No good in bailouts, says ex-chief of US regulator

BY **ADELINE PAUL RAJ**

Bailing out banks or companies using taxpayers' money is bad for the economy over the long term, says Sheila Bair, the former chairman of the US Federal Deposit Insurance Corporation (FDIC).

Bair helmed the FDIC, a regulator of insured banks, from 2006 to 2011 in what was arguably the most tumultuous time ever for the US economy, during which storied investment bank Lehman Brothers went bankrupt while other big financial institutions (FI) such as Citigroup and American International Group (AIG) were bailed out by the US government to avoid bankruptcy.

Bair had been vocal in her opposition of bailouts in that period, rendering her unpopular on Wall Street.

In an interview with *The Edge*, she was asked to comment on views that there may have been merits to some of the bailouts considering, for example, that the US government has made an overall profit of nearly US$15.5 billion (RM49.6 billion) on the Citigroup bailout alone almost five years on, and the jobs that many employees got to keep.

"I am against bailouts. I think banks, like other companies, should stand on their own two feet. If they get into trouble, they should be accountable for that. They shouldn't rely on the government or taxpayers for help even if [the latter] were paid back at a profit. They have to suffer the consequences of their own actions.

"I mean, one of the reasons too-big-to-fail is so pernicious is that if banks start thinking that way — that they can take risks and turn to the government for a bailout when they get into trouble — they will take big risks," Bair points out.

"If, however — and I don't support this — a jurisdiction decides that the for institutions, then they should make them utilities and have them heavily regulated, without big bonuses and dividends paid to shareholders. You can't have a system that privatises the profits and socialises the losses because first of all, it's not fair, and it's not right and it's not moral.

"But more importantly, it's bad economics because you give these big institutions huge competitive advantages over smaller institutions, and you give them incentives to take a lot of risk that will get them into trouble," she tells *The Edge* in Kuala Lumpur, where she was a key speaker at the World Capital Markets Symposium last week.

Bair: If they (banks) get into trouble, they should be accountable for that

Bair, these days an author, speaker and financial news commentator, is an ardent advocate and innovator of policies to end the doctrine of too-big-to-fail and taxpayer bailouts. She was lauded for being "the little guy's protector in chief" by *Time Magazine*, which named her as one of its 100 most influential people in 2009.

On views that the bailouts helped save jobs for many people, she says: "I think you want to have compassion for people and you don't want to see them lose jobs. But in the longer term, you'll have a healthier economy and a more efficient market if poorly-managed institutions and those that have antiquated businesses are allowed to fail. Those resources can be reallocated to companies or industries that are better managed.

"The transition can be painful, I know, and that's why you need unemployment compensation, job retraining and good bridge programmes. To try and keep a company propped up because you don't want people to have to lose their jobs — that protects them in the short term, but over the longer term, it's not good for the economy."

Bair is steadfast in her belief that losses at ailing FIs should be imposed on shareholders and creditors, not taxpayers.

The Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (Dodd-Frank Act) which was implemented in the US in the wake of the 2008/09 financial crisis, has ensured that taxpayer bailouts will never happen again, she says.

"When a bank fails, what you want to do is protect the customers. You want to keep services flowing to customers, but you want to make sure the managers, the shareholders and the bondholders are at risk for the losses.

"Title II of the Dodd-Frank Act [which spells out the creation of an entirely new insolvency regime for large, interconnected FIs] provides a good mechanism for doing that because the FDIC can take control of the holding company, where most of the debt and equity is, and make sure the losses are imposed on the equity and bondholders at the holding company. But they can continue to fund the operating subsidiaries, so the services to the customers can keep flowing. And that's really what you want to do," she remarks.

The FDIC is an independent agency of the US federal government. Looking back, she says the US could have handled the bank bankruptcy issues better.

"I do think there's more we could have done to impose accountability on the [banking] leadership and the people who provided funding for these institutions, and still keep the services flowing.

"Back then, we didn't have the tools we have now. During the crisis, we had a bankruptcy process which does not work for FIs. And we had an FDIC process that works for FIs, but we only had authority over insured banks. Lehman was not an insured bank, and neither was AIG — so we didn't have the right kind of tools to deal with them. We do now, with Dodd-Frank," she muses.

She advises other countries to come up with similar tools, so that if an FI fails, governments won't have to resort to bailouts.

Malaysia is no stranger to bailouts. It had bailed out banks — and was heavily criticised by the US for doing so — as well as the Renong group of companies during the 1997/98 crisis. In 2001, it came under fire for bailing out Malaysian Airline System Bhd in a bid to turnaround the national carrier, which resulted in a loss of public funds.

"We were lecturing Malaysia and other countries to get tough with your banks — and we [the US] didn't do that ourselves. I would understand if you were upset about that double standard. [In our case in the US], we were quite eager to bailout. We had to do something, but it was just the generosity of the response and the lack of willingness to embrace accountability — that was what really troubled me," says Bair.

On her concerns for Asia and its banks, she says they should learn from the US' past mistakes, go slowly with new product innovations and keep a close watch on the growth of commercial real estate.

"With rapidly growing economies especially, there's always a danger of overheating, so don't grow too fast, especially with commercial real estate. There's always all these wonderful buildings and developments, which are good, but make sure the banks don't get ahead of themselves in terms of what the actual demand is," she advises. E