WASHINGTON — President Obama’s signing of regulatory reform legislation Wednesday signaled the official end of a hard-fought legislative battle but just the beginning of the tougher task of implementing the new law.

By some estimates, federal regulators must complete 243 rules, largely during the next two years, along with 67 one-time reports or studies and 22 periodic reports.

Beyond a daunting breadth of new rules to write, regulators must flesh out the details of a host of highly complex requirements in the law with little or no guidance from Congress.

“The amount of work that the regulators are going to have to undertake under this legislation is nothing short of breathtaking,” said Charles Horn, a partner at Mayer Brown specializing in financial services regulation. “It isn’t just a question of the sheer number of studies, regulatory implementation requirements and things like that they have to comply with, but it is also the fact that the legislation in so many areas is, frankly, deliberately vague and does not really create a lot of substantive, quantitative support. … This is going to be close to an unprecedented challenge for the regulatory bodies in general.”

Far from settling long-standing disputes over controversial issues, observers said, the law will ultimately spark new ones.

“There is just a ton of work to be done on the implementation side,” said Anthony Plath, an associate professor of finance at Belk College of Business of the University of North Carolina, Charlotte. “The bureaucratic infighting and turf wars and political battles that are going to go on is just going to be a nightmare.”

Some tasks will be more difficult than others. In interviews with former regulators, academics, analysts and banking lawyers, general agreement emerged on the toughest challenges: creating a council to detect systemic risks, crafting capital and liquidity standards, building a consumer financial protection bureau, enforcing a ban on proprietary trading and setting standards for derivatives.

**FINANCIAL STABILITY**

With the president’s signature on the bill, the Financial Stability Oversight Council — comprising 15 members, 10 with voting rights — is now officially established and given the general task of identifying emerging threats and heading them off.

Creating the council is the easy part, but making it functional is likely to be a Herculean task.

Headed by the Treasury secretary, the council includes the heads of eight other agencies with oversight of the financial sector and an additional person designated by the president as an expert on insurance regulation.

The council must meet within 90 days and at least every quarter thereafter. Most of its actions will require a simple majority to authorize, but some special decisions, including whether to break up a financial company, would require a two-thirds majority, including the Treasury secretary.
The Top 5 Implementation Challenges of Reg Reform

Many observers said the agencies will bring with them competing, sometimes conflicting, agendas that may make finding consensus on major issues close to impossible.

“Ensuring cooperation among 15 members, including nine federal agencies — each with its own institutional culture, methodologies, outlook and priorities — will require an expansive framework of new procedures and protocols, and a tremendous amount of effort and good faith among regulatory colleagues,” said John Dearie, the executive vice president of the Financial Services Forum.

Then there is the question of whether the council can even accomplish its mission. Many questioned what criteria regulators will use to define a systemic threat and to identify institutions that pose a risk to the economy. The statute directs the council to consider assets, leverage, size, liabilities and interconnectedness, but it will be up to the council to figure out how to quantify such factors.

“It’s so complicated because there is no answer,” said Mark Zandi, the chief economist and co-founder of Moody’s Economy.com. “No one really knows. First of all, how do you define ‘systemic risk,’ then how do you measure it and then how do you respond to it? Conceptually, everyone’s on board, it’s just the practicality of actually addressing it, is incredibly difficult.”

The law does offer some clues. As of Wednesday, any bank holding company with at least $50 billion of assets is automatically deemed systemically significant and will be subject to heightened prudential standards to be designed and adopted by the Federal Reserve Board. Meanwhile, the council may also identify nonbanks as systemically significant, but it has more latitude on which ones it designates. Figuring out which nonbanks should be considered systemically risky will be tough, however, observers said.

“I don’t think anybody has a clue,” said Ernest Patrikis, a lawyer at White & Case LLP.

CAPITAL AND LEVERAGE

Though the law would require the Fed to impose tougher risk-based capital and leverage requirements, it is unspecific about how this should be done.

Only one thing is clear: The central bank must act quickly. Since the law explicitly says that all systemically important banks are subject to the to-be-written regulations, some said the Fed must put something in place fast.

“That is going to be a major priority,” said Richard Spillenkothen, a former director of banking supervision at the Fed, who is now a director in Deloitte & Touche LLP’s regulatory and capital markets consulting practice.

Spillenkothen acknowledged that a framework for developing these standards is already begun through the Basel Committee on Banking Supervision. But this process, which involves coordination among multiple international regulators, could take years to be completed. The Fed will probably have to move before then.

“Capital and liquidity are being discussed internationally already,” Spillenkothen said. “Some of these things are in various degrees of discussions and are already underway, but there is a whole raft of additional regulation to be put in place.”

CONSUMER PROTECTION

As he signed the bill President Obama cited the creation of a consumer financial protection bureau as one of the law’s key accomplishments.

“These reforms represent the strongest consumer financial protections in history,” he said. “And these protections will be enforced by a new consumer watchdog with just one job: looking out for people — not big banks, not lenders, not investment houses — in the financial system.”

Getting the agency up and running will be difficult. It is expected to take its staff from the existing federal banking agencies — but how many and how soon is unclear. The most important decision will be who leads the agency, observers agreed.

