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Financial Regulation: Past, Present & Future

Deregulating Wall Street

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2008 Financial Crisis: A Ten-Year Review

November 8, 2018

Roadmap

- Dodd-Frank
- Key tradeoff: higher capital substitutes for other policy tools (such as restrictions on scope)
- Recent regulatory shifts: impact on resilience
  - Legislative changes
    - CHOICE Act (passed House, 2017)
    - EGRRCP Act (S.2155; enacted 2018)
  - Discretionary changes
    - Treasury reports and FSOC
- Inefficiencies (Volcker Rule)
- Conclusion

Note: Comments based on joint paper with Matthew Richardson and Lawrence J. White, and on joint work with Stephen Cecchetti. Errors are all mine.

Dodd-Frank

- Stern faculty books
  - *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* (2010)
  - *Regulating Wall Street: CHOICE Act versus Dodd-Frank* (2017)
- Dodd-Frank addresses systemic risk using:
  - capital requirements (buttressed by stress tests)
  - liquidity requirements
  - resolution mechanism
  - restrictions on scope of activities
- Regulation creates compliance costs
  - Broad consensus: reduce burden on small institutions
  - Disagreement about large intermediaries

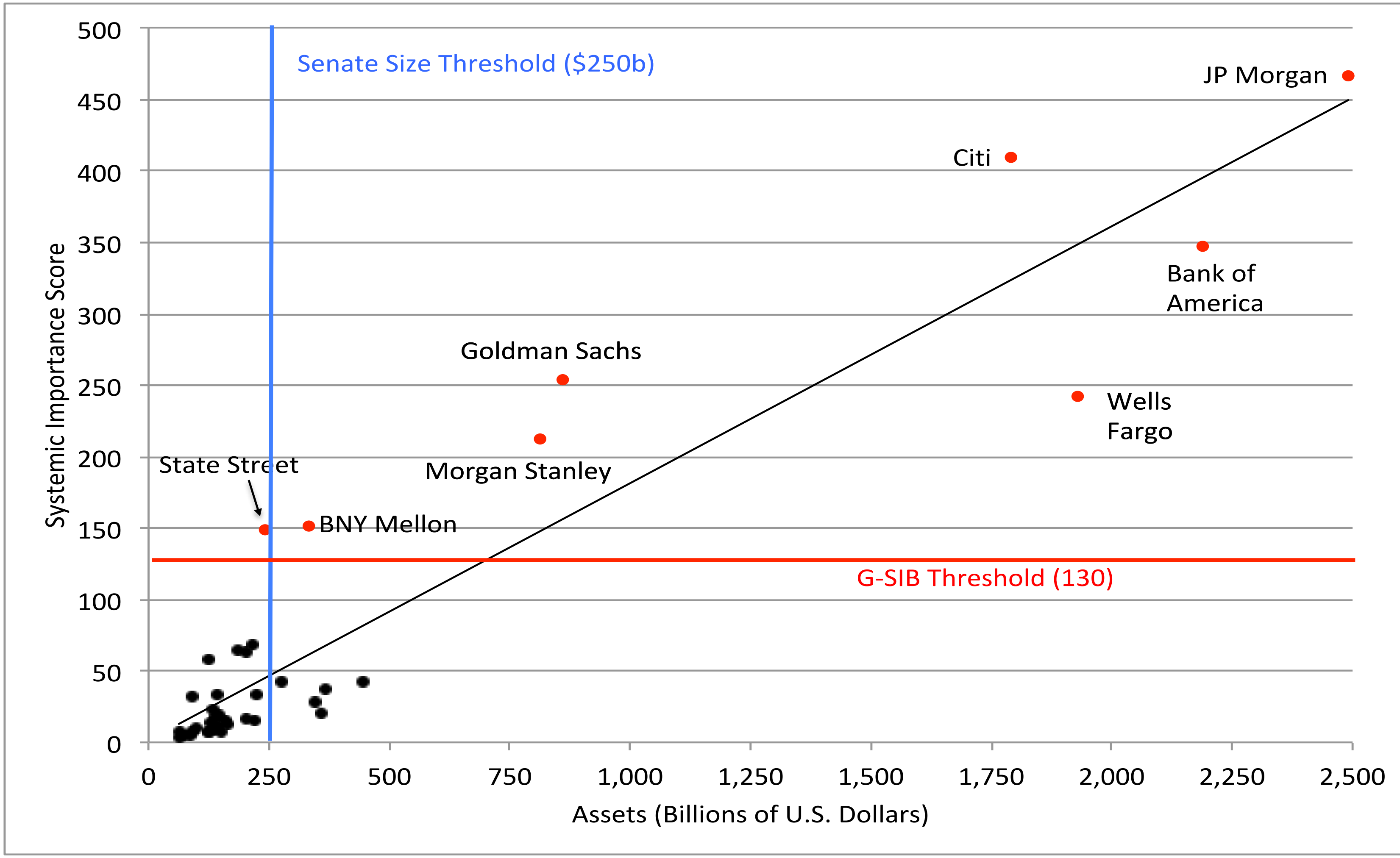
Lower Systemic Risk

Source: NYU Stern Volatility Lab, SRISK. Latest Observation as of 2018-10-26.

