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September 25, 2012

# The Dodd-Frank Act: A Moral Skeptic Framework

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The Dodd-Frank Act: a Moral Skeptic Framework

During times of national hardship and poor economic performance it is often taken for granted that the public would express its dissatisfaction and anger in every direction. What is notable about today's public outcry, however, is that it has been markedly targeted toward the financial world, most notoriously through the Occupy Movement. A large majority of the public believes that the current crisis is inextricably tied to Wall Street in one way or another. It seems generally that in terms of remedying the situation half the country wants more regulations and the other half wants less. What both sides have in common though is that they believe the current system is not fully living up to an ideological principle. Both believe the system is missing a true imposition of what is right and wrong for institutions to do. Simply put, the country is upset with how we deal with our financial system.

Thus, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law on July 21<sup>st</sup>, 2010. This legislation weighs in at a whopping 848 pages, and according to a report by an international law firm, will require the issuance of 243 new rules, 67 new studies, and 22 new periodic reports.<sup>1</sup> It is filled with hundreds of competing ideologies and philosophies, and, frankly, there is much work to be done towards understanding it. Currently, the scholarly community is in the midst of producing analysis and interpretation of the law, albeit in a slow fashion. Nevertheless, the new rules will need to be written, the

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<sup>1</sup> Davis Polk & Wardwell LLP, Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010, [www.davispolk.com/.../070910\\_financial\\_reform\\_summary.pdf](http://www.davispolk.com/.../070910_financial_reform_summary.pdf)

studies will need to be conducted, and, ultimately, federal agencies and courts will need to enforce the law. Adding to the pressure, according to University of Pennsylvania Professor David Skeel, Dodd-Frank is intended for a *completely* new regulatory future.<sup>2</sup> Co-author of the law, Senator Chris Dodd, wrote, “Though it’s important that these new regulations be implemented soon, it’s far more important that these regulations get it right.”<sup>3</sup> Therefore it is imperative that we explore ways of understanding and interpreting the law so as to answer society’s issues with our financial system.

With this paper, as the title suggests, I hope to create a framework for interpreting the broader meaning of the Dodd-Frank Act. You should note that I purposely write *a* framework as opposed to *the* framework because there is not one true way to interpret a law. Especially with something as massive as Dodd-Frank, it would be impossible for one single theory to understand all of its intricacies. Therefore, the legal community must explore various ways of understanding the law with the hope that each will add something to our understanding of it. For the sake of understanding the role of this paper, it is best to consider the regulatory regime brought upon by Dodd-Frank as a brand new house. The legislative act is the initial blueprint, but a framework of measured wood, posts, and supports is needed in order to actually build the house. This initial framework must represent the true intentions behind the design and make sure all of its parts are functioning for the proper purpose. That way the regulators, agencies, and courts will be able to complete construction of the new house. In the case of financial law, this framework

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<sup>2</sup> Skeel, David. *The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences*. (Wiley, 2011).

<sup>3</sup> <http://www.politico.com/news/stories/0712/78819.html#ixzz22LJ9HPp3>

must represent what legal scholars like to call the spirit of the law. That leads to a big question, what exactly is the spirit of the law?

For this paper I will explore the philosophical influence of public outcry on the spirit of the law. As the newspapers of the time made clear, a large impetus to the formation of the law was public outcry. The general public was fed up, and they wanted justice, for what they believed was corrupt Wall Street working against the interests of Main Street. A whopping 73% of Americans supported strong oversight of Wall Street and the ideas in the law's provisions, according to polling by Lake Research Partners.<sup>4</sup> This overriding desire to catch the "bad" guys permeates through the pages and pages of Congressional committee hearings and reports. If there was one major belief among the public dictating the purpose of Dodd-Frank, it was to bring justice to the "bad" banks, regulators, and financial institutions that the public believed to be at fault for the economic collapse. Thus a major framework used for interpreting the law should be guided by a legal philosophy hinged upon the desire to catch the "bad" guy, namely moral skepticism.

