Course 9

1/ Developments in the US

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1. Developments in US

Dodd–Frank Wall Street Reform and Consumer Protection Act (2010)

- A huge piece of legislation – nearly 850 pages (compared to the Glass Steagall Act, 1932, incorporated in Banking Act 1933 – 50 pages) (this is an indication of the problem of complexity)
- Several agencies covering many areas
- Raises questions of managing oversight

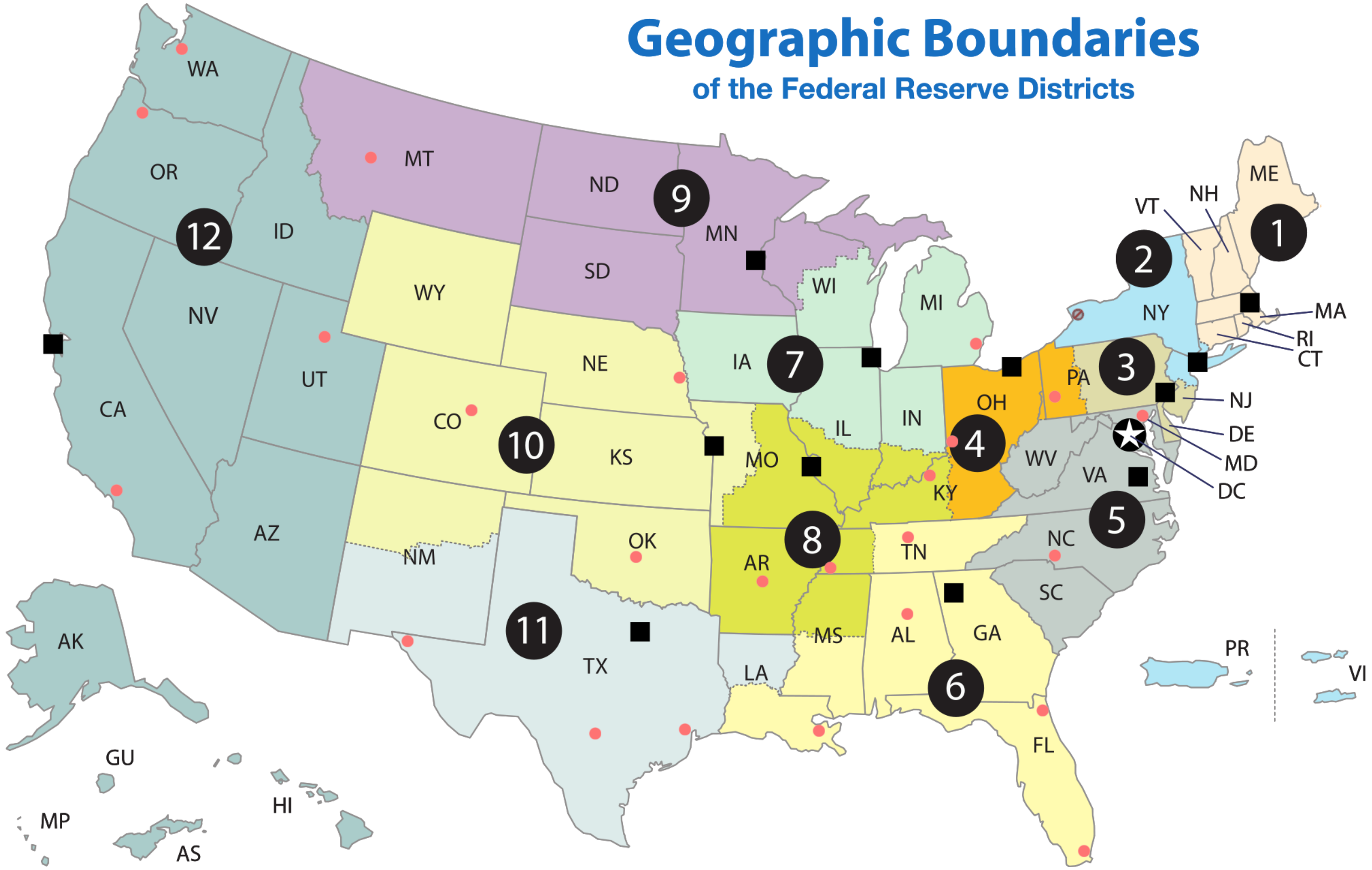
Some key measures:

