Making sense of MiFID II

Letter from America: The Dodd-Frank Act

As a result of the financial crisis which started in 2007, and whose effects are still felt in a severely depressed housing market and stubbornly high unemployment, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) was first proposed in December 2009 and signed into law in July 2010.

The Act is expected to take two to five years to complete and requires, according to one law firm that created a 130 page summary of it (the Act is over 800 pages long), about a dozen regulatory agencies to create 243 rules, conduct 67 studies, and issue 22 periodic reports.

So when I was asked to explain in a few sentences what effect the Act is likely to have on those on the sell-side and on the buy-side, my first reaction was to say "where do I start?". But, after some additional prodding, I decided I could start by summarizing the Act's background and providing some highlights of recent events, and make assurances to the majority of sell-side and buy-side firms that the impact of the Act on them will be minimal, at least in the near term.

Some time ago, the United States Senate Committee on Banking, Housing & Urban Affairs published a brief summary of the Act, stating that "years without accountability for Wall Street and big banks brought us the worst financial crisis since the Great Depression, the loss of 8 million jobs, failed businesses, a drop in housing prices, and wiped out personal savings," and that the purpose of the Act was to "create a sound economic foundation to grow jobs, protect consumers, rein in wall street and big bonuses, end bailouts and too big to fail, prevent another financial crisis."

But, since the Act became law, the Republicans have become a majority in the House of Representatives and they are starting the 2012 Presidential race by campaigning on the premise that President Obama's policies have worsened the deficit problem and the financial condition of the US in general, and resulted in anaemic job creation specifically. This has emboldened big banks, and other large financial institutions, to try to make the case that it is a surfeit of regulation that has worsened the financial crises and held back hiring.

Wall Street doesn't like being told that it, and its bonuses, will be reined in!

Among other things the Act creates the Consumer Financial Protection Bureau (CFPB) which is supposed to protect consumers from "hidden fees, abusive terms, and deceptive practices." Elizabeth Warren has been advocating for such an agency since well before this crisis - at one time she was expected to be a shoe-in to run it - and she has been a long-standing critic of the industry. As a result there is widespread opposition to Ms. Warren being appointed director and it was reported earlier this month that 44 Republicans wrote to President Obama saying they would not vote to confirm anyone as director of the bureau without changes to its structure (making it less effective).

As one of the measures of the Act, designed to end "too big to fail bailouts," additional capital thresholds for large and systematically important institutions were supposed to be defined and monitored so that there would be a sufficient cushion in case of future financial stress. There are two areas in contention with regards to this measure. The first is over who will be included in the company of these large systemically important financial institutions. Apparently some institutions that took TARP money are now arguing that they are not that important and should therefore not be included with this group. The second is the amount of additional capital that will be required; major institutions are lobbying for lower amounts. In addition, some institutions that are registered as bank holding companies with the Federal Reserve may seek to change their status so as to be required to meet the less stringent capital requirements of the US Securities and Exchange Commission (the Commission).

One year, less five days, after the Act was signed into law (this coming July 16th), certain provisions dealing with security-based swap transactions, a type of derivative, were to become effective. These included the requirement that all swaps be cleared by registered clearing organizations, the requirement for periodic reports to the Commission by large swap traders, including buy-sides, the mandate that trading takes place on a "board of trade" and that there be real-time public reporting of swap transactions. Well, that's not going to happen, by July anyway, and recently the Commission published notice that they will soon tell us what provisions of the rule will become operable by July and provide temporary relief from complying with the rule where appropriate.

As a final note to today's musings, there is one aspect of the Act that has not been delayed, and not changed. It was reported recently that the US Senate rejected a proposal to delay rules, set to take effect July 21st, that limit the so-called swipe fees banks collect on debit card transactions. The delay, of course, was proposed at the behest of large financial institutions because the proposed caps, it is estimated, would reduce their annual revenue by about $12 billion. Ultimately, this provision was not as controversial as the others noted above; its purpose is not to protect consumers at the expense of large financial institutions, but rather to transfer this revenue from large institutions to small business.

Jess Haberman

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