

Written Testimony of David A. Skeel, Jr.

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Chairman Hensarling, Ranking Member Waters, and distinguished members of the Committee, thank you giving me the opportunity to testify before you on “The Dodd-Frank Act Five Years Later: Are We More Free?” My name is David Skeel, and I am the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School. It is a great honor to appear before you today.

I’d like to start by applauding you for conducting this five year retrospective on the Dodd-Frank Act. The Dodd-Frank Act is still young. In fact, some of the estimated 280 rules that the Dodd-Frank Act instructed regulators to promulgate still are not in place. But it seems clear that the Dodd-Frank Act will be the centerpiece of American financial regulation for the next generation, so it’s essential to make it as effective as possible.

In my view, the Dodd-Frank Act has a number of features that have significantly improved American financial regulation. More careful regulation of derivatives and other financial contracts was sorely needed, for instance. But its framework for regulating the largest financial institutions—often called systemically important financial institutions, or SIFIs—sharply departs from traditional rule of law principles, carrying forward some of the most problematic qualities of the 2008 bailouts. Today, I’m going to focus on these worrisome features of the Dodd-Frank Act.¹

As I have written elsewhere, including in a book I finished shortly after the Dodd-Frank Act was enacted, key parts of the legislation reinforce the partnership between the government

¹ I will not be talking about the Consumer Financial Protection Bureau, which is the principal focus of several other panelists’ remarks. In my view, the Consumer Bureau has been a valuable and necessary innovation, though I recognize that it has raised rule of law concerns in some respects.

and the largest banks that was put in place during the financial crisis.² This partnership looks a lot like the European style of regulation that is known as corporatism. It is far removed from the rule of law virtues that have traditionally characterized American financial regulation.

In the remarks that follow, I'll briefly describe what I mean by the rule of law and then then quickly recount some of the departures from rule of law principles in 2008-2009. Rather than restoring the rule of law, as one might have expected, the Dodd-Frank Act created a corporatist framework for regulating American finance that invites continued departures from the rule of law. I will focus in particular on four major parts of the regulation: the process for designating financial institutions as systemically important; living wills and stress tests; the Orderly Liquidation Authority in Title II; and the Volcker Rule.

In my view, restoring the rule of law in these four areas would significantly improve the new regulatory framework, and would restore the values we have traditionally associated with American financial regulation.

The Rule of Law

A decade ago, the International Bar Association described the rule of law as “the foundation of a civilized society.” The rule of law “establishes a transparent process accessible and equal to all. It ensures adherence to principles that both liberate and protect.”³

In practice, our commitment to rule of law virtues is supposed to mean at least three things in the context of financial regulation. First, when regulators intervene, their intervention will be governed by legal rules, not simply by discretionary choice. Obviously, discretion exists, and it matters, but the key policy judgments should be made by those who *define* legal rules, not by those who *enforce* such rules. The second implication follows from the first: the provisions in question should have a reasonable measure of specificity. For law to rule, it must define the line between behavior that is permissible and behavior that isn't—not simply declare that the line

² DAVID SKEEL, *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS UNINTENDED CONSEQUENCES* (2011).

³ Resolution of the Council of the International Bar Association (2005)

exists and leave its definition to regulators and law enforcers. Third, when an individual or institution is alleged to have violated a particular rule, or where regulators intend to seize the institution or its property, the individual or institution must have a full and fair opportunity to respond. The right to due process must be honored.

As explained more fully below, the framework established by the Dodd-Frank Act violates each of these principles, especially in its oversight of systemically important financial institutions. It relies heavily on regulatory discretion, is insulated from effective oversight, and eschews transparency.

The Context: 2008-2009

To appreciate the corporatist tendencies of the Dodd-Frank Act, it is important to begin by briefly revisiting the handling of the 2008-2009 crisis by the Bush and Obama administrations. Many of the patterns established during the crisis, including its major departures from rule of law principles, have been replicated in the Dodd-Frank Act. In part this appears to reflect the remarkable fact that many of the same officials who bailed out several major financial institutions in 2008 also served as principal architects of the Dodd-Frank Act.

