

THE POST-CRISIS AND ITS CRITICS

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Many observers believe that the government has not done enough to regulate the financial system.¹ In this essay, I consider — and reject — the claims of those who believe the government has done too much. Three post-crisis government interventions in the marketplace exemplify, I think, the way the public sector has involved itself in the private sector during the aftermath of the bailout passed by Congress at the heart of the crisis. Some view these sorts of interventions as a threat to capitalism and even as a threat to freedom itself.² They worry that the government has started to erase the distinction between public and private in finance, and argue that any continuing intervention in the sector is prone to mismanagement and politicization.³ The question I will address here is: are they right to worry?

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1. See, e.g., Arthur E. Wilmarth, Jr., *Has Wall Street Captured Washington?*, 12 U. PA. J. BUS. L. (forthcoming 2010); Simon Johnson, *The Quiet Coup*, THE ATLANTIC, May 2009, available at <http://www.theatlantic.com/doc/200905/imf-advice>.

2. I would have expected to be discussing a fourth government intervention that usually marks financial crises, but that has not yet marked this one. This is a threat to freedom—particularly the freedom of the executives of crisis firms. It is the threat of criminal prosecution, and it is the shoe that has not dropped in the aftermath of the current financial crisis. People go to jail after financial crises, even though it is hardly obvious that the singling out of a few executives for jail time is the right way to police business mismanagement. Christine Hurt, *The Undercivilization of Corporate Law*, 33 J. CORP. L. 361 (2008). The Federal Home Loan Bank Board (FHLBB)—today’s Office of Thrift Supervision (OTS)—referred 11,000 cases to the Department of Justice (DOJ) in 1987 and 1988. By 1992, there had been 1,000 convictions, and a reported conviction rate of 91%. The Government Accountability Office (GAO) concluded that, of the 26 largest thrift failures, 60% had been marred by “serious criminal activity.” The Resolution Trust Corporation (RTC) said criminal fraud was a significant contributor to the failure of 33% of its institutions. KITTY CALAVITA ET AL., *BIG MONEY CRIME: FRAUD AND POLITICS IN THE SAVING AND LOAN CRISIS* 29 (1997). Yet, during this crisis, the executives of collapsed institutions have not yet been indicted for the most part. Two BSC fund managers heavily invested in subprime were recently acquitted. And while, in light of the many ongoing investigations, it is likely that there will be prosecutions of crisis firms, it appears that this crisis will be unlike prior ones with regard to the number of executives who are prosecuted.

3. Some economists seem particularly skeptical of almost any government intervention in the marketplace, particularly those made during and before the financial crisis. For the views of four such economists from the University of Chicago (Gary Becker, Kevin Murphy, Anil Kashyap, and Steve Kaplan), the Booth School has a useful podcast.

My answer is no. I will not attempt to resolve whether the bailout “worked” in this article, or attempt to justify public interventions in private markets using bailouts — that would be a tall order.⁴ The bailout did stabilize plummeting financial markets, even if it did so at high pecuniary and other costs, but I take this initial government intervention as a given, one that affected the markets, and am particularly interested in the slow, rather than rapid, retreat from market intervention that has happened since.⁵

The bailout has led to continuing government oversight over the recipients of the funds. The ongoing presence of government in the business sector blurs the public-private distinction and evidences the government’s role in business practices in which, as recently as 2007, it would not have dreamed of overseeing. But the regulators did not ask for the roles they were given in the aftermath of the collapse of the financial markets. And as the government’s crisis response matures, its market interventions have begun to look more and more prosaic. In fact, the government has acted as any other investor might in some cases, while in others it is doing things to the financial system that it has done many times before — and that investors expect the government to do. The government’s post-crisis roles as private equity manager and insolvency cleanup specialist are the sorts of tasks that we want it to take on, at least in extraordinary times — and they are essentially the same sort of services that we would expect of vulture funds and cramdown specialists in the private sector to provide were the intervention not to have happened.

Before detailing the reasons for sanguinity about the government’s post-crisis participation in the capital markets, it is worth recognizing that there were reasons to worry about it before it took shape. The government practiced creative administrative procedure in the depths of the crisis, which, though perhaps not unlawful, undoubtedly was an example of how far regulators can push their legislative mandates.⁶ Many of the pre-

Gary Becker et al., Faculty, Chicago Booth School, The Future of Markets Panel at the 57th Annual Management Conference (May 29, 2009), <http://www.chicagobooth.edu/multimedia/podcast/?play=http://chicagobooth.edu/multimedia/audio/2009-05-29-ManConKeynote.mp3#02:07:32>. And of course, there are legal academics sympathetic to that traditional Chicago approach. See Richard Epstein, *Greed or Incentives? The Moral of the Markets Story*, FORBES, Sept. 22, 2008, http://www.forbes.com/2008/09/22/libertarian-mortgage-lease-oped-cx_re_0923epstein.html (discussing reasons for the traditional Chicago approach).

