THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE MORE STABLE?

July 9, 2015

Todd Zywicki
George Mason University Foundation Professor of Law
Executive Director, Law and Economics Center
Mercatus Center Senior Scholar

Unites States House of Representatives
Committee on Financial Services

Thank you chairman Hensarling, ranking member Waters, and members of the committee. It is my pleasure to testify this morning on the question of "The Dodd-Frank Act Five Years Later: Are We More Stable?"

An animating premise of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was the belief that a primary source of financial instability was an inadequate consumer financial protection regime at the federal level. Dodd-Frank sought to address those perceived deficiencies by creating the Bureau of Consumer Financial Protection (CFPB) and vesting that new super-bureaucracy wielding an unprecedented combination of vast, vagely defined substantive powers with no democratic accontability.

At the outset, allow me to stress that I personally agreed with the proposal to combine the administration of federal consumer financial protection laws under one agency's roof. The preexisting system was too complicated, too fragmented, and too incoherent.

That Dodd-Frank squandered this historic opportunity to modernize and reform consumer protection laws for the benefit of consumers was, therefore, particularly disappointing. In the five years since the law came into effect it has resulted in higher prices and reduced choice for consumers and has done little to increase consumer financial protection.

Yet while this sorry result for American consumers is tragic, it is hardly surprising. The failure of Dodd-Frank's regulatory agenda to promote the interests of consumers was built in from the beginning.[1] The CFPB, for instance, is vested with extraordinarily broad

[1] Todd J. Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEORGE WASHINGTON L. REV. 856 (2013).

powers to regulate virtually every consumer credit product in America under the vague charge to prevent "unfair, deceptive, and abusive" terms and practices. At the same time, this vast power is vested in an agency with an unprecedented lack of democratic accountability. Under the statute, the president can nominate the director, but once confirmed the director can be removed only "for cause."[2] Furthermore, the CFPB is outside Congress's appropriations power, and is authorized to spend hundreds of millions of taxpayer dollars every year with no accountability to the American people.

Given this extreme lack of democratic accountability, the CFPB has done what all bureaucracies tend to do: it has constantly expanded its power, promoted its own bureaucratic interests at the expense of the public, and trampled under foot other public policies, such as consumer choice and financial innovation.

The impact on American families and the economy from the actions of this unaccountable super-regulator has been disastrous:

- By imposing a regulatory regime that substitutes the judgment of bureaucrats for consumer decisions, Dodd-Frank has raised prices and cut off access to mortgages, credit cards, and bank accounts, harming millions of American families that use credit to improve their lives and depressing economic growth.[3]
- By stripping consumers of mainstream financial products such as mortgages, credit cards, and bank accounts, Dodd-Frank has driven the most vulnerable Americans into the arms of check cashers, pawn shops, and payday lenders, increasing their reliance on those products for which sharp practices are most feared.
- The crushing regulatory compliance cost burden and destruction of community banks' traditional relationship lending model has accelerated consolidation of the retail banking system, making big banks even bigger and further eliminating competition and choices for consumers.
- The CFPB has launched a massive data-mining program that collects data on hundreds of millions of consumer credit cards, mortgages, bank accounts, and other products, an appetite for consumer information that far exceeds any reasonable regulatory purpose. Not only do these data-mining operations impose costs on banks and their customers, the operations' scale creates unprecedented threats to privacy and risks to personal information security.
- Because many small, independent, kitchen-table businesses use products such as personal credit cards, home equity loans, and auto title loans in financing their businesses, the CFPB's powers reach into all of these small businesses as well.

[2] *But see* Statement of Barney Frank, "Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, U.S. House of Representatives, (Feb. 15, 2012) at p. 8 ("Just a couple of points—first of all, this notion that the director cannot be removed is fanciful. It says in the statute that, yes, the director is appointed for a 5-year term, but can be removed by the president for insufficiency, neglect of duty, or malfeasance. No one doubts that if a change in administration comes, and the new president disagrees with the existing director, he or she can be removed. And proving that you were not inefficient, the burden of proof being on you, would be overwhelming.").

