

DAVID SKEEL

The
New
Financial
Deal

UNDERSTANDING

THE **DODD-FRANK ACT** AND

ITS (UNINTENDED) CONSEQUENCES

Introduction by WILLIAM D. COHAN,
bestselling author of *House of Cards* and *The Last Tycoons*

Foreword by HARVEY R. MILLER,
lead bankruptcy attorney for Lehman Brothers

The New Financial Deal

Understanding the
Dodd-Frank Act and Its
(*Unintended*) Consequences

David Skeel



WILEY

John Wiley & Sons, Inc.

Copyright © 2011 by David Skeel. All rights reserved.
Introduction © 2011 by William D. Cohan. All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8600, or on the Web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services or for technical support, please contact our Customer Care Department within the United States at (800) 762-2974, outside the United States at (317) 572-3993 or fax (317) 572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books. For more information about Wiley products, visit our web site at www.wiley.com.

Library of Congress Cataloging-in-Publication Data:

Skeel, David, 1961–

The new financial deal : understanding the Dodd-Frank act and its (unintended) consequences / David Skeel.

p. cm.

Includes bibliographical references and index.

ISBN 978-0-470-94275-8 (cloth); ISBN 978-1-118-01490-5 (ebk);

ISBN 978-1-118-01491-2 (ebk); ISBN 978-1-118-01492-9 (ebk);

1. United States. Dodd-Frank Wall Street Reform and Consumer Protection Act.
2. Financial services industry—Law and legislation—United States.
3. Financial institutions—Law and legislation—United States. I. Title.

KF969.58201A2 2010

346.73'08—dc22

2010042162

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

For H.P., T.G., and B.B.

Contents

Foreword	ix
Introduction	xi
A Few Major Characters	xv
Chapter 1 The Corporatist Turn in American Regulation	1
<i>The Path to Enactment</i>	3
<i>The Two Goals of the Dodd-Frank Act</i>	4
<i>A Brief Tour of Other Reforms</i>	6
<i>Two Themes That Emerge</i>	8
<i>Fannie Mae Effect</i>	11
<i>Covering Their Tracks</i>	12
<i>Is There Anything to Like?</i>	14
Part I Relearning the Financial Crisis	
Chapter 2 The Lehman Myth	19
<i>The Stock Narrative</i>	20
<i>Lehman in Context</i>	23
<i>Lehman's Road to Bankruptcy</i>	26

	<i>Lehman in Bankruptcy</i>	29
	<i>Bear Stearns Counterfactual</i>	31
	<i>Road to Chrysler</i>	33
	<i>Chrysler Bankruptcy</i>	35
	<i>General Motors “Sale”</i>	38
	<i>From Myths to Legislative Reality</i>	39
Part II The 2010 Financial Reforms		
Chapter 3	Geithner, Dodd, Frank, and the Legislative Grinder	43
	<i>The Players</i>	44
	<i>TARP and the Housing Crisis</i>	47
	<i>Road to an East Room Signing</i>	49
	<i>Channeling Brandeis: The Volcker Rule</i>	54
	<i>The Goldman Moment</i>	56
Chapter 4	Derivatives Reform: Clearinghouses and the Plain-Vanilla Derivative	59
	<i>Basic Framework</i>	61
	<i>Derivatives and the New Finance</i>	63
	<i>The Stout Alternative</i>	66
	<i>New Clearinghouses and Exchanges</i>	68
	<i>Regulatory Dilemmas of Clearinghouses</i>	69
	<i>Disclosure and Data Collection</i>	74
	<i>Making It Work?</i>	75
Chapter 5	Banking Reform: Breaking Up Was Too Hard to Do	77
	<i>Basic Framework</i>	78
	<i>New Designator and Designatees</i>	79
	<i>Will the New Capital Standards Work?</i>	82
	<i>Contingent Capital Alternative</i>	84
	<i>Volcker Rule</i>	85
	<i>What Do the Brandeisian Concessions Mean?</i>	91
	<i>Office of Minority and Women Inclusion</i>	93

