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Introduction to Regulation

Regulations are rules, principles and set conditions that govern procedures. Moreover, regulations are sets of processes that govern the monitoring and enforcement of rules. Regulations stem from legislations and are established with the force of law to ensure they are followed properly. Regulations may take the form of legal restrictions created by a government authority or they can be contractual mandates, which may bind certain parties (The Free Dictionary, 2013).

Regulations set boundaries and limits to be followed. Regulations may also govern so that duties or responsibilities are allocated a certain way. The government as well as specific industry controllers create and enforce regulations. Some examples of regulations are requirements to enter certain markets, wage requirements for workers, development approvals, safety rules, and production standards for goods.

Regulations can be found in many different types of industries. Some industries where one can see many types of regulations are healthcare, oil and gas, and the financial. For the purpose of this paper, we are going to focus on the domestic financial industry, its management and its legal regulations.

Introduction to the U.S. Financial Industry

The U.S. financial industry is a large industry that has many different types of firms that cater to various customers and their financial needs. Some types of firms in this industry include banks, investment funds, insurance companies and venture capital companies. Each of these businesses specifically provide types of financial services to institutional and individual customers. This industry offers the greatest assortment of financial products for consumers. It allows them to manage risk, create wealth, and meet their financial needs (Investopedia, 2013).

In order to understand the size and scope of the financial industry we turn to an analysis by SelectUSA. According to their analysis, the U.S. financial markets are the largest and most liquid markets in the world. Further, they create vast amounts of wealth opportunity. They specifically state that the financial industry has represented over \$1.3 trillion worth of the U.S. gross domestic product. This clearly shows the size and breadth of this industry. The Financial industry is not just a sector creating economic activity. It is a sector that creates

many jobs for our economy. The financial services sector has employed over 5 million people in the U.S. alone (SelectUSA, 2013). When the financial industry is doing well it even creates positions in other industries and it supports their business practices. This can be seen as financial services and products help facilitate and finance the starting of businesses. They also support the export of manufactured goods and agricultural products. Due to its outreach capabilities we can see how this sector supports other economic activities and creates employment opportunities for various markets.

To further see how large and influential the financial sector is we can analyze some of its industry subsectors. The U.S. Banking system has over \$13.9 trillion in assets and supports the world's largest economy. Asset management firms hold over \$36 trillion of conventional assets. Further, U.S. asset management firms are managing the pension funds of almost 60 percent of the global retirement market. U.S. retirement assets alone are valued at over \$18 trillion (SelectUSA, 2013). This shows that the asset management subsector is dominating in both depth and diversity. *How?*

When we look at venture capital activities we see a strong example of the breadth that financial services play on the economy. Venture capital firms finance companies that employ more than 12 million people. This shows how the financial industry is important for other industries and the economy as a whole. This subsector generates approximately \$3 trillion in revenue for the economy (SelectUSA, 2013).

After looking at the facts listed above we clearly see how important and powerful the U.S. financial industry is. Its many subsectors have integral parts which interact and effect jobs and economic activity outside the financial industry. Due to its size and functions we can understand why regulations are in place to govern and oversee the financial industry.

Regulation in the U.S. Financial Industry

Financial regulation in the U.S. is a form of supervision that subjects financial institutions to specific requirements and guidelines. Its overall goals are to protect customers and to maintain the integrity of the financial system as a whole. The U.S. financial industry is composed of a regulatory system that combines federal and state laws as well as governing organizations (SIFMA, 2013). In some cases, for both the national and state level, it can include private institutional oversight as well. At the federal level, the focus is on regulatory

issues that affect the whole nation. They focus on governances that keep markets fair and focus on issues that can affect all parties involved regardless of state of operation. At the state level, the regulatory institutions have a narrower focus for their oversight. They solely oversee regulation issues specific to and within their states.

At the national level there are many regulatory bodies. Each creates and enforces a large allocation of rules for member firms to follow. These institutions also have parameters in place to monitor that regulations are being followed. They also have penalties in place if rules are not adhered to. Some popular examples of national level regulating institutions are The Federal Deposit Insurance Corporation, The Financial Industry Regulatory Authority, and The Securities and Exchange Commission.

