Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Will Revising Dodd-Frank Send the Markets Souring?

By Mitch Zacks
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It has been nearly seven years since Dodd-Frank was signed into law, but some of the rules *still* haven't been finalized and implemented. Whatever your view about the necessity for the regulations and the need for placing a tighter belt around Wall Street, there is something wildly inefficient about taking seven years to implement rules. The confusion and complexity of the entire process has arguably been more detrimental to banks and financial institutions than the rules themselves.

Consider this fact as relayed from the Banking Compliance Index: since January 2013, banks and credit unions alone have dealt with 1207 new rules spanning 53,486 pages in the Federal Register. Read that again: 53,486 pages of rules! Now imagine trying to run your business, but then having a government agency hand you a 50,000-page rule book. "Frustrating" would not be an adequate way to describe the difficulty of doing business. It's beyond that.

I am not arguing that all of the regulations were/are bad – in fact, many were needed. Excesses and leverage at the world's biggest banks exacerbated the 2008 Financial Crisis and destroyed millions of jobs. There were some risk-taking practices that needed fixing. But it's the uncertainty and complexity of the rules that I (and the Financials sector) don't like. The CEO of J.P. Morgan, Jamie Dimon, said in an interview with *Bloomberg* that the most difficult feature of the rules weren't the rules themselves, but the lack of synchronicity and coordination amongst agencies and enforcement authorities.

Where Dodd-Frank Should Go from Here

Again, I would not argue that Dodd-Frank should be wholly removed. But I think the best we can hope for is a thorough analysis for understanding what rules worked effectively, keep those, and then consider removing the rules that aren't working and that are inhibiting fundamental bank functions, like lending. For example, at J.P. Morgan they have over $30 billion in capital reserves that Dimon refers to as "permanently idle capital," because not only can the bank not lend or invest that money – they can't do anything with it.

Such is the case for about $2.5 trillion in excess reserves parked at banks today. Some statutes in Dodd-Frank require banks to maintain certain capital ratios – which is important – but it is arguably a bit overreaching. Perhaps a modification is in order to loosen controls over how banks use their liquidity and capital. Many banks surveyed say that reducing such requirements would encourage them to lend more, which is one of the basic engines of economic growth.

There is a long road ahead. Legislative action is required to overturn laws, so even if Congress was fully committed and unified for deregulation and reform, it must take the slow and arduous path to tweaking the law. So far, Congress's ability to accomplish such a feat has been less than convincing. There was not even a vote on the American Healthcare Act. And, given the administration's higher priorities of tax reform and immigration, it is likely wishful thinking to assume that change will come fast.

Bottom Line for Investors

The bottom line is that *any* change that lightens the load or at least streamlines the rulebook will help, in my view. President Trump has vowed to reduce the inhibiting effects of Dodd-Frank but also wants to keep what's necessary. It's rhetoric like any other campaign promise, but Trump's business-mindedness is likely to keep Dodd-Frank high on the priority list.

No one is holding their breath, but if the administration and Congress manage to slip-through some deregulation and much needed reform, it could be a boon for banks and the economy, via increased lending and some additional risk-taking at the margin. Finding a middle ground will be the key, even if it takes years to locate.

-**Mitch**

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.