	<i>Institutionalizing the Government-Bank Partnership</i>	94
	<i>A Happier Story?</i>	95
	<i>Repo Land Mine</i>	96
Chapter 6	Unsafe at Any Rate	99
	<i>Basic Framework</i>	100
	<i>Who Is Elizabeth Warren?</i>	102
	<i>Toasters and Credit Cards</i>	105
	<i>The New Consumer Bureau</i>	106
	<i>Mortgage Broker and Securitization Rules</i>	109
	<i>Consequences: What to Expect from the New Bureau</i>	111
	<i>What It Means for the Government-Bank Partnership</i>	114
Chapter 7	Banking on the FDIC (Resolution Authority I)	117
	<i>Does the FDIC Play the Same Role in Both Regimes?</i>	118
	<i>How (and How Well) Does FDIC Resolution Work?</i>	122
	<i>Moving Beyond the FDIC Analogy</i>	126
Chapter 8	Bailouts, Bankruptcy, or Better? (Resolution Authority II)	129
	<i>Basic Framework</i>	130
	<i>The Trouble with Bailouts</i>	132
	<i>Who Will Invoke Dodd-Frank Resolution, and When?</i>	135
	<i>Triggering the New Framework</i>	137
	<i>Controlling Systemic Risk</i>	142
	<i>Third Objective: Haircuts</i>	145
	<i>All Liquidation, All the Time?</i>	148

Part III The Future

Chapter 9	Essential Fixes and the New Financial Order	155
	<i>What Works and What Doesn't</i>	156
	<i>Staying Derivatives in Bankruptcy</i>	158
	<i>ISDA and Its Discontent</i>	163
	<i>Other Bankruptcy Reforms for Financial Institutions</i>	168
	<i>Plugging the Chrysler Hole in Bankruptcy</i>	170
	<i>Bankruptcy to the Rescue</i>	173
Chapter 10	An International Solution?	175
	<i>Basic Framework</i>	176
	<i>Problems of Cross-Border Cases</i>	177
	<i>Scholarly Silver Bullets</i>	181
	<i>Dodd-Frank's Contribution to Cross-Border Issues</i>	182
	<i>New Living Wills</i>	185
	<i>A Simple Treaty Might Do</i>	186
	<i>Risk of a Clearinghouse Crisis</i>	188
	<i>Reinvigorating the Rule of Law</i>	189
	Conclusion	191
	Notes	195
	Bibliography	205
	Acknowledgments	211
	About the Author	212
	Index	213

Foreword

September 15, 2008, was a day of infamy for the global financial markets. The increasing financial stress precipitated by a free-fall subprime mortgage crisis, and fueled by excessive risk taking and greed, exploded. At approximately 2:00 A.M. of that day, at the virtual insistence of the U.S. Treasury, the Federal Reserve System, and the Securities and Exchange Commission, Lehman Brothers Holdings Inc., the fourth largest U.S. investment bank, with extensive international operations, filed a Chapter 11 bankruptcy case. This unleashed a tsunami that threatened to destroy the worldwide financial system. The bankruptcy of the Lehman enterprise has produced a plethora of articles, books, strange bedfellows, and all types of political intrigue and deal making.

David Skeel has entered the stage to succinctly focus sunlight on the events that occurred and resulted in the Dodd-Frank financial reform bill of 2010. David has undertaken a most difficult and sensitive task. To explain and critique a statute that has been the subject of intense public and private debate, media attention, and voluminous congressional hearings, replete with congressional competition for primacy of jurisdiction, requires a high degree of courage and intelligence. David has exhibited both.