Bear Stearns

In March 2008, Bear Stearns, one of the nation's largest investment banks, suddenly collapsed. Bear Stearns' demise began when questions about its liquidity arose, triggered in part by a rumor that Goldman Sachs had refused to renew the daily repo loans it was making to Bear.⁴ As hedge funds and other clients withdrew their money, Bear's CEO Alan Schwartz called superlawyer Rodgen Cohen, the chairman of Sullivan & Cromwell, who quickly contacted Timothy Geithner, then-president of the Federal Reserve Bank of New York.⁵ After failing to line up new financing, Schwartz contacted the head of JPMorgan Chase and proposed a deal.

⁴ See, e.g., Kate Kelly, *Fear, Rumors Touched Off Fatal Run on Bear Stearns*, WALL ST. J., May 18, 2008.

⁵ *Id.*

With heavy involvement by Geithner and Treasury Secretary Henry Paulson, including a \$29 billion loan guarantee by the Fed, the parties hastily agreed to a purchase of Bear by JPMorgan.⁶

This was no ordinary arms length business transaction. As the two banks gravitated toward a price of \$4-\$5 per share, Paulson insisted that they lower the price, so that Bear Stearns wouldn't benefit from the bailout.⁷ The Fed and Treasury also played an active role in structuring the transaction, which took the form of a merger in which JPMorgan acquired Bear Stearns' stock from its shareholders. To ensure that the government-endorsed transaction could not be disrupted, the parties added lockup provisions that clearly violated Delaware merger law.⁸ The key provision promised JP Morgan 49% of stock even if its acquisition fell through, thus making it impossible for a competing bidder to obtain control.⁹

Fannie Mae and Freddie Mac

In July, 2008, then Treasury Secretary Treasurer Paulson urged Congress to pass legislation giving Treasury essentially a blank slate to intervene with Fannie Mae and Freddie Mac if necessary. He assured Congress that he did not expect to need to use the new powers in the foreseeable future. In August, 2008, Treasury gave a massive bailout to the two entities and placed them in conservatorship. Rather the shutting down or restructuring Fannie Mae and Freddie Mac, the government has kept them in conservatorship. In 2012, after Fannie Mae and Freddie Mac had begun earning profits again, the government restructured its agreement with the two entities, creating a "sweep" of the profits that would direct the profits to the Treasury and ensure that private shareholders did not benefit. Fannie Mae and Freddie Mac continue in this state of limbo today. With any profits going the U.S. Treasury, there is little pressure to reform and restructure them.

⁶ *Id.* Kate Kelly, *Bears Stearns Nearing Collapse Twice in Frenzied Final Week*, WALL ST. J., May 29, 2008, at A1.

⁷ The price was later renegotiated upward to \$10 per share after the parties discovered a glitch in the terms of the merger agreement, which could be read as an open-ended commitment by JPMorgan to guarantee Bear Stearns' obligations.

⁸ The provisions and the deal are analyzed in detail in Marcel Kahan and Edward B. Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity*, 58 EMORY L.J. 713 (2009).

⁹ *Id.*

The AIG Bailout

Two days after Lehman Brothers filed for bankruptcy,¹⁰ AIG, the giant insurance and financial services company, threatened to collapse.¹¹ The Treasury and Federal Reserve put together a \$85 billion bailout package (later expanded to \$182.5 billion) to avert a default.¹² The rescue financing had a number of unusual features. Most important for present purposes, it appeared to give the New York Federal Reserve control of nearly 80% of AIG's stock, through trusts set up to facilitate the rescue.¹³ The stock feature was noteworthy because the Federal Reserve's emergency lending powers permit it to make loans, but not to buy or sell stock.¹⁴ The Federal Court of Claims recently held that this structure violated the Federal Reserve Act.

TARP and the Car Bailouts

In late September, Treasury Secretary Paulson asked Congress to enact legislation giving the Treasury Department \$700 billion to purchase troubled assets held by the banking industry.¹⁵ The direness of Paulson's warnings, and the paucity of details about Treasury's specific plans, terrified the markets.¹⁶ After the House initially rejected the proposed legislation, jolting the markets once again, both houses approved it and President Bush signed the \$700 billion Troubled Asset Relief Program into law on October 3, 2008.¹⁷ Although the Treasury

¹⁰ In my view, the biggest mistake of the 2008 crisis was the decision to bail out Bear Stearns rather than allowing it to file for bankruptcy six months before the Lehman Brothers collapse. If Bear Stearns had not been bailed out, Lehman Brothers almost certainly would not have assumed that it could expect a bail out too. Lehman would have prepared for the possibility of bankruptcy, and its filing would not have been nearly so disruptive. *See* SKEEL, *THE NEW FINANCIAL DEAL*.

