Breaking Down the Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010 as a response to the financial crisis of 2007-2008. Sponsored by Sen. Christopher J. Dodd (CT) and Rep. Barney Frank (MA), the Dodd-Frank Act targeted the sectors of the financial system that were believed to have caused the financial crisis. It passed the House and Senate almost exclusively along party lines.

As explained in **The Policy Circle's** **Housing Brief**, the financial crisis was, at its core, a housing finance crisis. Subprime mortgages, the government's regulatory lending requirements, and improper loan ratings were some of the most frequently cited causes of the crisis. With the goal of financial stability, the Act's 848 pages addressed these issues by placing new regulations on banks, mortgage lenders, and credit rating agencies, and establishing new government agencies tasked with overseeing various components of the law and financial system. Here are the basics of the Dodd-Frank Act:

Dodd-Frank created a number of new provisions and government offices:

- The **Consumer Financial Protection Bureau** **(CFPB)**, a new, independent government office designed to protect consumers by regulating financial products.
  - Due to widespread sentiment that the subprime mortgage market was partially to blame for the financial crisis, the CFPB aims to prevent predatory lending and make it easier for consumers to understand mortgages before agreeing by requiring lenders to disclose information on easily accessible forms.
  - The CFPB also governs other types of lending, including credit and debit cards, private student loan lenders, and payday loan lenders.

- The **Financial Stability Oversight Council**, an interagency group meant to identify risks, respond to potential threats to the financial system, and promote market discipline regarding failing financial firms. It is headed by the Treasury Secretary, and can break up banks deemed too big to fail.
  - The Council allowed regulators to designate firms (such as insurance companies, mutual funds, and asset managers) as "systemically important financial institutions." If deemed so, the government has significant regulatory powers over the business, so much so that many argue the

    government agencies created by Dodd-Frank have too much power and too little accountability.
  - MetLife, Inc. filed suit against the government over its designation.

- The **Orderly Liquidation Authority**, a provision that "provides a process to quickly and efficiently liquidate a large, complex financial company that is close to failing."
  - During the financial crisis from 2008 to 2010, over 250 banks failed and Lehman Brothers, the fourth-largest investment bank in the country, filed for bankruptcy.
  - To avoid a repeat of the government's attempt to bailout institutions deemed "too big to fail," Congress created the Orderly Liquidation Authority to serve as an alternative to bankruptcy. The Federal Deposit Insurance Corporation is appointed as a receiver to control assets, obligations, and operations of the company.
  - Some say this is more government overreach, and that while the measure may prevent the need for government bailouts, it does nothing to prevent a large bank failure and may even centralize the power of the banking community.

- Securities and Exchange Commission (SEC) Office of Credit Ratings, established because credit rating agencies were accused of improperly rating investments, providing individuals with misleading information.

- SEC Whistleblower Program, which broadened the scope of covered employees and extended the statute of limitations under which a whistleblower can bring a claim against an employer.

Dodd-Frank imposed regulatory and compliance requirements for banks:

- The **Volcker Rule**, which "prohibits banking entities from engaging in proprietary trading or investing in or sponsoring hedge funds or private equity funds." Proprietary trading occurs "when a firm or bank "invests for direct market gain rather than earning commission dollars by trading on behalf of its clients."
  - Essentially, this restricts how banks can invest (by limiting speculative trading) and prevents banks from being involved with hedge funds. Some support the measure, saying it prevents banks from engaging in risky financial trading; others maintain there was no evidence proprietary trading

had anything to do with the financial crisis and the measure prevents banks from making more money.

- **Capital requirements,** regulating how banks operate and how much they lend by requiring them to hold a higher percentage of liquid (easily accessible) assets to protect against a future crisis, such as loan defaults.
    - Some members of the financial community, including former Treasury Secretary Larry Summers and JPMorgan Chase & Co. CEO Jamie Dimon, argue that while financial institutions are safer, the constraints enacted by Dodd-Frank make for a more illiquid market. The higher reserve requirements means banks must keep a higher percentage of their assets in cash. This decreases the amount banks hold in securities, thereby limiting the role of banks in the bond market, a role they have traditionally undertaken.

- **Stress test procedures**, requiring financial institutions to produce modeling and financial projections.
    - This became one of the arguments against Dodd-Frank: that it forced banks to spend increased time and money on compliance rather than on their core business of lending money to individuals and businesses. A report from the Government Accountability Office (GAO) found Dodd-Frank regulations were burdensome to community banks in terms of staff, training, and time allocation for regulatory compliance, so much so that some reported declines in business activities.
    - In 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act meant to ease some of the regulations on small businesses.

Proponents of Dodd-Frank argue that its measures protect consumers and the economy from experiencing another crisis. Critics argue that the regulation harms the competitiveness of U.S. firms relative to foreign counterparts, and that the regulatory requirements are particularly burdensome for community banks and other small financial institutions that played no role in causing the financial crisis.