

# Regulating Finance: Dodd-Frank Decoded

## A talk with **Annette Nazareth**

### I. Birth and Implementation of Dodd-Frank

- A. The Dodd–Frank Wall Street Reform and Consumer Protection Act 124 Stat. 1376–2223 (2010) was enacted in 2010 in response to the financial crisis of 2007.
  - 1. The financial crisis of 2007 was the biggest since the Great Depression, resulting in significant unemployment rates and defaults on loans and mortgages.
  - 2. Some of the contributing factors of the financial crisis include inflated asset prices, excessive leverage, lax financial regulation, banking practices in subprime and other mortgage lending, certain types of unregulated securities, and poor performance by rating agencies.
- B. The stated aim of the Dodd-Frank legislation is to promote financial stability in the U.S. economy by, among other things, improving accountability and transparency, end bailouts, protect consumers from abusive financial services practices.
- C. It is an 898-page piece of legislation, with 398 rule makings. This is compared to the approximately 80-page legislation of the Glass-Steagall Act (Pub. L. 73-66) which was drafted following the Great Depression.
  - 1. The Dodd-Frank requires agencies to write and implement specific rules.
  - 2. Each agency, like the SEC<sup>1</sup> and the CFTC<sup>2</sup>, follows a multi-step rulemaking process: the agency issues proposed rules to allow for public commenting and it then reviews and issues final rules.
  - 3. Many key rules were required to be in place within a year of enactment of the ACT, but many of the deadlines were missed. However, the bulk if not all of the essential rules have been promulgated.

### II. Agency Oversight Reform

- A. Dodd-Frank created the Financial Stability Oversight Council, Office of Financial Research, and the Bureau of Consumer Financial Protection.
- B. Financial Stability Oversight Council (FSOC)<sup>3</sup>
  - 1. Is chaired by the Secretary of Treasury and the voting members consist of the heads of the Treasury, Federal Reserve, Securities Exchange Commission (SEC), Office of the Comptroller of the Currency (OCC), Federal Housing Finance Agency (FHFA), National Credit Union Administration (NCUA),

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<sup>1</sup> Securities Exchange Commission – Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act: <http://www.sec.gov/spotlight/dodd-frank.shtml>

<sup>2</sup> Commodity Futures and Trading Commission – Dodd-Frank Act: <http://www.cftc.gov/lawregulation/doddfrankact/index.htm>

<sup>3</sup> Financial Stability Oversight Council: <http://www.treasury.gov/initiatives/fsoc/Pages/home.aspx>

- Commodity Futures Trading Commission (CFTC), and the Bureau of Consumer Financial Protection.
- 2. The purpose of FSOC is to identify risks to financial stability and promote market discipline.
- 3. FSOC collects necessary information to assess financial risks, identifies threats to stability, facilitates information sharing, and identifies regulatory gaps. FSOC does it itself does not make rules.
- C. Office of Financial Research
  - 1. Is housed within the Department of Treasury.
  - 2. It supports the FSOC by collecting data on behalf of FSOC, standardizes the types of data, performs research, and develops tools for risk measurement and monitoring.

### III. Dodd-Frank Elements

- A. Living Will
  - 1. Living will requirements are implemented by the Federal Reserve and FDIC.
  - 2. Filing
    - a. Financial institutions must file and periodically update a resolution plan for as long as they continue to meet certain size or systemic-risk criteria.
    - b. Covered institutions include bank holding companies with at least \$50 billion in total consolidated assets, any nonbank financial company designated by the FSOC as a systemically significant financial institution, and any foreign bank with a US branch that has at least \$50 billion in total consolidated assets.
    - c. Dodd-Frank § 165(d) requires large financial institutions that are not US depository institutions to periodically submit to the FRB, the FDIC and the Financial Stability Oversight Council a resolution plan.
  - 3. The living will must detail their operations and exposures and how the institution could be dismantled without relying on government bailouts in the event of impending failure.
- B. Derivatives Regulation
  - 1. Title VII of Dodd-Frank grants the CFTC regulatory authority over swap and the SEC over security-based swaps. The agencies have rulemaking authority to impose new registration requirements on swap dealers and swap transactions.
  - 2. If the CFTC or the SEC determines that the swap or security-based swap is a type that must be cleared, it must be cleared by clearinghouses.
  - 3. New rules also impose business conduct, capital, and margin requirements on dealers and participants in the swap market. It requires establishing procedures for detecting internal conflicts of interest and increased disclosures of material information about swaps and security-based swaps.
- C. Volcker Rule
  - 1. Section 609 of Dodd-Frank

- a. Limits banks from engaging in proprietary trading activities and from owning interest in covered funds (generally hedge funds and private equity funds).
  - b. Trades are presumed to be for the trading account of a bank if the bank held the position for 60 days.
  - c. Banks may make and retain investments in a fund that it offers if it seeks unaffiliated investor for the fund. Within a year of the fund's commencement, the bank's investments cannot exceed more than 3% of the total ownership interests in the fund and the aggregate of the investments in such funds does not exceed 3% of the bank's Tier 1 capital.
2. The Volcker Rule was designed to prevent banks that receive federal support in the form of deposit insurance from engaging in risky trading activities.
- D. Consumer Financial Protection Bureau (CFPB)
1. The CFPB is charged with instituting rules and requirements to protect consumers.
  2. CFPB has instituted measures to:
    - a. Prevent predatory mortgage lending and make it easier for consumer to understand the terms of a mortgage.
    - b. Prevent mortgage brokers from earning higher commissions for closing loans with higher fees and/or higher interest rates.
  3. It also governs other types of consumer lending like credit cards.

#### **IV. Successes and Failures**

- A. Improved financial system stability
  1. By in large, many would argue that the Act has strengthened the financial system, particularly in regulating unregulated markets.
- B. When the Act was enacted, critics of Dodd-Frank contended that the Act would hurt economic growth and that it could harm the competitiveness of US firms relative to their foreign counterparts.
  1. Some argue that it would be ineffective in achieving its intended goals and that it puts too much faith in the same regulators who failed to prevent the recession.
  2. Whether Dodd-Frank would prove to be excessive or burdensome remains to be seen.