AN UNANTICIPATED CONSEQUENCE: WILL DODD-FRANK DROWN OUT SMALL BUSINESSES?

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I. INTRODUCTION

“[A]s one banker I will tell you this, my major risks are not credit risks, risks of theft, risks of some robber coming in with a gun in my office; my number one risk is federal regulatory risk.”

Thousands of pages of regulations will inevitably lead to thousands of critics. The banker quoted above is just one of the many people concerned with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act).2

The 2008 financial crisis was perhaps the worst financial crisis the United States has seen since the Great Depression.3 Many have labeled the crisis the Great Recession.4 Some of the most notable aspects of the crisis began in late spring of 2007 with the failure of many financial institution giants.5 A glaring example is the collapse of Lehman Brothers.6 Lehman Brothers was one of the largest financial institutions in the world.7 When the financial system faced sudden stress because of defaults in the subprime mortgage and commercial real estate markets, Lehman Brothers suffered a

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4 Id.
7 Id. at 1113.
massive loss and collapsed. Although the recession has technically ended and steps have been taken to stabilize the economy, the damage has been significant. The economy is still facing the consequences of the crisis. Effects continue to ripple throughout the country, as seen from the chronically high unemployment rate.

Approximately one year after Lehman Brothers collapsed, President Barack Obama called for reform in an attempt to rehabilitate the economy. The Obama Administration proposed Dodd-Frank in 2009. After a lengthy fight, the bill was signed into law by President Obama on July 21, 2010. Increased financial regulations are at the heart of Dodd-Frank’s comprehensive legislation. Dodd-Frank is intended to promote financial stability by improving accountability and transparency.

This note analyzes the different impacts that Dodd-Frank will have on small businesses. Part II begins with a brief history of the financial crisis that led to the need for increased financial regulation. Part III explores Dodd-Frank by discussing its proposal and introduction as well as the state of the Act today. Part II also explains leading criticism of the Act’s. Part IV begins to analyze the impacts of Dodd-Frank on small businesses. There are two significant ways in which Dodd-Frank will impact small businesses: increased regulation and small business exemptions. Part V proposes ways in which the goals of Dodd-Frank may be met without drowning out small businesses. These proposed changes include repealing, retaining or amending Dodd-Frank. This note proposes that the most effective solution to rehabilitate and stabilize the economy is to amend and save Dodd-Frank.

II. A BRIEF HISTORY OF THE FINANCIAL CRISIS

Throughout U.S. history, there has been an emphasis on bank oversight and regulation. However, the 2007 financial regulatory system was not able to keep pace with the modernization of financial markets. In 2007,

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8 Id. at 1113–15.
10 Burch, supra note 5, at 443.
13 Id.
14 See discussion infra Part IV.B for what type of business may qualify as a small business under Dodd-Frank.
16 Id.
the entire financial system nearly collapsed. Major financial institutions, insurers, enterprises and banks either failed or would have failed without significant federal support. A glaring example is the collapse of Lehman Brothers in late September of 2008. Lehman Brothers was one of the largest financial institutions in the world. Its biggest downfall was that its investments were concentrated in illiquid, risky assets. Lehman Brothers’ high-risk, high-leverage strategy made it vulnerable to market fluctuations. When the financial system faced sudden stress by defaults in the subprime mortgage and commercial real estate markets, Lehman Brothers suffered a massive loss. In the first half of 2008, Lehman Brothers’ stock fell by a startling 73%. No business deal was able to save the company. Lehman Brothers collapsed when the government refused to intervene and filed for Chapter 11 bankruptcy on September 15, 2008. This collapse was just one of many events that marked the beginning of the financial crisis.

Executive compensation and other practices on Wall Street likely contributed to the crisis. However, Wall Street is not solely to blame. There were a number of other key players. Loan officers were extending loans and mortgages to those who did not qualify. People were borrowing money when they could not afford to repay. Credit agencies were overrating investments. Banks were putting profits above the inevitable risk of creating an economy-wide vulnerable financial system. Regulators lacked sufficient pay incentives to compensate for the time and effort necessary to prevent excessive risk in the face of industry-wide changes. Moreover, regulators had no effective guidance or authority to address

18 Id.
19 Estrada, supra note 6, at 1129.
20 Id. at 1113.
21 Id. at 1116.
22 Id. at 1115-16.
23 Id. at 1113-15.
24 Id. at 1116.
25 Estrada, supra note 6, at 1117-18.
26 Id. at 1118, 1123.
27 See generally id.
30 Id.
31 Id.
32 Id.
33 Id.
34 Henderson & Tung, supra note 28, at 1003, 1045-46, 1048.
recent changes. They were left on their own to develop impromptu responses. In the face of an imminent collapse, this was not an easy task.

The accumulation of these factors resulted in extreme volatility in financial markets, failed attempts of state government regulation, a chronically high unemployment rate, government bank takeovers, a decline in stock market averages and billions spent on economic stimulus packages and bailouts. Accordingly, this period in economic history has appropriately been termed the Great Recession.

The Great Recession has affected a broad range of groups: government institutions, public institutions, private companies and citizens, to name a few. Additionally, small businesses and entrepreneurs suffered; entrepreneurship plunged and 170,000 small businesses closed. The stock market and housing market are still recovering from their fall. During the crisis, the S&P 500 Index fell by approximately 40%, while the Case-Shiller home price index fell by approximately 20%. Before the financial crisis, the unemployment rate was 4.7%. The unemployment rate reached 10% in 2009. Someone needed to step in to prevent a recurrence.

III. THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

Dodd-Frank represents the most comprehensive financial regulatory reform since the Great Depression. The provisions constitute “the toughest reforms on Wall Street since the 1930s.” Dodd-Frank was

35 Block, supra note 15, at 313.
36 Id.
37 Id.
38 Burch, supra note 5, at 431.
39 Fehr, supra note 3.
43 Id.
44 U.S. BUREAU OF LABOR STATISTICS, supra note 9.
45 Id.
47 Presidential Debate Questions and Transcript, supra note 29.
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proposed in light of the 2008 financial crisis. The Act was signed into law in 2010 and has been the center of controversy ever since.

A. The Proposal and Introduction of Dodd-Frank

Dodd-Frank is named after its authors, Christopher J. Dodd, former United States Senator, and Barney Frank, former Congressman. The Act was initially proposed by the Obama Administration in June 2009 in a political climate fraught with frustration over lax financial regulation and taxpayer-funded bailouts. Dodd-Frank passed Congress by relatively close margins: 223–202 in the House and 60–39 in the Senate. The Act was signed into law on July 21, 2010.

Dodd-Frank overhauls the existing agency oversight systems by introducing significant changes to financial regulation. New and existing offices and agencies are assigned to implement the reforms and enforce

50 Christopher Dodd is the principal author of Dodd-Frank. He was a former United States Senator from Connecticut and currently serves as the Chairman and Chief Executive Office of the Motion Picture Association of American, Inc. Christopher J. Dodd–A Career in Public Service, CHRISDODD.COM, http://chrisdodd.com/career/ (last visited Mar. 30, 2013).
51 Former Congressman Barney Frank is a coauthor of Dodd-Frank. He served as Congressman for the Fourth District of Massachusetts. Frank was the Chair of the Financial Services Committee from 2007 to 2010. He worked with both the Bush and Obama Administrations to deal with the 2008 financial crisis. Barney Frank Biography, BIOGRAPHY, http://www.biography.com/people/barney-frank-20878097 (last visited Mar. 30, 2013).
52 See Block, supra note 15, at 294.
57 The agencies mentioned are the following: Commodity Futures Trading Commission (CFTC), Bureau of Consumer Financial Protection (also known as the Consumer Financial Protection Bureau, or CFPB), Federal Deposit Insurance Corporation (FDIC), Federal Housing Financing Agency (FHFA), Board of Governors of the Federal Reserve System (Federal Reserve), Federal Trade Commission (FTC), Financial Stability Oversight Council (FSOC), Office of the Comptroller of the Currency (OCC), Office of Financial Research (OFR), Securities and Exchange Commission (SEC) and Department of the Treasury (Treasury). See PROF’L STAFF BANKING & INS. COMM., BILL ANALYSIS AND FISCAL IMPACT STATEMENT, S.M. 1778, 2012 Leg., Reg. Sess. (Fla. 2012).
compliance.\textsuperscript{58} The main purpose of Dodd-Frank is to promote financial stability by improving accountability and transparency.\textsuperscript{59} Among other things, Dodd-Frank is intended to end “too big to fail,” help protect taxpayers by ending bailouts and help protect consumers from abusive financial practices.\textsuperscript{60} In addition, the Act calls for stringent changes to capital requirements, over-the-counter derivatives regulation, credit rating agency regulation, corporate governance practices and executive compensation practices.\textsuperscript{61}

Dodd-Frank authorizes the Federal Reserve Board to supervise financial institutions with more enhanced standards.\textsuperscript{62} Some of these enhanced standards include “risk-based capital requirements, leverage limits, liquidity requirements, overall risk management rules, risk concentration limits, requirements for resolution plans (“living wills”) and credit exposure reports.”\textsuperscript{63} The Federal Reserve Board may also add prudential standards at their discretion.\textsuperscript{64}

B. The State of Dodd-Frank Today

There are changes that have already occurred, changes happening now and changes that have yet to be determined.\textsuperscript{65} More stringent regulation and closer supervision are natural responses to a banking crisis.\textsuperscript{66} However, effective reform is difficult because each crisis presents unique challenges requiring a tailored response.\textsuperscript{67} Dodd-Frank consists of 8843 pages of rules and regulations, with a substantial amount of work in progress.\textsuperscript{68} As a point of comparison, the National Bank Act, the law that established the United States’ banking system, was twenty-nine pages;\textsuperscript{69} the Federal Reserve Act of 1913 was thirty-two pages; the Glass-Steagall Act was thirty-seven

\textsuperscript{58} Id.; see also THE DODD-FRANK ACT: A CHEAT SHEET, supra note 46, at 6.
\textsuperscript{59} Dodd-Frank, 124 Stat. at 1376.
\textsuperscript{60} Id.
\textsuperscript{61} THE DODD-FRANK ACT: A CHEAT SHEET, supra note 46, at 3.
\textsuperscript{62} Arthur E. Wilmarth, Jr., The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem, 89 OR. L. REV. 951, 1006 (2011).
\textsuperscript{63} Id. at 1007.
\textsuperscript{64} Id. at 1006.
\textsuperscript{65} See generally The Dodd-Frank Act’s Impact on Public Companies: After One Year, DELOITTE (2011) [hereinafter DELOITTE].
\textsuperscript{67} Id. at 841.
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Additionally, the Sarbanes-Oxley Act only required the SEC to adopt sixteen rules and conduct fewer than ten studies. The Sarbanes-Oxley Act of 2002 was sixty-six pages. Provisions have made a positive impact on some public companies, particularly in areas of corporate governance; public companies now must disclose their leadership structure, and shareholders may instruct broker discretionary voting. Evaluation of executive compensation is now a more stringent process. The whistleblower program more strictly prohibits retaliation against employees. Within the first seven weeks of passing Dodd-Frank, the SEC received 334 high-quality whistleblower tips. Even so, some are less willing to comply with the Act. Credit rating agencies retaliated by continuing to rate new issues while refusing to consent to the use of the ratings in registration statements, a new requirement under Dodd-Frank. Despite the size and scope of Dodd-Frank, there is still room for improvement.

