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Discretion to Act: How the Federal Reserve's Decisions Whether to Provide Emergency Loans During the Financial Crisis Were Discretionary and Why Dodd-Frank Falls Short of Preventing Future Bailouts

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DISCRETION TO ACT: HOW THE FEDERAL RESERVE'S DECISIONS WHETHER TO PROVIDE EMERGENCY LOANS DURING THE FINANCIAL CRISIS WERE DISCRETIONARY AND WHY DODD–FRANK FALLS SHORT OF PREVENTING FUTURE BAILOUTS

JOHN DE VITO*

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I. INTRODUCTION

In September of 2008, following the collapse of the American housing market, Lehman Brothers Holdings, Inc. (Lehman) was facing almost certain bankruptcy.[1] Its stock price tumbled from $65.73 per share in January to under $4 per share in September—losing 94% of its value.[2] On the weekend of September 12, 2008, Treasury Secretary Henry Paulson, Federal Reserve Bank of New York President Timothy Geithner, SEC Chairman Christopher Cox, and executives from large financial institutions came together to devise a solution that would avoid the potentially disastrous effects of a Lehman bankruptcy.[3] Barclays Capital, Inc. (Barclays) negotiated a tentative deal with Lehman for a private takeover.[4] However, the United Kingdom's bank regulator, the Financial Services Authority (FSA), refused to waive Barclays' shareholder approval requirements for such a large transaction, so the deal ultimately fell apart.[5]

Because Lehman proved unable to secure sufficient capital on the open market to avoid bankruptcy, that weekend Secretary Paulson, President Geithner, and Chairman Cox also discussed the possibility of the Federal Reserve making a direct capital investment in Lehman, coupled with emergency loans.[6] Pursuant to section 13(3) of the Federal Reserve Act, the Federal Reserve is authorized to provide emergency loans to private companies as a lender of last resort in "unusual and exigent circumstances."[7] According to figures provided by former Federal Reserve Chairman Alan Greenspan in 2010, Lehman would have needed an investment of approximately $80.1 billion in capital to survive.[8] However, the government concluded that it did not have authority

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[1] *See* Report of Anton R. Valukas, Examiner at 2, *In re* Lehman Bros. Holdings Inc., 445 B.R. 143 (Bankr. S.D.N.Y. 2011) (No. 08-13555), *https://jenner.com/lehman* [hereinafter Bankruptcy Examiner's Report].

[2] *See id.*

[3] *See id.* at 11.

[4] *See id.* at 12.

[5] *See id.*

[6] *See id.* at 11–12.

[7] Federal Reserve Act § 13(3), 12 U.S.C. § 343 (2006).

[8] *See Subprime Lending and Securitization and Government-Sponsored Enterprises: Hearing Before the Financial Crisis Inquiry Commission*, 111th Cong. (2010), http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0407-Greenspan.pdf (last visited Apr. 4, 2017) (testimony of Alan Greenspan, former Chairman, Board of Governors of the Federal Reserve System) ("[W]ith 15% tangible equity capital, neither Bear Sterns nor Lehman Brothers would have been in trouble."); Shahien Nasiripour, *Greenspan Testifies To Financial Crisis Commission, Blames Fannie, Freddie For Subprime Crisis*, HUFFINGTON POST, (June 7, 2010), http://www.huffingtonpost.com/2010/04/07/greenspan-to-financial-cr_n_528147.html (last visited Apr. 4, 2017) (calculating that "15% tangible equity" capital would have equated to $80.1 billion for Lehman).

pursuant to section 13(3) of the Federal Reserve Act because Lehman did not have sufficient collateral to provide a guarantee for any emergency loans.[9] On September 15, 2008, Lehman filed for bankruptcy.[10]

A few days later, American International Group, Inc. ("AIG"), unlike Lehman, was provided with emergency loans that saved it from bankruptcy.[11] In September of 2008, following the collapse of the housing market, AIG was unable to secure capital on the open market to help it avoid bankruptcy.[12] AIG's Board of Directors sought an $85 billion loan from the Federal Reserve Board of Governors.[13] The Federal Reserve Bank of New York (FRBNY) provided the loan to AIG, pursuant to section 13(3) as a "lender of last resort"[14] in "unusual and exigent circumstances."[15] The FRBNY and the Treasury Department ultimately provided AIG with loans totaling $182 billion from September 2008 to April 2009.[16] The FRBNY and Treasury Department secured its loans to AIG with AIG's assets.[17]

To summarize, the Federal Reserve activated its emergency lending power pursuant to section 13(3) of the Federal Reserve Act to provide emergency loans to AIG, saving AIG from bankruptcy,[18] but concluded that Lehman was ineligible for emergency loans, sending Lehman to bankruptcy.[19] The Federal Reserve concluded that AIG had sufficient assets to securitize $182 billion in emergency loans, while simultaneously concluding that Lehman did not have sufficient assets to securitize $80.1 billion in emergency loans. These conclusions, on their face, seem difficult to reconcile and call into question the degree of discretion awarded to the Federal Reserve during the financial crisis in providing emergency loans pursuant to section 13(3).

This Comment has two objectives. The first is to bring attention to the wide discretion the Federal Reserve had during the financial crisis in issuing emergency loans pursuant to section 13(3) of the Federal Reserve Act. The second is to analyze whether the Wall Street Reform and Consumer Protection Act

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[9] Bankruptcy Examiner's Report, *supra* note 1, at 11–12.

[10] *Id.* at 13; *see also* Bankruptcy Examiner's Report, supra note 1, at 143.

[11] *See* Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 430–431 (2015).

[12] *Id.* at 442.

[13] *See id.* at 430.

[14] *Id.* at 434.

[15] *Id.* (citing Federal Reserve Act § 13(3), 12 U.S.C. § 343 (2006) (amended 2010) (internal quotations omitted)).

[16] Sewell Chan, *Bernanke Wants an Audit of Fed's Bailout of AIG*, N.Y. TIMES, (Jan. 19, 2010), http://www.nytimes.com/2010/01/20/business/economy/20fed.html?_r=0.

[17] *Id.*

[18] *See Starr*, 121 Fed. Cl. at 466.

[19] Bankruptcy Examiner's Report, *supra* note 1, at 11–12.

of 2009 (Dodd–Frank) diminished the amount of discretion awarded to the Federal Reserve in issuing emergency loans in the future.