The FDIC regulates banks with regard deposit insurance requirements. They are also the authority in charge of managing bank failures. They are an independent federal government agency, which member banks pay into for the insurance and management oversight. FINRA is a perfect example of a private institution that regulates at the federal scope. They are a self-regulatory body and they oversee securities firms. All firms and brokers that conduct business in the U.S. have to be licensed by and registered with FINRA to conduct business. The SEC, like FINRA, is an agency that oversees from the national scope. They are an independent federal government agency and they primarily focus on financial market transactions. They oversee securities markets to keep fairness and balance present. They also lend guidance on some accounting rules (SIFMA, 2013).

While these three may be among the most popular regulating institutions at the federal level, they are not the only ones. There are actually many other regulating bodies that set out to oversee markets and set parameters for business activities. The central bank of the U.S., also known as the Federal Reserve, is also a national example of a regulating authority. They are responsible for regulating the monetary system to ensure price stability as well as economic growth. We also have The Office of Thrift Supervision. This is another independent federal government agency. They stem from the U.S. Treasury Department and focus on oversight for federal savings and loan associations (SIFMA, 2013).

The Commodities Futures Trading Commission is also an independent federal government agency. They focus on market transactions in the commodity futures and options space. We also have The Office of the Comptroller of the Currency. They are commonly referred to as the OCC and are also an independent federal agency. They

regulate activity for national banks and supervise federal branches of foreign banks that are operating domestically.

At the state level we see focused state regulations from governing bodies and institutions. First, there are state bank regulators that are available to oversee all state-licensed and chartered financial institutions. They regulate bank branches, trust companies, and credit unions that are operating in their state. They ensure that these institutions are adhering to state rules for conducting business.

With respect to securities law, we have state securities regulators in place to enforce particular state securities laws. They do this by enforcing blue sky laws, which allow them to monitor securities transactions in their state. An example of this would be a particular stock not being able to be purchased for a client who is a resident of a particular state. It is also important to note that a state's attorney general's office can become involved in regulating financial institutions and transactions as well. With respect to insurance companies we have state oversight as well as monitoring from The National Association of Insurance Commissioners. This is a combined effort from all domestic insurance regulators to oversee insurance companies and their transactions within business territories (SIFMA, 2013).

Analysis of the U.S. Financial Industry Regulation

When analyzing the various agencies that govern this industry and the rules they enforce, we see how vast and present regulations are. There are arguments made that we have too much regulation and there are arguments made that we do not have enough regulation within the current system.

Some feel that we need more regulations to provide further provide market protection from corruption and crisis. They specifically want more regulations so market confidence is present and maintained in the financial system. Further, they feel that financial stability will be maintained when regulations are greater. There is belief that with more structure present, there is a better chance that markets will respond normally and crises are more likely avoided. Also, with increased regulation there are arguments made that there is a reduction of financial crime capabilities. Overall, all these arguments for increased financial regulations are routed for consumer protection.

Among the arguments for less regulation lie statements stating that less regulation frees the market place to do increased business which will grow the economy. Further, it is believed that with fewer rules there will be an encouragement for efficiency. This is believed to occur because firms will need to ensure they are working well or they will fail. There are also arguments that if there is less regulation firms will be able to be more innovative and create new products and services. This is again an argument made that fewer rules will lead to economic growth. While these may be valid assumptions they leave out the basis of consumer protection concerns. These concerns are at the forefront of the reasons why we need regulations. There is no question that we need forms of regulation in our financial system to be able to ensure market and consumer protection.

Changes to U.S. Financial Industry Regulation and their Effects

Due to the breadth and depth of the financial industry we see and understand why regulations are so important to the system. It is for these reasons that we have determined that the current system does not need less regulations. It is for these reasons that we have come to determine that the financial industry needs additional and enhanced regulations. From analyzing the current system we feel that we need more transparent regulations added to the industry as well as we need more precision added to current regulations.

Our outlook on the industry is in line with the majority of voters in the U.S. According to U.S. News and World Reports, a survey by Lake Research Partners determined that 71 percent of voters were in favor of more regulations for the financial system. The survey further revealed that regulations of financial services were seen as important by over 90 percent of voters (U.S. News & World Report, 2013). This clearly shows that the majority of people in the U.S. agree to the importance and necessity of financial regulation.