Legislation Relaxes Bank SIFI Oversight

- Eases burdens on small banks (EGRRCP Act)
- Relaxes scrutiny of larger ones
  - Bank asset threshold raised from $50bn to $250bn
  - Fed has to justify scrutiny of mid-sized banks

Threats to System: Size is Overrated



Source: Based on bank holding company data in Treasury Office of Financial Research update of Size Alone is Not Sufficient To Identify Systemically Important Banks.

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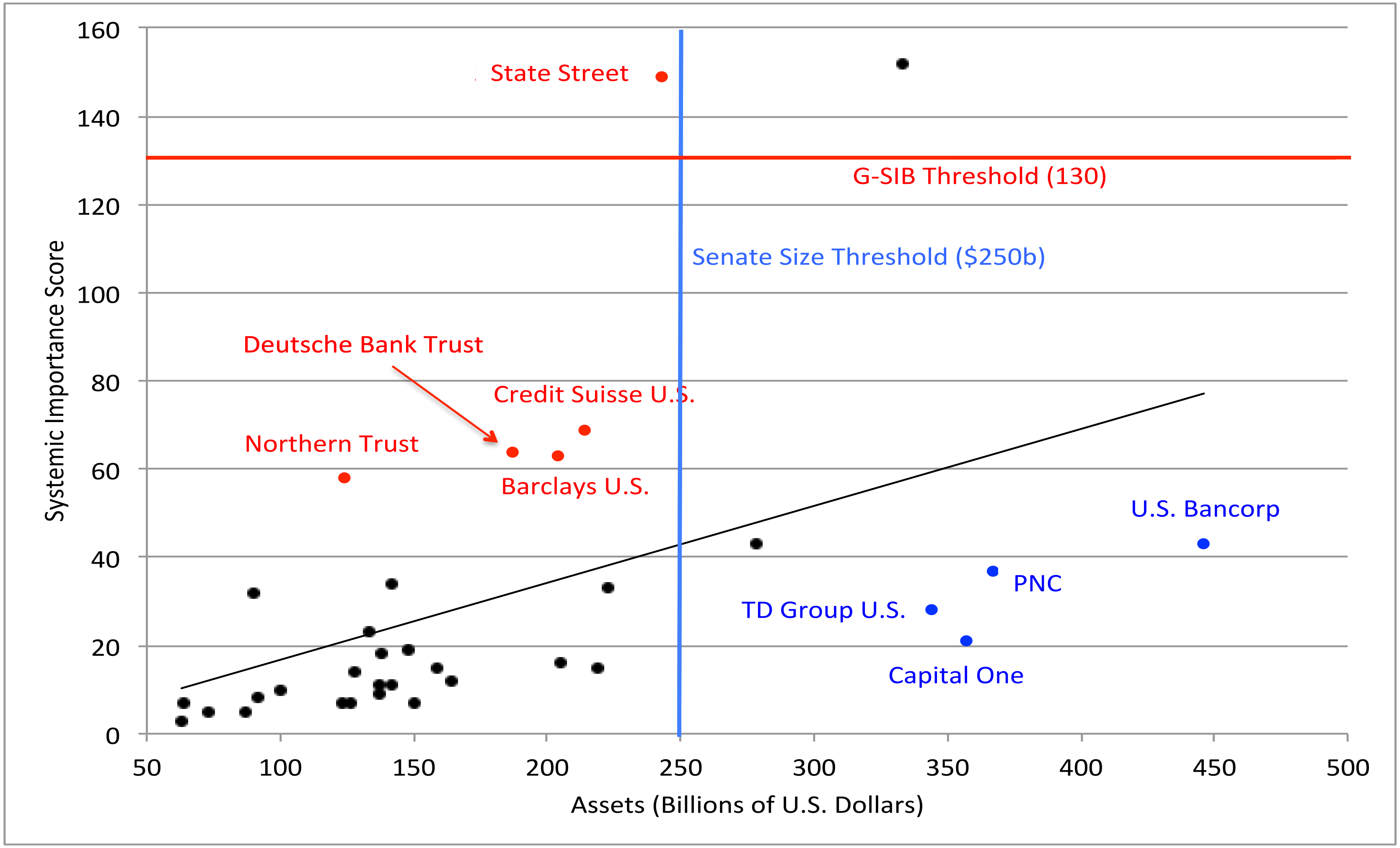

