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TESTIMONY

THE DODD-FRANK ACT AND REGULATORY OVERREACH

HESTER PEIRCE

Testimony Before the Oversight and Investigations Subcommittee of the Committee on Financial Services of the US House of Representatives

May 13, 2015

Chairman Duffy, Ranking Member Green, and members of the Subcommittee: thank you for the opportunity to appear before you today.

The financial crisis of 2007 to 2009 shook this country deeply. It upended the lives of Americans, many of whom found themselves without jobs and homes. As the crisis unfolded, the desire to do *something* in response was thick in the air in Washington, DC. The general sentiment in favor of action was *not* matched with specifics about what the problems were and how they could best be solved. People were angry and scared and understandably wanted to do what was necessary to prevent a similar crisis from happening again. The hastily crafted response—the Dodd-Frank Wall Street Reform and Consumer Protection Act[1]—does not make another crisis less likely. To the contrary, it sets the stage for another, worse crisis in the future.

Government regulation—from bank regulation to housing policy to credit rating agency regulation—played a key role in the crisis.[2] These policies shaped market participants' behavior in destructive ways. Dodd-Frank continues that pattern.

I will focus on three principal problems of Dodd-Frank:

- First, Dodd-Frank—built on the premise that markets fail, but regulators do not—places great faith in regulators to identify and stop problems before they develop into a crisis. Regulators have an important

1. Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).
2. *See, e.g.*, Emily McClintock Ekins & Mark A. Calabria, *Regulation, Market Structure, and the Role of Credit Rating Agencies* (Cato Policy Analysis, Aug. 1, 2012), *available at* http://object.cato.org/sites/cato.org/files/pubs/pdf/PA704.pdf; Arnold Kling, *Not What They Had in Mind* (Mercatus Ctr. at George Mason Univ. Working Paper, Sept. 2009), *available at* http://mercatus.org/sites/default/files/NotWhatTheyHadInMind(1).pdf; Stephen Matteo Miller, *Why Are CDOs and Structured Notes Making a Comeback?*, U.S. News & World Report, June 23, 2014, *available at* http://mercatus.org/expert_commentary/why-are-cdos-and-structured-notes-making-comeback; Russell Roberts, *Gambling with Other People's Money: How Perverted Incentives Caused the Financial Crisis* (Mercatus Ctr. at George Mason Univ. Working Paper, Apr. 28, 2010), *available at* http://mercatus.org/publication/gambling-other-peoples-money; Peter J. Wallison, Hidden in Plain Sight: What Really Caused the World's Worst Financial Crisis and Why It Could Happen Again (2015) (discusses of the role of government regulation in other areas).

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role to play in establishing and maintaining the financial markets' regulatory parameters, but centralizing financial market decision-making in regulatory agencies risks sparking an even deeper future crisis.

- Second, Dodd-Frank, despite language to the contrary, keeps the door open for future bailouts.[3]
- Third, Dodd-Frank includes many provisions that are not related to financial stability, but fails to deal with key problems made evident by the crisis.

The flaws of Dodd-Frank are not surprising; the drafters were working quickly under difficult circumstances without full information. Rather than relying on its own investigative powers, Congress delegated much of the legwork for determining what had gone wrong to the Financial Crisis Inquiry Commission.[4] That commission produced its report six months after Dodd-Frank became law.[5] Commission member Peter Wallison points out in his dissent to that report that "the Commission's investigation was limited to validating the standard narrative about the financial crisis—that it was caused by deregulation or lack of regulation, weak risk management, predatory lending, unregulated derivatives and greed on Wall Street."[6] That popular but inaccurate narrative[7] undergirds Dodd-Frank and continues to misinform debates about whether Dodd-Frank is working.

DODD-FRANK'S DANGEROUS RELIANCE ON REGULATORS

Partly as a matter of expedience, Dodd-Frank's drafters chose to leave many key decisions to regulators. The contours of systemic risk, for example, were left to regulators to define. Moreover, because the prevailing narrative of the crisis focused on market failure, Dodd-Frank expanded regulators' authority to shape the financial system. In addition to their substantial rule-writing responsibilities, under Dodd-Frank regulators now play a central role in monitoring, planning, and managing the financial markets. Relying on regulators in this way is unlikely to prevent another financial crisis and, in fact, threatens to destabilize the financial system.

Dodd-Frank responded to concerns that regulators were not properly coordinating with one another before the crisis with the formation of the Financial Stability Oversight Council (FSOC). Along with the Office of Financial Research (OFR), FSOC reflects an expectation that regulators, working together and armed with adequate information, will be able to spot and respond to "emerging threats to the stability of the United States financial system."[8] OFR and FSOC can play a helpful role in regulatory coordination,[9] standardizing government information collections, and keeping regulators informed of developing trends in the financial markets. No matter how well run, however, OFR and FSOC will never be as effective at collecting, analyzing, and reacting to information

3. These concerns are laid out in more detail in Dodd-Frank: What It Does and Why It's Flawed (Hester Peirce and James Broughel eds., 2012), *available at* http://mercatus.org/sites/default/files/publication/dodd-frank-FINAL.pdf.
4. Fraud Enforcement and Recovery Act, Pub. L. No. 111-21, § 5, 123 Stat. 1617, 1625–31 (May 20, 2009).
5. Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (Jan. 2011), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.
6. *Id*. at 452 (Peter J. Wallison, Dissenting Statement).
7. For a graphic illustration of the growth—not decline—of regulation leading up to the financial crisis, *see* Patrick McLaughlin & Robert Greene, *Did Deregulation Cause the Financial Crisis? Examining a Common Justification for Dodd-Frank* (Mercatus Ctr. at George Mason Univ., July 19, 2013), *available at* http://mercatus.org/publication/did-deregulation-cause-financial-crisis-examining-common-justification-dodd-frank. *See also* Mark A. Calabria, *Did Deregulation Cause the Financial Crisis?*, 31 Cato Policy Report 1 (July/Aug 2009), *available at* www.cato.org/pubs/policy_report/v31n4/cpr31n4-1.pdf.
8. Dodd-Frank § 112(a)(1)(C).
9. Even with regard to regulatory coordination, there are potential pitfalls. Dodd-Frank's drafters did not adequately consider the implications for the independence of financial regulators of allowing FSOC effectively to force the hand of independent regulators through the issuance of recommendations that demand an agency response. Dodd-Frank § 120. For an example of how this has worked in practice, see Hester Peirce & Robert Greene, *Money Market Maneuvering* (Mercatus Ctr. at George Mason Univ. Expert Commentary, Sept. 19, 2012), *available at* http://mercatus.org/expert_commentary/money-market-maneuvering.

as competitive markets.[10] Instead, if the existence of these super-regulators provides false confidence, FSOC and OFR could be detrimental to financial stability.

Dodd-Frank gives FSOC broad powers to designate nonbank financial institutions and financial market utilities (such as derivatives clearinghouses) systemically important.[11] These systemically important entities are subject to special regulatory oversight. Upon designation, the Board of Governors of the Federal Reserve System steps in to supervise the designated nonbank financial institutions alongside their existing regulators.[12] The Federal Reserve Board also plays a primary or backup role in regulating designated financial market utilities.[13]

Dodd-Frank thus empowers FSOC to create a two-tier system—systemically important entities are subject to an additional layer of regulation, but they are also likely to enjoy funding and competitive advantages. It is too early to tell whether the additional regulatory costs will outweigh the benefits to designated firms. Designated firms are likely to be perceived as the firms the government is likely to rescue, should that be necessary.

In addition to its new responsibility for systemically important nonbanks, Dodd-Frank otherwise expands the role of the Federal Reserve Board. It has supervisory authority over, among others, a large array of bank holding companies, savings and loan holding companies, and insurance companies.[14] FSOC is looking closely at the asset management industry, so the Board's supervisory mandate could expand further.

