HOLISTICA Vol 12, Issue 1, 2021, pp.1-10 DOI:10.2478/hjbpa-2021-0001

THE 2008 FINANCIAL RECESSION AND THE DODD-FRANK ACT

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Received: December 2020 | Accepted: February 2021 | Published: April 2021
Please cite this paper as: Spano, D. (2021) The 2008 financial recession and Dodd-Frank act, *Holistica Journal of Business and Public Administration*, Vol. 12, Iss. 1, pp.1-10

Abstract

The 2008 Financial Recession was one of the most significant fiscal downturns in the history of the United States. Considering that the world is in the midst of a global pandemic which may lead to another adverse economic climate, I believe that looking back at the causes of the 2008 Financial Recession is recommended. This may assist administrators to avoid the missteps which sparked this down economy in the future. By reading this paper, readers will also learn about the demographics effected by the recession and the Dodd-Frank Act, which was drafted to combat future occurrences of this nature.

Keywords: Recession, Dodd-Frank Act, Obama, Regulations, Policy

1. Introduction

The purpose of this paper is to inform readers about the 2008 Financial Recession. More specifically, it will focus on its causes, on the selection of the affected demographics, and the Dodd-Frank Act. This work will conclude with the understanding of the effects of the regulation as a necessary response to a financial downturn, and finalizing with the presentation of the major takeaways.

2. The 2008 Financial Recession

A recession is a period of economic construction in which the value of the gross domestic product declines for two consecutive quarters (Birkland, 2020, p. 49). The 2008 Financial Recession marked the most significant economic downturn since the Great Depression. In respect to Birkland's identification, many key fiscal figures were not only on the decline for a couple of quarters, but for years. This recession lasted from December 2007 to June 2009. In regards to data, in the fourth quarter of 2008, unemployment rose to 6.9%, or

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there were 10.6 million jobless professionals in the United States (Borbely, 2009). As a point of contrast, the unemployment rate during the fourth quarter of 1997, which is generally viewed as a booming economic period, was 4.7%. Though this percentage alteration may seem marginal, it encompassed an additional 3.38 million unemployed professionals during this period (llg, Clinton, 1998). The Dow Jones Industrial Average plummeted, falling from over 14,164 in October 2007 to 6,507 in March 2009 (Eisner, Allen, Ringquist, and Nestor, 2018, p. 91). Foreclosures were up 81% from 2007 to 2008 and 225% from 2006 to 2008 (Christie, 2009).

I chose to underscore unemployment, corporate figures, and the housing market, because they embody the state of the economy. I inspected the unemployment rate because this suggests how many professionals were affected due to the adverse economic climate, the Dow Jones and stock market figures indicate corporate strength, and less foreclosures signify a more viable housing market. These undesirable statistics serve as strong indicators of how dismal the domestic economy was during this period.

2.1. Causes of the 2008 Financial Recession

There were a variety of factors which contributed to this fiscal downfall, chief among them was erroneous mortgage lending. Consumers who would traditionally be denied lending opportunities were approved for mortgages and other loans during the early 2000's. In retrospect, it was not surprising that these consumers failed to repay their loans, and massive defaults followed in the mid 2000's. Said defaults led to the housing market deteriorating, and were a major contributing factor to this crisis (Eisner, Allen, Ringquist, and Nestor, 2018, p. 113).

A second reason for the 2008 Financial Recession was excessive credit card and general lending allocations. Though the lines of credit on these financial products are usually lower than those of mortgages, if enough clients default on making their payments, it can still be detrimental to the financial institutions. For example, while serving as a Banker at BB&T and PNC, these firms had a lending product called an unsecured loan. Though debt to income, credit, and other factors needed to be at a certain level for a client to be granted this loan, their actual income went unchecked. This meant that a client can be deceptive regarding their income level, and the figure which they orally presented to a bank associate was utilized on their application. There were many of these loans which were not paid back, and this led to a financial loss for the bank. Though I started working for BB&T in 2014, the restrictions to garner these loans and mortgages were even more lax in 2008. This led to clients not paying their loans back, and all parties suffering as a result.

