Financial Regulatory Reform Since the Crisis

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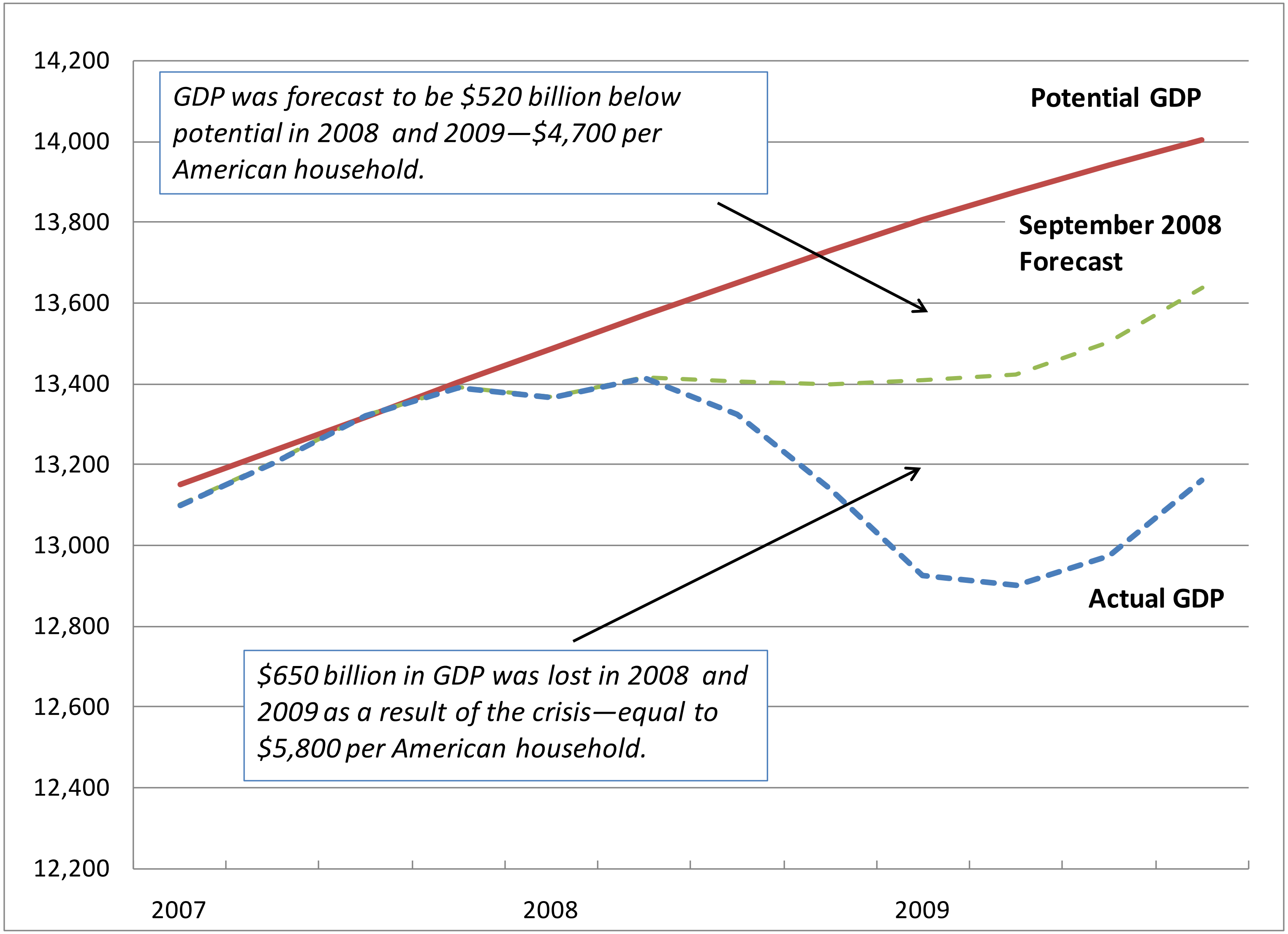
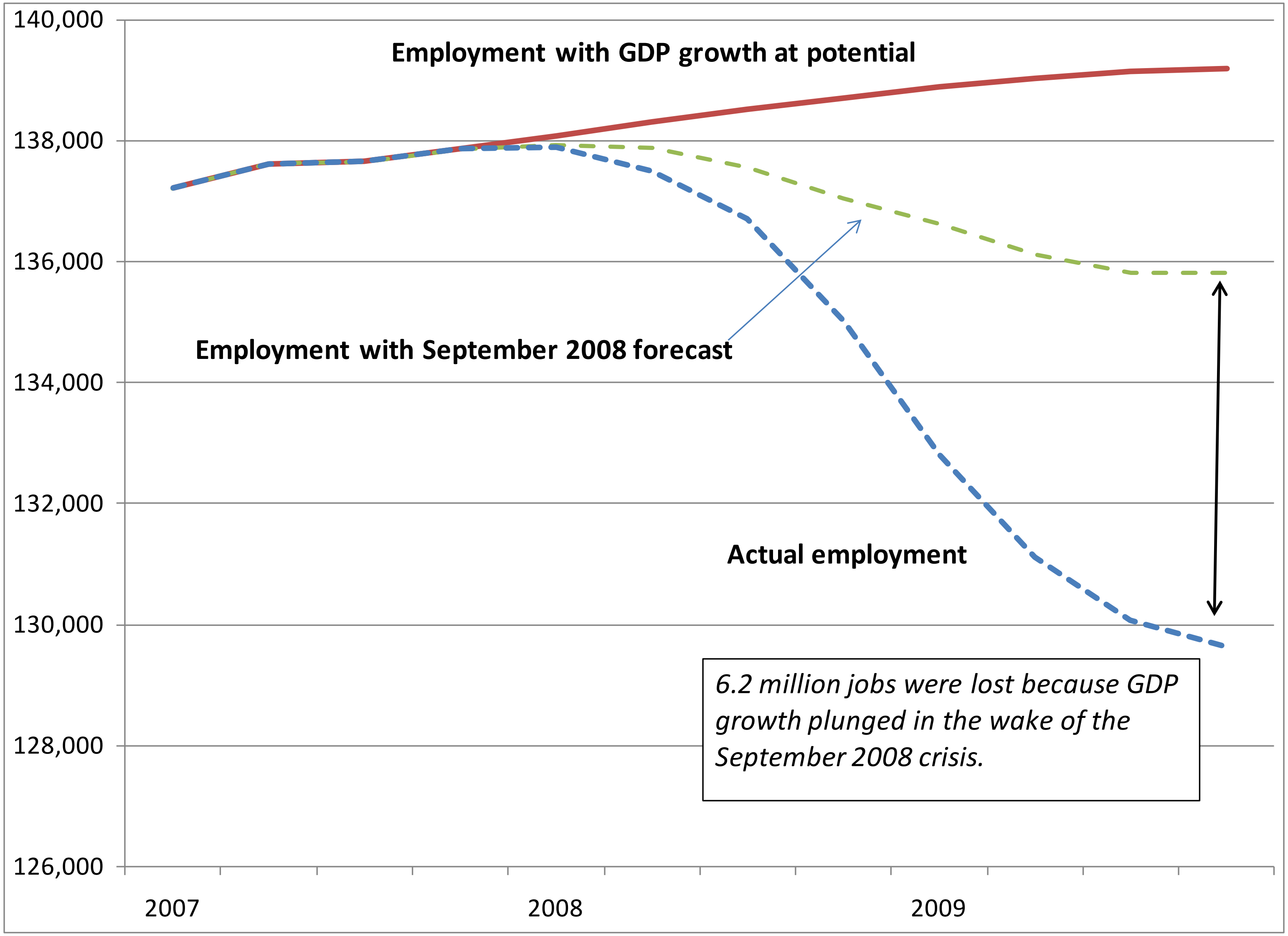
Economic and Fiscal Impacts of the Crisis

