

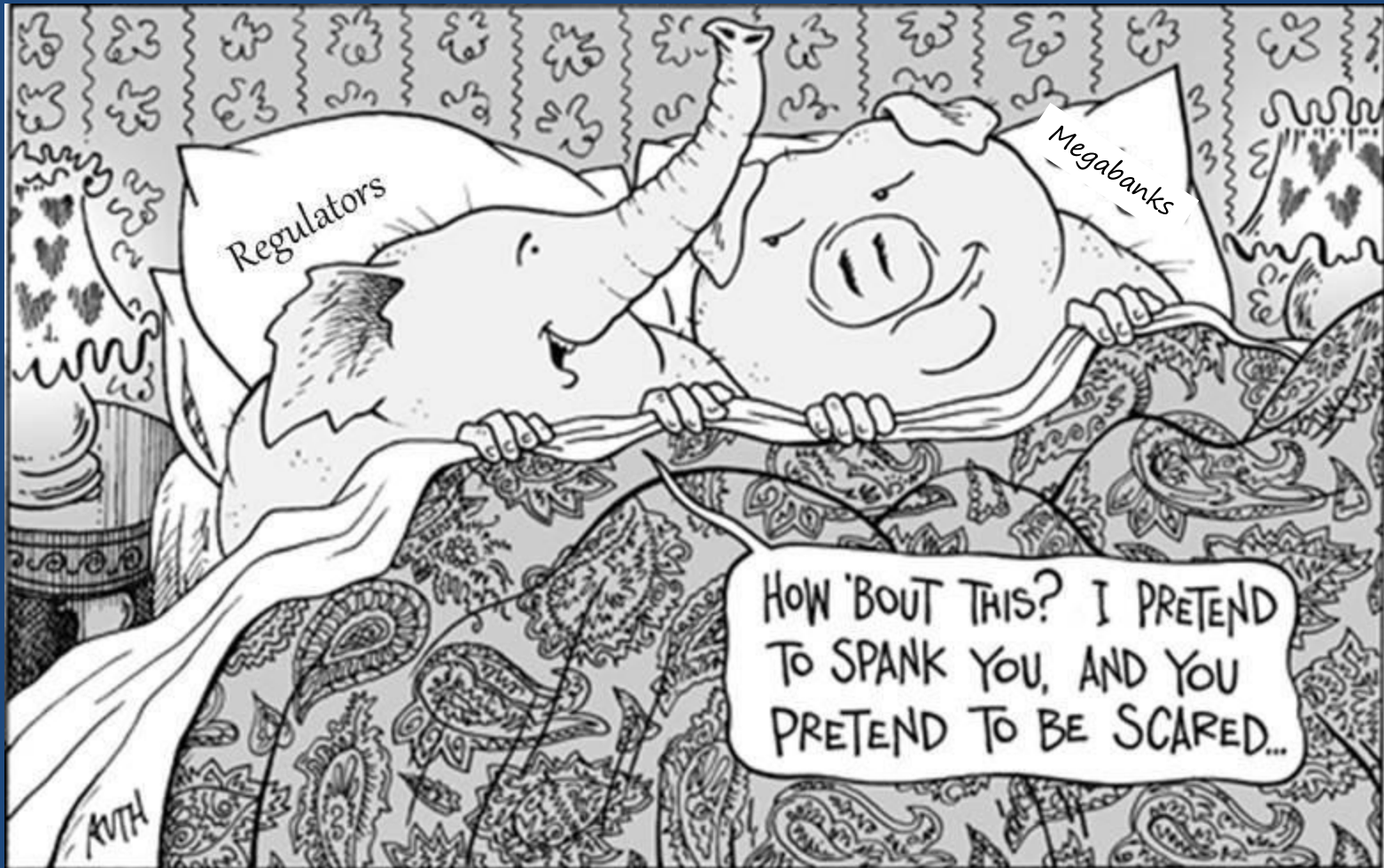
50th Annual Conference on Bank Structure and Competition
Federal Reserve Bank of Chicago
Chicago, Illinois
May 8, 2014

THE NEW NORMAL IS MERELY A MESSIER VERSION OF THE OLD ONE: THE FLUMMERY OF POST- CRISIS FINANCIAL REFORM

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My View of Dodd-Frank, Basel III, and Global Swaps Rule-Making



4-16-10 THE PHILADELPHIA INQUIRER. UNIVERSAL CLICK.