4. Scholars still do not agree if government action alleviated or exacerbated the Great Depression. Robert Whaples, *Where is There Consensus Among American Economic Historians? The Results of a Survey on Forty Propositions*, 55 J. ECON. HIST. 139 (1995), available at <http://www.jstor.org/pss/2123771>. No doubt the debate about the empirical consequences of the financial crisis bailout will rage for some time to come.

5. The risks of moral hazard associated with bailouts, for example, have long been chewed over. See *infra* note 14 (discussing such risks after bailouts).

6. Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's*

Emergency Economic Stabilization Act (EESA) steps taken by the government during the financial crisis — a forced sale of Bear Stearns, the opening of the Fed's discount window to investment banks and eventually AIG, the creation on the fly of a money market fund (MMF) insurance program by the Treasury, not to mention a number of unprecedented asset guarantee programs — were justified by stretched and creative interpretations of often broad Great Depression-era statutes, and by a turn to deals and to the Federal Reserve's ability to print money when the statutes would not serve.⁷ By relying on the Federal Reserve and the Treasury Department, the government turned to two agencies that have never been immersed in the world of administrative procedure.⁸ These agencies frequently do not follow the usual practice of notice and comment, do not often get sued by regulated industries, and have a relationship with the Federal Register, the Office of Management and Budget, and the D.C. Circuit that must make them the envy of the more closely supervised Environmental Protection Agency and Securities and Exchange Commission.⁹

The pre-legislation action by these agencies was innovative and unprecedented, both in procedure and substance — and lawyers tend to worry when agencies throw out the rulebook, as Treasury and the Fed did in the early stages of the financial crisis.¹⁰ The passage of more comprehensive legislation hardly allayed concerns about radical intervention in the economy. To be sure, the comprehensive bailout, or TARP, was authorized by Congress, which softened the legitimacy problems posed by prior emergency measures promulgated by

Response to the Financial Crisis, 61 ADMIN. L. REV. 463 (2009); Patricia A. McCoy et al., *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 493 (2009); Saule T. Omarova, *The New Crisis for the New Century: Some Observations on the "Big-Picture" Lessons of the Global Financial Crisis of 2008*, 13 N.C. BANKING INST. 157 (2009).

7. See Davidoff & Zaring, *supra* note 6 (discussing the government's response to the financial crisis).

8. Kristin E. Hickman, *A Problem of Remedy: Responding to Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 76 GEO. WASH. L. REV. 1153 (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1124576; Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's Compliance with Administrative Procedure Act Rulemaking Requirement*, 82 NOTRE DAME L. REV. 1727 (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=955929.

9. David Zaring, *Administration by Treasury*, 94 MINN. L. REV. ____ (forthcoming 2010).

10. So do economists. See Viral Acharya, David Backus, & Raghu Sundaram, *Government Money Should Have Strings Attached*, FINANCIAL TIMES, Jan. 6, 2009, <http://blogs.ft.com/economistsforum/2009/01/government-money-should-have-strings-attached/> (observing and criticizing that "[t]here is a tendency in a crisis to throw out the rulebook: we are in a unique situation, some will say, and that calls for unique measures").

unaccountable bureaucrats and applied to AIG, Bear Stearns, and the MMFs. But the TARP was also a massive and unprecedented economic intervention that delegated astonishing amounts of cash and authority to the Secretary of the Treasury.¹¹ Gary Lawson has concluded that the government's response to the financial crisis was unconstitutionally unmoored from Congressional instruction.¹² J.W. Verret has argued that the Treasury Department's interventions in the economy are alarming on a variety of policy grounds.¹³

And finally, it is worth noting — though it has not been proven in this case, I think — that turning an economic crisis into something that turns on government intervention creates its own degree of uncertainty, not to mention undesirable incentives for business. The moral hazard problems have been explored in great detail by a number of scholars.¹⁴ And John Taylor has argued that uncertainty about what the government was going to do with regard to a bailout was the cause of the collapse in the stock market in the fall of 2008, rather than market events such as the Lehman Brothers bankruptcy.¹⁵

In sum, if lawyers get paid to worry, there are plenty of reasons to worry about government intrusions in the marketplace once the markets stabilized, coming as they have on the heels of an intervention that to looked creative at best, and, to free market purists, terribly uncertain. But in this case, it is easy to worry too much, and far too many observers have

11. Steven M. Davidoff, *The 'Compromises' in the Bailout Bill*, N.Y. TIMES, Sept. 29, 2008, <http://dealbook.blogs.nytimes.com/2008/09/29/the-compromises-in-the-bailout-bill/>.

12. Gary Lawson, *Burying the Constitution Under a Trap*, 33 HARV. J.L. & PUB. POL'Y (forthcoming 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1436462.

13. J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice* (Geo. Mason L. & Econ. Research, Paper No. 09-43, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1461143.

