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Regulatory Reform: Study Trumps Compromise

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By Donna Borak

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WASHINGTON — It appears the best way to broker a compromise on a hot-button issue in the regulatory reform bill is to study it.

That, at least, is the approach taken in Senate Banking Committee Chairman Chris Dodd's 1,300-plus-page bill, which includes more than two dozen studies on topics from industrial loan companies to contingent capital to the implementation of the Volcker Rule.

The sheer number of topics to be studied underlines how intricate many of the issues are and reflects lawmakers' desire to deal with them sometime in the future.

"Doing a study on it is just an absolute dodging of the issue," said Mark Calabria, director of financial regulation studies for the Cato Institute. "We can't get an agreement, we think this might be an important issue, so we'll do a study and we'll talk about the study when it comes out. It just kicks it down the road for a little bit longer."

In most cases, the studies could take as long as a year, if not more, according to a compilation prepared by the Morin Center for Banking and Financial Law at Boston University. One study, on independence of credit rating agencies, would not be due for three years.

"This telegraphs a long, long process for regulatory reform," said Cornelius Hurley, a professor in the Boston University School of Law. "Most of these, if not all of them, will probably make into the final bill. Who's going to object to a study?"

Satish Kini, who co-chairs the banking group at Debevoise & Plimpton, agreed. "There's a sense that this will be a big undertaking once Congress finishes," he said.

Hurley said the number of studies is likely to grow before the bill becomes law. (The House version calls for close to 40 different studies).

"The list is only going to get longer … as more compromises are made," he said.

At least one issue — the proposed Volcker Rule — would be subject to multiple studies. The legislation's ban on proprietary trading and restrictions on investments with hedge funds and private equity would not go into effect until after a proposed interagency council completed a six-month study that defined proprietary trading and discussed how the rule would affect the safety and soundness of banks. Regulators would then have nine months to set final rules based on the council's recommendations. (The rules would not go into effect until two years later.)

During that same time period, however, the Government Accountability Office would also be examining the risks and conflicts posed by proprietary trading and its impact on the safety and soundness of the banking system.

The bill does not address what would happen if the GAO's conclusions differed from those of the oversight council, but some see the plethora of studies as a "catastrophic waste of time," as one observer put it. "Now we have another piece of busywork for regulators that will be just another excuse," said Richard Carnell, an associate professor at Fordham University School of Law.

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Regulators would also be required to study all exceptions to the Bank Holding Company Act, including industrial loan companies and other specialty charters. Though the Obama administration sought to eliminate such charters outright in its regulatory reform proposal last year, lawmakers have faced a small but vocal group of defenders.

In the case of ILCs, the charter has been protected in the past by Senate Majority Leader Harry Reid, whose home state of Nevada includes many such banks, and Sen. Robert Bennett of Utah, the No. 2 Republican on the Banking Committee, whose state houses most industrial banks.

Perhaps as a result, the bill would place a three-year moratorium on new ILC applications from commercial companies but leave it to regulators to study the issue further. While regulatory reform was the logical place to handle the issue — which has been a source of controversy for years after Wal-Mart Stores Inc.'s failed bid to start an ILC in Utah — observers said lawmakers clearly do not want to decide. "On that issue, along with dozens of others, they folded their tent, and this is the result that they're going to study it," Hurley said.

Along similar lines: though momentum to create a federal insurance charter has been building for years, the Dodd bill would relegate the issue to another study. Under the bill, a newly created but powerless Office of National Insurance would be asked to explore ways to improve insurance regulation. Considering that the collapse of American International Group contributed to the financial crisis, some were surprised lawmakers are not taking more aggressive action.

"You would think with American International Group being such a big, dominant part of the crisis that you would have something regarding insurance in the bill beyond studies," Calabria said.

Other studies tackle a wide variety of issues. One would give regulators two years to examine how to create contingent capital requirements for nonbank financial companies whose failure would be considered a threat to the economy. Federal Reserve Board officials have been pushing the creation of such instruments, which allow debt to be converted to equity in the event of a crisis.

Another study would examine a proposal by the Securities and Exchange Commission to curb short-selling, while others would seek to define the term "accredited investor" and examine the municipal securities market.

While many decry studies as a waste of time, some said they are valuable. "It's a way to compromise and try to move down the road to consensus," said Jane D'Arista, a research associate with the Political Economy Research Institute at the University of Massachusetts Amherst.

Others said they may eventually have a big impact. "This isn't condemning the issues to some rabbit hole somewhere. Attention will get paid when the studies come out," said Lawrence White, an economics professor at New York University.

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