A consequence of the Federal Reserve Board's broad authority over a wide range of institutions is homogenization across the financial industry. Although the Board likely will make some adjustments to accommodate industry differences, similar liquidity, capital, and risk management requirements could lead firms to hold similar assets. This homogenization could increase the likelihood that a problem at one firm would spread to other firms. Stress testing and resolution plans may further enforce a system-wide uniformity, which could prove harmful, particularly in a time of market stress.

Dodd-Frank stress testing and resolution planning, while useful mechanisms to help firms identify and plan for potential difficulties, can also be a dangerous distraction. Regulated firms may divert resources from their own risk management efforts to respond to regulatory stress tests, revise resolution plans, and comply with other regulatory demands. Firms can tailor their risk management programs to their unique circumstances and risks, while regulators are likely to employ more standardized approaches that are comparable across multiple firms. Firm-specific information is likely to be missed.

Firms' ability to act to safeguard themselves is further constrained by regulators' post–Dodd-Frank embrace of macroprudential regulation. Under this approach, regulators think holistically about the financial system;[15] they

10. Friedrich A. Hayek's explanation in his Nobel Prize lecture makes the point:

> We are only beginning to understand on how subtle a communication system the functioning of an advanced industrial society is based—a communications system which we call the market and which turns out to be a more efficient mechanism for digesting dispersed information than any that man has deliberately designed.

Friedrich A. Hayek, *Nobel Prize Lecture: The Pretence of Knowledge* (Dec. 11, 1974), *available at* http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1974/hayek-lecture.html.

11. In addition to designated financial market utilities, the "SIFIs" designated to date are American International Group, GE Capital, Prudential, and MetLife. FSOC, Designations, http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx#nonbank (last visited May 6, 2015).

12. Dodd-Frank §§ 113 and 115.

13. Dodd-Frank § 805.

14. *See, e.g.*, Bipartisan Policy Center, *How the Federal Reserve Became the De Facto Insurance Regulator* (July 30, 2014), *available at* http://bipartisanpolicy.org/blog/how-federal-reserve-became-de-facto-federal-insurance-regulator/; Hester Peirce & Robert Greene, *The Federal Reserve's Expanding Regulatory Authority Initiated by Dodd-Frank* (Nov. 13, 2013), *available at* http://mercatus.org/publication/federal-reserves-expanding-regulatory-authority-initiated-dodd-frank.

15. *See, e.g.*, Andrew Crockett, General Manager, Bank for International Settlements, Chairman, Financial Stability Forum, *Marrying the Micro- and Macro-prudential Dimensions of Financial Stability, Remarks Before the Eleventh International Conference of Banking Supervisors* (Sept. 21, 2000) (transcript available at http://www.bis.org/speeches/sp000921.htm). Crockett explains, "To bring out

may override a firm's decision, for example, to protect itself from exposure to a counterparty, if they believe that the counterparty should be protected. Thus, firms are hamstrung in their efforts to protect themselves. This macroprudential approach places too much confidence in the regulators to always get things right, and it inhibits market mechanisms from responding organically to problems as they arise. The last crisis taught us that regulators do not always get things right, and markets absorbed in regulatory compliance are very poor at disciplining themselves. The result is a less stable financial system.

DODD-FRANK'S OPEN DOOR TO BAILOUTS

Dodd-Frank was supposed to mark the end of taxpayer bailouts of financial firms. This pledge is undermined in several ways by the statute's other provisions and the regulatory-centric approach that cuts across the whole statute.

First, the intensive, post–Dodd-Frank role that regulators are playing in managing financial stability means that when there is a problem, firms will feel justified in asking the regulators that caused—or at least did not prevent—those problems to bail them out. The pressure on regulators to conduct bailouts is likely to be particularly strong with respect to systemically important institutions. By announcing that these institutions are important to the financial system, the government implies that it will step in to prevent them from failing.

Second, Title II of Dodd-Frank establishes the Orderly Liquidation Authority (OLA) as an alternative to bankruptcy for financial institutions. Regulators have broad discretion to choose this alternative to wind down troubled financial companies. Once regulators have decided that a company will be resolved under the OLA, the company or its creditors have little power to prevent the use of this alternative, and the Federal Deposit Insurance Corporation (FDIC) has broad authority to manage this alternative resolution process. Depending on how the FDIC exercises its authority, the OLA could be used to bail out favored creditors of the company.[16]

Another key pillar of Dodd-Frank that raises the possibility of a future bailout is Title VII, which imposes a detailed regulatory framework on the over-the-counter derivatives markets. The new regime forces many derivatives into central counterparties (also known as clearinghouses). As a result, large financial firms will no longer be exposed to one another through these derivatives transactions, but to the clearinghouse. The hope is that these clearinghouses will be consistently strong counterparties, even during a period of financial stress. Dodd-Frank makes the already difficult task of managing clearinghouses more difficult by increasing the number and type of products they must clear and constraining the steps they can take to manage their risk. Failing clearinghouses would be likely candidates for bailouts because of their central role in the financial system and ties to large financial firms. Dodd-Frank allows for the possibility of a bailout by authorizing the Board of Governors to give systemically important clearinghouses access to the discount window and deposit account and payment services.[17]

The Board of Governors also retains its emergency lending authority under section 13(3) of the Federal Reserve Act, which it used to bail out American International Group. Dodd-Frank pared back this authority by requiring any lending to be through a broad-based program rather than an institution-specific program.[18] This limitation will not serve as a much of a constraint on emergency lending unless it is also paired with other limitations, such as tighter solvency requirements.[19]

the contrast, think of the financial system as a portfolio of securities, i.e., the individual institutions. The macro-prudential perspective would focus on the overall performance of the portfolio; the micro-prudential vision would give equal and separate weight to the performance of each of its constituent securities."

16. Dodd-Frank § 214 prohibits taxpayer losses under the OLA, but the opacity of the process will make this difficult to enforce.
17. Dodd-Frank § 806. For a discussion of the implications of this authority, *see* Norbert J. Michel, *Financial Market Utilities: One More Dangerous Concept in Dodd-Frank* (Heritage Found. Backgrounder, Mar. 20, 2015), *available at* http://www.heritage.org/research/reports/2015/03/financial-market-utilities-one-more-dangerous-concept-in-doddfrank.
18. Dodd-Frank § 1101.
19. The Board of Governors has proposed, but not adopted, a rule, as required by Dodd-Frank, to "prohibit borrowing from programs and facilities by borrowers that are insolvent." Dodd-Frank § 1101(a) [amending 12 U.S.C. § 343(3)(B)(ii)]. Commenters are concerned

DODD-FRANK'S MISPLACED FOCUS

As further evidence that Dodd-Frank does not effectively shore up financial stability, it covers the wrong topics. On the one hand, Dodd-Frank fails to deal with issues central to the last crisis. On the other hand, many Dodd-Frank provisions have nothing to do with addressing the past crisis or averting a future financial crisis.

An issue central to the crisis—the government's role in housing finance—is almost entirely absent from Dodd-Frank. Fannie Mae and Freddie Mac remain intact in conservatorship. Dodd-Frank deferred the issue by directing the Secretary of the Treasury to conduct a study of reforming the housing finance system.[20] Congress missed an opportunity to address the government's role in housing finance, and the government continues to crowd out the private market in this space.[21]

Items unrelated to the crisis got more pages in Dodd-Frank than housing finance, even though the consequences of some of these provisions were not fully evaluated. An egregious example is the conflict minerals provision, which requires the Securities and Exchange Commission (SEC) to draft rules governing disclosure by public companies of their use of minerals such as coltan, cassiterite, gold, and wolframite.[22] A similar example is a provision requiring public companies that engage in resource extraction to disclose payments made to further commercial development.[23] Both provisions are costly to public companies (and, by extension, their shareholders) and have consumed considerable SEC resources.[24] Neither relates to the stability of the financial system.