14. See, e.g., Richard M. Hynes, *Securitization, Agency Costs, and the Subprime Crisis*, 4 VA. L. & BUS. REV. 231, 236 (2009) ("[T]he moral hazard created by the ability of lenders to shift losses to taxpayers."); Karl S. Okamoto, *After the Bailout: Regulating Systemic Moral Hazard*, 57 UCLA L. REV. 183, 183 (2009) (discussing the challenges posed by systemic moral hazard in crafting a regulatory response to the Financial Crisis); Eric A. Posner & Luigi Zingales, *A Loan Modification Approach to the Housing Crisis*, 11 AM. L. & ECON. REV. 575, 582 (2009) ("And even if the plan works as intended, it will cost taxpayers billions of dollars and potentially exacerbate moral hazard by revealing to market participants a standing government willingness to subsidize lenders and borrowers when financial crises strike."). For an informal discussion of why we should not worry so much about moral hazard during the financial crisis, see Tim Harford, *Bailouts Are Inevitable, Even Desirable*, SLATE, Oct. 4, 2008, <http://www.slate.com/id/2201343/>.

15. *Too Big To Fail: The Role for Bankruptcy and Antitrust Law in Financial Regulation Reform: Hearing Before the Subcomm. On Commercial and Administrative Law of the H. Comm. On the Judiciary*, 111th Cong. (2009) (statement of John B. Taylor, Stanford University), available at <http://judiciary.house.gov/hearings/pdf/Taylor091022.pdf>.

been doing exactly that.¹⁶ To understand why I have more equanimity than some about the ongoing oversight, I would like to look at three of the most dramatic ways that the government has been intervening in business, and explain why things are not quite as bad as some fear. The record has important implications for public choice and other skeptical theories of regulation. Rather than reflexively critiquing every government intervention in the market, if government organizations look like other market participants and organizations – like financial intermediaries, venture capital funds, and the like – then the case for concern is much less serious

To support this inference, we must take the worst (while nonetheless exemplary) cases, and carefully consider whether they represent overweening government intervention in private ordering. I first consider the government's regulation of executive compensation, in particular the executive compensation rules imposed by Kenneth Feinberg, the so-called "TARP Compensation Czar."¹⁷ Second, I consider the investment management practiced by the government of its stakes in bailed out firms. In particular, I examine the stakes it has been willing to sell back to firms, but that it has not given up as quickly as it possibly could. Finally, I consider the slightly different exercise of government power posed by resolution authority, under which the government seizes, with very little process, banks or thrifts that it deems to be insolvent. None of my reviews of these actions are meant to be comprehensive. For the purposes of this article, the goal is not only to understand what the government did, but also to understand why it fails to represent a blow to the heart of capitalism.

I. EXECUTIVE COMPENSATION

Some have argued that the government should regulate banker pay,¹⁸

16. See Posting of David Zaring to The Conglomerate, *It's The Market Too, Buddy*, <http://www.theconglomerate.org/2009/12/dont-forget-the-market-failures-that-caused-the-financial-crisis.html> (Dec. 3, 2009) (noting that much of the financial crisis commentary has focused on identifying the ways that the government policy precipitated each and every one of the problems).

17. See Deborah Solomon, *White House Set to Appoint a Pay Czar*, WALL ST. J., June 5, 2009, at A2, available at <http://online.wsj.com/article/SB124416737421887739.html> (reporting on the planned appointment of Kenneth Feinberg as a "Special Master for Compensation" to ensure that companies receiving federal bailout funds are abiding by executive-pay guidelines). For a discussion of Feinberg's ad hoc position as compensation czar, see his testimony to the House Financial Services Committee. Press Release, Special Master for TARP Executive Compensation Kenneth R. Feinberg Testimony Before the House Committee on Oversight and Government Reform (Oct. 28, 2009), available at <http://www.ustreas.gov/press/releases/tg334.htm>.

18. See Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 250-51 (2010) (discussing how pay regulation can complement and reinforce the

but many others view the public oversight of private compensation arrangements as very problematic.¹⁹ Compensation is a relationship between parties that have every incentive to press their interests. Should we be in the business of regulating executive compensation, and if so, exactly what sort of salaries or paydays should we intervene in? And so on.

The government has not regulated executive compensation at private firms much in the past; after the bailout it has done so for the largest recipients of TARP funds. But it has done so by asking Kenneth Feinberg, dubbed the so-called “TARP Compensation Czar” and a respected Washington lawyer, to examine the pay packages of senior executives of those companies that received extraordinary assistance from the government.²⁰ Feinberg engaged in a lengthy, executive-by-executive negotiated process to set compensation at these companies. Although the precise details of specific compensation packages are not easy to come by, the broad outlines have been widely publicized.²¹ The Feinberg process cut cash compensation for executives at affected firms, on average by 50%, and generally resulted in an average cash compensation of not more than \$500,000 per executive — a substantial payday, but less than many of the

traditional forms of financial regulation).

