



## Senator Dodd's Regulatory Reform: A Step Forward

*Morris Goldstein gives the new Dodd proposal a 7.5 rating out of 10, scoring well on resolution authority but less well on pricking future asset bubbles.*

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Steve Weisman: It's March 15—the Ides of March—and Senator Chris Dodd, chairman of the Senate Banking Committee, has just released his new proposal for legislation on financial regulatory reform. Who better to discuss it than Morris Goldstein of the Peterson Institute? This is Steve Weisman at the Institute. Morris, thanks for joining us.

Morris Goldstein: Well, delighted to be here, Steve.

Steve Weisman: What in your view, does this new legislation accomplish? What grade would you give it?

Morris Goldstein: All things considered, I think it's a pretty good bill. Certainly much better than where we are now, without financial regulatory reform. I think it's probably more amenable to a compromise with Republicans than the Senator's earlier bill. I suppose on a 10-point scale, I'd give it 7 and a half: 7 points for fundamentals and a half point for degree of difficulty. So pretty good marks overall.

Steve Weisman: Where does it improve things the most?

Morris Goldstein: I think one of the strongest provisions is on “combating too big to fail.” It would give the government the authority to liquidate systemically important nonbanks like in AIG or Lehman, subject to approval of the main regulators—the president, as well as a panel of three bankruptcy judges. It would pay for the government intervention by the combination of a prefunded assessment on large institutions and then by an exposed crisis assessment.

Steve Weismann: That was a compromise because some were resisting any kind of prepayment.

Morris Goldstein: That's right. Some people thought, “If you have a pool of money out there to be used, [it will be used].” But I think this is a good compromise. You get a certain amount—\$50 billion or so—from a fund preassessment and you get the rest imposed by taxing the institutions. The bill would also have wind-down authority, so that if systemically important institutions didn't have funeral plans that allowed an orderly wind down, the regulators could ask them to shrink, and it has key aspects of the Volcker Rule as well on proprietary trading. So, I think on that point, very good.

Steve Weisman: Where does it leave the Fed's role?

Morris Goldstein: The Fed would retain supervision over the largest bank holding companies, those with \$50 billion of assets or more—

Steve Weisman: Banks and nonbanks or just banks?

Morris Goldstein: They would also be able to extend supervision to systemically important nonbanks. Smaller state-chartered banks would go to the FDIC [Federal Deposit Insurance Corporation] and then they would also be—the OCC [Office of the Comptroller of the Currency] would handle national banks. So the Fed gets a somewhat reduced role. But they don't lose as much as under the original Dodd proposal.

Steve Weisman: There had been a lot of talk of stripping the Fed's role entirely in the regulatory area but they seemed to have changed their minds about that.

Morris Goldstein: They seem to. I would have preferred that they take all microprudential supervision and put it in a new banking supervisory agency that would combine the functions of the existing regulators. But they apparently decided to split the baby in half sort of.

Steve Weisman: What else is good about this bill?

Morris Goldstein: On monitoring of systemic risk, it would create a new systemic risk council, chaired by the Treasury secretary to address and monitor systemic risk.

Steve Weisman: And on consumer protection?

Morris Goldstein: On consumer protection, it would set up a new bureau housed in the Fed with an independent head, and that bureau would also enforce the regulations in banks and thrifts with \$10 billion or more of assets. So I think that's clearly much better than what we have now, which is nobody essentially watching it.

Steve Weisman: But also another victory for the Fed?

Morris Goldstein: Yes, sort of. I think they have a piece of supervision. Whether it would [be] good for them I don't know, but I think it's not as good as if we had an absolutely independent agency for consumer protection.

Steve Weisman: What do you see as the main problems with this legislation?

Morris Goldstein: Where I would give it some deductions is the bill really doesn't address identifying and pricking asset price bubbles, which have been such a problem particularly on housing in the run up to this crisis. And what you really need is for a larger tool kit where, when you [have] these bubbles, they're identified and then the regulatory authorities attempt to prick them by tightening capital liquidity standards, raising loan-to-value ratios, raising margin requirements. That's a very important function and it's not addressed adequately in this bill.

Steve Weisman: Is it addressed at all? Couldn't the new systemic regulator or council do something with that?

Morris Goldstein: They should do that in my view, but that needs to be laid out much better than it is in the bill. I think that's a negative. As I said earlier, I would also give them negatives for not going far enough on streamlining bank supervision, and a negative somewhat on consumer protection because what they have is better than the status quo but it's not as good as we could get.

Steve Weisman: Even so, the Republicans are still saying they oppose this. What are their main concerns?

Morris Goldstein: On consumer protection, they don't want these requirements enforced by the consumer protection agency. They'd rather have it done by the safety and soundness regulators, and that'll make it easier on the banks because when you have these terrible practices, they tend to increase the profits of the banks, which improve their safety and soundness.

Steve Weisman: Until they blow up.

Morris Goldstein: Right. Right. If you have the safety and soundness regulators [doing] this, they're not likely to be as tough. So, the Republicans would like that. They would've liked something even more along the bankruptcy line, on resolution authority, and "too big to fail."

Steve Weisman: No fund at all.

Morris Goldstein: No fund at all, only doing it after the crisis by taxing. The Republicans did get I think—and I think actually, this is a good provision—the resolution authority can only be used to liquidate institutions; it can't be used to keep them alive.

Steve Weisman: Or resell them or—

Morris Goldstein: Right. Not conserve, it's really liquidate.

Steve Weisman: What are the prospects?

Morris Goldstein: I think Republicans are in the difficult position now, if they can oppose it all. Since everyone pretty much agrees that faulty regulation was one of the main causes of this crisis, and if you don't have anything that addresses that, they're in the position of having done nothing on it. At the same time, Dodd has changed his bill a little bit to gain some Republican support. He has kept the Fed with a little more authority over the large institutions. He has put the Consumer Protection Bureau in the Fed rather than on its own, he has brought bankruptcy in, at least a little bit, on resolution. So he's made some compromises.

Steve Weisman: You sometimes hear the critics say, "What's the rush?"

Morris Goldstein: I think there's a rush in the sense that we've been at this a year. And I think it's important for confidence for the people to know that the problems that led to this crisis are really being addressed, and that there's been ample time to do that. They've had time for reflection. I think what's going on now is just stone-walling on the part of certain members of Congress.

Steve Weisman: Can this be done unilaterally without the Europeans?

Morris Goldstein: Some aspects can. Clearly, we can organize banking supervision here however we want, whether we have two agencies or four agencies. It doesn't really affect very much others. When we get into things like capital and the liquidity requirements, or changing the supervision of over-the-counter derivatives, those things are international matters and it's more difficult to put those in place if you're going to have large differences across countries. You really need some international agreement if you can get it.

Steve Weisman: Morris, thanks very much.

Morris Goldstein: Thank you.