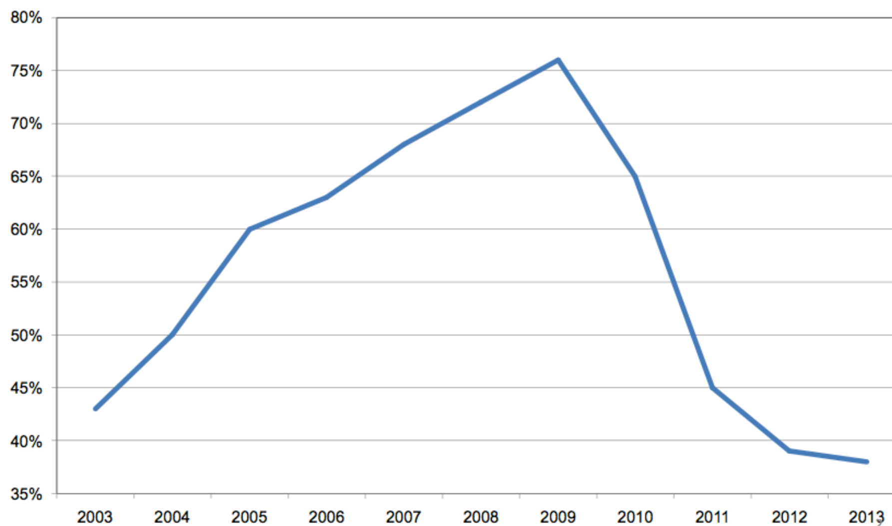
[3] *See* THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN, AND TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY (Oxford, 2014).

Little wonder then for the first time in American history more businesses are being destroyed than new businesses being started.[4]

After five years, has Dodd-Frank made American families better off? No. Instead, the overall impact of Dodd-Frank has been to slow our economic recovery, raise prices, reduce choice, and eliminate access to the financial mainstream for American families. And low-income Americans have been hit the hardest.

Bank Accounts and The End of Free Checking for Millions of Americans: The years 2001 to 2009 saw one of the most important pro-consumer innovations in the history of retail consumer financial services: the rapid spread of near-universal consumer access to free checking.[5] It is estimated that during that period, consumer access to free checking accounts increased from under 10 percent of all bank accounts to 76 percent. In the years since Dodd-Frank, however, the number has collapsed to half of that amount—38 percent, as shown in figure 1.[6]

Figure 1. Banks Offering Free Checking from 2003 to 2013



Source: Bankrate.com.

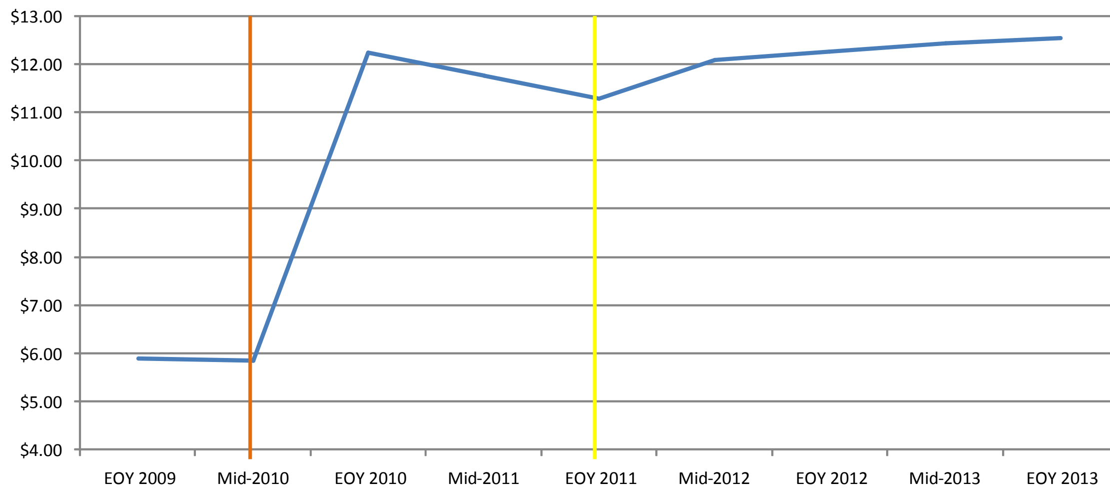
[4] *See* Ian Hathaway and Robert E. Litan, *Declining Business Dynamism in the United States: A Look at the States and Metros*, Brookings Institution Economics Studies (May 2014), http://www.brookings.edu/~/media/research/files/papers/2014/05/declining%20business%20dynamism%20litan/declining_business_dynamism_hathaway_litan.pdf.