¹¹ The most extensive scholarly analysis of the AIG collapse and bailout is William K. Sjostrom, *The AIG Bailout*, 66 WASH. & LEE L. REV. 943 (2009).

¹² *Id.* at 944-45.

¹³ *Id.* at 966.

¹⁴ *See, e.g.*, Eric A. Posner & Adrian Vermeule, *Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of 2008*, 76 U. CHI. L. REV. 1613, 1629-30 (2009).

¹⁵ *See, e.g.*, ANDREW ROSS SORKIN, *TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM AND THEMSELVES* 490-97 (2009)(paperback 2010).

¹⁶ *See, e.g.*, JOHN B. TAYLOR, *GETTING OFF TRACK* (2009).

¹⁷ *See, e.g.*, DAVID WESSEL, *DAVID WESSEL, IN FED WE TRUST: BEN BERNANKE'S WAR ON THE GREAT PANIC* 226-227 (2009)(paperback edition 2010).

Department originally planned to purchase bank's mortgage related assets, it used the funds to provide capital to each of the largest banks.¹⁸

Paulson insisted that none of the TARP funds would be used to bail out the auto industry. "The TARP is aimed at the financial system," he assured Congress a few weeks after its enactment. "[I]n terms of autos, I have said it would not be a good thing."¹⁹ After an auto bailout proposal was swatted away by Congress, he and the Bush administration changed their minds. They made \$17 billion in loans to General Motors and Chrysler, enough to ensure that neither company ran out of cash before the end of the Bush administration and transition to a new administration.²⁰

At the outset of his administration, President Obama set up an Auto Task Force to deal with General Motors and Chrysler.²¹ After reviewing the companies' own proposals for rejuvenation, the administration ushered each through a "quick rinse" bankruptcy.²² Rather than use the ordinary restructuring process, which requires a creditor vote and a variety of other protections, each company "sold" its most important assets to a new company set up for this purpose.²³ To finance the process, the Treasury Department lent additional TARP funds to each company. Many commentators, including me, believe that the Chrysler transaction violated basic bankruptcy law doctrine and that its approval set a dangerous precedent for American bankruptcy law.²⁴

Dodd-Frank Act Departures from the Rule of Law

¹⁸ *Id.* at 227.

¹⁹ *See, e.g.,* Wendy Jones, *Paulson, Bernanke Testify, Get Grilled*, FIRST READ (NBC), Nov. 18, 2008, available at <http://firstread.msnbc.msn.com/news/2008/11/18/4425489-paulson-bernanke-testify-get-grilled> (quoting Paulson testimony).

²⁰ *See, e.g.,* Michael Giusti, *Automakers Receive \$17 Billion in Bush Bailout*, BANKRATE.COM, available at <http://www.bankrate.com/finance/auto/automakers-receive-17-billion-in-bush-bailout-1.aspx>.

²¹ For a somewhat self-serving inside account of the Auto Task Force's work by its head, see Steve Rattner, *The Auto Bailout: How We Did It*, FORTUNE, Oct. 21, 2009.

²² *Id.*

²³ The Chrysler transaction is described and criticized in considerable detail, and General Motors more briefly, in Mark J. Roe & David Skeel, *Assessing the Chrysler Bailout*, 108 MICH. L. REV. 727 (2010).

²⁴ *See, e.g., id.*; David A. Skeel, Jr., *From Chrysler and General Motors to Detroit*, 24 WIDENER L.J. 121 (2015).

It is perhaps inevitable that the executive and other branches will be tempted to take liberties with the rule of law during a major financial crisis.²⁵ But rule of law principles usually are quickly restored after the crisis passes. That didn't happen after the 2008-2009 crisis. The Dodd—Frank Act reinforced many of the patterns established during the crisis. Of most concern, the legislation creates a corporatist-style partnership between the government and the largest banks that seriously undermines the rule of law. These departures have been extremely costly, and could magnify the consequences of the next crisis.

Before I describe these problems in greater detail, I should note that several parts of the Dodd-Frank Act reflect a genuine effort to restore rule of law principles. The Dodd-Frank Act limits the emergency power of the Federal Reserve under section 13(3) of the Federal Reserve Act by prohibiting the Fed from making emergency loans to individual institutions. This limitation is designed to discourage the kinds of bailouts the Fed made in 2008. I worry that the provision will not have its intended effect, but it clearly was designed to reinstitute rule of law principles in this context.