	Total impact of the crisis	Per Household Loss
GDP (total lost income)	$650 billion	$5,800
Employment (lost jobs)	6.2 million jobs	
Wages (total lost wages)	$360 billion	$3,250
Stock wealth (July 08-March 09)	$3.4 trillion	$30,300
Real estate wealth (July 08-March 09)	$7.4 trillion	$66,200
Fiscal cost (losses on TARP + GSEs)	$230 billion	$2,050

Impact on Output: <u>$5,800 per family</u>



Impact on Employment: 6.2 million jobs



Problems Highlighted by the Crisis

- Insufficient capital / excessive leverage
- TBTF and moral hazard
- Tools to respond to a crisis
- Derivatives lack of clarity
- Lack of faith in securitization
- Ineffective supervision
- Insufficient attention to consumer issues
- Cracks in the regulatory system (AIG)
- Global coordination (Lehman bankruptcy)
- Credit rating agency performance
- Performance of some regulators (OTS but also others)
- Political willingness/ability to act (Spring and fall 2008)

The Response: Dodd-Frank Wall Street Reform and Consumer Protection Act, July 21, 2010

- Systemic Risk Regulation
  - FSOC: Who is systemic? (Financial Stability Oversight Council)
  - OFR: What to investigate? (Office of Financial Research)
- Volcker Rule (proprietary trading)
- Derivatives
  - Swaps push out / limits on Bank Activities (Lincoln Amendment)
  - Clearing and Exchange Trading
- Bank regulation, including enhanced prudential standards
  - Merge OTS into OCC
  - Capital requirements (Collins Amendment) (plus Basel III)
  - Liquidity regulation
- Consumer Financial Protection Bureau
- Non-Bank Resolution Authority – Title II
- Limits on Fed emergency powers (perhaps)

Left Out or Only Partly Addressed

- Regulatory agency consolidation
  - SEC-CFTC; single prudential regulator
- Credit rating agencies
- Housing finance reform
- Money market mutual funds
- Shadow banking system
- TBTF (?)
- Could add tax system favors debt over equity

Tradeoff between Stability and Growth

- What’s the right capital level? More capital has a cost that eventually affects end users and the economy.
- Avoid actions that impose costs but do not add stability (what about symbolic actions?)
- Heisenberg principle - Regulation leads to industry shifts such as into less-regulated shadow banks. Or activity will migrate to foreign banks.

Resolution Authority

- Meant to be used beyond edge of bankruptcy.
- FDIC implementation with single point of entry (SPOE)
  - Impose haircuts on holding company senior debt (including through equity conversion)
  - Prop up a firm until it is wound down or sold off
  - Taxpayers repaid by haircuts and industry tax
- Will there be enough senior debt? What if not?
- Creditor rights and regulatory discretion
- International coordination

- Will Title II have an impact on ex-ante funding costs or on firm stability (hair trigger creditors)?
- Does Title II end bailouts or enshrine them?

Consumer Protection

- CFPB’s structure, governance, and budget, including quality and stability of staff
- Rulemaking process
  - Good: has met statutory deadlines and responded to comments (remittances)
  - Bad: regulation by blog post and lack of transparency
- Relationship with bank examinations – unwillingness to close out exams
- Data collection – uncoordinated and unexplained data requests
- Specific issues such as auto lending

Capital Markets

- Volcker Rule
  - Proprietary trading and the crisis
- Money market mutual funds
- Derivatives
  - Swaps push out (Lincoln Amendment)
  - Concentration of risk at clearinghouses

Regulatory Architecture

- Overlap among agencies? Pros and cons of regulatory diversity. Scope for consolidation?
  – SEC and CFTC, start with joint board meetings
- FSOC & OFR
- Federal-state regulatory relationships (including insurance)
- Supervisory quality and bank examiners
  – Joint examiner pool

Systemic Risk

- FSOC, including designations of SIFIs and transparency of activities
- Asset managers
- Insurance companies
- Restrictions on government actions, including the Fed’s 13-3 authority

Would it have prevented the last crisis?

- Housing bubble and sub-prime. CFPB has some authority over mortgage markets, but these are also regulated by state authorities.
  - GSE reform not part of Dodd-Frank and stalled in Congress
  - Regulators didn't see the last crisis in the works
  - Still hard to see bubbles in real-time and take away the punch bowl
  - FSOC process unclear. OFR remains a work in progress.

- Lehman and AIG. Title II Orderly Liquidation Authority. Prop up the next failing firm and then recoup losses through ex-post haircuts
  - Pro: can deal with the next Lehman better
  - Con: probably destabilizes a failing firm; Lehman creditors would have been more hair trigger knowing they face haircuts (see Ireland)

- Money market mutual funds. Not a great outcome for FSOC

Ultimately more capital is the best bulwark against crisis.

Looking Ahead

What to do when the law is not sufficient?

- CFPB and auto lending
- Small dollar lending and bank regulators
- CLOs and the Volcker Rule

- What does it mean for economic activity?
- Will it prevent the next crisis or make the policy response better or less costly?
- What is the tradeoff between regulation and growth or stability?