Federal Financial Analytics, Inc.

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NEW STUDY IS FIRST TO ASSESS CUMULATIVE IMPACT OF U.S. FINANCIAL REFORMS

Relying on FRB, BIS and academic research, FedFin finds that the sum total of new rules undermines monetary-policy implementation and endangers effective macroprudential regulation. The surprisingly slow U.S. recovery despite trillions in non-traditional FRB action may well be the result of changes to the financial market due in part to new rules. Without effective rules that address risks wherever they arise, systemic risk remains only partially addressed. FedFin thus calls for an immediate U.S. cumulative-impact analysis of the post-crisis framework as well as far more clarity from the FRB on its top-priority policy objectives.

WASHINGTON, DC, May 18, 2016 – Federal Financial Analytics, Inc. (FedFin) today issued the first-ever published study evaluating the impact of major financial rules on the ability of the Federal Reserve to implement monetary policy and protect the U.S. financial system and national economy from systemic risk. With the European Union only yesterday undertaking its own cumulative-impact analysis and the Federal Open Market Committee set later today to opine on U.S. financial stability, the study lays the groundwork for U.S. action to ensure that new rules work as intended and the Federal Reserve can guide monetary policy to smooth, sustained recovery.

"We took on this study," said FedFin managing partner Karen Shaw Petrou, "because there is all

too much troubling evidence of a growing disconnect between all the new rules and their intended, urgent goal." She continued, "Assessing cumulative impact is not the same thing as 'watering down' these rules." Further, "Identifying cross-currents in complex regulations may well uncover rules that need to be tougher, but no one can tell until U.S. regulators set their policy priorities and then determine how well actions so far have achieved them. Simply adding more rules is no panacea, especially given the evidence we have found in this study about unintended consequences even for the Fed."

The study first looks for prior forward-looking analyses based on verifiable data evaluating the cumulative impact of the post-crisis framework. Despite two FRB conferences making it clear that the central bank is worried about monetary-policy and macroprudential implications, studies to date take on only bits and pieces of the problem. FedFin's study today brings them together for a comprehensive analysis of the new rulebook.

Key points in today's FedFin paper include:

- Analysis of near-term cumulative impact cannot await completion of all of the new rules – competitors and investors will not await the definitive study before they change who offers which products to whom under which rules – if any.

- Non-traditional central-bank mechanisms (e.g., the reverse repo program, market-maker-of-last-resort facilities) are likely to exacerbate asymmetries in market regulation and create longer-term stability risks due to the absence of both micro- and macro-prudential regulation for many non-banks.

- The gap between policy-desired and actual rates is likely to widen, especially when the FRB wants to boost the economy because recent stringent bank rules have demonstrably constrained credit availability. Tightening is also complicated because bank deposits no longer serve a key monetary-policy transmission channel due to alternative liability products. Non-banks are not likely to be responsive to FRB interest-rate or other policy actions.

- Because of the interaction between the leverage rule as a binding constraint and the liquidity rules in concert with current ultra-low interest rates, large U.S. banks are increasingly declining to accept large cash deposits, challenging efforts to raise rates as well as increasing macroprudential risk (i.e., funds that would ordinarily go into safe cash now seek other repositories).

- Although the FRB is well along implementing counter-cyclical tools like a new capital charge for the largest U.S. banks, its own studies show that macroprudential rules are likely to have limited effect and could create new risks, a finding also reached in recent Treasury and global analyses.

- The FRB's own statements as to the goals of macroprudential regulation are so broad as to make it unclear which rules it should adopt to ensure the best-possible outcomes for which key risks.

To ensure that this study is as objective as possible despite the political focus on the post-crisis framework and the role of the nation's largest banks, the study relies for its conclusions on research conducted by the Federal Reserve Board, global regulators, and an array of academics – using only published research and related speeches to assess the critical question of forward-looking monetary-policy effectiveness and the prospects for continued financial stability.

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