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Deregulating America’s Big Banks and What It Means for You (with transcript)

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University of Pennsylvania Law School
Case in Point: ***Deregulating America's big banks, & what it means for you***
April 14, 2015

David Skeel and Kevin Cirilli examine how the U.S. government will regulate America's big banks in the wake of changes to Dodd-Frank, and what this means for Wall St. and Main St.

Experts:

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Author, The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences

Kevin Cirilli
Finance Reporter, The Hill
Author of The Hill's Overnight Finance Tip Sheet

Host:

Eleanor Barrett
Host, Case in Point

Eleanor Barrett: Welcome to Case in Point, produced by the University of Pennsylvania Law School. I am your host, Eleanor Barrett. With a new congress and a presidential election looming, our episode today will focus on whether, and to what extent, the United States Government will continue to regulate its largest banks and financial institutions. The passage of the latest federal budget bright with it a significant change to the Dodd-Frank Act. And we are fortunate to have with us today two experts to help us understand what that change means for Wall Street and for taxpayers.

We have with us first, David Skeel, Professor of Corporate Law here at Penn, and author of "The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences".

Also joining us is Kevin Cirilli, Finance Reporter at *The Hill* in Washington, DC, and author of "The Hill's Overnight Finance Tip Sheet".

Welcome, David and Kevin. All right, to start us off, Kevin, it's often been said that the law is intertwined with politics, and that seems to be very much the case here. Can you give us some context about hos this budget bill was passed and what was at stake if it didn't get passed?

Kevin Cirilli: Well, that's a great question. The bottom line is that if this bill was no passed, this one-point-one trillion-dollar bill was not passed, then the government would have shut down. But there were a lot of politics at play here. It was a really fascinating type of political tension that we, political watchers, here in Washington have been following all last year. And the culmination really came to one late night in December, up until about midnight when lawmakers were on The Hill trying to get this thing through. Two big takeaways. The first is immigration. You had the Tea Party saying that they wanted to withhold funding in this CRomnibus bill from the agencies that President Obama needed to fund his executive orders on immigration. Tea Partiers said hey, wait a minute. We don't want these immigration proposals going through. This is an overreach of constitution power. We are against it. So, we want to limit funding on that.

So, what they ended up doing was just funding the agencies on immigration through the end of February, early March, while funding the rest of the government through next fall. So, they spliced it off and were able to kind of compromise in that regard setting up a larger immigration fight in just a couple of weeks.

But the second things, which as a political watcher, this was more fascinating to watch, was that you had a lot of progressives and a lot of liberals really upset with a provision, known as the "push-out" provision, that impacts Dodd-Frank. Liberals said that this is going to reduce Wall Street regulations by allowing big banks to make more risky financial trades that they argue helped contribute to the 2008 financial crisis. Now, centrist Democrats, as well as Republicans, argued that this is the type of provision that was needed to help spur economic growth after the 2008 collapse.

The bottom line is, within the Democratic Party right now, we always talk about the Tea Party first as the centrists, but within the Democratic Party now, we are watching the far left, led by someone called Senator Elizabeth Warren, a rising progressive rock star, versus the more centrist Democrats. She was able to put a lot of pressure, but she ultimately failed in getting this Wall Street regulation that Jamie Dimon lobbied himself for, included in the bill.

Eleanor Barrett: Well, let's talk a little bit more about that push-out provision. But, before we get into detail, let's back up a step. David, you have written extensively on the Dodd-Frank Act. And can you give us just a little bit of the background of the act, about what were the circumstances surrounding its passage in 2010, and what the act was designed to do?

David Skeel: As most people who are watching this video will know, the legislation was passed as a direct response to the 2008 crisis. And in particular, the bailouts of a couple of investment banks, Bear Stearns, and, well, not the bailout of Lehman Brothers, but the failure to bail out Lehman Brothers, the bailout of the insurance company AIG, and all of the other things that were going on in 2008. There was a very widespread perception that the crisis – there were lots of causes of the crisis, but the crisis was, in part, caused by failures of regulation. And there were a number of areas where most people felt regulation let us down. One of them was derivatives, which we are talking about right now. Derivatives and other financial contracts were largely unregulated going into 2008. At the time when these big investment banks ran into trouble, nobody really knew what their derivatives positions looked like, and what some of their other financial contracts looked like. So that was one big problem.

