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Dodd–Frank at Year Three: Onerous and Costly

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This Sunday, July 21, will mark the third anniversary of Dodd–Frank, Washington's massive regulatory response to the housing market collapse, the failure of major financial firms, and the resulting shock to the economy in 2008.

Although three years in, the full effects of Dodd–Frank have yet to hit. Some of the most significant regulations are still winding their way through the bureaucracy. Dozens of rulemakings have been completed, but a backlog of hundreds more is prolonging regulatory uncertainty and inhibiting economic growth. Consumers are facing dramatically higher banking fees and fewer service options because of new government constraints on credit. And for all its vast regulatory scope, Dodd–Frank utterly fails to address some of the principal causes of the 2008 crisis.

All of which is the predictable result of policymakers' deeply flawed diagnosis of the financial crisis.[1]

Regulations and Their Costs. Virtually no aspect of the financial system remains untouched by Dodd–Frank, including checking accounts, credit cards, mortgages, education loans, retirement accounts, insurance, and all manner of securities. The enormity and complexity of this regulatory hijacking is reflected in the inability of agencies to meet statutory deadlines for implementing the law. As of July 1, nearly 63 percent of the rulemaking deadlines have been missed.[2] Preliminary proposals have not been prepared for more than one-third of the rules still outstanding.[3]

Dodd–Frank's onerous regulatory demands are driving up banking fees, and regulatory uncertainty is prompting banks to be cautious about extending credit. The House Financial Services Committee estimated that the Dodd–Frank regime would impose at least $27 billion in new assessments on financial firms and require more than 2.2 million annual labor hours—the equivalent of 56,516 work weeks—to comply with *just the first 10 percent of rules* issued.[4]

Consider the effect on checking accounts, for example. Only 39 percent of banks in 2012 offered a checking account with no minimum balance requirement and no monthly fee, compared to 45 percent in 2011 and 76 percent in 2009.[5] Meanwhile, the minimum account balance needed to avoid a monthly fee has nearly doubled in the past two years, to $6,118.

The Volcker Rule. The Volcker Rule[6] would generally ban proprietary trading—i.e., transactions in which banks make investments using federally insured deposits and other funds. It would also cap banks' total investments in hedge funds and private-equity funds. Ratings agency Standard & Poor's estimated the rule could collectively cost the 10 largest U.S. banks as much as $10 billion annually.[7] In essence, the rule resurrects some of the

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Depression-era constraints imposed by Congress under the Glass–Steagall Act—prohibitions that actually prompted banks to service riskier borrowers in order to stay in business. That increased risk was a major factor in the 1999 repeal of the law.

As if designed to actually thwart rulemaking, a 298-page rudimentary proposal for the Volcker Rule was issued jointly more than 20 months ago by the Office of the Comptroller of the Currency, the Federal Reserve, the Federal Deposit Insurance Corporation, and the Securities and Exchange Commission. Some 19,000 comments flooded the agencies—including submissions expressing concern from Canada, Japan, the United Kingdom, and the European Union. Disputes between the agencies themselves over several key provisions remain unresolved.

A variety of experts[8] warn that the Volcker Rule would limit the amount of money available for investment worldwide—exacerbating the painfully limp recovery from the 2008 crisis. For the time being, the financial institutions that would be affected by the rule are relegated to regulatory limbo, unable to plan for the future with any confidence.

Swaps Regulations. Regulators also are bogged down in trying to fashion swaps regulations. Just the government's definition of swap runs 160 pages (with 1,448 footnotes). The Commodity Futures Trading Commission has issued more than 1,979 pages of new swap rules that entail nearly 4,000 distinct tasks for swap dealers and market participants.

The CFPB. Of enormous consequence is the Consumer Financial Protection Bureau (CFPB), which is imbued by Dodd–Frank with unparalleled powers over virtually every consumer financial product and service.[9]

Although lacking a properly confirmed director (until this week), the CFPB has been fully engaged in restructuring the mortgage market; devising restrictions on credit bureaus, education loans, overdraft policies, payday lenders, credit card plans, and prepaid cards; and amassing an Orwell-worthy database on all manner of consumer spending. The Government Accountability Office is preparing to investigate the data grab.

