Dissecting the Dodd-Frank Act of 2010: Peering through the Lens of Economic Principles and Constitutional Precepts

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The recent passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) compels us to look at its backdrop. The genesis of the financial debacle can be understood broadly in the ex-ante inability to predict the calamitous impact of interconnected chain of fragile short-term debts being hit by a common shock. The intended goal of the DFA is to act as bulwark against such future disruption of intermediation in households and corporations caused by widespread security devaluation. Therefore, the efficacy of the Act is better understood if viewed from the framework of underlying economic principles that have been put under stress ex-post the financial meltdown and to explore whether the Act addresses those concerns. The creation of both the Consumer Financial Protection Bureau and the Financial Stability Oversight Council, in addition, has raised constitutional questions in some parlance as to whether the broad regulatory power bestowed upon the agencies is discordant with the Constitution's Plenary Power doctrine. Against this backdrop, this article proceeds on two predominant threads in order to shed light on this newly enacted legislation.

In the first segment of the article, I intend to evaluate how the legislative goals of the Act deals with the broader economic principles related to the financial meltdown. First, to deal with the time consistency dilemma associated with ambiguous implicit guarantees of the federal government, broadly seen as contributing to the meltdown, the Act attempts to broaden the future ambit of the federal safety net. While the specific requirements from the broader legislative goals are yet to be fleshed out in the form of rules and regulations, it appears that, the Act might make it discriminatory among the broader participants of the financial market, eventually paving the way for consolidation among the financial intermediaries. Second, the legislative intent of the Act remains incapable to attenuate the moral hazard dilemma posed by banks that are "too big to fail," by neglecting to make adequate reference to the specific issues in question. Given that the relationship between constructive ambiguity and rational expectation will continue to animate the interconnectedness amongst banks, the lack of specificity leaves open the possibility of further disastrous meltdowns.

In the second segment of this article, I intend to illuminate some of the legal implications of the Act as it ushers into the post-enactment process that requires developing rules and regulations. First, looking at the federal rule-making process, which is governed by the Administrative Procedures Act (APA), punctuated with public participation and at times, reshaped by judicial review of rules and regulations. If and when the judiciary is called upon to review and scrutinize rules, they will do so through the twin lenses of constitutional framework and economic cost-benefit analysis. While the economic cost-benefit analysis can proceed along multiple complex threads, from how to assign value of a credit default swap on company books to procedural steps to disclose contingent liabilities for an interconnected financial intermediary, the constitutional issue at hand is rather straight forward. The form and function of the Consumer Financial Protection Bureau is to be reviewed once all the governing rules are promulgated. An analysis of the form's structural insularity with respect to the Congressional control will allow us to assess whether its formation gives rise to conflict with the U.S. Constitution.

Finally, the Act follows the familiar trap, seen before in the enactment of Sarbanes-Oxley Act of 2002, as it attempts to regulate via form rather than function, an issue I have explored elsewhere. It is not clear yet, however, whether the focus on form can adequately empower legislature to competently instruct agencies how to regulate areas of finance that can experience continuous change. While the full impact of the Act is difficult to fully comprehend at this time, it is debatable whether rules can be written robust enough to fully capture the changing dynamics associated with structured investment vehicles, or whether rules can adequately prevent socially excessive risk taking by financial intermediaries, something we will have to wait and see when the actual rules are developed next year.