Another big problem, obviously, was the entire mortgage industry and the way that mortgages were made by banks and then packaged and re-packaged and securities and then were sold. That process, which is known as "securitization" was problematic. There also was a perception that consumers weren't being protected in all of this. There were concerns about the bailouts, the fact that Bear Stearns and AIG were bailed out. That Fannie Mae and Freddie Mac were bailed out. So there were concerns about that. And there were concerns that regulators didn't have enough power to do the things they wanted to do. So, there were a huge number of concerns.

Dodd-Frank, the legislation that was passed in 2010, tries to deal with many of these concerns. It doesn't deal with all of them. It doesn't deal with all of them. It doesn't deal with all of the ones it tries to handle effectively, but it is an effort to take aim at some of these problems.

Eleanor Barrett: Okay, I am hearing you say that the push-out provision relates specifically to the derivative piece of the Dodd-Frank Act. Could you explain to us a little bit more what that change was that was enacted as part of last year's budget deal?

David Skeel: Sure. And maybe I should take a step back and first say a tad more about what a derivative is—

Eleanor Barrett: Sure. Absolutely.

David Skeel: -- because I kind of raced past that in my description—

Kevin Cirilli: Everybody gets scared when you say the D-word, right?

David Skeel: No, this is for sure. And, so, if you are trying to scare people it's great. But if you are trying to explain things to people it's not quite so great. And derivatives are a lot of different things. But basically what they are is they are just contracts. It's a contract between two parties. And the reason it is called a derivative is because the payoff in the contract is based on some other value or some other event. So, an interest rate derivative contract will pay somebody – or pay one of the parties depending on what interest rates do. Currency derivatives, the payouts under currency derivatives are based on what the U.S. dollar is doing or what the Euro is doing. You can have derivatives that are triggered by weather events. You can have derivatives that do almost anything. But the basic idea is it's a contract, and the payout under the contract is based on something else, often an interest rate or a currency or something like that. A change in the value of something else. Or, a triggering event.

So, one of the most common types of derivatives that was a problem during the crisis was essentially an insurance policy. They are known as "credit default swaps", and they are insurance on the debt of a company, or on something else.

So, a derivative is basically a contract whose value is derived from something else. The way they relate to the swaps push-out is there is a provision in Dodd-Frank, a swaps push-out provision that forbids commercial banks, the kinds of banks that take deposits and make loans, forbids commercial banks from having derivatives in the commercial banking part of the business. And the idea is deposits are guaranteed by the U.S. taxpayers, and they should not be funding derivatives gambles that banks might be taking. So that if you are a giant financial institution like JP Morgan or Citigroup that has an investment-banking arm, a commercial banking arm, has other branches to the business, other subsidiaries, the push-out said you can't have derivatives in the part of the bank that does commercial banking.

Eleanor Barrett: Can I just ask you one follow-up question on that. You mentioned that the push-out provision is designed to keep these gamble out of the commercial banks. Are these kinds of instruments, derivatives, always used for gambles? Or, do they have some other business purposes as well?

David Skeel: Certainly, the banks wouldn't say they are ever used for gambles, or they are often used for gambles. They do have business purposes as well. The classic use of a derivative is as a hedge to protect yourself against some change in price or some other event. And the example many people use is that a couple of decades ago when Southwest was still a young, up and coming airline, they bought oil derivatives. They bought derivatives contracts that paid Southwest if oil prices went up. And in effect, what they did is they hedged Southwest. Back then, oil prices did go up, and it really reduced Southwest's costs. And it protected them against the surprise of rising oil prices.

So, when people talk about the non-speculative uses of derivatives, what they usually are talking about is hedging. Protecting yourself against a change in oil prices, a change in the U.S. dollar, a change in the oil, a change in interest rates, a change in almost anything you can imagine.

Eleanor Barrett: Kevin, after the budget that passed last winter, is it fair to say that commercial banks can now hold these kinds of derivatives or these kinds of credit default swaps that David was talking about?

Kevin Cirilli: Well, yeah. Because this was something that passed, and this was included in this one-point-one trillion-dollar CRomnibus. And from a larger standpoint, there are a couple of important points to make about why this is important. The first is this is the first major crack in Dodd-Frank's armor. That was how the top senior Republican aide described it to me. He said, you know, Kevin, the Republicans have been trying to chip away at Dodd-Frank ever since it was enacted in 2010. They say that it has a lot of unnecessary regulatory red tape that slows down economic growth. But this is a bigger bill, mind you, than the Obamacare Law. But I mean a lot of folks don't necessarily realize that, but this is a hallmark piece of the Obama Administration's domestic policy. And, quite frankly, from a line history standpoint, he has tried vehemently to protect it despite attacks on this law because of the argument that folks have been chipping at, that it is stifling economic growth.

