



March 5, 2017

Dear Senator:

On behalf of Americans for Financial Reform, we are writing to urge you to vote against S.2155, “The Economic Growth, Regulatory Relief, and Consumer Protection Act”.¹ Of the three goals laid out in the bill’s title, this legislation provides only one – regulatory relief. The deregulatory provisions in the bill would be actively harmful to consumers and increase the instability of the financial system. The small number of consumer measures included in Title III of the bill do not come close to counterbalancing the impacts of weakening or eliminating important regulatory protections in areas ranging from mortgage lending to the oversight of large banks. These measures, and indeed even stronger consumer protection measures, could and should be passed as standalone legislation.

Support for S 2155 is support for stripping back and weakening the regulatory safeguards passed in response to the disastrous 2008 financial crisis. This is especially dangerous at a time when the Trump Administration is already pushing hard to deregulate Wall Street. This legislation actively assists their efforts by removing requirements for strong regulation of some of the nation’s largest banks. It is true that S 2155 does not include some of the most egregious deregulatory proposals favored by Wall Street. But avoiding some provisions Wall Street favors is not a sufficient standard for sound policy.

Passage of S 2155 would be harmful to consumers, and it would weaken oversight of the financial system as a whole. This is made even more troubling by the fact that there is no clear economic argument that the changes it includes are needed. . There is no evidence that overregulation of the banking sector is having a negative impact on economic growth.² Both overall commercial bank lending and overall bank business lending have been growing more rapidly than historical averages since the passage of the Dodd-Frank Act. Bank revenues have increased to record levels, and over 95% of community banks showed a profit in 2016, up from just 79% in 2010, the year Dodd-Frank was passed.³

Core problems with S 2155 include:

- Increasing the fragility of the financial system by weakening risk controls at dozens of large banks that collectively received tens of billions in TARP funds.
- Lowering risk capital requirements at key Wall Street banks designated as critical to our financial system, possibly including megabanks like Citibank and Goldman Sachs.

¹ Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of AFR members is available at <http://ourfinancialsecurity.org/about/our-coalition/>

² Americans for Financial Reform, [The Trump Treasury and the Big Bank Agenda](http://bit.ly/2AtnCos), June, 2017. <http://bit.ly/2AtnCos>

³ Americans for Financial Reform, [Analysis of 2016 Bank Earnings Data](http://bit.ly/2AmKCaV), March, 2017. <http://bit.ly/2AmKCaV>

- Significantly weakening mortgage protections for numerous homebuyers, especially those buying manufactured homes and those who are customers of banks with less than 10 billion dollars in assets.
- Weakening protections against racial discrimination in credit markets by vastly expanding exemptions from the Home Mortgage Disclosure Act (HMDA), the key source of public information about lending discrimination.

Against these major deregulatory changes, S 2155 includes only a few relatively minor consumer benefits, such as permitting consumers to freeze credit bureau reporting of their scores to third parties. Even though public interest and community organizations, including AFR, submitted numerous consumer protection ideas to the Banking Committee as part of the Committee's economic growth initiative, none of these meaningful changes are included in S 2155.⁴

We urge the Senate to step back before approving such an unnecessary and harmful bill. The measures in this bill are not needed given the profitability of the banking industry and the stance and approaches of the appointees now in charge of the major bank regulatory agencies. Furthermore, they are actively harmful to both consumers and the financial system. In many cases, they would encourage consolidation in ways that are harmful to community banks, as lowering risk controls would free larger banks to purchase and acquire smaller institutions.

Below, we discuss issues in S 2155 in more detail.

Increasing Financial Sector Fragility by Weakening Bank Risk Controls

Several provisions in S 2155 would significantly weaken risk controls at banks ranging from community banks to some of the largest banks in the country. Some of the critical sections of the bill that do this are listed and explained below:

- **Section 401** exempts large banks that collectively hold trillions of dollars in assets from enhanced prudential standards that safeguard our economy, removing the Federal Reserve mandate to provide strong oversight of these banks. It would also weaken regulation of subsidiaries of large foreign banks operating in the U.S., banks which received public assistance during the 2008 crisis and play a crucial role on Wall Street.
- **Section 402** creates a new statutory exemption to capital protections for large custody banks that are crucial to the financial system, and could be broad enough to exempt other systemically important megabanks.
- **Section 202** creates inappropriate statutory exemptions from regulatory risk controls for "hot money" brokered deposits in order to benefit insider bank lobbyists,
- **Section 203** ends Volcker Rule protections against financial speculation using insured deposits at banks below \$10 billion in size.

