they would collapse just as their rivals had. Commercial banks stopped lending to each other. The stock markets dove.<sup>3</sup>

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1. Press Release, Lehman Brothers, Lehman Brothers Holdings, Inc. Announces It Intends to File Chapter 11 Bankruptcy Petition; No Other Lehman Brothers' U.S. Subsidiaries or Affiliates, Including Its Broker-Dealer and Investment Management Subsidiaries, Are Included in the Filing (Sept. 15, 2008), *available at* [http://www.lehman.com/press/pdf\\_2008/091508\\_lbhi\\_chapter11\\_announce.pdf](http://www.lehman.com/press/pdf_2008/091508_lbhi_chapter11_announce.pdf).

2. Press Release, Board of Governors of the Federal Reserve System, Federal Reserve Will Lend Up To \$85 Billion To American International Group (AIG) (Sept. 16, 2008), *available at* <http://www.federalreserve.gov/newsevents/press/other/20080916a.htm>.

3. Lori Montgomery et al., *A Joint Decision to Act: It Must Be Big and Fast*, WASH. POST, Sept. 20, 2008, <http://www.washingtonpost.com/wpdyn/content/article/2008/09/19/AR2008091903996.html?sid=ST2008092001054>.

On the evening of September 18, I was among a group of senior Senators from both parties who attended an emergency meeting at the Capitol with Treasury Secretary Henry M. Paulson, Jr., and Federal Reserve Chairman Ben S. Bernanke. The meeting was off-the-record and the discussion confidential but it has subsequently been publicly reported that Paulson and Bernanke said they would be proposing legislation to allow the government to buy “troubled assets” from financial institutions and urged its immediate passage.<sup>4</sup> “Unless you act, the financial system of this country and the world will melt down in a matter of days,” Secretary Paulson was quoted as saying.<sup>5</sup> And Chairman Bernanke was quoted as saying, “If we don’t do this tomorrow, we won’t have an economy on Monday.”<sup>6</sup>

This was the predicate for a dramatic meeting of the Banking Committee on September 23, 2008, when Secretary Paulson, Chairman Bernanke, Securities and Exchange Commission Chairman Christopher Cox, and Federal Housing Finance Agency Director James B. Lockhart III appeared to present the Bush Administration’s request for authority to purchase troubled assets—to become known as “TARP”—for “Troubled Asset Relief Program.”<sup>7</sup>

The sense of urgency was palpable. After all, Chairman Bernanke—a man who, it was safe to say, is not known for engaging in hyperbole—had just told us that we were perhaps only a matter of days from the beginning of a major economic collapse. He had warned of nothing less than the free fall of our financial markets and the beginnings of a severe and protracted recession that could put companies out of business and result in many jobs lost, savings wiped out, people losing their homes, and real distress for our country.

We needed to ask what alternatives had been considered. Why were we convinced that this was the right path? Were there no private sector solutions available that would perhaps lead to better outcomes than the ones that have been proposed? For me, the focus was on getting it right, and I wanted us to take the time to do just that.

Among my concerns were these. Several of my colleagues, including Senator Robert Menendez of New Jersey, had mentioned that our purpose should be to protect the taxpayers by buying the “troubled assets” from financial institutions at market prices. If that was to be the case, I needed to know how that would help solve the capitalization problem of these institutions.

On the other hand, if we were to pay above market prices, I needed to know what the taxpayers would receive in return. If equity was to be the answer to that

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4. *Frontline: Inside the Meltdown* (PBS television broadcast Feb. 17, 2009), transcript available at <http://www.pbs.org/wgbh/pages/frontline/meltdown/etc/script.html>.

5. *Id.*

6. *Id.*

7. See David M. Herszenhorn, *Administration Is Seeking \$700 Billion for Wall Street*, N.Y. TIMES, Sept. 20, 2013, available at <http://www.nytimes.com/2008/09/21/business/21cong.html>; see also *Text of Draft Proposal for Bailout Plan*, N.Y. TIMES, Sept. 20, 2013, available at [http://www.nytimes.com/2008/09/21/business/21draftend.html?\\_r=2&](http://www.nytimes.com/2008/09/21/business/21draftend.html?_r=2&).

question, that would be one thing. But if not equity, I wanted to know why not. And I wanted to know why we encouraged (or at least permitted) sovereign wealth funds to invest in American companies and markets, but perhaps would not allow the American taxpayers to take a similar interest in our own companies and markets.