- <u>Financial Stability Oversight Council</u> – to monitor firms (too-big-too-fail) – orderly liquidation fund – it can break up banks (under authority of US Treasury)

- <u>Consumer Financial Protection Bureau (CFPB)</u> – prevents predatory mortgage lending (independent agency)

- <u>Securities and Exchange Commission (SEC) Office of Credit Ratings</u> – to oversee ratings agencies.
- Whistleblower Program – with bounties from litigation

The Federal Reserve System



Federal Reserve Bank of Boston

Federal Reserve Bank of New York

Federal Reserve Bank of Philadelphia

Federal Reserve Bank of Cleveland

Federal Reserve Bank of Richmond

Federal Reserve Bank of Atlanta

Federal Reserve Bank of Chicago

Federal Reserve Bank of St. Louis

Federal Reserve Bank of Minneapolis

Federal Reserve Bank of Kansas City

Federal Reserve Bank of Dallas

Federal Reserve Bank of San Francisco

Federal Deposit Insurance Corporation (FDIC)

- Set up in 1933 to insure deposits

- Since Dodd-Frank, the FDIC insures deposits in member banks up to $250,000 per ownership category

- (In Europe €100,000 for all accounts in the same bank, Bercy Infos [retrieved 16/11/2023]).

Volcker Rule (to protect commercial banking)

1927-2019

Binyamin Appelbaum and Robert D. Hershey Jr., "Paul A. Volcker, Fed Chairman Who Waged War on Inflation, Is Dead at 92", The New York Times, Dec 9, 2019.

- Prohibits propriety trading
- Commercial banks cannot trade on their own account: i.e. it cannot use its own capital to trade in financial assets (notably derivatives)
- See Investopedia "Proprietary Trading:…" and video

Amendments to Volcker Rule

In 2019, FDIC and OCC Approve Volcker 2:

- increased ability of banks to invest in so-called “covered funds” (essentially investment companies, including private equity, hedge funds and commodity pools)
- Special Documentation Obligations eliminated for banks without significant trading activities. (Source: Schulte Roth + Zable, News & Insights, 8/23/2019.)

In 2020, rule finalized by five federal regulatory agencies concerning “covered funds”. The rule modified by:

- Streamlining the covered funds portion to the rule;
- Addressing the extraterritorial treatment of certain funds; and
- Permitting banking entities to offer financial services and engage in other activities that do not raise concerns that the Volcker rule was intended to address (Source: Fed, “Financial regulators modify Volcker rule”, June 25, 2020)

Trump Rollback on Dodd-Frank:
Economic Growth, Regulatory Relief, and Consumer Protection Act, (EGRRCP or the "Reform Act"), May 24, 2018

Trump hypes himself as a "deregulator" of the economy.

The financial industry lobbies against capital liquidity, stress requirements for regional and community banks – bad for the economy.

- Threshold of SIBs/SIFIs up from $50 to $250 billion
- Companies with less than $100 bn exempted from prudential standards
- Limited stress testing for banks with $100 bn or more
- lenders with assets less than $10 billion from Volcker rule requirements

Key members of the Trump team – and deregulation

The “foreclosure king” at OneWest after GCF.

COO at Goldman Sachs before entering White House.