The process that resulted in the Dodd-Frank reform has the makings of at least three challenging documentaries or films. The threat of financial reform galvanized a broad base of opposition. The financial community, which ironically may be charged with having been a primary culprit in causing the financial crisis that almost dismembered the global financial system, generally was unalterably opposed to any meaningful financial reform. It mounted an extensive and extremely costly lobbying effort that enlisted the extensive cooperation of the House minority leader, Congressman John Boehner, who worked closely with the lobbyists in the attempt to defeat financial reform.

The New Financial Deal comprehensively and skillfully navigates the circumstances that created an environment for financial reform. The book illuminates the strains, pressures, and vicissitudes of attempting to enact a remedial statute that may materially affect the way business is conducted. The book describes the new world of finance that had evolved during the first decade of the twenty-first century that included new forms of investments and securities, such as derivatives, which were barely understood because of their esoteric and opaque characteristics. They befuddled regulators, to the extent they were regulated at all, and enabled huge risk taking. Also, access to credit enabled excessive leverage that put investors and the economy at great risk.

The crushing circumstances of the financial disaster are vividly described in *The New Financial Deal*. The crosscurrents that arose in respect of the need for financial reform and the scope of any financial reform are presented with clarity. *The New Financial Deal* properly raises the issue of whether the Dodd-Frank reform and its failure to deal with global concerns will result in real, meaningful financial reform that will prevent another financial crisis similar to that of 2008. The answer is not crystal clear, as *The New Financial Deal* illustrates.

The New Financial Deal is mandatory reading for all those interested in the financial markets and the global economy. David Skeel is to be commended for casting sunlight, the best disinfectant, on the events preceding the enactment of the Dodd-Frank reform, its efficacy, and the potential consequences, intended and unintended.

HARVEY R. MILLER
Lead Bankruptcy Attorney
for Lehman Brothers

Introduction

Just as surely as little boys on sleds follow a winter snowfall—to paraphrase the Yale economist Arthur Okun—a rip-roaring financial crisis is bound to result in a new swath of financial regulation. Such, famously, was the case during the years following the stock market crash of 1929, when Congress passed—and President Franklin Roosevelt signed into law—a slew of financial reforms designed both to reduce the rampant speculation and risk taking that infected the nation’s banking system and to increase the disclosure about companies seeking to sell their securities to public investors. The Securities Act of 1933 was the first federal law to regulate the sale of securities to investors, and required corporations to register their securities by filing a mountain of disclosure with the Securities and Exchange Commission (SEC), which was established the following year. (In the one-year interim period, the Federal Trade Commission approved the issuance of corporate securities.) The so-called 1933 Act required the SEC to approve an issuer’s “registration statement” before the securities could be sold to investors. By and large for the past 77 years, the system has worked well and prevented most egregious scams.

There also was the Banking Act of 1933—more commonly known as the Glass-Steagall Act—that not only created the Federal Deposit Insurance Corporation but also forced banks to choose between commercial banking, which took deposits from the general public, and investment banking, which focused on the supposedly riskier activities of underwriting stocks and bonds. The Glass-Steagall Act gave banks until 1936 to make their decisions and was relatively straightforward: Choose one or the other, with the idea being that American savers would be protected from the tendency of bankers to take unwarranted risks with their money.

For most banks, this decision was simple, since few dabbled in both commercial and investment banking. Goldman Sachs, which to this day has little interaction with the public, stuck with investment banking, as did Lehman Brothers and Lazard Frères & Co. J.P. Morgan & Co., which had feet in both camps, chose commercial banking and jettisoned the investment-banking partners, who together formed Morgan Stanley & Co., which this year is celebrating its 75th anniversary. In 1932, the First Boston Corporation was founded as the investment banking arm (through the combination of a few firms) of the First National Bank of Boston; in 1934, per Glass-Steagall, First Boston was spun out of the commercial bank and became the first publicly traded Wall Street firm.

In the wake of Glass-Steagall, Wall Street seemed to mature, steady, and settle into a reliable pattern of behavior, none of which particularly threatened the stability of the financial system. By and large, the small, private partnerships that comprised Wall Street took prudent risks with their partners' money. Many thrived, and their partners got rich.