To further expand on our analysis for the industry, we feel we need additions made in two different aspects. First, we believe we need more character built into the current regulations. It is clear that when analyzing many of the rules that are required in the industry one cannot help but notice their complexity. Many rules are written in complicated legalize which make them hard to understand, let alone follow. We feel that current lawmakers and regulators, whether they are from the federal level or the state level, should focus on making regulations precise, clear and transparent. We feel this would make for an improved regulatory environment.

We believe that if the current rules in place favored these characteristics they would be more easily manageable for firms and more easily applied by regulators. Further, we see that many regulations have sub parts with vast amounts of depth. This leaves room for varied interpretation of rules. Both of these factors show that the more complex regulations are the more at risk they are of being followed and enforced properly. Our determination here is also supported by the U.S. News and World Reports article. According to their article, regulatory agencies are still determining how to enforce parts of the Dodd Frank Act even though it has been in effect for 3 years (U.S. News & World Report, 2013). This clearly shows that the law's complexity and broad scope has prevented even the regulators from getting their arms around the law and its enforcement.

Second, we believe that some regulations should be split up into separate regulations so that appropriate financial institutions can more easily and accurately apply them. We see that many financial laws and regulations have many sub rules, each filled with its own requirements, and they are applied to all institutions to follow. We feel that this creates confusion for firms and for regulators. Our outlook here is that some regulations should be split into separate rules and should only be applied to the firms that need to follow each regulation respectively. While this supports a growing number of regulations in the system, we believe that it will make requirements more manageable for institutions as well as for auditors and regulators.

By analyzing the infamous Dodd-Frank Act mentioned above, we can see first hand a complex law that has many subparts. From analyzing this law we see its vast outreach and how it is placing burdens on firms that may not be necessary. According to attorneys from Leonard, Street and Deinard, the Dodd-Frank Act is a broad and deep law that has implications that touch every corner of financial services as well as other industries (Leonard, Street, and Deinard, 2013). The law is so complex that this law firm has dedicated an entire website to helping businesses understand and make sense of this complex legislation. This shows that this Act is creating confusion and burden across many sectors.

For the purpose of this paper and to support our determination that laws need to be precise, more transparent and split into completely separate laws we are going to focus on the Dodd-Frank Act. We intend to show that this law's complexity is creating hardship for financial firms and regulators. We intend to show evidence that if we had improved and additional separate regulations in place, firms and regulators would be able to conform to rules in a healthier fashion.

Background of the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act is a federal regulation that oversees financial institutions and their customer activities. It was passed in 2010 and has affected many institutions on how they conduct business. It is such a large regulation that it even created other agencies. Its outreach is vast because it is a mixture of federal regulations put together in an attempt to prevent the recurrence of events that caused the 2008 financial crisis. Its overall goal is to reduce the risks in various parts of the financial system.

Analysis of the Dodd-Frank Act

While the goals of the law are noble and we believe they oversee valid concerns, we believe that its outreach is too large and could continue to create problems for firms as they try and follow the rules. An analysis by Price Waterhouse Cooper confirms that this Act is one of the most complex pieces of legislation ever written. They state that financial service firms and other impacted organizations are only just starting to understand the Act's many components (PricewaterhouseCoopers, LLP, 2013).

By name and most of the characteristics of the law, it is deemed a Wall Street regulating phenomenon that was passed to govern large complex financial institutions. However, Dodd-Frank's many sub parts stretch into various businesses including local community banks and their activities. The law stretches into bank lending activities, deposit requirements and even into the credit card business. The law requires 387 different rules from 20 different regulatory agencies (ProPublica, 2013). One part of the law deals with placing parameters on ways banks can trade derivatives. This is done through Dodd-Frank's sub rule, the Volcker Rule. In another part of the regulation Dodd-Frank has the power, through its Consumer Financial Protection Bureau, to set parameters on how banks make their product disclosures.

We feel that one rule should not be this complex or have this much reach. We also feel that one rule should not be applicable to all institutions. We believe that such a law should not be applied to all institutions and then let it be left to these institutions to figure out which parts they need to comply with. We believe there should be separate laws that are applied only to the specific institutions that need to follow them. Further, we feel that only the appropriate regulatory bodies should govern institutions respective to their business activities. According to a publication from the Mercatus Center at George Mason University, we see how the Dodd-Frank Act is creating

unnecessary burdens. Specifically, they show how the law's complexity is trickling down and placing great burdens on local community banks.