Moral skepticism bases itself in the claim that there is no way for society to know what is truly right or wrong, but rather society imposes its own standard of virtue and vice. In the legal field Supreme Court Justice Oliver Wendell Holmes Jr. first championed this philosophy. Justice Holmes did not believe that it is relevant what is ethically right or wrong when creating or interpreting law. He even went so far as to hypothesize that morality might have a negative effect on law, "For my own part, I often doubt whether it would not be a gain if every word of moral significance

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<sup>4</sup> <http://www.politico.com/news/stories/0712/78819.html#ixzz22JgUC2ql>

could be banished from the law altogether.”<sup>5</sup> From a moral skeptic approach, law is the sole meaningful tool for society to determine what is right and wrong. Therefore society’s moral and political theories have an extremely large, significant role in determining the rules of society forcing us to deeply explore these theories when interpreting law.

Justice Holmes’ overriding belief was that law should be read as if it were solely addressing the “bad” guys in society.<sup>6</sup> These “bad” guys, according to Holmes, do not care for what is considered ethical, but rather are persuaded to follow the rules of society through the threat of punishment. This belief stems from his early work on the origins of legal systems. In *The Common Law* he writes, “It is commonly known that the early forms of legal procedure were grounded in vengeance.”<sup>7</sup> It seems most appropriate that the law would be directed towards those that society seeks vengeance. Especially prevalent in the economic world is a cost-benefit analysis of action, which is the same approach moral skeptic Friedrich Nietzsche propounded.

Nietzsche’s overriding belief in the field of law was that people act solely in private interest, hence law must seek to channel that away from less desired results. The main driving force of humans is their “will to power”, and people are motivated by ambition, greed, and achievement. Nietzsche stressed that people are very individualistic. This led him to the conclusion that they would always prefer to do what is best for them even at the expense of others. Applied to law, this would mean

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<sup>5</sup> Holmes. *The Path of the Law* . 10 Harvard Law Review (1897) p. 464

<sup>6</sup> Holmes. *The Path of the Law* . 10 Harvard Law Review (1897)

<sup>7</sup> Holmes. *The Common Law* (1881) 2.

that society, through the guise of law, would have to corral and force individuals into abiding by mutually beneficial rules. Nietzsche even claimed that law could force people to engage in any behavior society deemed important. Professor of law at Yeshiva University, Peter Goodrich, summarized Nietzsche's belief by saying that law is society's transmission of value.<sup>8</sup> There is no set value that all people live by, but rather law imposes it on society. Law is the defining factor of our morals, not some intrinsic belief system all people have when they are born. Therefore, according to Nietzsche, criminals exist insofar as our "will to punish".<sup>9</sup> Further analysis of legal moral skepticism brings us to 18<sup>th</sup> century British philosopher David Hume.

The premise of Hume's argument for moral skepticism is that justice is not natural, but rather a necessity of mankind. Desire, rather than reason, governs human behavior. In his *Treatise of Human Nature* Hume writes, "We have no real or universal motive for observing the laws of equity."<sup>10</sup> People only follow their individual motives and incentives, so society should seek to address and coerce those people whose desires do not go along with our broader goals. It is law that can force people's actions. In a slightly moral nihilistic tone, Hume believed that true virtue and vice could never be understood through reason. He compares virtue and vice to hot and cold in that they are relative terms that change from person to person and circumstance to circumstance.<sup>11</sup> It is with this understanding of the

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<sup>8</sup> Goodrich and Valverde. Nietzsche and Legal Theory: Half-Written Laws. (2005). 4.

<sup>9</sup> Balke, Friedrich. "Nietzsche's Philosophy of Crime from a Biopolitical Point of View" Nietzsche and Legal Theory: Half-Written Laws. (2005) 53.

<sup>10</sup> Hume. A Treatise of Human Nature (1739) 483.