19. See, e.g., William W. Bratton, *The Academic Tournament Over Executive Compensation*, 93 CAL. L. REV. 1557, 1559 (2005) (providing an overview of the literature on executive pay); John E. Core, Wayne R. Guay, & Randall S. Thomas, *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142, 1144 (2005) (suggesting that it is not clear that there are systematic failures in U.S. executive compensation); Obama to Slash Exec Pay at Bailout Firms, Professor Bainbridge.com, <http://www.professorbainbridge.com/professorbainbridge.com/2009/10/obama-to-slash-exec-pay-at-bailout-firms.html> (Oct. 21, 2009) (commenting that by regulation executive compensation the Obama administration has shown a shocking disregard for the rule of law and contract rights); The Stupid Bailout Pay Caps, Ideoblog, <http://busmovie.typepad.com/ideoblog/2009/02/the-stupid-bailout-pay-caps.html> (Feb. 4, 2009, 10:59 AM) (remarking that the proposed pay caps are “blindingly stupid” and threaten to impede economic recovery). For an interesting overview of an earlier fight about regulating executive compensation of publically traded companies, see Harwell Wells, “No Man Can Be Worth \$1,000,000 A Year”: *The Fight Over Executive Compensation in 1930s America*, 44 U. RICH. L. REV. 689 (2010) (discussing the history of fights over executive pay).

20. Feinberg won plaudits for his handling of the compensation for the victims of the 9/11 attacks. For a recent profile, see Elizabeth Kolbert, *The Calculator*, THE NEW YORKER, Nov. 25, 2002, at 42, available at http://www.newyorker.com/archive/2002/11/25/021125fa_fact (profiling Kenneth Feinberg and his role as the Special Master of the Victim Compensation Fund after 9/11); see also Frances Romero, *Biography of Kenneth Feinberg Compensation Czar*, TIME, Oct. 23, 2009, <http://www.time.com/time/nation/article/0,8599,1903547,00.html> (collecting facts and quotations about Kenneth Feinberg).

21. Deborah Solomon & Aaron Lucchetti, *Got TARP? If So, Pay Czar Plans Compensation Review*, WALL ST. J., Mar. 23, 2010, at C1.

affected were used to getting.²² Feinberg also eliminated many of the perks that corporate executives enjoy, such as corporate jet travel and country club memberships. However, he often permitted deferred stock compensation in excess of cash, which, of course, raised salaries commensurately.²³

Perhaps even more portentously, the Fed has announced that it would also review compensation practices at institutions that it regulated—a potentially very broad commitment indeed, given that the Fed supervises the largest and most important banks through its oversight of holding companies.²⁴ But while a Pay Czar and Federal Reserve review might look like a striking post-crisis intervention in free employment markets, there is less to the Feinberg pay regulation than meets the eye, while the Fed's efforts have been cautious indeed.

As of this writing, it is too soon to know what the Fed will do, or indeed, whether it will do anything. It is also important to remember what the TARP pay oversight was not. The TARP Pay Czar process was set up not to try to pass definitive rules about bonuses, but to delegate the making of particularized bonus determinations to a part-time mediator for a brief job that would be eliminated once the TARP recipients paid back their money. The ostensible reason for this delegation laid in the care that had to be taken when regulating executive compensation.²⁵ The Pay Czar could tailor specific compensation plans to the specific business plans of the government charges.²⁶ He could pay AIG executives in ways that would incentivize the winding up of the firm at the best terms for the government.

22. Press Release, U.S. Dep't of the Treasury, Interim Final Rule on TARP Standards for Compensation & Corporate Governance (July 1, 2009), available at http://www.financialstability.gov/latest/tg_0609b2009.html.

23. *Id.*; see also Stephen Labaton, *U.S. Will Order Pay Cuts At Firms With Bailout Aid*, N.Y. TIMES, Oct. 22, 2009, at A1, available at http://www.nytimes.com/2009/10/22/business/22pay.html?_r=3&hp (discussing how Feinberg's plan places tight limits on pay and perks, as well as changes the form of pay to align the personal interests of executives with the longer-term financial health of the companies).

24. See Press Release, Board of Governors of the Federal Reserve System, Federal Reserve Issues Proposed Guidance on Incentive Compensation (Oct. 22, 2009), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20091022a.htm> ("The Federal Reserve Board on Thursday issued a proposal designed to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of their organizations.").

25. Deborah Solomon, *Pay Czar Gets Broad Authority over Executive Compensation*, WALL ST. J., June 11, 2009, at A4.

26. See Podcast: Regulating Executive Compensation: Ought There to be a Law? (Princeton University, Woodrow Wilson School of Public and International Affairs Sept. 29, 2009), available at <http://uc.princeton.edu/main/index.php/home-mainmenu-1/28-all-videos/5003-regulating-executive-compensation-ought-there-to-be-a-law> [hereinafter Regulating Executive Compensation Podcast] (discussing powers of TARP Pay Czar).

He might take a different approach to Citibank executives, who were arguably expected to participate in the sort of lending that could help bring the country out of an economic crisis.

