

Forefront

New Ideas on Economic Policy from the FEDERAL RESERVE BANK
of CLEVELAND

The Future of Financial Market Regulation

INSIDE:

Slowing Speculation in Housing

Introducing the
Cleveland Financial Stress Index

A Bad Bank, for the Greater Good

PLUS:

Interview with Charles Calomiris

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Rules and Regulations: How the Details Take Shape



April McClellan-Copeland,
Community Relations and Education

Last summer, Congress approved the most sweeping reforms to the financial market regulatory system since the Great Depression with the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010. But that was only the beginning. Now come the details—hammering out more than 250 rules among 11 different regulatory agencies (the Federal Reserve itself is responsible for developing more than 50 new rules). Many of the rules are geared toward the same goal—preventing a replay of the financial crisis that crippled the economy from 2007 through 2009.

Most people know the Federal Reserve for its highest-profile job—conducting monetary policy. But it's the Federal Reserve Board's role as a regulatory agency that empowers it to write rules to govern banks and protect consumers' financial transactions. In years past, the Federal Reserve has aimed to protect Americans in their financial dealings by implementing and enforcing laws such as the Truth in Lending Act and the Credit Card Accountability, Responsibility, and Disclosure Act.

Americans have been able to comment on proposed rules and regulations in the federal decision-making process for many years, but the rule-writing phase of the Dodd–Frank implementation provides an unusually significant opportunity for people to weigh in. Consider that the Federal Reserve Act of 1913 was all of 31 pages long; the Dodd–Frank legislation was more than 2,000 pages. The impact of Dodd–Frank is wide and deep. It is safe to say this is the best opportunity for citizens to influence federal regulatory policy in generations.

The Writing of a Regulation

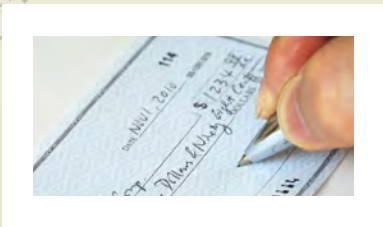
Laws often do not include all of the details needed to explain how an individual, business, state or local government, or nonprofit might follow the law. To make laws practical on a day-to-day basis, Congress authorizes certain government agencies—including the Federal Reserve's Board of Governors—to create regulations.

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New rules under Dodd–Frank will reach nearly every piece of the financial market apparatus. Among the key provisions:

- A Financial Stability Oversight Council, whose members include the Federal Reserve Chairman, Treasury Secretary, and Federal Deposit Insurance Corporation head, to monitor systemic risks

Examples of Past Board of Governors Regulations



Regulation CC

Check Clearing for the 21st Century Act (Check 21)

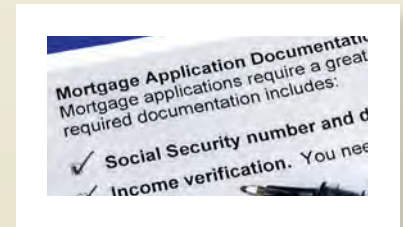
The 2003 Check 21 Act allows banks to process more checks electronically with a new negotiable instrument called a substitute check. If you need to retrieve a record of canceled checks, now you can see copies of check fronts and backs, the legal equivalent to the real thing.



Regulation B

Equal Credit Opportunity Act

Enacted in 2003, this regulation prohibits lenders from discriminating against credit applicants, establishes guidelines for gathering and evaluating credit information, and requires written notification when credit is denied.



Regulation C

Home Mortgage Disclosure Act

As amended in 2002, this regulation provides the public with loan data that can be used to help determine whether financial institutions are serving the housing needs of their communities; assists in identifying possible discriminatory lending patterns; and enforces anti-discrimination statutes.

The Rule-Making Process

PROPOSAL AND NOTICE

- Agency proposes regulation, issues a press release, and lists it in the *Federal Register* as an advance notice of proposed rulemaking, which invites the public to participate in the rulemaking process.
- Agency sends proposed regulation to the Office of Management and Budget (OMB) for approval.

PUBLIC COMMENT

- Public has a comment period (usually 30 to 90 days), during which time written comments either supporting or opposing the proposed regulation or ideas for changes can be submitted at www.regulations.gov or through specific regulatory agencies.
 - Comments can be simple or contain detailed arguments.
 - Anyone—from professional lobbying groups to organized interest groups to individuals—can submit comments on a proposed rule.
- Recent research finds evidence that public input influences policy content, especially when the public is involved in the early stages, though there are conflicting opinions about the role that public feedback plays during rulemaking.

What's the Difference Between a Law and a Regulation?

Law: a rule of conduct or procedure established by custom, agreement, or authority; once approved by Congress and the president, a new law is called an *act*

Regulation: specific requirements issued by governmental agencies about what is legal and what is not

Rule-making: the process by which regulations are developed

- Enhanced standards for all large bank holding companies—those with greater than \$50 billion in assets—as well as certain nonbank financial firms (insurers such as AIG, for example)
- Greater transparency to the over-the-counter derivatives market; derivatives include vehicles such as credit default swaps, a sort of insurance that was blamed for the buildup of risk that led to the financial crisis
- A Consumer Financial Protection Bureau, funded by the Federal Reserve but operating independently, to administer consumer financial protection laws

And that's just for starters. Other elements will reform the regulation of credit rating agencies and require registration by hedge fund managers with the Securities and Exchange Commission.

The rule-writing phase of Dodd–Frank began in earnest early last fall. By the end of 2010, the Federal Reserve, sometimes jointly with other agencies, had already opened comments for seven proposals and initiated studies on several others. A study of the proposed Volcker Rule, for example, was launched with the Financial Stability Oversight Council to learn more about the impact of limiting the amount of proprietary trading—essentially, playing the market with their own money—that banks can do. In late December, the Board asked for comments on a rule to establish new standards on debit card interchange fees, trying to ensure that debit card transactions are reasonable and proportional to their costs. ■

GOVERNMENT OVERSIGHT

- OMB reviews the proposed regulation and the analysis supporting it and makes sure the proposal fits with current administrative policy. In the majority of cases, OMB approves the regulation as is.
- The OMB review has historically been a confidential process, though the level of confidentiality changes with each administration.
- In recent years, special interest groups have sprung up to promote open government, accountability, and citizen participation.

FINAL RULE

The agency considers all the comments, revises the regulation accordingly, and issues a final rule, which is published in the *Federal Register*.

AMENDMENTS

- Agency proposes changes to the final rule, based on a new law or review of the regulation.
- Changes are offered for public comment.
- Final amendments are approved by the agency and published in the *Federal Register*.
- If there are unusual circumstances, an agency may instead issue an interim final rule.

Resources



For updates on regulatory reform progress, the Federal Reserve provides a number of resources, including

The Federal Reserve Board's "Regulatory Reform" news webpage at www.federalreserve.gov/newsevents/reform.htm

The Federal Reserve Board's Freedom of Information Office at www.federalreserve.gov or www.regulations.gov, where you can view or comment on a proposed rule

The Federal Bank of St. Louis' "Dodd–Frank Regulatory Reform Rules" webpage at www.stlouisfed.org/regreformrules