[5] Todd J. Zywicki, Geoffrey A. Manne, and Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (June 4, 2014), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.

[6] *Id.* at 6, figure 1.

Not only are more consumers forced to pay fees to maintain their checking accounts, those (and other) fees have soared. Fees are twice as high on average as before Dodd-Frank was enacted, as shown in figure 2.[7]

Figure 2. Monthly Maintenance Fee (Non-Free Checking)



Source: MoneyRates.com.

Most troubling, however, is that low-income and other vulnerable populations have been most adversely impacted by Dodd-Frank's destruction of access to free checking: according to the FDIC, the number of unbanked consumers increased by 1 million between 2009 and 2011 and the number of underbanked consumers increased still faster.[8] Sadly, Dodd-Frank has put bank accounts—once the first rung on the ladder of financial inclusion—out of the reach of millions of young and lower-income Americans, forcing them to rely on alternative financial services such as check cashers and pawn shops.

To strip the most vulnerable Americans of access to bank accounts in order to line the pockets of the shareholders of big box retailers is simply unconscionable.

Credit Cards: Consumers have also suffered a loss of access to credit cards in the post-crisis era, not only because of Dodd-Frank but also the impact of the Credit Card Accountability Responsibility and Disclosure Act—and once again, low-income consumers have suffered the most. According to the CFPB's own estimates, the period between July 2008 and December 2012 saw the closure of 275 million credit card

---

[7] *Id.* at 8, figure 4. Mid-2010, of course, is when Dodd-Frank was passed into law. EOY 2011 marks the period at which regulations from the Federal Reserve System (Federal Reserve) regulations implementing the "Durbin Amendment" to Dodd-Frank became effective.

[8] FEDERAL DEPOSIT INSURANCE CORPORATION, 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf;

accounts and elimination of $1.7 trillion in credit card line of credit.[9] Overall, the CFPB found a significant decline in the percentage of households that had cards, from 76 percent to 71 percent. But even this figure understates the disproportionate impact on low-income consumers. According to Federal Reserve Board economists Glenn Canner and Gregory Elliehausen, the percentage of households in the lowest quintile of credit scores with credit cards fell from 65 percent in 2008 to 54 percent in 2010.[10] Loss of access to credit cards has forced those consumers into great reliance on higher-cost products such as payday loans and overdraft protection.[11]

Mortgages: The CFPB's "qualified mortgage" (QM) and "ability to repay" rules have dramatically slowed the recovery of the housing market, and fears of government liability have caused even large lenders to lend cautiously, especially to riskier borrowers. As Janet Yellen has noted, "banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores."[12] Despite the heavy regulatory burden imposed by the CFPB's mortgage rules, however, the rules are silent with respect to one of the most important risk factors for mortgage foreclosures—the reduction or elimination of minimum down payment requirements.[13] Nor do the rules address state antideficiency laws or cash-out refinancing by homeowners, both of which have been shown to have materially contributed to the foreclosure crisis.[14] Peter Wallison, former general counsel of the Department of the Treasury, estimated that had the QM rules applied in the period leading up the financial crisis, the default rate on QM–conforming mortgages would have still been 23 percent.[15] The end result is a dramatic increase in the regulatory cost and liability risk of mortgage lending, while doing little to reduce financial instability.

---

[9] CONSUMER FINANCIAL PROTECTION BUREAU, CARD ACT REPORT: A REVIEW OF THE IMPACT OF THE CARD ACT ON THE CONSUMER CREDIT MARKET 56 (Oct. 1, 2013).

[10] Glenn B. Canner and Gregory Elliehausen, *Consumer Experiences with Credit Cards* at 10 Table 2, FEDERAL RESERVE BULLETIN (Dec 2013), online at http://www.federalreserve.gov/pubs/bulletin/2013/pdf/consumer-experiences-with-credit-cards-201312.pdf. By contrast, for highest-quintile households, card holding fell only one percentage point (from 91 percent to 90 percent of households).

[11] *See* Robert L. Clarke and Todd J. Zywicki, *Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau*, 33 REVIEW OF BANKING AND FINANCIAL LAW 235 (2013-14).