Another provision unrelated to financial stability authorizes the SEC to introduce a fiduciary duty for broker-dealers.[25] The debate over the proper standard of conduct for broker-dealers working with retail customers, particularly as it compares to the standard for investment advisers, predates the financial crisis.[26] The controversial issue warrants careful congressional consideration because its resolution will affect many retail investors. The issue did not get adequate attention since it was only a small part of the much larger Dodd-Frank deliberations and was not a contributor to the crisis.

CONCLUSION

As the failures and bailouts of the financial crisis accumulated, so too did the calls for a quick and thorough rewriting of the financial regulatory rulebook. The resulting Act was the product of fear and fury, not of careful analysis. Grounded in an inaccurate market failure narrative, Dodd-Frank expands regulators' authority to enable them to play a more central role in managing the financial system and identifying and mitigating systemic risks. This approach to financial regulation, while a natural response to a market failure narrative, only increases the vulnerability of financial system to regulatory failure.

that the Board's proposed approach is too lax. *See, e.g.*, Marcus Stanley & Mark Calabria, *Fed Proposal to End Bailouts Falls Short*, The Hill, Congress Blog, July 24, 2014, *available at* http://thehill.com/blogs/congress-blog/economy-budget/213175-fed-proposal-to-end-bailouts-falls-short.

20. Dodd-Frank § 1074. That report came out in February 2011. Department of the Treasury and Department of Housing and Urban Development, Reforming America's Housing Finance Market: A Report to Congress (Feb. 2011).

21. At the end of 2014, the Congressional Budget Office reported that, through Fannie Mae, Freddie Mac, and the Federal Housing Administration, "the federal government now directly or indirectly insures over 70 percent of all new residential mortgages." Congressional Budget Office, Transitioning to Alternative Structures for Housing Finance, at 2 (Dec. 2014), *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/49765-Housing_Finance_0.pdf.

22. Dodd-Frank § 1502 [15 U.S.C. § 78 m].

23. Dodd-Frank § 1504 [15 U.S.C. § 78 m].

24. *See, e.g.*, Daniel M. Gallagher, Commissioner, SEC, The Importance of the SEC's Rulemaking Agenda—You Are What You Prioritize, Remarks at the 47th Annual Securities Regulation Seminar of the Los Angeles County Bar Association (Oct. 24, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370543283858.

25. Dodd-Frank § 913 [15 U.S.C. §78 o note].

26. For example, the SEC commissioned a study in 2006 of how investment advisers and broker-dealers interact with their customers. *See* Angela A. Hung et al., *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (RAND Inst. for Civil Justice Report 2008), *available at* https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

Regulatory failure played an important role in the last crisis by concentrating resources in the housing sector, encouraging reliance on credit-rating agencies, and driving financial institutions to concentrate their holdings in mortgage-backed securities. Dodd-Frank gives regulators more authority and broad discretion to shape the financial sector and the firms operating within it. When the regulators fail at this ambitious mission, they will again face internal and external pressure to cover those failures with a taxpayer-funded bailout.

Appendices to Testimony

1. Hester Peirce, "No, Mr. Tarullo, We're Not All Macroprudentialists Now," *Real Clear Markets*, February 25, 2015.

2. Hester Peirce, "Dodd-Frank Most Likely to Be at the Root of a Future Crisis," *Real Clear Markets*, January 14, 2015.

3. Hester Peirce, "A New Congress Must Perform Major Surgery on Dodd-Frank," *Real Clear Markets*, November 19, 2014.

4. Hester Peirce and Robert Greene, "The Federal Reserve's Expanding Regulatory Authority Initiated by Dodd-Frank" (annotated infographic, Mercatus Center at George Mason University, November 2013)

5. Patrick McLaughlin and Robert Greene, "Did Deregulation Cause the Financial Crisis? Examining a Common Justification for Dodd-Frank" (chart, Mercatus Center at George Mason University, July 19, 2013)

6. CV for Hester Peirce

7. Truth in Testimony

EXPERT COMMENTARY

No, Mr. Tarullo, We're Not All Macroprudentialists Now

Real Clear Markets

By Hester Peirce | Feb 25, 2015

Federal Reserve Governor Daniel Tarullo began a speech last month by saying, "Standing in front of this audience I feel secure in observing that we are all macroprudentialists now." Having been a member of that audience, I can assure Mr. Tarullo that his statement was inaccurate. Macroprudentialists' intensifying focus on the asset management industry offers the latest glimpse into how such an approach could undermine financial stability.

Mr. Tarullo explained that the macroprudential approach to regulation "focuses on the financial system as a whole, and not just the well-being of individual firms." Regulators are central to the macroprudential approach; only they have the breadth of vision to know how and when-for the good of the collective-to override careful decisions made by individual firms.

The focus of Mr. Tarullo and other macroprudentialists has turned most recently to the asset management industry. Asset managers include the investment advisers and mutual fund companies that manage the investment portfolios of institutions and households. Asset managers control a lot of money-$63 trillion according to a recent speech by Mary Jo White, chair of the Securities and Exchange Commission, which oversees the asset management industry.

Ms. White's colleagues on the Financial Stability Oversight Council-a collection of top financial regulators-are not confident that SEC oversight is adequate. The FSOC and its international cousin-the Financial Stability Board-are on the lookout for particular asset managers and asset management activities that might put the financial system at risk. Dodd-Frank gives the FSOC authority to make recommendations to the SEC about how it should regulate the asset management industry. The FSOC also can designate asset managers for regulation by the Federal Reserve.

The FSOC is soliciting input on a document that runs through worst-case scenarios in asset management. What if asset managers don't manage their funds "in a way that prevents or fully mitigates the risks to the investment vehicle and the broader financial system"? What if asset managers are forced to conduct fire sales, which could drive asset prices down? What if a key industry service provider goes out of business?

The risks the FSOC described pale in comparison to the risks it could create by adding a new macroprudential regulatory layer to asset management. Attempts to centrally mitigate risk likely would create new risks by narrowing the differences in the way assets are managed. There are thousands of asset managers and mutual funds. Even very large mutual fund complexes employ many managers, each of whom takes her own approach to investing. More prescriptive regulation will eat away at that system-strengthening diversity.

Mr. Tarullo envisions a macroprudential regime that "builds on the traditional investor protection and market functioning aims of securities regulation by incorporating a system-wide perspective." Asset managers will have the impossible task of balancing their fiduciary duties to their own funds and investors with regulatory obligations to do what's best for their competitors and the rest of the financial system.

Using tools like stress tests and liquidity requirements, regulators would corral asset managers into similar strategies, assets, and risk management techniques. If regulators make bad choices, the entire industry will be affected. But even if regulators make good choices, making asset managers follow a single formula makes it more likely that the actions of one manager-such as asset sales to meet redemptions-would reverberate throughout the industry.

Moreover, as bank regulators play an increasingly central role in regulating asset managers, the differences that distinguish the banking industry from the asset management industry will start to disappear. Shocks will more easily transmit across the entire financial sector. Imagine the scene as banks and asset managers all fight during a crisis for the safe assets that their common regulatory frameworks permit. When problems arise, taxpayer money will flow to all macroprudentially regulated corners as regulators seek to mask their mistakes.