GPT-4 (16/12/2023), also lists:

-restructuring the CFPB (reduced enforcement and fines)

-greater flexibility to financial advisors (handling retirement accounts)

-SEC: more simplified disclosures

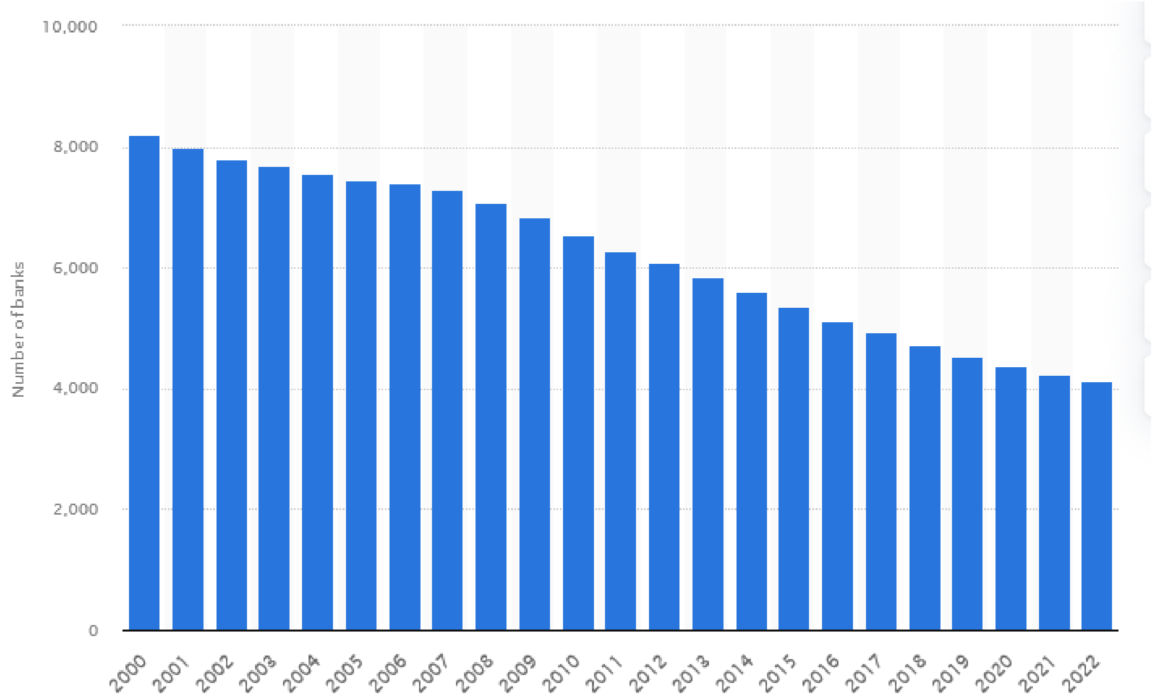
-**Tax Cuts and Jobs Act (2018)** :not deregulation but the $1.125 in net benefits to individuals and entities plus $320 billion for corporations.

A big boost to businesses and financial institutions.

See PDF file for more detail

Steady concentration of banking system

Number of FDIC-insured US commercial banks, 2000-2022 (down from just over 8,000 to just over 4,000)



Source: Statista, **[Number of FDIC-insured commercial banks in the United States from 2000 to 2022](#)**, 2023 [retrieved 16 November 2023].

Jamie Dimon bails out First Republic – and FDIC

By **Lauren Silva Laughlin**

May 2, 2023 9:43 AM GMT+2 · Updated 6 months ago

Aa

Commentary | By Lauren Silva Laughlin

Jamie Dimon, CEO of JPMorgan Chase, leaves after the launching of the Advancing Cities Challenge, in Pantin, a suburb of Paris, France, November 6, 2018. REUTERS/Benoit Tessier *Acquire Licensing Rights*

After the rough ride of bailing out Bear Stearns in 2008, Dimon and JP Morgan get a "sweetheart" deal from the FDIC.
Lauren Silva Laughlin, [Reuters](#), May 2, 2023

Shadow banking could be a significant weakness…

Investopedia

Michael Bromberg (reviewed Julius Mansa), "[Shadow Banking System: Definition, Examples, and How It Works]", Investopedia, updated August 02, 2023.

Financial institutions like hedge funds, private equity funds, mortgage lenders and even large investment banks etc.

