THE NEW ENGLAND COUNCIL

Committee Update

July 24, 2014

New England Council Financial Services Committee – Hearing Summary

Assessing the Impact of the Dodd-Frank Act Four Years Later
House Financial Services Committee
Wednesday, July 23, 2014 at 10:00 a.m.

SUMMARY

The House Financial Services Committee held a hearing entitled "Assessing the Impact of the Dodd-Frank Act Four Years Later" at 10:00 a.m. on Wednesday, July 23, 2014. The purpose of the hearing was to review a variety of specific provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) and "the cumulative effect that the legislation has had on the American financial services industry and the economy more generally over the four years since President Obama signed it into law."

The following witnesses appeared before the Committee:

- Mr. Dale K. Wilson, Chairman, President, and CEO of the First State Bank of San Diego (San Diego, TX);
- (ii) Mr. Anthony J. Carfang, Partner, Treasury Strategies, Inc. (Chicago, IL);
- (iii) Mr. Paul H. Kupiec, Resident Scholar, American Enterprise Institute (Washington, DC);
- (iv) Mr. Thomas C. Deas, Vice President & Treasurer, FMC Corporation (Philadelphia, PA), on behalf of the Coalition for Derivatives End-Users; and
- (v) The Honorable Barney Frank, former Chairman, Committee on Financial Services.

KEY TAKE-AWAYS

Former Committee Chairman Barney Frank (D-MA) testified before the committee, and offered the following insights into his namesake law:

- He believes that "it would be a mistake" to designate asset managers as SIFIs, and said that asset managers and insurance companies that just sell insurance as

traditionally defined don't have the leverage that would have a systemic reverberation
- He would be willing to revisit the $50 billion threshold for SIFI designation, pointing to recent comments from Federal Reserve Governor Daniel Tarullo that the threshold should be raised and calling it a "reasonable" approach
- He does not believe in a return to Glass-Steagall.
- He is not happy with what regulators have done on risk retention thus far.
- He reiterated his desire to merge the CFTC and the SEC, but does not believe it will occur because of political impediments.

MEMBER OPENING STATEMENTS

In his opening remarks, Chairman Jeb Hensarling (R-TX) rehashed his speech from the CATO-Meractus forum last week where he suggested that "it wasn't deregulation; it was bad regulation that helped lead us into this crisis," and that Dodd-Frank has been the wrong remedy because of the incorrect diagnosis. Hensarling says that by the end of this Congress, his committee will have dealt with both Dodd-Frank's "sin of omission" – housing finance reform – as well as it's "sin of co-mission" – not ending Too-Big-To-Fail.

In her opening remarks, Ranking Member Maxine Waters (D-CA) reminded the Committee of the scale of the financial crisis and how Democrats and some Senate Republicans passed Dodd-Frank to give regulators the tools necessary to end Too-Big-To-Fail, eliminate loopholes that allowed risky practices, and restore accountability and responsibility to our financial system.

SUMMARIES OF TESTIMONIES

- Dale Wilson, representing the Texas Bankers Association, said that 1,500 community banks have disappeared nationwide over the last decade, in large part due to a "tsunami of regulation" that brings with it increased compliance costs of between 50 and 200 percent. In particular, Mr. Wilson cited the new Qualified Mortgage (QM) rules as driving small banks away from making mortgage loans, as he feels that "community banks are being made to pay for the sins of others."
- Anthony J. Carfang of Treasury Strategies, Inc., said in short that "the rollout, rule writing and implementation of Dodd-Frank created a climate of uncertainty of enormous proportions. In turn, this has led to a culture of indecision that is choking the U.S. economy and paralyzing American businesses and financial companies that had nothing at all to do with the financial crisis."
- Former Committee Chairman Barney Frank (D-MA) said that he believes "asset

management firms should not automatically be designated systemic. And I believe the FSOC should be very clear in explaining its position on this," agreeing with the letter Reps. Capuano and Lynch sent to Secretary Geithner on FSOC transparency. He said he was "particularly troubled by the notion that QM/QRM should be merged." Frank added that he, too, "share[s] the frustration that many feel about the rate of progress in adopting regulations and implementing the financial reform bill," but believes that a complete set of rules will be in place "before any major crisis that they are intended to prevent, but later than they should be for the certainty that financial institutions deserve." On Too-Big-To-Fail, Frank says "The Dodd-Frank Act is clear: not only is there no legal authority to use public money to keep a failing entity in business, the law forbids it," by "repeal[ing] the power the Federal Reserve had possessed to extend funds to any financial institution" as well as establishing a process for federal regulators to deal with large financial institutions unable to pay their debts.

