Dodd–Frank Act implementation: Well into it and no further ahead

Wayne A. Abernathy

A parlor game that we have inflicted on our family and friends involves one person reading the first line of a book while the others try to guess the title and author. For example, here is one that some of you would get right away, although it might cause others of you to struggle: "It is a truth universally acknowledged, that a single man in possession of a good fortune, must be in want of a wife." Of course, that is from Jane Austen's *Pride and Prejudice*. Those of you who guessed that one right away may be feeling very smug.

Here is another, a first line that my children would get every time, but one that may not be as familiar to adults: "Mr. and Mrs. Dursley, of number four, Privet Drive, were proud to say that they were perfectly normal, thank you very much." And of course, that is from J. K. Rowling's *Harry Potter and the Sorcerer's Stone*.[1]

One of my own favorites, which I am sure just about everyone would quickly identify because of the boost to the book's sales from the Obama administration, is this opening line: "'Who is John Galt?'" This line of dialogue is uttered at the beginning of Ayn Rand's *Atlas Shrugged*.[2]

No doubt most of you have found these first lines to be relatively easy chestnuts. Consider the game from another direction. What if you had to come up with the first line yourself? What would be the appropriate first line for the Dodd–Frank Act? Of course, technically it is as follows: "This Act may be cited as the 'Dodd–Frank Wall Street Reform and Consumer Protection Act.'" Unlike the other first lines, however, that is far too prosaic and tells us really nothing, providing us no legitimate clue as to the real contents awaiting the reader. It does little to prepare you adequately for what follows. Maybe this first line would be better for the act: "Marley was dead: to begin with." That line actually opens Charles Dickens's *A Christmas Carol.* And it is certainly better and more informative than what opens the act now, but in view of the act's impact on the banking industry, I feel some partiality for yet another first line: "One January day, thirty years ago, the little town of Hanover, anchored on a windy Nebraska tableland, was trying not to be blown away." That is the opening line to *O Pioneers!* by Willa Cather. Although this book is less well known than Dickens's holiday classic, Cather's novel provides us with a first line that is more appropriate for describing the act's effects.

Secretary Geithner's six principles

Just how is implementation of the Dodd–Frank Act faring? How might we measure its progress? Within

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two weeks of enactment, Treasury Secretary Timothy F. Geithner did the nation an important service by outlining the Obama administration's vision for the implementation of this unprecedented legislation. In an address delivered on August 2, 2010, at New York University's Stern School of Business, Secretary Geithner outlined six principles that would not only guide but govern how the administration would proceed with the act's implementation.[3] This was an important and necessary speech because the legislation's 2,319 pages are surprisingly short on details, delegating the duty of writing them to the executive branch.

As a measure of the value that the Obama administration had given to the principles laid out in the speech, Secretary Geithner made the bold but appropriate declaration to the world that "you should hold us accountable for honoring them."[4] No one should complain, then, if 18 months following enactment we do just that. How is the Obama administration, by its own chosen yardstick, doing at implementing the Dodd–Frank Act?

First principle: Speed

Secretary Geithner described his first principle in these words: "First, we have an obligation of speed." He elaborated on that principle by stating the following:

> We will move as quickly as possible to bring clarity to the new rules of finance. The rule writing process traditionally has moved at a frustrating, glacial pace. We must change that.[5]

This was a bold promise, given the unprecedented rulemaking challenge. At least in the financial regulatory history of the United States, there has never been anything like it. I have seen no definitive count of the number of regulations that the Dodd–Frank Act calls forth. The numbers seem to range between 250 and 400—numbers so large that they are numbing. It all defies hyperbole. The Fair and Accurate Credit Transactions Act, adopted in 2003, astonished the financial industry with more than a dozen significant new regulations to be written. Looking at the Dodd–Frank challenge, I note that the following words of the Lord Chancellor in Gilbert and Sullivan's comic opera *Iolanthe* are appropriate: "I conceive you may use any language you choose to indulge in, without impropriety." In short, it is an impossible task—one on which the regulators are surely working as best they can. From early on, they all fell behind and have no hope of catching up. The law firm Davis Polk &Wardwell LLP keeps a monthly "progress report" on the rulemaking. The report found that by January 2012 some 200 statutory deadlines for new regulations had come and gone, and 75 percent of them had been missed.[6] One proposed rule—the so-called Volcker rule[7]—alone contains an astonishing 1,400 questions from regulators back to the public for input. This is hard stuff if you want to get it right.

