Dodd-Frank Users in a Corporatist Era in Banking

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Perhaps counterintuitively, the financial Goliaths supported the Dodd-Frank Act.

Goldman Sachs CEO Lloyd Blankfein has argued that the vast bulk of Dodd-Frank was good and that his firm would "be among the biggest beneficiaries of reform." Blankfein told the Senate, "We’re not against regulation. We partner with regulators."

At the keynote address for Citigroup’s financial services investor conference March 7, 2012, Vikram Pandit, then Citi’s CEO, kissed President Obama’s ring, singing the praises of increased regulation.

CEO Jamie Dimon has said JPMorgan Chase supported 70% to 80% of Dodd-Frank. Since the 1990s, Dimon and his wife have given more than half a million dollars to Democratic candidates who supported Dodd-Frank in lockstep, including Hillary Clinton, Chuck Schumer, Chris Dodd, John Kerry, Barack Obama, Debbie Stabenow, and Joe Biden.

In 2010, it was reported that Bank of America CEO Brian Moynihan said he was voting for Congressman Barney Frank – one of the regulatory straitjacket’s principal architects.

Why would bank chieftains support stifling regulation? Could they be progressives believing society is better served if banking is a public utility?

In New York bank CEOs’ social circles, soft leftism is fashionable and they’re uncomfortable making a full-throated defense of free-market capitalism. Given anti-bank sentiment and increased state power over banking, deference to Caesar is understandable.

But a dollop of cynicism is in order. Dodd-Frank works to their advantage.

While Dodd-Frank mandates higher capital requirements for large banks and exempts issuers with under $10 billion in assets from punitive debit price controls, it tilted the playing field decidedly to giants' advantage. The more onerous the regulatory burden, the more difficult it is for smaller banks and new entrants to compete.

Massive regulation provides a deep moat protecting large financial institutions against competition from community banks and innovators. B of A, Chase, Citi and Wells Fargo have legions of lawyers, compliance staff and lobbyists to manage regulators, and they're hiring more. Wells Fargo increased government relations spending by more than 40% in 2011.

The army banks deploy dealing with regulation is a deadweight loss. It doesn't serve customers (savers or borrowers), design better products or develop new markets. It caters to regulatory overlords, typically folks who've never made a loan, much less built a business.

The Goliaths are getting bigger. From 1995 to 2009 the six largest banks' assets increased from 18% of gross domestic product to 68%. They're considered by regulators, politicians, management and the market to be systematically important, too big, too interconnected, and therefore too big to fail. Consequently TBTF institutions enjoy a funding advantage over smaller banks, which will be permitted to prosper or fail. Harvey Rosenblum, an economist at the Federal Reserve Bank of Dallas, suggests the difference in funding costs may be as much as a percentage point or more.

Worrying about economic concentration, a century ago Justice Louis Brandeis contended that corporations beyond a certain size and complexity became less efficient and less innovative. With de facto government-sponsored enterprises such as B of A, Chase, Citi, Goldman, Morgan Stanley and Wells Fargo, Brandeis' fear is truer than he could have imagined.

The economist George Stigler famously observed and warned of the phenomenon of regulatory capture: industries influencing regulation to suppress competition.

Incumbents have the wherewithal and motivation to influence legislation and the crafting and implementation of regulation to protect – indeed feather – their nests.

In the financial services regulatory capture has a long history. The Glass-Steagall Act of 1933 banned banks from paying interest on deposits payable on demand and gave the Fed the authority to establish price controls on interest rates payable on a broad range of deposit accounts. Prohibiting banks from competing on paying for deposits wasn't pro-consumer. It protected banks from having to compete by paying consumers and businesses for use of their savings.

The Federal Reserve Board's implementation of Dodd-Frank's mandate that debit-interchange price controls be "reasonable and proportional" to issuers' incremental processing costs is another example. Bank Goliaths' marginal debit-processing costs are close to zero. After intense lobbying, the Fed granted large issuers price caps of 22 cents and 5 basis points per transaction.

The Consumer Financial Protection Bureau represents the consumer-activist industry capturing the regulatory apparatus, but it also fortifies behemoths' position relative to community banks and challengers.

Expect a wave of small-bank failures and consolidation exacerbating the TBTF problem that politicians and regulators make a great show about being concerned about.

The president, Treasury Secretary Geithner and kindred corporatists will shed crocodile tears. A handful of behemoths with embedded Washington overseers are easier to direct than thousands of vigorously competing small institutions.

B of A is illustrative. Moynihan has a reputation of engaging his Washington overlords and bragged B of A had nearly 90% of its money invested in government-guaranteed mortgage-backed securities and Treasuries. It's hardly a private-sector enterprise any longer.

In Obama's dirigiste era, notwithstanding bankers understandably doing their utmost to cultivate cozy relations with and capture regulators, Washington is master.

Dodd-Frank has driven a stake into the heart of private-sector banking. Washington now treats the financial services industry as a public utility, proscribing products it can offer, how it competes and insulating TBTF

GSEs from market discipline. Economic growth and consumer and business value are being systematically suppressed.

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