They do not take demand deposits! So they are less regulated.

Make large loans, and (speculative) investments.

49.2%

The shadow banking system's relative share of total global financial assets at the end of 2021, according to the Financial Stability Board (FSB).[6]

Regulatory changes under the Biden administration (some policies, as identified by ChatGPT 4o, 14 November 2024)

Consumer protection:

Student Loan Debt Relief (more than 1 million debt forgiveness): Investopedia 13/11/2024

Regulation of “Junk Fees”: the Consumer Financial Protection Bureau (CFPB) has targeted excessive banking fees.

Corporate Accountability and Market Integrity:

Enhanced oversight of private funds: SEC, increased transparency and accountability of private funds industry (including hedge funds and private equity)

Insider trading regulations:

Modernization of regulatory process to strengthen agency effectiveness.

Changes to the Basel Endgame capital hike rule

September 2024 – agreements to weaken regulations

Credit risk: lower risk-weights for residential real estate loans and loans to retail customers; reduced risk-weights for low-risk corporate exposures; scrapping of minimum haircut for securities financing.

Equity exposure: low risk-weight for tax credit equity funding structures.

Operational risks: operational risk capital requirement to be softened.

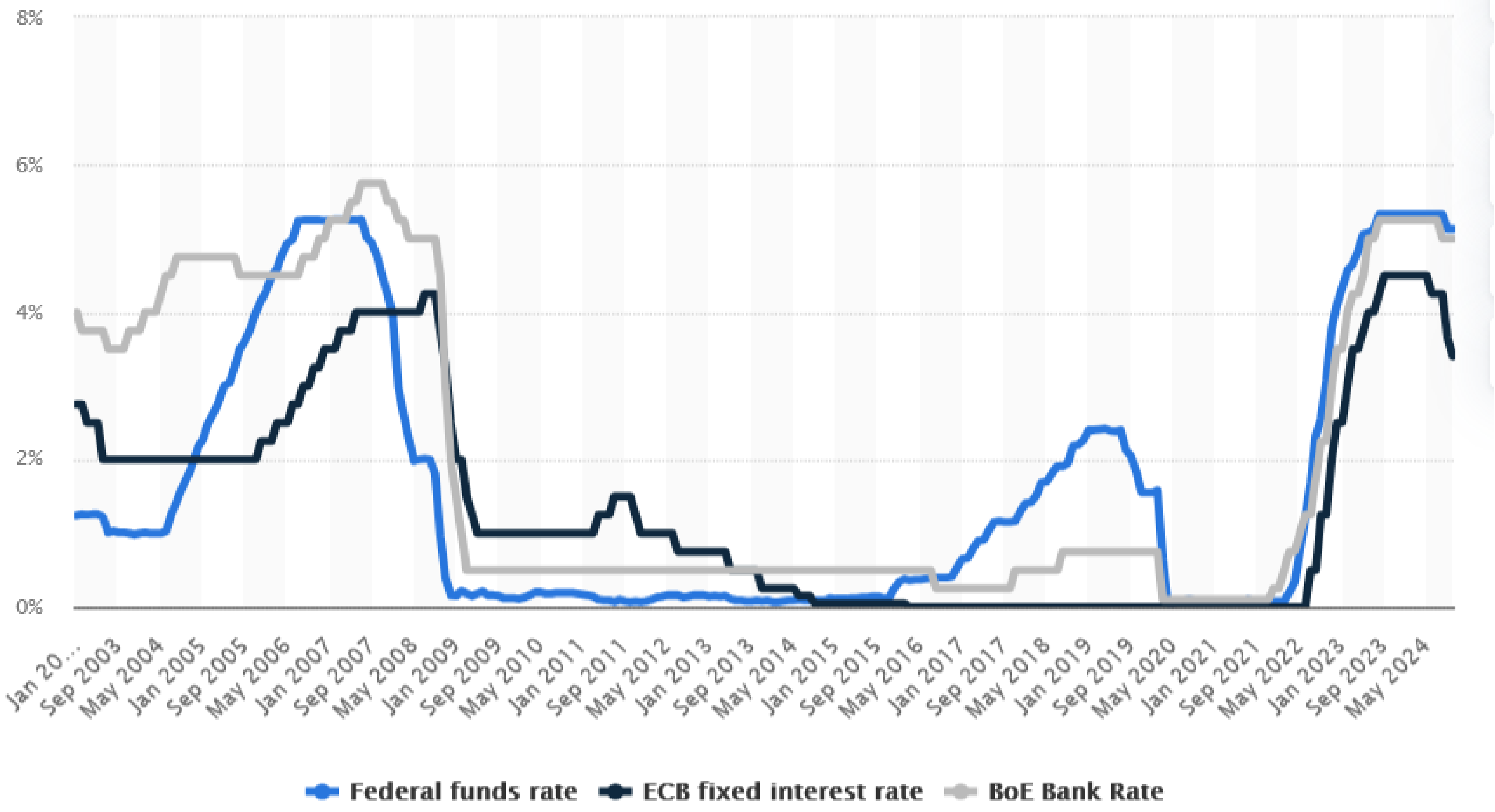
Market risks and derivatives: easier constraints on banks' use of internal modelling of risk of trading and derivatives activities.

