The Dodd-Frank banking law five years on

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The Dodd-Frank “Wall Street Reform and Consumer Protection Act” turned five this month. Signed into law on July 21, 2010, the act was intended to shield the major financial institutions and regulatory agencies from any substantive change while leading the public to think that the predatory and illegal practices of Wall Street were being curbed.

Before signing the bill, President Obama described it as imposing “the strongest consumer financial protections in history.” He added, “It demands accountability and responsibility from everyone… there will be new rules to make clear that no firm is somehow protected because it is ‘too big to fail’… There will be no more tax-funded bailouts—period.”

Five years on, the law, largely a token measure to begin with, has, under pressure from financial industry lobbyists and Obama himself, been watered down further in the so-called “rulemaking” process to the point of near irrelevancy. To this day, only 247 of the act’s 390 rules have been finalized. Key provisions, such as the so-called “Volcker rule,” have only just gone into effect—allowing ample time for lobbyists to bribe regulators and congressmen to remove any serious restrictions on banks and hedge funds.

Background

Dodd-Frank was drafted in the aftermath of the 2008 financial meltdown, under conditions of intense public anger against Wall Street and the taxpayer bailout of the banks. Following the crash, 8.8 million Americans lost their jobs. Cumulatively, $19.6 trillion in household wealth was destroyed. The median household in 2013 had a net worth of $56,335, 43 percent lower than in 2007.

The financial disaster was triggered by manic and reckless profiteering by the major banks that was of an essentially criminal character. In 2011, Senator Carl Levin, chairman on the Senate Permanent Subcommittee on Investigations, which issued a 630-page report on the financial crash, said the investigation had uncovered “a financial snake pit rife with greed, conflicts of interest and wrongdoing.”

In order to keep the financial system intact, the US Federal Reserve made roughly $17.7 trillion in cheap or free loans available. Most of this money went to the large banks; the eight largest borrowers received about $11.5 trillion. The US government, in an unprecedented move, took over the insurance giant American International Group (AIG) with a $180 billion taxpayer-funded bailout.

Obama proposed the act in June of 2009. At the time, he described it as a “sweeping overhaul of the United States financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression.”

Banking regulation: 1929 versus 2008

It is worth reviewing what actually took place in the aftermath of 1929 to better understand the role and nature of the Dodd-Frank bill.

After the 1929 stock market crash, there was mounting public hostility towards the banks and the capitalist system as a whole. In 1934, three historic struggles of the working class occurred: the Toledo Auto-Lite strike, the Minneapolis General Strike (led by the Trotskyist movement) and the San Francisco General Strike.

The Roosevelt Administration decided to set up an independent public inquiry to investigate the banks and force leading bankers to appear under oath in a series of highly publicized hearings. The “Pecora Commission” is remembered by the name of its fourth and final chairman, Ferdinand Pecora. A lawyer who emigrated from Sicily as a boy, Pecora rose to prominence by shutting down illegal Wall Street betting houses as an assistant district attorney for New York City.

Pecora personally interrogated most of the bankers. Charles Mitchell, the president of the largest bank, National City Bank, was discovered to have been engaged in a massive proprietary trading scheme that played a role in the financial collapse. He resigned his post and was indicted on tax evasion. However, he avoided a guilty verdict and instead paid a $1 million civil fine ($18 million today).

The case led to the Glass-Steagall Act of 1933, which separated investment and commercial depository banking through a series of laws. This harmed investment banks such as JP Morgan. Before the law, half of the members of JP Morgan’s board of directors also sat on commercial bank boards of directors. This allowed JP Morgan to leverage huge quantities of capital from commercial banks to fund its speculative operations. Pecora also exposed the fact that JP Morgan had dispensed bribes in the form of loans to at least 60 directors and officers of other banks.

The head of Chase National Bank, Albert Wiggin, was criminally charged after his illegal activities were uncovered by the commission. Wiggin used his own money to bet against his bank’s stock even as he encouraged others to buy the stock. This led to “anti-Wiggin” sections of the Securities Exchange Act (1934), prohibiting insider trading.

Wiggin fled the country after being indicted. He returned a few years later and successfully fought off the charges with a team of lawyers, eventually paying a civil fine. Pecora said of him, “In the entire investigation, it is doubtful if there was another instance of a corporate executive who so thoroughly and successfully used his official and fiduciary position for private profit.”

The commission also exposed the fact that JP Morgan, Jr. and many of his associates paid no income tax in 1931 and 1932.

The Roosevelt Administration never went as far as jailing any of these financial titans; however, the period did see the indictment of some leading Wall Street bankers, the break-up of some banking empires, and significant financial reform.

In contrast, after the 2008 crisis, the Department of Justice signed a series of sweetheart deals with JPMorgan Chase, Bank of America, Citigroup, Deutsche Bank and other major banks protecting the executives from prosecution and facilitating the growth of their control over the national economy.