Regulators are not wrong to think about the stability of the whole financial system. They are wrong, however, to assume that centralized risk management will foster systemic stability. Instead, it will introduce new

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vulnerabilities into the financial system. These vulnerabilities likely will manifest themselves when the financial system is already under stress. Rather than seeking to extend macroprudential regulation, regulators should emphasize microprudential responsibility. Asset managers, governed by their legal responsibilities to their clients, need to plan for bad events. This is not a task that can be outsourced to government regulators.

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Dodd-Frank Most Likely To Be At the Root Of a Future Crisis

Real Clear Markets

By Hester Peirce | Jan 14, 2015

In an **op-ed** last week, Treasury Secretary Lew defended Dodd-Frank against efforts by the new Congress to reform the financial law. In his view, changing-or even suggesting changes to-Dodd-Frank seems to be tantamount to inviting another financial crisis. Far from being the cornerstone of a new era of financial stability, however, Dodd-Frank is more likely to be at the root of a future crisis.

Secretary Lew argues that Dodd-Frank has "made our financial system safer and more resilient, and consumers, investors and taxpayers are now protected from the types of abuses that helped cause the crisis." Before we kick back and enjoy this new Dodd-Frank era of financial stability, let's take a closer look at whether the new financial regime will work.

Dodd-Frank builds upon the crisis prevention mechanisms that failed us last time. Contrary to the deregulation mythology, the financial industry was **highly regulated** prior to the crisis. Some of those regulations gave banks a financial incentive to invest in securities that ran into deep trouble during the crisis. Others encouraged financial institutions to make loans to borrowers that would have difficulty repaying. Still other regulations caused investors to rely on credit ratings rather than looking at underlying credit quality. Meanwhile, the industry's many regulators failed to identify building problems at the financial institutions under their watch.

Dodd-Frank's approach to financial stability simply intensifies the pre-crisis dependence on governmental regulators to shape the financial industry through regulatory prescription and proscription. In weakening the ability of market participants to make their own decisions, the law makes it less likely they will reap the consequences of bad decisions. I.e., if regulators are pulling most of the strings, the industry will expect a taxpayer bailout if there is a problem.

Dodd-Frank puts regulators in the driver's seat in numerous ways. Under Title I of the Act, for example, the Federal Reserve makes decisions regarding risk-based capital, liquidity, concentration, and risk-management at systemically important firms. Under Title II of the Act, regulatory whim is enough to force a company to be wound down outside of the standard bankruptcy process. Under Title VII of Dodd-Frank, regulators decide whether, how, and where over-the-counter derivative products are traded and cleared. The Consumer Financial Protection Bureau, established by Title X of the Act, has changed the mix of products that financial services firms offer to consumers.

Enhancing regulatory powers may seem like a good way to prevent people at financial companies from doing stupid or greedy things. Regulators, however, also do stupid and greedy things. The stakes are higher when regulators make mistakes because regulatory influence is not limited to one firm.

If a firm relies on a flawed model to estimate its vulnerabilities or incompetent risk managers to assess a new product, it might get itself into trouble. It will lose money, and the responsible individuals may lose their jobs. If allowed to fall on the responsible parties, such consequences breed a healthy caution.

When regulators apply a flawed model to assess firms' resilience or give their blessing to a bad product, they can put an entire industry or the whole financial system at risk. Widespread failure, government bailouts, and calls for yet more regulation are likely to follow. That's what happened in the last crisis, and we got Dodd-Frank, which only intensifies our regulatory addiction.

Dodd-Frank supporters take comfort in the fact that the regulatory powers are now housed in purportedly more capable hands than they were prior to Dodd-Frank. For example, the Office of Thrift Supervision (OTS)-AIG's much maligned consolidated regulator (meaning the regulator charged with overseeing the whole company, as opposed to an individual piece of it) is gone. The Fed is AIG's replacement consolidated regulator.

A recently released **redacted report** by the Fed's Office of Inspector General in connection with the Fed's failure to prevent JPMorgan's notorious "London Whale" derivatives losses a couple years ago illustrates the Fed's susceptibility to the same the problems that plagued the OTS. The Inspector General explains that the New York Fed-JPMorgan's consolidated supervisor-ran into a number of problems during the critical time period that prevented it from stopping the Whale. Among these, the New York Fed was busy with other

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priorities. It made significant structural changes to the way it oversaw large financial institutions. The team overseeing JPMorgan changed, and the institution-specific knowledge was not transferred to the new team. The New York Fed's coordination with JPMorgan's primary supervisor, the Office of the Comptroller of the Currency, was lousy. As a result of these problems, the New York Fed did not follow up on the Whale-related concerns it identified.

The New York Fed's problems in overseeing JPMorgan were remarkably similar to the OTS's **AIG oversight challenges**. OTS identified AIG's derivatives unit as a potential source of problems, but failed adequately to follow up. The OTS faced competing priorities, structural changes to its large firm consolidated supervision program, changing team members, inadequate knowledge transfer, and poor coordination with other regulators.

The New York Fed pledges to correct the problems identified by the Inspector General, but reform efforts will be no match for human and organizational obstacles to perfect monitoring. There's a better way than relying on regulators to get their supervisory houses in order. Faced with the fear of losing their own money, we should look to the AIGs and JPMorgans of the world and their creditors to watch for problems. As long as Dodd-Frank stands in the way of this natural form of supervision by promising to keep companies up and running through regulatory measures, the financial system is at great risk.

Hand-wringing over tweaks to Dodd-Frank is warranted, but not because the tweaks will destroy an effective law. The real cause for concern is that these tweaks are inadequate to address the fundamental flaw at the heart of Dodd-Frank-the displacement of market discipline by regulatory oversight. Tweaking the law-if done properly-can help to lessen the law's costs and unintended consequences, but only more sweeping changes will stop Dodd-Frank from undermining the nation's financial stability.

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EXPERT COMMENTARY

A New Congress Must Perform Major Surgery On Dodd-Frank

Real Clear Markets

By Hester Peirce | Nov 19, 2014

In the four years since the passage of Dodd-Frank, the financial regulators have written a lot of new rules. Throughout the implementation period, at least one of the chambers of Congress has been under the control of the party that passed Dodd-Frank. Agencies therefore have been spared some painful scrutiny of their Dodd-Frank implementation programs. This month's election changed that, and agencies are likely to face a lot more uncomfortable oversight in the upcoming Congress. But the new Congress, not as wedded to Dodd-Frank as its predecessors, could also make life more bearable for regulators by eliminating some of Dodd-Frank's extraneous statutory mandates.

The Securities and Exchange Commission is a prime candidate for mandate trimming. Dodd-Frank assigned the SEC responsibilities that are far from its core mission. For example, Dodd-Frank directed the SEC to require companies to assess and report their use of minerals tied to the violence in and around the Democratic Republic of the Congo. Companies have spent many hours and dollars trying to identify whether they are using minerals that fund the conflict, but the task appears to be futile. The Department of Commerce recently published a **list** of facilities that process the minerals at issue, but stated that it could not determine "whether a specific facility processes minerals that are used to finance conflict in the Democratic Republic of the Congo or an adjoining country." In other words, the government cannot do what it is asking companies to do.

Another mandate that imposes tremendous burdens on the SEC and companies without proportionate benefit for investors is the so-called pay ratio rule. Under Dodd-Frank, the SEC is working on the rule, which requires companies to disclose the ratio of their median employee compensation to the CEO's pay. Writing such a rule might be a simple task if all companies had no more than ten full-time employees working in a single location, but it is quite a bit more complicated to write such a rule for multinational companies that employ thousands of employees working a mix of full- and part-time schedules.

The conflict mineral and pay ratio mandates do not further the SEC's tripartite mission-protecting investors; facilitating capital formation; and maintaining fair, orderly, and efficient markets. Rather they distract from the considerable work the SEC has to do in these areas. For example, the economy's precarious health depends on the ability of financial markets to direct investable funds to the parts of the economy that need it most. Would-be entrepreneurs and growing small businesses face many obstacles to getting the money they need-obstacles that the SEC could work on removing if it were not so preoccupied with pointless Dodd-Frank mandates.