But that justification for particularized pay packages is not at all inconsistent with the possibility that the government was not that interested in making broad and general statements about appropriate executive compensation. By delegating the compensation question to Feinberg, the government made it possible for executives at most bailed out institutions to receive paydays that were not incommensurate with the paydays they were getting before they needed government assistance, only with deferred stock in the place of cash, and with far fewer perks.

I also find perk regulation to be modest regulation indeed. It has always been politically popular to go after country club memberships, limousines or company cars, and so on, and the TARP Pay Czar did all those things. But of course, the regulation of perks for certain executives probably amounted to something in the low millions of dollars worth of government oversight—a modest regulatory imposition, though it certainly sounded good in newspaper headlines.²⁷

Moreover, the focus of the compensation limits was to change cash compensation to deferred stock compensation. Again, this is hardly command and control compensation regulation; it leaves the level of compensation up to the company, but regulates the type of pay executives receive, at least as practiced in the bailout. Moreover, deferred stock is a method of payment beloved by many economists because it aligns the short-term incentives of executives and workers at firms with the longer-term incentives of the shareholders who own the firms.²⁸ Investment banks have increasingly implemented deferred compensation arrangements for their own executives.²⁹

Finally, it is also worth remembering that the TARP Czar's compensation only applied to seven recipients of particularly extraordinary government largesse, including AIG, Citigroup, Bank of America,

27. The New York Times article regarding the pay czar's regulation of executive compensation appeared as the paper's lead business story on October 13, 2009. Mary Williams Walsh, *U.S. Pay Czar Tries Again to Trim A.I.G. Bonuses*, N.Y. TIMES, Oct. 13, 2009, at B1. See also Labaton, *supra* note 23 (discussing the effect of the regulation plan).

28. See Faqs.org, Abstracts: Stock and compensation; Agency Costs, Risk Management, and Capital Structure; Agency, Delayed Compensation, and the Structure of Executive Remuneration, <http://www.faqs.org/abstracts/Business/Stock-and-compensation-Agency-costs-risk-management-and-capital-structure.html> (last visited Mar. 23, 2010) (collecting articles analyzing deferred compensation arrangements).

29. See The Epicurean Dealmaker, *Nature Red in Tooth and Claw: Part II*, <http://epicureandealmaker.blogspot.com/2009/09/nature-red-in-tooth-and-claw-part-ii.html> (Sept. 25, 2009 17:39 PM). Of course, investment banks and other financial intermediaries also use these packages to create handcuffs to keep executives with the firm and prevent them from leaving for competitors.

Chrysler, GM, GMAC, and Chrysler Financial.³⁰ Thus, regardless of the drama surrounding the idea of the government regulating executive compensation, only a few firms have ever had to deal with it, and then only on a one-time basis for as long as they remain under government supervision. Two of these seven firms, Citigroup and Bank of America, were the first to get out of government supervision, while the rest have been following as fast as they can.³¹

Executive compensation regulation so far has proceeded by model, rather than by fiat.³² The government has hoped that its approach might inspire financial intermediaries to take similar approaches to the way that they compensate their own executives.³³ Regulation by model is a modest way of enacting compensation regulation, and whether one concludes that it is a good or bad thing, its voluntariness makes it difficult to conclude that it is an overweening thing.

In sum, the government's executive compensation regulation after the financial crisis has been of a sort that most principal-agent theorists endorse (and that investment banks themselves practice), that affected very few financial intermediaries, and that is short in duration. It is a light touch example of government regulation that neither looks severe, broad, nor even a very bad idea.

II. INVESTMENT MANAGEMENT BY GOVERNMENT SUPERVISORS

After appropriating money for a systematic bailout, the government took stock in a number of financial and auto companies. It has not divested its holdings as fast as it possibly could. There are a number of essentially nationalized firms that would have failed during the crisis had it not been for an injection of government funds—either in the form of debt guarantees or equity. These firms included Fannie Mae, Freddie Mac, AIG, Chrysler,

30. *Pay Czar Issues More Rulings on TARP Execs*, ABC NEWS/MONEY, Apr. 16, 2010, <http://abcnews.go.com/Business/wireStory?id=10395489>; Press Release, U.S. Dept. of the Treasury, Kenneth R. Feinberg, Special Master for TARP Executive Compensation, Written Testimony before the House Financial Services Committee (Feb. 25, 2010), <http://www.ustreas.gov/press/releases/tg565.htm>.

31. Special Master for TARP Executive Compensation, Written Testimony before the House Financial Services Committee (Feb. 25, 2010), <http://www.ustreas.gov/press/releases/tg565.htm>.

32. See Regulating Executive Compensation Podcast, *supra* note 26 (discussing actions of TARP Pay Czar).

33. Richard Squire, *Shareholder Opportunism in a World of Risky Debt*, 123 HARV. L. REV. 1151, 1201 (2010) (“Although the pay czar has formal jurisdiction over only a handful of bailout recipients such as AIG and General Motors, the Obama Administration has expressed a hope that other firms will treat his approach as a “best practice” that they too should follow.”).

and General Motors.³⁴ The government has made it clear that its ownership stake in these and other firms may last for years, not months.

