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AFR Bulletin: Attempts to Undermine Dodd-Frank Reforms Mount

The Dodd-Frank financial reform bill is popular with the public, but opponents of financial reform are still trying to undermine key elements of the legislation. This bulletin describes three of the most prominent attacks on central elements of financial reform: 1) efforts to handcuff the Consumer Financial Protection Bureau (CFPB), 2) attempts to weaken derivatives reforms, and 3) depriving the regulators of the funding they need to implement financial reforms.

Handcuffing the Consumer Financial Protection Bureau (CFPB)

Establishing an independent agency with the sole responsibility of enforcing consumer protection laws was a vital part of financial reform. Prudential banking regulators, such as the Federal Reserve and the Office of the Comptroller of the Currency (OCC), were historically charged with enforcing consumer financial protection laws. But these agencies have as their main focus ensuring the financial stability of banks rather than protecting consumers. They are also heavily influenced by the banks they regulate. As a result, they have repeatedly ignored or even actively obstructed consumer protection efforts. These choices contributed greatly to abusive mortgage practices, the related housing bubble and the financial crisis.

The CFPB is months away from even beginning its operations. But critics of the agency have already proposed a set of structural changes that would effectively restore the pre-Dodd Frank status quo by subjecting CFPB decisions to approval by the very same prudential regulators who consistently failed to enforce consumer protection laws in the past. The changes include giving a simple majority of financial regulators the power to veto any CFPB decision that threatens the "soundness" of any bank – in essence allowing CFPB decisions to be vetoed if they prioritize consumer protection over bank profits. Critics have also called for subjecting CFPB funding (unlike the funding of any other banking regulator) to the appropriations process, and for replacing the simple, accountable single-director structure of the CFPB with a board. The proposals have been advanced in House legislation, and 44 Republican Senators signed a letter pledging to filibuster any nominee for CFPB director unless these changes are made.

Nonpartisan observers have pointed out the major problems with these proposals in everything from Congressional testimony to newspaper editorials. Proponents justify them with the claim that the CFPB's powers are unchecked and unaccountable. But the CFPB is already subject to extensive checks on its powers. Unlike any other regulator, CFPB decisions can be overturned by two-thirds of other financial regulators based on a determination that a CFPB decision threatens U.S. financial stability. The CFPB's funding is statutorily capped. And the CFPB's single-director structure mirrors that of most Federal agencies -- including the Office of the Comptroller of the Currency, the major banking regulator for our largest national banks.

Undermining Derivatives Reforms

The report by the Financial Crisis Inquiry Commission confirmed what many others had previously concluded: that "over the counter (OTC) derivatives contributed significantly" to the financial crisis. Because of the clear connection between unregulated OTC derivatives and the financial crisis, the Dodd-Frank Act instituted reforms designed to make the derivatives markets more transparent, safe and sound.

Recent legislative proposals (such as HR 1610 / S. 947) would create significant loopholes in the Dodd-Frank derivatives regime. The legislation claims to simply "clarify" certain regulatory exemptions that already exist in the Dodd-Frank rules for companies that use derivatives to hedge risks arising from production of commercial goods and services. But it would significantly weaken the ability of regulators to oversee major players in the derivatives market, and would also exempt a broad range of purely speculative derivatives transactions from regulation. Under this legislation, major market participants would not have to reserve money to back up their derivatives bets, which would threaten the stability of the financial system.

HR 1573 would delay the implementation of all the Dodd-Frank derivatives reforms by 18 months, until early 2013. As Representative Collin Peterson, the Ranking Member of the House Agriculture Committee, has pointed out, this is a completely unnecessary intrusion into the regulatory process, would increase market uncertainty, and delays everything from new rules controlling speculative manipulation of oil markets to prohibitions on taxpayer bailouts of derivatives dealers. Regulators have consistently accommodated requests for reasonable timelines on new derivatives rules. A blanket statutory delay in implementing Dodd-Frank rules is uncalled for and delays numerous critical regulations.

Denying Regulators Funding to Oversee the Markets

The Dodd-Frank Act gives major new responsibilities to the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC), especially in the area of derivatives market regulation. The CFTC will be responsible for regulating roughly $280 trillion in previously unregulated derivatives markets -- a more than seven-fold increase in the notional size of the market the agency supervises. The Dodd-Frank Act also requires the CFTC to crack down on the commodity speculation that is affecting prices of everything from gasoline to food. The SEC will be responsible for regulating previously unregulated securities-based swaps like the credit default swaps that brought down AIG. The SEC also has other new responsibilities in areas ranging from credit rating agencies to municipal bonds.

Incredibly, despite these major increases in responsibility, some have recently called for reductions in funding for these agencies. This would be a major assault on Dodd-Frank implementation and on law enforcement in the financial sector generally. Regulator budget shortfalls are already impacting their ability to police financial markets. Fortunately SEC and CFTC budgets were slightly increased in the final 2011 budget. However, it is critical that both agencies be fully funded in 2012. Fully funding both agencies would only require a few hundred million dollars in additional spending. The great majority of this spending would have no impact on the deficit because it is funded by industry fees.