Reforms Are Too Narrowly Focused

- SIFIs currently enjoy a license to steal. Authorities propose to measure risk exposures a tad more accurately, but falsely suppose that incentives to pursue potentially ruinous tail risk can be cured by intensifying the level and intensity of regulation and supervision without also enhancing procedures for monitoring and punishing *willful pursuit and concealment of potentially ruinous tail risk inside the world's largest financial institutions.*
- Two good first steps would be for the US to refocus its accounting and examination procedures on banking institutions' risk of ruin and to classify aggressive corporate and managerial exploitation of government backup as felonious thievery *and require the Department of Justice to prosecute at least one SIFI corporation and its managers for this crime.*

Governments Should act as Fiduciaries for the Citizenry

- In principle, government regulators are **fiduciaries that are expected to act loyally, competently, and carefully on behalf of the citizenry as a whole.** In a modern society, vulnerable citizens invest their allegiance, good faith, reliance, and trust in agent officials whose aid, advice or protection they expect to receive in return.
- In contract law, a fiduciary owes the highest standard of care to the "trustor." A fiduciary is supposed to be extremely loyal to the person

Financial Regulation Is a Rigged Game

- **Principal Players** are Regulated Institutions, Regulators (including politicians), and Taxpayers.
- Ethically challenged institutions build political clout and **feel entitled** to **hide salient information** from other players in both time-tested and innovative ways. Have more skill, more information, and fewer scruples than other players.
- Regulators **join in a partial coalition with the Regulated** not only to help them with **concealment**, but also to cooperate in **overstating** the effectiveness and fairness of regulators' own play [i.e., authorities express too much confidence in control strategies (such as capital requirements) and overstate their enforceability]
- Taxpayers **own the agencies that operate the net**, but are **deceived** by **accounting and examination procedures** that force them to play from a poorly informed, **disequilibrium** position. Taxpayers are **equity investors of last resort**, but are denied the protective rights of disclosure and redress accorded to **explicit shareholders**.

BANKS USE REGULATORS TO RUN A PROTECTION RACKET: THEFT BY SAFETY NET



BAILOUTS ARE NEITHER INSURANCE PAYOUTS NOR LOANS : THEY ARE **COERCED WEALTH TRANSFERS**

- Costs and benefits of rescue programs impose future tax liabilities on **ordinary folks** to help higher-income financial-sector creditors and stakeholders.
- To avoid acknowledging anti-egalitarian nature of the thievery, central bankers tell us that, *as compared to doing nothing*, extravagant wealth transfers saved everyone from disaster. Political pressure for **presuming** the conscientiousness of foreign regulators is part of the deception: **desupervision** is going to offset superficial tightening of the rules.
- Taxpayers Finance unquantifiable **Knighthian uncertainty**, not risk. Regulators make them provide loss-absorbing **equity funding to insolvent or near-insolvent firms** when private parties will not. (The ready availability of government credit support to zombie firms subsidizes macroeconomically destructive **tail risk**.)
- The **supervisory process must be re-engineered** to attack the subsidies directly. Treating accounting capital as an inverse proxy for risk exposure – without also specifying & **enforcing** managers' common-sense **fiduciary duties to taxpayers**--is doomed to fail because tail risks can be increased faster than traditional accounting and government exams can reveal them.

TAXPAYERS' EQUITY POSITION IS INFERIOR TO THAT OF SHAREHOLDERS IN 5 WAYS

- Taxpayers cannot trade their Positions Away.
- Downside liability is not contractually limited, but upside gain is.
- Taxpayer Positions carry no Procedural or Disclosure Safeguards.
- Taxpayer positions are not recognized legally as an “equitable interest.” This means protected firms may exploit them without fear of lawsuits.
- Managers can and do abuse taxpayers by Blocking or Delaying Recovery and Resolution.

