THE DODD-FRANK FINANCIAL REGULATION BILL:

Complications and Budget Gimmicks

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FUTURE TAXPAYER BAILOUTS

Vast complications continue to emerge from the over-2,300 page "Dodd-Frank Wall Street Reform and Consumer Protection Act." It contains layer-upon-layer of new bureaucracy sewn together by complex regulations, but fails to address key problems – such as Fannie Mae and Freddie Mac – that led to the worst financial meltdown in recent history. And although the bill is dubbed "Wall Street reform," it actually intensifies the problem of too-big-to-fail by giving large, interconnected financial institutions advantages that small firms will not enjoy. It continues a disturbing trend of increasing the size and reach of government. Instead of economic decisions being made by individual Americans and businesses, they will be increasingly governed by this law, the reams of regulations that will need to be written to implement it, and the new and expanded bureaucracies that will enforce it.

The full adverse unintended consequences are difficult to quantify. The Congressional Budget Office [CBO] has estimated that the bill results in $26.9 billion of new spending over ten years, mainly attributed to the $20.3 billion cost of bailing out banks that are deemed to be too-big-to-fail – "systemically significant" – by paying off their creditors.

CBO's explanation of its estimate admits to much uncertainty over the expected cost of unwinding a "systemically significant" firm, or several of these firms at a time. Its estimate is based on a broad range of possible outcomes. There is almost no chance an actual liquidation led by the FDIC under the Dodd-Frank bill will cost exactly $20.3 billion, especially considering it could be the size and complexity of a Citigroup or Lehman Brothers. While the House and Senate both went to great lengths to denounce future bailouts, in effect, this bill only sustains them.

BUDGET IMPACT AND GIMMICKS

To comply with House and statutory PAYGO requirements, the conference committee initially inserted a $19-billion tax to form a "Financial Crisis Special Assessment Fund." The "fee" would have applied to financial institutions with assets of over $50 billion and hedge funds with assets of over $10 billion. It was designed to cover the cost of the FDIC's new "liquidation authority," which is the complex architecture that would appoint the FDIC as the receiver of large financial firms, putting it in charge of unwinding the institutions and paying off their debt holders with "borrowed" taxpayer funds.

This week, however, the bank tax became a sticking point and the conference committee had to reconvene to approve, with no Republican conferee support, other offsets to replace the first controversial provision.

1. Double-Counting of FDIC Fees

One provision inserted in the Dodd-Frank bill to provide an offset for PAYGO purposes would permanently increase the deposit insurance limit for banks, thrifts and credit unions to $250,000. While this action amplifies both the FDIC's and NCUA's overall liabilities, CBO expects institutions to charge higher premiums so that insurance funds will cover the larger pool of insured deposits. CBO estimates that it will increase collections by $8.8 billion from 2011-2020, which is then used to defray the legislation's cost. This is clearly double-counting, however: the Deposit Insurance Fund [DIF] is reserved to protect insured deposits but this bill uses it as a gimmick to offset the estimated losses stemming from the FDIC's liquidation of large, interconnected firms.

Another offset related to the FDIC in the Dodd-Frank bill would raise the floor on DIF reserves from 1.15 percent to 1.35 percent of all insured deposits. Banks with insured depositories will be required to pay higher premiums to make up the difference.[1] As a result, CBO estimates budgetary savings through increased collections of $5.7 billion.

This second offset can only have one of two meanings: (1) it is again double-counting fees meant for the insured deposit fund, or (2) no funds will be used from the DIF to pay for the FDIC's liquidation authority *but* the FDIC will face a shortfall of $5.7 billion and must tap taxpayer funds. The fees from banks cannot both boost DIF reserves *and* simultaneously pay for the cost of unwinding large-scale failing institutions in the Dodd-Frank bill – many of which do not have insured deposits.

2. Using TARP as a Slush Fund

The bill also contains an offset to end all new authority for the Treasury Secretary to use funds from the Troubled Asset Relief Program [TARP]. Enacting this provision would reduce direct spending by $11 billion in 2010, an amount equal to savings gained from restricting funds that would likely be used between now and the expiration of TARP, according to CBO. TARP is scored on a credit reform basis, equal to the net present value of cash flows associated with the program, adjusted for market risk.

Rescinding such authority and redirecting it to pay for new spending contradicts the governing law of TARP. The Emergency Economic Stabilization Act [EESA] states, "rescissions of any amounts provided in this Act shall not be counted for purposes of budget enforcement."[2] This language was carefully constructed to ensure funds obligated under TARP would not count for budgetary offsets in other areas. EESA was designated as emergency legislation to stabilize markets during a time of crisis and to reflect the extraordinary nature of the bill. In addition, the TARP bill clearly establishes guidelines for taxpayer protection and deficit reduction, which the Dodd-Frank bill also violates: "Revenues of, and proceeds from the sale of troubled assets purchased under this Act, or from the sale, exercise, or surrender of warrants or senior debt instruments acquired under section 113 shall be paid into the general fund of the Treasury for reduction of the public debt."[3]

While the provision in the Dodd-Frank bill may claim to end TARP, by using TARP authority to pay for future bank failures it is further ensuring that bailouts continue with the passage of this legislation. The irony is that the Administration has opposed Republican efforts to rescind remaining TARP funding to reduce the deficit and debt – while actively using TARP beyond its intended purpose to bail out

[1] Language in the bill exempts depository institutions with assets of under $10 billion.
[2] Emergency Economic Stabilization Act of 2008, Sec. 204, "Emergency Treatment."
[3] Emergency Economic Stabilization Act, Sec. 106(d).

automobile companies and those failing to pay their home mortgages – and *now* supports rescinding these funds to finance future Wall Street bailouts.

3. Cloaking Spending by a New Bureaucracy

The bill provides off-budget financing for the new Consumer Financial Protection Bureau. Off-budget and off-balance sheet financing are the approaches that have gotten countries and companies in trouble. This new regulatory agency will be housed at the Federal Reserve but have complete autonomy apart from the Fed. Even still, the Dodd-Frank bill finances the $6-billion new bureau by diverting $1.2 billion in remittances from the earnings the Federal Reserve transfers to Treasury. To preserve its independence as the Nation's monetary authority, the Federal Reserve is off-budget and its earnings from monetary operations are returned to the Treasury to reduce the deficit. Now, instead of directing these remittances to reduce the deficit, they will be used to pay for a new bureaucracy with the authority to write far-reaching rules on financial products and restrict credit to the very customers it seeks to "protect."

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