And it seemed to me that while we had to act, we also had to be willing to take the steps to make sure that this situation did not reoccur in the future. Underlying my concerns in this regard was the sense of outrage on the part of ordinary taxpayers. I was hearing from my constituents constantly. These were people who had behaved prudently, who had not taken inordinate risks, who had saved their money, who had not gotten in over their heads, who had not participated in highly leveraged instruments that had now come back to haunt them. We owed it to them to make sure that we learned the right lessons from this so that it would not happen again.

I was not cynical but skeptical about the way Washington can work in times like these. Congress will act in a moment of crisis, but once the crisis has abated, the sense of urgency will dissipate. The forces of reform would not have the energy that they had at the moment of crisis. All the interests opposing reform would then circle Washington like hungry birds looking at carrion in order to prevent us from taking the steps that were necessary. I was determined to try to prevent that from happening.

I recognized that Congress could not make the long-term reforms needed in the time frame that was at our disposal in September 2008, but I told my colleagues that I would be looking for some mechanism that would force us to revisit this issue. I firmly believed that absent long-term reform, a similar financial crisis would happen again, that history would judge us poorly, and our children and grandchildren would not forgive us.

The Emergency Economic Stabilization Act of 2008<sup>8</sup> containing TARP came before the Senate for a final vote on October 1. Viewing it as a distasteful but necessary step to protect millions of innocent people from the malfeasance of a few, I voted for the bill.

In doing so, I recognized that people were angry, and they had a right to be. I was, too. We should not have been in that mess, but we were. What were we going to do? After all, Chairman Bernanke, our nation's top economic expert, believed that if swift action was not taken to stabilize our financial system, Americans would face a deep and protracted recession, and millions will lose their jobs, life savings, and businesses. These were not just faceless statistics or big shots on Wall Street. Those who would pay the price for inaction were the workers at the cancelled construction project, small business owners who could no longer make payroll, students who would not be able to attend college because they could not get a loan, and senior citizens who could no longer make ends meet because their nest eggs had been devastated. All would suffer if we did not act.

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8. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008) (codified in 12 U.S.C. §§ 5201-5261 (2008)).

Could Chairman Bernanke have been wrong? Yes. Was ignoring his advice a risk worth running at that precarious time for our nation? I did not believe so. As distasteful as it was for Congress to pass the TARP legislation, doing nothing would likely have made things much worse. That was the choice before us as I saw it.

Although not a good option, I did think the final bill we were voting on was far better than the original proposal. Executives who had brought their companies to the brink of ruin and now sought public help would be prevented from profiting. There would be no golden parachutes or outrageous executive pay packages. There would be independent oversight to prevent conflicts of interest and outright corruption. The taxpayer would be protected by receiving an ownership interest in any company that received government assistance. If after five years the government had lost money, the financial industry would be required to pay it back.

I also thought the bill had been improved by including tax cuts to help middle class families. I calculated that more than 900,000 Hoosier homeowners would be eligible for a property tax cut. Tens of thousands of students would receive a \$4000 college credit. Thousands of middle class Hoosier families would not see their taxes rise due to the Alternative Minimum Tax.

I remained firm in my resolve that, once we had dealt with the present crisis, we must channel our anger into making sure this never happened again. There were, of course, many culpable parties. Houses had been appraised at above market rates to make ill-advised loans possible. Loans had been given to individuals with no verification as to their ability to repay. These bad loans had been packaged into securities and sold to financial institutions, undermining their financial strength. Rating agencies had given their blessing, saying that these “junk” securities were “AAA” rated. Financial firms, seeking massive profits, had become highly leveraged, greatly exacerbating the harm of any potential mistake. Credit default swaps and other derivative products had proliferated in unregulated markets to such an extent that the entire financial system had been endangered. “Off-balance sheet accounting” had permitted companies to hide assets from public view. They were supposed to have been inconsequential. It turned out they were anything but. All of these items and countless others had contributed to the crisis that faced us on October 1, 2008. I was firmly convinced that all needed to be corrected.

The TARP legislation was no panacea. More difficult decisions lay ahead. But the TARP bill was better than doing nothing—and that was the alternative.

