

As Regulatory Reform Push Continues, Federal Reserve Vice Chair for Supervision Randal Quarles Sets Out His Guiding Principles

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Federal Reserve Vice Chair for Supervision Randal Quarles recently [sought to answer](#) the question that he has been asked most frequently since assuming his post three months ago: What's next? He expressed his support for the reforms that have made the financial system stronger and more resilient since the Financial Crisis. At the same time, Vice Chair Quarles pointed out that, now that most post-crisis regulation is in place, it is "an eminently natural and expected time to step back and assess" the reforms that have been made. In his view, that effort should be guided by the three principles of transparency, efficiency and simplicity. This blog post—the first in a series of several posts on Vice Chair Quarles' short but wide-ranging speech—explores those guiding principles.

Transparency. Vice Chair Quarles has urged greater transparency in regulatory matters before, noting in an interview with Greg Baer of The Clearing House that transparency is a fundamental part of the "relationship between the government and the governed." We read the focus on transparency as an allusion to the advance public notice and comment required by the Administrative Procedure Act as well as a sense of fundamental fairness. This most recent speech also brings to mind Vice Chair Quarles' [analogy](#) comparing insufficient regulatory transparency to a refusal by state troopers to post speed limit signs. We hope there is a link between more transparency and the Vice Chair's previously announced agenda to rethink confidential supervision as well as regulation. The Vice Chair, as well as other Federal Reserve staff, have begun to make it clear that transparency also means that guidance and regulations are improved by exposure to outside perspectives.

Efficiency. As rightly suggested by Vice Chair Quarles, some financial regulations, while well-intentioned, have created unintended adverse consequences and perverse incentives. To address these instances of poorly calibrated regulation, Vice Chair Quarles intends to focus the Federal Reserve on the degree to which the benefit of a regulation may be outweighed by its net costs, such as reduced economic growth or increased friction in the financial system. The Federal Reserve has recently demonstrated its commitment to cost-benefit analysis by [making hires](#) for a new office intended to analyze the economic costs and benefits of its regulations. Vice Chair Quarles' speech is an indication that a deeper focus on costs and benefits, whether seen in the traditional cost-benefit mode or otherwise, is a serious effort. This cost-benefit focus is also consistent with President Trump's [core principles](#) for regulating the U.S. financial system and the reports on [banks and credit unions](#) and on [capital markets](#) released by the Treasury Department in response to those core principles, each of which recommended enhanced use of regulatory cost-benefit analysis. There is no doubt that cost-benefit analysis is trickier in the financial sector than in, for example, industrial products. Nonetheless, other countries, such as the UK, have managed to engage in a reasonable cost benefit analysis in the financial sector and, as noted in the Vice Chair's speech, while it is difficult to know precisely the "socially optimal number of loss absorbency requirements for large banking firms," we can be "reasonably certain that 24 is too many."

Simplicity. Transparency and efficiency have been much discussed in the administrative and regulatory literature. The concept of simplicity in financial regulation is innovative in the post financial crisis context and makes a great deal of sense. Vice Chair Quarles' comments were that simplicity has the potential to promote public understanding of regulation, encourage meaningful compliance by the industry with regulation, and reduce unexpected negative synergies among regulations. Many have called out the implementing regulations of the [Volcker Rule](#) as too complex; somehow, in

the interagency drafting of this regulation, complexity trumped common sense. Capital regulation is another example, as Andrew Haldane has so aptly pointed out with his analogy of [the dog and the Frisbee](#). The concluding comments from Haldane's speech are worth quoting here:

Modern finance is complex, perhaps too complex. Regulation of modern finance is complex, almost certainly too complex. That configuration spells trouble. As you do not fight fire with fire, you do not fight complexity with complexity. Because complexity generates uncertainty, not risk, it requires a regulatory response grounded in simplicity, not complexity. Delivering that would require an about-turn from the regulatory community from the path followed for the better part of the past 50 years.

Kudos to Vice Chair Quarles for introducing this concept into public discussion in the U.S. regulatory arena. We can do better by keeping a principle of simplicity in mind.

We will explore in more depth how Vice Chair Quarles envisions his guiding principles being applied to specific topics in our forthcoming blog posts.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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