Tiering: non-GSIB banks (with assets between $250 bn and $700 bn) will not have comply with market risk and other frameworks if they do not trade international (banks with lower assets will not have to apply frameworks).

Source: Hannah Lang, "How regulators have overhauled contentious Basel Endgame capital hike rule", Reuters, Sept 11, 2024.

2/ “Accidents” – SVB, the UK “mini-budget”, Crédit Suisse

Change in interest rate environment, since the rise in inflation



Source: Statista, "[Monthly Federal funds effective rate, European Central Bank fixed interest rate, and Bank of England Bank Rate from 2003 to 2024]", retrieved 14 November 2024.

Cryptos – have escaped regulation

Source: Financial Times, 30 November 2022

- Cryptos have so far remain unregulated: due to their nature (decentralised ledgers), their complexity, operations across jurisdictions.
- Central banks have warned investors about total losses.
- (Tooze – after FTX collapse – suggested regulating like gambling)
- Ponzi scheme nature
- Illicit business
- CBDCs could be a way forward: centralised – problems of civil liberties and competition with banks

Silicon Valley Bank (SVB) – bank run – closed March 10, 2023

Under EGRRCPA, SVB (and others) nor required to calculate and report Liquidity Coverage Ratio (LCR), the Net Stable Funding Ratio, or carry out liquidity assessment reviews.

Capital and Liquidity are not the same thing.

SVB not obliged to calculate Net Stable Funding Ratio
Trump weakened Comprehensive Liquidity Assessment Review (for serious stress-testing).

Largest failure since 2008

-concentration in one sector

-higher interest rates made getting new venture capital hard, companies (start-ups) withdrew cash > bank run

-SVB held long-term government bonds – safe but low yields (2%). As interest rates rose, prices fell.

