A Brief Look at the Dodd-Frank Act

BY WILLIAM L. PITTENGER, MAI

THE DODD-FRANK WALL STREET REFORM AND CONSUMER Protection Act, as it is formally known, is the most sweeping piece of financial legislation enacted in the U.S. since The Great Depression of the 1930s. It was created to enhance the stability of the U.S. financial system and address many of the things that led to its near collapse in late 2008. The stated purpose of the act is to *"promote the financial stability of the United States by improving accountability and transparency in the financial system, to end too big to fail, to protect consumers from abusive financial services practices and for other purposes."* The Act was first proposed in December 2009 and was signed into law by the President on July 21, 2010.

The act contains some 2,000 pages of text, 16 titles and appears to require agencies to conduct at least 40 studies and perhaps as many as 67 to determine how to proceed putting regulatory flesh on the legislative bones. It requires regulators to create some 243 rules and to periodically issue 22 reports. It creates new agencies, merges some, eliminates others and creates new oversight for *specific* institutions deemed to be systemically important and whose failure could put the nation's economy at risk. The act affects the entire financial services industry including financial institutions, their regulators and even consumers.

The financial crisis that began in 2008 was largely a product of outdated regulation and supervision combined with credit innovation and technology that were advancing faster than regulatory and risk management controls. One gaping hole in the prior regulatory system was that no one had clear responsibility for monitoring the financial system as a whole. While financial innovation was hailed as a positive, the mismatch between that and risk management was an unintended consequence that led to near disastrous results.

While protecting consumers through new agencies, proposed efficiencies, enhanced enforcement, greater transparency and more are lofty goals, legislation as far reaching as Dodd-Frank will certainly have unintended consequences not yet even envisioned. With the holes in the law intended to be filled by further study and regulation, agencies, attorneys, advocates, and others will likely parse the language for years as they argue intent, try to clarify the law's ambiguities and debate such things as *does the law really mean "and" or was it intended to be "or."*

The law sets forth timelines for certain implementation steps. Moreover, each implementation step creates additional timelines and deadlines, many of which seem impossible to meet given their complexities and political

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realities surrounding them. Creation of the Consumer Financial Protection Bureau (CFPB), for example, is among the biggest and most complex endeavors. While the bureau's duties look clear on paper, implementation of regulation together with how the new agency draws resources from or delegates examination authority to existing agencies is currently a tangled web.

Its director, when appointed, is subject to Senate confirmation which, if recent history is a guide, will be a lengthy and politically charged process. The leading candidate for the position was widely thought to be Harvard Law Professor and Presidential assistant, Elizabeth Warren. As of this writing, however, she serves as a "special advisor" to the CFPB, under appointment by the Treasury Secretary, and has not yet been nominated to be the permanent head. That adds uncertainty and will almost certainly create delays in implementing the bureau's mission.

Perhaps the biggest hole left unplugged in the act is the future of Fannie Mae and Freddie Mac. The two government sponsored entities were placed into conservatorship in late 2008 but for reasons that are not clear, Congress chose not to address their future as part of the Dodd-Frank Act.

What is clear is that the Act's many provisions and those that will follow with creation of numerous regulations will increase regulatory and legal risk and the cost of doing business for virtually all financial service institutions. With that broad backdrop, let's explore several of the key provisions of the Dodd-Frank Act.

The Dodd-Frank Act covers nearly all aspects of consumer and mortgage lending from origination through packaging and sale as securities. While there are 16 titles in the Dodd-Frank Act, we will briefly summarize a few pertaining directly to commercial and mortgage banking and their regulation. For now, we'll skip several of the titles dealing with securities, rating agencies, insurance and transparency.

Title I, also known as the ***Financial Stability Act of 2010***, creates two agencies and clarifies the comprehensive supervision authority which are charged with monitoring systemic risk, researching the state of the economy and generally looking out for the next big problem. It also clarifies the comprehensive supervision of bank holding companies by the Federal Reserve.

The Financial Stability Oversight Council and the Office of Financial Research are two new agencies that are part of the Treasury Department. The chairman of the Council is the Treasury Secretary, and the head of the research office is a Presidential appointee who will have Senate confirmation. The Council is charged with identifying risks to the financial stability of the United States from both financial and non-financial companies., It is also charged with promoting market discipline and maintaining investor confidence.