[12] For example, Janet Yellen, chair of the Board of Governors of the Federal Reserve System, has stated, "Banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores. They mention in meetings with us consistently their concerns about put-back risk, and I think they are—it is difficult for any homeowner who doesn't have pristine credit these days to get a mortgage. I think that is one of the factors that is causing the housing recovery to be slow. And of course, you know, there were a lot of practices in connection with mortgage lending that really needed to be changed, we don't want to go back to those days, but it is important to clarify—for us to work to clarify the rules around mortgage lending to create an environment of greater certainty for lenders to be willing to extend mortgage credit." Federal Reserve Board, *Transcript of Chairman Yellen's Press Conference* at p. 12 (June 18, 2014).

[13] *See* Zywicki, *supra* note 1, at 913.

[14] *See* Todd J. Zywicki and Joseph Adamson, *The Law and Economics of Subprime Lending*, 80 UNIVERSITY OF COLORADO L. REV. 1 (2009) (summarizing studies).

[15] PETER WALLISON, HIDDEN IN PLAIN SIGHT: WHAT REALLY CAUSED THE WORLD'S WORST FINANCIAL CRISIS AND WHY IT COULD HAPPEN AGAIN (2015).

The CFPB's regulatory costs have fallen particularly heavily on smaller and community banks. For example, a study by the Mercatus Center at George Mason University found that 71 percent of small banks stated that the CFPB has affected their business activities.[16] Sixty-four percent of small banks reported that they were making changes to their mortgage offerings because of Dodd-Frank and 15 percent said that they had either exited or were considering exiting residential mortgage markets entirely. Nearly 60 percent of small banks reported that the CFPB or the qualified mortgage rule had a "significant negative impact" on their mortgage operations. Nearly 60 percent said that the CFPB has had a significant negative effect on bank earnings and more than 60 percent said that changes in mortgage regulations had had a significant negative effect on bank earnings.

Moreover, by imposing a one-size-fits-all mechanical underwriting system for mortgages, the QM rule has deprived community banks of their one competitive advantage against megabanks: their intimate familiarity with their customers and their ability to engage in relationship lending with their customers.

According to a study by researchers at Harvard University's John F. Kennedy School of Government, community banks are shrinking at twice the rate since Dodd-Frank's enactment than before, while larger banks have grown in size.[17]

Data Mining: Perhaps the most egregious example of the CFPB's bureaucratic hubris—and subordination of the interests of American consumers to its own narrow bureaucratic agenda—is the agency's extraordinary data mining program of American families' financial accounts. Currently, the CFPB collects and monitors information for some 600 million American credit card accounts, "22 million mortgages, 5.5 million student loans, two million bank accounts with overdraft fees, and hundreds of thousands of auto sales, credit scores, and deposit advance loans."[18] Yet even this vacuuming up of our financial information isn't enough. The CFPB wants to enlarge its portfolio to 95 percent of all credit card accounts—almost 1 billion accounts in total.

Is it necessary for the CFPB to snoop so deeply into our bank accounts and credit card statements in order to further its regulatory agenda? Of course not. In fact, George Mason University economist Thomas Stratman has estimated that the number of credit card accounts for which the CFPB wants to collect consumer information is some 70,000 times greater than is necessary for the agency to execute its regulatory mission.[19]

But the costs of CFPB's demand for information do not fall solely on the banks that must provide it. While the CFPB claims that this data is anonymous, every bit of information

---

[16] Hester Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Fairing Under Dodd-Frank?*, Mercatus Center Working Paper No. 14-05 (Feb. 2014).
[17] Marshall Lux and Robert Greene, *The State and Fate of Community Banking*, Harvard Kennedy School M-RCBG Associate Working Paper No. 37 (2015), *available in* http://www.hks.harvard.edu/centers/mrcbg/publications/awp/awp37.
[18] Newt Gingrich, *A Government Snoop That Puts the TSA to Shame*, WALL STREET J. (July 1, 2015).
[19] *See* Letter of Professor Thomas Stratman to Congressman Scott Garrett (Jan. 23, 2014), *available in* http://mercatus.org/sites/default/files/StratmannCFPBStatisticMethods.pdf.