The final reason for the 2008 Financial Recession was a lack of government regulations. Though some regulations existed, such as the 1999 Financial Services Act, a broad and large sweeping legislation in the financial sector had not been drafted for some time prior to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

2.2. Select demographic effected

There were a multitude of professionals and individuals who suffered as a result of the 2008 Financial Recession. I feel that the following demographic categories were the most impacted:

1. Prospective professionals fresh out of college: Many individuals attend college to enhance their knowledge, but they still hope to garner a livelihood following this experience. I obtained my Bachelor's Degree in Business Administration from the University of Miami in 2007, and attempted to secure employment thereafter. I participated in countless job interviews, signed up to over a dozen employment agencies, took part in at least one networking event weekly, and connected with many colleagues. Despite my best efforts, I was unable to launch my career. I ultimately attended graduate school at Florida Atlantic University and earned a Masters of Business Administration in 2010. At this point, a well-paying job should have been a guarantee. I again conducted all of the aforementioned efforts to achieve this objective, but they were initially in vain. After many years, I earned an entry level job. This job was as a Personal Banker for BB&T, with an annual salary of $35,000, significantly less than I expected with any degree. My experiences during this period personified those of many individuals. It was a time where expectations were not met, and dreams of achieving success were shattered due to the adverse financial climate.

2. Middle management professions: This refers to individuals who were generally middle aged, but moreover, were the major source of financial aid for their families. They were ultimately terminated from their positions as a result of the recession. I feel that this exemplifies the group which endured the most unpleasant experiences due to this downturn, as it not only lost a steady flow of income, but the chances of these professionals having a significant other or dependents were higher than the aforementioned demographic. I knew many professionals in this position who not only gave up their livelihoods, but were forced to abdicate their homes, marriages, and in extreme cases, some even claimed their own lives.

3. Seniors: Many seniors went back to work during this period, even in lower paying jobs. The reason for this was that they wanted to assist their adult children, who were displaced from significantly more lucrative careers. Interestingly, I witnessed instances where older demographics found a renewed sense of purpose as a result of going back to work. Regardless, their reasons of taking said actions were to assist their families.

3. The Dodd-Frank Act

Though this is not the case with every regulation passed, it is necessary that significant context in respect to the 2008 Financial Recession was provided prior to discussing the Dodd-Frank Act. The reason is because the Dodd-Frank Act was drafted as a direct response to this financial downturn (Eisner, Worsham, Ringquist, and Nestor, p. 56). The Dodd-Frank Act became effective on July 21, 2010, under the Obama administration.

Considering that this regulation was 848 pages, with sixteen separate titles and acts, it would be nearly impossible to contest its breadth and depth (Scott, 2013, p. 1).

This act sough to accomplish a number of aims. The first aim was to create a new regulatory authority to systematically oversee important events. One example of a new agency established under this act was the Bureau of Consumer Financial Protection (BCFP). This agency was tasked with monitoring many financial regulations, from credit card charges to home loan interest rates. This bureau's mission is to make financial markets work for consumers, responsible providers, and the economy as a whole. It protects consumers from unfair or abusive practices, and takes action against companies which break the law. The BCFP accomplishes these aims by arming citizens with the information and tools that they need to make reasonable financial decisions (Consumer Financial Protection Bureau, 2020). This is evidence that this legislation was created as a response to the financial crisis. If various items, such as the credit score in which prospective clients needed to obtain a mortgage and interest rates were tracked prior to the fiscal meltdown, it is possible that it never would have occurred. The Obama administration recognized this was a pressing issue, and established this agency. I have had multiple experiences in banking which underscored the importance of this enterprise. For example, this agency ensured that if a mortgage rate is posted in a financial institution, said figure must be guaranteed to consumers. It must also be made lucid in the financial product advertisements that the presented rate may not be applicable to all consumers (i.e.: a rate as low as 2%). Following the establishment of this bureau, bank associates were also instructed to be crystal clear with customers. Financial institutions were so adamant about this subject that associates were required to attend multiple training sessions on it. The Dodd-Frank Act also championed this aim by empowering the Security and Exchange Commission (SEC) to oversee credit-rating agencies, regulating derivative trades, and creating a more transparent environment for how agencies rated derivates and compositions. Monitoring credit-rating agencies is applicable to bank clients, as they are approved for mortgages, credit cards, lines of credit, and other financial instruments based on if credit agencies deem them to be worthy of paying back their debts. Recall that erroneous lending was the primary cause of the 2008 Financial Recession, so this served as a course correction to this issue. Regulating trades is not necessarily related to banking, but applicable to corporate professionals. These professionals were not immune to enhanced financial regulations, and monitoring this sector was a boon to overall financial prosperity. Finally, a key takeaway via this task is the word 'transparent,' as this was a major objective of the Dodd-Frank Act. This regulation wished to make all enterprises associated with banking apparent and comprehensible to clients, and eradicate deceptive practices in the field. This is vital to bank customers, as they deserve to know actual rates of mortgages and other products.