Two days later, on October 3, President Bush signed the Emergency Economic Stabilization Act into law, thereby establishing the \$700 billion TARP program.<sup>9</sup> And ten days after that, on October 13, the Treasury Department announced that TARP would make \$250 billion of capital available to U.S. financial institutions by purchasing preferred stock and that nine large institutions intended to participate.<sup>10</sup>

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9. *Id.*

10. See Mark Landler, *U.S. Investing \$250 Billion in Banks*, N.Y. TIMES, Oct. 14, 2008,

## II. AUTO INDUSTRY ASSISTANCE

Of particular concern to me in this time period was the health of the American auto industry. For whatever problems American automakers had brought upon themselves, there was no denying that the financial crisis had caused a severe decline in consumer demand in general and drying up of consumer credit in particular. The resulting drop in consumer demand had materially adversely affected auto sales.<sup>11</sup>

On November 18 and 19, the leaders of Chrysler, Ford, and General Motors appeared on Capitol Hill to request emergency government financial assistance.<sup>12</sup> On November 19, they testified before the Banking Committee. At this hearing, I urged my colleagues to support action to help the struggling domestic American auto industry.

My analysis was grounded in the historic nature of the times. We faced, of course, what Chairman Bernanke had described as the greatest financial panic since the 1930s, a situation that had contributed, at least in part, to the greatest real downturn in the economy since at least the early 1980s. But more than that, this was the first significant economic downturn since the advent of globalization. Rather than having rapidly growing parts of the world serving as countervailing forces to weakness at home, now weakness in one part of the world begot further weakness. As such, we were running the risk of an accelerating economic decline around the world.

These unprecedented times had, as discussed above, led our government to intervene in the banking sector, taking significant equity stakes in the largest banks of our country, and in the insurance sector, virtually taking over one of the largest insurance companies in the world.

In addition, we had taken over Fannie Mae and Freddie Mac, turning government sponsored enterprises into government-run concerns. We had moved to stabilize the money market system. We were looking at the credit card

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<http://www.nytimes.com/2008/10/14/business/economy/14treasury.html?pagewanted=print>; see also Mark Landler & Eric Dash, *Drama Behind a Banking Deal*, N.Y. TIMES, Oct. 14, 2008; EDWARD NELSON, THE GREAT RECAPITALIZATION, ECONOMIC SYNOPSES, FEDERAL RESERVE BANK OF ST. LOUIS (No. 29 2008), available at <http://research.stlouisfed.org/publications/es/08/ES0829.pdf>.

11. The impact of the financial crisis on the entire auto industry was highlighted late in 2008 by Toyota's announcement of its first operating loss in seventy years. As the Wall Street Journal reported, "The recent pleas from the Big Three U.S. auto makers for a bailout from Washington have kept the spotlight on Detroit. But Toyota's forecast of an operating loss indicates auto makers of every stripe are facing extraordinary challenges." Yoshio Takahashi & Kate Linebaugh, *Toyota Sees First Loss in 70 Years: Global Plunge in Car Demand Creates an "Emergency That We've Never Experienced"*, WALL ST. J., Dec. 23, 2008, <http://online.wsj.com/news/articles/SB122992788012825897>.

12. Bill Vlasic & David M. Herszenhorn, *Detroit Chiefs Plead for Aid*, N.Y. TIMES, Nov. 18, 2008, <http://www.nytimes.com/2008/11/19/business/19auto.html>.

situation and student loans. And we were even debating whether entire states and municipalities may need financial assistance from our government to weather the unprecedented and unpredicted challenges of the times.

To permit the auto industry to fail would only add to the instability, fragility, and unpredictability of the economy that these steps reflected. In my view, if we allowed tens of thousands of ordinary people to lose their jobs, thousands of small businesses, suppliers, dealerships and others to be imperiled, three of the largest corporations in the country to run the risk of going down, it would have not only had those effects on the economy but unintended consequences as well, some of them quite possibly severe.

At the same time, I recognized that all of the major stakeholders needed to participate and make contributions if government assistance was to be forthcoming. Fortunately, there was a model to go by—the 1979 plan that had rescued the Chrysler Corporation. In that particular case, all the stakeholders did step up. The right decisions were made. And the net result was that the jobs were saved, the company was saved, and the taxpayers were repaid ahead of time and earned a profit. I was of the view that the current crisis, like the crisis of 1979, could be a win-win situation.

The requests of the auto executives on November 18 and 19 did not produce immediate positive results.<sup>13</sup> But discussions among the industry, Congressional leaders, and the Bush administration ultimately produced a plan, called the Auto Industry Financing and Restructuring Act, to provide up to \$14 billion in emergency loans to General Motors and Chrysler.<sup>14</sup> The House of Representatives passed the bill on December 10 by a vote of 237 to 170.<sup>15</sup> On the day of the House vote, I issued the following statement:

We're faced with trying to choose the best among unpalatable alternatives. Nobody wanted to give money to the banks or to the insurance companies, and nobody wants to give money to the auto industry. I don't. But if the alternative is losing hundreds of thousands of jobs and having automakers, dealerships, part suppliers, and other retailers in local communities go down, we have to make a hard choice here.