Not that Wall Street had stopped being a dangerous place. For instance, there was the—long forgotten now—back-office crisis of the late 1960s and early 1970s, which started during 1967 when trading volumes on the major stock exchanges exploded, and the poorly capitalized Wall Street partnerships were ill equipped to handle the extensive paperwork of settling trades occasioned by the sudden and unexpected upsurge in trading. Many firms were slow to add the back-office personnel required to handle the new flow. Unfortunately, when the personnel were eventually hired—in a rush, of course—talent suffered. Some firms were drowning in a sea of unprocessed, and inaccurately accounted for, paper.

But by the end of 1969, “the worst of the paperwork problems had been surmounted,” according to Lee Arning, then a New York Stock Exchange executive. The crisis, though, had just begun, for at the very moment that many brokerages had increased their personnel costs to scale the mountain of paper, the volume of business fell off a cliff. There was a feeling that 1970 was capitalism’s most acute test since 1929. “We were looking at the world from a 650 Dow Jones, the Penn Central bankruptcy, a credit crisis, Cambodia, Kent State—and we didn’t know where anything was going and it was a pretty grim world at this time,” Felix Rohatyn, one of the senior partners at Lazard Frères & Co., told the *New York Times*.

By midsummer 1970, Rohatyn had a full-fledged crisis to resolve as head of the New York Stock Exchange’s Crisis Committee: The near dissolution of the old-line, blue-blood retail brokerage Hayden, Stone & Co., where Joseph P. Kennedy had begun to build the fortune that would be used to propel his second son to the presidency. (Joseph Kennedy was also the first chairman of the SEC.) Hayden, Stone had 62 offices nationwide, but its back-office systems were a mess. Compounding its problems, the firm’s older partners, upon retiring, were withdrawing their capital from the firm. This, combined with the failing fortunes on Wall Street in general, created operating losses that together pushed Hayden, Stone dangerously close to default. Although Wall Street would be aghast, Rohatyn quickly found a savior for Hayden, Stone in Sandy Weill, the wunderkind financier who had presciently built a state-of-the-art securities clearing operation at his firm, Cogan, Berlind, Weill & Levitt (known as “Corned Beef with Lettuce” among Wall Street wags). Rohatyn decided that Weill, who would go on to create the financial behemoth Citigroup, was one of the few people able to grapple quickly with Hayden’s accounting deficiencies. Rohatyn then proceeded to orchestrate a few more mergers, matching struggling brokers with their healthier brethren. Eventually, the crisis passed.

By the early 1990s, though, commercial banks—with J.P. Morgan, Citibank, and Chase Manhattan in the forefront—began encroaching on the turf of the investment banks, and sought to underwrite debt and equity securities and to provide mergers and acquisitions (M&A) advice. Commercial banks figured that, since they were taking the balance sheet risks by lending to corporate America, they might as well

also get a slice of the lucrative fee-based business that Wall Street was hoovering up without seeming to take balance-sheet risk. In 1998, thanks to Sandy Weill, the Rasputin of finance, and his proposed merger between Travelers, which owned Salomon Smith Barney, and Citibank, the walls that separated commercial banking and investment banking came crashing down. In 1999, President Clinton signed the Gramm-Leach-Bliley Act, which made de jure what was already de facto: the Glass-Steagall Act was dead.

In the following decade, all hell broke loose. And the rest is history. Thanks to the financial crisis of 2007 and 2008, we have the Dodd-Frank Wall Street Reform and Consumer Protection Act, which President Obama signed into law in July 2010. Unlike the financial reform that emerged in the 1930s, which was fairly clear and explicit about what compliance meant for Wall Street, the Dodd-Frank Act's 2,300 pages seem to have muddied the already choppy waters: Must banks dump their proprietary traders? Can they still own hedge funds? What about private equity funds? Are banks actually limited to having just 3 percent of their Tier 1 capital invested in alternative investments? What types of derivatives will end up being traded on an exchange? How many clearinghouses will there be? The answers to these questions—and many others—must await the laborious process of drafting new regulations by the SEC, the Treasury, and the Federal Reserve, among others, as required by the new law.