The second aim was to enhance consumer and investor safeguards. One illustration of a safeguard of the Dodd-Frank Act is that it gave the Federal Deposit Insurance Commission (FDIC) the power to dismantle large financial companies if their operations became untenable (p. 121). I find this to be comforting, as there have been instances where

financial institutions were unable to tend to the obligations of consumers. Lehman Brothers serves as an example. Financial institutions may be powerful and have significant resources, but they are not 'too big to fail.' The FDIC has the latitude to determine if this is a viable possibility, and take steps to be proactive in this situation, or even order financial institutions to discontinue operations. The FDIC also increased the insurance per individual account to $250,000 under this act. This is important because it enhanced the finances that a bank customer may retain in their account, without the fear of losing their capital. The Dodd-Frank Act's provisions intended to end predatory lending by forbidding balloon payments, interest-only loans, and similar 'innovations' popularized in the 1990's (Eisner, Allen, Ringquist, and Nestor, pp. 121-122). Having studied loans from the 1990's, I verify that many of the methods in which interest rates were previously calculated were questionable. The Dodd-Frank Act made it nearly impossible to conduct business in this fashion. This also created an additional provision for mortgage borrowers, as it required lenders to certify the eligibility of would-be borrowers via House Counselling, in the Housing and Urban Development Department. Considering that the point of a loan is to be beneficial to the borrower and the lender, as the borrower receives financial aid and the lender is supposed to garner the principle plus an agreed upon interest rate, I feel that the borrower should be highly scrutinized prior to granting him or her a loan. This reason for this is because allocating an inappropriate candidate a loan which they cannot repay is adverse for each entity.

The third aim tried to mitigate one of the primary causes of the 2008 Financial Recession, the mortgage lending industry. This is sensible and necessary, giving the part that unsound mortgage lending played in causing the 2008 Financial Recession. The Dodd-Frank Act altered mortgage lending under four key areas. The first area included expanding the scope of regulations on non-bank entities involved in the mortgage industry. More specifically, the Consumer Financial Protection Bureau (CFPB) focused more heavily on these organizations. It even issued penalties of $15 million against certain national mortgage security companies for paying kickbacks to mortgage lenders through the purchases of capital reinsurance. Some people are unaware that a mortgage can be obtained at institutions other than banks. Many of my former clients who were denied a mortgage from my past employers attempted to obtain this financial boon via non-mortgage lenders. I am not shocked that unscrupulous dealings were occurring in these establishments because they usually accept customers with lower credit scores and offer them higher mortgage rates. I feel these organizations should be scrutinized, as just because they are not part of the traditional banking system, they may still function in a questionable manner. An argument can be made that due to traditionally accommodating clients with lower credit who are often desperate to accept any mortgage rate, these establishments may be prone to this behavior. This is all the more reason that this stipulation was a prudent decision to include in the Dodd-Frank Act. The second area was civil libraries. Under the Dodd-Frank Act, the Consumer Financial Protection Act (CFPA) was empowered to bring a civil action against any entity who violated a federal consumer finance law. Some examples of penalties which can be enforced by the CFPA include refunds of monies, rescissions of contracts, and payment of damages. As of April 2013,

the CFPA has taken actions in eight or more enforcement proceedings and imposed over $57 million in civil penalties. I feel that granting the CFPA the authority to take these actions via the Dodd-Frank Act was a commendable decision for two reasons. The primary reason was that it granted bureaus the clout to take such actions. The secondary reason was the CFPA can conduct this business without having to communicate with many other authorities or agencies. This streamlines the process, and thus led to more progress. The third area was as a defence to foreclosures. This regulation made it so that a consumer can assert a violation by a creditor via sections 129B(c) and 129C(a) of the Truth in Lending Act (TILA). This can be utilized as a way to recoup and setoff foreclosures without regards to the applicable three-year statute of limitations. This section of the Dodd-Frank Act not only guaranteed that the amount of recoupment or setoff equals the amount which the consumer would be entitled to for damages via a valid claim, but it includes the costs and attorney fees for customers. I laud this section of the Dodd-Frank Act because it granted a great deal of privilege back to citizens. The final area involved arbitration. This legislation prohibited arbitration for residential mortgage loans or open-ended loans secured by a principal dwelling. The parties may agree to arbitrate only after the dispute. Considering that the arbitration process is generally lengthy, expensive, and slow moving, I deem this as a reasonable portion of the Dodd-Frank Act (Scott, pp. 105-106).