C. Some Initial Complications, Particularly for Small Businesses

Dodd-Frank creates the Financial Stability Oversight Council (FSOC) and assigns it the task of identifying risks and responding to emerging threats to financial stability. However, the specific companies subject to oversight are unclear. FSOC aims to identify risks for “large, interconnected bank holding companies, or nonbank financial companies, or that could arise outside the financial services marketplace.” Financial companies include banking entities and their holding companies.

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72 DELOITTE, supra note 65, at 2.
73 Id. at 5–6.
74 Id. at 4.
75 Id. at 2.
77 Burch, supra note 5, at 447–48.
80 A “banking entity” is “any insured deposit institution . . . any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity.” See id. § 619(h)(1).
81 A “holding company” includes bank holding companies, financial holding companies and savings and loan holding companies. See id. § 2(18)(B).
nonbank financial companies and foreign banks operating in the United States.

These broad and vague definitions leave room for uncertainty, speculation and confusion. This is especially true for nonbank financial companies and small businesses. Ultimately, FSOC determines whether a nonbank financial company is subject to regulation. In making that determination, FSOC considers whether the company is systemically important—that is, if material financial distress to the company could pose a threat to financial stability in the United States. A mere eleven guidelines exist to determine this sweeping consideration. The guidelines are as vague as “the nature, scope, size, scale, concentration, interconnectedness and mix of the activities of the company.” To complicate things further, FSOC has discretion to determine the stringency of reporting and disclosure requirements per company. For example, the Act places limitations on the requirements and authority to regulate small businesses. More specifically, the Act grants small businesses an exemption from Sarbanes-Oxley section 404(b)’s auditor attestation requirements related to internal control over financial reporting. Section 404(b) typically would require an independent outside auditor attestation on internal control over financial reporting. Dodd-Frank exempts small businesses, referred to as non-accelerated filers, from complying with section 404(b). However, allowing FSOC discretion in deciding who is subject to regulation makes it impossible for a business to make that same determination. Additionally, finding a consistent definition of a small business for other provisions in Dodd-Frank is difficult. These are just a few of the complications that are already apparent.

82 A “nonbank financial company” encompasses any type of foreign or U.S. company predominantly engaged in financial activities. See id. § 102(a)(4).
83 Id. § 622.
84 Id. § 113(a)(1).
86 Id. § 113(a)(2)(A)–(K).
87 Id. § 115(a).
88 Id. § 1027(a)(2)(D)(ii).
89 Id. § 989G.
90 DELOITTE, supra note 65, at 2.
91 Dodd-Frank Act Permanently Exempts Non-Accelerated Filers from Auditor Attestation Requirement of Section 404(b) of Sarbanes-Oxley Act, LUCOSKY BROOKMAN (Sept. 21, 2010) [hereinafter LUCOSKY BROOKMAN], http://www.lucbro.com/client-articles/dodd-frank-act.html (defining a non-accelerated filer as a “public company with market capitalization of less than $75 million” and defining market capitalization as the “aggregate worldwide market value of voting and non-voting common equity held by non-affiliates as of the last day of the most recently contemplated second fiscal quarter”).
92 DELOITTE, supra note 65, at 2.
93 See discussion infra Part IV.B.2.
D. Various Criticisms of Dodd-Frank

It comes as no surprise that with the thousands of pages of Dodd-Frank there are just about as many critics. The critics have quite a range of viewpoints. A common critique is that Dodd-Frank attempts to be too comprehensive and does not relieve the difficulties of marketplace impenetrability.\(^94\) Nor does Dodd-Frank adequately address perverse market incentives that encourage financial firms to grow “too big to fail.”\(^95\) Instead, it leaves many details to agency discretion and imposes hurdles for regulatory action.\(^96\) The Act does not provide specific instructions about the new requirements, only general categories of requirements left to supervisory discretion.\(^97\) As such, regulatory forbearance is likely to continue and potentially increase.\(^98\)

In addition, the private and public sector cost of implementing Dodd-Frank will be substantial.\(^99\) One estimate suggests Dodd-Frank will cost the federal government nearly $3 billion over the first five years.\(^100\) It is further estimated that agencies will need 2600 new full-time employees while their existing employees will need to have their job functions redirected to meet the new regulations.\(^101\) This money will come from taxpayers\(^102\) and from the agencies charged with implementing Dodd-Frank.\(^103\) Finally, the burden of increased regulation may create carryover effects on government agencies.\(^104\) Agencies probably have been and will continue to be distracted by the substantial burdens imposed on them by Dodd-Frank, which will diminish their abilities to execute their pre-existing duties.\(^105\) Overall, Dodd-Frank will fail as other financial reforms have failed in the past if it continues to exist in its current form.\(^106\)

\(^{94}\) Kao, supra note 66, at 846–47; see also Block, supra note 15.
\(^{95}\) Kao, supra note 66, at 843.
\(^{96}\) Block, supra note 15, at 327.
\(^{97}\) Wilmarth, supra note 62, at 1012.
\(^{98}\) Block, supra note 15, at 327.
\(^{100}\) The $2.9 billion figure is obtained from a baseline estimate that Dodd-Frank would cost eleven agencies a total of $974 million in the first year alone. Id.
\(^{101}\) Id.
\(^{102}\) Id.
\(^{103}\) Agencies get money from assessments on the entities they oversee, revenues they collect or Congressional appropriations. Id.
\(^{105}\) See id.
\(^{106}\) See Wilmarth, supra note 62.
Some critics maintain that there will be no practical impact, depending on the regulators.\textsuperscript{107} They argue that although the Act purports to increase regulation and oversight, the fundamental dynamics of regulatory decision-making in a time of crisis will not change.\textsuperscript{108} Regulators will have to be vigilant to implement the Act.\textsuperscript{109} For whatever reasons, regulators have not been particularly vigilant and have repeatedly failed to restrain excessive risk-taking.\textsuperscript{110} This is possibly because regulators’ efforts are undermined by both political and practical challenges,\textsuperscript{111} while Congress also restricts regulators’ authority.\textsuperscript{112} Some other factors curtailing regulators’ efforts include large political contributions made by certain financial institutions, the popularity of deregulation and interpersonal relationships between the higher-ups of financial institutions and regulatory agencies.\textsuperscript{113} This forces regulators to face perverse incentives to resist early intervention, especially at larger financial institutions.\textsuperscript{114} Some critics argue that regulators should be paid for performance to increase incentives and help reduce the incidence of future regulatory failures.\textsuperscript{115}