In coming months, the bureau is expected to finalize its reformulation of mortgage disclosure requirements. It is also expected to issue final guidance for its "ability-to-repay" regime, under which the lender—not the borrower—can be blamed for a loan default and sued by homeowners if they cannot make their payments and face foreclosure.

Fannie Mae and Freddie Mac. Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs) that hold nearly 90 percent of the mortgage market, remain in conservatorship.[10] A

1. See Peter J. Wallison, *Bad History, Worse Policy: How a False Narrative about the Financial Crisis Led to the Dodd-Frank Act* (Washington, DC: AEI Press, 2013).
2. DavisPolk, "Dodd–Frank Progress Report," July 2013, http://www.davispolk.com/files/Publication/093bb6dd-6d24-4efb-a9fb-58b92085e252/Presentation/PublicationAttachment/974c57ea-eac4-4cc6-ae90-5d50991ca308/Jul2013_Dodd.Frank.Progress.Report.pdf (accessed July 18, 2013).
3. Ibid.
4. Committee on Financial Services, U.S. House of Representatives, *One Year Later: The Consequences of the Dodd-Frank Act*, http://financialservices.house.gov/uploadedfiles/financialservices-doddfrank-report.pdf (accessed July 18, 2013).
5. Claes Bell, "Checking Fees Rise to Record Highs in 2012," Bankrate, http://www.bankrate.com/finance/checking/checking-fees-record-highs-in-2012.aspx#slide=1#ixzz2ZOjoAJ4y (accessed July 18, 2013).
6. See David C. John, "Volcker Rule May Make the Financial and Banking System Riskier," Heritage Foundation *Issue Brief* No. 3584, April 26, 2012, http://www.heritage.org/research/reports/2012/04/volcker-rule-may-make-the-financial-and-banking-system-riskier.
7. Research Recap, "Volcker Rule Could Cost Big US Banks $10 Billion Annually," FinancialContent, October 23, 2012, http://markets.financialcontent.com/stocks/news/read/22572827/Volcker_Rule_Could_Cost_Big_US_Banks_$10_billion_Annually (accessed July 19, 2013).
8. NYSE Euronext, comment on the Comptroller of the Currency (OCC) Proposed Rule: Prohibitions and Restrictions on Proprietary Trading, February 13, 2012, http://www.regulations.gov/#!documentDetail;D=OCC-2011-0014-0156 (accessed July 19, 2013).
9. See Diane Katz, "The CFPB in Action: Consumer Bureau Harms Those It Claims to Protect," Heritage Foundation *Backgrounder* No. 2760, January 22, 2013, http://www.heritage.org/research/reports/2013/01/the-cfpb-in-action-consumer-bureau-harms-those-it-claims-to-protect.
10. See David C. John, "End Fannie Mae and Freddie Mac to Build Tomorrow's Housing Finance System," Heritage Foundation *WebMemo* No. 3147, February 10, 2011, http://www.heritage.org/research/reports/2011/02/end-fannie-mae-and-freddie-mac-to-build-tomorrows-housing-finance-system?ac=1.

House bill released last week by Financial Services Committee chairman Jeb Hensarling (R–TX) would entirely phase out the GSEs. A Senate bill by Bob Corker (R–TN) and Mark Warner (D–VA) would create a new government agency to regulate private mortgage insurers.

Too Big to Fail. Taxpayers also remain susceptible to future bailouts of big banks. Under Dodd–Frank the Financial Stability Oversight Council[11] is tasked with designating specific firms as "systemically important financial institutions" (SIFIs). But doing so reinforces the perception that the designated firms are "too big to fail." The perception that regulators would provide a bailout gives the protected firms an edge over their smaller and more vulnerable competitors. In April, the council approved a final rule to designate nonbank SIFIs as well. Just last week, the council proposed such designation for American International Group, Prudential Financial, and GE Capital.

No Reason to Celebrate. When crafting the law, Congress did not take sufficient account of the fact that Dodd–Frank further empowers the very regulators that failed to prevent the financial crisis. Lawmakers have instead saddled consumers and the economy with thousands of costly regulations that provide no reason to celebrate the third anniversary of Dodd–Frank. In year four, lawmakers should undertake reforms that would benefit the nation rather than harm it.

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11. Composed of the heads of each financial regulatory agency.