Part II A of this Comment shares a history of the Federal Reserve and its emergency lending powers pursuant to section 13(3). Part III A examines the decision-making process that the Federal Reserve followed during the financial crisis when it decided to issue emergency loans to Bear Stearns and AIG but not to Lehman. Part III B discusses how Dodd–Frank impacted the Federal Reserve's decision-making process, particularly whether Dodd–Frank diminished the level of discretion the Federal Reserve has in issuing emergency loans.

II. BACKGROUND

This section will discuss the history of the Federal Reserve and its emergency lending powers pursuant to section 13(3) of the Federal Reserve Act. It will then look at how section 13(3) was, and was not, used during the financial crisis.

A. The Federal Reserve

Congress established the Federal Reserve in 1913, pursuant to the Federal Reserve Act, to create a central bank that would "establish a more effective supervision of banking in the United States."[20] This was in response to a period of financial panics, bank runs, and a lack of available credit that threatened to destabilize the U.S. economy.[21] To account for these threats, the Federal Reserve "[c]onduct[s] the nation's monetary policy . . . supervis[es] and regulat[es] banks . . . and contain[s] systemic risk."[22] The Federal Reserve's role in banking and in supervising the U.S. economy has grown during the past century, taking on responsibilities for lending, regulating, policymaking, and advising Congress.[23]

1. The Federal Reserve's Emergency Lending Powers: Before the Financial Crisis

The Federal Reserve's powers are detailed in section 13 of the Federal Re-

[20] The Federal Reserve Act, Pub. L. No. 43, 38 Stat. 251 (codified as amended in 12 U.S.C. 221 et seq.).

[21] *See The Federal Reserve System in Brief*, FED. RESERVE BANK S.F., http://www.frbsf.org/education/teacher-resources/what-is-the-fed/history (last visited April 13, 2017).

[22] *What is the Purpose of the Federal Reserve System?*, BD. GOVERNORS FED. RESERVE SYS., https://www.federalreserve.gov/faqs/about_12594.htm (last updated Nov. 3, 2016).

[23] *See* Federal Reserve Bank of San Francisco, *supra* note 21.

serve Act.[24] The Federal Reserve's power to make emergency loans was conferred during the Great Depression, when Congress passed the Emergency Relief and Construction Act of 1932 (ERCA).[25] The ERCA amended section 13 of the Federal Reserve Act to provide the Federal Reserve with the authority to make emergency loans.[26] The Federal Reserve's power to make emergency loans is enumerated in section 13(3) of the Federal Reserve Act and this power is the focus of this Comment.[27] The text of section 13(3), in pertinent part, reads as follows:

> In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 357 of this title, to discount for any participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal reserve bank: *Provided,* That before discounting any such note, draft, or bill of exchange, the Federal reserve bank shall obtain evidence that such participant in any program or facility with broad-based eligibility is unable to secure adequate credit accommodations from other banking institutions. All such discounts for any participant in any program or facility with broad-based eligibility shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.[28]

The key elements of section 13(3) require that, prior to any issuance of emergency loans, (a) there be unusual and exigent circumstances, (b) there be evidence that the debtor is unable to secure credit accommodations on the open market, and (c) any debt issued is "secured to the satisfaction of the Federal reserve bank."[29]

Prior to 2008, the Federal Reserve Board of Governors rarely found these elements to be satisfied.[30] During the Depression, the Federal Reserve made emergency loans to 123 entities, totaling $1.5 million, and "did not actually make any further loans until 2008" during the financial crisis.[31] The few instances where the Federal Reserve did find the elements of section 13(3) to be

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[24] *See* Federal Reserve Act § 13(3), 12 U.S.C. §§ 341–47 (2006) (amended 2010).

[25] *See* Emergency Relief and Construction Act of 1932, Pub. L. No. 72-302, § 210, 47 Stat. 709, 715.

[26] *See id*.

[27] 12 U.S.C §§ 341–347 (2006).

[28] *Id.* § 343.

[29] *Id.* § 343(3)(A).

[30] *See* Alexander Mehra, *Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis*, 13 U. PA. J. BUS. L. 221, 229 (2010).

[31] *Id.* at 234.

satisfied, and subsequently issued emergency loans, include the following examples: In 1932, the Federal Reserve (a) issued a $300,000 loan to Smith-Corona, a typewriter manufacturer; (b) made a $250,000 loan to "Miller Cummings Company, a vegetable grower;"[32] and (c) in 1933, made a "$25,000 loan to L.N. Renault and Sons [an alcoholic beverage manufacturer] secured by 5,000 shares of common stock in a brewing company."[33] Also, in 1936, the Federal Reserve made a $13,000 loan "to Phenix Marble Company secured by shipments of marble products."[34] The Federal Reserve did not issue any further emergency loans until the 2008 Financial Crisis.[35]

After the Great Depression, and before the Financial Crisis, there were a few examples where companies, and even municipalities, sought, but were denied, emergency loans from the Federal Reserve.[36] For example, in 1975 the City of New York faced financial hardship that led to speculation about whether the Federal Reserve might make emergency loans to the city, but emergency loans were not granted because Congress passed legislation providing the city with other federal loans.[37] The Airline Industry sought emergency loans after the September 11th tragedy, but was denied; instead, many airlines faced restructuring, merger, and bankruptcy.[38]

In sum, the Federal Reserve seldom made loans pursuant to section 13(3) of the Federal Reserve Act before the financial crisis.[39] Of those few examples, totaling $1.5 million combined,[40] none is analogous in scope to the multi-billion dollar loans made by the Federal Reserve during the financial crisis.

2. The Federal Reserve's Emergency Lending Powers: During the Financial Crisis

In 2008, three major financial institutions faced the strong possibility of bankruptcy with potentially disastrous effects on the U.S. economy.[41] These in-

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[32] Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 467 (2015).

[33] *Id.*

[34] *Id.*

[35] Mehra, *supra* note 30, at 229.

[36] *See Lender of More Than Last Resort*, FED. RES. BANK MINNEAPOLIS (David Fettig, ed.) (Dec. 1, 2002), http://www.minneapolisfed.org/publications/the-region/lender-of-more-than-last-resort.

[37] *See id.*; *see also* Jesse Nankin & Krista Kjellman Schmidt, *History of U.S. Gov't Bailouts*, PROPUBLICA, https://www.propublica.org/special/government-bailouts (last updated April 15, 2009).

[38] *See Lender of More Than Last Resort*, *supra* note 36.

[39] *See id.*

[40] *See id.*

[41] *See* Colin Barr, *Why the Fed Saved AIG and Not Lehman*, FORTUNE (Sep. 02, 2010), http://fortune.com/2010/09/02/why-the-fed-saved-aig-and-not-lehman/.

cluded Bear Stearns, Lehman, and AIG.[42] The Federal Reserve facilitated the success or demise of these companies using different methods, and each institution is analyzed, *infra*, separately.

