News

Bennetts: Dodd-Frank rules are RINOs

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Louise Bennetts, the associate director of financial regulation studies at the Cato Institute, recently said that a rule-based approach to financial regulation yields better outcomes but added that many Dodd-Frank provisions are "rules in name only."

"The thousands of pages of 'rules' released under the Dodd-Frank Wall Street Reform and Consumer Protection Act may lead a reasonable person to assume that we have entered an era where rules reign supreme," Bennetts said. "Upon closer inspection, however, many of these rules are 'RINOs'—Rules in Name Only—or, put differently, discretion masquerading as rules."

Bennetts said that the key principle in a rule-based system is that the outcome will be the same, regardless of who implements the rules.

"Well-drafted rules minimize the temptation of regulators to pick winners and losers in the marketplace," Bennetts said. "Yet, under Dodd-Frank, outcomes will depend on who sits in the driver's seat at the major regulatory agencies. Many of Dodd-Frank's provisions are triggered by a determination of what has become known as 'systemic importance'...Dodd-Frank makes vague references to institutions whose failure 'could pose a threat to the financial stability of the United States.' However, any potential threat is in the eye of the beholder, and one regulator's 'systemic event' may be another's market correction."

Under Dodd-Frank's Orderly Liquidation Authority, the FDIC is authorized, at the discretion of the U.S. Treasury secretary, to bypass traditional bankruptcy processes to liquidate failing financial institutions. Bennetts noted the lack of guidelines that would stipulate how and when the authority should be used, as well as the limitations of its use.

"Given the absolute discretion that regulators have to use this tool, the question is: will they?" Bennetts said. "Historical precedent suggests not. Seemingly no treasury secretary would want to initiate the failure of a major financial company. Also, it must not be forgotten that Fannie Mae and Freddie Mac are subject to their own dedicated insolvency regime that is still begging to be used."

Bennetts also pointed to a "recent agency trend" to release rules as guidance in favor of rules, a move that Bennetts said is "preferential" for the regulator.

"It does not require the standard public notice and comment periods," Bennetts said. "It affords regulators maximum discretion to change the guidance without going through a formal revision process. Most importantly, it is far more difficult for market participants who feel that an agency has overstepped its authority to challenge regulatory guidance in the courts."

Additionally, Bennetts said that allowing regulators too much discretion breeds uncertainty.

"And while uncertainty in the market is a fact of life, uncertainty in regulations is costly and ultimately self-defeating," Bennetts said. "We have had 70 years of the rule of the regulator, with decidedly mixed results. Perhaps it is time to give the rule of law a chance."