The fourth aim was to attach citizens back to the banking industry, as they had lost faith in it due to all of the aforementioned points. This was part of the regulation's agenda because it assisted in building up the economy. The Dodd-Frank Act included incentives that encouraged low to medium income people to partake in financial services. It is no coincidence that the demographic which was hit hardest by the recession was now being courted to work with the banking system again. This was a concentrated effort to re-established trust. There were many incentives from financial institutions to these individuals to accomplish this aim. They included grants, tax exemptions, and other perks for working with fiscal entities. One interesting example is that micro level loans of $2,500 or less were offered in various banks. This was sensible because the risk for the customers and the banks were low, and it served as an initial step for both parties to re-establish confidence in each other. It is of note that following the Dodd-Frank Act, loans were now offered to appropriate candidates (Scott, 2013).

The fifth aim was to manage top executive compensation. This was accomplished via Section 951 of the Dodd-Frank Act, as it provided shareholders a non-binding vote to approve the compensation of the CEO, CFO, and the next three most highly paid executives. Shareholders are also allowed a non-binding frequency vote, in determining how often the ballot to discern the wages of top-level executives would occur. Companies were required to disclose golden parachute payments provided to named officers based on a merger, acquisition, or consolidation of the company’s assets (Hughen, Malik, Shim, 2019). Though this portion of the act did not necessarily affect everyday citizens, it was still important for two reasons. The first reason was that it attempted to mitigate the salaries and Wall Street misdeeds of overpaid executives. For years, executive salaries were exponentially higher than middle management, and this act served to alleviate this

issue to some capacity. The second reason is that it showed working professionals that this behavior and high earnings would no longer be tolerated. This was important, as they are the same group which was affected by the 2008 Financial Recession, and it signified that they are vital to the American economic system. These actions should have occurred before the Dodd-Frank Act.

The final aim was to improve coordination amongst and elimination of gaps between financial regulators (Eisner, Allen, Ringquist, and Nestor, p. 119). The Dodd-Frank Act organized and streamlined much of the connections between the FDIC, BCFP, CFPB, SEC, and other entities which regulated the financial industry. In most of these cases, it also enhanced their power to monitor financial players. All of the aforementioned items serve as illustrations as to why this was the case.

4. Was regulation necessary?

There are a number of reasons why I believe that regulations were necessary in this particular circumstance. First, the figures in the initial section of this paper in respect of the 2008 Financial Recession highlight this point. Though it was my goal to provide an overview of this meltdown, there have been papers with countless other figures which can further strengthen this argument. Regardless, it is nearly incontestable that this nation was nearly crippled from a financial perspective, and regulations were needed to mitigate future adverse happenings.

Second, I laid out the categories which I feel suffered the most as a result of the financial recession. Statistics serve as a way to enhance a theory, but actually experiencing a focusing event, such as the 2008 Financial Recession, is perhaps more impactful than any data which can be presented. My aforementioned experiences were devastating and discouraging. Even over a dozen years following this period, I am still suffering for student debt, and I believe that my career trajectory would have been significantly better if I started working upon completing the University of Miami. It is also possible that it had lasting psychological effects on all individuals in this demographic, as being unemployed or underemployed made it challenging to live away from home. I resided with my parents substantially longer than I wanted to due to the recession, and this was difficult on my family.

I also knew many middle-aged professionals who lost their jobs. It was even more of a hardship for this demographic to have secured acceptable employment for two reasons. The first reason is ageism. Unfortunately, years of experience are often overlooked, and a prospective candidate's age is overly scrutinized in the corporate sector. The second reason is that younger and less experienced employers may be deemed as 'cheaper.' More to the point, why would a company such as BB&T hire a middle aged professional for a Personal Banker role via a starting salary of $50,000/year, when it could have a younger professional, for $35,000/year? I have more empathy and consideration for these professionals over the other demographics articulated.

I also knew a number of senior citizens who went back to work to assist in supporting their households. These individuals seemed to be more open on taking lesser paying jobs, such as working at McDonald's, perhaps because the major portion of their career was behind them. For example, my Aunt accepted a job working for McDonald's during that period, to assist her unemployed daughter and son-in-law, while they attempted to find higher paying jobs. I previously noted that most of the senior citizens that I associated with at the time obtained a renewed sense of self-esteem due to their new enterprises, but there were some who felt degraded. I believe that if professionals wish to enjoy their 'golden years' and an event, such as the 2008 Financial Recession, strips them of this lifestyle, it only further underscores the seriousness of this disaster.

By examining my prior statistics and these categories, it is clear that regulations were necessary following the 2008 Financial Recession. If the Dodd-Frank Act was never presented, the economy would possibly have further sunk into a depression, and never recovered. Fortunately, the Dodd-Frank Act, other financial legislations, the passage of time, the Obama administration's leadership, and other factors led to periods of future financial prosperity.

