AMERICAN ACTION FORUM

April 14, 2017

U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Sens. Crapo and Brown:

The American Action Forum (AAF) appreciates the opportunity to submit a proposal in response to your request for submissions identifying priorities to promote economic growth and/or enable consumers, market participants, and financial companies to better participate in the economy. We hope that these comments will be helpful as the Committee develops its legislative agenda for this congress.

AAF is an independent, nonprofit 501(c)(3) organization that is not affiliated with or controlled by any political group. Its focus is to educate the public about the complex policy choices now facing the country and explain as cogently and forcefully as possible why solutions grounded in the center-right values that have guided the country thus far still represent the best way forward for America's future.

Below are four proposals for legislative action. Please do not hesitate to reach out if we can be of any further assistance.

**Reforming FSOC**

<u>Description</u>

The Financial Stability Oversight Council's (FSOC) process for designating companies, especially non-bank financial companies as systemically important financial institutions (SIFIs) is not analytically sound nor is it grounded in data or regulatory history. At a minimum, FSOC's designation process should turn to designating activities that are systemically risky, instead of entire institutions. At a maximum, FSOC's ability to designate SIFIs should be removed entirely.

<u>Impact on economic growth, ability of consumers, market participants, and financial companies to participate in the economy</u>

FSOC's regulatory designation imposes direct costs and risk on the designated institutions. The magnitude of the costs is uncertain, especially given that the specific rules and capital requirements are yet to be determined, but it cannot be presumed negligible. More worrisome is the fact that the FSOC's two-tiered system will alter competitive dynamics in the insurance sector. Other things being equal, the increased costs of enhanced supervision will reduce their ability to compete effectively, plausibly shifting some amount of business and risk to entities not subject to the additional level of regulation, and destabilizing rather than stabilizing the market.

On the other hand, large banks who compete with each other are all under the same regulatory umbrellas.

FSOC designations should also raise questions of regulatory scale, scope, and overreach. At a very basic level, it should be obvious that FSOC's decisions to regulate insurers, capriciously or not, disregards the role that state regulators already play in overseeing insurance companies. It ignores their historical solvency record, pays little attention to the history of improvements in solvency regulation, and dismisses states' ability to issue stays on policyholder withdrawals because doing so could undermine financial stability during an unspecified crisis. The treatment reflects the notion that the lack of a true consolidated regulator at the state level trumps any argument for the effectiveness of state regulation, including changes in response to the crisis.

Similarly, given FSOC's failure to perform a basic cost benefit analysis, it has continuously failed to consider even the costs of its macroprudential regulation to consumers of those companies' products. A 2013 Oliver Wyman report explains how FSOC's heightened capital requirements on insurance companies result in increased costs to consumers. The report shows that designated insurers will reduce their capacity or exit the market entirely, leaving the remaining insurers to increase their prices. And in markets with higher barriers to entry with a high market share by the designated insurers, the ability for the undesignated insurers is even greater, leaving consumers with significantly increased costs for the same or fewer benefits. Specifically, the report found that the annual consumer cost of designating a non-bank financial company as a SIFI could range from $5 billion to $8 billion.

Legislative language

The Financial CHOICE Act includes what we feel to be appropriate language for removing FSOC's authority to designate non-bank financial companies as SIFIs. It can be found on pages 36-49 of the bill text here: http://financialservices.house.gov/uploadedfiles/bills-114hr-hr5983-h001036-amdt-001.pdf

Other background

Please see other AAF work on FSOC here:

https://www.americanactionforum.org/research/systemic-risk-regulation-misguided-case-insurance-sifis/

https://www.americanactionforum.org/insight/insurance-fsoc-systemic-risk-parable/

https://www.americanactionforum.org/research/the-investor-cost-of-designating-investment-funds-as-systemically-important/

https://www.americanactionforum.org/insight/impending-fsoc-decision-larger-policy-implications/

**Repealing the Volcker Rule in its Entirety**

Description

The Volcker Rule was a solution in search of a problem. It has long been proven that proprietary trading was not a cause of the financial crisis. Former Treasury Secretary Geithner said, "If you look at the crisis, most of the losses that were material for the weak institutions – and the strong, relative to capital – did not come from those [proprietary trading] activities. They came overwhelmingly from what I think you can describe as classic extensions of credit." Yet we have a rule that is estimated to cost $4.3 billion annually. Banks lose money when borrowers cannot repay. During the crisis, those borrowers were homeowners with mortgages. During the next crisis they will be another class of borrower, and the Volcker rule will not change a thing.