The bottom line, though, and what was really interesting is we just got a great explanation from David about what derivatives are. But outside of the academia world, and outside of the wonk world that I live in here in Washington, it's really tough to break through that communication bubble, and you had someone like Senator Elizabeth Warren saying, using the grassroots, progressive level in a way that no one really in the banking community has seen before. And here's why. She was able to say that this provision, and this how she pitched it to the base of the Democratic Party, that by including this provision, it would make it more risky for the average American. And that those very unpopular bank bailouts following the 2008 collapse could happen again if big banks were able to engage in riskier trades in the derivatives market.

Now, clearly Republicans pushed back against that. They sat that this stifles economic growth. It's also worth noting that many of the cosponsors of this provision were, in fact, Democrats, and top Democrats, including Barney Frank himself, the guy who coauthored Dodd-Frank, was actually in support of this provision before he was against it. I asked him why. He said that that

was because times have changed, so, you know, he's not in office anymore, but still the politicking continues.

David Skeel: Can I ask Kevin quick question, as a follow-up on that, which is very, very interesting. With this economic growth argument, was there any content to that argument? Was it just that having the swaps push-out would make banking a little bit more expensive, and that's a bad thing? Or, was there more content to the argument than that?

Kevin Cirilli: Well, there are two main points that folks need. The first was, you know; this is the provision that would no longer require the big banks to separate trades in financial derivatives from commercial banking accounts. And so that means that those accounts are going to be backed by the Federal Deposit Insurance Corporation, the FDIC. But, you know, these are, as you had mentioned, these are the types of accounts that are included in – you know, in that banks need in order to get involved in retirement savings, in order to kind of grow small business on Main Street. So, we always hear the demonization of Wall Street, but from a Main Street perspective, this is the provision that if they are able to kind of engage in these types of derivative trading, supporters of this argue, that they will be able to grow business and help produce growth at a time when capital is still very tight, at a time when businesses are still very reluctant to kind of engage in the type of spending needed, some would argue, to help spur more economic growth.

Eleanor Barrett: We've been talking about the politics of this, but, David, can you tell us a little bit more about this from the perspective of banking regulation? Was this derivatives push-out effective regulation? Was it implemented for long enough to be able to assess whether it was effective, and how this change affect regulation going forward.

David Skeel: The swaps push-out rule was under pressure from the very beginning. It was very controversial when it got put into Dodd-Frank. It was controversial from the moment Dodd-Frank was passed. So, there was never anything like an opportunity to see how it would work. So, the short answer to your question is, no, we don't know whether it would work or not. The banks hated it. It would have increased their costs, possibly fairly significantly. On the other

hand, the optics of it are horrendous. I mean it's pretty amazing that this got kicked out of the legislation. But, the short answer is we don't know whether it would have worked or not and whether it would have had the kinds of costs attached to it that the banks are complaining about.

Eleanor Barrett: Okay, Kevin, your publication, *The Hill*, recently reported that the Republicans in congress are planning another big push – and the Wall Street banks, I should say, are planning to push the Republicans in congress to further attack, or further create additional chinks in the Dodd-Frank armor with the new congress. Can you tell us a little bit more about that? What are some other specific targets?

Kevin Cirilli: There is one happening right now, today, and Capitol Hill. And, in fact, it was part of a terrorism insurance bill that lawmakers were supposed to re-authorize before they left town. But, they got some unfinished business because they didn't do it. And the reason they didn't it, Eleanor, was because of another Dodd-Frank provision. This is a provision that would – that essentially is similar in that it includes in it an end-user provision. And essentially what it does is allows for more of the types of mixed trading in – in for, for like the farming market and a lot of these other type of industries that, again, Dodd-Frank looked to separate, but with regards to end-uses, you have Senator Chuck Schumer saying get this thing out of there, we can't support it. Again, people like Senator Elizabeth Warren really opposing this end-user provision. But the White House is kind of in a tough spot because it is so supported by the industry, this bill, saying that while they have concerns about it, they do support the bill. They are not going to veto it.