-**Fed stepped in to bail-out depositors with more than $250,000**

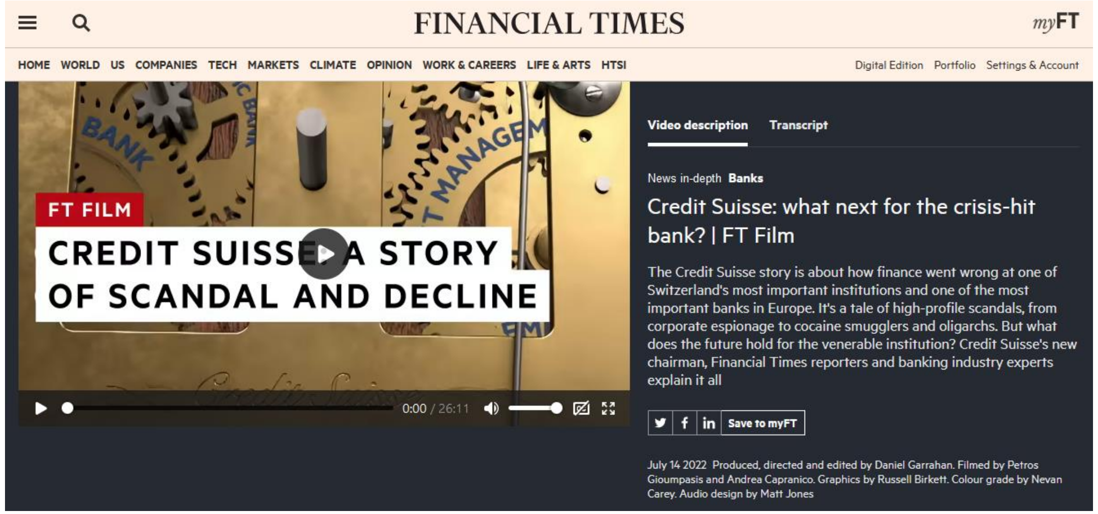
Next, the **First Republic Bank** was rescued by major banks, led by Jamie Dimon and JPMorgan.

“Credit Suisse falls prey to a crisis of confidence”

SVB’s collapse has led to jittery markets seeking banking’s weakest link, Editorial Board, Financial Times, March 16, 2023

Credit Suisse received an emergency $54bn backstop from the Swiss central bank but it is unclear whether the support will be more than a sticking plaster in the longer term © Pascal Mora/Bloomberg

A complex failure following multiple errors, including significant conflict within top management.



[Financial Times video, July 14, 2022]

Essentially a private bank for wealthy individuals.

A rescue with UBS was organised, which itself had to be bailed-out after the GFC.

The consequences of higher interest rates

- Higher interest rates are putting pressure on bond markets and stocks

- Possibilities of financial instability: the UK mini-budget and mini-crash in September 2022; when pension funds faced a liquidity crunch, suggest unexpected weaknesses in markets.