The Financial Stability Oversight Council is another agency that could use some congressional refocusing. The FSOC, a creation of Dodd-Frank, had the potential to play the important role of bringing regulators together to share information, ideas, and concerns about the financial system. Congress, however, loaded the agency down with the responsibility of identifying companies that are systemically important. This function has absorbed considerable regulatory time and has caused undue angst in the market; designated companies will face substantial regulatory costs and are likely candidates for future taxpayer bailout. If Congress were to eliminate this responsibility, the FSOC could focus on the more important task of bringing regulators together to think holistically about financial system regulation. Eliminating the designation exercise would have the added benefit of preventing the emergence of a new category of too-big-to-fail entities.

Removing the FSOC's power to designate also would free the Federal Reserve of the responsibility of regulating entities like insurance companies about which it has no expertise. Congress could further refocus the Fed on its role as a lender of last resort by quashing the Fed's Dodd-Frank-fueled ambitions of being the regulator of last resort. The Fed will be able to focus on its core central bank functions if Congress shifts its regulatory responsibilities to other bank regulators.

Regulators are not looking forward to heightened congressional oversight of their activities, but the new Congress offers them something to offset the pain. Unencumbered by having voted for Dodd-Frank, the incoming Congress can jettison unnecessary statutory mandates so that agencies can get back to their core missions.

HESTER PEIRCE

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Full Bio →

THE FEDERAL RESERVE'S EXPANDING REGULATORY AUTHORITY INITIATED BY DODD-FRANK

BY HESTER PEIRCE AND ROBERT GREENE

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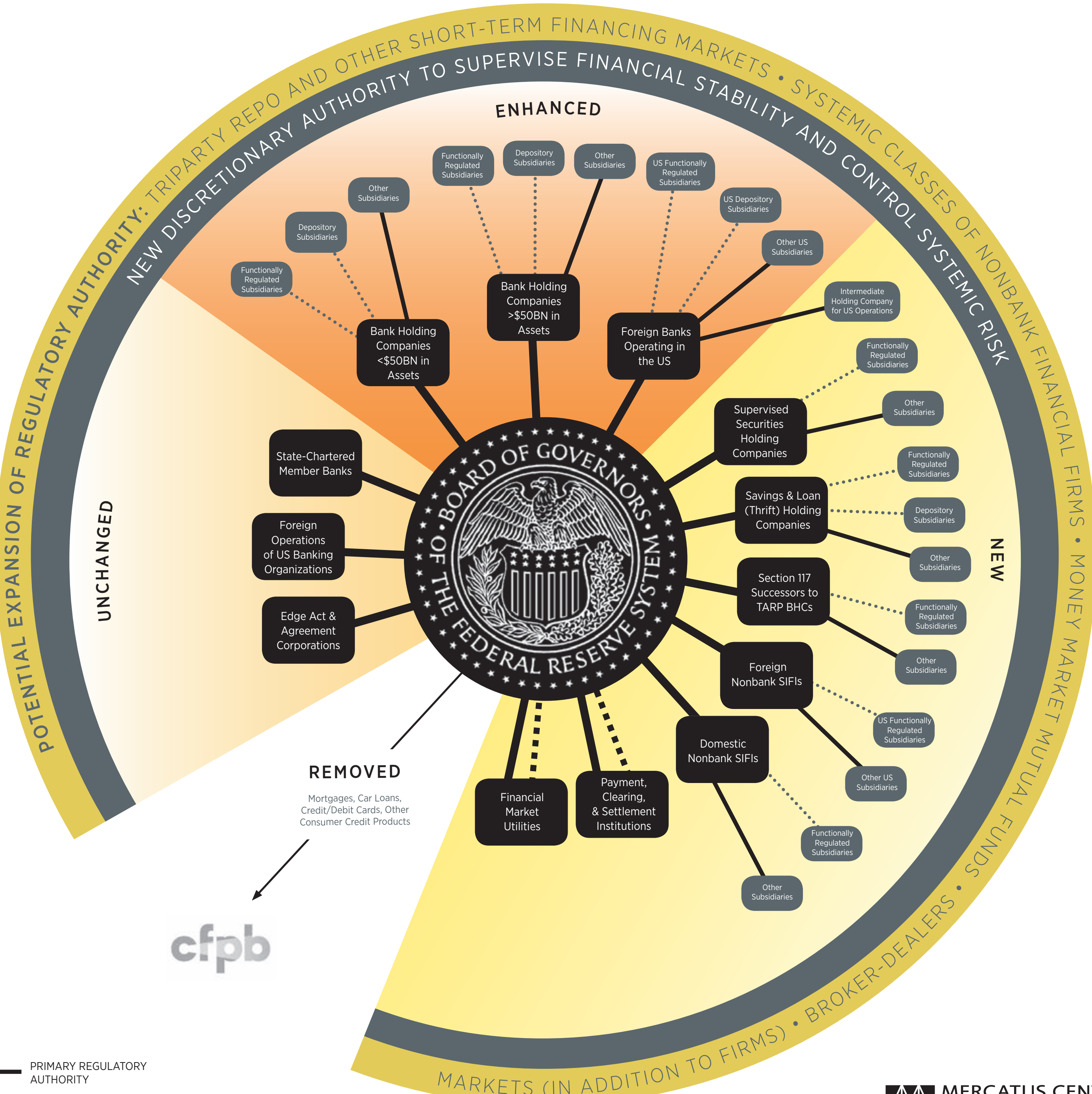
THE FEDERAL RESERVE'S EXPANDING REGULATORY AUTHORITY INITIATED BY DODD-FRANK



PRIMARY REGULATORY AUTHORITY

BACK-UP REGULATORY AUTHORITY

NONEXCLUSIVE REGULATORY AUTHORITY

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Produced by Hester Peirce and Robert Greene. Sources: Dodd-Frank Wall Street Reform and Consumer Protection Act; Hester Peirce and Robert Greene, "The Federal Reserve's Expanding Regulatory Umbrella," Mercatus on Policy, Mercatus Center at George Mason University, April 3, 2013.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) significantly expanded the regulatory authority of the Federal Reserve Board of Governors (the Board) over banking institutions, financial firms, and their subsidiaries.

Dodd-Frank **enhanced** the Board's authority over bank holding companies (BHCs), foreign banks, and subsidiaries of these entities.

Dodd-Frank gave the Board **new authority** over several types of institutions. The Board now has direct or back-up authority over certain financial market utilities (FMUs) and payment, clearing, and settlement institutions designated as systemically important by the Financial Stability Oversight Council (FSOC), an entity created by Dodd-Frank. It also now has authority over nonbank firms "predominantly engaged in financial activities" that are designated as systemically important financial institutions (SIFIs) by the FSOC, including subsidiaries of these firms. Authority to regulate thrift holding companies, supervised securities holding companies, and the subsidiaries of these entities was also transferred to the Board.

Dodd-Frank **removed** some of the Board's regulatory authority, primarily its supervisory authority over consumer credit products such as mortgages, car loans, credit/debit cards, etc. This authority was transferred to the newly created Bureau of Consumer Financial Protection (CFPB).

Dodd-Frank left **unchanged** the Board's regulatory authority over state-chartered member banks, foreign operations of US banking organizations, and Edge Act and agreement corporations.

The Board's mandates are overlaid with a new responsibility for the stability of the US financial system.

The chart above depicts the growth of the Board's regulatory powers. Below is an overview of the main ways in which Dodd-Frank augments the Board's regulatory authority.