Proponents maintain that Dodd-Frank will be beneficial to the economy. They argue that the Act makes improvements to the regulation of financial institutions.\textsuperscript{116} The creation of FSOC, the new oversight body, is a good start to holding financial institutions to higher accountability.\textsuperscript{117} Also, the additional authority granted to the Federal Reserve Board helps to enforce heightened standards.\textsuperscript{118} As such, Dodd-Frank may change best practices or affirm existing best practices, encouraging other businesses to follow suit.\textsuperscript{119} This could lead to more thorough corporate governance, executive compensation and risk management practices across the economy.\textsuperscript{120} Regulators, such as the SEC and the Small Business Administration, may even consider providing tax incentives or better loan terms to businesses that comply with Dodd-Frank.\textsuperscript{121}

\textsuperscript{107}But see, e.g., Block, supra note 15, at 383.
\textsuperscript{109}See Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 DAILY COMP. PRES. DOC. 1 (July 21, 2010).
\textsuperscript{110}Wilmarth, supra note 62, at 1011.
\textsuperscript{111}Id.
\textsuperscript{112}Block, supra note 15, at 384.
\textsuperscript{113}Wilmarth, supra note 62, at 1011.
\textsuperscript{114}Id.; see also Block, supra note 15, at 383–84.
\textsuperscript{115}Henderson & Tung, supra note 28, at 1003.
\textsuperscript{116}Wilmarth, supra note 62, at 1053.
\textsuperscript{117}Id.
\textsuperscript{118}Id.
\textsuperscript{119}Burch, supra note 5, at 413.
\textsuperscript{120}Id. at 416.
\textsuperscript{121}Id.
Considering the volume and vagueness of Dodd-Frank, one thing can be said with certainty: Dodd-Frank will cause unforeseen results.\textsuperscript{122}

\subsection*{IV. IMPACTS OF DODD-FRANK ON SMALL BUSINESSES}

At the forefront of much of the debate are the unanticipated consequences Dodd-Frank may have on small businesses.\textsuperscript{123} These consequences have potential advantages and disadvantages. Specifically, Dodd-Frank’s increased regulation and small business exemptions attempt to protect small businesses, yet expose them to additional burdens. It is important for these advantages to outweigh the disadvantages. Small businesses created an estimated 65\% of all new jobs in the past fifteen years.\textsuperscript{124} As President Obama stated in a discussion about the need for economic recovery, “[o]ur economy as a whole can’t move ahead if small businesses . . . continue to fall behind.”\textsuperscript{125}

Dodd-Frank may affect small businesses in the following two ways: either the business must comply with Dodd-Frank, or it will be affected by a trickle down of the practices of businesses who are required to comply with the Act.\textsuperscript{126} Businesses will have to change their practices to comply with Dodd-Frank if they want to stay in business, even if they are not directly subject to regulation. Despite the minimal amount of attention directed towards improving small business conditions, Dodd-Frank expressly anticipates consequences for small businesses.\textsuperscript{127} The Act mandates exemptions and studies intended to protect small businesses.\textsuperscript{128} Several provisions direct agencies, such as the SEC and Comptroller of the Currency, to study and report to Congress on how the burden of compliance for small businesses can be reduced.\textsuperscript{129} For example, Dodd-Frank requires the SEC to conduct a study on the burden of complying with Sarbanes-Oxley section 404(b) for companies with a market capitalization between $75 and $250 million.\textsuperscript{130} However, no one is required to educate small business owners, or any business owners, about the purpose, impacts and

\begin{thebibliography}{9}
\bibitem{122} Id. at 447.
\bibitem{123} Presidential Debate Questions and Transcript, supra note 29.
\bibitem{125} Id.
\bibitem{126} Burch, supra note 5, at 413.
\bibitem{128} See discussion \textit{infra} Parts IV.A.1 and IV.B.
\end{thebibliography}
benefits of the extremely comprehensive Act.\textsuperscript{131} Without proper knowledge, complying with such a substantial increase in regulation is difficult.

A. Increased Regulation

Regulation is essential for both businesses and the economy. Some critics maintain that for any regulation to be effective, it should be either significantly reduced or left to the states.\textsuperscript{132} Dodd-Frank has nearly 9000 pages of regulations and rules.\textsuperscript{133} Dodd-Frank even anticipates that it may have an impact on small businesses. Some sections require agencies to study the effects that enactment has had on small businesses.\textsuperscript{134} Nonetheless, regulation is likely to result in both advantages and disadvantages for small businesses.

