Insight

The 5-5-5s of Dodd-Frank at 5: Episode 1

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*This week, as we approach the 5th anniversary of Dodd-Frank, AAF will be reviewing the 5-5-5s of the law: 5 problems, 5 repercussions, and 5 fixes, one of each, every day this week, culminating in a comprehensive lookback of AAF's work on the topic.

The Problem: Egregious Regulatory Burden and Creation of Superfluous Agencies

From the creation of entire new agencies to the imposition of hundreds of new rules, Dodd-Frank's burdens continue to outweigh its benefits five years later. It created the Financial Stability Oversight Council (FSOC), the Consumer Financial Protection Bureau (CFPB), the Office of Financial Research (OFR) within the Department of Treasury, and the Office of Credit Ratings (OCR) within the Securities and Exchange Commission, just to name a few. It imposed the Volcker Rule, the conflict minerals rule and the Durbin Amendment; rewrote corporate governance; mandated new securitization rules; modified guidance for oversight of derivatives; set prudential standards for risk-based capital, leverage, liquidity, and contingent capital; and much, much more. All total, it required 398 separate rulemakings – 282 of which still have yet to be implemented.

The Repercussion: Crippling Economic and Compliance Costs

The 116 rules that have been implemented thus far bear a staggering price tag of over $20 billion and 60 million paperwork hours. To put those hours in perspective, that's 30,370 employees working full-time just to complete the annual paperwork burden associated with the rules. A study released in February of 2015 by the Harvard Kennedy School quantifies the disastrous costs of compliance that community banks are facing as a direct result of Dodd-Frank. Particularly troubling is the study's finding that community banks came out of the financial crisis relatively well, having lost only 6 percent of their share of U.S. banking assets between 2006 and 2010. However, since Dodd-Frank was signed into law in 2010, community banks' market share shrunk at double the rate – having shed over 12 percent since the second quarter of 2010.

A 2014 Mercatus Center study showed that over 25 percent of community banks would hire new compliance or legal officers within the next year and that over one third of banks had already hired new staff to keep up with the new regulations. The study found that hiring two additional personnel would reduce the banks' median profitability by 45 basis points, which would render at least one third of those banks unprofitable.

Shortly after Dodd-Frank implantation was underway, in 2012, William Grant, then chairman of the Community Bankers Council at the American Bankers Association, testified before the House Financial Services Committee that his "very conservative" estimate of total industry compliance costs was $50 billion annually, approximately 12 percent of total operating costs – costs that will, in one way or another, be passed on to consumers.

Perhaps more troubling is the overall economic impact of Dodd-Frank. Recent AAF research calculates a reduced Gross Domestic Product (GDP) of $895 billion or $3,346 per working age person over the next ten years. Not only is Dodd-Frank hurting Americans individually, it is hurting America as a whole.

Bonus Repercussion: Financial and Social Devastation in eastern Congo

A country 7,000 miles from American shores is seeing disastrous impacts emanating from Dodd-Frank. In a short section, nestled 838 pages into the law, Dodd-Frank requires companies to disclose whether they are receiving any "conflict minerals." The four minerals are defined (coltan, tungsten, tin and gold), but the "conflict" qualification is determined through an extensive certification process by the International Conference on the Great Lakes Region which looks at each mine on a case-by-case basis. Surprisingly the conflict minerals rule has been the most costly in dollars ($4,742,000,000) and second most costly in paperwork hours (2,225,273), even though it had nothing to do with the financial crisis.

Maybe more costly were its effects in Congo: In 2010, seeking to comply with Dodd-Frank's provisions, Congo's government shut down the entire mining industry for six months before proposing a certification process to assure U.S. companies that the country's minerals do not come from conflict zones. The delays and politics of the process have all but stalled the country's mining industry which has resulted in a lack of demand and a sharp decline in prices. As of October 2011, only 11 of more than 900 mines in South Kivu, Congo, met Dodd-Frank's standards. Before the law was passed a kilogram of tin sold for $7, now it sells for $4 even in the certified mines. The Congolese artisanal mining industry employs around 11 million people, most of whom now are being forced to find work elsewhere which, more often than not, ends up being with an armed militia – the very groups Dodd-Frank aimed to curtail.

The Fix(es): Improve CFPB; Coordinate Where Necessary

Two fairly simple fixes could make the CFPB more transparent and accountable. As it stands now, CFPB can hand out individual mandates to companies or industries with little to no input from involved stakeholders. At the very least, having some sort of comment period before issuing a new policy or guidance would allow for a better analysis of the issues and hopefully would result in a more effective rule.

Second, the CFPB should be subject to more checks and balances. Unlike any other agency, the CFPB is led only by a sole director, has a very difficult veto process (needing 7 of 10 votes to overturn any decision, one of which is by the CFPB director himself), and is not dependent upon appropriations (rather relying on a set, guaranteed fund from the Federal Reserve). For CFPB to be an effective agency, it must be subject to oversight, whether that is commission-based leadership, a more fair veto process, reliance on appropriations, or all of the above.

Dodd-Frank created several regulatory gaps and a lot of confusion, but two areas demonstrate that the most: 1) the overlap in capital markets regulation by both the SEC and the Commodity Futures Trading Commission (CFTC) and 2) the split authority over bank living wills in Title I and the Orderly Liquidation Authority in Title II. Congress should clear up the SEC/CFTC confusion either by merging the two entities or allowing them to hold joint meetings, and the FDIC and the Fed should align their authorities under Title I and Title II to coordinate and make more efficient the living will review and failed bank wind down processes.

As for the conflict minerals provision: Congress should wipe that slate clean and start from scratch.

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