Impact on economic growth, ability of consumers, market participants, and financial companies to participate in the economy

The Volcker Rule forces banks to shed their market-making operations, which takes away consumers' ability to trade quickly and at a steady price. When added to Dodd-Frank's capital requirements, Volcker is resulting in banks not taking up any excess space holding inventories of assets awaiting a buyer. For example, JPMorgan carried $2.7 trillion in corporate bonds in 2007. By 2016 that number was down to $1.7 and falling.

A 2006 Amihud and Mendelson study shows that the level of liquidity (which the study measures as the bid-ask spread on a sample of stocks) affects the anticipated return on those stocks and the firm's resulting cost of capital and shows a positive relationship between stocks' excess monthly returns and its bid-ask spreads. Thus, average returns are higher when bid-ask spreads are higher and vice versa, and the increase in the bid-ask spread as a result of Volcker will result in higher capital costs for those businesses.

Further, lack of liquidity was a major cause of the last financial crisis. If we are truly aiming to prevent systemic risk, we should avoid new regulations that further restrict liquidity.

Legislative language

"In General – The following section of title VI of the Dodd-Frank Wall Street Reform and Consumer Protection Act are repealed, and the provisions of law amended or repealed by such sections are restored or revived as if such sections had not been enacted:

(1) Section 603.
(2) Section 618.
(3) Section 619.
(4) Section 620.
(5) Section 621.

Clerical Amendment – The table of contents under section 1(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act is amended by striking the items relating to sections 603, 618, 620, and 621."

Other background

Please see other AAF work on Volcker here:

https://www.americanactionforum.org/insight/volcker-rule-a-costly-way-to-solve-a-non-problem/

https://www.americanactionforum.org/insight/the-5-5-5s-of-dodd-frank-at-5-episode-3/

https://www.americanactionforum.org/insight/regulate-first-analyze-later/

**Restructuring CFPB**

Description

In its short life, the Consumer Protection Financial Bureau (CFPB) has finalized 49 rules, with more in the pipeline. Many of these rules disproportionately affect small and community banks and lower and middle income consumers – especially those that are unbanked or underbanked. CFPB's structure's constitutionality itself is in question, and the subject of much debate. But at a very minimum, an agency so readily able to impose costs on the engines of economic growth should be subject to the Congressional appropriations and oversight process.

Impact on economic growth, ability of consumers, market participants, and financial companies to participate in the economy

Just 26 of CFPB's 29 final rules have imposed $2.8 billion in costs with an associated 16.9 million paperwork burden hours. For perspective, it would take 8,450 employees working full time to complete the agency's new recordkeeping and reporting requirements. And, on top of that, the agency's rulemaking pace is 3.5 times faster than that of other significant executive agency actions, opening it up to questions of proper administrative procedure.

With regard to regional and community banks, since CFPB's inception: In 2014, credit unions experienced $6.1 billion in regulatory costs and $1.1 billion in lost revenue, bringing the total impact of financial regulation on them to $7.2 billion. The number of compliance officers has increased 13 percent since 2010 and 20 percent since 2005, while their wages have risen 24 percent since 2005. In 2013 the Federal Reserve Bank of Minneapolis found that the median reduction in profitability for banks with less than $50 million is 14 basis points if they have to increase staff by one half of a person; 45 basis points if they increase staff by 2 employees. The former leads an additional 6 percent of banks to become unprofitable while the latter leads to 33 percent becoming unprofitable. Community banks have lost market share at a rate double what they did between 2006 and 2010.

And since Dodd-Frank's passage, small business lending has decreased by 15 percent while large commercial lending has increased by 35 percent, largely due to regional and community banks' disproportionate share of small business lending and Dodd-Frank's impact on them.

There are many CFPB rules that could show how burdensome the agency has become on the very people it claims to be protecting, but the prepaid card rule might be the best yet. Before the CFPB, 76 percent of banking accounts did not charge a usage fee or require a minimum balance. Now it's down to 38 percent. Those that do charge monthly maintenance fees or require minimum balances have continued to raise those since 2010, making it increasingly difficult for lower-income consumers to afford traditional banking services.