⁴ See submissions by Americans for Financial Reform, AFL-CIO, Center for Responsible Lending, Public Citizen, and other public interest and community groups, available at <http://bit.ly/2igZuwY>

Section 401 Exempts Certain Large Banks from Enhanced Prudential Standards

This part of the bill would eliminate the mandate for enhanced regulatory supervision of 25 of the largest 38 banks in the country. Specifically, the provision would increase the asset threshold for enhanced prudential supervision in Title I of the Dodd-Frank Act from \$50 billion to \$250 billion. It also weakens some risk controls even at financial institutions over \$250 billion in size.

Impact at U.S. Banks Between \$50 and \$250 Billion in Size: Prior to the 2008 financial crisis, Federal regulators failed to properly oversee risks at numerous large commercial banks, many of which failed or were taken over during the crisis. Large regional banks like Washington Mutual, Wachovia, Countrywide, Golden West, and Indymac, while smaller than the very largest Wall Street banks, engaged in risky and irresponsible lending practices that made a major contribution to the mortgage bubble and eventual financial crash. All of these banks effectively failed. The failure of Indymac alone, the smallest of these banks, cost taxpayers almost \$11 billion.⁵

In response to this failure, Congress required the Federal Reserve to impose enhanced prudential standards on banks over \$50 billion, which includes only the largest few dozen banks in the country. The Dodd-Frank Act requires these banks to be more strongly regulated than small and medium size banks, with the nature and stringency of the regulation scaled to the size and risks of the bank. It also imposes some basic internal risk management requirements on these banks.

Section 401 of this legislation would remove the requirement for enhanced prudential standards for banks ranging in size from \$50 billion to \$250 billion. This eliminates the mandate for higher prudential standards at some two dozen of the nation's largest banks. These banks collectively hold over \$3.5 trillion in assets, about one sixth of total assets held by U.S. bank holding companies and almost a quarter of commercial bank assets. Collectively, they received over \$45 billion in TARP bailout funds.⁶ Section 401 would eliminate mandates for core risk management requirements at these banks such as internal risk committees, company-run stress tests (forward looking risk forecasts), and credit exposure limits.

Section 401 does preserve some discretionary authority of the Federal Reserve to re-impose risk controls at banks from \$100 billion to \$250 billion in size. However, the point of the Dodd-Frank mandate on the Federal Reserve was to require regulators to properly supervise large banks, in light of their failure to do so in the lead up to the financial crisis. The removal of the mandate would permit regulators to once again close their eyes to emerging risks. In a practical sense, the bill would eliminate many existing risk controls and require their re-imposition through a new rulemaking that would be subject to legal challenge to determine if it met requirements laid out in S 2155. It is overwhelmingly likely that either new rules would not be imposed or that they would be far more lenient than previously.

Impact at the Largest Financial Institutions: Section 401 also negatively impacts the supervision of even the very largest financial institutions. The legislation reduces the requirement for self-administered stress tests at the largest Wall Street banks from "biannual" to "periodic". This grants the Federal Reserve complete discretion over the frequency of these key

⁵ Office of the Inspector General, Department of the Treasury, Material Loss Review of IndyMac Bank, OIG 09-032, February 26, 2009. <http://bit.ly/1M0Lmnv>

⁶ Calculation using National Information Center, "Holding Companies with Assets Greater Than \$10 Billion," available at <https://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx>; *Pro Publica*, "Bailout Tracker," <https://projects.propublica.org/bailout/>

internal risk management exercises rather than ensuring they take place on at least an annual basis.

This section would also entirely eliminate the requirement for either self-administered or regulatory stress tests at large non-banks, including giant asset managers like Fidelity or Blackrock that manage trillions of dollars in client assets and are also critical to the financial system.

