CENTER FOR FINANCIAL STABILITY

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

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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

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