Dodd-Frank Implementation: Act II*

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If we think of the implementation of the Dodd-Frank Act as a play, we have seen the first act, and 2012 marks the beginning of the second act.

In Act I, the players were introduced and the story line was established. The leading players are the financial regulators, which are required to write the regulations implementing the Dodd-Frank Act. This includes the Federal Reserve Board, which has new authority over nonbank financial companies and savings and loan holding companies, and the Bureau of Consumer Financial Protection, which was given consolidated authority over consumer financial protection laws.

The financial industry and Congress have only supporting roles in this play. Congress can seek to influence the rule-writing process through oversight hearings and comment letters, but already has delegated rule-writing authority to the financial regulators. Likewise, the financial industry can comment on proposed regulations, but the financial regulators have the final say on the regulations.

The story line is the remaking of financial regulation through the promulgation of new safety and soundness and consumer protection regulations that are designed to prevent a repeat of the recent financial crisis. Act III will reveal if this goal has been achieved. That act also may contain some surprises.

Act I got off to a slow start. In Act I, the financial regulators started the process of writing the regulations mandated by the Dodd-Frank Act, but finalized relatively few of those regulations. One notable exception was the regulation that requires financial firms to prepare "living wills." The slow start to this play was due to the overwhelming number of new regulations mandated by the Dodd-Frank Act, and the difficulty financial regulators

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faced in turning some of the provisions of the Dodd-Frank Act into regulations. The 300-plus questions embedded in the proposed Volcker Rule and the 90-plus questions posed in the section 165 rule are illustrative of that challenge.

Act II will be more action packed. This year, we can look forward to final regulations on the Volcker Rule; the regulations governing the designation of nonbank financial companies that will be subject to supervision by the Federal Reserve Board; the enhanced prudential standards that will apply to those nonbank financial companies that are subject to supervision by the Board, as well as those bank holding companies with more than $50 billion in assets; the regulations governing derivatives activities; and the underwriting and risk retention regulations applicable to mortgage lending.

Act II also contains a not-so-minor subplot. That subplot is the imposition of other safety and soundness regulations not mandated by the Dodd-Frank Act. Those regulations are the capital planning requirements established by the Federal Reserve Board under its general safety and soundness authority, and the new Basel capital and liquidity rules that have been agreed upon by U.S. and foreign financial regulators. The SEC also is taking a hard look at the regulation of money market funds. The combination of the new regulations mandated by the Dodd-Frank Act and these other non-Dodd-Frank regulations will create some exciting(?) compliance challenges for financial firms.

The resolution of this play will occur in Act III, which has yet to be written. The intended resolution is a fortress financial sector that does not take excessive risks, especially with insured deposits, and that can withstand future financial crises. The unintended resolution could be a much more utility-like banking system. It also remains to be seen precisely how the body of regulations generated by the Dodd-Frank Act will be enforced over time. A very good case can be made that the financial regulators had all the powers and authorities needed to prevent financial crises before the passage of the Dodd-Frank Act. The fact that those powers were not fully exercised was not a regulatory failure. It was an affirmative policy driven by policymakers in the executive and legislative branches of both political parties. In the near term, one can assume that compliance with the new regulations will be expected and closely monitored, especially as memories of the financial crisis remain fresh. However, memories fade and economic conditions change.

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Could Act III have a surprise ending? One possible surprise ending would be the repeal of Dodd-Frank or major revisions to that Act. The candidates running for the Republican nomination and some members of Congress have been highly critical of the Dodd-Frank Act. Nonetheless, the chances of a surprise ending seem remote. Many of the Act's provisions were originally proposed by the Bush Administration, including a consolidated consumer regulator. Even the financial industry may be reluctant to support repeal or major revisions after it has implemented the new systems and procedures necessary to comply with the Act. At best we may see some adjustments to the Dodd-Frank Act to address some of the law's unintended consequences.

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