A new requirement in Section 401 of S 2155 also requires that the Federal Reserve must differentiate among banks on an individual basis or by category, based on a list of risk-related factors. This new statutory requirement (optional in the current text of Dodd-Frank) would give even the largest banks leverage for lawsuits attempting to overturn any regulatory rules they claimed were not properly justified by the listed factors, possibly creating new weaknesses in regulatory oversight for the largest banks.

Impact at U.S. Subsidiaries of Foreign Mega-Banks: All U.S. subsidiaries of the largest global banks – including Credit Suisse, Deutsche Bank, Barclays, Santander, and others – fall within the \$50 billion to \$250 billion asset size range that would be deregulated by S 2155.

Drafters of the bill claim that the legislation maintains regulatory controls on these foreign mega-banks, since the new \$250 billion threshold would apply to global consolidated assets of the parent bank, not the size of the U.S. subsidiary. Although this interpretation of the threshold has never been tested in court, it is possibly correct.

However, even if that were to be the case, the change in S 2155 would still severely weaken the oversight of these banks. In implementing Dodd-Frank, the Federal Reserve took special steps to ensure that standards governing foreign bank subsidiaries over \$50 billion in size could be directly implemented by U.S. regulators, rather than deferring to foreign regulators for oversight as had been done prior to the 2008 financial crisis. This new “intermediate holding company” (IHC) requirement was put in place at \$50 billion because this was the applicable threshold for U.S. banks in Dodd-Frank.⁷

Raising the statutory threshold to \$250 billion would thus bring tremendous pressure on the Federal Reserve to change regulatory practices, eliminate requirements to establish an intermediate holding company that permits direct oversight by U.S. regulators, and once again defer to foreign regulators to determine whether enhanced prudential standards were properly applied to foreign banks operating in the U.S. Indeed, Treasury Secretary Mnuchin stated in recent Banking Committee testimony that the passage of S 2155 would lead to this outcome.⁸

Deferring oversight to foreign regulators is precisely the regulatory framework that failed during the 2008 financial crisis. The irresponsible activities of foreign bank subsidiaries greatly

⁷ “The Board believes that establishing a minimum threshold for forming a U.S. intermediate holding company at \$50 billion helps to advance the principle of national treatment and equality of competitive opportunity in the United States by more closely aligning standards applicable to the U.S. non-branch operations of foreign banking organizations under section 165 with the threshold for domestic U.S. bank holding companies that are subject to enhanced prudential standards under Title I of the Dodd-Frank Act.” See CFR 17272 in the Federal Reserve Board’s final rule on enhanced prudential standards, available at <http://bit.ly/2FPTKW1>.

⁸ See transcript of January 30th, 2018 Banking Committee hearing on the annual report of the Financial Stability Oversight Committee, Treasury Secretary Mnuchin’s response to Senator Brown’s questions.

increased stress on the U.S. financial system and led to large amounts of Federal Reserve assistance flowing to these foreign megabanks.⁹

In sum, Section 401 of S 2155 would eliminate enhanced safety and soundness standards for dozens of the nation's largest banks collectively holding trillions of dollars in assets, would gravely weaken oversight of the foreign subsidiaries of global megabanks, and would also reduce risk management requirements for even the very largest globally significant U.S. banks.

Section 402 Slashes Capital Requirements for Large Systemically Significant Banks

Section 402 of S 2155 exempts large banks, particularly custody banks, from requirements to hold their own equity capital against potential losses in funds they have deposited with the Federal Reserve or any other central bank around the world. The exemption would apply to banks large enough to be subject to the Supplementary Leverage Ratio (SLR), which requires the largest systemically significant banks to hold 5% equity funding against their balance sheets to protect from financial risks. Exempting funds held at the Federal Reserve could reduce leverage capital requirements by up to thirty percent, and would also encourage banks to hold funds with the Fed instead of lending them out to real economy businesses.