Before each institution is discussed, note the sequence of the following events. On March 14, 2008, Bear Stearns received the benefit of emergency loans to facilitate a merger with JP Morgan, avoiding bankruptcy.[43] On September 15, 2008, the Federal Reserve decided not to issue emergency loans to Lehman and Lehman declared bankruptcy.[44] On September 16, 2008, the Federal Reserve decided to lend AIG emergency loans, avoiding bankruptcy.[45] This Comment discusses Bear Stearns first.

a. Bear Stearns

Towards the end of 2007, foreclosures began to rise across the country.[46] Major financial institutions experienced substantial declines in asset value, diminishing their liquidity pool.[47] Like other large financial institutions, in the months leading up to the housing market crash, Bear Stearns operated on a highly-leveraged, thirty-three to one debt-to-equity ratio.[48] Bear Stearns exposed itself to significant portfolios of residential mortgage backed securities (RMBS) that rested on the assumption that homes would never experience widespread, cumulative declines in value.[49]

During the crisis, the Federal Reserve activated its emergency lending power pursuant to section 13(3) of the Federal Reserve Act in order to direct credit to "systematically-important institutions" and "avoid a disorderly failure of those institutions" to mitigate possible disruption to the broader economy.[50]

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[42] *See* John Crawford, *Wargaming Financial Crises: The Problem of (In)experience and Regulator Expertise*, 34 REV. BANKING & FIN. L. 111, 182 (2014).

[43] *See* Press Release, Fed. Reserve Bank of N.Y., Summary of Terms and Conditions Regarding the JPMorgan Chase Facility (March 24, 2008), https://www.newyorkfed.org/newsevents/news/markets/2008/rp080324b.html.

[44] Phillip Swagel, *Why Lehman Wasn't Rescued*, N.Y. TIMES (Sept. 13, 2013), https://economix.blogs.nytimes.com/2013/09/13/why-lehman-wasnt-rescued/?_r=0.

[45] *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT PURSUANT TO SECTION 129 OF THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008: SECURED CREDIT FACILITY AUTHORIZED FOR AMERICAN INTERNATIONAL GROUP, INC. (Sept. 16, 2008), https://www.federalreserve.gov/monetarypolicy/bst_reports.htm [hereinafter AIG BD. REPORT].

[46] *See* Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 437 (2015).

[47] *See* Bankruptcy Examiner's Report, *supra* note 1, at 9.

[48] *See* Alison Hashmall, *After the Fall: A New Framework to Regulate "Too Big to Fail" Non-Bank Financial Institutions*, 85 N.Y.U. L. REV. 829, 847 (2010).

[49] *See id.* at 848; *see also* John Waggoner et al., *Red Flags in Bear Stearns' Collapse*, ABC NEWS (Mar. 20, 2008), http://abcnews.go.com/Business/story?id=4469815&page=1.

[50] *See Starr,* 121 Fed. Cl. at 459 (quoting Ben Bernanke, former Chairman of the Federal Reserve).

As previously mentioned, in order to make a loan pursuant to section 13(3), three elements must be met."[51]

The Federal Reserve Board of Governors determined that Bear Stearns satisfied these elements at a meeting on March 14, 2008.[52] Board members unanimously decided "unusual and exigent circumstances existed" because of the market's "fragile condition" and the "expected contagion" that would result from Bear Stearns' failure.[53] The Board of Governors determined that Bear Stearns was unable to find credit on the open market from private sources,[54] and that no adequate credit sources "appeared available."[55] Due to the reasons above, Bear Stearns satisfied the second element of section 13(3).[56] The Board of Governors also determined that Bear Stearns' assets sufficiently secured a $29 billion loan to facilitate JP Morgan's purchase of Bear Stearns—satisfying the third element of section 13(3).[57] The minutes of the Federal Reserve's meeting on March 16, 2008, authorized credit extension to JP Morgan in the Bear Stearns purchase, but did not discuss how the Board determined that Bear Stearns' assets were capable of "fully collateraliz[ing]" a $30 billion loan.[58]

The JP Morgan–Bear Stearns acquisition protected the creditors from incurring losses they would have suffered had Bear Stearns declared bankruptcy, thereby avoiding disruption to other markets.[59] JP Morgan repaid the FRBNY loans in full, plus interest, in June 2012.[60] Lehman's creditors, however, were

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[51] 12 U.S.C. § 343 (2012).

[52] *See* Fed. Reserve Bank of N.Y., *supra* note 43.

[53] BD. OF GOVERNORS OF THE FED. RESERVE SYS., MINUTES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYS. 2 (Mar. 14, 2008), https://www.federalreserve.gov/newsevents/press/other/other20080627a1.pdf [hereinafter March 14th Minutes].

[54] *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT PURSUANT TO SECTION 129 OF THE EMERGENCY ECON. STABILIZATION ACT OF 2008: LOAN TO FACILITATED THE ACQUISITION OF THE BEAR STEARNS COMPANIES, INC. BY JP MORGAN CHASE & CO., 2 (Dec. 29, 2008), https://www.federalreserve.gov/monetarypolicy/files/129bearstearnsacquisitionloan.pdf [hereinafter ACQUISITION OF BEAR STEARNS].

[55] *Id* .at 3.

[56] *See* 12 U.S.C. § 343 ("[B]efore discounting any such note, draft, or bill of exchange, the Federal reserve bank shall obtain evidence that such participant . . . is unable to secure adequate credit accommodations from other banking institutions.").

[57] *See id.*; *see also* ACQUISITION OF BEAR STEARNS, *supra* note 54, at 4.

[58] BD. OF GOVERNORS OF THE FED. RESERVE SYS., MINUTES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYS. 2 (Mar. 16, 2008), https://www.federalreserve.gov/newsevents/press/other/other20080627a2.pdf.

[59] *See* Hearing Before the S. Comm. on Banking, Housing and Urban Affairs, 110th Cong. 4 (2008) (statement of Benjamin Bernanke), https://www.federalreserve.gov/newsevents/testimony/bernanke20080403a.htm.