5. Key takeaways

There are several takeaways that I consider for analysing the 2008 Financial Recession and the Dodd-Frank Act:

1. Being knowledgeable on context around regulations is recommended: In some cases, exclusively studying a regulation with little knowledge of its context or background can be somewhat fruitful. The Dodd-Frank Act does not constitute as one of these circumstances. It was by design that an overview of the 2008 Financial Recession was granted prior to discussing the Dodd-Frank Act. This was my approach because the 2008 Financial Recession qualified as a focusing event, or sudden event which generated attention to public problems or issues, particularly those which are adverse (Birkland, p. 224). Articulated differently, since the Dodd-Frank Act was manifested as a direct response to the 2008 Financial Recession, I deemed it to be auspicious to have working knowledge on this focusing event to better understand this legislation.

2. Being proactive over reactive: Though I laud the Dodd-Frank Act, I feel that it was articulated in a reactive fashion. This regulation was created as a response to the 2008 Financial Recession, but it should not have taken the most glaring financial meltdown since the Great Depression to influence top level administrators to draft this legislation. Flawed financial practices have been prevalent for decades prior to 2008, but many of them culminated in this adverse happening, which sparked the Dodd-Frank Act. I do not feel that waiting for focusing events, such as the 2008 Financial Recession, September 11, 2001, or COVID-19, should be the government's preferred methodology. All of these focusing events caused causalities and financial issues, and if a more proactive framework was implemented, the outcomes would likely be superior.

3. Structuring regulations as a result of the focusing event which caused them: It has been noted that the 2008 Financial Recession was the major causation of the Dodd-Frank Act. To further this point, this act was actually structured around studying the 2008 Financial Recession. As a personification of this notion, multiple regulations and provisions in this act and this paper most predominantly underscored its mortgage clauses. This was by design, as the mortgage crisis was amongst the most significant reason for the 2008 Financial Recession, and needed to be addressed in detail in the Dodd-Frank Act. It is suggested that if any focusing event occurs, a legislation which is articulated as a direct response should focus deeply on mitigating any future causes of these happenings.

4. Structure in financial matters is preferred: One of the main objectives of the Dodd-Frank Act was to offer structure to the financial sector. It did this in many ways. First, it set up the BCFP and granted more authority to the FDIC. Second, it placed more stipulations on how financial products and services must be marketed. Finally, it streamlined communications via the financial bureaus. The financial sector was severely lacking this level of structure prior to the Dodd-Frank Act. I believe that enacting this organization was advantageous to this industry. From my career experiences, I concur that clients deserve to know the exact rates of a mortgage or other financial products. In respect to bureaus which regulate this industry, it was helpful to strengthen their communication, and thus improve the lives of financial representatives and their clients.

5. If something is questionable, it may be erroneous: It was not only questionable, but nonsensical that clients with very low credit were approved for sizable mortgages. Regardless, the clients accepted the terms of said mortgages, likely knowing that their economic conditions would not allow them to repay the loans. This was one of the factors which led to the Dodd-Frank Act. The lesson is that if a deal is dubious, it is recommended for individuals to seriously ponder if it is the optimal course of action.

6. Greed is not good: Greed was one of the major reasons that the domestic economy suffered as a result of the 2008 Financial Recession. For example, the mortgage companies and financial institutions granted mortgages to clients that had very slender chances of repaying their debts, because they wanted to capture maximum profits. These clients accepted the terms and conditions of said loans because they felt they needed to purchase large residencies from these bloated lines of credit. Per a second illustration, the compensation of many of the previously mentioned top level executives was egregious, and the Dodd-Frank Act minimized this in the future.

6. Discussion, and Conclusions

The Dodd-Frank Act is interesting, as the major contributing factor to its manifestation was the 2008 Financial Recession. It was necessary for this act to be drafted, as the domestic economy was in near collapse at this time, and government bailouts coupled with this regulation helped the United States to avoid this fate, and hopefully elude such

a devastating climate in the future. The fact that a financial recession of this magnitude has not affected the domestic economy since this time displays the effectiveness of this act. However, I believe that further focusing events, such as COVID-19, may eventually lead to another recession, and the Dodd-Frank Act or another legislation may have to be redrafted as a direct result of this happening. My strongest suggestion is to be proactive, to avoid any adverse financial events. If administrators fail to follow this recommendation, they should at least expect that this will eventually happen again, as recessions are part of a regular economy, and make adjustments based on the situation, like how the Dodd-Frank Act was created around lessons learned from the 2008 Financial Recession.

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