Delays, Dilutions and Delusions: Implementing Dodd-Frank

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Presented at the
Chinese University of
Hong Kong
May 25, 2013
Claim 1

The conditions that brought the US financial system to the brink of failure in 2008 persist including:

• Bank size & concentration
• Permitted & actual leverage
• Interconnection
• Excessive risks with safety net of government-insured deposits & Fed lending
Claim 2

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, while a good starting point, is insufficient --both as enacted and as currently implemented (nature and nature) -- to fulfill its preamble’s promise to:

“To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’”
“[I]t wasn’t to help the big firms that we intervened . . . These companies have turned out to be too big to allow to collapse because . . . when the elephant falls down, all the grass gets crushed as well. We really need . . . a new regulatory framework that will make sure that we do not have this problem in the future. . . .”
Five Years After Crisis . . .
Top 6 US BHC Assets

As a Percentage of GDP (2013 data from FFIEC & BEA)
US Accounting Rules
Minimize “Real” Bank Size
(JPM Assets $Trillions)

Source: Bloomberg based upon 3rd Q 2012 data
Pre-Crisis Leverage

Excessive Leverage

- 33-1 leverage ratio (some 40-1)
- Risky BHCs and IBs were borrowing $97 or more for every $100 in assets
Today: Still Too Little Equity Capital Permitted

Excessive Leverage

- Can Borrow $97 for every $100 in assets owned under DFA and Basel
- Thin Equity Cushion
Safer Equity Capital
Admati & Helwig

Safer Leverage ratio

- Can Borrow $70 - 80 for every $100 in assets owned
- Conservative Minimum Equity Cushion
Source of Fragility: Hot Money in the Shadows -- Repo

![Bar chart showing trillions of dollars in triparty alone from 2008, 2011, and November 2012. The chart indicates a significant increase in 2008, followed by a decrease in 2011, and a slight increase in November 2012.]
Volcker Rule?

‘This trade doesn’t violate the Volcker rule, but it violates the Dimon principle.’

J.P. Morgan CEO James Dimon, May 10, 2012

‘London Whale’ Rattles Debt Market

BY GREGORY ZUCKERMAN AND KATY BURNE

In recent weeks, hedge funds and their investors...

The Wall Street Journal, April 6, 2012
Additional Persistent Concerns

- Cross-border Insolvencies
- Untested Intervention
- Too-Big-To-Manage
- Too-Big-To-Regulate
- Too-Big-To-Prosecute
How Did We Get Here?
Lobbying Persists

Outnumbered By Bank Lobbyists

20 to 1. The new Dodd-Frank finance reform law has been under siege by Wall Street lobbyists intent on weakening, delaying, and dismantling it. Lobbyists for consumer protection groups are few.

In 2012, the top 5 consumer protection groups defending Dodd-Frank sent 20 lobbyists to Capitol Hill.

AFSCME: 10
US PIRG: 6
Center for Responsible Lending: 2
Consumer Federation of America: 2
Americans for Financial Reform: 0

U.S. Chamber of Commerce: 183
American Bankers Association: 90
JP Morgan Chase: 60
Goldman Sachs: 51
Wells Fargo: 22

That same year, the top 5 finance industry groups trying to destroy Dodd-Frank sent 406 lobbyists to Capitol Hill.
Strong Provisions Introduced but Not Enacted in 2010 in Dodd-Frank

• SAFE Banking Act (Sherrod Brown-Ted Kaufman)

• Ending Repo Bankruptcy Safe Harbors (Bill Nelson)

• Reinstatement of Glass-Steagall (John McCain-Maria Cantwell)

• A Stronger Volcker Rule (Merkley-Levin got watered down in order to gain support)
Weaker Measures Enacted

– Size not restricted
– Repo/liquidity risk discretionary
– Leverage too high, capital too low
– Capital relies on internal valuations
– Prevention too discretionary
– Intervention untested and funded by Treasury (with possible back-end payment by industry) instead of upfront bank funding
Implementation: Further Delays and Dilution

- Shadow banks: Not a single NBSIFI has been designated
  - Gaps in rule re non-debt funding risk (par put rights such as money funds)

- Leverage and Size:
  - 165 & 166: Enhanced prudential and early remediation standards
  - Triggers too little, too late
  - Basel leverage measure delayed, weak
  - Section 121: Won’t be used according to seasoned regulators

- Volcker: Rule not finalized. Questions as to whether it will be weakened, meanwhile the London Whale

- Efforts to weaken derivatives reform
Solutions?

• Expanding Chorus: Break up the Banks
  – Across the political spectrum
  – Various methods: size, or line of business, etc.

• Return of Sherrod Brown’s Bill
  – Co-sponsored with Republican David Vitter
  – Related non-binding measure from Merkley as indicator

• Give Dodd-Frank more time:
  – Pressure to use pre-emption powers under Title I
  – Hope for a strong Volcker implementing rule
  – Or, just wait and see if Title II will work
Delusions

“The things we did in this crisis, and certainly the things we did in financial reform, will significantly reduce the probability and the intensity of crises for a long period of time. Because there’s much more capital in the financial system. We did a pretty brutal restructuring of our financial system as a part of the crisis response. . . It is true that there is an ongoing political effort to legislate a weakening Dodd-Frank or block appointees. But that effort does not have much political force now. ”

Secretary Timothy Geithner 2013