<sup>11</sup> Hume. A Treatise of Human Nature (1739) 470.

principles of moral skepticism that we can explore how beneficial of a framework this philosophy provides for understanding Dodd-Frank.

Washington did not believe that the financial system knew what was right and wrong. Look at the “shadow” banking system that rose in the years preceding the crisis. Investment banks began acting exactly like commercial banks but hid their actions so that they did not need to be regulated like commercial banks.<sup>12</sup> This was genuinely wrong in a regulatory and, most likely, an ethical manner. The same goes for commercial banks that began using structured investment vehicles to move assets off their balance sheets and do what were legally dubious activities. Moral hazard was rampant, especially with the firms deemed “too big to fail”. The Dodd-Frank Act has provisions that attempt to fix all of these issues. In an opinion piece Senator Dodd wrote the main goal of the legislation was, “responsibly implementing an effective regulatory structure that puts the best interests of the American people above all else.”<sup>13</sup> Therefore, since the purpose of the legislation was to listen to and promote the welfare of an enraged public, a moral skeptic approach would be beneficial to understanding the law.

To understand how the moral skeptic framework will develop we must look at the spirit and purpose of the law in its clauses. The basis of the law came from a template issued by the Treasury in March 2009 titled, “Rules for Regulatory Reform”. The template laid out four main areas of focus for new financial law: addressing systemic risk, protecting consumers and investors, eliminating gaps in

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<sup>12</sup> Shiller, Robert. *Finance and the Good Society*. (2012) 42.

<sup>13</sup>[http://www.politico.com/news/stories/0712/78819\\_Page2.html#ixzz22LjwCA5R](http://www.politico.com/news/stories/0712/78819_Page2.html#ixzz22LjwCA5R)

the regulatory structure, and fostering international coordination.<sup>14</sup> The law itself was heavily based on the 2009 template, and individual clauses were built from that.

Here we find two divergent ways to look at the broader context of Dodd-Frank. One way is to look at clauses such as the Volcker Rule, which imposes a specific cap on proprietary trading by commercial banks, in a literal sense. However, a wise ancient proverb goes, “if you show me a 15 foot wall, I will show you a 16 foot ladder.” If the Volcker Rule is looked at with a non-moral skeptic framework, it could be interpreted to simply mean that banks can only use a specific amount of a certain type of money for what is effectively gambling. With that approach, it will only be a matter of time until banks figure out a way to climb over that wall. The other way to look at the broader context of Dodd-Frank would be using what we know about the spirit of the law and a moral skeptic approach. This approach would mean that the Volcker Rule, as opposed to setting a literal cap on specific things, tells us what is right and wrong for a financial institution to do. Paul Volcker, who proposed the rule, stated, ““I’d write a much simpler bill. I’d love to see a four-page bill that bans proprietary trading and makes the board and chief executive responsible for compliance. And I’d have strong regulators. If the banks didn’t comply with the spirit of the bill, they’d go after them.”<sup>15</sup> Here we see a former Federal Reserve Chairman promoting the spirit of the law and a moral skeptic framework for understanding Dodd-Frank.

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<sup>14</sup> Skeel, David. The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences. (Wiley, 2011).

<sup>15</sup> Stewart, James (October 21, 2011), "Volcker Rule, Once Simple, Now Boggles", New York Times.



With the goal of protecting consumers and investors in mind, the act includes provisions that require a CEO to give back “erroneously awarded compensation” that was the result of “material noncompliance of the issuer with any financial reporting requirement under the securities law.”<sup>16</sup> A non-moral skeptic approach towards this clause would mean giving a corporation some loose estimate of what amounts to material noncompliance. Looking at the clause through a moral skeptic lens, however, means that regulators and courts should see the imposition of what is right and wrong by this clause. Congress is stating that, categorically, any compensation given because of fraud should be returned end of story. Furthermore, this clause contains terms that resemble the Squam Lake Group’s recommendation. Looking at their proposal reveals a desire to deprive the CEO of the rest of the compensation if ever there were a bailout or failure of the company.<sup>17</sup> The proposal’s influence further reveals how the law utilizes a moral skeptic mindset in its imposition of what is right and wrong.

