Is the Pendulum Swinging on the Dodd-Frank Act?*

Jim Sivon

June, 2011

Recently, some Members of Congress have started to call for delay in the implementation of certain provisions of the Dodd-Frank Act and others are advocating changes to various provisions in the Act. Does this mean that the momentum for financial reform is dissipating?

There is no doubt that the implementation of the Dodd-Frank reforms is slowing. Yet, the causes for this delay are not the result of a fundamental retreat from the terms of the Dodd-Frank Act.

The slowdown is due, in part, to the broad scope of the Act. Regulators, especially the SEC and CFTC, are simply overwhelmed and cannot implement the Act's provisions in the time frame envisioned in the statute.

The pace of reform also has slowed because some of the unintended consequences of the Act have started to emerge. For example, it is increasingly apparent to some Members of Congress that the mortgage reforms mandated in the Act could make it more difficult for some consumers to obtain mortgage credit. This concern has contributed to a delay in the implementation of the risk retention provisions of the Act. Similarly, it now appears that some of the extraterritorial impact of margin requirements for derivative transactions may place U.S. firms at a competitive disadvantage to foreign firms, which are not currently subject to similar requirements. This has caused some Members of Congress to call for a delay in the implementation of margin rule until foreign regulators adopt comparable requirements.

Lastly, the pace of reform has slowed because some provisions are simply hard to implement. The designation of systemically significant nonbank financial companies is a prime example. The statute gives the Council a great deal of latitude in making these designations, and it is evident that the Council would like to exercise a significant degree of flexibility in making

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

determinations. However, designations that are not sufficiently grounded in some standards will create uncertainty for many market participants and may even expose the agency to litigation.

On the other hand, it does not appear that any of the various bills introduced to either delay provisions in Dodd-Frank (e.g., derivatives) or to revise provisions (e.g., change the structure of the CFPB) have any realistic chance of enactment. Some of these bills may pass the House of Representatives, but passage in the Senate is unlikely.

Moreover, the financial crisis has transformed the federal financial regulatory agencies. These agencies are intent on implementing the provisions in Dodd-Frank that are intended to avoid a repeat of the recent financial crisis. They also have become highly skeptical of industry claims that some reforms will have unintended consequences (e.g., higher capital will harm economic growth). Indeed, it appears that regulators see higher capital as a way to force larger banks to shrink.

Public anger with the financial services sector also drove passage of the Dodd-Frank Act, and that anger has not gone away. I saw this first hand last week when I attended a book signing by Gretchen Morgenson and Joshua Rosner for their new book "Reckless Endangerment," which focuses on the role of Fannie Mae and Freddie Mac in the financial crisis. (I should note that my oldest daughter works for the company that published the book.)

What was most striking about this event was the tone of the question and answer period. Everyone that posed a question conveyed a continuing anger over the financial crisis and those institutions or individuals that are perceived to have contributed to it. For example, a former math teacher said the crisis demonstrated a failure in basic principles of math. A former prosecutor said he could not understand why the Justice Department has not filed fraud suits against many of the officers and directors of financial firms. Even more disturbing than this continuing anger was the feeling held by many in the audience that our financial system is "rigged" and lacks accountability.

In sum, the implementation of the Dodd-Frank Act appears to have hit a speed bump, but this does not represent any fundamental reversal by Congress or financial regulators. Financial regulators, in particular, remain committed to implementing the Act and taking other actions that they deem necessary to avoid a repeat of the crisis. Moreover, the public anger that drove passage of the Act is still with us.

Jim Sivon is a partner with the law firm of Barnett Sivon & Natter, P.C.