increases the risk to consumers of identity theft and other misuse of their information. In fact, testifying before this committee last year, CFPB director Richard Cordray admitted that the information the CFPB collects is not 100 percent secure and could be hacked.[20] Moreover, according to a recent article in *Science*, using only three months of anonymous credit card data, the researchers were able to reidentify 90 percent of individuals, with women being more readily reidentifiable than men.[21]

While the unnecessary acquisition and retention of troves of Americans' information is troubling enough in itself, it is especially worrisome in light of repeated rebukes of the CFPB's faulty data security systems.[22] Following massive data security breaches and compromising of personal information by the Internal Revenue Service and Office of Personnel Management, it is inexplicable that the CFPB continues to insist on vacuuming up excessive amounts of consumer data without considering the privacy threat to consumers.

Bureaucratic Overreach: Finally, despite Dodd-Frank's broad grant of authority to the CFPB to regulate every consumer credit product in America, even that broad reach has proven insufficiently expansive for the agency. For example, Dodd-Frank expressly prohibits the CFPB from regulating loans made by auto dealers—yet through the rubric of enforcing fair-lending laws the CFPB has essentially deputized banks and other indirect auto lenders as de facto arms of the federal government. Moreover, recognizing that the information necessary to implement such a scheme simply does not exist, the CFPB has instead turned to a scientifically dubious methodology (Bayesian Improved Surname Geocoding) to try to impute the alleged race of each loan applicant.[23] The CFPB has also given itself authority to regulate third-party sellers of cell phone apps[24] and for-profit colleges, and it has even required a land developer to improve the condition of the roads in a housing development.[25]

---

[20] *See* Richard Pollock, *Federal Consumer Bureau Data-Mining Hundreds of Millions of Consumer Credit Card Accounts, Mortgages*, WASHINGTON EXAMINER (Jan. 29, 2014), *available in* http://www.washingtonexaminer.com/consumer-bureau-data-mining-hundreds-of-millions-of-consumer-credit-card-accounts-mortgages/article/2543039.

[21] Yves-Alexandre de Montjoye, Laura Radaelli, Vivek Kumar Singh, and Alex "Sandy" Pentland, *Unique in the Shopping Mall: On the Reidentifiability of Credit Card Metadata*, 347 SCIENCE No. 6221 536-39 (Jan. 30, 2015).

[22] *See* Government Accountability Office, *Consumer Financial Protection Bureau: Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced* (Sept. 2014); Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Office of Inspector General, *Security Control Review of the CFPB's Cloud Computing–Based General Support System*, 2014-IT-C-010 (Washington, D.C.: July 17, 2014).

[23] *See* Arthur P. Baines and Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market*, Charles River Associates (Nov. 19, 2014), http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf.

[24] *Consumer Financial Protection Bureau v. Sprint Corp.*, Civil Action 14-9931 (Dec. 1, 2014), *available in* http://files.consumerfinance.gov/f/201412_cfpb_cfpb-v-sprint-complaint.pdf.

[25] *In the Matter of International Land Consultants, Inc.*, *et al.*, Administrative Proceeding File No. 2015-CFPB-0010 (May 1, 2015) (consent order), *available in* http://files.consumerfinance.gov/f/201505_cfpb_consent-order-international-land-consultants.pdf.

Scholars of the regulatory process have long understood that agency imperialism is a predictable tendency of bureaucracies, as they seek to enlarge their power and influence over policy. Given the absence of meaningful internal or external institutional controls on the CFPB, it is hardly surprising that the CFPB has aggressively sought to expand its reach into all of these areas, from telecommunications services to the provision of higher education.

Looking back on the last five years, it is disappointing that Dodd-Frank squandered the historic opportunity presented by the financial crisis to create a modern and coherent consumer protection regime—one that would not only protect consumers from sharp practices but promote competition, innovation, and consumer choice. Even worse, Dodd-Frank imposed a regime that instead has led to higher prices, less innovation, and less choice in consumer credit products, while doing little to improve consumer protection. By taking away preferred choices for consumers, such as mortgages, bank accounts, and credit cards, Dodd-Frank and other laws have increased consumer dependence on less preferred products like payday loans, pawn shops, and check cashers. Most tragic of all, low-income and younger consumers—who already had the fewest choices—are those who have suffered the most from Dodd-Frank's regulatory onslaught.

Thank you.