[60] *See* Press Release, Fed. Reserve Bank of N.Y., New York Fed Announces Full Repayment of its Loans to Maiden Lane LLC and Laiden Lane III LLC (June 14, 2012), https://www.newyorkfed.org/newsevents/news/markets/2012/an120614.

not protected from losses after Lehman declared bankruptcy.

b. Lehman

Lehman's assets, like Bear Stearns', suffered declines in value during the housing market crash. During the second quarter of 2008, the market was uncertain about the value of Lehman's assets.[61] As the value of Lehman's assets declined during the second quarter, Lehman quickly ran out of liquidity to pay its obligations and faced the prospect of imminent bankruptcy.[62] Between March and September 2008, before the Lehman bankruptcy, Lehman's CEO, Richard Fuld, contacted the Treasury Secretary, Paulson, and FRBNY Chairman, Geithner, regarding "Lehman's capital raises, market rumors[,] and Lehman's liquidity."[63]

As late as September 12, 2008, the Federal Government was still trying to facilitate a private takeover of Lehman.[64] Bank of America negotiated an agreement to purchase Lehman's assets, but eventually pulled out of the negotiations because the Federal Government refused to use taxpayer money to insure against losses by Lehman's most troubling assets.[65] Barclays, a British company, also negotiated an agreement to purchase Lehman's assets, but the United Kingdom's Financial Services Authority refused to waive a shareholder vote required under London Stock Exchange rules, so the deal ultimately fell apart.[66]

Lehman satisfied at least two of the elements of section 13(3). First, fragile market conditions produced "unusual and exigent" circumstances.[67] Second, Lehman was unable to secure credit on the open market as evidenced by the breakdown of negotiations between Lehman, Bank of America, and Barclays.[68] The third element for emergency loans, pursuant to section 13(3), requires that any debt issued be "secured to the satisfaction of the Federal reserve bank."[69]

At a conference in December 2008, former Federal Reserve Chairman Ben Bernanke suggested that Lehman's assets were not sufficient to collateralize emergency loans.[70] Chairman Bernanke stated that Lehman's collateral "fell

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[61] *See* Bankruptcy Examiner's Report, *supra* note 1, at 205 ("Lehman's valuations, or its 'marks,' for its illiquid assets, were being questioned by market participants.").

[62] *See id.* at 208.

[63] *Id.* at 711.

[64] *Id.* at 1523.

[65] *See* Andrew Ross Sorkin, *Lehman Files for Bankruptcy, Merrill is Sold*, N.Y. TIMES (Sept. 14, 2008), http://www.nytimes.com/2008/09/15/business/15lehman.html?_r=0.

[66] *Id.*

[67] *See* March 14th Minutes, *supra* note 53.

[68] *See* Sorkin, *supra* note 65.

[69] 12 U.S.C. § 343 (2006).

[70] Ben Bernanke, *Speech at the Greater Austin Chamber of Commerce, Austin, Texas*, FED. RESERVE (Dec. 1, 2008), http://www.federalreserve.gov/newsevents/speech/bernanke20081201a.

well short of the amount needed to secure a Federal Reserve Loan" and "the firm's failure was thus unavoidable."[71] This conclusion rendered Lehman ineligible for emergency loans, pursuant to section 13(3).[72] Therefore, the Federal Reserve did not activate its section 12(3) powers to provide emergency loans to Lehman.[73] On September 15, 2008, Lehman filed for bankruptcy.[74]

c. American International Group (AIG)

Like Bear Stearns and Lehman, AIG was similarly affected by the collapse of the American housing market.[75] AIG was exposed to a substantial portfolio of RMBS[76] that declined in value as mortgages went into default.[77] AIG also invested in $465 billion of credit default swaps (CDS),[78] which obligated AIG to insure the RMBS of other institutions against declines in value in exchange for a premium.[79] The housing market collapse triggered AIG's obligation to put up additional liquidity, and by September 15, 2008, AIG was in need of $75 billion to meet its obligations.[80]

On September 16, 2008, the Federal Reserve Board of Governors ("Board of Governors") determined that AIG was in need of emergency loans.[81] The Board of Governors voted unanimously to provide AIG with $85 billion in emergency loans.[82] As a prerequisite to receiving emergency loans, AIG had to satisfy the three aforementioned elements of section 13(3).[83]

The Board of Governors found that the market volatility that was the basis for emergency loans to Bear Stearns in March 2008 was enough to satisfy the

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[71] *Id.*

[72] *See* 12 U.S.C. § 343 (2006).

[73] *See Transcripts of the Federal Open Market Committee Meeting*, FED. RESERVE (Sept. 16, 2008), http://www.federalreserve.gov/monetarypolicy/files/FOMC20080916meeting.pdf.

[74] *Case Study: The Collapse of Lehman Brothers*, INVESTOPEDIA (Feb. 16, 2017), http://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp.

[75] *See* Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 439–442 (2015).

[76] *See Residential Mortgage Presentation*, AIG 20 (Aug. 9, 2007), http://www.aig.com/content/dam/aig/america-canada/us/documents/investor-relations/revised-aig-and-the-residential-mortgage-market-final-08-09-07-report.pdf (AIG held $94.6 billion in residential mortgage backed securities).

[77] *See Starr*, 121 Fed. Cl. at 440–442.

[78] *Residential Mortgage Presentation*, *supra* note 28.

[79] *See Starr*, 121 Fed. Cl. at 439.

[80] *See id.* at 442.

[81] *See* AIG BD. REPORT, *supra* note 45.

[82] *Id.*

[83] *See* 12 U.S.C. § 343 (2006) (requiring (a) unusual and exigent circumstances, (b) evidence that the debtor is unable to secure credit accommodations on the open market, and (c) that any debt issued is "secured to the satisfaction of the Federal reserve bank.).

unusual and exigent circumstances element.[84] The Board of Governors tried to facilitate the private sector provision of credit to AIG, but JP Morgan and Goldman Sachs elected not to proceed with the deal, fulfilling the second element of section 13(3).[85] On September 16, 2008, the Board of Governors announced that it would provide emergency loans to AIG and was satisfied that the loans would be secured because they were "collateralized by all the assets of AIG."[86] The board did not elaborate on AIG's collateral.[87]

The Federal Reserve initially made $85 billion in loans to AIG.[88] However, the loans required to keep AIG solvent swelled to $182 billion.[89] AIG made its final repayment in March of 2013.[90]

The Federal Reserve does not provide a legal rationale for its determinations pursuant to section 13(3). Absent a legal rationale, the analysis section of this Comment investigates how the Federal Reserve was able to discern between Bear Stearns, Lehman, and AIG when deciding whether to provide emergency loans. Some commentators suggest that the Federal Reserve's decision to bailout Bear Stearns and AIG, while allowing Lehman to fail, was a discretionary political decision for which section 13(3) provided a convenient vehicle.[91] This Comment assesses the level of discretion awarded to the Federal Reserve to administer emergency loans during the financial crisis as well as the influence of political pressures on that discretion.