As part of its duties, the Council will monitor the financial services marketplace and make general recommendations to affiliated agencies. It can also compel the Federal Reserve to assume direct oversight of certain institutions deemed to pose systemic risk to the economy.

The Council has two very broad authorities designed to help it monitor and assess risk. It may collect information from *any* state or federal financial regulatory agency. It can also direct the Office of Financial Research to collect information from bank holding companies as well as non-bank financial companies.

The executive director of the Council will also be the director of the Office of Financial Research. The Council and the affiliated Office of Financial Research are responsible for facilitating information-sharing among the Council's member agencies as well as other federal and state agencies with responsibility for financial services, rule-making, policy development, examinations, reporting, and enforcement. In the previous regulatory scheme, which was often disjointed and operated in a parochial fashion, there was very limited information-sharing, particularly between federal and state banking agencies. Indeed, federal agencies often exercised their pre-emption authority over state agencies, and that may have contributed to both worsening and prolonging the financial crisis.

Importantly, the director of the Office of Financial Research will have subpoena powers which will compel any bank or non-bank financial services company to produce data the agency deems necessary to carry out its functions.

The law will specifically end *too big to fail bailouts* by prohibiting use of tax payer dollars to fund bailouts of individual companies.

Title II sets forth ***Orderly Liquidation Authority*** and describes how and under what circumstances financial

service companies can be liquidated. In addition to companies already covered by the liquidation authority of the FDIC and SIPC (Securities Investor Protection Corporation), the Act expands authority to include liquidation of insurance companies and creates an *Orderly Liquidation Fund.*

Title III is also known as the ***Enhancing Financial Institution Safety and Soundness Act of 2010.*** It streamlines banking regulation and permanently increases FDIC and NCUSIF (National Credit Union Savings Insurance Fund) insurance coverage from $100,000 to $250,000.

One of the most significant and far-reaching provisions of the Dodd-Frank Act is Title X which creates the Bureau of Consumer Financial Protection. It is more formally known as the ***Consumer Financial Protection Act of 2010***.

The CFPB has been charged with a wide range of consumer protection duties and has been given unprecedented authority and independence. The new bureau will be housed at the Federal Reserve with a dedicated budget funded by the Federal Reserve, yet the bureau will be independent of the Fed. The bureau will have an independent director appointed by the President and confirmed by the Senate. The bureau will contain five major units including Research, Community Affairs, Complaint Tracking and Collection, Office of Fair Lending and Equal Opportunity, and Office of Financial Literacy.

The CFPB will have rule-making authority and will be able to autonomously write rules for consumer protections governing all bank and non-bank financial institutions. The bureau will have authority to examine and enforce regulations for banks and credit unions with assets over $10 billion. Those institutions $10 billion or less will continue to be supervised by their primary regulator, such as the Office of Comptroller of the Currency and others. The CFPB will supervise and examine all mortgage-related businesses including lenders, servicers and mortgage brokers. The bureau will also take on supervision of payday lenders and student lenders.

One of the more significant but little noticed provisions is the ability to act quickly. The bureau will constantly watch for bad or predatory business practices and has been granted authority to act quickly to stop them without waiting for Congress to pass enabling legislation.

Title XIV is more formally known as ***Mortgage Reform and Anti-Predatory Lending Act.*** Its subtitles A, B, C, and E will be administered by the new CFPB. These four subtitles cover residential loan origination standards, minimum standards for mortgages, high-cost and reverse mortgage products, as well as escrow and settlement procedures for consumers who are having difficulty repaying their mortgages. It also makes changes to RESPA, The Real Estate Settlement and Procedures Act of 1974, specifically in matters relating to how servicers interact with borrowers.

Title XIV addresses a variety of appraisal and valuation issues. For example, it prohibits a broker price opinion as the primary valuation tool in connection with valuation of a primary residence. It allows use of an automated valuation model but requires bank regulators in concert with the Appraisal Standards Board of the Appraisal Foundation to establish quality control standards. The Act also addresses appraisal management companies which are widely used by financial service institutions. It requires that the fee paid to the appraiser and the administration fee charged by the management company both be set forth on the closing statement, commonly referred to as the HUD-1.

Within one year, the Government Accountability Office is required to conduct a study of the effectiveness and impact of various appraisal methods, valuation models and distribution channels as well the HVCC and the Appraisal Subcommittee. ■

Editor's note: *This article can also be accessed at William Pittenger's Web site at http://billpittenger.com/real-estate-economic-commentary/.*