AMERICAN BANKER

May 28, 2013

Take a Deep Breath and Think Before Rushing Further Reform

By Greg Wilson

Before Congress and financial regulators act on any new structural reforms or finalize pending Dodd-Frank Act rules, they should pause, call a time-out, and affirm Washington's version of the Hippocratic Oath – "first do no harm."

This pause is more for our economy and the end-users of financial services than it is for the companies that provide those services to their customers.

We need a far better informed public discussion of the role we want and need banks and other financial institutions to play to ensure a vibrant and robust economy that can sustain non-inflationary growth, produce good jobs, and create wealth opportunities for all in our society

Given that large banks are in a much stronger capital and liquidity position than they were before the financial crisis[1] – as Federal Reserve Board Governor Dan Tarullo recently affirmed – we can afford such a time-out on legislation and regulation, and really rethink a winning game plan without harming our economy.

Even as regulators do their best to implement a poorly drafted law, there are new calls for sweeping structural reforms before we understand the full impact. Sen. Bernie Sanders (I-VT) wants to break up big banks directly, while Sen. Sherrod Brown (D-OH) and Sen. David Vitter (R-LA) have teamed up to increase indirect pressure on big banks to break up by imposing growth-inhibiting capital levels and prohibitions on inter-affiliate transactions. The Brown-Vitter bill would go further by crippling the Federal Reserve's historic role as a lender of last resort, which would only further exacerbate the next financial panic. Not only are such proposals potentially detrimental to our economy, but at least Brown-Vitter is dangerous simply because it would handcuff the Federal Reserve in future crises and panics.

If we pursue a break-up strategy through legislation or regulatory fiat, we will be crossing into a great economic unknown. Instead of wasting more time and energy on narrow issues, we instead should answer more basic questions about the best way to ensure a diverse, dynamic, and robust financial system – a smartly regulated system that finances commerce and deploys capital as effectively and efficiently as anywhere on the planet.

What is the optimal way for the financial system to sustain economic growth while maintaining stability? How do we attract and retain capital in this vital sector of our economy?

Who finances international trade, finance, and infrastructure in a global economy, and if U.S. companies are not leaders, then who fills the gaps? What financial companies are best equipped to finance manufacturing, services, agriculture, and what growth-enabling reforms are in order? Who finances innovation and start-ups – risk-takers critical to a vibrant economy? How to we further facilitate risk-based lending to small and midsize businesses? What is the best way to reform housing finance five years after the crisis? How do we ensure a truly responsive financial system that meets the savings, credit, and payment needs of all retail consumers, including the unbanked? And under what terms and conditions are these needs best met, and by whom? These are some of the fundamental questions we need to answer before further major reforms.

If there is any good news today, it is that there is little chance of any new major legislation being enacted into law given our divided government – absent another panic. The bad news, however, is that even narrow proposals can still influence regulators to be even more aggressive in final rules and supervisory actions.

So, what should be done during a time-out? Three actions are required.

First, the industry can do a better job of telling the public the full story of its role in our economy, a point I argued in my most recent book. Financial companies also need to do a much better job of educating policymakers regulators on the impact of new reforms and rules on *their customers and the economy,* not just themselves.

Second, the Financial Stability Oversight Council could play a much more active role, not just in coordinating and prioritizing rules, but in actually stepping back to fully assess their impact on the financial needs of end-users and the collective impact on the growth of the U.S. economy. Gov. Tarullo effectively conceded this point with respect to Basel III and credit availability in his speech.

Third, Congress has a role to play to play as well. At a minimum, the chairmen of the relevant House and Senate committees should jointly agree to focus their oversight for the rest of this session on the broad theme of what role we want banks and other financial institutions to play in our economy, and how best to create the environment to enable growth-oriented finance and capital to flourish under prudent regulatory standards to sustain an economy second to none. Alternatively, Congress could even convene its own Commission, with a 2015 reporting deadline, to get beyond the 2014 elections and rise above pure politics in the near term.

We owe it to ourselves and future generations to launch a larger debate on the role of our financial sector in a modern, globally competitive economy. We need to do this before we arbitrarily jettison or further harm parts of the U.S. financial sector and before we hurt needed economic recovery in other unintended ways, without all the facts and more informed thinking on the table.

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References

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