3. *The Federal Reserve's Emergency Lending Powers: After the Financial Crisis*

In response to emergency lending during the financial crisis, Dodd–Frank was enacted to "end 'too big to fail'" and "to protect the American taxpayer by

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[84] BD. OF GOVERNORS OF THE FED. RESERVE SYS., MINUTES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE 4 (Sept. 16, 2008), http://www.federalreserve.gov/newsevents/press/monetary/monetary20090311a1.pdf.

[85] *See* Laurence Ball, *The Fed and Lehman Brothers NBER Working Paper No. w22410*, JOHN HOPKINS U., July 14, 2016, at 172, http://www.econ2.jhu.edu/People/Ball/Lehman.pdf.

[86] Press Release, Bd. of Governors of the Fed. Reserve Sys. (Sept. 16, 2008), https://www.federalreserve.gov/newsevents/press/other/20080916a.htm.

[87] *See id.*

[88] Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 430 (2015).

[89] *See* Chan, *supra* note 16.

[90] Javier E. David, *AIG Makes Final Repayment to Government for Bailout*, CNBC (Mar. 1, 2013, 1:37 PM), http://www.cnbc.com/id/100397698; *see also* BD. OF GOVERNORS OF THE FED. RESERVE SYS., PUBLIC REPORT PURSUANT TO SECTION 129(B) OF THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008 (Dec. 29, 2008), https://www.federalreserve.gov/monetarypolicy/files/129periodicupdate.pdf [https://perma.cc/JG7V-BRKD].

[91] Mehra, *supra* note 30, at 258–59; *see* Ball, *supra* note 85, at 197; *see* also Barr, *supra* note 41.

ending bailouts."[92] In furtherance of this objective, Dodd–Frank made a number of changes to section 13(3) of the Federal Reserve Act, which are enumerated in Title XI of the law.[93]

The first of these changes requires that Federal Reserve emergency loans be subject to "broad-based eligibility" so that "any emergency lending program . . . is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company."[94] The second change requires collateral for emergency loans to be "sufficient to protect taxpayers from losses."[95] A third change removes a degree of discretion from the Federal Reserve Board of Governors by requiring "prior approval of the Secretary of the Treasury" before emergency loans are issued.[96] The fourth of these changes promotes transparency by the Federal Reserve by requiring the Federal Reserve Board of Governors to provide a report to Congress outlining the details of any emergency loans it makes.[97]

Section 13(3) of the Federal Reserve Act has not been activated subsequent to the financial crisis to provide emergency loans to any entity.[98] Therefore, there is no example to which to turn to help determine whether Dodd–Frank affected the discretion awarded to the Federal Reserve in making emergency loans.[99] This Comment continues by analyzing the degree of discretion the Federal Reserve had to make emergency loans during the financial crisis and then assesses the extent to which Dodd–Frank affected the Federal Reserve's degree of discretion in making future emergency loans.

III. ANALYSIS

Section 13(3) of the Federal Reserve Act provides the Federal Reserve the authority to make emergency loans.[100] Three elements of section 13(3) must be satisfied as a prerequisite to the issuance of emergency loans.[101] The Federal Reserve Board of Governors has seldom activated its emergency loan making

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[92] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[93] *See* 12 U.S.C. § 343 (2012).

[94] *Id*. § 343(3)(B)(i).

[95] *Id*.

[96] *Id*. § 343(3)(B)(iv).

[97] *See id.* § 343(3)(C).

[98] *See* Barr, *supra* note 41.

[99] *See id.*

[100] *See* 12 U.S.C. § 343.

[101] *See id.*

authority pursuant to section 13(3),[102] but during the 2008 financial crisis, the Federal Reserve's decision to provide emergency loans to Bear Stearns and AIG while declining to provide emergency loans to Lehman has drawn criticism.[103]

A. How Did the Federal Reserve Determine Whether to Provide Emergency Loans During the Financial Crisis?

This section examines the process by which the Federal Reserve Board of Governors determined whether to provide emergency loans to Bear Stearns, Lehman, and AIG respectively. Because the Federal Reserve is not required to provide legal rationale for its section 13(3) determinations, this section examines testimony to the Financial Crisis Inquiry Commission, minutes from Federal Reserve Board of Governors meetings, Federal Reserve press releases, news articles, and scholarly writing to provide insight.[104]

1. Unusual and Exigent Circumstances

The unusual and exigent circumstances element of section 13(3) is not defined by statute.[105] During the financial crisis, there was no requirement that the Federal Reserve publicly disclose the process by which it determined circumstances to be "unusual and exigent."[106] The Federal Reserve assumed circumstances to be "unusual and exigent" because of the market volatility and uncertainty associated with the housing market collapse.[107]

The fragile condition of the economy satisfied the "unusual and exigent circumstances" element of section 13(3) of the Federal Reserve Act for Bear Stearns, AIG, and Lehman alike.[108] Because each financial institution satisfied this element, it is not helpful in determining why Bear Stearns and AIG received emergency loans while Lehman went bankrupt. However, this element could be important in future instances where the Federal Reserve activates its emergency lending powers because Dodd–Frank amended the Federal Reserve Act to require the Federal Reserve to provide a "justification for the exercise of authority to provide [emergency] assistance."[109]

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[102] *See* Mehra, *supra* note 30, at 230–34.

[103] *See id*. at 258–60.

[104] *See* 12 U.S.C. § 343.

[105] Mehra, *supra* note 30, at 227; *see also* 12 U.S.C. § 343.

[106] 12 U.S.C. § 343.

[107] *See March 14th Minutes*, *supra* note 67, at 2 ("Given the unusual and exigent circumstances, the Board authorized the Federal Reserve Bank of New York . . . to extend credit to JPMorgan . . . on a nonrecourse basis to provide financing to Bear Stearns . . . .").

[108] 12 U.S.C. § 343.

[109] Dodd–Frank § 1101.

2. Evidence that a Debtor is Unable to Secure Credit on the Open Market

Section 13(3) does not define what "evidence" or degree of due diligence is necessary to fulfill the second element required for emergency loans, namely that the debtor be "unable to secure adequate credit accommodations" on the open market.[110] Therefore, when the Federal Reserve does determine that a financial institution was unable to secure adequate credit accommodations, the Federal Reserve inherently uses its discretion to determine whether the financial institution was diligent enough in its search.

To the Federal Reserve's credit, before making emergency loans to Bear Stearns, it declined to extend emergency loans to Lehman and AIG, instead trying to facilitate a private sector solution to prevent the bankruptcy of each company, respectively.[111] In each instance, the private remedy failed absent federal assistance.[112] Objectively, this suggests that Bear Stearns, Lehman, and AIG[113] were each unable to secure credit from private sources.