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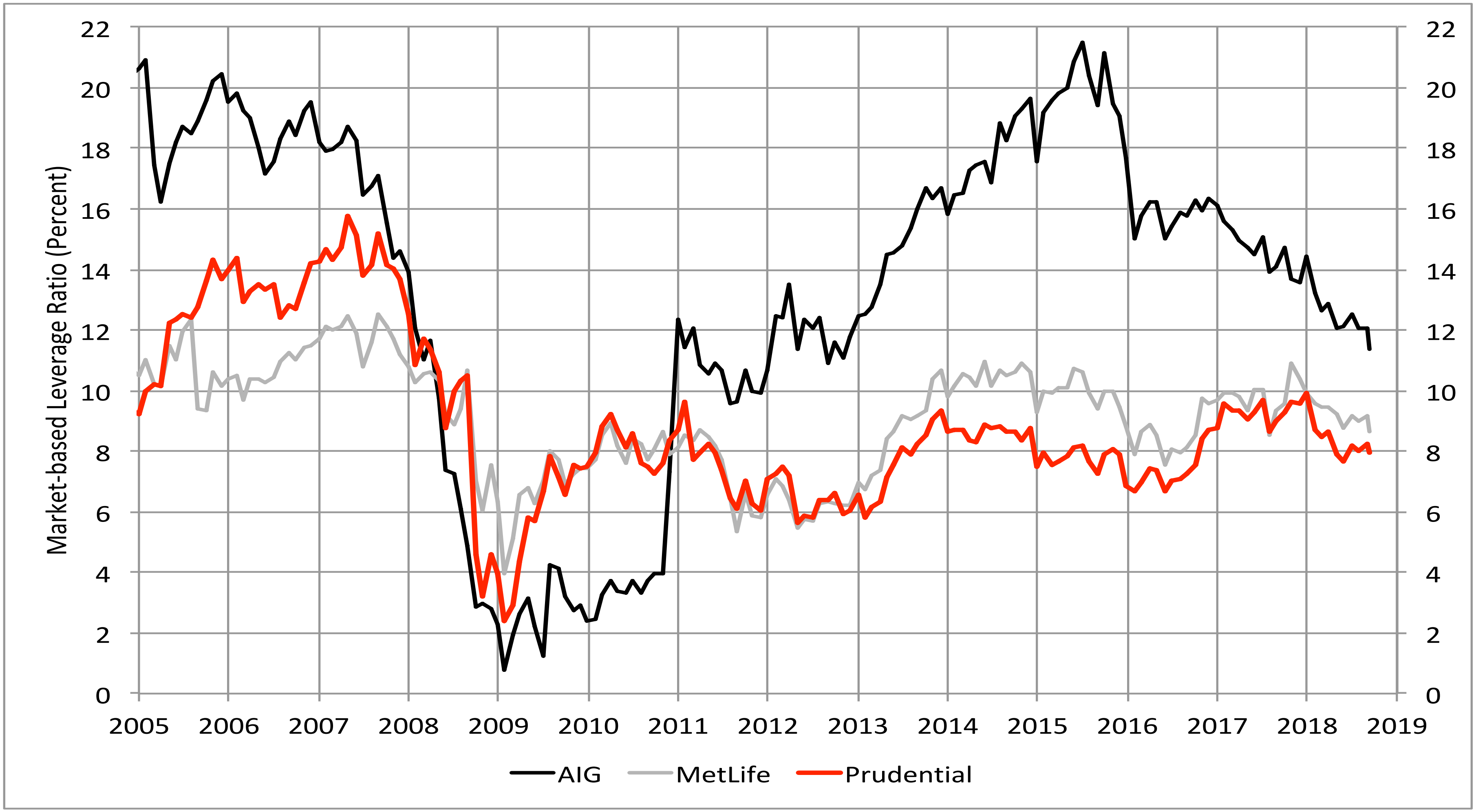
Treasury/FSOC: Amplifying Regulatory Arbitrage

- Principles and goals for designation
- Nov 2017: Treasury report — *activities* over *entities*
- FSOC Actions
  - 2013-14: AIG, GE Capital, MetLife, and Prudential
  - 2016-17: De-designation of GE Capital and AIG
  - Jan 2018: Treasury withdraws court appeal of MetLife
  - Oct 2018: Prudential de-designated

Discretionary Changes: Nonbank SIFIs



Notes: The numerator of each ratio is the market value of equity. The denominator is the sum of debt and the market value of equity. These leverage measures *exclude* "separate accounts" that are segregated from the firm's "general account." Final observation as of October 12, 2018. *Source: NYU Stern Volatility Lab.*

Volcker Rule Not Cost Effective

- Long and complex
- Not focused on risk management
- Market making vs. proprietary trading
- More effective tools available: higher capital

What is to be done?

- Streamline byzantine regulatory framework
  - U.K. has 3 regulators
  - U.S. has more than 100
- Transparency to promote market discipline
- Raise capital requirements further

  (remain alert to side effects)
- Address other forms of risk