Moreover, although many of the largest banks have already repaid their TARP funds, many other smaller institutions continue to retain their government investments, which took a form between debt and equity, and included preferred stock.³⁵ The banking sector bounced back quickly in 2009; why does had the government continued to hold shares in these intermediaries after that year has ended?

This has always been a country in which there are very few nationalized government industries or institutions. There has been a fear that politics could play a role in the decisions made by partly nationalized auto companies, insurance companies, and mortgage guarantors. Moreover, there has been some evidence in the past that there may be some reason to worry that Fannie Mae and Freddie Mac, for example, may have made some of the lending decisions they made because they were strongly encouraged to do so by Congress.³⁶ Government ownership of these companies could, in theory, make the politicization of resource allocation hard to resist.

Should we worry about this government imposition into the private sector? I am sanguine. There has not been much evidence that the government has been politicizing its ownership of financial institutions.³⁷

34. Hollis Colquhoun, *Treasury Announces 2010 Guidelines for TARP Executive Pay*, TECHNORATI, Apr. 20, 2010, <http://technorati.com/business/article/treasury-announces-2010-guidelines-for-tarp/>

35. ProPublica, *Eye on the Bailout, Bailout Timeline: Another Day, Another Bailout*, <http://bailout.propublica.org/main/timeline/index> (last visited May 9, 2010) (tracking the disbursement and payment of bailouts on a daily basis). Preferred stock, because it has a claim on the assets of the firm ahead of common stock, but is not precisely identical to a bond or a loan, occupies a nebulous position between debt and equity. Anthony P. Polito, *A Modest Proposal Regarding Debt-Like Preferred Stock*, 20 VA. TAX REV. 291, 292-93 (2000) (“Preferred stock, it goes without saying, rests at some intermediate point between corporate debt and common stock along the spectrum of corporate financing. Common stock represents the ‘real’ equity of a corporation, whereas preferred stock typically lacks many of the indicia of paradigmatic equity (lacking both voting rights and unlimited potential for gain, but having dividend and liquidation preferences)”).

36. See Podcast: Chicago Booth Podcast: The Future of Markets, held by the University of Chicago Booth School of Business (June 29, 2009), <http://www.chicagobooth.edu/multimedia/podcast/?play=http://chicagobooth.edu/multimedia/audio/2009-05-29-ManConKeynote.mp3#02:07:32> (discussing possible congressional influence on Fannie Mae and Freddie Mac).

37. The auto companies may be somewhat different; for example, the government has replaced one CEO of GM. See Mike Allen & Josh Gerstein, *GM CEO Resigns at Obama's Behest*, POLITICO, Mar. 29, 2009, <http://www.politico.com/news/stories/0309/20625.html>. But it may not be so different; for example, the administration has not expressly interfered with the business plans of GM and Chrysler, and the President said that he has better things to do than run auto companies. Posting of Brian Montopoli to Political Hotsheet, Obama: We Don't Want To Run GM,

Regarding financial intermediaries, the government has urged banks to lend, but when they have not done so, it has not conditioned TARP repayments, tried to vote its stock, or participated in the management of the companies in order to encourage lending. There is no sign that the government has instructed the automakers to sell particular cars, or instructed AIG on which units it should divest.

Instead, I suspect the model for how the government has managed its new investments is at least no different from, and possibly more modest than that of other private investors. We might even expect a private equity vulture investor to interfere more in the management of a desperate company in which it has taken a saving stake.³⁸ Indeed, many of the things the government can do by regulation, investors can do by contract. Investors can — and often do — change the way the executives of the firm are compensated, for example, more strictly than has the government. They might order the sale of lines of businesses (the government apparently has not), loot the company by ordering large dividend or debt repayments (again, no evidence of this), and so on.

Thus, one question is whether we ought to worry so much about what the government might do, given that the private sector is not so constricted. Private investors sometimes drive hard bargains, and exercise life or death power over distressed businesses that are in no position to cavil. If we permit that kind of intervention to happen in the private sector, the question is whether we should treat the government, when it invests, any differently.

Furthermore, to the extent the government has generally acted as a silent partner even while retaining its stake longer than strictly necessary, it has followed the playbook that sensible private investors might employ in order to maximize their return. Fire sales are not usually sales at the best price. Nor is the fact that the government has not exited immediately anything new in the history of its oversight of insolvent institutions. The FDIC has often held on longer than absolutely necessary to stakes in banks it takes over.³⁹ Given the modesty of supervision by the government-as-investors, and the precedent offered by government investments in failing financial intermediaries in the past through the FDIC, it is difficult to conclude that the lingering aftermath of the bailout should strike us as particularly troubling.

<http://www.cbsnews.com/blogs/2009/06/01/politics/politicalhotsheet/entry5054616.shtml>
(June 1, 2009, 12:56 PM).

38. See William A. Birdthistle & M. Todd Henderson, *One Hat Too Many? Investment Desegregation in Private Equity*, 76 U. CHI. L. REV. 45 (2009) (discussing vulture investing).

