

A CONSULTANT'S VIEW OF DODD-FRANK

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Introduction

The Dodd-Frank Wall Street Reform and Consumer Protection Act¹ (Dodd-Frank) is ambitious and complex legislation designed to significantly transform the way the financial system operates. Yet in a year's time, the rule-making and regulatory process has not yet delivered the kind of detail or clarity anyone expected. A big reason: The sheer scale of the law—more than 2,300 pages, requiring more than 290 new regulations and 13 new agencies.²

This is the kind of systemic challenge strategy consultants face frequently. We typically stand on the periphery of a complex and often conflicted system. From that position, we help public and private sector clients bring clarity, definition, and potential solutions to the key players who otherwise are focused on meeting daily challenges. We are able to help key players visualize the emerging regulatory universe, raise questions about intended and unforeseen consequences, and help all players understand their greatest priorities and how to achieve desired outcomes.

While others can do this work—and often do—strategy consultants tend to draw on the experiences of those working on problems close-in and daily, analyze how each part affects the other, and provide a holistic sense of how to make things work better.

Dodd-Frank, like most major pieces of major reform legislation, resulted from

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¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

² See, e.g., A. Nicole Clowers, Testimony before the House Committee on Financial Services Subcommittee on Oversight and Investigations (July 14, 2011), <http://www.gao.gov/new.items/d11808t.pdf>.

significant shocks to the political system and systemic failures. Its first goal, therefore, is to prevent similar shocks and failures in the future.³ Understood as a response, rather than a proactive measure, the legislation should therefore be seen as similar to other major legislative reforms—the post-9/11 Homeland Security Act of 2002,⁴ the Intelligence Reform and Terrorism Prevention Act of 2004,⁵ the Post-Katrina Emergency Management Reform Act,⁶ and the Patient Protection and Affordable Care Act passed in 2010.⁷

Like each of these major pieces of legislation, the first year of Dodd-Frank has been a period of maximum confusion, with characteristics similar to a company that has undergone a merger, a consolidation, and a start-up—all at the same time. The focus at the outset within the regulatory and other implementing agencies is to meet deadlines under strict time constraints.⁸ This can lead to a series of actions that are merely reactions to deadlines—a web of new reports, plans and policies that meet the requirements of the new law, but lack the kind of planning, coherence, and strategic foresight likely to lead to the legislation's desired outcomes.

What is almost always lacking is the guiding hand of a systemic approach to the challenge of implementation. And this absence perpetuates the likelihood of conflicting or weak policy and responsiveness.

In such a situation, our goal as strategy consultants is to bring clarity of purpose to all decisions and actions. We want to make sure that participants within a regulatory agency or regulated industry understand where they fit in within the new regulatory universe, and what their priorities should be. We often highlight those areas where challenges remain outstanding—not necessarily to resolve them, but merely to elevate them so the participants themselves can begin to work on them.

With Dodd-Frank, this is a challenge for both government entities and private sector players. Government entities are trying to understand and meet new responsibilities to see whether previously held responsibilities now belong to a new agency, and to learn whether their authority has been sublimated in any way. For the private sector, the primary challenge is to identify who its new regulators are, how expectations are different, and how the new regulatory universe will affect its business.

³ See, e.g., President Barack Obama, Remarks at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), <http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act>.

⁴ Homeland Security Act of 2002, Pub. L. No. 107-296, 116 Stat. 2135.

⁵ Intelligence Reform and Terrorism Prevention Act of 2004, Pub. L. No. 108-458, 118 Stat. 3761.

⁶ Post Katrina Emergency Reform Act of 2006, Pub. L. No. 109-295, 120 Stat. 1355.

⁷ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

⁸ See, e.g., Silla Brush, *CFTC May Delay Until December Dodd-Frank Swap Regulations Slated for July*, BLOOMBERG, June 14, 2011, <http://www.bloomberg.com/news/2011-06-14/cftc-may-delay-until-december-dodd-frank-swap-regulations-slanted-for-july.html>.

Where's my turf?

The regulatory community is still trying to figure out its responsibilities, and where the water's edge is for their oversight. While Dodd-Frank aimed to create clear authorities over financial services institutions (particularly those judged too big to fail), it is not immediately clear to us as strategy consultants how certain regulatory overlaps will be resolved—for example, the question of judging the credit health of banks is a responsibility shared in various ways between the Federal Reserve, the FDIC and the Treasury.⁹ In many cases, regulators are not seeking to expand their authority but to focus it. The assumption that regulators are always seeking to amass more power is incorrect; some regulators resist the requirement to do more, and hope to see others assume responsibilities for which they lack resources or expertise.

