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REIMAGINE THE RULES

Doomed to Repeat: Debunking the Conservative Story about the Financial Crisis and Dodd-Frank

Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, conservative think tanks and financial industry lobbyists have sought to repeal or dismantle core provisions of this critical financial reform by disputing basic facts about the financial crisis, positing misinformation about the reform and its effects, and advocating for a return to a deregulated financial industry. The real story, however, is that a fragmented regulatory system failed to check Wall Street's growing appetite for risk or to adequately protect consumers and the health of the financial industry. Dodd-Frank imposed sweeping, sorely-needed reforms in order to prevent such a massive regulatory failure from repeating.

Dodd-Frank's Critical Reforms: What The Law Does

- Establishes a dedicated consumer protection agency. Had the Consumer Financial Protection Bureau (CFPB) existed before the crisis, it would have cracked down on the rampant predatory lending that fueled the housing bubble.

- Creates mortgage-lending rules, known as the Ability to Repay and Qualified Mortgage rules, to ensure loans can't be made if consumers can't afford them. These rules would have corrected the poor lending practices that banks were engaged in prior to the financial crisis.

- Forbids commercial banks from engaging in proprietary trading, including owning hedge funds and private equity – this provision is known as the Volcker Rule. The Volcker Rule ensures banks no longer prioritize betting in the market over lending to Main Street.

- Prevents future government bailouts by establishing Orderly Liquidation Authority (OLA). Instead of bailing out banks, OLA gives regulators the ability to wind down big banks in a coordinated manner at no cost to taxpayers and minimal impact on the financial system.

- Overhauls the derivatives market by reforming the way over-the-counter derivatives are traded and cleared, allowing previously hidden risks to be better managed by regulators and market participants.

Dodd-Frank created common-sense safeguards so we would never experience a financial crisis like the one of 2007-08 again. If Congress repeals these regulatory tools and dismantles the structural reforms of the financial sector, Wall Street will most certainly revert to the familiar, risky behavior of the past, and we will be doomed to repeat our crisis.

MYTH	FACT
Origins of the Crisis: Wall Street, Not Affordable Housing Policy	
The Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac are to blame for the financial crisis.	There is no evidence that the GSEs caused the crisis. Their losses were lower than private-label mortgage securities during and after the crisis.
Federal Housing Affordability Goals were an underlying cause of the Financial Crisis.	Leading studies by the Federal Reserve found no connection between that affordable housing goals and the Crisis. Lenders participating in these policies engaged in less risky practices and faced fewer delinquencies.
Replacing Fragmented Consumer Protection: An Accountable and Effective CFPB	
The CFPB Is Unaccountable to Congress and Enjoys an Unlimited Budget.	CFPB has ample accountability measures. It is subject to the Administrative Procedure Act, and other regulators can veto its rules. It is annually audited by the Government Accountability Office (GAO), and the director must testify semiannually before Congress. Its budget is hardcoded as a percent of the Fed's budget, instead of receiving fees from the firms it regulates, like the OCC and FDIC.
Setting Industry Standards: Mortgage Lending Reform	
Dodd-Frank's mortgage lending rules increase compliance costs for banks and restrict credit availability.	Complaints that compliance costs cut into bank profitability are exaggerated given bank year-over-year growth. It has not impacted credit availability given the upward trend since 2011. The number of home purchase mortgage origination also increased by 14% in 2015, further undermining this claim of onerous compliance costs crippling other bank functions.

Standardizing mortgage-lending products, through the Ability to Repay (ATR) rule and Qualified Mortgage (QM) rules, limits consumer choice.	A leading study shows Dodd-Frank had no impact on the availability of interest-only mortgages or loans that carry prepayment penalties. The ATR and QM rules established safer lending standards that did not exist before the crisis, which protect consumers and reduce the risk profile of lenders.
Dodd-Frank's exemptions from certain mortgage lending requirements for government-based insurance and the GSEs create moral hazards.	Dodd-Frank addressed this issue by sun-setting the exemptions in 2021, and the moral hazard claim is exaggerated given the heightened oversight of GSE activities by regulators.
Making Exemptions for Community Banks: A Tiered Regulatory Approach	
Community banks are subjected to the same regulations as large banks.	Dodd-Frank is not one-sized-fits-all. The statute requires regulators to consider the regulatory burden on small banks, and establishes exemptions from mortgage lending rules, enhanced macro-prudential regulation, and stress testing, among others.
Dodd-Frank's high compliance costs make community banks unprofitable.	The data show community banking is healthy and continues to gain economic strength.
Dodd-Frank caused mass mergers, market concentration and the rapid decline of community banks.	The decline in community banks is a 30-year trend. The total number of banks in the U.S. has dropped for decades because of deregulation of interstate banking laws, technological change, and the financial crisis, not Dodd-Frank.
Returning to Banking: The Volcker Rule	
The Volcker Rule reduces banks' market-making abilities and hence negatively impacts liquidity.	The Volcker Rule is working, with no notable impact to liquidity. Banks have eliminated proprietary trading operations. Goldman Sachs reduced its non-Volcker-compliant holding in "covered funds" by 60 percent.
The requirement to distinguish proprietary trading from routine market-making and risk-mitigating hedges is difficult to meet and results in overly burdensome compliance costs.	Complaints about compliance costs are disingenuous since banks already have internal control mechanisms. The Volcker Rule ensures banks are taking a hard look at their trading activities, something they should already be doing.
Preventing Government Bailouts: The Orderly Liquidation Authority	
OLA is a government bailout.	OLA ensure the government will not have to bail out Too Big To Fail banks. This power is designed explicitly to make private actors bear the costs and to provide another bailout from becoming necessary.
The bankruptcy code could better handle the failure of a large firm.	Bankruptcy is ill suited to handle a failure of a large bank. A randomly assigned bankruptcy judge would have little experience with the firm and the international regulatory community. There's no financing mechanism to the bankruptcy code, which in times of a crisis means it may be impossible to keep essential finance operations running.
Bringing Transparency to Shadow Banking: A New Approach to Derivatives Trading	
Centralized clearing requirement creates systemic risks.	The centralized clearing mandate reduces systemic risk by enhancing market transparency of bilateral OTC derivative transactions. This enables central counterparties to pool resources with market participants to absorb shocks from defaults.
Registration and reporting requirements for swap dealers and market participants constitute "barriers to entry" for market entrants, reducing competition while increasing market concentration.	Even before the introduction of Dodd-Frank derivatives rules, the OTC derivatives market was already highly concentrated. A total of just 5 dealers had the market to themselves. The transparency resulting from a move away from bilateral trading towards swaps execution facilities and centralized clearing creates an environment that is more conducive to competition, but also necessitates market participant regulation and reporting requirements to function properly.