While we wait and wonder what the true denouement of the Dodd-Frank Act will be, we are blessed with Professor David Skeel's timely, informative, and lucid explanation of the ins and outs of the new law. For readers trying to understand what Dodd-Frank will likely mean for Wall Street's future—and for ours—Skeel skillfully dissects the Act's nuances and intricacies and provides regulators a road map for how to make sure Wall Street doesn't double-cross us again anytime soon.

WILLIAM D. COHAN

Author of *House of Cards*, *The Last Tycoons*,
and an upcoming title on Goldman Sachs
to be published in 2011

A Few Major Characters

Ben Bernanke: Chairman, Federal Reserve, 2006–

Ben Bernanke had been a longtime economics professor at Princeton University when he was nominated to be a Governor of the Federal Reserve in 2002. As a scholar, he was best known for his studies of the causes of the Great Depression. Bernanke has often vowed not to repeat the Depression-era Fed's mistake of restricting access to funds during a crisis. Whatever one thinks of Bernanke's performance, there is no doubt that Bernanke and his fellow Federal Reserve Governors made good on his vow, steering funds to Bear Stearns, American International Group (AIG), the commercial paper market, and other recipients. He, Henry Paulson, and Timothy Geithner were the three musketeers of the regulatory response to the Panic of 2008.

Christopher Dodd

A three-term senator from Connecticut, Christopher Dodd announced in late 2009 that he would not be running for reelection in 2010.

Dodd's decision not to run was construed by many as a response both to a minor scandal—he had been given a below-market home loan by Countrywide Financial, the leading subprime lender—and to the dimming electoral prospects for congressional Democrats. As chair of the Senate Banking Committee, Dodd was the point person for the legislation in the Senate. Dodd was critical of some of the populist additions to the Act, such as the Volcker Rule.

Barney Frank

A longtime member of Congress from Massachusetts and chair of the House Financial Services Committee, Barney Frank was the point person for the legislation in the House. Frank was criticized during the Panic of 2008 for having resisted reform of Fannie Mae and Freddie Mac earlier in the decade. Frank was a strong advocate of the new Consumer Financial Protection Bureau and the more populist additions to the Act.

Richard Fuld: Chief Executive Officer, Lehman Brothers, 1994–2008

Richard Fuld was seen as something of a Lehman hero early in the decade, having risen through the ranks in a long career at the bank. His reputation quickly changed after the fateful summer of 2008, when Lehman failed to reach a deal with any of several possible buyers and investors, and then collapsed in September.

Timothy Geithner: Secretary of the Treasury, 2009–

The son of a diplomat, Tim Geithner has often been described as a former Wall Street banker, but he never actually worked in the private sector on Wall Street. After a short stint in Henry Kissinger's consulting firm, Geithner worked in the Treasury Department during the Clinton administration in the 1990s. This period saw bailouts of Mexico in

1994–1995 and (with funding from Wall Street banks) the hedge fund Long-Term Capital Management in 1998. As president of the New York Federal Reserve Bank, a position he held from 2003 to 2009, Geithner joined Henry Paulson and Ben Bernanke as the key architects of the bailouts of 2008. He and Larry Summers were the most important Obama administration advisers on the Dodd–Frank Act.

Henry Paulson: Secretary of the Treasury, 2006–2009

Henry Paulson was the head of the investment bank Goldman Sachs, after a long career as a investment banker at Goldman, when he joined the Bush administration as secretary of the Treasury in 2006. Paulson initially declined consideration, but then agreed to take the post on the condition that he have regular access to the President. He appears to have favored the Bear Stearns and AIG bailouts, and to have argued against a bailout of Lehman to send a signal that no company could count on receiving a bailout. He later claimed that the government did not have the power to bail out Lehman, because Lehman did not have adequate collateral to secure a loan under the Federal Reserve’s emergency lending powers. He asked Congress for the funding that became the \$700 billion Troubled Asset Relief Program (TARP) legislation in October 2008, and spearheaded the use of \$17 billion of the money for loans to General Motors and Chrysler.

