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Unhappy Anniversary: Dodd–Frank Hits the Terrible Twos

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This week marks the second anniversary of the Dodd–Frank Wall Street Reform and Consumer Protection Act. There is nothing to celebrate. With every new rule concocted by one of the 11 federal agencies involved, the flaws of the statute and its injurious costs to consumers have become glaringly, painfully apparent. Congress should devote Year Three of Dodd–Frank to remedies.

The act is all too characteristic of "crisis" legislation—devoid of reasoned analysis and thoughtful consideration. In ways both big and small, Congress has grossly misdiagnosed the factors responsible for the financial crisis while ignoring primary culprits such as Fannie Mae and Freddie Mac. It is urgent that lawmakers reverse the grave mistake that is Dodd–Frank so that a year from now, Americans are celebrating its demise rather than lamenting its anniversary.

Uncertainty Reigns. Coming in at some 2,300 pages, Dodd–Frank presented a challenge to implement within the statutory deadlines: at least 400 separate rulemakings affecting virtually the entire financial sector. As of July 2, 63 percent of the deadlines have been missed,[1] which has intensified the cloud of uncertainty enveloping the finance sector—and the economy—since passage of the act. Thousands of businesses do not know what the government demands they do differently or when they must do it. With financial firms constrained by undue caution, consumers will experience tight credit, higher fees, and fewer service innovations. Job creation will suffer.

The proposed and final rules issued in the past 12 months reveal the alarming extent to which the federal government is seizing control of financial services—from individual checking accounts to the $300 trillion "swaps"[2] market. As a result, financial firms of all sizes are shelling out hundreds of millions of dollars for regulatory compliance officers and attorneys rather than making loans for new homes and businesses.

Just last month, Moody's Investors Service cut the ratings of 15 of the world's biggest banks, in part because of looming regulatory burdens.[3] Community bankers, meanwhile, are restraining growth to remain below the asset threshold at which the more stringent Dodd–Frank rules kick in.[4] And consumers are paying more for financial services: The number of large banks that offer free checking has declined from 96 percent in 2009 to 34.6 percent in 2011.[5]

The Worst of the Worst. Many of the Dodd–Frank provisions are excessive and wholly unrelated to the financial crisis that provided the excuse for their creation. But some are far worse than others, including:

- **Unchecked authority of the Consumer Financial Protection Bureau (CFPB).** Unparalleled powers were granted to the CFPB, including consolidated and expanded regulatory authority over credit and debit cards, mortgages, student loans, savings and checking accounts, and most every other consumer financial product and service. Because the statute sets bureau funding as a fixed proportion of

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the Federal Reserve's budget, it is not subject to congressional control. Moreover, its status within the Fed effectively precludes presidential oversight.

- **Orderly Liquidation Authority.** Dodd–Frank expands government authority to seize control of firms that regulators designate as failing. Unlike bankruptcy, the process is not directly supervised by a court, and it allows only very limited judicial review, thereby inviting abuse and possibly violating constitutional protections against the taking of private property.

- **The Volcker Rule.** As proposed, this rule would effectively bar banks from investing their own funds, in most cases. Lower earnings will undoubtedly increase service fees paid by consumers. The regulation remains in flux—exacerbating the regulatory uncertainty—in large part because Congress was so vague on the particulars and regulators are unfamiliar with the complex derivatives market.

- **The Durbin Amendment.** Dodd–Frank empowered the Federal Reserve to regulate the fees that financial institutions may charge retailers for processing debit card purchases. The statute calls for such "interchange" fees to be "reasonable" and "proportional" to the cost of processing debit card transactions—both rather arbitrary measures. The loss of revenue from price controls on debit-card processing is prompting financial institutions to hike fees on a variety of other credit instruments. Consumers are also likely to face higher interest rates and reduced credit options.