This provision was originally drafted to benefit BNY Mellon and State Street, the two custody banks large enough to be subject to the SLR. However, the provision was modified in committee to apply to all banking entities “predominantly engaged in custody, safekeeping, and asset servicing activities”. As written, this provision may now be broad enough to potentially apply to the other six U.S. Wall Street megabanks, including Citibank, Goldman Sachs, JP Morgan, Wells Fargo, and Bank of America. It is thus possible that Section 402 could significantly cut leverage capital requirements for the largest Wall Street banks across the board. Indeed, big banks are pressing for further language changes to ensure this takes place. Sheila Bair, the former chair of the FDIC, has stated that Section 402 “would weaken a key constraint against excessive leverage” and that it would be “the height of irresponsibility” for Congress to weaken capital requirements through this provision.¹⁰

Even if the impact of Section 402 is limited only to the two largest custody banks, these banks hold enormous amounts of client assets and are by any measure central to the financial system. The effect of this new statutory exemption is to significantly reduce capital held by all the banks to which it applies and lower their protection against insolvency. The vital importance of strong equity capital holdings by the largest and most systemically significant banks means that this issue is more suited to regulatory than statutory treatment. Congress simply should not create statutory exemptions from capital rules for large, systemically significant banks.

Section 202 Weakens Risk Controls for “Hot Money” Deposits

Section 202 of the bill would create a new statutory loophole in the ability of regulators to control “brokered deposits”, a category of “hot money” deposits that have been found to increase

⁹ For more detail, see Daniel Tarullo, “Regulating Large Foreign Banking Organizations”, March 27, 2014. <http://bit.ly/2thqkgP>.

¹⁰ Bair, Sheila, “Congress Flirts With Disaster on Bank Leverage Ratios”, *Wall Street Journal*, February 12, 2018.

the risk of bank failure.¹¹ Brokered deposits are designed to circumvent limits on public insurance for deposits. Brokered deposit systems are designed to allow deposits that are larger than the legal FDIC insurance limit of \$250,000 / depositor to be fully publicly insured. By breaking up large, multi-million dollar deposits into separate chunks that are each smaller than the \$250,000 limit and distributing these among multiple banks, brokered deposit networks permit institutional investors and wealthy investors to benefit from insurance that is designed for retail investors.

The main innovator of brokered deposit networks is Promontory Financial, a consulting firm employing many former regulators. Promontory profits by running the CDARS network of reciprocal brokered deposits. Section 202 of this bill would exempt certain types of brokered deposits, including CDARS, from new regulatory rules designed to limit the risks that brokered deposits present to bank safety and soundness. Up to \$5 billion of brokered deposits per bank could be exempted from Federal Deposit Insurance Commission (FDIC) controls in this manner.

It is entirely inappropriate to grant financial insiders a statutory exemption from regulatory risk controls in order to circumvent limits on insured deposits, as well as benefit products created by powerful organizations of insider lobbyists.

Section 203 Weakens the Volcker Rule

Section 203 of the bill would create a significant new loophole in the Volcker Rule, which bans banks from using publicly insured deposits to fund trading on their own account. Holding of assets for proprietary trading was a significant contributor to the financial crisis of 2008.¹²

The section would exempt all banks with under \$10 billion in assets and less than \$500 million in trading assets from the Volcker Rule, on the grounds that such banks would not be expected to engage in proprietary trading. This assumption is conceptually problematic. If banks of a certain size are unlikely to engage in proprietary trading, then their compliance could be facilitated by granting a rebuttable presumption or assumption that they are not proprietary trading. But moving them entirely outside of the Volcker Rule effectively grants them permission to proprietary trade. The restriction on trading assets is not a particularly effective barrier against this, since smaller banks could also choose to trade out of their “available for sale” account. It simply does not make sense to say that community banks may trade for their own account with publicly insured deposits, but larger banks may not.

Weakening Protections against Predatory Mortgage Lending

S 2155 would erode protections for homebuyers, and especially for rural and lower income home buyers.