People think the economy is bad now, but if we let all these companies go belly up, and all those folks get laid off, I'm afraid it would be much worse.

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13. Bill Vlasic & David M. Herszenhorn, *Auto Chiefs Fail to Get Bailout Aid*, N.Y. TIMES, Nov. 19, 2008, <http://www.nytimes.com/2008/11/20/business/20auto.html>.

14. David M. Herszenhorn & David E. Sanger, *House Passes Auto Rescue Plan*, N.Y. TIMES, Dec. 10, 2008, <http://www.nytimes.com/2008/12/11/business/11auto.html?pagewanted=all&gwh=AEEE7883B17F88E371594994C377946F&gwt=pay>.

15. *Id.* The vote was mostly along party lines. Voting in favor were 205 Democrats and 32 Republicans. Voting against were 150 Republicans and 20 Democrats. *Id.*

Indiana has a huge stake in this debate. If the big auto companies go down and thousands of jobs are lost, it's going to hit us a lot harder than almost any place else in the country.

We are establishing strict criteria that the auto companies have to meet, and we are insisting that all of the different stakeholders make the sacrifices necessary for the long-term survival of the industry.<sup>16</sup>

The next day the Senate took up the Auto Industry Financing and Restructuring Act but the measure failed to garner the 60 votes necessary under the Senate rules to permit consideration.<sup>17</sup> My Indiana colleague, Senator Richard Lugar, and I both voted in favor of considering the bill.<sup>18</sup>

Following defeat of this legislation, the Bush administration immediately fashioned an emergency loan program for General Motors and Chrysler that it implemented without explicit authorizing legislation.<sup>19</sup> The Obama Administration, which took office the next month, later fashioned its own assistance program for General Motors and Chrysler.<sup>20</sup> Today, the American auto industry has been revitalized.

### III. DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

As discussed above, my vote for TARP was accompanied by a resolve to support additional legislation to prevent a reoccurrence of the financial crisis. Legislation to that end was enacted approximately two years later when President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") into law on July 21, 2010.<sup>21</sup>

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16. Press Release, Office of Senator Evan Bayh, Statement from Senator Bayh on Auto Rescue Legislation (Dec. 10, 2008), *available at* <http://www.insideindianabusiness.com/newsitem.asp?ID=32986>.

17. David M. Herszenhorn, *Senate Abandons Auto Bailout Bid After G.O.P. Balks*, N.Y. TIMES, Dec. 12, 2008, <http://query.nytimes.com/gst/fullpage.html?res=9500E7DE1F3EF931A25751C1A96E9C8B63>.

18. The Senate voted 52 to 35 to reject a motion to invoke cloture on a motion to proceed to consider House Resolution 7321. *Id.*

19. See John D. McKinnon & John D. Stoll, *U.S. Throws Lifeline to Detroit*, WALL ST. J., Dec. 20, 2008, <http://online.wsj.com/news/articles/SB122969367595121563>; see also Jack Healy, *Stocks & Bonds; Shares End Mixed After Brief Bounce*, N.Y. TIMES, Dec. 20, 2008, <http://query.nytimes.com/gst/fullpage.html?res=9904E4DB133EF933A15751C1A96E9C8B63> (discussing the affect of the Bush administration's action on the financial markets).

20. See generally STEVEN RATTNER, OVERHAUL: AN INSIDER'S ACCOUNT OF THE OBAMA ADMINISTRATION'S EMERGENCY RESCUE OF THE AUTO INDUSTRY (Houghton Mifflin Harcourt 2010) (recounting the Obama administration's actions to further assist the auto industry).

21. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat 1376 (2010); see also Helene Cooper, *Obama Signs a Contentious Overhaul of the U.S. Financial System*, N.Y. TIMES, July 22, 2010, <http://query.nytimes.com/gst/fullpage.html?res=9E03EFD71331F931A15754C0A9669D8B63>. My recollections on Dodd-Frank at the time of its passage set forth here are derived from comments I made on July 26, 2010, in an interview with

I voted for Dodd-Frank because I believed that it made it less likely in several ways that there would be a recurrence of the financial crisis.

First, when Lehman Brothers failed—which, as we have seen, was the domino that threatened to tip over all the other dominos in the economy—one of the problems was that there was no mechanism for the government to step in and seize that entity. The new law included a systemic risk council, where the government would monitor the level of risk that was being run by key financial institutions. If they threatened to get so big and take on such levels of risk that it threatened the national or global economy, the government would be in a position to do something about that.

