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Report

No, Dodd-Frank was neither repealed nor gutted. Here's what really happened

Aaron Klein Friday, May 25, 2018

Editor's Note:

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The largest legal change to financial regulation since passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 just occurred. This new law neither repeals nor replaces Dodd-Frank as House Speaker Ryan claimed nor does it 'gut Dodd-Frank' as some of its opponents argue. Here are five false narratives promoted about the new bill, along with a surprising ramification of what passage of this legislation likely means: Dodd-Frank is here to stay.

False narratives:

1. The bill repeals and replaced Dodd Frank.

To the contrary, the legislation leaves intact the core Dodd-Frank framework: increasingly tougher regulation on larger banks, new authority and discretion for the Federal Reserve, enhanced authority for the federal government to unwind a failed financial institution, and the creation of new federal regulators, including the Consumer Financial Protection Bureau (CFPB). The legislation itself does not touch the CFPB, a key requirement for Democratic congressional support.

The House of Representatives did consider a true repeal and replace, the CHOICE Act, which passed the House with no bipartisan support in June 2017. The core of that legislation was rejected by the Senate, which reached a different bipartisan deal that attracted the support of 17 Democratic Senators.[1] The Senate bill passed verbatim by the

House, where almost all Republicans joined 33 Democrats to pass this law. Congress rejected the CHOICE Act's repeal and replace and instead embraced the Senate's modifications of existing law.

2. This law 'guts' Dodd-Frank.

The major change cited in this argument is the increase of the so-called 'Bank SIFI' threshold, which increases the size at which a bank is subject to enhanced regulation by the Federal Reserve. Dodd-Frank set this line at $50 billion, unindexed for inflation or economic growth. The law raises this figure to $250 billion, with an important caveat that the Federal Reserve retains the discretion to apply enhanced regulatory standards to any specific bank greater than $100 billion, if the Fed feels that is warranted.

Dodd-Frank attempts a difficult balancing act in regulating large banks. The idea is to internalize the negative externalities that a large, complex financial institution creates through the imposition of higher regulatory scrutiny, specifically through higher capital standards and other forms of enhanced regulation. This was Dodd-Frank's solution to the debate raging at the time, between nationalizing and breaking up the largest banks or allowing the market to determine proper bank size. Dodd-Frank delegated, largely to the Federal Reserve, the important task of how to set the scales to achieve this balancing act. The new legislation goes further down this path, granting the Fed greater discretion in how to set those scales for institutions between $100 and $250 billion, including providing the option of essentially no penalty for size. Congress is changing the weights on the scale, and is empowering the Fed even more, but it is continues the Dodd-Frank structure.

3. Major new lending is coming to individuals and small businesses.

This is the argument put forth by many in Congress and within the banking industry. As the Independent Community Bankers Association argues: "The new law will spur greater consumer access to credit and business lending in Main Street communities nationwide." There is no direct provision in this law that accomplishes this and the argument that reduced regulatory costs for a subset of banks will translate into more lending as opposed to greater profits is just speculation. Bank profits just reached a record $56 billion last quarter, and small business lending by community banks is already growing twice as fast as that by large banks, according to the FDIC. The new tax law and this new bank de-regulation law will continue to help boost profits, what trickles down in lending is less clear.

Consider two provisions of the new law: the repeal of Truth-In-Lending Act protections for certain mortgages on mobile homes, and the exemption of small banks and mortgage lenders from enhanced reporting of data to detect racial discrimination (known as HMDA+).

The mobile home provision does not even touch banks, big or small. Instead it exempts manufactured home retailers and their employees from TILA requirements, ultimately perpetuating "the conflicts of interest and steering that plague this industry and allow lenders to pass additional costs on to consumers," according to the Center for Responsible Lending. Mobile home buyers will have less visibility into true costs, making it harder to shop for the best deal. An argument that boils down to the extra profit generated by steering consumers to products not allowed under Truth-In-Lending, may produce more marginal mobile home purchases, is weak.

