# In making banks less risky for consumers, the Dodd-Frank Act produced mixed results at best, study finds

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The Dodd-Frank Act, enacted in 2010 to promote economic stability and protect consumers in response to the 2008 global financial crisis, is

showing mixed results, according to a new study by Case Western Reserve University.

Most banks in the United States are not taking fewer risks, while others have increased their risk-taking after adopting the law's key consumer-protection provisions: Banks with more than $10 billion in assets must have a risk committee; banks with more than $50 billion in assets must have a chief risk officer.

"Overall, these aspects of the Dodd-Frank Act had little direct impact on reducing bank risk," said Lakshmi Balasubramanyan, co-author of the research and an assistant professor of banking and finance at the university's Weatherhead School of Management. "In terms of improving bank risk management, these Dodd-Frank mandates produced mixed results and seem to lack the bite necessary to lessen risk."

In fact, the appointment of a chief risk officer led to an increase in some measures of banks' risk-taking. That includes their overall risk and "tail risk"—a measure of extreme events—but not in others, such as the expected frequency of bank defaults or in their use of derivatives, researchers found.

Risk committees also did not make firms less risky, either, researchers found.

"Banks may comply with the Dodd-Frank Act, but treat the regulatory requirements as nothing more than a nuisance," researchers concluded. "Even if banks take these mandates seriously, the risk committee members and the risk officers may not be qualified enough to catch serious problems."

In forcing firms to monitor risk more closely—and optimize their risk profiles—the law led to some firms choosing more risk, while some

scaled back.

It's possible some banks realized they weren't taking enough risks, Balasubramanyan said—and by adding the mandated oversight of risk—may have felt more confident to increase their risk-taking.

## The question of how to capture risk

The Dodd-Frank Act did not stipulate which oversight measures to use to determine levels of risk.

In this study, little to no risk reduction was shown by standard measures used in the banking and finance industry, including the volatility of a bank's stock.

By widening the scope of measures, researchers found that an uncommon assessment—expected default frequency—was sensitive to increased risk-taking by banks.

"Knowing which measures show the effectiveness of regulations can help convince bank to comply," said Balasubramanyan."This is significant, as banks spread out costs of compliance by becoming ever bigger—an especially concerning trend after banks 'too big to fail' triggered the last economic downturn and a massive bailout by the U.S. government."

**More information:** Working paper: www.clevelandfed.org/~/media/content/newsroom%20and%20events/publications/working%20papers/2019/wp1901.pdf

Provided by Case Western Reserve University

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