Secretary Geithner's first principle sounds much like Glendower's boast to Hotspur in William Shakespeare's *Henry IV* that he "can call spirits from the vasty deep." To which we may be forgiven for rejoining with Hotspur, "But will they come when you do call for them?"

To Secretary Geithner's credit, he also said in his speech, probably drawing upon his vast government experience, "Now, this process is very broad in scope and very complicated. It will take time."[8] In view of all that, it is perplexing that there have been other voices from the Treasury Department calling for what some might characterize as "pedal to the metal" implementation, despite the impossibility of meeting the Dodd–Frank Act deadlines.

Second principle: Transparency and consultation

Consider Secretary Geithner's next principle: "Second, we will provide full transparency and disclosure." The Treasury Secretary explained this principle this way:

> The regulatory agencies will consult broadly as they write new rules. Draft rules will be published. The public will have a chance to comment. And those comments will be available for everyone to see.[9]

The latter parts of this pledge are unsurprising. They are the law. With regard to consulting broadly, that is certainly intended by the law on federal rulemaking, too. If Secretary Geithner meant anything beyond doing what the Administrative Procedure Act and other relevant statutes require, then the record to date has been spotty. Again, this is not meant as a pointed criticism of the rule writers. It is tough for regulatory staff to write so many complex rules in such a short amount of time as the Dodd–Frank Act allows and, at the same time, meet with the people who will have to live with the consequences. Yet meeting with those people is exactly what is needed if we want to have rules that do not do much more harm than good.

Especially at the beginning of the process, proposed rules were published with unusually short comment periods. Many were offered as interim final rules, which means that they went into effect immediately upon publication, even while they were open for comment as drafts. Consultation with industry members, affected parties, and the public while the rules were still being thought over and before their formal presentation has been the exception rather than the norm. In more recent weeks, regulators have slowed down the process and increased their consultation with others when necessary, possibly ignoring the statutory deadlines. That is all to the good and will make for better rulemaking and fewer mistakes needing correction later.

Third principle: Avoiding layering of new rules on top of old ones

Here is the third principle, in Secretary Geithner's words: "Third, we will not simply layer new rules on top of old, outdated ones." This very welcome idea was explained like this:

> Everyone that is part of the financial system—the regulated and regulators—knows that we have accumulated layers of rules that can be overwhelming, and these failures of regulation were in some ways as appalling as the failures produced where regulation was absent.
>
> So alongside our efforts to strengthen and improve protections for the economy, we will eliminate rules that did not work. Wherever possible, we will streamline and simplify.[10]

President Obama reinforced this message of reducing the regulatory burden in an initiative that he announced on January 24, 2011. The premise and the promise were both right on target. All banks and their customers feel the weight of excess regulation (ask anyone who has been through a mortgage closing, for just one example). Sadly, the promise remains unfulfilled. In a news article in May 2011 examining this very issue, *American Banker* editor at large, Barbara A. Rehm, observed, "None of the numerous people interviewed could name a single rule that has been repealed or simplified."[11] The situation has not improved since May 2011.