On March 14, 2008, Bear Stearns faced imminent bankruptcy, so the Federal Reserve provided it with a bridge loan to allow Bear Stearns the opportunity to seek credit accommodations on the open market.[114] Finding none, the Federal Reserve facilitated a deal with JP Morgan that required JP Morgan to purchase Bear Stearns' illiquid assets in exchange for emergency loans.[115]

On September 12, 2008, the Federal Reserve facilitated tentative deals with Bank of America and Barclays to allow the private purchase of Lehman, but both Bank of America and Barclays pulled out at the last minute.[116] On September 16, 2008 the Board tried to facilitate the private sector provision of credit to AIG, but JP Morgan and Goldman Sachs elected not to go ahead with the deal.[117]

In all three cases, the Federal Reserve found the inability to secure credit element of section 13(3) to be satisfied as Bear Stearns, Lehman, and AIG each failed to negotiate private sector solutions to avoid bankruptcy.[118] Therefore,

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[110] 12 U.S.C. § 343.

[111] *See* Bankruptcy Examiner's Report, *supra* note 1, at 126–27, 186.

[112] *See id.*

[113] Ball, *supra* note 85, at 172.

[114] *Bear Stearns, JPMorgan Chase, and Maiden Lane LLC*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., https://www.federalreserve.gov/regreform/reform-bearstearns.htm (last visited Apr. 14, 2017).

[115] *See id.*

[116] *See* Sorkin, *supra* note 65.

[117] *See* Ball, *supra* note 85, at 172.

[118] *See id.*; *see also Bear Stearns, JPMorgan Chase, and Maiden Lane LLC*, *supra* note 114.

this factor is not helpful in determining why Bear Stearns and AIG received emergency loans while Lehman went bankrupt. However, like the first factor, this could be instructive as to where the Federal Reserve activates its emergency lending powers, because Dodd–Frank requires a "justification for the exercise of authority to provide [emergency] assistance."[119]

Unfortunately, Dodd–Frank does not impose due diligence requirements on financial institutions seeking federal emergency loans to demonstrate that they thoroughly exhausted their private sector search for credit.[120] Therefore, post Dodd–Frank, the Federal Reserve still exercises discretion when determining whether the second element of section 13(3) is satisfied.

3. Requirement that Any Debt Issued by the Federal Reserve be Secured to the Satisfaction of the Federal Reserve Bank

As discussed above, Bear Stearns, Lehman, and AIG each satisfied the first and second elements of section 13(3) required as prerequisites to the issuance of emergency loans. Therefore, the analysis turns to the third element—the requirement that any debt issued by the Federal Reserve be secured to the satisfaction of the Federal Reserve Bank. The collateral held by Bear Stearns and AIG each satisfied the Federal Reserve, and those companies were issued emergency loans, which saved them from bankruptcy.[121] The Federal Reserve, on the other hand, declined to provide Emergency Loans to Lehman, and Lehman ultimately declared bankruptcy.[122]

This outcome is surprising, especially when you compare the relative capital requirements for AIG and Lehman to remain solvent. AIG required $182 billion to remain solvent,[123] whereas Lehman would have required only $80.1 billion.[124] In addition, it is clear that political pressures, extrinsic to the solvency of Lehman and AIG, played a significant role in the Federal Reserve's determination to provide emergency loans to AIG and not to Lehman.[125] This is discussed below.

AIG was worse off relative to Lehman. According to figures provided in 2010 by former Federal Reserve Chairman, Alan Greenspan, Lehman would have needed an investment of approximately $80.1 billion in capital to sur-

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[119] *See* Dodd–Frank § 1101.

[120] *See generally id.*

[121] *See* Ball, *supra* note 85, at 1, 4, 13.

[122] *Id.* at 1.

[123] *See* Chan, *supra* note 16.

[124] *See* Nasiripour, *supra* note 8.

[125] *See* Ball, *supra* note 85, at 197.

vive.[126] Compare this to AIG's initial estimated need of $85 billion of emergency loans.[127] Yet by April 2009, AIG received loans from the Federal Reserve and the Treasury totaling $182 billion.[128]

It is not clear how the Federal Reserve reached the conclusion that AIG's assets were capable of securitizing $182 billion in loans, whereas Lehman's assets were incapable of securitizing a potential bailout of $80.1 billion. Federal Reserve officials attempt to distinguish AIG's assets from Lehman's assets by explaining that Lehman's assets were illiquid.[129] For example, the Federal Reserve Board may have concluded that Lehman accumulated "potentially illiquid assets that could not easily be sold in a downturn."[130] Illiquid assets, generally, are less reliable to use as collateral for borrowing.[131] Federal Reserve officials provided this narrative on several occasions *subsequent* to the Federal Reserve's refusal to issue emergency loans to Lehman.[132] However, whether the illiquid nature of Lehman's assets was the *actual* reason that the Federal Reserve determined that Lehman did not qualify for emergency loans is merely speculative because the Federal Reserve was not required to disclose its legal justifications.

4. Political Pressure Influenced the Federal Reserve's Decision to Provide Emergency Loans to AIG, but not Lehman.

The Federal Reserve was not required to provide a rationale for its legal determination that AIG, but not Lehman, was eligible for emergency loans pursuant to section 13(3) of the Federal Reserve Act.[133] Furthermore, the third element of section 13(3) is highly deferential to the Federal Reserve Board. Therefore, the Federal Reserve commanded significant discretion when awarding emergency loans.[134] There is evidence to suggest that political pressure influenced the Federal Reserve's decisions on when to provide emergency loans and when not to provide emergency loans.[135] The high level of discretion awarded to the Federal Reserve may have enabled it to succumb to political pressure and

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[126] *See* Greenspan, *supra* note 8 ("with 15% tangible equity capital, neither Bear Sterns nor Lehman Brothers would have been in trouble."); *see also* Nasiripour, *supra* note 8.

[127] *See* Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 430 (2015).

[128] *See* Chan, *supra* note 16.

[129] Bankruptcy Examiner's Report, *supra* note 1, at 1530; *see also id.* at 57.

[130] *Id*.

[131] *Id.* at 62.

[132] *See id*. at 1530.

[133] 12 U.S.C. § 343 (2006).

[134] *See* Mehra, *supra* at 30, at 229 ("The phrase 'secured to the satisfaction of' indicates that a Reserve Bank has some measure of discretion in the collateral it chooses to accept.").