The second provision targets banks that originate between 100 and 500 mortgages a year, exempting them from collecting enhanced data used to detect predatory and racially discriminatory mortgage lending. Those banks originate only around one out of seven mortgages and are competing with other national mortgage lenders who are subject to this data-reporting requirement. In the scope of a nationally competitive mortgage origination business, with far greater costs and inefficiencies than this additional data, it is hard to see how any savings will translate to borrowers, or how additional mortgages will be made. However, it could allow for greater undetected steering of minorities to higher cost mortgages – which was prevalent during the housing boom – as well as create more false positives where traditional information show discrimination but enhanced data would demonstrate otherwise.

These two provisions are both bad policy and unlikely to spur greater overall lending. Instead, they are likely to generate higher profits for the providers of credit and potentially worse terms for borrowers.

4. This law fulfills President's Trump promise to 'do a big number' on Dodd-Frank.

A bill signing ceremony is a natural moment for a President to say he has delivered on a campaign promise. The lack of major legislative achievements for President Trump and the Republican Congress only compound the pressure to argue that this bill does more than it actually does. This is Congress's likely only bite at the apple on financial reform. Dodd-Frank survives Trump's first two years.

To the Trump Administration's credit, its thinking has evolved to see the benefits to major components of Dodd-Frank. For example, the Treasury Department's report on Dodd-Frank's failure resolution regime (Title II of Dodd-Frank) recommended keeping it with only minor modifications. This stopped efforts in Congress to repeal Title II, which remains in place.

Ultimately, the success of the Dodd-Frank framework depends on the prudence and judgment of the financial regulators who are generally given substantial authority and discretion in applying the Dodd-Frank framework. As Trump finally assembles his regulatory team – the last major piece of which was the Senate's confirmation of the new FDIC Chair McWilliams on the same day the new law was signed – the efficacy of Dodd-Frank under a new regime will be tested.

Trump may still deliver on his promise, not by legislation, but by the actions of financial regulators he appoints. Appointing his top budget staffer, Mick Mulvaney, as Acting Director of the Consumer Financial Protection Bureau, has resulted in a series of major rollbacks and revisions of key rules and regulations to protect consumers and prevent many of the abuses that were at the heart of the financial crisis. If the CFPB is the cop on the beat patrolling against unscrupulous lending, Mulvaney, as the new chief of police is ordering the force to take a nap.

5. The legislation meaningfully addresses #EquifaxScandal.

The Equifax scandal broke during consideration of the legislation, pressuring Congress to do something. Unfortunately, the legislation does not address the fundamental problems inherent in the credit reporting system, including that 1 out of every 4 readers of this piece has a material error on their credit report. Congress settled on a small provision regarding the right to freeze credit reports without cost, while also providing Equifax and the other bureaus a major victory by limiting their liability for certain lawsuits regarding credit monitoring services they provided.

In financial regulation, scandals are often the drivers of legislation to fix problems both exposed from the scandal and long festering. This bill does neither for credit reporting agencies nor for other recent financial scandals, such as the Wells Fargo fake account scandal.

Key takeaways from the new financial law

Despite Republican control of Congress and the White House, Dodd-Frank's structure remains largely intact. If this legislation is the largest change made to Dodd-Frank during Trump's time in office, then Dodd-Frank will have survived its first major political test. The failure of the Republican Congress to alter significantly Dodd-Frank does not mean that it will remain effective. Personnel changes are a far greater threat to Dodd-Frank's success than this new law. And just because the law's impacts are not likely to threaten financial stability does not mean that they are not problematic and will not result in significant problems for certain borrowers (check back for scandals where the CFPB pulled back or in mobile homes in a few years).

Finally, it is important to note that even for those who disagree with many provisions of the new law, there are some that are positive. The law changes a definition by the Federal Reserve on the treatment of certain municipal debt to allow it to count for a regulatory requirement for greater liquidity. It also creates a reasonable parity with the treatment of corporate debt, striking a better balance for the financial system and ultimately allocating more capital to municipal governments. Hopefully they will use to build more infrastructure as it has become clear that is another campaign promise that Trump will not fulfill this year.

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Footnotes

1. 1 This includes Senator Angus King (I-ME) who caucuses with the Democrats in calculating the number of Democratic Senators.