In addition, the Dodd-Frank Act has introduced new clearing and exchange trading requirements, as well as other oversight, for over-the-counter derivatives. These requirements are not perfect, but they have significantly enhanced the transparency and regulatory oversight of derivatives and related financial contracts.

In the discussion that follows, I will focus on four specific areas whether the corporatist structure of the Dodd-Frank Act has invited serious departures from rule of law principles. There are other problem areas, but these are four of the most serious.

Title I designation and oversight

²⁵ See, e.g., Eric A. Posner & Adrian Vermeule, *Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of 2008*, 76 U. CHI. L. REV. 1613, 1629-30 (2009).

Title I gives bank regulators the authority to designate financial institutions as systemically important. (Although there is no simple definition of systemically important, it generally means that the institution's failure could create a crisis for the broader financial system). Bank holding companies that have more than \$50 billion in assets are automatically deemed to be systemically important, and so far, regulators have designated four others as systemically important: AIG, Prudential, GE Capital, and Metropolitan Life.

The designation process raises two serious problems from a rule of law perspective. The first is its direct contribution to the Dodd-Frank Act's corporatist tendencies. Once an institution qualifies as systemically important, regulators are given sweeping oversight authority over it. In theory, these institutions will be subject to stricter regulation, including requirements to fund more of their assets with cash rather than debt. But they also will be singled out for special treatment, and will have a special relationship with bank regulators. This is exactly how corporatism works: the government has sticks that it can use to whack a favored institution if it gets out of line, but in return for doing the government's bidding, the favored institutions are protected from competition.

The second problem is that the designation process is highly arbitrary. The Federal Systemic Oversight Council has unfettered discretion which institutions to designate as systemically important. Although the FSOC has promulgated a rule outlining its designation procedures, the rule imposes few real constraints on the FSOC. The potential abuse of the rule is has been most evident in the FSOC's consideration in the past two years whether to designate large mutual funds or hedge funds as systemically important. Although mutual funds do not appear to create a real threat of systemically destructive consequences, nothing prevents regulators from designating them as systemically important.

The designation process is currently being challenged by Metropolitan Life, which argues that the process by which it was designated is legally flawed.

Another key feature of Title I is a requirement that institutions that have been designated as systemically important prepare a rapid resolution plan each year. The rapid resolution plan, colloquially known as a “living will,” the financial institution must outline how it would pursue an orderly bankruptcy if it falls into financial distress, and minimize the likelihood that its failure could cause systemic harm.

I have been a proponent of living wills, and I continue to support this feature of the Dodd-Frank Act. I believe that the living will process may produce genuine benefits, such as at least a limited simplification of the structures of the largest financial institutions.

But the living will process has been highly opaque. Regulators—in this case the Federal Reserve and the FDIC—have complete discretion whether to accept an institution’s living will, or to punish the institution for noncompliance. Although each institution releases a public statement about its living will, the public statements have consisted largely of boilerplate discussion that gives few details about the specifics of the institution’s plan.

In the last several years, stress tests and living wills appear to have been the principal regulatory tool used by the Federal Reserve to regulate the largest view. In my view, some of the regulation that has been effected through this process has been quite desirable.²⁶ But it is regulation that is far removed from the rule of law. There has been almost no transparency. The regulation reflects the priorities and considerations of the regulators themselves, largely detached from any formal, public legal framework.

Title II Resolution

Title II, or the Orderly Liquidation Authority, is designed to give regulators the authority to take over a financial institution whose impending default could cause systemic damage. Based on the FDIC’s authority to resolve ordinary banks, Title II gives regulators sweeping discretion whether and when to take over a troubled financial institution, and how to resolve the

²⁶ For example, the Fed and FDIC appear to have forced the largest banks and the International Swaps and Derivatives Association (ISDA) to incorporate into their derivatives contracts a short standstill on the termination of the derivative in the event an affiliate enters bankruptcy or insolvency proceedings. *See* ISDA 2014 Resolution Stay Protocol (Nov. 4, 2014).

financial distress once regulators have intervene. The discretion vested in regulators in both contexts is far removed from traditional rule of law virtues, and the initiation framework is probably unconstitutional.