- Thomas Deas, on behalf of the Derivative End-Users Coalition, spoke of the coalition's concern "that the proposed regulations relating to margin requirements, particularly those of the Prudential Banking Regulators, will impose unnecessary margin requirements on nonfinancial derivatives end-users that did not contribute to the financial crisis and do not create systemic risk."
- Paul Kupiec of the American Enterprise Institute summed up his testimony this way: "the Dodd-Frank Act has failed to achieve its stated goals of ending too-big-to-fail and reducing the fragility of the U.S. financial system. Instead, the balance of accumulating evidence suggests that Dodd-Frank has reinforced investor's perceptions that the largest financial institutions enjoy an extended government safety net. Rather than ending too-big-to-fail, Dodd-Frank's provisions create new uncertainties around the resolution process for large financial institutions."

KEY QUESTIONS

Chairman Hensarling shared letters from bankers across the country about the impacts of Dodd-Frank, including one who said the law is "strangling" community banks and another who pointed to his bank reducing services as a result of Dodd-Frank regulations. He said he has seen data that suggests there are 800 fewer community banks post-Dodd-Frank, with a smaller market share. Hensarling cited the drop in banks offering free checking after enactment of the law, and pointed out that the QM rule and other provisions are making and will continue to make it more difficult for minorities to access financial products.

Ranking Member Waters asked former Chairman Frank to identify some actions he took to help small banks. In his response, Frank mentioned reductions in FDIC insurance premiums for small banks as well as the CFPB's exemption from parts of the QM rule for lenders with less than $2 billion of assets that make 500 mortgages or fewer per year. Frank also pointed to recent comments by Federal Board Governor Tarullo who suggested community banks under a certain level should be specifically exempted from the Volcker Rule, and Frank submitted that this "could ease the problem."

Rep. Carolyn Maloney (D-NY) reiterated the point that Dodd-Frank explicitly prohibits the use of public funds for bailing out financial institutions.

Rep. Scott Garrett (R-NJ) asked former Chairman Frank if he believed that, if a non-bank is designated a SIFI, it should be categorized as such in perpetuity, and Frank said no. Frank also said he is "skeptical" of designating non-banks as SIFIs. Mr. Kupiec said that SIFI designation should be up for consideration on an annual basis, so that firms can shed the designation after making changes. Frank also said there is a formula that would minimize asset managers' contributions in the case of a bailout.

Rep. Brad Sherman (D-CA) said two problems that remain are the continuation of Too-Big-To-Fail and the credit rating agencies. Sherman said that even in 2008 the law prohibited use of public funds to bailout institutions, yet Congress did it anyway, and that there is a strong likelihood that it would bailout large institutions again. He said that the "sweet spot" for financial institutions is to be a SIFI but not actually be designated as a SIFI. The solution to TBTF is to not to have institutions so large. Sherman would like the Financial Services Committee to markup the only two legislative solutions that the recently released Republican Committee staff report (more details below) identifies as capable of ending TBTF – Rep. Capuano's bill that requires banks to hold additional capital, and Rep. Sherman and Sen. Sanders' bill saying if you're too big to fail, you're too big to exist. Chairman Hensarling responded that he indicated in his opening remarks that the committee would deal with TBTF before the end on this Congress.

Rep. Blaine Luetkemeyer (R-MO), a former banker and examiner, said he hears frequently from community bankers about the amount of regulation coming out of Washington and the uncertainty that it has caused. Luetkemeyer said he has a bill on the SIFI designation process for banks that would require the designation to be based on a combination of factors – size, complexity, interconnectivity, and risk the bank is taking on (H.R. 4060, the *Systemic Risk Designation Improvement Act of 2014*).

Rep. Michael Capuano (D-MA) called the hearing a "show-and-tell hearing with no purpose to it," and said rather than moving to repeal Dodd-Frank, he would prefer to work with individuals who wish to amend the law and make it better.

