Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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We Are Not Done Yet*

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The Senate has now passed H.R. 4173, the "Restoring American Financial Stability Act of 2010," and both houses are preparing for a conference on the bill. In what is expected to be a short, and perhaps on some provisions a spirited, conference, agreement will be reached between the conferees in a short time, and all signs point to the bill being passed in Congress and signed by the President by the Fourth of July recess. Much has been said about the effect of the bill on consumers, businesses, lenders, securitizers, appraisers, real estate brokers, credit rating agencies, insurance companies — the list is lengthy. Much more will be written.

But, careful; not so fast — even after the bill is signed into law, the process isn't done. It is instructive to somewhat mechanically review the bill to grasp a real appreciation of what will be passed and what must happen next.

The Senate passed version of H.R. 4713 is a 15 title bill with around 380 sections that require 1600 pages to articulate (While similar to the Senate bill, the House version is different — it even has full titles addressing issues not addressed in the Senate bill). As Chairman Frank has been reported to have said, there aren't very many words on any of the pages of either of these versions. The number of words, of course, might be relevant. Some strong laws take very few words. The original language of the Community Reinvestment Act of 1977 had in its major operative section no more than 70 or so words, so you don't need a whole lot of words to have a major impact on business activity. It is too tedious, however, to count the words in this bill, so suffice it to say there are just enough to begin with the title on Financial Stability and end with the title on Congo Conflict Materials.

Among other things, H.R. 4173, as passed by the Senate, creates these offices, functions and authorities, among others:

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Financial Stability Oversight Council
Bureau of Consumer Financial Protection
Office of Financial Research
Office of National Insurance
Office of Investor Advocate
Office of Municipal Securities
Supervision of non-bank companies by Federal Reserve
Categorization of some companies as systemically significant
Prohibition of new federal thrift charter and merger of OTS and OCC
Selection of FDIC as receiver of major non-bank companies and as federal supervisor of all state chartered depository institutions
Adoption of a radical change in method of assessments for DIF after 75 years
Regulation of hedge fund advisers
Wholesale changes in derivatives regulation, including push out from banks of major derivatives activity
Limitations on proprietary trading by bank holding companies and affiliates
Creation of the authority to force divestitures from systemically significant institutions
Supervision of payment, clearing and settlement facilities
Government directed appointment of credit rating agencies for ratings purposes
Limitations direct and indirect on executive compensation
Transfer of consumer protection authority to CFPB from agencies
Transfer of personnel to CFPB
Creation of broad, nearly limitless, consumer protection authority for CFPB over both banks and non-banks
Creation of minimum underwriting standards for residential mortgages, prohibitions against YSPs, and limitations on prepayment penalties
Restrictions on Federal Reserve emergency lending powers
Transfer to merchants of major authority on interchange fees and use of credit cards
Requirement that bank holding companies have capital equal to depository institutions, but with limitations on what securities may be counted for what purposes.

Left undone were a variety of implementing provisions. Whether that is a good thing or not can be debated. Many believe that it is better to sacrifice some flexibility for certainty (and therefore would opt for statutory certainty even if it appears somewhat harmful), while others feel that regulators understand the complexities of financial services activity better than does Congress (and therefore would opt for some vagueness in the statute with authority for the regulators to pass regulations to make the provisions function as they should).

However they may be classified, there are a lot of regulations that must be promulgated to implement the provisions of the bill. While sometimes it is difficult to count them cleanly, it appears as though there are at least 120 mandated under the bill.

The time frame for promulgation varies: some must be done fairly soon. For example, many that the CFTC must adopt must be completed within 6 months after enactment, and a few as quickly as 90 days after enactment. Similarly, many for a variety of agencies are one year after enactment, or a set time period after the Transfer Date, a date that itself is one year after enactment. The largest number have no specific date for promulgation of regulations however, or use terms such as "as necessary," "expedited process," for target dates, or have no date designated at all. What is clear is that regulation writing will engage immediately and will probably be ongoing at an intense level for as much as two years or more.

Promulgating such a massive number of significant regulations will stress both the agencies and the industries, including the consumer advocacy industries.

From the agency perspective, these requirements will be imposed against a backdrop of massive movements of personnel and regulatory authority. The chaos created by snuggling in the Consumer Financial Protection Bureau at the Federal Reserve, or carving it as a new agency out of nothing if that is what the conference decides, cannot be overestimated. Merging OTS and OCC will be difficult, but certainly easy compared with the gyrations around CFPB. The Office of Financial Research may turn out to be the biggest monolith of them all, and it must go somewhere and with new people.

New enlistees will be needed immediately at CFPB and the OFR. A new Comptroller of the Currency will be needed late this summer, as will a new Vice Chair at the Board of Governors. While a replacement for the latter post has been nominated (as well as two additional Board governors) the replacements are not in place yet. A new director will be needed in a month or so at the FDIC, and while the Chair has another year to go in that spot, that time can fly by while all of the resolution regulations are being processed. The Chairs at the CFTC and the SEC are in place, but haven't had the reins of those agencies very long.

The sheer numbers of people who will be reporting to new bosses will be staggering. Everything will be done to make the transitions smooth, but it cannot be accomplished without major delays and disgruntlements. Good people may take this as a good time to retire; others may see it as a way to improve their status. Persons that have been anxious to join the government roles may find this as the ideal time for pressing their suits, and many who are totally unfamiliar with the way government operates may find this disruption provides them the opportunity to become employed in one of the new agencies.

Beyond the regulations, the integration of new personnel, the build out of new office space, and the coordination of new and modified agency functions, there are significant studies that must be conducted. Many are traditional studies that try to determine in advance what will happen if certain conditions are met. Others, however, seem upside down.

For example, propriety trading by bank holding companies and their affiliates is restricted in the bill itself, but a study by the Oversight Council to determine its risks is not to be completed until 6 months after the date of enactment. A second study by GAO on the same subject is not due until 15 months after enactment.

Similarly, a study in the House bill (it is not in the Senate version) that will attempt to understand the impact of FAS 166 and 167 will have on lending is due 90 days after enactment. Nevertheless, H.R. 4173 establishes requirements of risk retention on assets that are transferred, even though the accounting standards may effectively require those assets be consolidated on the balance sheet of the transferor in many cases. That will certainly have an impact on lending, as will regulations the FDIC and the SEC are already preparing that contain the approach of these agencies to the same question of risk retention and offer no deference to what the Congress might adopt.

The study after the fact may explain this puzzle and lead to the necessity of changing the law or regulations just passed, or it may show that nothing needs to be changed. It would seem to make sense to complete studies before the provisions they are studying become effective, but that is not the way Congress (or in this case, the Congress, the FDIC and the SEC) has addressed these issues in this bill.

All in all, the Senate version of the bill has over 30 studies to be completed within reasonable periods of time. While not all are to be conducted by the agencies, many are, and in almost all of them, the opinion of the agencies will be sought by those conducting the study.

So we have here a 15 title, 380 section, 1600 page bill changing dramatically the face of financial services. To fully implement it with the necessary regulations will require the promulgation of at least 120 regulations of varying size and complexity and the creation of more than 30 major reports. This all must be done within the next 90 days to 2 years in great part by agencies whose leaders and many of whose major staff are either new or have not even been appointed yet. This must be done at the same time that major shifts of personnel among agencies are occurring, and some agencies are being created from whole cloth.

Viewed from this perspective, we may not know what we have for another year or so after the bill becomes law, and the chances of needing modifications of the bill in the near term, perhaps even this Congress, remain high.

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