



Dialog • Insight • Solutions

***The Dodd-Frank Act:
From a U.S. Economy Perspective***

Steven Lofchie

Non-Resident Senior Fellow / Legal Studies

Center for Financial Stability, Inc.

and

Co-Chairman of the Financial Services Department

Cadwalader, Wickersham & Taft LLP

Symposium
University Club of New York
September 23, 2010

Impacts of Dodd-Frank on Financial Institutions

- Increases the Degree of Regulation and Related Costs
- Subjects Institutions to Double or Triple Regulators
- Prohibits Certain Profitable, Not Particularly Risky, Businesses
 - (Volcker Rule)
- Makes Other Business Less Profitable, More Expensive
 - (Derivatives)
- Increases Capital Requirements
- May Increase Risk (Risk Retention)

Affected Institutions

- U.S. Banking Organizations
- Non-U.S. Financial Organizations with US Bank Branch or Agency (Deemed to be BHCs)
- Larger US Broker-Dealer Organization (now parts of banks; Hotel California provisions)
- Private Funds (to a lesser extent)
- Public Funds (double regulation)
- Systemically Important Organizations
- Major Swap Participants
- End-Users of Derivatives

Creates Regulatory Uncertainty as to Transactions

Which Regulator Has Authority?

- Are Trades Subject to CFTC or SEC? or Both?
- If SEC, is it a Security-Based Swap or Security?
- What is Regulated as Insurance?
- What is the realm of state contract law?
 - (all contracts with contingencies are "swaps")

Creates Regulatory Uncertainty as to Entities

Who Will be Regulated?

- Major Swap Participant
- Systemically Significant Nonbank Financial Institution
- Entities Subject to Orderly Liquidation Authority

Creates Double Regulation

- Registered Investment Company That Uses Swaps will be regulated both by the SEC and the CFTC
- Any Sell side Entity Engaged in Derivatives likely to be both SEC and CFTC Regulated
- To say nothing of Bank Regulation
- Private Fund Advisers Also Likely to be SEC and CFTC Regulated

Added Enforcement Risks

- CFPB will have an enforcement mandate
- SEC trying to regain credibility post-Madoff, Goldman, Stanford
- CFTC trying to prove value
- FERC trying to fend off CFTC incursion
- Banking regulators trying to prove consumer friendly
- Whistleblowers trying to make money?

Capital Requirements and Risk Retention

- Must raise more capital under Basel III, even if slowly
- Does central clearing and limits on derivatives reduce or increase risk to the system?
- Skin in the game

Expense for Funds and Advisers: Big and Small

- Big Advisers: SEC Registration
- Big Funds: Potential Regulation as MSP, SSNFC
- Small Advisers: Multi-State Registration-Regulation
- Public Funds: Dual SEC and CFTC Regulation
- Multi-Country Regulation?

International Tensions?

- Foreign Banks Subject to Volcker
 - If have US Branch
- Foreign Banks Must Create US Swaps Entity
 - Inefficient and Costly
- Foreign Advisers Must Register with the SEC
 - Even if De Minimis US Business
- US Customers Precluded from Investing in Foreign Banks' Funds (Volcker Rule)
- Foreign Futures Exchanges Must Follow US Positions Limits (No Empirical Support for Value)
- Will There be Retaliation? Protectionism?

Quality Issues

- Typos
- Undefined Terms
- Overbroad Terms
- Impracticality
 - (Credit Rating Agency)
- Impossibility
 - (Hedge Fund Capital Regulation?)
- Did Not Address Actual Problems?

How Did We Get Something So Bad? (Speaking as a Technocrat)

- Role of Congress
 - Avoiding Blame
 - Claiming Credit
 - Lobbying Dollars to Come
- Role of the Press
 - Story with a Narrative
 - Story with Bad Guys
 - Pretend Expertise
- Role of the Academics
 - Belief in the Big Idea
 - Fame and Power
 - Limited Practical Experience
- Role of the Regulators
 - Beleaguered (SEC, Fed)
 - Empowered (CFTC)

How Did We Get Something So Bad?

(Continued)

- Role of the Financial Institutions
 - Demonized
 - Cowed
 - Ignored

About CFS and Disclosure

The Center for Financial Stability (CFS) is a private, nonprofit institution focusing on global finance and markets. Its research is nonpartisan.

The organization is unique, as it focuses on market mechanics and linkages while serving as a private sector check and balance on government actions. The CFS is dedicated to the integration of finance, law, and economics. CFS promotes a stronger and more stable financial system through practical policy-oriented research, structured dialog between private sector experts and policy-makers, and education and outreach to the broader public.

This publication reflects the judgments and recommendations of the author(s). They do not necessarily represent the views of Members of the Advisory Board or Trustees, whose involvement in no way should be interpreted as an endorsement of the report by either themselves or the organizations with which they are affiliated.