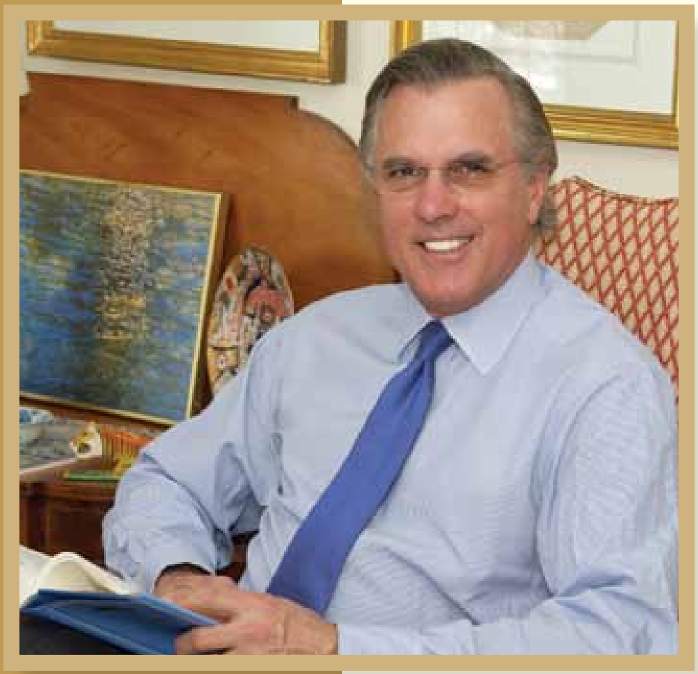
President's Perspective



The Dodd–Frank Wall Street Reform and Consumer Protection Act—one of the most significant responses to the financial crisis—was signed into law a little more than a year ago. The act establishes a new regulatory infrastructure for promoting financial stability.

Dodd–Frank mostly provides high-level direction, leaving critical decisionmaking and a number of details to regulatory discretion. Many of its most prominent features, including the Financial Stability Oversight Council and new Federal Reserve responsibilities overseeing some nonbank financial companies, are explained in greater detail by Dallas Fed Executive Vice President Robert D. (Bob) Hankins in the "On the Record" feature in this issue of *Southwest Economy*.

A primary purpose of Dodd–Frank is ending "too big to fail." During the recent financial crisis, when smaller banks got into deep trouble, regulators generally took them over. Failing big banks, however, were allowed to lumber on with government support, despite extensive fallout. Big banks that gambled and generated unsustainable losses received a huge public benefit: too-big-to-fail support.

If we have not eradicated too big to fail from our financial infrastructure with the myriad rules and regulations we are writing and implementing, financial reform and stability will have eluded us yet again.

As a result, the most imprudent lenders and investors were protected from the consequences of their decisions. This strikes me as counter to the very essence of competition that is the hallmark of American capitalism. In crafting Dodd–Frank mandates, we need to restore market discipline in banking and let the market mete out its own brand of justice for excessive risk taking, rather than prolong the injustice of too big to fail.

We still have work to do. The top 10 banking institutions now account for 65 percent of banking assets, substantially more than the 26 percent of 10 years ago. When it comes to these largest institutions, we must apply Dodd–Frank extensively and vigorously. If we have not eradicated too big to fail from our financial infrastructure with the myriad rules and regulations we are writing and implementing, financial reform and stability will have eluded us yet again.

I trust regulators will rise to the challenges posed by the financial crisis and too big to fail. By doing so, we will leave a legacy of success and functional infrastructure for next-generation supervision and regulation.

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