For me, as a reporter, though, to watch the top Democrats on the House Financial Services Committee, through its representative, Maxine Waters, she took a member of the Congressional Black Caucus, a staunch supporter of President Obama throughout his presidency, to watch her criticize President Obama for what she, and other progressives say is caving on the issues, was fascinating. Because it is not something that you see happen at all. I don't think I have ever seen it since President Obama has taken office. To see that type of criticism coming from within his own party.

It also really sets the stage as we enter into this new election cycle with a lot of progressives saying that they have concerns with Hilary Clinton, the presumed and assumed front-runner of the Democratic Presidential Party, being too center. You have someone like Senator Elizabeth Warren, who has really positioned herself to the left of former Secretary of State Clinton, and as someone who was an advocate for the creation of the Consumer Financial Protection Bureau, she is really kind of rallying troops in congress trying to push the party to the left despite Republicans taking control of congress.

Eleanor Barrett: Well, David, what did these changes – so, we have heard about a proposed change to this end-user provision, as well as the swap push-out position. How integral are they to the overall functioning of Dodd-Frank? And without those provisions, can the basic goals of the legislation still go forward?

David Skeel: I think the goals of the legislation can go forward, but to allude back to something Kevin had said earlier, there really is a camel's nose under the tent feel about this. This really is the first breach in Dodd-Frank – the first time there has been any giving on any of these provisions. So, I don't think the particular provisions are decisive. They are important. I mean the swaps push-out is pretty important, and the size of the end user exclusion is pretty important. But each one of these by themselves doesn't seem to me to get at the very heart of the regulation. I think the regulation can still be effective. But the fact that we are seeing these cracks does seem significant. And the responses are, I mean just to sort of marvel at what Kevin just said, they're pretty remark—the politics are pretty remarkable. I mean, the people who are upset, it's mostly the far left. But it's also a little bit of Tea Party. There is some Tea Party upset-ness still about the bailouts and some of the weakening of Dodd-Frank. So, the politics are incredibly interesting.

But, to go back to your – the question itself, I don't think any of these things by itself is devastating for the regulation, but they may be a hint of things to come. And they are not trivial. These are not minor little things.

Kevin Cirilli: Yeah, David, I would totally agree. I think these are very small tweaks in the larger context of Dodd-Frank. With that being said, I mean, you know, from a legacy standpoint for the Obama Administration, if you look at his two major pieces of legislation, Obamacare and Dodd-Frank, we have seen him be very reluctant – very reluctant to budge and to tweak any of it because you know, if you look at historically any type of major legislation that has seen cracks in it, it's just those cracks get bigger, bigger, bigger as time goes on. So, he hasn't really budged at all on Obamacare. But on the issue of Dodd-Frank, we are seeing that he has decided to play ball a little bit, which has created a lot of tension within his own party.

Eleanor Barrett: Well, so, David, after these changes, what remains of Dodd-Frank? I remember – we talked a little bit about how it was designed to address the bailout situation. Is there still a mechanism in place to address potential bailouts other than these particular derivative and end-user provisions? And what is that mechanism?

David Skeel: So, there are a number of different things that Dodd-Frank does with bailouts in mind. And I will just mention a couple of them. So, one is that it explicitly ties the Fed's hands. Or, more accurately, it restricts what the Federal Reserve can do to bail out an institution. So, what the Federal Reserve did in 2008 is they bailed out Bear Stearns, they bailed out AIG, they thought about bailing out Lehman Brothers – none of that would be possible under current Dodd-Frank – the changes Dodd-Frank made. What Dodd-Frank says is if the Federal Reserve wants to make an emergency loan, they have to make it industry-wide. They cannot make loans to particular institutions to bail them out. So, that is one thing Dodd-Frank did.

Another thing that it did is it has stiffened up the capital requirements, and it's given bank regulators much more authority to regulate the biggest banks, the so-called systemically important financial institutions. That's designed to keep the banks stable enough so that we never need to think about bailing them out.

Dodd-Frank also gave bank regulators the power to take over one of these giant institutions if it's in trouble. And those are the resolution rules of Dodd-Frank, Title II of Dodd-Frank. And, in theory, what they are supposed to be used to do is to take over a troubled giant bank and to

liquidate it. It was one of the provisions that was put into Dodd-Frank was a provision that Barbara Boxer, Senator Barbara Boxer had put in that says you have to liquidate these institutions. It's not looking like that's the way those provisions will be used, but that is another thing that is designed to limit the likelihood of bailout.

So, a number of different things. They're not always pointing in the same direction. Some of them are trying to make it so these banks will be really stable, and they will never run into trouble. Other provisions are designed to prevent a bailout if they do run into trouble.