1. Advantages for Small Businesses

Despite the criticisms and potential disadvantages, some advantages should be recognized. Although the costs are easy to quantify, the benefits are also tangible.\textsuperscript{135} Dodd-Frank’s increased regulation overhauls existing agency oversight.\textsuperscript{136} Credit may become more readily available to small banks on which so many small businesses depend.\textsuperscript{137} Small businesses will be more cautious when making important decisions because of the increased disclosure requirements. Some practices directly affected by Dodd-Frank’s disclosure requirements are corporate governance, executive compensation and risk management practices.\textsuperscript{138} Regulators may consider providing certain incentives to businesses that implement best practices, such as tax incentives or more favorable loan terms.\textsuperscript{139} Reform will either

\textsuperscript{131} See THE DODD-FRANK ACT: A CHEAT SHEET, supra note 46, at 22.
\textsuperscript{133} Section 1421 directs the Comptroller General to study the effects that enactment will have upon the availability and affordability of credit for small businesses. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1421, 124 Stat. 1376, 2156–57 (2010). Section 1071 requires each financial institution to retain and submit annual records of small businesses who make an application for credit so that the Bureau can regulate the access to credit. Id. § 1071, 124 Stat. at 2056–59.
\textsuperscript{134} See PROF’L STAFF BANKING & INS. COMM., BILL ANALYSIS AND FISCAL IMPACT STATEMENT, S.M. 1778, 2012 Leg., Reg. Sess., at 1 (Fla. 2012); see also THE DODD-FRANK ACT: A CHEAT SHEET, supra note 46, at 6.
\textsuperscript{135} Weekly Address: President Obama Says Small Business Must Be at the Forefront of the Recovery, supra note 124.
\textsuperscript{136} Burch, supra note 5, at 415–16.
change best practices or affirm that existing practices are indeed the best, encouraging other businesses to follow suit.

2. Disadvantages for Small Businesses

Despite the small business studies mandated and exemptions created by Dodd-Frank, disadvantages still exist. A critic of the Act made a statement about Dodd-Frank that conveys an unintended consequence it may have on small businesses: “I think it’s added such a burden and such confusion that people don’t even know what they’re supposed to comply with, and that’s particularly hard if you’re a smaller institution and you don’t have an army of lawyers to tell you how to do it.”

Perhaps the most significant disadvantage for small businesses will be the cost of compliance. Small businesses spend 36% more per employee than larger firms do in order to comply with federal regulations. Small institutions have limited resources, yet must spend a disproportionate amount of those resources on compliance. Every dollar and hour spent on compliance is a dollar that could have been used to reduce costs for small businesses or an hour that could have been spent consulting with a small business’ owner or entrepreneur. If a small business does not spend money on counsel and other resources to comply with the Act, it will end up spending money on litigation costs. An increase in regulation will also lead to an increase in litigation costs because of greater exposure to liability for noncompliance, fraud or other types of misconduct.

Another disadvantage stems from the secondary effects that may arise from this reform. The possibility of drowning out small businesses, including small banks, poses a real problem. Small businesses often choose not to enter into the public market because of the high cost of compliance. Other businesses may choose to remove their securities from

140 Id. at 446–47.
143 See We Listened: What Small Banks and Small Businesses Are Saying About the Dodd-Frank Act, supra note 1 (statement of William Bates, Jr., Executive Vice President and General Counsel, Seaway Bank and Trust Company).
144 Id. (statements of Greg Ohlendorf, President and Chief Executive Officer, First Community Bank and Trust and Ed Templeton, President and Chief Executive Officer, SRP Federal Credit Union).
146 See id.
147 Presidential Debate Questions and Transcript, supra note 29.
148 See Schwartz, supra note 145, at 547.
major exchanges, resulting in high penalties that may be difficult for them to handle.\textsuperscript{149} Increased regulation may cause the United States to lose its small businesses to less regulated markets outside the United States.\textsuperscript{150}

Although correlation does not equal causation, 122 small banks have closed since the enactment of Dodd-Frank.\textsuperscript{151} Such massive legislation, and perhaps overregulation, imposes an undue burden on small banks.\textsuperscript{152} Small banks are less capable of handling this burden than big banks; they will have a more difficult time keeping up with the cost of compliance and with their big bank competitors.\textsuperscript{153} Small banks know the community and their borrowers the best.\textsuperscript{154} Because small banks work closest with small businesses,\textsuperscript{155} drowning out small banks will work to drown out small businesses. Small businesses will then have to work even harder to obtain financing just to stay competitive.\textsuperscript{156}

Regulatory schemes make resources less available to low-income and middle-income consumers, such as small businesses.\textsuperscript{157} A majority of small businesses have outstanding credit from commercial banks in the form of a credit line, loan or capital lease.\textsuperscript{158} Even so, businesses need greater access to financing and capital resources.\textsuperscript{159} Businesses turn to financing as a profit maximizing strategy or because they do not have enough capital on their own.\textsuperscript{160} Alternative forms of credit such as owner loans, credit cards and trade credit will cost more in terms of interest rates and tracking expenses.\textsuperscript{161} Dodd-Frank’s specific focus on reducing the risk in lending practices may result in banks passing through increased costs to their higher-risk customers.\textsuperscript{162} Small businesses and entrepreneurs are riskier. They have a high failure rate, especially compared to businesses that have

\textsuperscript{149} See id.
\textsuperscript{150} Id.
\textsuperscript{151} Presidential Debate Questions and Transcript, supra note 29.
\textsuperscript{152} 158 CONG. REC. H6265 (daily ed. Sept. 21, 2012) (statement of Mr. Gohmert).
\textsuperscript{153} Id.
\textsuperscript{154} Id.
\textsuperscript{155} Id.
\textsuperscript{156} Id.
\textsuperscript{157} See id. (statement of Mr. Gohmert); Thomas O. McGarity, \textit{Administrative Law as Blood Sport: Policy Erosion in a Highly Partisan Age}, 61 DUKE L.J. 1671, 1686 (2012).
\textsuperscript{158} Traci L. Mach & John D. Wolken, \textit{Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances}, FED. RES. BULL. A167, A178 (Oct. 2006) (“More than 60 percent of small businesses reported outstanding credit in the form of a credit line, a loan, or a capital lease [in 2003].”).
\textsuperscript{159} Stephen Rose, \textit{Understanding the Financial Crisis}, STATISTICAL ASSESSMENT SERV. (Sept. 26, 2008).
\textsuperscript{160} Id.
\textsuperscript{161} See Mach & Wolken, \textit{supra} note 158, at A180.
\textsuperscript{162} DELOITTE, \textit{supra} note 65, at 2.
greater access to capital resources. Banks and other investors are less likely to invest in a higher-risk investment. Making financing more difficult for small businesses could inhibit and even preclude innovation and startups. Indirectly increasing costs of compliance for small businesses through increased regulation will prohibit businesses from staying in or even entering competition.