39. See 12 U.S.C. § 1813(i)(2006) (defining “new bank” and “bridge bank”).

III. RESOLUTION AUTHORITY

“Resolution authority” is the polite term for seizing failing banks and thrifts, and either shutting them down or selling them off for the best possible price.⁴⁰ Either way, when the government resolves a financial institution, it essentially nationalizes it, but in ways that the depositors rarely notice—at least not immediately. Banks tend to fail on Fridays and on Monday are open under new management, usually with new signs on the door and with the same old depositors in the books, entirely intact.⁴¹ During the financial crisis, hundreds of banks and thrifts failed in this way, and were then subjected to the tender care of the FDIC.⁴²

In Europe, the prospect of resolution authority is something that people worry about.⁴³ They ask, as we might ask: what if the government seizes a bank that actually has some going concern value, wipes out the shareholders, pays them nothing, and does so on a whim, without any process? What kind of remedies and controls should we exercise over the government before it does so?

There were very few controls over some of the resolutions that happened during the crisis. In addition to the FDIC seizures, the government also employed a sort of cajoling “wink and nudge” resolution authority by forcing sales of a number of institutions (notably Wachovia and Bear Stearns) without bothering to go through the limited administrative process required before seizing them.⁴⁴ In the case of Bear Stearns, the forced sale came at a very low share price, essentially wiping out the shareholders.⁴⁵ So the European worry about uncontrolled resolution authority might seem to be a pertinent one.

Resolution authority is, indeed, a strong government power, exercised broadly and widely during the crisis. And it can be improved.⁴⁶ But even

40. Press Release, U.S. Dept. of the Treasury, Treasury Proposes Legislation for Resolution Authority (Mar. 25, 2009), <http://www.ustreas.gov/press/releases/tg70.htm>.

41. Paul Kiel, *Bank Failure Friday: Nine Banks, One Big Failure*, PROPUBLICA, Oct. 31, 2009, <http://www.propublica.org/ion/bailout/item/bank-failure-friday-nine-banks-one-big-failure-1031>.

42. See ProPublica, Failed Banks List, <http://projects.propublica.org/tables/failed-banks/> (last visited Mar. 20, 2010) (charting failed banks); Federal Deposit Insurance Corporation, Failed Banks List, <http://www.fdic.gov/bank/individual/failed/banklist.html> (last visited Mar. 20, 2010) (collecting list of banks that have failed since Oct. 1, 2000).

43. For the European perspective, see Apanard Angkinand & Clas Wihlborg, *Bank Insolvency Procedures and Market Discipline in European Banking*, (Ctr. for Law, Econ. & Fin. Insts. at Copenhagen Business Sch., Working Paper 2005-2006), *available* *at* <http://openarchive.cbs.dk/bitstream/handle/10398/6798/wplefic062005.pdf?sequence=1>.

44. Davidoff & Zaring, *supra* note 6.

45. *Id.*

46. Additional checks on the government are needed, both before and after the decision,

without reform, is resolution authority a sign that the government is unwilling to let private markets work? It is not without precedent. The FDIC and state banking regulators have been closing insolvent institutions for years, and the constitutionality of resolution authority has been upheld time and again.⁴⁷ Moreover, the ability of the government to swoop in and seize an insolvent institution is not the end of the story. For example, the government both resolved and bailed out Fannie Mae and Freddie Mac, zeroing out their shareholders, but paying their creditors 100 cents on the dollar – in that case, the nationalization treated some stakeholders very well. Moreover, private sector insolvencies are hardly immune from fast and brutal workouts and cramdowns.⁴⁸

Moreover, resolution authority's long pedigree is due to the sense that it is the flip side of a good deal for private investors. One of the reasons why banks and thrifts (and their stocks) have done so well over the last few years is because they have federal deposit insurance. When investors take shares in banks or thrifts, they not only get cheap money in the form of the depositor's note, they have the protection of the FDIC, which makes it even cheaper. It is not unreasonable then that the advantages of owning an institution like a bank or a thrift should come with some costs. After all, this is a regulated industry, and one of those costs is that the owner must submit to the possibility of resolution authority.

In addition, while resolution authority is a dramatic government action, the government rarely uses it outside of financial crises, so it is not as if there has been any tradition of government nationalization run amok.⁴⁹ While hundreds of institutions have been resolved during the past several decades, the vast majority of these occurred during the savings and loan crisis of the 1980's, or during the present crisis.⁵⁰ In between the end of the

to nationalize a financial institution. I would propose making a list of potentially nationalizable institutions public ex ante, and then ex post permitting the owners of the seized institutions a brief window in which they could buy their institutions back from the government with whatever resources they can obtain. This proposal would add both a process check and a market check to this most severe form of decision-making. These pre-deprivation and post-deprivation proposals would alleviate the constitutional problems presented by enhanced resolution authority and would help to ensure that the resolution process is used accurately, and where needed. David Zaring, *A Lack of Resolution*, 60 EMORY L.J. (forthcoming 2010).