Section 107 of the bill destroys important existing consumer protections for some of the most vulnerable homeowners -- buyers of manufactured housing. The section amends the Truth in

¹¹ Federal Deposit Insurance Commission, Study on Core Deposits and Brokered Deposits, July 8, 2011. <http://bit.ly/2ASwJIX> ; Shaffer, Sherrill, “Reciprocal Brokered Deposits and Bank Risk”, January 1, 2010, CAMA Working Paper No. 15/2010. <http://bit.ly/2zOQKFu>

¹² Americans for Financial Reform, “Comment Letter on the Volcker Rule”, February 13, 2012. <http://bit.ly/2A1TLqr> ; Merkeley, Jeff and Carl Levin, “Policy Essay: The Dodd-Frank Restrictions on Proprietary Trading and Conflicts of Interest”, *Harvard Journal of Legislation*, Volume 48, No 2, Summer, 2011. <http://harvardjoi.com/archive/48-2/>

Lending Act to exempt retailers of manufactured homes from the definition of a “mortgage originator”, thus also exempting these retailers from rules that limit conflict of interest and prevent steering home buyers into exploitative or predatory loans. This exemption means that there would be no barrier to placing buyers of manufactured homes into higher-cost loans that benefit the retailer but harm the consumer, possibly increasing the funding cost of the home by thousands of dollars.¹³ More than one in ten homes in rural and small-town America are manufactured homes, and they are usually purchased by lower income individuals.¹⁴ This is not a provision that benefits community banks. Instead, it benefits the few large entities which dominate the manufactured housing market, most notably Berkshire Hathaway’s Invitation Homes, which sells almost 40% of manufactured housing in the country.¹⁵

The bill does require retailers to mention at least one non-affiliate lender to consumers and also states that the direct compensation of an employee providing financing must be similar to an employee performing a cash sale. There are no limits on indirect compensation for loan steering. Given the complexity of these transactions, these requirements are entirely inadequate to provide safeguards in practice.

Section 109 of the bill would remove the guarantee of escrow account services for home buyers with higher-priced mortgage loans at banks with less than 10 billion dollars in assets across the country. Such accounts are a key consumer protection that has been demonstrated to reduce foreclosures.¹⁶ Without an escrow account, a home buyer may not understand the full costs of homeownership, including taxes and insurance, and later lump-sum payments for such costs may trigger foreclosure. Section 109 expands the current limited regulatory exemption for certain small rural lenders with under \$2 billion in assets to a significantly larger statutory exemption for all banks with \$10 billion and under in assets.

Section 103 of the bill would create a major new exemption from appraisal requirements for many home sales taking place in rural areas of the U.S. meaning that these rural area homebuyers would now be more vulnerable to buying an overpriced home and owing more on their mortgage than their home is worth. Specifically, the bill states that bank portfolio mortgages of \$400,000 or under in rural areas would be exempt from appraisal requirements so long as sellers find that no certified appraiser was available “within a reasonable amount of time”. Since the median home value in rural areas is approximately \$114,000, this would exempt numerous home sales in rural areas from firm appraisal requirements. Such requirements would be replaced with a mandate to simply make an effort to find an appraiser.

As documented by the Financial Crisis Inquiry Commission (FCIC), appraisal fraud was a significant contributor to the housing price bubble that preceded the 2008 financial crash.¹⁷ Accurate appraisals are a crucial protection for both home buyers and the integrity of the broader

¹³ Consumer Financial Protection Bureau, Manufactured Housing Consumer Finance in the United States, September, 2014. <http://bit.ly/ZosI7E>

¹⁴ Ibid

¹⁵ Mike Baker and Daniel Wagner, “The Mobile Home Trap: How a Warren Buffet Empire Preys on the Poor,” *The Seattle Times*, April 2, 2015. <http://bit.ly/2BvOyTO>

¹⁶ Joe Valenti, Sarah Edelman, and Julia Gordon, Lending for Success, Washington: Center for American Progress, 2015. <http://ampr.gs/2kkWAfd>

¹⁷ National Commission on the Causes of the Financial and Economic Crisis in the United States, Financial Crisis Inquiry Report, January 2011. <http://bit.ly/1SxIyj3>

housing market. While appraiser availability may be an issue in some rural areas, this does not justify such a broad rollback of appraisal requirements.