Then-Attorney General Eric Holder, while posing as being ‘tough’ on the banks, admitted that the banks were essentially above the law. Testifying before Congress, he stated, “I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them, when we are hit with indications that if we do prosecute—if we do bring a criminal charge—it will have a negative impact on the national economy, perhaps even the world economy…”

Holder now works at his prior job, a law firm that represents Wall Street banks. The firm held an office empty for him during his six-year term as attorney general.

Dodd-Frank

The Dodd-Frank act was part of the cover-up carried out by the Obama administration. Similar to the sweetheart deals shielding bankers, the law shielded the industry from oversight and regulation while pretending to do just that.

The bill was introduced by Obama in conjunction with its two major architects, Senator Chris Dodd (Democrat from Connecticut) and Congressman Barney Frank (Democrat from Massachusetts). At the time, Dodd was the chair of the Senate Committee on Banking, and Frank was the chair of the House Financial Services Committee.

Both Democrats were heavily backed by the financial industry over the course of their careers. Dodd raised over $48 million for campaigns between 1989 and 2010. Citigroup, the Royal Bank of Scotland, JPMorgan Chase and Hartford Financial Services were four of his top five contributors. Frank’s four top donors were FMR (Fidelity Investments), the National Association of Realtors, JPMorgan Chase and the American Bankers Association.

The bill itself is a mind-numbing 2,300 pages long and is composed of 16 provisions. These provisions are supposed to be interpreted and enacted by the regulatory agencies. In a telling statement, Senator Dodd said before its passage, “[N]o one will know until this is actually in place how it works.”

Rules range from identifying minerals coming from conflict zones to giving power to the Federal Reserve to use taxpayer money to take over and liquidate banks without congressional approval—a de facto institutionalization of financial rescue operations.

In sizing up the huge bill, it is useful to understand what it did not do. It did not break up the major banks. On the contrary, the biggest banks were allowed to grow even bigger.

The bill did not restore the legal wall between commercial and investment banking, a 1930s reform that had been increasingly eroded during the 1980s and finally overturned at the end of the 1990s, under Bill Clinton. It did not eliminate or substantially limit derivative trading, nor did it place any limits on executive pay.

Immense lobbying efforts went into the drafting of the bill. Eight congressmen—five Republicans and three Democrats—were investigated by the Office of Congressional Ethics for raising a combined $405,000 from the financial sector in the six weeks leading up to the December 11, 2009 vote in the House of Representatives.

A portion of the act concerns consumer protection. The relevant provisions purportedly make financial decisions regarding credit cards, home ownership and student loans more transparent for consumers. The law, for instance, makes overdraft programs voluntary and prohibits credit card companies from hiking fees on existing balances. It established the Consumer Financial Protection Bureau (CFPB), which is supposed to help enforce these measures. An agency within the Federal Reserve Board, the CFPB has little real power.

The four most important sections of the bill concern “living wills,” the “Volcker rule,” limitations on derivatives trading, and incentive-based banker pay.

Living wills

The “living will” requirement is comprised of regulations mandating some 130 banks to submit documents showing that, in case of bankruptcy, their failure would not result in contagion spreading to other banks and triggering a financial crisis. This is the supposed guarantee against any financial institution being “too big to fail.” Banks have to be able to demonstrate that they have an exit strategy that does not rely on massive infusions of taxpayer cash.

In 2014, the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve issued a statement commenting on the largest banks’ first round of “living will” filings. Bank of America, Citigroup, Deutsche Bank, Goldman Sachs, JPMorgan Chase, and UBS were among the banks reviewed.

Thomas Hoenig, vice chairman of the FDIC, described the findings. He said, “Despite the thousands of pages of materials these firms submitted, the plans provide no credible or clear path through bankruptcy that doesn’t require unrealistic assumptions and direct or indirect public support… in my view each plan being discussed today is deficient and fails to convincingly demonstrate how, in failure, any of these firms could overcome obstacles to entering bankruptcy without precipitating a financial crisis.”

The major banks today are larger than they were before the crash. It would thus be more destructive if one of them failed. According to the International Monetary Fund’s 2014 Global Financial Stability report, the largest three banks in the US—JPMorgan Chase, Bank of America and Citigroup—increased their share of the country’s banking assets from a little below 40 percent in 2006 to nearly 45 percent in 2014.

Volcker rule

Another major component of Dodd-Frank is the “Volcker rule” named after Paul Volcker, former Federal Reserve chairman (1979-1987). Volcker raised interest rates dramatically at the end of the 1970s and the early 1980s to increase unemployment and break the power of the labor movement. In his words, “The standard of living of the average American worker has to decline.”

The Volcker rule is supposed to prevent federally insured depository banks from engaging in proprietary trading, that is, financial speculation for the bank’s own profit, as opposed to using the money of client investors to speculate on their behalf. The Glass-Steagall Act had prohibited proprietary trading.

The Volcker rule was supposed to go into effect in 2012, but instead went into effect last week, after years of Wall Street lobbying to put in place loopholes that have rendered the rule virtually meaningless.

