

## **5 Key Fixes That Will Improve Dodd-Frank;**

*OPINION: The CFPB should be reconstituted and the residential mortgage system should be fixed.*

National Law Journal

January 23, 2017

By George W. Madison, Michael E. Borden and William A. Shirley

When it comes to financial regulation and reform, one issue matters more than all others: systemic risk. In 2010, when Congress passed the Dodd-Frank Act, its authors made choices that they believed would address that problem. Since then, debate about the law has not been particularly constructive. One side has argued that no part of its 2,000 pages could be modified or improved. The other side has found little to respect in the legislation.

The authors of this article found themselves on three sides of the financial crisis - as a Democratic senior Treasury official, as a Republican Financial Services Committee staffer and as an attorney representing a distressed institution. Today, we agree that Dodd-Frank needs reform.

In evaluating any choice that Congress made in 2010, the Congress of 2017 should ask whether the choice meaningfully reduced systemic risk. If it did, then that choice should be respected, no matter its provenance. If it did not reduce systemic risk in a meaningful way, then the reform should be reconsidered, and different legislative decisions may be warranted. With systemic risk firmly in mind, we propose five specific ways to make the legislation better.

### **RAISE THE THRESHOLD**

Raise the threshold for banking organizations that are subject to Dodd-Frank's enhanced prudential requirements. It's currently at \$50 billion. It should be at least \$200 billion.

Instead of sweeping in more than 40 banking organizations, it should corral only the largest dozen or so. Our financial system is complex and interconnected. Failure beyond the largest banks, while painful and potentially costly, could likely be contained. Failure of any of the largest banks could collapse the entire system. Thus, enhanced prudential requirements make sense for them.

### **REVISE THE VOLCKER RULE**

The Volcker Rule is not an enhanced prudential requirement, and we do not support it. Any debate about whether the Volcker Rule should be entirely repealed is not about systemic risk. In any case, we would recommend that the rule be revised to reduce its costs.

As the rule operates, any short-term trading is presumed to be improper unless a bank can demonstrate that it falls within one of several excruciatingly detailed exemptions. That presumption should be flipped on its head: the rule should permit all trading activity unless it is clearly speculative.

Banks should not have to spend what they spend on complying with this rule; and regulators should not have to expend large amounts of limited resources on Volcker. Moreover, a looser standard may return to the markets some of the liquidity that NY Federal Reserve staff have recently concluded was siphoned off by the Volcker Rule.

### **FIX OUR MORTGAGE SYSTEM**

Our residential mortgage system must be fixed. Of all the tasks assigned to the federal government by the financial crisis, that task may be the most difficult. It's certainly the task that has spent the longest time on legislative back burners.

However, no matter what legislative solution is ultimately adopted - whether a complete privatization of Fannie Mae and Freddie Mac, or something else - it is time to permit the organizations to retain cash and recapitalize their balance sheets, subject to oversight by their regulator/conservator. Congress should end the cash sweep that takes place every quarter in the form of dividends by Fannie and Freddie to the federal government.

Eventually, these organizations (or their successors) will need stand-alone balance sheets. While better balance sheets alone will not address the moral hazards arising from the GSEs, building a capital buffer now will help shield the public from bearing the costs of a future housing correction.

## RECONSTITUTE THE CFPB

The Consumer Financial Protection Bureau (CFPB) should be de-politicized. Its role in consumer financial protection is too important. We believe that it should be reconstituted as a commission subject to presidential appointment and Senate consent. We would leave it within, and funded by, the Federal Reserve, subject to the Board of Governors' safety and soundness oversight.

This recommendation might seem to have little to do with "de-politicizing" the agency or with systemic risk. But there is a broader principle to consider: financial regulation, in general, should not be perceived as political or partisan. Without structural reform of the CFPB, that goal seems impossible.

Congress should set policy broadly, stand back, and then provide principled oversight with respect to a politically balanced agency.

## REINSTATE EMERGENCY LENDING POWERS

Most importantly, the Federal Reserve's emergency lending powers should be reinstated, not further limited.

An instinct to protect taxpayers is understandable in the aftermath of the crisis. But it was a risky mistake when Dodd-Frank limited the very power that the Federal Reserve used to rescue AIG. That rescue, perhaps more than any act, staved off worldwide economic disaster. We can hope that there is no next time. But we'll all be safer with a Federal Reserve that has robust tools to protect the global economy if next time comes.

*George W. Madison and Michael E. Borden are partners and William A. Shirley is counsel of Sidley Austin. During the financial crisis, Madison served as general counsel of the U.S. Treasury Department (2009-2012), Borden served as senior counsel of the U.S. House Financial Services Committee (2007-2012), and Shirley served as general counsel of AIG Financial Products Corp. (2007-2011).*

Reprinted with permission from the January 23 edition of the "National Law Journal"© "2017" ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited, contact 877-257-3382 or reprints@alm.com.