B. Exemptions and Costs for Small Businesses

Dodd-Frank is likely to create an increased burden for small businesses because of the increased regulations. However, exemptions exist to ease this burden. Exemptions put small businesses on a more level playing field with their larger competitors by increasing uniformity of financial regulation and standards. At least in theory, businesses are less likely to be at an unfair competitive disadvantage. Even so, the small business exemptions of Dodd-Frank are narrow.

1. What Exactly Are These Small Business Exemptions?

Small businesses are exempt from Sarbanes-Oxley section 404(b)’s auditor attestation requirements related to internal control over financial reporting. Section 404(b) requires an independent outside auditor attestation on internal control over financial reporting. Overregulation has resulted in companies moving out of the United States. For purposes of Dodd-Frank’s small business exemption, a small business with a market capitalization below $75 million is a non-accelerated filer. Small businesses are also exempt from an evaluation by a registered public accounting firm of their internal control structure and procedures for financial reporting.
However, determining whether a company qualifies as a small business is costly and difficult. Moreover, complying with section 404(b) promotes important goals—full accountability and transparency. As such, exempting any company from compliance with section 404(b) would arguably invalidate the effect and purpose of both the Sarbanes-Oxley Act and Dodd-Frank.

2. Costs for an Exempt Business

Small businesses may be affected even when a provision exempts them from a particular regulation. First, even if a business is not required to comply with the Act, the business will likely be affected by a trickle down of business practices from those who are required to comply with the Act. These practices will become norms of conduct for all businesses. As such, reform will either change best practices or affirm that existing practices are indeed the best, encouraging other businesses to follow suit. In effect, businesses will have to change their practices to comply with Dodd-Frank, even if they are not directly subject to regulation.

Next, it may be too costly for small businesses to determine if they are exempt. Businesses need to either ensure compliance with Dodd-Frank or determine whether compliance is necessary. Businesses may be required to create positions in their company or hire external consultants to make this determination. Despite the numerous agencies and offices created by Dodd-Frank, no position or office has been created to educate business owners about the purpose, impacts and benefits of the Act. Without anyone appointed to oversee the various agencies responsible for regulating financial institutions, businesses remain vulnerable to regulatory gaps and oversight failures.

Even if a business is small according to another agency or definition, it may not be deemed small under Dodd-Frank. Finding a concrete definition of a small business in Dodd-Frank is difficult. One definition in Dodd-Frank labels a business as small if it meets the relevant industry size threshold to be considered a small business concern—based on annual

174 See discussion infra Part IV.B.2.
175 Lucosky Brookman, supra note 91.
176 Id.
177 Burch, supra note 5, at 413.
179 Burch, supra note 5, at 446–47.
180 Id.; see The Dodd-Frank Act: A Cheat Sheet, supra note 46, at 22.
182 See Wise, supra note 141.
183 See The Dodd-Frank Act: A Cheat Sheet, supra note 46, at 4, 22.
184 Id.
receipts—under Article Three of the Small Business Act. The Small Business Act defines a small business concern as an enterprise “which is independently owned and operated and which is not dominant in its field of operation: Provided . . . an agricultural enterprise shall be deemed to be a small business concern if it (including its affiliates) has annual receipts of $750,000 or less.” Additionally, even if a business is “small,” it is not exempt from Sarbanes-Oxley section 404(b) if its market capitalization is above $75 million. Market capitalizations are reevaluated on an annual basis. Qualifying for an exemption one year does not mean that the business is exempt for any other year. This is particularly problematic for businesses that are right around the $75 million limit for exemptions.

Because of these difficulties, sanctions for not complying with Dodd-Frank exist. Dodd-Frank authorizes the Federal Reserve Board to take enforcement actions against institutions. For example, the Federal Reserve Board may issue “cease-and-desist orders, civil money penalty orders, and orders removing directors and officers.”

The existing exemptions do not relieve businesses from all auditing requirements. To the contrary, the exemptions add to other annual auditing fees and still require compliance with federal and state regulations. Small businesses must still comply with Sarbanes-Oxley section 404(a). Section 404(a) requires disclosure of management’s attestation on the adequacy of the company’s internal control over financial reporting. Small businesses must still maintain a substantive internal control framework and process. Dodd-Frank’s attempts to protect small businesses may end up harming them instead.

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187 LUCOSKY BROOKMAN, supra note 91.
188 Id.
189 111 CONG. REC. 14,724 (2009).
190 Wilmarth, supra note 62.
191 Id.
192 111 CONG. REC. 14,723–24 (2009).
193 Id.
194 Id. at 14,724.
195 LUCOSKY BROOKMAN, supra note 91.
196 DELOITTE, supra note 65, at 4.
V. HOW CAN THE GOALS OF DODD-FRANK BE MET WITHOUT DROWNING OUT SMALL BUSINESSES?

Regardless of the current state of Dodd-Frank, the goals of the Act—to promote efficiency and transparency—are essential to a strong economy. In light of the 2008 financial crisis, some change to financial regulation is necessary for stability. Legislation requiring compliance in order to meet the goals of transparency and accountability is a step in the right direction.