Rep. Mick Mulvaney (R-SC) also spoke on replacing the $50 billion SIFI designation threshold with an approach that considers a variety of factors.

Rep. Lacy Clay (D-MO) asked former Chairman Frank is we should return to the Glass-Steagall Act, and Frank replied no, because Glass-Steagall would not have stopped the risky practices that led to the crisis. Frank also pointed to an amendment offered by former Rep. Paul Kanjorski (D-PA) that was added to Dodd-Frank to allow the Fed to order the divestiture of any particular segment of any institution if it has gotten out of hand. For those who say the banks are too big, Frank asked what level do you need to get them down to?

Rep. Sean Duffy (R-WI) agreed with Frank that we should not be making loans to people who can't pay them back, but said he's concerned about the individuals who now cannot get loans because of Dodd-Frank but could afford them. On the CFPB, Duffy said the agency is out of control and is collecting a vast amount of information on the American public, and he is concerned that Congress has no input over its funding and accountability. Mr. Wilson told Duffy that he is appreciative that community banks are not examined by the CFPB, but they still have to follow the rules put out by the agency, which affect his operations.

During Rep. Carolyn McCarthy's (D-NY) questioning period, former Chairman Frank and Mr. Kupiek argued about SIFI designation for non-bank entities. Frank posited that firms have vigorously fended off being designated as SIFIs; Mr. Kupiek says that while he agrees that they don't publicly want to be designated due to the associated regulatory burdens, being denoted as a SIFI increases the expectation that the firm would later be bailed out by the federal government if necessary because the Federal Reserve will have been so involved in the oversight of the firm up to that point.

Rep. Stephen Lynch (D-MA) pointed to a recent *Wall Street Journal* article to suggest that Dodd-Frank is working. Lynch said that "asset managers are not the folks we intended to go after on the risk side" and also asked Frank about whether or not it is appropriate to designate asset managers as SIFIs, to which Frank replied no, it would be a mistake. However, Frank noted separately that the FSOC has "shown its value" by moving forward on money market funds when the SEC would not.

In response to Rep. Robert Hurt (R-VA), several witnesses commented that we're transitioning from a system of "relationship banking" to one of "compliance banking" and suggesting that compliance costs are forcing banks to be of a bigger size to survive.

Rep. Ed Perlmutter (D-CO) dismissed the notion that ending Too-Big-To-Fail was the primary goal of the Dodd-Frank Act, citing the CFPB, increased disclosure and transparency, securitization, and a range of other important aspects of the legislation.

Rep. Andy Barr (R-KY) discussed his legislation, H.R. 2673, the *Portfolio Lending and Mortgage Access Act*, a portfolio lending bill that would encourage more risk retention on the part of mortgage lenders and small banks. It was marked up by favorably by the House Financial Services Committee. Mr. Wilson said his bank would be likely to reenter the mortgage lending if he could hold a mortgage in portfolio.

Rep. Keith Ellison (D-MN) said he was concerned about a lack of funding for agencies that are carrying out the implementation of the Dodd-Frank Act, to which former Chairman Frank noted he was glad they insulated the CFPB from the whims of Congressional appropriators.

Rep. Jim Himes (D-CT) says asking whether Dodd-Frank ended Too-Big-To-Fail is the wrong question to ask, because we won't know until the next crisis; Dodd-Frank gives tools to regulators, but his question is what more should we do? Former Chairman Frank said he doesn't imagine a scenario where the federal government will ignore the law – and public sentiment against a bailout – in a future crisis. Frank said the government could mandate banks be smaller, but he then noted that Lehman Brothers precipitated the crisis, and he's not sure what it would take to get all banks to be worth $1 less than Lehman.

Rep. John Carney (D-DE) asked about the importance of preserving the 30-year fixed mortgage and former Chairman Frank noted that, absent some government involvement, it would not be sustainable. Frank also said that it is time to get rid of Fannie Mae and Freddie Mac. Carney has introduced legislation along with Rep. Himes on housing finance reform called the *Partnership to Strengthen Homeownership Act* (H.R. 5055).

Rep. Steve Pearce (R-NM) spoke about the difficulty of low-income individuals in rural areas to get a mortgage loan under Dodd-Frank due to the increase in compliance costs and loss of smaller community banks, and expressed concern that payday lenders are filling the gap.

