Research

Dodd-Frank at 4: More Regulation, More Regulators, and a Sluggish Housing Market

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EXECUTIVE SUMMARY

The Dodd-Frank Act limps into its fifth year of implementation, saddled by an unconstitutional recess appointment, several setbacks in federal courts, and an expensive regulatory portfolio. The Act imposed 398 new regulations that have thus far added more than $21.8 billion in costs and 60.7 million paperwork burden hours. These measures have transformed the financial industry, overhauled mortgage lending, and directly affected the availability of credit. With roughly one-quarter of the law still left to implement, it's safe to say that the true economic impacts won't be understood for years.

RISING REGULATORY BURDENS

Everyone within government and the financial sector knew that Dodd-Frank would impose substantial new burdens. As the Congressional Budget Office noted prior to passage, "[T]he cost of the mandates on private-sector entities would significantly exceed the annual threshold." It's difficult to imagine a scenario where 398 new regulations fail to impose huge costs. After four years of implementation, the price tag stands at $21.8 billion and 60.7 million paperwork burden hours, the equivalent of 30,370 employees working full-time to complete annual paperwork. These burdens are up from $15.4 billion and 58.3 million hours last year, increases of 41 percent for costs and four percent for paperwork hours.

The charts below track the growth of annual Dodd-Frank final rules, from July 21, 2010 onward. As implementation progressed, the largest cost increases have occurred during the past two years.

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The largest recent burden was the final "Volcker Rule" or ban on proprietary trading. Volcker is the second most expensive Dodd-Frank rule and strangely, regulators omitted a cost-benefit analysis when it was officially released in December 2013. Instead, the administration released the $4.3 billion cost estimate three months after the release.

Moreover, the administration did not even follow its own guidance on establishing the proper baseline. There is ample evidence from 10-k reports (annual disclosure reports by publicly traded companies) that companies began winding down their proprietary trading desks before regulators implemented the final rule. Bank of America actually "exited its stand-alone proprietary trading business as of June 30, 2011 in anticipation of the Volcker Rule." However, the rule's analysis notes, "[W]e use a post-statute baseline to evaluate the discretionary elements of the final rule…. Although some costs are clearly a result of the final rule, we cannot separate the extent to which other costs are attributable to the statute or the final rule." In other words, the administration didn't include the costs of the Volcker Rule on Bank of America or other entities until December 2013, more than three years after Dodd-Frank passed.

Regulators were supposed to include a pre-statute baseline, that is, "the way the world would look absent the proposed action." Official administration guidance allows a post-statute baseline, like the one used in the Volcker Rule, only "if you are able to separate" statutory requirements from regulatory action. However, the cost-benefit analysis plainly admitted, "we cannot separate." Thus, the administration ignored its own guidance and still produced the second most expensive Dodd-Frank rule on the books.

Moreover, the Volcker Rule is not the entire picture of Dodd-Frank costs. A handful of rules impose a majority of the burdens. Below are the top Dodd-Frank rules by costs, with their corresponding paperwork burden.

Rule	Agency	Costs (in millions)	Paperwork Hours
Conflict Minerals	SEC	$4,742	2,225,273
Volcker Rule	Federal Reserve	$4,346	2,392,440
Swap Data Recordkeeping	CFTC	$3,598	445,910
Resource Extraction Issuers	SEC	$1,407	332,123

Readers should note that the Conflict Minerals and Resource Extraction rules had absolutely nothing to do with the financial crisis, yet cost more than $6 billion combined. Furthermore, courts have not been kind to either rule, striking both down because of constitutional concerns. There is also little evidence that proprietary trading even played a role in the Great Recession. Thus, a majority of the most expensive rules addressing the financial crisis have hardly any relationship to the root causes of the downturn.

These are the most visible burdens, however, since many independent agencies have extensive discretion to implement Dodd-Frank, there is little independent review of their cost estimates, and in many instances, agencies simply forgo the monetization of costs. For example, when the Federal Reserve required large banks to submit capital plans under Dodd-Frank, it quantified the number of hours required (more than 432,000), but failed to monetize this cost. If they used the figure for a typical regulatory compliance officer ($32.10 per hour), the cost of regulation eclipses $13.8 million.

The same is true for other missing cost figures from Dodd-Frank. There are at least 40 regulations that contain paperwork requirements, but omit cost data, accounting for 40.3 million hours, or more than two-thirds of the law's total paperwork burden. If regulators bothered to monetize these hours, even at a conservative $32.10 per hour, they would have added $1.2 billion in direct paperwork costs alone. Instead, the public is largely blind to the full costs and benefits of Dodd-Frank.