In the publication, they state that they cannot even determine yet how exactly Dodd-Frank will continue to affect local banks due to the statute's size and length (Mercatus Center, 2013). According to the article, local banks are having a difficult time deciphering the law to see if certain parts even apply to their business and to what extent they need to change their operations. Local Banks have had a hard time with the law because the statute is approximately a thousand pages long and many of the implementing rules equally as long.

Moreover, there are complex interactions among the many statutory and regulatory mandates that make the analysis of the bill even more difficult. Because this law governs all financial institutions local banks have had to change the way they do business. They have had to hire additional compliance personnel and consult outside associations to ensure they are following the rules they need to be in accordance with the law. We feel this is excessively consuming for certain financial institutions and creates unnecessary financial burdens for them.

We feel that the Dodd-Frank law should be split into separate laws so it is less complex and more efficient for appropriate firms to follow. It should be separate laws applied to specific institutions so firms can comply with the requirements with ease and so regulators can monitor with efficiency. We feel a local bank should not have to hire outside consultants just to determine if they need to comply with a subsection of a law. Further, a local bank should not have to hire additional personnel to oversee a part of the law that they are not engaging in. This is happening in local banks more frequent and creating unnecessary costs.

Due to the time and cost to get exemptions from certain parts of the law, many local banks are resorting to hiring compliance personal to supervise activities they are not engaging in. This is seen with local banks hiring compliance personnel to comply with the Vulcker rule part of the statute even though they are not engaging in derivative activities. In addition to the costs of hiring new compliance personnel banks need to employ new software tools to implement new oversight tools. This is creating additional costs for implementations that may not be necessary for certain institutions.

manner in supervising financial institutions if what they are looking for is precise and clear. In an article from The Guardian, it is stated that legislators are now realizing the many problems with the Dodd-Frank Act due to its complexity. The article states that oversight needs to be redesigned in a clearer manner. It states that regulatory activities need to be redesigned so they are transparent and politically balanced (Peirce, 2013). Once again showing that for rules to be efficient they need to be clear and understandable.

Furthermore, we discussed that lawmakers should make changes to rules by creating an increased amount of separate rules. They should focus on eliminating the unreasonable sub parts that many rules have. As we saw with the effects Dodd-Frank had on local banks, having many sub rules with moving parts can be detrimental for firms and the financial system. We feel that separate rules that focus on specific goals would make for a healthier regulatory environment. Having more and separate rules will also reduce the room for interpretation by financial institutions. This would not only be reducing room for firms to not follow the rules it would be mitigating the risk of firms not following rules by accident. We also feel that separate rules would be more efficient for regulators to enforce. As we outlined earlier, many of the problems the Dodd-Frank Act is causing is on regulators. This is why they have had a difficult time enforcing many parts of the law.

Due to Dodd-Frank's vast reach many regulatory resources are being over deployed trying to catch firms not following a sub detail or proper interpretation of one of its many rules. In The Guardian article we see that legislators are now realizing this with the Dodd-Frank Act, thus supporting our notion for separate rules. Lawmakers are acting because the law needs to be split up to be efficient. The article states that legislators have already begun separating parts of the Act since much of the law is either harmful or useless for certain firms (Peirce, 2013). This clearly supports our earlier statement that one law being applied to and governing all firms is not efficient.

Conclusion

Overall, we favor strong regulations to maintain the reliability of our financial system. However, we support better and enhanced regulations. We feel this would be beneficial for financial institutions, regulatory bodies and would overall increase the health of the financial system. Transparency and separate rules is a dynamic approach to regulation that would fit into our current regulatory system. It would because as we saw from The Guardian

article, legislators are already adapting to these principals. If firms are able to adapt to the rules with less complications they will be able to focus more on business opportunity and markets will be able to grow with safety. Such a dynamic oversight system would help reduce unnecessary costs for firms as well as to the overall economy. We believe such changes to our regulatory framework would be an improved and more dynamic approach that would more efficiently match the dynamic nature of our financial system.

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