Section 101 creates a new statutory exemption from predatory lending protections that would impact mortgage borrowers at the thousands of banks with up to \$10 billion in assets across the country. The Dodd-Frank Act addressed the devastating experience of predatory lending that victimized millions of families by requiring lenders to demonstrate mortgage affordability prior to lending. The CFPB's "Qualified Mortgage" (QM) rule lays out the affordability requirements lenders must satisfy to gain legal "safe harbor" from being sued for violation of this rule.

S 2155 expands the carefully crafted regulatory small lender exemptions to the QM requirements by creating a broad statutory exemption to QM affordability requirements for loans held in portfolio by all banks with \$10 billion or less in assets. As compared to current small lender exemptions, this would exempt a further 300 banks holding some \$1.3 trillion in assets from important mortgage affordability requirements.¹⁸ It is true that Section 101 does exclude certain types of toxic loans from receiving QM immunity from affordability requirements. But these exclusions still fall well short of the affordability requirements in the CFPB's current rule. For example, they permit adjustable rate mortgages and other types of potentially deceptive products controlled under the current CFPB rule.

Section 110 of the bill creates a loophole in mortgage disclosure rules that could allow lenders to substitute a loan that is harmful to the consumer at the mortgage closing without giving adequate time for assessment of the loan. This section eliminates the three-day wait period required for mortgage disclosures if a creditor extends to a consumer a second offer of credit with a lower annual percentage rate. This waiting period is intended to give the consumer time to assess written loan terms. The three-day period starts over if there is a material change in terms requiring a new disclosure. Section 110 eliminates any waiting period provided that the loan's annual percentage rate is lower than the initial disclosure. While a lower rate benefits the homeowner, there may be other changes that accompany this shift that require more examination by the borrower. This creates a loophole that unscrupulous lenders could utilize to circumvent disclosure requirements.

Weakening Protections against Racial Discrimination in Credit Markets

S 2155 also greatly expands reporting exemptions from the Home Mortgage Disclosure Act (HMDA), which is the major public tool for detecting racial discrimination in mortgage lending markets.

Section 104 of the bill would create a new statutory exemption for depository institutions that have originated fewer than 500 closed-end mortgage loans or fewer than 500 open-end lines of credit in each of the last two years from HMDA reporting requirements. This new threshold, which is over twenty times higher than the current CFPB de minimis exemption limit, would exempt the vast majority of the nation's mortgage lenders from updated HMDA requirements. The new threshold would sacrifice key data about lending in underserved communities. Based on 2013 data, under the threshold set by the CFPB, 22 percent (1,400) of the depository institutions

¹⁸ See list of commercial bank asset size as of June, 2017, www.usbanklocations.com, <http://bit.ly/1uOxlyK>

that currently report on their closed-end mortgages would be exempt. In contrast, if this provision and bill are enacted, the Bureau estimates that 85 percent (5,400) of depositories would not have to update reporting on their mortgages.

The National Community Reinvestment Coalition (NCRC) has estimated the loss of post-crisis data about loan originations by state under this limit and found states with large rural areas face some of the largest losses of updated data about mortgage originations. The additional data that would be eliminated from reporting requirements due to S 2155 includes information on credit scores and loan eligibility that is critical to determining whether racial discrimination is taking place.¹⁹ Given recent evidence of continued major gaps between racial groups in loan approval rates, it is vital to require reporting of this data in order to create more equitable access to credit.²⁰

In sum, the numerous deregulatory measures included in S 2155 are dangerous for consumers and for the stability of the financial system that we all depend on. They are not justified either on their own merits or by the relatively insignificant consumer benefits included in the bill. We therefore urge you to reject this bill.

For more information please contact AFR's Policy Director, Marcus Stanley, at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform

¹⁹ See the introduction and background discussion in the CFPB HMDA final rule, available at <http://bit.ly/211FJFC>, for a discussion of the additional data items affected by S 2155 and their significance in determining discrimination.

²⁰ Aaron Glantz and Emmaneul Martinez, "Kept Out: How Banks Block People of Color from Homeownership", Associated Press, February 15, 2018. <http://bit.ly/2Fcd0w0>