UK “Fiscal event” / “mini-budget” 23 Sept 2022 >> potential crash

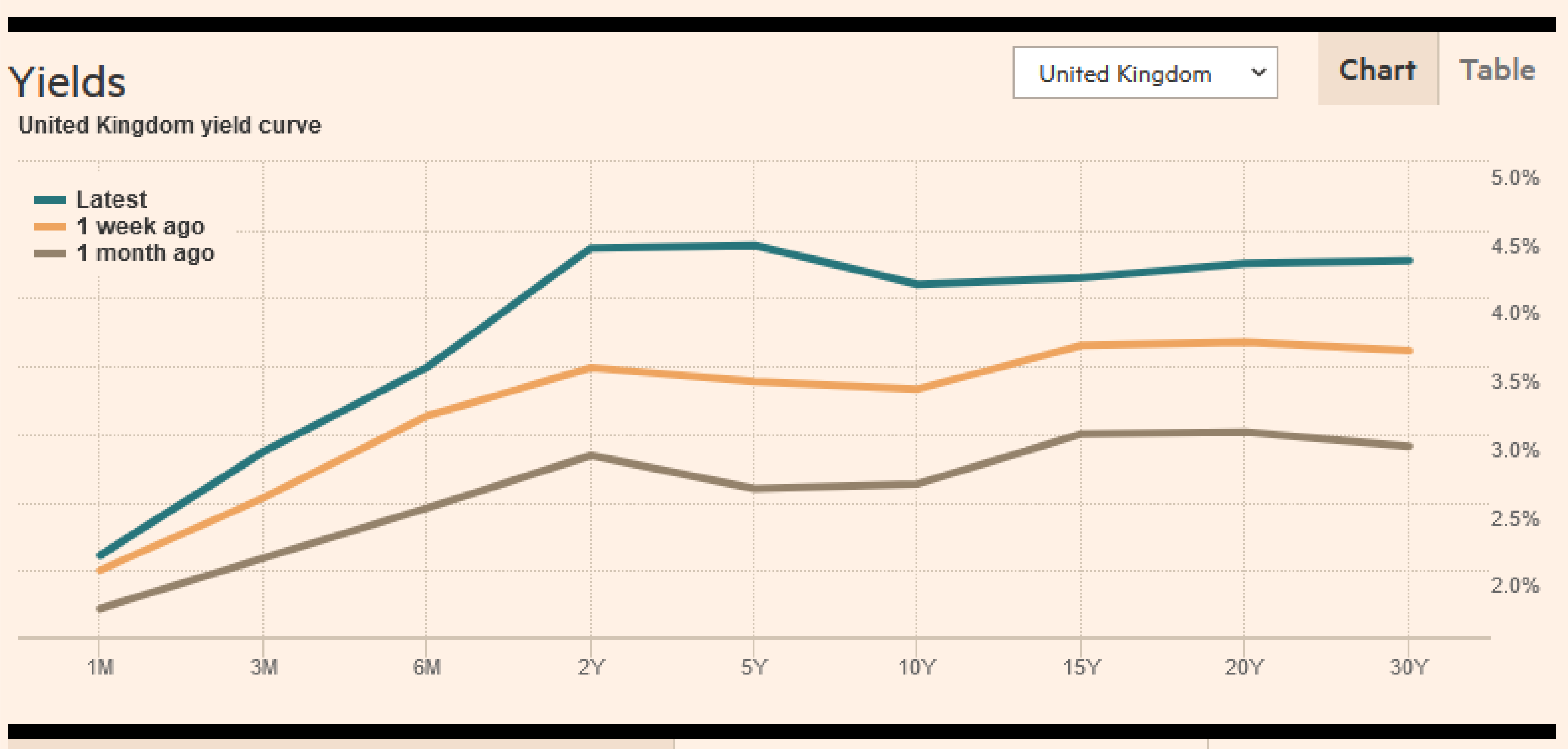
Tax cuts £45 billion

- Top tax rate (45%) abolished (April 2023)
- Basic rate cut to 19%
- April 2022 rise in NI of 1.25% reversed
- Stamp duty threshold up (£425,000)
- Bankers’ bonus limit scrapped

£60 billion to cap energy prices

Freeze on energy bills (price cap around £2,500 per year,) for 2 years from Oct 2022.