IMPACT ON AVAILABILITY AND COST OF CREDIT

The purpose of Dodd-Frank was partly to stem abuses and fix systemic weaknesses in the financial services sector, made apparent when the housing bubble burst and helped bring about the 2008 financial crisis. Yet many of the regulations promulgated under Dodd-Frank, intended to create a safer financial system, have had adverse effects, burdensome costs, and consequences beyond the financial services industry on small businesses and consumers. Banks of all sizes have reported increased costs to comply with Dodd-Frank, potentially driving up the cost of banking and lending for consumers. In its effort to make the financial system safer, Dodd-Frank has also restricted the availability of financial products and credit, particularly for low-income borrowers, young people, and minorities.

Dodd-Frank has affected lending in a number of ways. Banks have faced numerous challenges including increased costs from compliance, increased costs raising capital standards, and regulatory uncertainty. With regard to home mortgages, lenders have been particularly conservative in part because of this uncertainty. Regulators have missed statutory deadlines and made repeated revisions to proposed rules. Lenders have therefore been forced to prepare for the strictest future standards fearing the forced buyback of loans, a problem with economic impacts detailed in a recent bulletin by the Federal Reserve Bank of Kansas City.

Figure 2 shows how lending—whether commercial, real estate, or consumer—has not recovered in this economic recovery as quickly as the average post-WWII economic recovery due to the severity of the financial crisis and environment of tightened credit encouraged by Dodd-Frank. Of the three types, only commercial lending has rebounded to the same level it was in June 2009, the end, or trough, of the recession. Consumer loans, which include auto loans and credit cards, underwent a change in reporting requirements prior to passage of Dodd-Frank that caused a significant spike in the reported value of those loans. Figure 2, therefore, includes an alternate projection that estimates the loan volume if future increases were based on the prior reporting system.

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Source: Federal Reserve; Based on Author's Calculations and NBER Recession Dates

There have been numerous studies attempting to shed light on this environment of tightened credit and other hidden costs associated with Dodd-Frank implementation. For example, a survey of small banks by the Mercatus Center at George Mason University showed that more than 80 percent of respondents reported compliance cost increases of more than 5 percent since the passage of Dodd-Frank in 2010. Increased compliance costs include the need for outside expertise, additional staff, and time spent on additional paperwork . In the survey, many small banks reported the need to trim back or eliminate some products and perks offered to customers, especially with regard to residential mortgages, home equity lines of credit, overdraft protection, and credit cards. Some have also argued that these increased costs have resulted in higher fees for consumers, a pickup in bank mergers and market consolidation, and a dearth of new bank charters, which is anti-competitive and may limit consumer choice.

Similarly, the results of a survey on lending from the American Bankers Association taken in early 2014 showed that two-thirds of respondents would restrict lending because of the ability-to-repay/qualified mortgage rule as defined by regulators with authority under Dodd-Frank. Furthermore, 80 percent of respondents expected new regulations to measurably reduce credit availability. Compliance costs and regulatory burdens were also the top concerns cited by survey respondents.

Anecdotally, many market participants have expressed concerns over burdens stemming from Dodd-Frank, but the law also has very real economic costs. An AAF report in 2012 showed the economic impact of Dodd-Frank and Basel III regulations, concluding that the rules, as proposed at that time, would reduce lending and result in fewer home sales. That decrease in loans and sales negatively impacted housing starts, employment, and GDP. While those rules have since been altered, regulators continue struggling to balance the need to protect the safety and security of consumers and investors while also encouraging a continued and sustainable housing and economic recovery.

FAILURE TO FIX HOUSING

While numerous regulations issued through Dodd-Frank are changing the landscape of mortgage lending, housing finance reform continues to be the most important unfinished business of the recession. While housing reform bills have finally passed the committees of jurisdiction of both the House of Representatives and U.S. Senate and await votes in their respective chambers, Fannie Mae and Freddie Mac remain a very real risk to taxpayers and the very definition of too-big-to-fail because the housing finance system wasn't addressed by Dodd-Frank. The failure to tackle housing finance reform directly relates to the uncertainty surrounding the future housing system, which, when coupled with recent regulations, have worked to reduce the availability of mortgage credit particularly for traditionally riskier borrowers.

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Source: U.S. Census Bureau; Based on Author's Calculations and NBER Recession Dates

With tightened mortgage credit, high rates of foreclosure, and weak job and wage growth, many have turned to renting. Shown in Figure 3, more robust multifamily starts have helped pushed total starts to the same level they were at the beginning or peak of the recession in December 2007. Yet single-family housing starts stand at only 77 percent of that level, now closing in on 80 months since the recession began and 60 since it ended. Botched initiatives to help struggling homeowners and the failure to tackle housing finance reform have both contributed to the slow recovery of the housing market when compared with the average post-war recovery.