Lawrence Summers: Director, National Economic Council, 2009–2010

The son of two economists and the nephew of two others (Nobel Prize winners Paul Samuelson and Kenneth Arrow), Larry Summers was a wunderkind who earned tenure at Harvard University at the age of 28. He served as assistant secretary of the Treasury under Robert Rubin, then took over as Treasury secretary at the end of the Clinton administration. Summers became president of Harvard in 2001, but his tenure turned rocky after he suggested at a conference that scientists

should study the possibility that there are more intelligent men than women “at the high end.” One year and several more controversies later, he was forced to step down. Summers crept back into the public eye in a more favorable way as a result of a series of columns he wrote on economic issues for the *Financial Times* in 2007 and 2008. He was an important adviser to Barack Obama during Obama’s presidential campaign. Many observers suspect that Obama would have nominated him as Treasury secretary if it weren’t for the controversies at Harvard. In his post as director of the National Economic Council, which did not require Senate confirmation, Summers has been a key adviser to President Obama. He and Geithner appear to have significantly shaped the administration’s contributions to the Dodd-Frank Act.

Paul Volcker

Paul Volcker is revered by many in Washington and elsewhere for his tough-minded handling of the rampant inflation of the late 1970s. As chair of the Federal Reserve, he and his fellow Federal Reserve Governors ratcheted up interest rates. Although some believe that the Fed stance cost President Carter reelection, it is widely viewed as having tamed inflation. During the 2008 campaign, Volcker was an important adviser to Barack Obama. But his role sharply diminished after the election. Volcker’s signature position during the debates on the Dodd-Frank Act was a proposal that commercial banks be banned from engaging in proprietary trading—trading in derivatives and other financial instruments for their own accounts. The administration initially was cool to the proposal, but President Obama endorsed it—calling it the Volcker Rule—two days after the election of Scott Brown to Senator Edward Kennedy’s seat in Massachusetts suggested that populist discontent with health care reform and the bailouts of 2008 was widespread.

Elizabeth Warren

A law professor at Harvard, Elizabeth Warren is a longtime critic of the credit card industry and advocate of the interests of consumer debtors.

Prior to the recent crisis, Warren was best known as the co-author of two books based on extensive empirical studies of consumer debtors, as well as *The Two-Income Trap*. Written with Warren's daughter, *The Two-Income Trap* argues that the two-income families that emerged after women began entering the workforce in large numbers in the 1970s are actually more economically vulnerable than their predecessors, not less. In late 2008, Warren was named by Senator Harry Reid to serve as chair of the TARP Oversight Committee, which has issued regular reports on monitoring expenditures under the TARP legislation that gave Treasury \$700 billion to quell the crisis in the banking system. The proposal for a new consumer regulator was conceived by Warren, and outlined in articles she wrote in 2007 and 2008. Although Warren was the obvious choice to head the Consumer Financial Protection Bureau, it was unclear whether she could be confirmed over the opposition of Republicans and some moderate Democrats. To sidestep this impediment, President Obama named her as his assistant and as a special adviser to Treasury Secretary Geithner—and thus as de facto initial head—for the new Consumer Bureau.

Chapter 1

The Corporatist Turn in American Regulation

When President Obama signed the Dodd-Frank Act into law on July 21, 2010, he began a new epoch in financial regulation. The old epoch dated back to the early 1930s, when President Roosevelt and the New Deal Congress enacted the securities acts of 1933 and 1934, as well as banking reforms that broke up the giant Wall Street banks and put deposit insurance in place for the first time. Never again, they promised, would investors be forced to live by their critical wits in unregulated markets, or ordinary Americans lose their life savings if their bank failed.