Dodd-Frank as it exists today is too broad and vague. The Act unrealistically attempts to solve all problems related to the U.S. financial crisis in one legislative act. The main problems with the Act are the cost of compliance, the difficulty in deciphering the provisions and the difficulty with enforcement. However, change needs to start somewhere. Not all legislation is perfect the first time around. Much legislation is amended, repealed or otherwise changed. Dodd-Frank directs studies to be conducted to analyze its impact. Changes to Dodd-Frank may be forthcoming depending on the results from those studies.

Some proposed changes include the following: (1) repealing Dodd-Frank, (2) retaining Dodd-Frank as is and working to better educate small business owners or (3) amending Dodd-Frank. Repealing Dodd-Frank altogether is not an effective solution. Repealing any law is difficult, but it is especially difficult without a Senate majority in favor of repeal. Even more importantly, the absence of additional regulations will not increase financial stability. Financial stability is important for a successful economy. Some type of legislation to regulate financial industries is a step in the right direction. To retain Dodd-Frank as it is and work to educate small business owners is also unlikely to be effective if it is the only solution instituted. The most effective solution to rehabilitate the economy may be to amend and save Dodd-Frank. Instead of repealing Dodd-Frank in favor of new legislation with greater specificity, its goals may still be met by making changes to the Act. The more expeditious and efficient the changes, the lesser the negative impact will be on small businesses.

However, a lot of work needs to be done before a practical impact will be seen. This note proposes the following amendments: (1) make a cheat sheet, (2) amend the twenty-two scattered definitions sections into one section, (3) better define terms using definitions common to the legal or

198 In a 2012 Presidential Debate, former GOP Candidate Mitt Romney claimed that he would “repeal and replace” Dodd-Frank if elected as president. Presidential Debate Questions and Transcript, supra note 29.
199 Dodd-Frank has definitions sections in twenty-two different locations: see, e.g., §§ 2, 102, 151, 201, 302, 124 Stat. at 1376–77.
financial communities,\textsuperscript{200} (4) amend the small business exemption to include businesses with a market capitalization under $75 million, (5) educate small business owners about Dodd-Frank and (6) educate, incentivize and oversee the regulators responsible for enforcing the Act.\textsuperscript{201}

A major change that would ease compliance, reduce confusion and educate the relevant people is creating a “cheat sheet.” Even a one-hundred-page cheat sheet would be significantly more workable than 9000 pages of legislation. The cheat sheet would explain the major provisions of Dodd-Frank and direct the reader to the location of those provisions within Dodd-Frank. This would not be unreasonably burdensome. In fact, The Federal Reserve Board already does this semi-annually for a number of acts and compiles the sheets in its Consumer Compliance Handbook.\textsuperscript{202} The substantial understanding that would result would outweigh the minimal cost and time required to create this cheat sheet.

Although some amendments\textsuperscript{203} clarify Dodd-Frank provisions, there needs to be a greater emphasis on creating more effective provisions. Specificity is essential for any legislation to be effective. This is more true where the Act has the potential of widespread economic and financial consequences. Making more effective and specific provisions would create greater uniformity. Less regulation would need to be passed by different agencies. There would be no need for businesses to defer to different agencies and acts or to hire outside experts. Businesses would be able to look directly to Dodd-Frank to determine what actions are necessary to comply with the Act. Not only would clarity and specificity decrease the burden on small businesses by making compliance easier, it would make compliance less expensive. There should be no need for interpretation because adding a clear provision would resolve any confusion. The existing provisions do not use definitions as recognized by the legal community or the financial community.\textsuperscript{204}

An amendment should clarify definitions. This can be achieved by making all definitions more easily accessible. Considering the length of


\textsuperscript{201} Henderson & Tung, supra note 28, at 1040.

\textsuperscript{202} FED. RESERVE SYS., CONSUMER COMPLIANCE HANDBOOK (Publications Fulfillment, 2012).


\textsuperscript{204} Chamorro-Courtland, supra note 200, at 466–67.
Dodd-Frank, this can be achieved by combining all definitions into one section near the beginning of the Act. Instead, to complicate interpretation further, a term in one section of the Act may not be defined the same as it is in another section of the Act. If definitions apply consistently to the entire Act instead of varying among sections, there will be greater uniformity and less ambiguity. Further, identifying terms using definitions readily recognized by the legal or financial community would increase effectiveness. “[L]aw cannot have effect if it does not define its subject matter.” When definitions are vague or incomplete, there is no shared conception of what a term means. This can result in confusion, mistakes and even fraud.

Finding a concrete definition of a small business is difficult. Instead of referring the reader to a separate act, which has a good possibility of being amended or repealed, Dodd-Frank should include the definitions within its own act. By referring to separate acts, the definitions in Dodd-Frank “nest vague terms and fail to include one or more essential elements” of the definition. There is another factor that complicates the determination further: even if a business is determined to be “small,” they are not exempt from section 404(b) if their market capitalization is above $75 million. Since market capitalizations are reevaluated annually, qualifying for an exemption one year does not mean the business is exempt other years. This is particularly problematic for businesses that are right around the $75 million limit for exemptions, which may be considered a small business for all other purposes but Dodd-Frank.

Moreover, there are brand new definitions created under the Act, despite preexisting definitions elsewhere. One example is the new “private fund” definition, which defines a private fund as “any issuer that would be an investment company, as defined in the Company Act, but for sections 3(c)(1) and 3(c)(7).” Funds that are no longer identified as “private funds” are now subject to regulation. This can be confusing and easily overlooked by funds that were previously designated as “private funds.” Dodd-Frank should borrow terminology used by the financial community rather than creating new definitions.