Fourth principle: Innovation

The fourth principle addresses an issue of progress that is important to banks and bank customers. Secretary Geithner said, "Fourth, we will not risk killing the freedom for innovation that is necessary for economic growth." The description provided for this principle is as follows:

> Our system allowed too much freedom for predation, abuse and excess risk, but as we put in place rules to correct for those mistakes, we have to strive to achieve a careful balance and safeguard the freedom, competition and innovation that are essential for growth.[12]

Given how relatively few of the Dodd–Frank Act rules have been finalized and how even fewer of them have gone into effect, it may now be too early to test this principle. It is clear, however, that there has been no innovation in financial services since the enactment of the Dodd–Frank Act, unless we should count the degradation in customer services developing in response to the Durbin Amendment's price controls on debit card interchange fees.[13]

Rather than a realization of the promises of Secretary Geithner, what we have been seeing is more of a fulfillment of the predictions of investigative journalist John Stossel (commenting on the behavioral costs of regulation):

> The bigger harm is the indirect cost, all the money businesses spend trying to wade through the red tape (lobbying, filling out forms, hiring lawyers), plus the damage the regulation does to the American spirit. So much creativity now goes not into inventing things, but into gaming the system, manipulating the regulatory leviathan.[14]

Fifth principle: Level playing field

Secretary Geithner combined the fifth principle with its explanation in this way:

> Fifth, we will make sure we have a more level playing field—not just between banks and nonbanks here in the United States—but also between our financial institutions and those in Europe, Japan, China, and emerging markets who are all competing to finance global growth and development. We will do this by setting high global standards and blocking a "race to the bottom" from taking place outside the United States.[15]

Again, these promises are good and reassuring, likely to raise no objections other than those from nonbanks and foreigners. Advocates for the new federal Consumer Financial Protection Bureau (CFPB) have repeatedly pledged to go after nonbanks. Additionally, those making pronouncements regarding the new Financial Stability Oversight Council (FSOC) have pledged to extend the FSOC's monitoring for systemic risk to nonbanks. Finally, defenders of the new, elevated capital standards for banks and the Volcker rule have assured us that these regulations will be embraced internationally.

As of this writing, all of these pledges have yet to be fulfilled, and the assurances remain largely unrealized. CFPB leaders continue their rhetorical offensive, but six months after receiving responsibility for 17 consumer laws and following the appointment of a bureau director, no action has been taken against any nonbanks; in addition, a rigorous nonbank examination program has not emerged from the planning stages. FSOC continues to promulgate rules about how it will go about designating certain nonbanks as systemically important financial institutions (SIFIs), as well as guidelines for what it will do to nonbank SIFIs. However, at the time of this writing, not a single nonbank firm has been declared to be a SIFI, despite the fact that it was the collapse of the "shadow" banking system[16] that inaugurated the recent financial crisis. The cloud of burdensome uniform international capital rules has spread across the globe, but the Europeans are already trying to figure out how to fudge them as they recognize the contractionary effect of excessively high capital requirements. No nation outside of the United States has embraced the Volcker rule. Indeed, the word is that European financial authorities are preparing to lodge protests against it with the U.S. Treasury Department.

Sixth principle: Coordination and cost–benefit analysis

Perhaps the Treasury Secretary did not want seven principles, so he combined two for his sixth and last:

> Finally, we will bring more order and coordination to the regulatory process, so that the agencies responsible for building these reforms are working together, not against each other. This requires us to look carefully at the overall interaction of regulations designed by different regulators and assess the overall burden they present relative to the benefits they offer.[17]

Again, these are worthy desiderata that all can embrace. The Dodd–Frank Act significantly increased the number of federal regulators and expanded their scope, so coordination—hard to come by leading up to and during the financial crisis—is essential to a cohesive regulatory program. Rigorous cost–benefit analysis is essential for the justification of any federal regulatory program if it is not to become detrimental to the public good.

Sadly, these remain unfulfilled goals rather than operative administration mandates. One of the most common criticisms of Dodd–Frank implementation has been a lack of order and coordination in the regulatory process. Instead, the Dodd–Frank Act has succeeded in replacing the financial crisis with a regulatory crisis. No agency has been able to reach equanimity about its primary job, in large part because each agency has been so preoccupied with implementation issues; in addition, cooperation with other agencies appears to have been achieved only when driven by necessity or convenience. As agencies are grappling with impossible rulemaking tasks, most of them are also engaged in major structural reorganizations and shifts in the areas of responsibility.

