Dodd-Frank's Third Anniversary:
Taking Stock of Financial Reform

by Wallace C. Turbeville, *Senior Fellow*

Three years have passed since David (the American public) defeated Goliath (the big banks) and the Dodd-Frank Act became law. Implementation staggers forward and there have been some recent encouraging developments. But, overall, there is reason for serious concern about the fate of financial reform.

Almost 5 years ago, the world came within a hair's breadth of a financial collapse that would have caused more misery than the Great Depression. The prudent response would have been to reform the financial system from the ground up, asking two questions of every product and practice employed by the financial sector: Does the product/practice, as it is intended to be used, serve broad public interest; and does the product/practice imperil the stability of the financial system so that its social value, if any, is outweighed by attendant systemic risk?

Of course, this never happened. Dodd-Frank, though an unprecedentedly broad regulation of the financial sector, did not reach deeply into the system. The scope of the financial markets was unchanged, though overall transparency and risk management were improved. Policy makers said they relied on the adage, "the first priority is to do no harm." In reality they were cowed by twin perceived dangers. Intimidated by the complexity of modern finance and baffled by bank obfuscations, they shied away from fundamentally altering the way financial markets worked. They were petrified of triggering a second financial crash that would worsen the recession. And they were even more afraid of the wrath of the politically powerful banks. Nonetheless, Dodd-Frank must be implemented and supported, even though it falls short of being a reform that is proportionate to the depravity that caused the 2008 financial crisis.

THE TWO WEEKS BEFORE THE DODD-FRANK ANNIVERSARY THIS SUNDAY HAVE BEEN RELATIVELY PRODUCTIVE FOR REFORMERS:

- Richard Cordray, at long last, secured Senate confirmation. Devised by now-Senator Elizabeth Warren back in 2007, the Consumer Financial Protection Bureau finally has a secure, permanent Director and can continue its work on behalf of the American people. Since the CFPB came online, the agency has returned more than $400 million to nearly six million consumers cheated by credit card companies.

- The Commodity Futures Trading Commission issued a final guidance to establish the procedure to integrate US derivatives regulation with foreign jurisdictions. Once again, hostage taking was necessary, as the Commission Chairman threatened to let a deadline expire that would have caused US rules to govern derivatives everywhere, regardless of borders, in order to get European regulators, banks and other Commissioners to agree. The outcome is imperfect, to say the least, as the CFTC relies too heavily on the enforcement of rules by other jurisdictions. But further delay would likely have made it even worse.

- The prudential regulators— the Fed, FDIC and others—adopted bank leverage and capital adequacy rules that are even stricter than Basel III rules that apply globally. Again, there were major imperfections that one hopes will be rectified, but the substance of the rulemaking is important. And principle of requiring US banks to be better capitalized than the other major banks is far from trivial

Other notable developments as the third year of Dodd-Frank draws to a close are worth noting. Two bills with bipartisan sponsorship would take a more aggressive approach than Dodd-Frank to breaking the concentrated power of the megabanks. Senators Sherrod Brown and David Vitter approach the problem through capital requirements while Senator Elizabeth Warren and John McCain opt for a 21st version of the Glass-Steagall Act. If nothing else these legislative proposals establish a defense perimeter for a properly robust final regulation under the statutory Volcker Rule, which prohibits banks from engaging in specific dangerous trading activities. Yet delay of the final Volcker Rule regulation may be even greater than most recently anticipated. There are signs that a widely anticipated autumn release of a final rule may not happen. If it takes until the end of the year, the implementing rule would have taken 3 ½ years to draft and adopt, a record that does no one proud. Indeed, many elements of Dodd-Frank still must be implemented. Some of these required rulemakings involve multiple agencies working jointly. Examples include the Volcker Rule and the required regulation of executive compensation at the banks. The regulators consistently use the excuse that consensus among multiple agencies is a difficult task. That makes sense. But it is hard to imagine that the quest for consensus, by itself, requires years of negotiation. The Volcker Rule prohibition of proprietary trading (making bets with the balance sheet) by federally insured banks and executive compensation limitations each hit the bankers where it hurts, in their wallets. There is no doubt that industry lobbyists, perhaps even more than consensus building, have caused the delay.

Recently, a regulator described the multi-agency process in a troubling way. She said that multi-agency rulemaking inevitably results in multiple positions on a given issue. She explained that the reconciliation process typically causes the regulators to adopt the "least common denominator." She meant that the approach to the rule that was least onerous on the regulated entities was adopted so as to cause the least difficulty for the financial sector. This is not only an outrageous abandonment of the public trust; it portends trouble for the long-term future of financial regulation. It makes far more sense to default to the safest rule, the one that most certainly protects the public even, if it might constrain the banks more than absolutely necessary. But that is not how the regulators think. Even though they are entrusted with the public's interests, they confuse what is good for the banks with what is good for the society. As long as the regulators think this way, the benefits of Dodd-Frank and the implementing regulations will wither away over time as the regulators methodically compromise away the protections that were fought for and (we thought) won 3 years ago.