ENHANCED AUTHORITY

Bank Holding Companies (BHCs)

- Expands the Board's examination capacities over, and requires that **BHCs** serve as a source of strength for, depository subsidiaries.[1]
- Broadens the Board's ability to write rules for, impose reporting obligations on, examine the activities and financial health of, and bring enforcement actions against subsidiaries, including functionally regulated subsidiaries (those already regulated by the SEC or the Commodity Futures Trading Commission (CFTC) and state-regulated entities).[2]
- Requires the Board to examine certain activities of subsidiaries that do not have another financial regulator.[3]
- Subjects **BHCs with $50 billion or more in assets** to "more stringent" prudential standards including liquidity and risk-based capital requirements, leverage limits, risk-management requirements, resolution plan and credit exposure report requirements, and limits on credit exposure; grants Board authority to impose other heightened prudential standards, including contingent capital requirements, enhanced public disclosures, and short-term debt limits.[4]

Foreign Banks Operating in the US

- Broadens the Board's authority to impose prudential regulations, such as liquidity and risk-based capital requirements, leverage limits, and risk-management requirements on large **foreign banks operating in the US**.[5] As part of implementing this authority, the Board proposed to require large foreign banks with a significant US presence to form intermediate holding companies to consolidate US operations for easier Board oversight.[6]

NEW AUTHORITY

Discretionary Authority to Supervise Financial Stability and Control Systemic Risks

- Expands the Board's discretionary authority with a nebulous mandate to consider risk to the financial system in different contexts, such as examinations, merger and acquisition approvals, and divestitures.[7]

Supervised Securities Holding Companies

- Provides the Board consolidated supervision authority over companies that own or control one or more SEC-registered brokers or dealers.[8] Authority reaches subsidiaries, including functionally regulated subsidiaries.[9]

- Ensures, as implemented by the Board, that a supervised holding company will "be supervised and regulated as if it were a bank holding company."[10]

Section 117 Successors to Troubled Asset Relief Program (TARP) BHCs

- Ensures the Board retains regulatory authority over BHCs with more than $50 billion in assets as of January 1, 2010, that participated in the Capital Purchase Program under TARP. Section 117 of Dodd-Frank directs the Board to treat these firms like designated nonbank SIFIs if they cease to be BHCs.[11]

Savings and Loan (Thrift) Holding Companies

- Shifts regulatory authority over these companies from now defunct Office of Thrift Supervision to the Board.[12]

- Requires that **thrift holding companies** serve as a source of strength for depository subsidiaries.[13]

- Grants the Board ability to write rules for, impose reporting obligations on, examine the activities and financial health of, and bring enforcement actions against thrift holding company subsidiaries, including functionally regulated subsidiaries.[14]

- Requires the Board to examine certain activities of otherwise unregulated subsidiaries.[15]

Foreign/Domestic Nonbank SIFIs

- Subjects nonbank companies "predominantly engaged in financial activities" and designated as **SIFIs** by the FSOC because they could pose "a threat to the financial stability of the United States" to prudential standards, including liquidity and risk-based capital requirements, leverage limits, risk-management requirements, resolution plan and credit exposure report requirements, and limits on credit exposure.[16]

- Gives the Board the ability to write rules for, impose reporting obligations on, examine the activities and financial health of, and bring enforcement actions against subsidiaries, including functionally regulated subsidiaries.[17]

FMUs and Entities Engaged in Payment, Clearing, and Settlement Activities

- Subjects designated **FMUs** and financial **institutions engaging in payment, clearing, and settlement activities** determined by the FSOC to be or likely to become "systemically important" to enhanced regulatory standards—for example, rules that govern risk-management policies, margin and collateral requirements, and counterparty default policies and procedures.[18] The Board has direct authority or—in the case of FMUs and financial institutions regulated by the SEC or CFTC—back-up authority.[19]

REMOVED AUTHORITY

Mortgages, Car Loans, Credit/Debit Cards, and Other Consumer Credit Products

- Transfers authority to regulate these products to the **CFPB**. [20] The Bureau is officially independent from the Board, but it is technically housed within and funded by the Federal Reserve System.[21]

UNCHANGED AUTHORITY

- The Board continues to supervise and regulate **state-chartered member banks** of the Federal Reserve System.

- Dodd-Frank did not alter the Board's supervisory authority over **Edge Act and agreement corporations**, which are chartered by the Board and states respectively to engage in international banking transactions.

- Dodd-Frank also did not affect the Board's oversight of **domestic banks' foreign operations**.

POTENTIAL EXPANSION OF REGULATORY AUTHORITY

The Federal Reserve's performance as a regulator in the years leading up to the 2007–08 crisis earned it widespread criticism. Dodd-Frank, instead of responding to these criticisms, greatly enhanced the Fed's regulatory authority. Recent comments by Federal Reserve officials indicate an institutional eagerness to expand this authority further into all corners of the financial markets, even those already overseen by other regulators.

Triparty Repo Markets

Federal Reserve System officials have highlighted the Federal Reserve's efforts with respect to the triparty repurchase agreement ("repo") markets and have expressed a desire for additional authority over these markets. One potential idea includes creating a liquidity facility with a government backstop and attendant prudential regulation by the Board.

> A second phase of triparty reform is now underway, with the Federal Reserve using its supervisory authority to press for further action not only by the clearing banks, who of course manage the settlement process, but also by the dealer affiliates of bank holding companies, who are the clearing banks' largest customers for triparty transactions. But this approach alone will not suffice. All regulators and supervisors with responsibility for overseeing the various entities active in the triparty market will need to work together to ensure that critical enhancements to risk management and settlement processes are implemented uniformly and robustly across the entire market, and to encourage the development of mechanisms for orderly liquidation of collateral, so as to prevent a fire sale of assets in the event that any major triparty market participant faces distress.[22]
>
> *—Daniel Tarullo, Governor, Federal Reserve Board. Speech at the Conference on Challenges in Global Finance, June 12, 2012*
>
> One could imagine a mechanism that was funded by tri-party repo market participants and potentially backstopped by the central bank. . . . Because no single market participant has a strong incentive to develop such a mechanism, however, sustained regulatory pressure may be required to reach such a solution.[23]
>
> *—William Dudley, President, Federal Reserve Bank of New York. Speech at New York Bankers Association's 2013 Annual Meeting and Economic Forum, Feb. 1, 2013*

Other Short-term Securities Financing

Other short-term securities financing transactions, besides triparty repo transactions, have been targeted by Federal Reserve officials for further regulation.

> A major source of unaddressed risk emanates from the large volume of short-term securities financing transactions (SFTs)—repos, reverse repos, securities borrowing and lending transactions, and margin loans--engaged in by broker-dealers, money market funds, hedge funds, and other shadow banks. . . . SFTs, particularly large matched books of SFTs, create sizable macroprudential risks, including large negative externalities from dealer defaults and from asset fire sales. The existing bank and broker-dealer regulatory regimes have not been designed to materially mitigate these systemic risks.[24]
>
> *—Janet Yellen, Vice-Chairman, Federal Reserve Board. Speech at the International Monetary Conference, June 2, 2013*

Systemic Classes of Nonbank Financial Firms

Governor Daniel Tarullo views "systemic classes" of nonbank financial firms as a source of potential threats to financial stability and has expressed the belief that additional regulatory oversight is needed.