- **Qualified mortgage rules.** Under Dodd–Frank, the portion of a mortgage loan that a lender can securitize is limited unless the mortgage is "qualified," i.e., deemed to be low risk. In setting this standard, regulators have severely limited the mortgages that would meet the criteria for "qualified." The result: Home loans will be costlier and harder to obtain, particularly for moderate-income borrowers.

The status quo is indefensible, and Dodd–Frank should be repealed in its entirety. Congress should also ease regulations that undermine home sales, eliminate barriers to investment, and increase accountability in the rulemaking process.

Imprudent Delegation. The volume of regulation, while crushing, is only part of the problem. Reflecting utter confusion among lawmakers about the causes of the 2008 financial crisis, Dodd–Frank is largely composed of vague and imperious sentiments rather than explicit regulatory instruction. More than half of the regulatory provisions in Dodd–Frank appear to be discretionary in nature, stating that agencies "may" issue rules or shall issue rules as they "determine are necessary and appropriate."[6]

For example, lawmakers left it up to the new Financial Stability Oversight Council whether and when to impose more stringent regulation of financial activities, providing very little guidance on how to make this decision or what rules should be imposed. Congress has delegated decision making to the bureaucrats.

What Should Be Done. The statute is too flawed to be salvaged and should be repealed. But until repeal is possible, there are several interim steps that could improve matters, including:

- Require independent cost-benefit analysis for all Dodd–Frank rules and disallow any regulation for which costs are not commensurate with benefits,

- Suspend the July 2014 conformance deadline for the Volcker Rule and submit the proposed regulations to Congress for examination and reform,

1. DavisPolk, "Dodd–Frank Progress Report," July 2012, http://www.davispolk.com/files/Publication/8bc2b1c4-c800-45b1-8324-0381454f6ceb/Presentation/PublicationAttachment/b9462d4e-0be9-4eee-9829-0455bca61e9a/July2012_Dodd.Frank.Progress.Report.pdf (accessed July 17, 2012).
2. A swap is an exchange between parties of streams of payments to offset other investment risks.
3. Robin Sidel and Aaron Lucchetti, "Ratings Cut for Giant Banks," *The Wall Street Journal*, June 22, 2012, http://online.wsj.com/article/SB10001424052702304441404577480751440488004.html (accessed July 17, 2012).
4. Matthias Rieker, "Growing Up Looks Scary to Some Banks," *The Wall Street Journal*, February 22, 2012, http://blogs.wsj.com/deals/2012/02/22/growing-up-looks-scary-to-some-banks/ (accessed July 17, 2012).
5. Maria Aspan, "Free Checking Thrives at Smaller Banks, Durbin Notwithstanding," *American Banker*, August 29, 2011, http://www.americanbanker.com/issues/176_168/free-checking-durbin-debit-interchange-1041641-1.html?zkPrintable=1&nopagination=1 (accessed July 17, 2012).
6. Curtis W. Copeland, "Rulemaking Requirements and Authorities in the Dodd–Frank Wall Street Reform and Consumer Protection Act," Congressional Research Service *Report for Congress*, November 3, 2010, http://www.llsdc.org/attachments/files/255/CRS-R41472.pdf (accessed July 17, 2012).

- Exempt interest rate swaps and foreign exchange swaps from Dodd–Frank regulation,
- Eliminate automatic Federal Reserve funding of the CFPB and subject the bureau to the congressional appropriations process, and
- Replace the regulatory "orderly liquidation authority" with a judicial bankruptcy process tailored to the financial industry.

Anathema to a Dynamic Economy. By excessively delegating their lawmaking powers to risk-averse regulators, Congress has ensured that the finance sector will be unduly constrained—which is anathema to a dynamic economy. Without bold reform, consumers and businesses will lack ready and affordable access to financial services. Without consumer and business investment, the economy will continue to sputter. And rather than having suffered financial uncertainty of limited duration, America will face protracted economic malaise that will limit the opportunities that have long made the nation so exceptional.

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