Eleanor Barrett: And you mentioned a minute ago it's not clear that resolution provisions are going to be used the way they were intended. Can you talk a little bit more about that? How might they be used?

David Skeel: Sure. So, bank regulators, the Fed and the FDIC, in particular, have rolled out a proposed way of using these resolution rules that they call single point of entry. And I won't get into the particular details of it unless you make me because—

Kevin Cirilli: That's even worse than derivatives.

David Skeel: It's even worse than derivatives. But the basic idea is that what they plan to do is a quick and dirty restructuring of the financial institution if it runs into trouble. So, it technically would be in the form of a transfer to a new bridge institution. But basically what it would do is wipe out the stock – wipe out the stockholders. Reduce some of the debt of the big bank. And then pretty quickly sent it back out into the world. It basically would restructure and write down some of the obligations of the bank, which in my view, is not consistent with the spirit of what the resolutions rules were trying to do. But it is actually a pretty creative approach to resolving a giant bank failure.

Kevin Cirilli: It is a creative approach that also gets a lot of heat from Republicans on Capitol Hill because I think, you know, their concern, just from a free market perspective is that you have Feds and regulators, you could just kind of step in at any time and take control of these big

businesses and do what they want with them. And, you know, some would argue that's an overreach of power.

But, you know, from a larger perspective, what is also worthwhile is that President Obama in two days, on Thursday, is going to be making a couple of key economic speeches across the country. Yes, the Dodd-Frank law impacts Wall Street regulations and the Main Street regulations and where it increases oversight from a regulatory perspective, but it doesn't really do anything on the issue of housing finance reform. And that is the last remaining issue that lawmakers have yet to tackle. Housing finance reform. So all of those housing bubbles and all of the home foreclosures, all of Fannie Mae and Freddie Mac, all of that bailout. Yeah, Fannie Mae and Freddie Mac have paid back the money that they owe the taxpayers, but clearly they are involved if they needed the bailout in the first place. They are still alive, they are still operating on a government conservatorship. And again, the politics of this, you had lawmakers in the last congress, bipartisan lawmakers, a group of them really pushing and coming together to get a type of housing and financial reform proposal through. And then you had the far left derailing that and saying that it wasn't good enough. And now they are going to have to start from ground zero.

But, I think that when you look from a larger perspective about whether or not Dodd-Frank will stop bailouts, I ask this every time we have any sort of Dodd-Frank function, we always ask are bailouts over? Are the taxpayer bailouts over? And you get a mixed bag of answers. You've got people in the Tea Party and people in the Elizabeth Warren ring of the Democratic Party saying that no, they are not. That, but they say why for two very different reasons. And, you know, Republicans say that there's too much regulations, which have increased the chance of a bailout. Democrats say there is not enough regulation, so there is still a chance for a bailout. But still, the fact that that conversation continues I think is indicative that there is a lot of unrest in mainstream America about the pace of this economic recovery where you've got unemployment at five-point-eight percent. The participation rate at a rate that we haven't seen since the nineteen-seventies, so low. Meaning that the number of people that they are counting in the workforce is at an all low. You look at baby boomers struggling, not able to retire, having to work longer. You look at millennials having to get a slow start on their professional careers.

People delaying buying homes, starting families. All of that contributes to this unrest about the pace of this economic recovery. There is a lot of uncertainty from a lot of the folks that I have talked with on both sides of the aisle that Dodd-Frank, perhaps, did not do all that it was set out to do or maybe wasn't the best mechanism to fix it.

David Skeel: Can I jump in on that with a couple small things and just reinforcing what you've just said, Kevin. And that is coming out of 2008, one of the standard conventional wisdom lines was Wall Street was bailed out but Main Street wasn't bailed out. And it seems to me that that's one of those cases where the conventional wisdom was actually exactly right. That there was a lot done for Wall Street. There wasn't that much done for Main Street.

In my view, I do bankruptcy as well as this stuff. The one thing that might have made things a lot better earlier on is if the bankruptcy laws had been changed to allow underwater homeowners to rewrite their mortgages. To write their mortgages down to the current value of the property. You cannot do that in bankruptcy. Bankruptcy does not allow mortgages to be restructured. Everything else can be restructured in bankruptcy except mortgages. That could have been changed. It would have helped out millions of people, in my view, but it wasn't. And, ironically, one of the reasons apparently it wasn't was that the president was afraid of losing healthcare votes. That if he spent capital on that change, which there was a lot of support for in 2009 and 2010, he might not be able to get the healthcare bill through. So, this is one of those situations where those two big pieces of legislation were, in a sense, at war with each other.