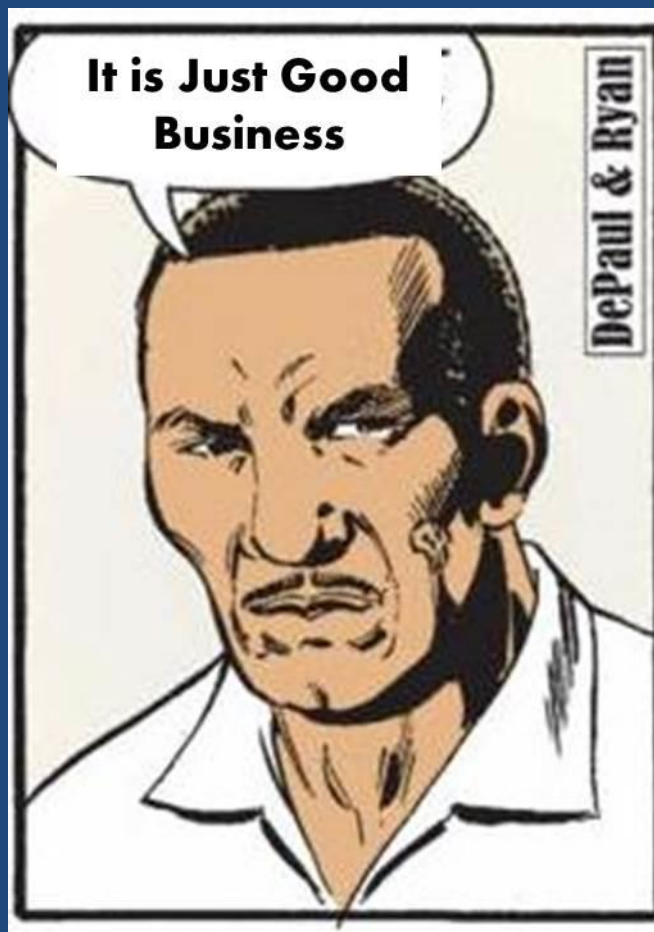
WORST FIRMS AND MANAGERS DESERVE TO BE PROSECUTED AS FELONS

- Genuine reform would **compel** the DOJ to prosecute megabank holding companies that engaged in easy-to-document **securities fraud**.
- Evidence: **Representations and Warranties** can be shown to be deliberately deceptive and designed to benefit indiv. firms at the expense of the rest of us.
- As legal persons and convicted felons, guilty US SIFIs would have to break **themselves** up. Subsidiaries of felonious companies could no longer take insured deposits or act as broker-dealer firms and futures merchants. The beauty of this is that Governments would not have to design the breakup plans.

CAPITAL REQUIREMENTS HAVE AND WILL LET US DOWN REPEATEDLY. EVENTUALLY, GOVERNMENTS MUST MEASURE AND SERVICE SAFETY-NET SUBSIDIES DIRECTLY

- Theme 1: To align incentives, corporate law for giant financial institutions should recognize that national safety nets makes taxpayers into **unfairly compensated equity investors**.
- Theme 2: Taxpayers deserve to be protected from such expropriation, but regulators and examiners have been assigned other and conflicting goals that keep this from being uppermost.
- Two ways to do this: Change training, recruiting and oaths of top regulators and establish single-purpose **trusteeships at DFU firms** that have the power to require managers to see that taxpayer equity stakes are calculated honestly, disclosed publically, and fairly compensated by managers of DFU firms.

FINANCIAL REGULATIONS ARE NEGOTIATED, NOT IMPOSED. MEGA-INSTITUTION “CRIMINALS” ARE FIGHTING TO KEEP TAXPAYER EQUITY POSITIONS **UNDISCLOSED AND UNSERVICED.**



Don't think that I am putting words in CEO Mouths

"Our business model is the right business model, I don't think there should be an expectation that there should be a radical change. It was a very conscious process to get to where we are today... We're managing our risk based on what we see as the **opportunity** and what we see as being **prudent**."... Citicorp CEO Mike Corbat

As quoted in Dakin Campbell, "Corbat Sees No Drawback in Boring Citi, Up 34% as Vision Queried," posted at Bloomberg Newsroom, 2014-02-25 05:00:00.16 GMT.