In response to Rep. Terri Sewell (D-AL), former Chairman Frank reiterated that, as a general rule, he doesn't view asset managers and insurance companies that just sell insurance as traditionally defined as systemically important since they don't have the leverage that would cause a systemic reverberation.

Rep. Lynn Westmoreland (R-GA) asked Mr. Kupiek about the effectiveness of cost-benefit analysis done by both global and domestic regulators regarding the Dodd-Frank Act. Mr. Kupiek said that the FDIC, where he previously worked, did not do a cost-benefit analysis, nor did he see any such analysis come out of the Federal Reserve or OCC in relation to Basel III.

Rep. Marlin Stutzman (R-IN) cited a study by Oliver Wyman that says the impact of the Volcker Rule will be similar to the financial crisis itself, with disrupted liquidity and credit availability.

HOUSE FINANCIAL SERVICES COMMITTEE SUMMARY OF REPUBLICAN STAFF REPORT

On Monday, July 22nd, House Financial Services Committee Chairman Jeb Hensarling and Oversight and Investigations Subcommittee Chairman Patrick McHenry (R-NC) released a committee staff report titled *Failing to End Too Big to Fail: An Assessment of the Dodd-Frank Act Four Years Later*. It concludes that "the Dodd-Frank Act did not end 'too big to fail' as the law's supporters claim, but actually had the opposite effect of further entrenching 'too big to fail' as official government policy." The Committee staff also released the following summary of the report:

Key Findings

"Failing to End Too Big to Fail: An Assessment of the Dodd-Frank Act Four Years Later"

- **Problems with Title I of Dodd-Frank**
    - The Financial Stability Oversight Council (FSOC) is an unwieldy conglomeration of regulatory officials charged with identifying risks and taking steps to mitigate them
        - FSOC has failed to live up to its statutory mission to identify and mitigate systemic risk
        - The authority to designate nonbank financial companies undermines market discipline by signaling that some firms are "too big to fail"
        - FSOC's voting structure displaces regulatory expertise and makes FSOC itself a source of systemic risk
        - FSOC's designations of non-bank financial companies to date underscore the flaws in its governance structure and statutory mandate
        - FSOC's record-keeping practices undermine public and congressional oversight, reducing FSOC's accountability and increasing the likelihood that FSOC will not remedy deficiencies in its operations
    - The Office of Financial Research (OFR) is charged with collecting financial data to identify systemic risks
        - OFR has taken some steps to carry out its mission, but its progress has been unsatisfactory and its data collection efforts

risk imposing substantial costs in return for speculative benefits

        - OFR failed its first high-profile test in identifying sources of "systemic risk," issuing an analysis of the asset management industry that most experts have criticized as superficial and uninformed.

    - "Living wills" submitted under Section 165(d) of Dodd-Frank may give regulators greater understanding of the firms they regulate but do not end "too big to fail"

- **Problems with Title II of Dodd-Frank**

    - The proponents of Dodd-Frank never offered an adequate explanation of how the "Orderly Liquidation Authority" would end bailouts

    - Almost four years after Dodd-Frank's passage, the effectiveness of the "Orderly Liquidation Authority" as a tool for addressing the failure of large, complex financial institutions remains seriously in doubt

    - The FDIC's strategy for implementing Title II – the "Single Point of Entry" – is a recipe for future AIG-style bailouts

    - Contrary to the claims of its proponents, Dodd-Frank leaves taxpayers exposed to the costs of resolving large, complex financial institutions

    - The "Orderly Liquidation Authority" has not ended "too big to fail"

- **Dodd-Frank misses some obvious problems and creates new ones**

    - The Government-Sponsored Enterprises (GSEs) are still "too big to fail"

    - Firms designated as Financial Market Utilities under Dodd-Frank are the next generation of GSEs

    - As amended by Dodd-Frank, Section 13(3) of the Federal Reserve Act remains a powerful bailout tool

    - Dodd-Frank does not rein in other bailout authorities possessed by regulators

    - Regulatory requirements imposed under Dodd-Frank create compliance burdens that distort the free market by making it harder for small-to-medium sized financial institutions to compete with larger firms, further entrenching "too big to fail"

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