In the case of Dodd-Frank, we recommend a process guided by desired outcomes—as defined by the law itself, and shepherded by strong regulators who understand the impact they can have if they set out the new regulatory universe in a methodical way. Government agencies are not naturally hostile to overlap and regulatory rivalries. That was a feature of the pre-Dodd-Frank world and sometimes serves the public's needs. The goal should not be to arbitrate all those disputes, but to make sure they do not get in the way of good regulatory action and market impacts.

In our work so far, we have found that many policy makers generally do want to understand whom they should collaborate with, how to effectively share information with the right players, and how their decisions will impact the overall marketplace. However, they are unable to focus on such large issues because they have such stringent requirements set to meet certain deadlines and maintain compliance with the new law. Fundamentally, no matter how valuable it would be for regulators to focus on establishing a good working relationship with a fellow regulator on a matter of shared concern, additional responsibilities and daily demands hamper that ability.

Know thy regulator

The private sector has had a voice in the shaping of the legislation and the regulatory work that has followed, but that does not mean they understand its full impact, or what they need to focus on next. We have found that merely presenting a visual map of the legislation—doing an inventory of authorities, showing the affected agencies and their roles and responsibilities, recognizing those regulatory fault-lines where they exist, and understanding the implications of those overlaps—is essential to setting priorities and sequencing decisions in response to Dodd-Frank.

Just as a good road map shows not only the way from point A to point B, but also

⁹ See Proposed Rule, Credit Risk Retention, 76 Fed. Reg. 24090, 24090 (April 29, 2011).

the alternatives and the potential pitfalls, a visual map of the legislation makes clear where leadership needs to be most focused, and wherein lies the route to success in meeting regulatory demands.

For instance, Dodd-Frank created the two major new entities, the Financial Stability Oversight Council¹⁰ and the Consumer Financial Protection Bureau,¹¹ in addition to other new offices and agencies.¹² The private sector is trying to understand who is in charge of what, whether authority was taken away from some places and redistributed elsewhere, how best to share the right information with the right people, and how to build a government-relations infrastructure to interact with offices that previously did not exist. Simply looking at the legislation and its requirements is not enough to meet all these needs. One has to be guided by an understanding of how each individual part relates to the greater whole.

Any effort to bring clarity to the new regulatory universe is bound to help strengthen public confidence in the legislation. While the general public is rarely expected to understand or appreciate the difference between concepts such as a derivative and a swap, the public has grown to appreciate that the regulation of financial markets can have an outsized impact not only on the overall economy, but also on its personal financial well-being. When strategic consultants deploy an outsider's informed perspective, it helps bring clarity to key issues within the legislation; the lessons learned from that exercise can be broadly applied by agencies and regulated entities as they explain how they have improved their practices to the general public. That greater clarity is likely to lead to better outcomes, as both regulators and the regulated better understand the rules of the road, and who is enforcing them.

What's next

We expect that over the next year, regulators will remain as focused on meeting the obligations of the law, even as they respond to constantly changing macroeconomic conditions. For public entities, this challenge will have the same character as the last year: a near-singular focus on meeting deadlines, often at the expense of thinking about the long-term ambitions of Dodd-Frank and its strategic imperatives. The fact that implementation is likely to remain behind schedule should not be a surprise, simply because of the sheer size and complexity of the law. At the same time, leadership within the public sector must not forget that they are shaping the way a significant share of our economy is regulated, and should act with that interest in mind. That means taking the

¹⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 § 111, 124 Stat. 1376, 1392-94 (2010).

¹¹ *Id.* §§1011-1013, 1017, 124 Stat. at 1964-73, 1975-79.

¹² *E.g., id.* §152, 124 Stat. at 1413 (establishing the Office of Financial Research).

time to consider how agencies will interact with each other and evaluate how to achieve the core purposes of the law.

Among private sector entities, the impulse to wait out the current transition period would be a mistake. The lack of definition at this stage is not unusual and in a year's time, this period may well be forgotten as the legislation is implemented to a far more detailed degree. Since the industry is likely to see a significant increase in reporting requirements, for example, now is a good time for firms to evaluate their own compliance with existing reporting requirements, and to study the emerging reporting rules as they take shape. For those firms that have rarely had any reporting requirements, now is a good time to develop a working understanding of best practices. A rolling understanding of the legislative implementation process, informed by an appreciation of the way regulations will affect the daily operations of the financial services industry, is the most certain way to achieve success once Dodd-Frank is put fully into effect.