> The threats to financial stability from the shadow banking system do not reside solely in a few individual nonbank financial firms with large systemic footprints. Significant threats to financial stability emanate from systemic classes of nonbank financial firms and from vulnerabilities intrinsic to short-term wholesale funding markets. . . . we need to increase the transparency of shadow banking markets so that authorities can monitor for signs of excessive leverage and unstable maturity transformation outside regulated banks. Since the financial crisis, the ability of the Federal Reserve and other regulators to track the types of transactions that are core to shadow banking activities has improved markedly. But there remain several areas, notably involving transactions organized around an exchange of cash and securities, where gaps still exist.[25]
>
> *—Daniel Tarullo, Governor, Federal Reserve Board. Testimony before the Senate Committee on Banking, Housing, and Urban Affairs, July 11, 2013*

Money Market Mutual Funds (MMMFs)

Many Federal Reserve officials have called for further reform of money market funds.[26] Eric Rosengren, president of the Federal Reserve Bank of Boston, has been one of the most outspoken. By emphasizing financial stability—now part of the Board's mandate—Rosengren suggests that money market funds ought to be within the Board's regulatory sphere.

> Prime MMMFs remain a very important source of financing for short-term debt instruments—and thus any disruption in the MMMF sector could again impede the provision of stable funding to financial intermediaries. Many of the tools used to offset the 2008 run by MMMF investors have been ruled out by legislation. And once again, some MMMFs are beginning to take riskier positions. Thus, the financial stability concerns surrounding MMMFs remain real, five years after the financial crisis.[27]
>
> *—Eric S. Rosengren, President & CEO, Federal Reserve Bank of Boston. Speech at the Conference on Stable Funding, Sept. 27, 2013*

Broker-Dealers

Federal Reserve Bank of New York President William Dudley raised the possibility of extending the Federal Reserve's lender of last resort function to nonbanks with attendant prudential regulation.

> We have banking activity—maturity transformation—taking place today outside commercial banks. If we believe these activities provide essential credit intermediation services to the real economy that could not be easily replaced by other forms of intermediation, then the same logic that leads us to backstop commercial banking with a lender of last resort might lead us to backstop the banking activity taking place in the markets in a similar way. . . . However, any expansion of access to a lender of last resort would require legislation and it would be essential to have the right quid pro quo—the commensurate expansion in the scope of prudential oversight. Substantial prudential regulation of entities—such as broker-dealers—that might gain access to an expanded lender of last resort would be required to mitigate moral hazard problems. . . . Extension of discount window-type access to a set of nonbank institutions would therefore have to go hand-in-hand with prudential regulation of these institutions.[28]
>
> *—William Dudley, President, Federal Reserve Bank of New York. Speech at New York Bankers Association's 2013 Annual Meeting and Economic Forum, Feb. 1, 2013*

Markets (in Addition to Firms)

Governor Daniel Tarullo has hinted at a new regulatory paradigm in which markets, in addition to firms, are regulated by the Board.

> As we make more progress in reorienting the regulation of large financial firms toward more macroprudential objectives, we will need to watch carefully for such leakage of financial transactions. This concern returns us to the larger project of macroprudential regulation, which implicates a more complicated set of issues around legal authorities and institutional capacities for prudential regulation of markets, as well as firms.[29]
>
> *—Daniel Tarullo, Governor, Federal Reserve Board. Speech at the Yale School Conference on Challenges in Global Financial Services, Sept. 20, 2013*

The pursuit of new regulatory power is a troubling manifestation of the Board's embrace of macroprudential regulation in which every aspect of the financial system is monitored and controlled by regulators. This approach not only displaces market discipline, it also displaces other regulators. In the process, it may undermine financial stability by ensuring that regulatory mistakes by the Board reverberate through the entire financial system.

ENDNOTES

1. Dodd-Frank §§ 604(b) and 616(d).
2. Dodd-Frank § 604.
3. Dodd-Frank § 605.
4. Dodd-Frank § 165.
5. Ibid.
6. Board of Governors of the Federal Reserve System, 77 Fed. Reg. 76628, 76637 (Dec. 28, 2012) (proposing to "apply a structural enhanced standard under which foreign banking organizations with total consolidated assets of $50 billion or more and combined U.S. assets of $10 billion or more (excluding U.S. branch and agency assets and section 2(h)(2) companies) would be required to form a U.S. intermediate holding company").
7. See, for example, Dodd-Frank §§ 121, 163, 173(b), and 604.
8. Dodd-Frank §§ 617 and 618.
9. Dodd-Frank § 618. Dodd-Frank mandates some deference to other regulators. See, for example, ibid. at (c)(2)(B).
10. Board of Governors of the Federal Reserve System, Supervised Securities Holding Company Registration, 77 Fed. Reg. 32881, 32882, (June 4, 2012).

11. Dodd-Frank § 117.

12. Dodd-Frank § 312(b).

13. Dodd-Frank § 616(d).

14. Dodd-Frank § 604.

15. Dodd-Frank § 605.

16. Dodd-Frank §§ 113 and 165.

17. Dodd-Frank §§ 113 and 162(b).

18. Dodd-Frank §§ 804, 805, 807, and 808.

19. Dodd-Frank §§ 805, 807, and 808.

20. Dodd-Frank § 1061(b).

21. See, for example, Dodd-Frank §§ 1017, and 1012(c).

22. Governor Daniel Tarullo, Speech at the Federal Reserve Bank of San Francisco Conference on Challenges in Global Finance (June 12, 2012), available at http://www.federalreserve.gov/newsevents/speech/tarullo20120612a.htm.

23. William Dudley, President, Federal Reserve Bank of New York, Speech at New York Bankers Association's 2013 Annual Meeting and Economic Forum (Feb. 1, 2013), available at http://www.newyorkfed.org/newsevents/speeches/2013/dud130201.html.

24. Vice-Chairman Janet Yellen, Speech at the International Monetary Conference (June 2, 2013), available at http://www.federalreserve.gov/newsevents/speech/yellen20130602a.htm.

25. Governor Daniel Tarullo, Testimony Before the Senate Committee on Banking, Housing, and Urban Affairs (July 11, 2013), available at http://www.federalreserve.gov/newsevents/testimony/tarullo20130711a.htm.

26. See, for example, Letter from 12 Federal Reserve Bank Presidents to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Sept. 12, 2013), available at http://bostonfed.org/news/press/2013/pr091213-letter.pdf.

27. Eric S. Rosengren, President & CEO, Federal Reserve Bank of Boston, Speech at Conference on Stable Funding (Sept. 27, 2013), available at http://www.bostonfed.org/news/speeches/rosengren/2013/092713/092713text.pdf.

28. William Dudley, President, Federal Reserve Bank of New York, Speech at New York Bankers Association's 2013 Annual Meeting and Economic Forum (Feb. 1, 2013) (footnote omitted), available at http://www.newyorkfed.org/newsevents/speeches/2013/dud130201.html.

29. Governor Daniel Tarullo, Speech at the Yale Law School Conference on Challenges in Global Financial Services (Sept. 20, 2013), available at http://www.federalreserve.gov/newsevents/speech/tarullo20130920a.htm.