JPMorgan estimated that these increased fees/minimum balances would result in as many as 5 percent of its banking customers getting pushed out of the banking system The Federal Reserve estimated that even just a one percent decline in checking accounts would result in the loss of checking access for roughly one million households – or an increase in unbanked individuals of 12 percent. As a result these individuals turn to alternative financial services like prepaid cards. But CFPB has written rules restricting access to those – one time compliance costs for prepaid card companies of $1,168,134 and annual costs of $342,408 will surely be passed on to consumers.

Legislative language

The Financial CHOICE Act includes what we feel to be appropriate language for restructuring the CFPB into a bipartisan commission and subjecting it to Congressional appropriations. It can be found on pages 81-117 of the bill text here:
http://financialservices.house.gov/uploadedfiles/bills-114hr-hr5983-h001036-amdt-001.pdf

Other background

Please see other AAF work on the CFPB here:

https://www.americanactionforum.org/insight/cfpb-now-decides-able-repay-loan/

https://www.americanactionforum.org/research/consumer-financial-protection-bureaus-alphabet-soup-of-regulation/

https://www.americanactionforum.org/insight/consumer-financial-protection-bureaus-brief-fast-rulemaking-history/

https://www.americanactionforum.org/insight/look-cfpbs-unconstitutional-actions/

https://www.americanactionforum.org/insight/congressional-disapproval-cfpbs-prepaid-card-rules-know/

https://www.americanactionforum.org/research/from-free-checking-to-the-financial-fringe-a-tale-of-two-regulations-and-lo/

**Reengaging Ex-Im**

Description

The Export-Import Bank's (Ex-Im) most important function is to provide American companies with lines of credit for large-scale projects. They're a crucial part of doing international business and often are an important factor in enabling American companies to win these project contracts. In fact, in 27 countries, Ex-Im support is essential because these countries require some sort of support from an export credit agency before they will even consider a bid. Unfortunately, even though Ex-Im was reauthorized last year, the board lacks a quorum, which prevents it from authorizing any loans over $10 million. This committee should either legislate away the need for a quorum to authorize large loans or confirm a board nominee.

Impact on economic growth, ability of consumers, market participants, and financial companies to participate in the economy

At the end of January of this year, Ex-Im lending was at its lowest point in 40 years. With only the ability to authorize loans under $10 million – which make up less than 15 percent of its total business – Ex-Im is operating well below capacity, and American businesses are either waiting for loan approval or foregoing Ex-Im support and losing out on a number of contracts.

By February of this year, since Ex-Im was shut down, 5,238 loans have gone unauthorized, with American companies losing out on $28.71 billion as a result. Of those, 4,680 and $7.15 billion would have gone to small businesses.

Not only does a quorum allow Ex-Im to finance large deals, aiding American businesses, but it allows Ex-Im to be one of the few federal programs that actually sends money back to the taxpayers. However, without that ability, Ex-Im is nearing the point where it will be required to become an appropriations requirement and add to the government's deficit – possibly as soon as this fall.

Legislative language

The easiest legislative action here would simply be to approve just one nominee to Ex-Im's board. However, should Ex-Im could also return to being fully operational by legislation that removes the requirement of a quorum, as below:

"Section 3 of the Export-Import Bank Act of 1945 (12 U.S.C. 635a) is amended to read as follows:

(c) Board of Directors; composition; oath; terms; duties; quorum; bylaws

…

(6) A quorum of the Board of Directors shall consist of a majority of members currently approved and sitting as Members of the Board of Directors."

Other background

Please see other AAF work on Ex-Im here:

https://www.americanactionforum.org/infographic/businesses-still-losing-ex-im-isnt-fully-operational/

https://www.americanactionforum.org/infographic/businesses-still-losing-ex-im-isnt-fully-operational/

https://www.americanactionforum.org/insight/ex-ims-closure-precludes-u-s-companies-from-bidding-on-projects-abroad/

https://www.americanactionforum.org/insight/ex-im-debate-ignores-international-context/

https://www.americanactionforum.org/insight/revisiting-ex-im-supports-for-american-small-business/