47. See generally Christopher T. Curtis, *The Takings Clause and Regulatory Takeovers of Banks and Thrifts*, 27 HARV. J. ON LEGIS. 376 (1990) (discussing the compensation required by the Takings Clause during government takeovers of banks); *FDIC v. Mallen*, 486 U.S. 230 (1968) (analyzing due process).

48. For an overview of the insolvency regime, see Carol J. Perry, Note, *Rethinking Fannie and Freddie's New Insolvency Regime*, 109 COLUM. L. REV. 1752 (2009).

49. CONGRESSIONAL OVERSIGHT PANEL, DECEMBER OVERSIGHT REPORT: TAKING STOCK: WHAT HAS THE TROUBLED ASSET RELIEF FUND ACHIEVED 45 (2009), available at cop.senate.gov/documents/cop-120909-report.pdf.

50. *Id.*

savings and loan crisis in 1992 and the peak of the current crisis in 2008 however, the federal government used its authority almost never.⁵¹ In short, while resolution authority is real government intervention in the private marketplace, there is no worrisome trend, it arguably constitutes a fair bargain for investors in a regulated industry when paired with deposit insurance, and making it better is attainable, as I argue elsewhere.⁵²

IV. CONCLUSION

I have attempted to present the “worst,” albeit real and emblematic, cases of public involvement in the private sector after the bailout. If you do not recoil at these interventions, you may safely assume that post-bailout government — where it is extricating itself from the financial sector slowly, where it is cautiously and minimally regulating executive compensation by example, and where at some points it is swooping in and seizing institutions that it deems to be insolvent—is not an example of a death of capitalism or even an example of the inefficiency of regulation.

Indeed, I think an alternative approach by the government might look *more* inefficient. It would be inefficient for the government to sell its stakes in these financial institutions at the first opportunity. The fast bankruptcies offered by resolution authority are efficient ways to resolve financial institutions as quickly as possible and with relatively little inconvenience to the contagion-prone financial sector; counterparties and correlated intermediaries would prefer a government with resolution power to one with only recourse to clumsy bankruptcy.⁵³ Moreover, few firms are unfamiliar with the concept of a workout or a cramdown. While executive compensation regulation is potentially serious, what the government has implemented — largely tailored packages of deferred stock designed to lead by example — is the kind of thing that banks, investment banks, and private equity firms increasingly do themselves,⁵⁴ and is both modest and

51. *Id.* The government has tended to fail institutions when times are bad, such as in the 1980s and during the current financial crisis, but not when they are good; the agency’s resolution authority bureau all but closed up shop between 1995 and 2005, in two of those years failing no institutions at all, and over the decade failing fewer than it did in the year 1993 alone. For a list of resolutions done by the FDIC over the past thirty years, see Federal Deposit Insurance Corporation, Failures and Assistance Transactions, <http://www2.fdic.gov/hsob/HSOBSummaryRpt.asp?BegYear=2010&EndYear=1980&State=1> (last visited Feb. 7, 2010).

52. Zaring, *supra* note 46.

53. Zaring, *supra* note 46.

54. Most of the most senior executives of investment banks in 2009 took home most of their pay in deferred stock. Christine Harper and Michael J. Moore, *Goldman Sachs’s Blankfein Receives \$9 Million Bonus for 2009*, BLOOMBERG, Feb. 6, 2010, <http://www.bloomberg.com/apps/news?pid=20601108&sid=atcUs6E1p6ck>. This concept is not new to investment banking.

perceived to be a useful (and even efficient) method for control and incentivization of corporate executives.⁵⁵

One way to think about government interventions in the post-crisis financial markets is to ask: what would private investors do? Would they wait to sell quickly? Are they willing to embrace the possibility of a cramdown? Do they want to align the incentives of management with their own longer-term incentives? I think the answer to all of these questions is yes. The difference between those investors and the kinds of investment and other involvements by the government in financial institutions can easily be overstated. It has never been clear whether government bureaucrats are so different than large corporate bureaucrats, in both their daily incentives (such as promotion and the ability to go home at a reasonable hour), and in the lives they lead as organizational people. There is an old saw that Washington is Hollywood for ugly people.⁵⁶ If that is true, then perhaps we should not worry if government officials act the way that private businesses – such as Hollywood – might in their only somewhat new engaged role in the financial sector.

55. John C. Coffee, Jr., *Shareholders Versus Managers: The Strain In The Corporate Web*, 85 MICH. L. REV. 1, 75 (1986) (“[T]he use of deferred compensation reduces the incentive for the manager to shirk or consume excessive perquisites and makes it possible to factor into the amount of compensation information not currently available (such as the eventual success or failure of a long-term research or marketing project.”).

56. Wonkette, [Blank] for [Blank] People, <http://wonkette.com/114667/blank-for-blank-people> (July 27, 2005, 20:06 PM) (noting that comedians have long stated Washington is “Hollywood for ugly people”).