Petrou Speech at OCC Conference: U.S. Regulators Behind Curve When It Comes to "Shadow" Banks, Must Act Fast

Monday, March 31, 2014
CONTACT: Arezou Rafikian (202) 589-0880

Karen Shaw Petrou, managing partner of Federal Financial Analytics, will deliver the talk attached to this e-mail later today at the conference jointly sponsored by the Office of the Comptroller of the Currency and Boston University on the future of national banks over the next 150 years.

> "The future of national banks over the next 150 years will be driven, at least for the next ten or so, by the sharp realignment in competitive power resulting from the post-crisis rulebook, most of which has so far fallen exclusively on insured depositories and their holding companies. I am not saying that the rulebook is wrong – much in it is urgently needed. I am saying that banks – even the biggest of the big – aren't the only sources of consumer harm and systemic risk. Regulating them solely because they are banks and leaving non-banks in the free and clear is already realigning core financial-intermediation activities in ways I urge the OCC and other policy-makers quickly to recognize and, then, to address by refocusing rules on critical financial function, not accidents of charter birth."

Petrou argues that U.S. banks face a challenge comparable to that confronted by U.S. steel and auto manufacturers – that is, seeming dominance even as markets shift quickly to more nimble, non-traditional providers. If only big banks suffer as markets change, that's why they are private, shareholder-owned institutions and so be it, Petrou says. However, as detailed in this presentation, even the most traditional financial services –

1121 Fourteenth Street, N.W.
Washington, DC 20005
www.fedfin.com

PHONE 202.589.0880
FAX 202.589.0423
E-Mail: info@fedfin.com

small-business and corporate loans, deposit-taking, and the like – are rapidly being transformed into business where "shadow" entities play a major role. Global regulators clock "shadow" banks at $71.2 trillion worldwide, but Petrou argues that even this astonishing number underestimates its size because it focuses largely on capital-market operations, not longstanding traditional banking services that are quickly converting into non-bank ones.

"Traditional banking is redefining itself with a rapidity not seen since upstarts like Apple and Google dared to challenge IBM. That fight was bare-knuckles because few rules in the technology arena dictate comparative advantage. This is of course very much not the case in finance, meaning not only that banks start the fight with one hand tightly tied behind their backs, but also that regulators should quickly become referees to ensure the fight becomes a more fair one," Petrou argues.

She argues that U.S. regulators should realign the current framework – where rules are based on the charter a financial institution holds – into one where rules target products and services that pose risk to consumers, investors, and the financial system regardless of who offers them. The Dodd-Frank Act allows U.S. regulators to do this quickly under current law instead of trying one-by-one to name systemic non-banks. It also allows U.S. regulators to construct a resolution framework that prevents bail-outs not just for big banks, but also for any systemic financial-services institution.

"Regulation by form, not function sows the seeds of the next systemic crisis," Petrou argues. "A tough rulebook for the biggest banks may well be warranted, but one only for them creates strong incentives for profitable activities simply to flee banks for non-banks and, then, to pose new risks because non-banks are lightly regulated, if at all."

####

Federal Financial Analytics, Inc. is a proprietary think tank providing analytical and advisory services on legislative, regulatory, and public-policy issues affecting global financial-services companies. Since 1985, the firm's practice has been a unique blend of strategic advice and policy analysis, serving as a thought leadership resource for boards of directors and senior management seeking a forward looking assessment of risks, opportunities, governance, and other matters critical to success. Clients also include senior regulators and policy-makers around the globe, who rely on the firm's objectivity for confidential forecasts of the market impact of actions under consideration.