EMPLOYMENT TRENDS IN FINANCIAL SERVICES SINCE DODD-FRANK'S PASSAGE

By imposing 60.7 million paperwork burden hours and costing more than $21 billion, Dodd-Frank is restricting growth in the financial services industry. However, while many of the rules enacted under Dodd-Frank are intended to limit risk among the largest financial companies, small firms seem to be paying the price with stagnant job growth. Figure 4 illustrates the growth in financial businesses since lawmakers passed Dodd-Frank.[1]

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The financial industry as a whole has struggled since 2010, with the number of all financial firms growing 0.2 percent from 2010 to 2013. However, the lack of growth only appears among small financial businesses. For instance, the number of firms with fewer than five workers and the number with 20 to 49 fell 1.2 percent and 1.0 percent respectively. The number of businesses with 5 to 9 workers only grew 0.2 percent and those with 10 to 19 workers were unchanged. Many of the small financial businesses are community banks, which have clearly struggled since Dodd-Frank's passage. Meanwhile, the number of large companies has grown rapidly, as the number of firms with 1,000 or more employees increased 10.2 percent since 2010. So while large financial companies seem to be unaffected by Dodd-Frank, small firms appear to be absorbing most of the bill's costs.

When one analyzes employment in the financial sector, a similar pattern emerges, as the lack of job growth since 2010 in the financial sector has been concentrated in small firms.[2]

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Just as in the growth in the number of businesses in the entire financial industry, the industry's employment levels only increased 2.9 percent from 2010 to 2013. Within the industry, what types of firms grew? Again, it was the large financial companies as employment in businesses with 1,000 or more workers advanced 10.9 percent. Meanwhile, employment in small financial firms have either stagnated or contracted.

The continual decline in many financial services industries is illustrated in employment in savings institutions in Figure 6. Since Dodd-Frank became law, savings employment continued to fall.[3]

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One of the largest illustrations of the increase in financial regulation since Dodd-Frank's passage is the growth in employment in financial regulatory agencies, which stands in stark contrast to the lack of growth in banking and finance. Figure 7 illustrates the substantial increase in financial regulatory jobs in the federal government.

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While jobs in the financial industry only increased 2.9 percent since Dodd-Frank became law, the number of jobs at federal financial regulatory agencies spiked 16.2 percent. However, this understates the growth in employment in some agencies. For instance, the number of workers at the Federal Housing Finance Agency (FHFA) and employees at the entire Federal Reserve System (all Federal Reserve Banks and the Board of Governors) increased 33.2 percent and 29.4 percent since Dodd-Frank.[4]

THE CONSUMER FINANCIAL PROTECTION BUREAU AT 3

July 21 also marks the third anniversary of the Consumer Financial Protection Bureau (CFPB). With its extensive authority to regulate "unfair, deceptive, or abusive" practices, the CFPB has had a checkered birth, an unconstitutional adolescence, and an expensive regulatory slate.

As soon as current Director Richard Cordray received a recess appointment, when according to the Supreme Court, the Senate was not in recess, he started expanding CFPB's regulatory power. Currently, CFPB imposes more than 39.4 million hours of paperwork through just 18 forms. However, it takes 2 hours and 20 minutes to comply with their average paperwork requirement.

In addition, CFPB reports that their regulatory burdens cost $793 million, or $20 per hour. The vast majority of this figure is from "Real Estate Settlement Procedures," accounting for $727 million annually. Yet, CFPB monetizes just eight of its current paperwork requirements. If it monetized its entire regulatory slate, using a figure of $32.10 per hour, its paperwork total would eclipse $1.2 billion annually.

Director Cordray's CFPB has also witnessed incredible growth in staff since its inception three years ago. Buoyed by funds from the Federal Reserve, full-time equivalent employees (FTE) have grown from 178 FTE in FY 2011 to an estimated 1,796 by FY 2015, a tenfold increase. See the Figure 8 below for the exponential growth of CFPB employees.

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Not surprisingly, spending at CFPB has also skyrocketed. Initially at just $9.2 million, it jumped to $541 million in FY 2013. By FY 2015, CFPB expects to spend more than $583 million, or more than double the FY 2015 budget request from the Commodity Futures Trading Commission, an independent agency also heavily involved in Dodd-Frank implementation.

CONCLUSION

Dodd-Frank is now four and the CFPB reaches three after imposing more than $21 billion in costs and 60.7 million paperwork burden hours. As time passes, the law becomes more expensive as regulatory agencies like

CFPB and FHFA grow with the mission to implement burdensome rules. Meanwhile, small financial services firms continue to struggle as the law restricts the availability of financial products. With about one-quarter of the law still left to implement, one can only expect the costs to continue to rise.

[1] Author's calculations of change in number of establishments from 2010 to 2013 in Financial Activities. Establishment level data by number of employees come from the Bureau of Labor Statistics, available at http://data.bls.gov/cgi-bin/dsrv?en