And the general perception that the housing situation still hasn't been fixed I think is right. I mean, Dodd-Frank doesn't do it. The one thing Dodd-Frank does not touch is Fannie and Freddie. And it really – it does almost nothing to deal with the housing situation.

Kevin Cirilli: And, you know, and that sets the stage, I think, for the president, as he looks to close out his next two years. I mean, the fact that you have a proposal put forth by the – in the last congress by the Chairman of the Senate Banking Committee, then now retired Senator Tim Johnson and Mike Crapo, the top Republican on that panel. The fact that they were able to – I mean, I sat in truly like a dozen housing finance reform hearings, watching this bill kind of come

up from the ground up. And then to have it just pushed aside and not even taken to the senate floor for a vote because Democrats said that it was too centrist. To kind of watch in a Democratic-controlled upper chamber was quite remarkable. And now, you've got an interesting situation, though, or one of a rising star within the Democratic Party, the HUD Secretary – Housing and Urban Development Secretary, Julian Castro, you know, the former mayor from Texas, is a young, rising star within the Democratic Party, from his legacy standpoint, we often talk about him as a potential running mate to a Hilary Clinton or whomever would be chosen for the Democratic 2016 Presidential ticket. From his standpoint, I think that housing reform is something that he would like to push just to kind of get it through, but, you know, to kind of wind down Fannie Mae and Freddie Mac.

But, on the flip side of that, and David, I would be interested in your thoughts on this, that the more time that has passed since 2008, the more that people forget about Fannie Mae and Freddie Mac. I mean there is always a small window to kind of push through, especially these wonkier type of deals. I mean, people remember that Fannie Mae and Freddie Mac were bailed out, but when you look at things like immigration, and you look at Obamacare, and you look at our foreign policy and the debate that we are having with that, often times these issues get pushed below, back down on the list. So, I think housing reform, there really isn't that much of an impetus to get it done immediately.

David Skeel: Just a couple quick follow-ups on that. I agree completely with Fannie and Freddie and there not being much of an impetus to do anything. One of the problems, in a sense, is that Fannie and Freddie are making money now, which is just reinforcing that. There is less of an urgency that there would have been. Combined with the fact that there is some legislation, as I am sure you know, Kevin – not legislation, there is some litigation against Fannie and Freddie by shareholders who feel like the takeover of Fannie and Freddie was unfair to them and was a taking of their property. That litigation is not looking good right now. So, it is looking like the government is okay on that. And for that reason, too, there is just no pressure to do anything. I mean, Fannie and Freddie can be left where they are, and there's no immediate reason something needs to be done, unfortunately.

Kevin Cirilli: After the financial collapse, there is all of those – there is bailouts and we all remember how upset everybody was after those bailouts. And regulators said hey, wait a minute, you guys – we're going to have to bail you out, you know, you're – you know, you're doing all of your financial deals with the government backing, and yet you're not saving any money set aside in case there is a financial collapse. So, essentially, you have no savings. And so what Dodd-Frank did was said you got to start saving just like everyday Americans who have to issue savings. I mean, if something happens to a family living in Delco, where I grew up, outside of Philly, and they lose – and you know, their car crashes or something, they've got to go into their savings to buy a new car. So, why shouldn't a big bank have to follow those same rules? And that was the argument for a lot of the capital requirements, as they are called, from a Dodd-Frank perspective.

But, as David said, I mean is this just smoke and mirrors? Are there ways to get around it? And the banks, to some extent, I do think make a pretty solid argument in saying that a lot of this regulatory burden that has been placed on them, not from the larger parts of Dodd-Frank, but from those smaller parts of Dodd-Frank. I get a lot of complaints from Main Street businesses about the Consumer Financial Protection Bureau, or the Consumer Agency, as it is called, that was designed to help consumers if they have a complaint have somewhere to go in the government. But, you know, a lot of small business is saying they're not really familiar with all this paperwork and investigations and rule-making process that has been created as a result of this agency. And a lot of people they have concerns about – and David, I would be interested in your take on this too – about yeah, you've got regulators that are watching Wall Street and watching Main Street, but who's watching the regulators? You know? And who is watching the revolving door between folks that used to work in these big businesses now going to write rules? And who is looking at the cyber security of these regulators that have access to all of this consumer information?