“The key to it being a successful entity in the relative short term is going to be to appoint leadership that is able to work with the administration, Congress, consumer interests, the industry and the other regulatory agencies,” said Andrew Sandler, a partner at Buckley Sandler LLP. “Starting this agency is going to be a very difficult job, and having somebody who has credibility with all of the various constituencies is going to be critically important.”

Consumer groups and prominent Democrats are urging the Obama administration to tap Elizabeth Warren, the Harvard law professor who first advocated a consumer agency, as its first director. But Obama may also name Michael Barr, the Treasury assistant secretary for financial institutions, who before going to the Treasury was a noted consumer advocate.

The Treasury secretary is to run the bureau on an interim basis until a director is confirmed. The agency said this week that its first focus is on the logistics of staffing, personnel transfers, salaries, information technology infrastructure and obtaining a physical site for the bureau and its dozen satellite offices.

Whoever gets the job will have their work cut out for them. Within a year, the bureau must harmonize the Truth-in-Lending Act with the Real Estate and Settlement Procedures Act, two massive laws that
at times conflict on proper disclosures to consumers. It also gains oversight of a host of other existing statutes, including the Home Mortgage Disclosure Act and recent credit card reforms.

Within six months, the bureau’s director must detail additional areas of jurisdiction.

The bureau is also empowered to promulgate mortgage underwriting standards that ban abusive loan terms and require the borrower to show an ability to repay.

“The challenges are immense with respect to the new consumer protection bureau,” said Alan Kaplinsky, chairman of the consumer financial services group at Ballard Spahr LLP. “If it is someone like Elizabeth Warren, I would anticipate a very ambitious program to adopt new regulations under the new authority that Congress has given the director, namely, to proscribe unfair and deceptive or abusive practices. Those terms are so vague and so broad … that the new director essentially, with virtually no limitations at all, could decide that certain products or financial services are no longer offered to consumers.”

**VOLCKER RULE**

The financial stability oversight council will have to spend up to six months studying how to enforce the Volcker Rule, which generally bans banks from doing proprietary trading or investing in hedge funds and private-equity funds.

But deciding what constitutes proprietary trading will be no simple feat, observers said, because the definition must distinguish between trading aimed at enrichment, which is banned, and that in which profit is incidental, which is allowed. During hearings on the issue this year, regulators struggled with a definition, ultimately embracing a “you-know-it-when-you-see-it” description. But in rulemaking, this kind of broad definition will not work.

Regulators must specify trades allowable to hedge a bank’s risk, as well as ways to legitimize the selling and securitizing of loans and other market-making activities.

Defining the terms limiting investments in hedge funds and private-equity funds will also be tricky. Under the statute, banks may sponsor hedge funds and private-equity funds for permitted seed investments, minor investments up to a 3% stake. They may also invest in such funds if regulators determine it is immaterial to the banking company, so long as total investments do not exceed 3% of the bank’s Tier 1 capital.

Michael Wiseman, a managing partner of Sullivan & Cromwell’s financial institutions group, said one core challenge for regulators will be to interpret the statute to determine what kinds of investments are permissible under the Volcker Rule. “There are [a] number of very difficult interpretational issues in the statute that they are going to have to come to grips with — the Volcker Rule provisions dealing with funds are going to be quite complicated to figure out … in general, as to what kinds of investments are covered and not covered,” he said.

**DERIVATIVES**

The Commodity Futures Trading Commission and the Securities and Exchange Commission will be tasked with expanding on several details to carry out the derivatives regulations in the new law.

Essentially, the derivatives section of the bill requires most swaps to be cleared and traded on an exchange but leaves it up to regulators to determine what kinds of derivatives are exempt. Though commercial end-users are generally exempted, regulators are given wide discretion to determine who qualifies for exemption.

“So much of the derivatives section is ultimately going to be based on rulemaking done by the SEC and CFTC,” said Michael Greenberger, a law professor at the University of Maryland and a former CFTC director. “There is a lot in the derivatives section that needs to be fleshed out more specifically.”

He said deciding what transactions must be cleared will be crucial. “The CFTC has to make a decision of what types of transactions will be subject to clearing,” Greenberger said. “The SEC will have to make the same kinds of determinations for securities-based swaps. That’s going to be a very important determination.”

Regulators are also left with the tricky task of implementing a push-out rule written by Sen. Blanche Lincoln, D-Ark. The law lets banks still engage in most swap activities within the bank, including those related to rates, currencies and investment-grade credit default swaps, as well as any activity to hedge its own risk.

But banks must push out into a separately capitalized affiliate for agricultural, energy and uncleared commodities, and most metals.

Most of the derivatives rules are required to be adopted within a year of the law’s enactment. The Lincoln push-out divestiture rules begin to take effect three years after the rules are issued, with a two-year phase-in that may be extended for a year.

Observers said the simultaneous rulemakings and overlapping jurisdictions are bound to complicate things.

“It isn’t going to be easy,” said Daniel Crowley, a partner at K&L Gates. “It’s going to be a constant give and take, and as the proposed rules start coming out and the people in the regulated industry start looking at the fact that there may be divergent approaches taken by the regulators, the first thing they are going to do is run back to the Hill and say, ‘Hey we need to fix this.’”

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