And if these institutions began to fail, the government would now have resolution authority to step in and have an orderly unwinding of a business like Lehman Brothers rather than a chaotic one or one that took place over years. So there were mechanisms in Dodd-Frank that would help deal with the kind of panic that we had been through.

I think Dodd-Frank sent a number of messages. The hope was to make the financial markets more stable while minimizing the increased costs to both industry and, ultimately, to the consumer. However, Dodd-Frank was not going to prevent the recurrence of financial instability from time to time. No reform in the history of financial markets has ever accomplished that.

Although Dodd-Frank had these positive aspects, I nevertheless had concerns about the future.

My biggest concern was that we would continue to see an imbalance in consumption and savings in the global economy. Some economies—most notably China, Germany and some other parts of the developing world—were growing rapidly, saving large amounts of money, and basing their economies on exports.

The United States and a few other countries continued to consume more than we produced. So we were running fairly sizeable current account imbalances. As long as we had these imbalances that were unsustainable, they were going to manifest themselves in some way. It was a tech bubble back around 2000 that burst. It was a real estate bubble that burst in 2007 and 2008. When you have large disequilibrium, something bad is going to happen unless you move to correct it.

As mentioned above, I thought that the actions of Fannie Mae and Freddie Mac contributed to the financial crisis. I was in the small minority of the members of my political party who voted to include Fannie Mae and Freddie Mac reform in Dodd-Frank. They should have been included in the legislation, but they were not.

Another concern I had was that in the absence of global consensus and convergence on some of the standards in Dodd-Frank, its intent would be defeated, and Dodd-Frank could actually have some harmful effects on U.S.

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reporter Nin-Hai Tseng of CNN. Nin-Hai Tseng, *Bayh: How Financial Reform Could Impede Growth*, CNN MONEY, July 26, 2010, [http://money.cnn.com/2010/07/26/news/economy/bayh\\_financial\\_reform.fortune/](http://money.cnn.com/2010/07/26/news/economy/bayh_financial_reform.fortune/).



employment and growth in jobs and capital overseas. That would not be a good thing. So we would need to work with our allies to try and promote common standards in this regard.

Derivative trading was an example. We could do whatever we want regarding derivatives in this country, but if most other major economies did not have the same standards, the activity was still going to occur, it was just going to occur offshore. The risks would still be run, but the jobs and capital would no longer be here in our country. We needed to watch out for such unintended consequences.

As far as protecting consumers, the Consumer Financial Protection Bureau created by Dodd-Frank had real enforcement powers over consumer lending and so had great potential to safeguard consumers. But it also had the potential for abuse. I called for the Director of the Bureau to be very practical and understanding of the real world consequences of the decisions the Bureau would make.

More broadly, I was concerned that if Dodd-Frank was not enforced in the right way, it could impede economic growth. We did not want financial institutions to go back to reckless lending—lending that was not based on sound fundamentals. But we did want them to lend to credit-worthy businesses and individuals. That would be important to economic growth. If the new regulations made financial institutions so much less profitable that they did not have as much money to lend, or made financial institutions so gun-shy that they did not lend to even very credit-worthy customers, that would impact economic growth. That was something that would need to be corrected if it happened.

I thought the concern expressed by some that Dodd-Frank puts too much authority in the hands of regulators was a real risk and a legitimate criticism. But the alternative was to have legislators writing the rules with great specificity. These are people who are well-intended but they are not sufficiently familiar with these very complex issues. I thought that would have been a worse alternative.

We could also have done nothing, which given the panic we had been through was also not a satisfactory alternative. So I thought that what we had to do was be very vigilant over the regulators. If they started making ill-advised decisions, then elected officials needed to step in and say, “Wait a minute, that’s not what we meant.” Or to be honest and say, “We thought this was going to work well, but it didn’t, and now some parts need to be substantially corrected.”

#### CONCLUSION

The foregoing sets forth some of my recollections of efforts made in Congress to address the financial crisis that afflicted our country and the world at the end of the last decade. As a United States Senator from Indiana, it was a privilege and honor to represent the people of our great state in addressing these matters. Let me say in conclusion that in doing so, my focus was not only on the future of our country’s financial institutions and manufacturing enterprises but even more on the innocent victims of the financial crisis whose homes, pensions, and livelihoods were jeopardized if not destroyed by the catastrophe.