At the outset, Treasury is the quarterback of the new resolution process. If the Treasury, backed by two-thirds votes of the Federal Reserve and the FDIC, concludes that a financial company is on the verge of default, or has defaulted, and that its failure “would have serious adverse effect on financial stability in the United States,” it can trigger resolution by filing a petition in federal court in Washington, D.C. Judicial review is extremely limited. The court has only twenty-four hours to rule on the petition, the hearing is secret, and the court must approve the petition so long as it was not “arbitrary and capricious” for regulators to determine 1) that the institution was a financial company, and 2) that it was in default or in danger of default. Given that any financial institution that is taken over by regulators will be in danger of default the moment the intervention becomes publicly known, even if it was still healthy the day before the takeover, it will be essentially impossible for any financial institution to challenge the regulators’ intervention. The secrecy and speed of the decision makes an effective challenge even more unlikely. The absence of any meaningful opportunity for the financial institution to contest the regulatory takeover appears to violate the U.S. Constitution’s Due Process Clause.²⁷

After the petition is approved, the FDIC is appointed receiver (other than with investment banks, where the SEC is receiver; and insurance companies, whose receiver is the new federal insurance regulator), and is given extensive authority to borrow money and to take over the company’s operations during the receivership. On the surface, Title II seems to have a clear priority structure that limits bank regulators’ ability to pick and choose which creditors get paid and which do not. The FDIC is instructed to “ensure that unsecured creditors bear losses in accordance with the priority of claim provisions,” and to wipe out shareholders unless all creditors are paid in full.²⁸ Title II also borrows a cluster of other provisions from bankruptcy, each of which has related rule of law concerns in mind.

²⁷ For a detailed analysis, see Kenneth E. Scott, *Dodd-Frank: Resolution or Expropriation?*, in *BANKRUPTCY NOT BAILOUT: A SPECIAL CHAPTER 14* at 199 (Kenneth E. Scott & John B. Taylor, eds, 2012).

²⁸ Dodd-Frank Act § 206.

Unfortunately, the apparent constraints are a mirage. The priority rules only apply to claims that the FDIC leaves behind-- the ones that it has not decided to pay in full. As with ordinary bank resolution, Title II gives the FDIC blanket authority to pay claims in full if it wishes. Title II also gives the FDIC the authority to abandon the priority rules and make ad hoc payment decisions if the regulators concludes this is necessary for systemic stability. The framework leaves the FDIC free to do nearly anything it wishes.

In the past three years, the FDIC has devised a strategy for resolving systemically important financial institutions that has become known as a “single point of entry” approach. Under single point of entry, the FDIC would put only the holding company of a systemically important financial institution into resolution. It would recapitalize the holding company by transferring the holding company’s assets and short term liabilities to a new bridge bank, leaving the holding company’s stock and longterm debt behind. This strategy deviates quite significantly from the traditional priority structure, which would treat short-term and longterm debt as equivalent claims, each expected to bear losses.

Although the new strategy strikes me as superior to the rules of Title II as actually written, it is problematic in two respects. First, if the FDIC were more serious about incorporating rule of law virtues into the resolution process, it would disclaim its discretion to pick and choose which creditors to pay, and would commit to the priority structure implied in the single of entry process. But the FDIC has refused to limit its discretion.

Second, Title II explicitly requires that the resolution provisions be used to liquidate troubled financial institutions, not to reorganize them. The “thou shalt liquidate” provision is perhaps the single clearest mandate in the entire Dodd-Frank Act, introduced with much fanfare late in the legislative process. Yet the single point of entry process quite clearly would reorganize the troubled bank, not liquidate it.

The Volcker Rule

A fourth provision that seriously undermines rule of law principles is the Volcker Rule. The Volcker Rule, named for former Federal Reserve Chairman Paul Volcker, who is justly lionized for his role in helping tame inflation in the 1970s, is designed to replicate the New Deal separation of commercial and investment banking by prohibiting bank holding companies from engaging in proprietary trading—that is, trading activities for the bank’s own account—and by sharply limiting their investments in hedge funds and equity funds.

Whatever one thinks of the wisdom of the Volcker Rule in theory, it has been disastrous in application and sharply at odds with the rule of law. The central problem is that it is nearly impossible to distinguish proprietary trading from very similar activities such as market-making and trading for clients’ accounts that nearly everyone believes bank holding companies should be permitted to engage in. The rule is further hampered by the fact that five different agencies have a role in its implementation.