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206 See id. at 1232–33.
207 Id. at 1233.
208 Id. at 1261.
209 LUCOSKY BROOKMAN, supra note 91.
210 111 CONG. REC. 14,724 (2009).
212 Id. at 103–04.
213 Chamorro-Courtland, supra note 200, at 466–67.
Additionally, a number of terms have been left undefined. Some of these definitions are not generally known or may be subject to more than one interpretation. For example, the Act does not include the term “LOLR,” lender of last resort. “LOLR,” a term of art in the banking community, refers to the ultimate lender to extend credit to banks in a time of crisis. Moreover, even though Dodd-Frank purports to fix securitization, the term “securitization” is never defined. Since the main purpose of Dodd-Frank is to increase transparency and accountability, clearer definitions would allow those required to comply to determine whether and how they need to comply with the regulations.

The legislature should reconsider an amendment to the small business exemption to section 404(b) for businesses with a market capitalization above $75 million. This is a relatively narrow exemption—setting the limit at $75 million is too strict. Small businesses should not have the same burden of compliance as large businesses. Providing the exemption to all small businesses will help stimulate the economy. Some small businesses become large businesses, create jobs for thousands of people and decrease the unemployment rate. Overregulation creates the risk of running these businesses out of the United States before they get the chance to become large, or at least more successful.

Another potential amendment would educate small business owners about the purpose, impacts and benefits of the Act. Small business owners should be educated about whether they need to comply with Dodd-Frank without having to use their limited resources to hire outside help. If small businesses do need to comply with Dodd-Frank, they should be educated about how to comply with the Act. If small businesses do not need to comply with Dodd-Frank, they should be educated about the impacts from a trickle-down effect of other businesses complying with Dodd-Frank and how they can prepare to sustain their businesses despite these changes.

No position or office is created or assigned under Dodd-Frank to educate business owners. Implementing a position or office with this task would be beneficial to business owners. However, relying on this alone without amending Dodd-Frank may not be the most effective solution. This solution by itself may be impracticable and unfeasible. Educating every small business owner in the United States would create too great a burden.

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214 Id. at 451–52, 467.
215 Lipson, supra note 205, at 1229.
217 Id. § 989G.
218 See 111 CONG. REC. 14,724 (2009).
219 Id.
220 See id.
221 Burch, supra note 5, at 415–16.
on agencies that have existing responsibilities. Some critics have suggested that the SEC should fulfill this role.223 This is particularly burdensome for the SEC, an agency with an incredible amount of existing responsibilities and additional duties added by Dodd-Frank.224 The SEC has insufficient resources to address the increased demands placed upon it by the Act.225 The SEC has already had to create a new agency, the Office of Credit Rating Agencies, as a result of Dodd-Frank.226 The SEC has expended countless staff hours in drafting specific regulations in areas in which they have no particular expertise.227 In addition, creating a new agency dedicated to this purpose will cost more. Aside from cost, there is the additional hurdle of getting the government to approve the creation of a new agency. These additional changes are not resolved merely by educating small business owners—in particular, making amendments and increasing regulator vigilance.

This leads to another possible amendment—to change how regulators are involved with Dodd-Frank.228 Regulators will have to be vigilant for the Act to be effectively implemented.229 All regulators should be educated in the same way that was proposed for business owners previously: regulators should be assigned an agency or office to educate them about the purpose, impacts and benefits of Dodd-Frank. In addition, regulators should have access to all available information regarding the location and magnitude of risks in the financial system.230 Regulators were complicit in causing the financial crisis.231 They had no effective guidance or authority to address the changes in the financial industry landscape.232 Regulators should be held to a higher standard to meet their job requirements, but they must also be given the appropriate guidance to meet those requirements. As stated by a critic, “[b]etter information is no cure-all: even if regulators are forewarned of trouble, they may fail to act.”233 To increase regulator vigilance, some critics have proposed providing performance incentives to

223 Burch, supra note 5, at 416.
224 The SEC is now represented on Dodd-Frank’s FSOC, receives comments from FSOC regarding existing or proposed accounting principles and must also adapt to Dodd-Frank’s increased and heightened requirements. THE DODD-FRANK ACT: A CHEAT SHEET, supra note 46, at 4–6.
227 Black, supra note 225, at 1096.
228 See Block, supra note 15, at 313; Henderson & Tung, supra note 28, at 1009–10.
229 Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act, supra note 109.
230 John Crawford, Predicting Failure, 7 VA. L. & BUS. REV. 171, 228 (2012).
231 See Block, supra note 15, at 313.
232 Id.
233 Crawford, supra note 231, at 229.
Regulators typically lack sufficient pay incentives to compensate them for the time and effort needed to prevent excessive risk.235

Dodd-Frank needs to be amended to reduce the cost of compliance, the difficulty in deciphering the provisions and the difficulty with enforcement. Making the aforementioned amendments would be a strong starting point to increase the effectiveness of Dodd-Frank.

VI. CONCLUSION

Regardless of the current state of Dodd-Frank, the goals of the Act—to promote efficiency and transparency—are essential to a strong economy. In times of crisis, there must be reform. Change needs to start somewhere: not all legislation is perfect the first time around. Unfortunately, the weaknesses of Dodd-Frank are likely to impact small businesses the most, particularly through increased regulation and small business exemptions. It may be too costly to comply with regulations; it may also be too costly to determine whether a business is exempt. As such, Dodd-Frank may result in an unanticipated consequence: drowning out small businesses.

By imposing changes to the Dodd-Frank Act as it exists today, the goals of Dodd-Frank may still be met without drowning out small businesses. If implemented within a reasonable time, the foregoing proposals may save Dodd-Frank and, in effect, help the United States bounce back from the financial crisis.

234 Henderson & Tung, supra note 28, at 1031–32.
235 Id. at 1003.