[135] *See* Ball, *supra* note 85, at 14.

not bailout Lehman,[136] instead placing blame on the third element of section 13(3).[137]

In talks and publications subsequent to the Lehman Bankruptcy, former Treasury Secretary Paulson,[138] Federal Reserve Chairman Ben Bernanke,[139] and others working with the Federal Reserve suggest that Lehman was unable to satisfy the third element of section 13(3) requiring emergency loans to be "secured to the satisfaction of the federal reserve bank"[140] and therefore was ineligible for bailout loans.[141] Secretary Paulson distinguished AIG from Lehman by describing Lehman as having "liquidity problems" and being without "hard assets against which to lend."[142] AIG's assets, on the other hand, were "perceived by the market as stable, well-capitalized, and having real value."[143]

Although Secretary Paulson has repeated this account on many subsequent occasions, the Secretary has not offered any details about Lehman's assets supporting this conclusion.[144] When the Financial Crisis Inquiry Commission pressed Secretary Paulson to explain why Lehman was ineligible for emergency loans, he answered with frustration and repeated his affirmation that Lehman faced liquidity problems.[145]

When the Financial Crisis Inquiry Commission asked Federal Reserve Chairman Ben Bernanke, in a follow up letter, to report a dollar value for the "shortfall of Lehman's collateral relative to the collateral necessary to issue a bridge loan,"[146] the Chairman provided instead a collateral estimate ($57.5 billion) relative to total outstanding debts ($365 billion).[147] The Chairman conflat-

136 *See generally, id.* at 194–96 (suggesting that Hank Paulson, the Treasury Secretary, instructed the Federal Reserve to deny Lehman a bailout based on political concerns even though he had no authority in the matter).

137 *See* Ball, *supra* note 85, at 197.

138 Bankruptcy Examiner's Report, *supra* note 1, at 1530.

139 Ball, *supra* note 85, at 2 ("[T]he company's available collateral fell well short of the amount needed to secure a Federal Reserve loan of sufficient size to meet its funding needs. As the Federal Reserve cannot make an unsecured loan . . . the firm's failure was, unfortunately, unavoidable." (internal citation omitted)).

140 12 U.S.C. § 343 (2006).

141 Bankruptcy Examiner's Report, *supra* note 1, at 1530; *see also* Ball, *supra* note 85, at 71.

142 Bankruptcy Examiner's Report, *supra* note 1, at 1530.

143 *Id.* at 1530–31.

144 *See The Shadow Banking System: Hearing Before the Financial Crisis Inquiry Commission*, 111th Congress (2010), 68–69 http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0506-Transcript.pdf.

145 *See id.* at 68 ("Thank you for asking that question because, despite the fact I've written a book and answered this hundreds of times . . . people still question us . . . .").

146 Letter from the Wendy Edelberg, Exec. Dir., Fin. Crisis Inquiry Comm'n, to Ben Bernanke, Chairman, Bd. of Governors of the Fed. Reserve (Oct. 1, 2010), http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/TBTF/Chairman%20Bernanke%20Follow%20Up.pdf.

147 Letter from Ben Bernanke, Chairman, Bd. of Governors of the Fed. Reserve, to Philip An-

ed what would be necessary for Lehman to survive in the form of credit with the amount that would be required to extinguish Lehman's total debt.[148] Therefore, the Chairman did not answer the question.[149]

It is clear that the Federal Reserve had considered activating section 13(3) of the Federal Reserve Act to provide emergency assistance to Lehman.[150] Before the Lehman bankruptcy, between March and September 2008, the CEO of Lehman, Richard Fuld, was in regular contact with Treasury Secretary Paulson and FRBNY Chairman Geithner regarding "Lehman's capital raises, market rumors[,] and Lehman's liquidity."[151] As late as September 12, 2008, the Federal Government was still trying to facilitate a private takeover of Lehman.[152] In fact, the multinational bank Barclays came close to purchasing Lehman, and Chairman Bernanke "remained in Washington, given the possibility that the Federal Reserve might need to exercise its emergency lending powers."[153] Unfortunately, the U.K.'s Financial Services Authority squashed the deal by refusing to waive a shareholder vote requirement.[154]

Understanding that the Federal Reserve expanded great effort in preventing a Lehman bankruptcy, and that it was prepared to provide emergency assistance pursuant to section 13(3) to facilitate a private takeover, it is curious that the Federal Reserve ultimately allowed Lehman to fail. What changed?

To understand what changed we must keep in mind this sequence: (1) Bear Stearns was bailed out, (2) Lehman declared bankruptcy, and then (3) AIG was bailed out.[155] This article suggests that the political fallout after the bailout of Bear Stearns was so immense that the Federal Reserve succumbed to political pressure and refused to bailout Lehman.[156] Then, after realizing the damage that occurred after Lehman's failure, the Federal Reserve understood the necessity of bailing out AIG.[157]

The political fallout subsequent to the bailout of Bear Stearns was intense

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gelides, Chairman, Fin. Crisis Inquiry Comm'n (Nov.4, 2010) http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/TBTF/Chairman%20Bernanke%20Follow%20Up.pdf (follow up letter from Ben Bernanke).

[148] *See id.*

[149] Ball, *supra* note 85, at 11.

[150] *See* Bankruptcy Examiner's Report, *supra* note 1, at 716–18.

[151] *Id.* at 711.

[152] *Id.* at 1523.

[153] *Id.* at 1524.

[154] *See id.* at 1528–30.

[155] *See* Press Release, Fed. Reserve Bank of N.Y., Summary of Terms and Conditions Regarding the JPMorgan Chase Facility (Mar. 24, 2008), https://www.newyorkfed.org/newsevents/news/markets/2008/rp080324b; *see also* AIG BD. REPORT, *supra* note 45.

[156] *See* Ball, *supra* note 85, at 197–200.

[157] *Id.* at 206.

and bipartisan. Democratic Congressman Barney Frank described the Federal Reserve's emergency assistance to Bear Stearns as a "ransom," while Republican Senator Jim Bunning accused the Federal Reserve of practicing "socialism."[158] Former Federal Reserve officials went further, describing it as the "worst policy mistake in a generation," while both presidential candidates Barack Obama and John McCain condemned the rescue.[159] Journalists joined the cacophony, leading the Wall Street Journal to opine that a Lehman bailout would lead to "a new de facto federal policy of underwriting Wall Street that [would] encourage even more reckless risk-taking."[160]

The harsh criticism following the bailout of Bear Stearns fell hard on Bernanke, Paulson, Geithner, and others.[161] Paulson was quoted as saying that there was "no will to do this in Congress," and "I'm being called Mr. Bailout. I can't do it again."[162] Staff feared how the press would respond to a Lehman bailout.[163] It is entirely reasonable to surmise that these intense political pressures influenced the decision makers in the Federal Reserve. Because the Federal Reserve had wide discretion in issuing emergency loans pursuant to section 13(3), and because the Federal Reserve was not required to disclose the details of its legal determination, we may never know.