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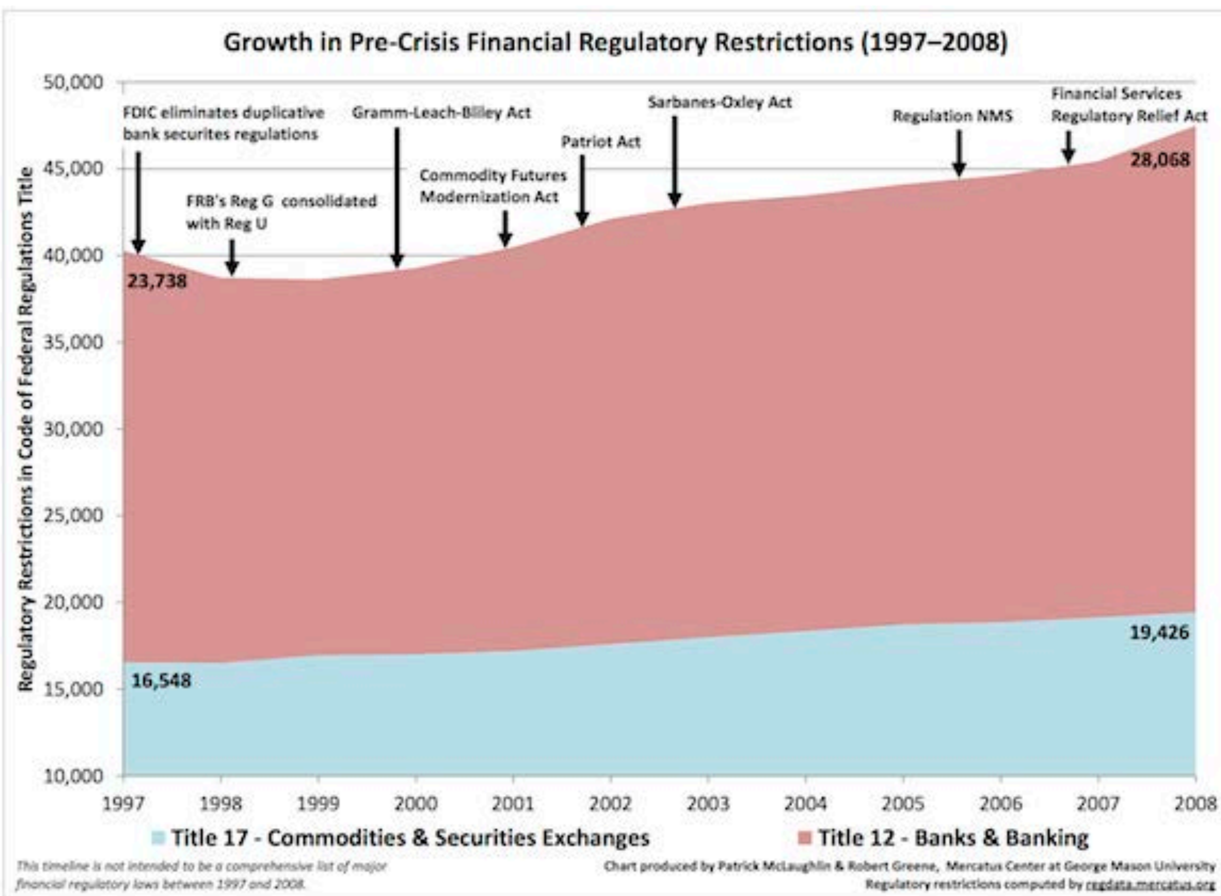
Did Deregulation Cause the Financial Crisis? Examining a Common Justification for Dodd-Frank

Patrick McLaughlin [1], Robert Greene [2] | Jul 19, 2013

Three years ago the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Deregulation of the financial services sector in the years leading up to the 2008 crisis was—and still is—used to justify Dodd-Frank's substantial regulatory burdens. But financial regulation did not decrease in the decade leading up to the financial crisis—it increased.



[3]

Using the Mercatus Center at George Mason University's RegData [4], we find that between 1997 and 2008 the number of financial regulatory restrictions in the Code of Federal Regulations (CFR) rose from approximately 40,286 restrictions to 47,494—

an increase of 17.9 percent. Regulatory restrictions in Title 12 of the CFR—which regulates banking—increased 18.2 percent while the number of restrictions in Title 17—which regulates commodity futures and securities markets—increased 17.4 percent.

RegData [4] measures regulatory restrictions by counting the number of restrictive words and phrases—such as "may not," "must," "shall," "prohibited," and "required"—in each title of the CFR. Developed by Patrick A. McLaughlin and Omar Al-Ubaydli, RegData is computer-based and thus only able to calculate regulatory restrictions for 1997 and subsequent years because electronic copies of the complete, annual CFR are publicly available from the Government Printing Office for only that time period.

Total regulatory restrictions pertaining to the financial services sector grew every year between 1999 and 2008, increasing 23 percent during this time. The Patriot Act, the Sarbanes-Oxley Act, and Regulation NMS all contributed to this growth. The repeal of parts of the Glass-Steagall Act via the Gramm-Leach-Bliley Act did not result in noticeable deregulation of the financial services sector. Nor did the Commodity Futures Modernization Act facilitate overall financial deregulation. Not even the Financial Services Regulatory Relief Act of 2006, legislation intended to decrease regulatory burdens on the financial industry, reversed the ever-growing burden of regulatory restrictions faced by the financial services sector in the years leading up to the financial crisis.

Net decreases for Title 12 regulatory restrictions between 1997 and 1999 largely reflect an effort to streamline regulatory text. Only the FDIC portion (volume 4) of Title 12 experienced a significant decrease in pages between 1997 and 1998, and it was almost entirely isolated within 12 C.F.R. § 335, which was shortened from 136 to 7 pages in an effort to streamline FDIC regulations with pertinent SEC Securities Exchange Act regulations. Similarly, the comparatively small decrease in overall regulatory restrictions in Title 12 between 1998 and 1999 is in large part attributable to the Federal Reserve's 1999 consolidation of Regulation G—which pertained to nonbanks' extension of leverage for the purpose of purchasing certain securities—with Regulation U, which was revised to be applicable to both banks' and nonbanks' extension of leverage. Without this consolidation, Title 12 pages would have increased between 1998 and 1999. Neither of these episodes had any relation whatsoever to Gramm-Leach-Bliley or the Commodity Futures Modernization Act.

As we show in this analysis, financial regulatory restrictions increased 17.9 percent in the years leading up to the crisis. Without the streamlining efforts of the late 1990s—which reduced duplicative regulatory text and were unrelated to the acts of Congress typically blamed for alleged deregulation—this figure would likely be even higher. In Dodd-Frank: What it Does and Why it's Flawed [5], we used the RegData methodology to estimate that Dodd-Frank will cause a 26 percent increase in financial regulatory restrictions. Policymakers should reexamine the presumption that Dodd-Frank's substantial regulatory restrictions are necessary to offset previous deregulation of the financial services sector. On net, RegData [4] shows that no such deregulation occurred. In fact, the financial sector was increasingly regulated over the decade leading up to the financial crisis.

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Op-Eds and Blogs
Regulator contributor to Real Clear Markets and The Hill. My work has also appeared in other publications, including City AM, The American Banker, The Guardian, Point of Law, and U.S. News & World Report. Many of these pieces are available at http://mercatus.org/person/expert-commentary/1163700.

EXPERIENCE

Mercatus Center at George Mason University (Arlington, VA) January 2012-Present. Senior Research Fellow.

George Mason University School of Law, Adjunct Professor, Spring 2014 and Spring 2015, *Perspectives on Regulation*.

United States Senate Committee on Banking, Housing, and Urban Affairs (Washington, D.C.) August 2008-December 2011. Counsel/Senior Counsel on Staff of Ranking Member Richard Shelby.

United States Securities and Exchange Commission (Washington, D.C.) 2000 – 2008.
June 2004-August 2008: Counsel to Commissioner Paul S. Atkins.
April 2000-June 2004: Staff Attorney, Division of Investment Management.

Wilmer, Cutler & Pickering (now WilmerHale) (Washington, D.C.) Oct. 1998 – March 2000. Associate.

U.S. Court of Federal Claims (Washington, D.C.) Fall 1997 – Fall 1998.
Law Clerk to Judge Roger Andewelt.

PROFESSIONAL AFFILIATIONS
Member of the Investor Advisory Committee to the Securities and Exchange Commission (2014 to present)

Member of the District of Columbia Bar

Co-Chairman of the D.C. Bar Committee on Small and Emerging Business of the Corporation, Finance, and Securities Law Section (2014 to present)