So, you know, there is a really interesting tension between regulators right now and American businesses.

David Skeel: Just a couple real quick things on that. The who's watching the regulators is a really interesting issue. And I, too, from my academic perch am seeing lots of discussion about the fact that people on Wall Street go to Washington and then go back to Wall Street. That there is a lot of back and forth.

The other thing, just to throw out is part of this argument has revolved around the consumer bureau. And one of the things that drives conservatives crazy is this – the consumer bureau is basically, not self-financing, but the consumer bureau does not have to go to congress for funding. The consumer bureau's funding comes from the Federal Reserve, so the consumer bureau is insulated from congress, and that drives conservatives nuts. And I think there is going to be a lot of pressure—

Kevin Cirilli: Crazy. Nuts is an understatement. It drives then crazy that when you think about a government agency being funded not through congress – I mean, that's what lawmakers – the power of the purse, right? I mean that's elementary to them. And the fact that it's through the Federal Reserve, which also, folks argue, doesn't have a lot of congressional oversight or needs more it, yeah, it drives them nuts.

Eleanor Barrett: Well, just to come back to one point that you mentioned earlier, Kevin. You talked about the capital requirements being a form of savings, analogous to a household's savings. And I think that's something that is very concrete, and people can understand very easily. Has there been a lot of pushback on that provision from the banks? I have heard, certainly, you talking about controversy over the consumer bureau, over some of the other rules and the swap provisions, but what about the capital requirements? Have those been implemented – the higher capital requirements – have they been implemented? And is there a continuing controversy where?

Kevin Cirilli: I was just going to say it is interesting to watch the different industries bicker with each other, to say the least. So, of course, the insurance industry, for example, doesn't think that the same capital requirement standard should be applied to the industry that should be applied to the banking industry. The agriculture industry doesn't think that the same rules that

were written for Wall Street banks should be applied to agriculture. So, a lot of that, again, does one size fit all? Should someone have to follow all the same rules, especially if they weren't one of the big financial institutions that got bailed out after the 2008 collapse? So, that is the debate that we hear a lot about that.

I think the rate and the percentage – and that's what we talk about capital requirements. So, if you are just a typical family and you say at the start of the year hey, you know what, this year we are going to try to put aside maybe 12-percent of our income into our savings or into our 401k. That's kind of the same type of debate that gets had in congress with financial institutions and with regulators about what percentage of their liquidity or the – and what percentage of the money that goes into these big financial institutions, and the size of them, how much should they have to set aside in case that something were to happen where they would have to reach into them.

Another issue, though, and this is really, it gets to the point David mentioned about is all just smoke and mirrors? So, how do you really know? How do you really know if a big bank is actually saving the right amount of percentage that Dodd-Frank requires them to do? And, so, the regulators said, you know, well, we've got to – and how do you prepare for the next economic collapse, which, you know, is going to happen maybe – hopefully it doesn't happen in our lifetime, but it's – we have seen this happen every couple of decades. So, how do you know? And regulators came up with this idea of a stress test. And what that is, is it's pretty much like a mock trial, to put it in UPenn Law terms. And what they do is, is it's a test, really, that big banks and big financial institutions have to pass. And they've got to say this is our game plan. This is how we would respond in this type of scenario if – when the regulators say, you know if this happens, how would you respond? And, so, they have to pass a stress test, or they get some sanctions if you will, or some consequences that they have to deal with.

So, we are entering – we are at the beginning phase of a new era of financial regulation that – and you know, you literally wrote the book on it, David, but you know, this is so much of this stuff is so new, and then you throw in the issue of cyber security and it just – it all goes to – it all goes to the wind.

Eleanor Barrett: Just talk about that last point about the stress test. Because, David, when your book came out, I think one of the things that you said was that either the stress tests or the contingency plans were a good idea. And are they working? How is that process going?

David Skeel: So, the stress tests, in my view, definitely are working. I mean one of the odd things about all of this is we have all these new rules. Kevin was talking about the capital requirements, and I love your description of them – I am going to steal it, and probably steal the mock trial metaphor as well – maybe I will credit you. But, we have all these new rules, and we are in the process of developing all these new rules, but the rules aren't really the binding constraint on the big banks right now. What's determining how much capital they have, how much of these savings they set aside is not so much what the rules are, but it's what comes out of those stress tests? And what the bank regulators are insisting that they have as a prerequisite for the regulators giving them a clean bill of health. So, the stress tests are having an enormous effect. There are stress tests the regulators put in place before Dodd-Frank – they first put them in place in 2009, the year before. There are also a set of stress tests in Dodd-Frank itself, which are similar to, but a little bit different. They have been very effective. Or, they seem to be very effective so far.