These concerns about Volcker Rule have been amply confirmed by its history since the enactment of the Dodd-Frank Act. Regulators’ initial attempt to craft a rule implementing the Dodd-Frank Act included several hundred questions and did not even purport to provide a proposed rule. The Dodd-Frank Act ostensibly required regulators to complete the rule by summer 2012, two years after the enactment of the legislation. The rule was more than a year late, fills well over a hundred pages of the Federal Register, and did not go formally into effect until this summer.

The rule has already proven enormously costly. Many of the largest banks now have new departments devoted largely to Volcker Rule compliance. The Office of the Comptroller of the Currency has estimated that the Volcker Rule will cost \$4.3 billion to the institutions that are subject to the regulation, and \$413 million to implement.²⁹ Not only is the Volcker Rule costly in an absolute sense, but the costs fall disproportionately on comparatively smaller banks. The largest banks already have substantial compliance departments, so they are much better able to bear the costs than smaller banks that are subject to the rule.

²⁹ See, e.g., Jesse Hamilton, *Volcker Rule Will Cost Banks Up to \$4.3 Billion, OCC Says*, BLOOMBERG.COM, March 21, 2014.

In the short time that the Volcker Rule has been in place, there already have been reports of illiquidity in the markets for some bonds, since the major banks no longer have nearly as large a portfolio of bonds on hand. Although the seriousness of the problem is debated, it is evidence that the rule is already having negative unintended consequences.

Costs of Departing from the Rule of Law

The costs of these departures from rule of law principles are enormous. Let me briefly mention five.

The first is the costs of the uncertainty created by imprecise regulations and a regulatory framework that depends heavily on regulators' discretion. The financial institutions that are subject to the regulations cannot be sure how they will be applied. As a result, they will incur significant costs trying to protect themselves, and may steer clear of products and transactions that could later be subject to challenge.

Second, there is a real risk that the activities that bank holding companies shed or begin to do less of—such as market making after the promulgation of the Volcker Rule—will end up being pushed into the shadow banking system and performed by entities that are subject to far less regulatory oversight.

Third, the adjustments the banks are making to avoid regulatory complaints appear to be highly inefficient. In my view, the largest financial institutions control too large a portion of the financial services industry. One of the most dangerous consequences of the handling of the 2008 financial crisis, in my view, was a further concentration of an industry that was already highly concentrated. The Dodd-Frank Act has forced the largest banks to shed some of their business—most notably their proprietary trading business. This is a form of downsizing. The problem is that it's the wrong kind of downsizing. Systemically important banks are being forced to retreat from businesses like market making and client services that they handle effectively. Rather than

forcing the banks to abandon services they perform efficiently, it would be far better to induce the banks to decide themselves how best to downsize. The Dodd-Frank Act forces the banks to downside both inefficiently and insufficiently, and the risk of regulatory intervention gives the banks a strong incentive to be nontransparent about their operations. Transparency invites intrusion.

Fourth, although the principal target of many of the features of the Dodd-Frank Act that abandon rule of law principles is systemically important financial institutions, a significant portion of the burden falls on the small and medium sized banks that play such an essential role in our economy. Some have pointed to the numerous exceptions the Consumer Financial Protection Bureau has made from its regulatory requirements for small banks as evidence that these banks have not been harmed by the Dodd-Frank Act. In my view, the exceptions have precisely the opposite implication. They confirm that the legislation is highly burdensome for small and medium sized banks. The exceptions reduce a small portion of the burden, but potentially crippling costs remain. As I have already noted, the Volcker Rule also will disproportionately hurt banks that are not systemically important.

The overall imbalance between the largest banks and smaller financial institutions creates serious distortions in the financial services industry. It is likely to discourage innovation. And because small and middle sized banks are the ones that lend to small and middle-sized businesses, it is likely to limit loans to these businesses and act as a drag on the economy.

Finally, the corporatism enshrined in the Dodd-Frank is sharply at odds with the commitment to transparency and competition that has always been the hallmark of American financial regulation. Even apart from the adverse economic effects, it offends our sense of fair play when regulation takes place behind closed doors and with little opportunity for meaningful scrutiny.

Let me conclude by emphasizing that I would not favor repealing the Dodd-Frank Act. Although I have been very critical of many of its features, both here and elsewhere, I believe that other features have improved American financial regulation. My hope is that you will seriously consider amending the parts of the legislation that are most at odds with traditional rule of law principles, and produce a regulatory framework that will serve us as well as its New Deal predecessor did.