Undoubtedly there are many more loopholes and hedges that only the army of bank lawyers who helped write the rule understand. The *Economist* quotes a leading banker who read a 298-page proposal on the rule’s implementation. He said that it was “unintelligible any way you read it.”

While banks are theoretically not allowed to make proprietary trades, they can trade on their own account for the purpose of what is called "market-making." This refers to the purchase and sale of securities in a manner that benefits the banks' clients.

A report by Public Citizen explains that Goldman Sachs likely evaded the spirit of the Volcker rule simply by relabeling its investments to portray them as part of its "market-making" operations. While Goldman Sachs CEO Lloyd Blankfein claimed in 2013 that his bank had stopped proprietary trading, the section of its financial report that read "trading and principal investments" had simply been cut out. In its place was a new category, "Market-making," which had roughly the same volume of assets.

During the protracted process of drafting the Volcker rule regulations, JPMorgan CEO James Dimon, at one time known as Obama's "favorite banker," insisted that the language permit banks to make bets in order to "hedge" entire investment portfolios as well as specific investments. Using such caveats, the banks can justify any financial bet. For instance, Dimon and JPMorgan defended the bank's massive bet on derivatives in 2012 that led to a $6.2 billion loss—the so-called "London Whale" scandal—as a hedge permitted under the Volcker rule.

The most blatant way banks use their government-insured deposits to gamble is through hedge funds. The Volcker rule says that banks can have ownership of up to only 3 percent of a hedge fund. However, the date at which this is to be implemented has been pushed back to 2022.

An exposé by Bloomberg highlights how the regulations might be gotten around. Bloomberg interviewed more than 20 employees who at one time worked in a "secretive" Goldman Sachs group called Multi-Strategy Investing (MSI). One of the interviewees told Bloomberg: "MSI is very much like a hedge fund." The interviews took place after Goldman said it had shut down proprietary trading. According to Bloomberg, Goldman "doesn't report on the holdings or performance of MSI, or of the Special Situations Group in which it's housed."

Derivatives

A third major component of the Dodd-Frank act is the so-called Lincoln amendment, named after former Senator Blanche Lincoln (Democrat of Arkansas). The Lincoln amendment was supposed to bar FDIC-insured banks from using swaps, the most elaborate form of derivative trading.

A credit default swap (CDS) is a way of hedging against the failure of a bond. If the bond fails, the CDS holder is paid by its issuer. Ostensibly, this should be a kind of insurance. But, the holder of the CDS is rarely the same person as the holder of the underlying bond that is being bet on. This allows banks to bet on the failure of bonds. As the *Public Citizen* report notes, "[T]he default of one bond might trigger payments many times the value of that bond." It continues: "In the case of AIG [American International Group], US taxpayers paid more than $180 billion to the CDS holders of contracts written by the insurance giant."

Before Dodd-Frank was passed, Senator Lincoln allowed for several caveats and loopholes to be appended to her amendment. However, after the bill was passed, the amendment was all but eliminated. As Congress was working through the December 2014 $1.1 trillion government spending bill, Citigroup lobbyists successfully tagged on a piece of legislation that virtually eliminated the Lincoln amendment. JPMorgan CEO Jamie Dimon and President Obama both personally spoke to members of Congress who were upset about the maneuver to make sure that the government-spending bill passed.

Incentive-based pay

A final provision that was supposed to, in the words of Obama, "rein in the abuse and excess that nearly brought down our financial system," is Section 956 of the Wall Street Reform act. This section gives regulators authority to "prohibit any type of incentive-based payment arrangement." This broad section remains a dead letter. No part of this section has been rolled out. Regulators have already missed a 2011 deadline set by the bill, and there is no concrete plan for it to be implemented in the near future.

Rather than having their excess reined in, top bankers have given themselves record-high or near record-high compensation packages. As *Public Citizen* notes: "The top executives of Bear Stearns and Lehman Brothers received a collective $2.5 thousand million in the years preceding their failure, and repaid none of it. More than 1,500 employees of JPMorgan take home more than $1 million each… [At Goldman Sachs] nearly 1,000 workers enjoy yearly compensation of more than $1 million each."

In 2014, top bankers' pay rose 17 percent. Jamie Dimon personally took home $27.6 million. This, of course, is to say nothing of the hedge fund chiefs. The 25 top-earning hedge fund managers took in an average of $400 million in 2014. That's $200,000 per hour, assuming a 40-hour workweek.

When Obama called the Dodd-Frank bill a "sweeping overhaul of the United States financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression," he was lying. Dodd-Frank is a smokescreen intended to deceive the American public into thinking that something substantive has been done about Wall Street.

Years of lobbying have seeded the gargantuan bill with loopholes aplenty. Today, nearly seven years after the financial collapse, the stock markets are soaring. While the underlying economy is stagnating, cheap credit from the Federal Reserve has spurred a speculative frenzy surpassing the lead-up to 2008. The legacy of the Dodd-Frank bill is that it has given a free pass to Wall Street as the financial system heads toward a new and even more disastrous crisis.