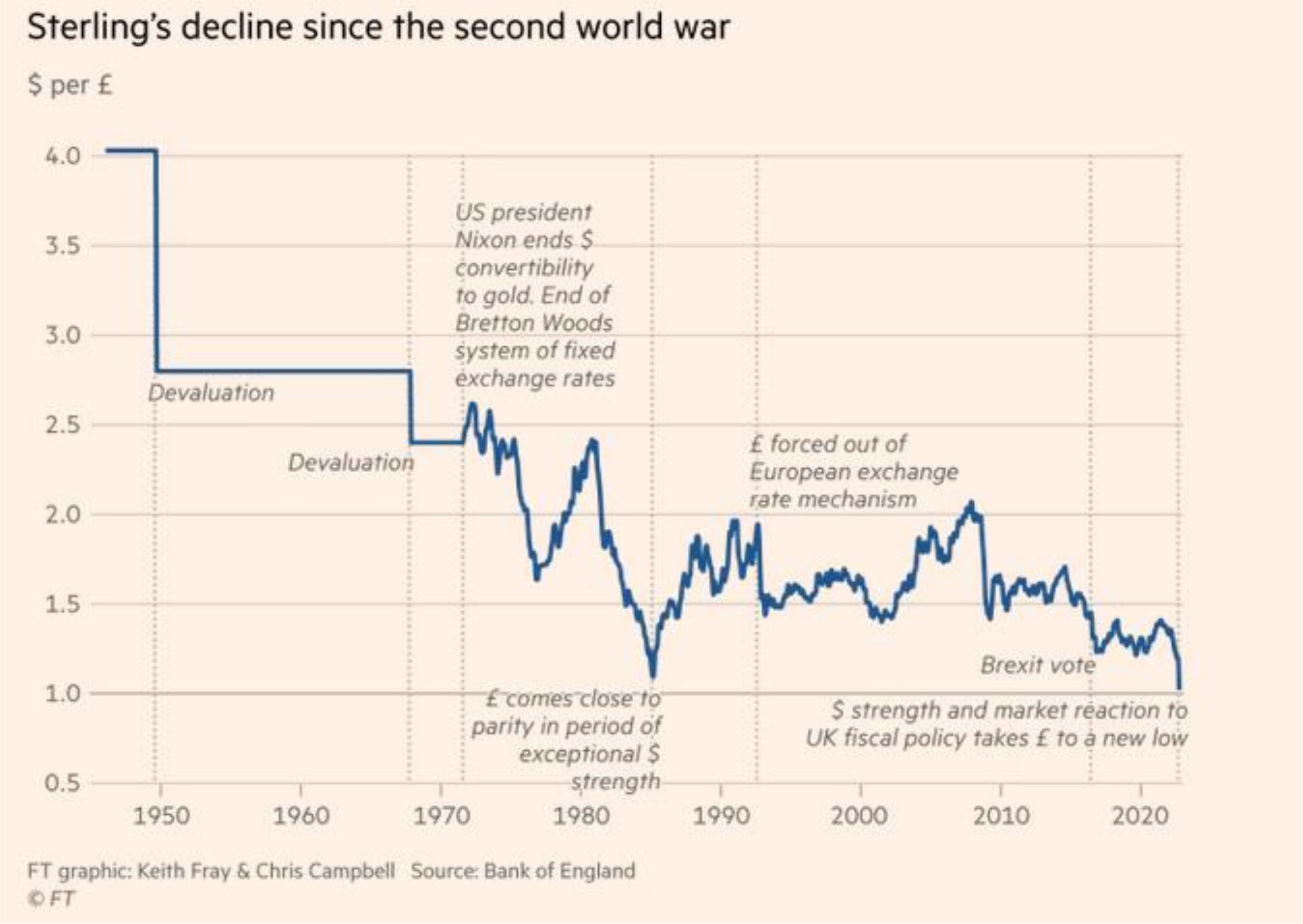
Immediate impact on interest rates…



Source: https://markets.ft.com/data/bonds - about 4pm 28 September 2022.

“The chapter on the Fall of the Rupee you may omit. It is somewhat too sensational.”

Oscar Wilde, *The Importance of Being Earnest*



Chris Giles and George Parker,
“How Significant is the sterling crisis?”,
The Financial Times, Sept. 26, 2022.

The Bank of England steps in 28 Sept 2022

"whatever scale is necessary" to stabilise gilts market

- £65 billion to buy up long term bonds - £5 billion per day
- Run on pension schemes gilt prices fell: a problem in so-called "liability-driven investment derivatives". Pension schemes used these to "reach for yield" when interest rates were low, but led to damaging exposure with gilt prices fell.

3. Conclusion

Mayra Rodriguez Valladares, "How Trump's Deregulation Sowed The Seeds For Silicon Valley Bank's Demise", Forbes, March 3, 2023.

"It saddens me greatly that people ignore history. Every couple of years lenders and traders tell me that "this time, it will be different." *The style of the movie may be different, but the ending is always the same*. Every time bank regulations are eliminated or made lighter, banks proceed to take on more risks and reduce risk identification and measurements. They then implode."

Final take-outs

- Uncertainty is high (but then I have said this for years ☹ ☺)
- We still don't know what monetary tightening and the run down of CB assets will entail.
- Little financial dominance so far: i.e. central banks being obliged to undertake more expansionary policies for fear of financial instability.
- For the moment, the international financial architecture seems unlikely to change > despite the GFC and Covid-19, there is little support more radical change to banking and finance.
- But there may be liquidity risks in the system ("accidents")
- Credit and debt drive capitalism
- The lure of lucre is inexorable

There will always be financial crises.