One concern about them is, at this point, at least, they are only as good as the regulators are. And if the regulators weaken their oversight in the stress tests over time, they will stop being as effective. And we do not know exactly what is going on behind the closed doors.

The other provision that you mentioned is the living will provision. And what that is, what Dodd-Frank calls is a rapid resolution plan. The biggest banks, the banks that are considered to be systemically important, and the other financial institutions that are considered to be systemically important, have to, every year, give bank regulators a detailed plan for what they would do in a crisis. How the bank would make sure that if it defaulted, that default would cause larger economic damage – would not cause a systemic crisis.

So, we have been through those for a couple years now. We don't really know whether they are working or not because what has been disclosed about them is just a bunch of boilerplate. All that we know that's interesting at this point is the bank regulators last summer rejected eleven of the living wills suggesting that they were not adequate, which if you read it optimistically suggests that they are being implemented in a fairly tough way.

As far as whether living wills are a good idea or not, I am not sure if I just said stress tests earlier, I should be talking about living wills, I do think they are a good idea. And I think they could have a number of different effects. One is, they may force the banks to simplify a little bit because the banks have to explain what they are going to do if they are in a crisis. In the best of all possible worlds, they really will prepare us for a crisis in the event a crisis happens. So, I do think they were a good part of Dodd-Frank. I praised them in the book. I still praise them. I wish the bank regulators would tell us a little bit more about what's in them so that we could judge them a little more effectively.

Kevin Cirilli: And that brings up the issue of regulatory transparency, which we alluded to earlier about that issue of okay, who is watching the regulators? I mean how do we know what exactly it is that they are doing. And when we talk about systematically important financial institutions, in wonk world we call it SIFIs, where we shortened the term of – there is always an acronym and a name for everything here in Washington, but we call them SIFIs. And, essentially what David just told us is that you have the government now deeming big financial institutions as big enough, or dubbing them SIFIs, and what that means is that they are big enough that if they screw up, they could take out the entire economy and lead to another financial collapse.

So, you have this tension now within the financial industry where you have businesses saying how big is too big? How big are these businesses going to be and in order to be qualified as a SIFI? So, it's a really a new era, really, in financial regulatory policy where these regulators are now deeming businesses big enough to take out the entire economy should there be another collapse.

David Skeel: Can I just say one thing on that? I am seeing that on my end as well. The debate about that and the anxiety about that. So, everybody agrees that the biggest banks should be subject to this tougher oversight, should be subject to these capital requirements. But, insurance companies say we are not going to cause the same kind of damage that if Prudential fails, it is not going to be as destructive as if Citigroup or JP Morgan fails. A little hard to make that argument after AIG during the crisis, but they do make that. And they arguing at least they shouldn't have to have the same capital requirement.

What I am hearing a lot about, or have been hearing a lot about over the last few months is the anxiety of mutual funds and folks like that about whether they will be treated as systemically important. To me, that is a particularly interesting debate because they have a pretty good argument they are different than insurance companies and banks, and they don't cause the same systemic problems, or they wouldn't cause the same systemic problems if they failed. But, they are enormous. And if Vanguard or Fidelity or one of those mutual funds – if there was a crisis and they had to start selling a lot of their assets. That could cause some problems. So, it is a very interesting debate on that dimension, which I think is going to continue through the year. I don't think the mutual fund side of the debate is resolved at this point.

Eleanor Barrett: All right, well thank—sorry, Kevin, do you want to finish up?

Kevin Cirilli: Oh, no, no, no. I was just going to say just to put it – put simply, it's essentially if you're, you know, just an everyday average folk American just trying to get a loan from a bank, you got to apply for the loan. You've got to show your financial history, and go through that whole entire process. And so, pretty much what regulators are trying to do is set up a system for the biggest financial banks to kind of have to go through a similar process in order to receive a lot of the benefits that they receive from the federal government.

Eleanor Barrett: All right. Well, thank you, David and Kevin, both, very much for you time. I really enjoyed your conversation, your insights on all these issues, and look forward to seeing you all on the next episode of Case in Point.

David Skeel: Thanks, Eleanor.

Kevin Cirilli: Thanks—and have a great day!

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