The new legislation comes in the third year of the worst American financial crisis since the Great Depression, a crisis that was exacerbated by financial instruments and new forms of financing that were not dreamed of in that earlier era. Most Americans had never even heard of

the financial assembly line known as securitization before the collapse of major mortgage lenders like Countrywide and the more cataclysmic failures of Bear Stearns, Fannie Mae, Freddie Mac, Lehman Brothers, and American International Group (AIG). Many still don't understand just what this process is all about—other than to repeat familiar clichés about the “slicing and dicing” of mortgages—but they know that the failure to adequately regulate these innovations has figured prominently in the crisis.

After watching the government bail out Bear Stearns and AIG in 2008, and pump well over \$100 billion into Citigroup, Bank of America, and the other big banks the same year, Americans also know that the existing regulatory framework could not adequately oversee our largest financial institutions. Perhaps the best evidence of just how rickety that old regulatory structure was can be found in the best-selling books about the financial crisis. Bill Cohan's *House of Cards* showed just how little the nation's top regulators—then-Treasury Secretary Henry Paulson, Federal Reserve Chair Ben Bernanke, and then-head of the New York Federal Reserve Bank Timothy Geithner—knew about Bear Stearns's financial condition as they decided the investment bank's fate. Andrew Ross Sorkin's riveting page-turner on the crisis, *Too Big to Fail*, revealed just how unscripted and unnervingly ad hoc the decisions whether to nationalize (as with Fannie Mae and Freddie Mac), let go (as with Lehman Brothers), or bail out (as with AIG) were in the calamitous months that followed. The picture of one page from Henry Paulson's phone log in Sorkin's book is enough to make one's heart stop.¹

The Dodd-Frank Wall Street Reform and Consumer Protection Act—the Dodd-Frank Act for short—is the response to Americans' call for help, for a new regulatory framework for the twenty-first century. To understand what American financial life is likely to look like in 5, 10, or 20 years, and how regulators may respond to the next crisis, we need to understand the Dodd-Frank Act: both what it says and what it means. This, in a nutshell, is what the book you are reading is about.

The Path to Enactment

The Dodd-Frank Act got its start in March 2009, when the Department of the Treasury released a framework it called “Rules for the Regulatory Road” shortly before a major meeting of the G-20 nations. Treasury released a more complete White Paper and proposed legislative language several months later. The White Paper would provide the template for all of the major parts of the legislation that eventually passed.

Throughout the summer and fall of 2009, Treasury Secretary Tim Geithner and other defenders of the proposed legislation were hammered by critics. On the right, the emerging Tea Party movement lumped the financial reforms together with the health care legislation as evidence of the Big Government inclinations of the Obama administration, and condemned the reforms as institutionalizing the bailout policies of 2008. Many on the left were equally critical. For liberal critics, the bailouts and the proposed legislation suggested that the administration was catering to Wall Street, while doing very little to ease the suffering that the financial crisis had brought to Main Street.

In response to these criticisms, the administration tightened up portions of the legislation that could be construed as inviting bailouts. They also insisted that the legislation wouldn’t perpetuate the bailouts of the prior year. By giving regulators the power to dismantle systemically important financial institutions that were on the brink of collapse, they argued, it actually would end the use of bailouts.

The next major step toward enactment came when Congressman Barney Frank steered a version of the proposed legislation through his Financial Services Committee, and then, on December 11, 2009, through the House of Representatives.

In January 2009, the Obama administration was forced to make a major concession to populist criticism of the legislation by the stunning victory of Republican Scott Brown in the election to fill Edward Kennedy’s Senate seat in Massachusetts. Two days after Brown’s election, President Obama endorsed a proposal by former Federal Reserve Chairman Paul Volcker that would ban banks from engaging in proprietary trading—that is, trading for their own accounts. Until the