What we do know is that the consequences of Lehman's bankruptcy were so significant that the Federal Reserve ended further opposition to activating its emergency lending powers.[164] Lehman's bankruptcy led to a run on money market mutual funds,[165] made it difficult for corporations to raise capital,[166] and led to widespread layoffs across economic sectors.[167] The fear of letting AIG fail and causing "a second depression" essentially overpowered any fear of political criticism, making the bailout of AIG more palatable to critics.[168]

As discussed above, AIG ultimately received $182 billion in emergency loans to avoid bankruptcy[169] whereas Lehman would have required $80.1 billion.[170] Additionally, the Federal Reserve, despite its best efforts, was unable to

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[158] *Id.* at 197.
[159] *Id.* at 198.
[160] *Id.* at 199.
[161] *See id.* at 199–200.
[162] *Id.*
[163] *See id.* at 200.
[164] *See id.* at 206.
[165] *Id.* at 44–45.
[166] *Id.* at 45, 208.
[167] *See id.* at 45.
[168] *See id.* at 207–09.
[169] *See* Chan, *supra* note 16.
[170] *See Subprime Lending and Securitization and Government-Sponsored Enterprises: Hearing*

demonstrate why AIG was eligible for emergency loans but not Lehman, pursuant to section 13(3).[171] Therefore, this Comment concludes that political factors, not sound legal reasoning, likely drove the Federal Reserve's decision to issue emergency loans to AIG and not to Lehman. The discretion awarded to the Federal Reserve to issue emergency loans without disclosing a legal rationale enabled this reality. This same discretion, although diminished, remains intact even after Dodd–Frank.

B. Post Dodd–Frank, Are Future Bailouts Insulated from Discretion?

Dodd–Frank, in its effort to "end too big to fail" and "protect the American taxpayer by ending bailouts" has sought to limit the Federal Reserve's discretion when issuing emergency loans.[172] In furtherance of this objective, Dodd–Frank made a number of changes to section 13(3), which are enumerated in Title XI of the law.[173]

The first of these changes requires that Federal Reserve emergency loans be subject to "broad-based eligibility" so that "any emergency lending program . . . is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company."[174] The second change requires collateral for emergency loans to be "sufficient to protect taxpayers from losses."[175] The third change removes a degree of discretion from the Federal Reserve Board of Governors by requiring "prior approval of the Secretary of the Treasury" before emergency loans are issued.[176] The fourth change promotes Federal Reserve transparency by requiring the Federal Reserve Board to provide a report to Congress outlining the details of any emergency loans it makes.[177]

Dodd–Frank does decentralize decision-making in emergency loan making power by requiring the approval of the Secretary of the Treasury. However, the Federal Reserve was designed to be politically insulated,[178] and it does not

Before the Financial Crisis Inquiry Commission, 111th Cong. (2010) http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0407-Greenspan.pdf (last visited Apr. 4, 2017) (testimony of Alan Greenspan, former Chairman, Board of Governors of the Federal Reserve System).

171 *See* Ball*, supra* note 85, at 183.

172 Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

173 12 U.S.C. § 343 (2012).

174 *Id.* § (3)(B)(i).

175 *Id.*

176 *Id.* § 343(3)(B)(iv).

177 *Id.* § 343(3)(C)(i).

178 *U.S. Monetary Policy: An Introduction*, FED. RESERVE BANK S.F., http://www.frbsf.org/education/teacher-resources/us-monetary-policy-introduction/federal-reserve-structured/ (last updated Feb. 6, 2004).

seem that empowering the Secretary of the Treasury, a political appointee, to sign off on or veto the issuance of emergency loans removes the Federal Reserve's discretion so much as it adds a political element to its decision-making process.

Dodd–Frank's most effective tool to remove discretion from the Federal Reserve when issuing emergency loans is to require that emergency loans be subject to "broad-based eligibility," and therefore, the Federal Reserve will be unable to pick winners and losers among financial institutions. However, because section 13(3) has not been activated subsequent to the financial crisis, it is uncertain as to what broad-based eligibility might look like.

Additionally, although a broad-based eligibility system would limit the discretion of the Federal Reserve, it is unlikely that this system serves Dodd–Frank's other objectives, namely ending bank bailouts. This is because after the financial crisis, liquidity became even more concentrated among even fewer big banks.[179] Therefore, the same financial institutions that threatened the global economy during the financial crisis would be the institutions eligible for emergency loans under a broad-based eligibility system.

Lastly, this Comment raised concerns that the Federal Reserve was not required to disclose its legal rationale when deciding whether to issue emergency loans. This lack of disclosure allowed the Federal Reserve to act with great discretion when issuing emergency loans. Dodd–Frank amends the Federal Reserve Act to require the Federal Reserve to provide a "justification for the exercise of authority to provide [emergency] assistance."[180] This helps, but further clarification is needed and a justification for denying financial institution emergency loans should also be required.

To conclude, the Dodd–Frank reforms, particularly the requirements that future emergency loans be subject to broad-based eligibility and that the Federal Reserve provide a justification for issuing emergency loans, do help lessen the degree of discretion awarded to the Federal Reserve when making emergency loans. However, Dodd–Frank unwisely injects political pressures into the Federal Reserve by requiring that the Treasury Secretary sign off on any emergency loans the Federal Reserve issues. Additionally, given that large banks consolidated and are larger in 2016 than during the financial crisis, even if future emergency loans are subject to broad-based eligibility, they will still likely go to the large institutions that threatened the global economy in the first place. In any event, this Comment would be remiss not to mention that whatever gains Dodd–Frank made may be threatened by the new Trump Administration, as President

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[179] Brynne Krause, *The Dodd–Frank Wall Street Reform and Consumer Protection Act: How Increased Regulation Has Given Large Banks an Artificial Competitive Edge*, 83 UMKC L. REV. 1045, 1048 (2015).

[180] 12 U.S.C. § 343(3)(C)(i).

Trump pledged to "dismantle" it.[181]

[181] Glenn Thrush, *Trump Vows to Dismantle Dodd–Frank 'Disaster,* N.Y. TIMES (Jan. 30, 2017), https://www.nytimes.com/2017/01/30/us/politics/trump-dodd-frank-regulations.html.