A good example is consumer protection regulation. A whole new federal agency, the CFPB, was created to centralize consumer protection in one agency. Not to be left out of this area of regulation, the Federal Deposit Insurance Corporation (FDIC) has established its own division of consumer protection, and the Office of the Comptroller of the Currency has found consumer protection to be part of its remaining safety and soundness responsibilities. Additionally, the Dodd–Frank Act encourages state attorneys general to get more actively involved in enforcing federal consumer protection standards. There are and will continue to be more independent regulatory and enforcement players wearing consumer protection sashes than there were in 2007.

It is worth noting with some comfort that the Dodd–Frank Act reinforces the importance of regulators conducting cost–benefit analyses in the promulgation of the new rules, and the courts are showing some appetite for enforcing those statutory requirements. It cannot be said that the regulatory analyses are anywhere near adequate yet, but regulators are paying more attention, as are the entities being regulated.

Failing to follow the Geithner principles

By the standard of the six principles set out by Secretary Geithner, the implementation of the Dodd–Frank Act—as measured a year and a half after its enactment—is not going well. Not only is it failing to follow the Geithner principles, it is violating them in many cases.

Acknowledging that this is actually the case is not the same as placing fault with those charged with the act's implementation. Nothing like this has ever been tried before in the history of the United States. Writing 400 financial regulations of the highest significance and the greatest complexity in a couple of years has clearly been too much to expect. Policymakers in Congress and in the executive branch can easily discern from the experience thus far that a reform of the Dodd–Frank Act is in order, as others have recognized in the past for many far less ambitious legislative projects.

Getting on with the work to end our self-inflicted regulatory crisis should be among the highest priorities. It is hard for regulators to do their jobs while enmeshed in impossible implementation tasks—and even harder for financial institutions and their customers to get on with life while all this regulatory reshuffling and reconstruction take place. The Gramm–Leach–Bliley Act (also known as the Financial Services Modernization Act of 1999) was built upon the foundation of functional regulation. The Dodd–Frank Act has produced dysfunctional regulation.

Unless the failings of the Dodd–Frank Act are addressed, the closing line of that legislation will not be:

"And they lived happily ever after." A more appropriate final line might be one borrowed from *The Guns of August* by historian Barbara W. Tuchman:

> After the first thirty days of war in 1914, there was a premonition that little glory lay ahead.[18]

NOTES

[1]J. K. Rowling, 1998, *Harry Potter and the Sorcerer's Stone*, New York: Scholastic / Arthur A. Levine Books.

[2]Ayn Rand, 1957, *Atlas Shrugged*, New York: Random House.

[3]Timothy F. Geithner, 2010, "Rebuilding the American financial system," speech at New York University, Stern School of Business, August 2, available at www.treasury.gov/press-center/press-releases/Pages/tg808.aspx.

[4]Ibid.

[5]Ibid.

[6]Davis Polk & Wardwell LLP, 2012, *Dodd–Frank Progress Report*, January, p. 2, available at www.davispolk.com/publications/list.aspx.

[7]See http://lexicon.ft.com/Term?term=volcker-rule.

[8]Geithner (2010).

[9]Ibid.

[10]Ibid.

[11]Barbara A. Rehm, 2011, "The principal issues with the Geithner principles," *American Banker*, May 2, available at www.americanbanker.com/issues/176_84/geithner-dodd-frank-1036842-1.html.

[12]Geithner (2010).

[13]Interchange fees are per debit (or credit) transaction fees paid by merchants' financial institutions to the card issuer. For details on the Durbin Amendment, see http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SP03989:.

[14]John Stossel, 2004, *Give Me a Break: How I Exposed Hucksters, Cheats, and Scam Artists and Became the Scourge of the Liberal Media* ..., New York: HarperCollins, p. 49.

[15]Geithner (2010).

[16]The shadow banking system represents the network of financial firms (for example, hedge funds and insurance companies) that are outside the traditional banking system.

[17]Geithner (2010).

[18]Barbara W. Tuchman, 1962, *The Guns of August*, New York: Macmillan, chapter 22.