The hallmark of the Dodd-Frank Act is the creation of the Consumer Financial Protection Bureau (CFPB). Harvard Law School professor Elizabeth Warren’s papers in 2007 and 2008 held the basis for the new bureau. In those papers she was alarmed at the lack of consumer protection in the financial industry. She uses an apt example of a consumer purchasing both a toaster and a mortgage.<sup>18</sup> In our world a consumer need not worry much when buying a toaster because it is impossible to buy one that has a one-in-five chance of bursting into flames and burning down

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<sup>16</sup> Dodd-Frank Act, H.R. 4173-579, Section 954.

<sup>17</sup> Shiller, Robert. Finance and the Good Society. (2012) 23.

<sup>18</sup> Warren, Elizabeth. “Unsafe at Any Rate” (2007). [www.democracyjournal.org/pdf/5/Warren.pdf](http://www.democracyjournal.org/pdf/5/Warren.pdf).

their house, but it is very possible to refinance an existing home with a mortgage that has the same one-in-five chance of putting the family out on the street. Not only that, but the mortgage will not even carry a disclosure of the danger to the consumer. Even more so, as evident by the recent financial crisis, financial products like that are pushed upon consumers. This is a grossly absurd situation. Professor Warren argues that we need to have the same consumer protection for financial products as we do for appliances. Adding in the second goal of the March 2009 Treasury report (protection consumers and investors), we can develop a solid framework for understanding the role of the CFPB.

According to the text of the act, the CFPB may make rules, litigate on behalf of consumers, hold hearings, and can provide model forms for financial products. The bureau has six subdivisions each with their own powers to fulfill the duty of the bureau.<sup>19</sup> This new agency becomes the determinant of what is right and wrong for companies to do when issuing consumer financial products. Dodd-Frank should be properly interpreted as giving the CFPB a mandate of protecting consumers in any way possible within the scope of its power. Regulators and courts alike may seek to underestimate the bureau, but, as evidenced by public desire, large congressional support, and outside reports, the CFPB is one of the most important results of Dodd-Frank in its aim at bringing about a new regulatory future.

There are many more clauses to analyze and understand within Dodd-Frank, but for the sake of this paper, it would be superfluous to elaborate much more. Financial law, like most law, is extremely complicated and requires a lot of work to

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<sup>19</sup> Dodd-Frank Act, H.R. 4173-579, Title X.

understand it fully. In terms of Dodd-Frank many factors lead me to believe that moral skepticism would provide a proper framework for understanding its intricacies. The public outcry towards Wall Street and the financial world had a large influence on legislators, especially Democratic ones that authored the legislation. This outcry was also directed towards vengeance and a desire to catch the “bad” guys which, whether true or not, were believed to have caused the economic collapse. Stemming from that desire the subtext of Dodd-Frank must be rife with moral skeptic ideas and principles. Therefore, in order to create a proper framework for implementing Dodd-Frank we must include a moral skeptic approach towards understanding the law.

It might seem that the approach I laid out is a very positivist approach, but that is an unavoidable truth. Oliver Wendell Holmes was a dedicated legal positivist and it showed throughout his work in moral skepticism. He is known for his famous introductory line from *The Common Law*, “The life of the law has not been logic: it has been experience.”<sup>20</sup> The roots of Dodd-Frank were sown in the realities of the financial crisis of the late 2000s, not from some unrelated whim of a legislator. As more time passes and more actions are taken by all parties to align themselves with the new legislation it is important that we take the time to fully understand the law as it is what will ultimately govern the future of the financial world.

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<sup>20</sup> Holmes. *The Common Law* (1881) 1.