AFR Americans for Financial Reform

June 7, 2017

Dear Representative,

On behalf of Americans for Financial Reform (AFR),[1] we are writing to express our opposition to H.R. 10, the "Financial CHOICE Act" and to urge you to oppose this measure. This legislation would be better dubbed "Wall Street's CHOICE Act," as it would have a devastating effect on the ability of regulators to protect consumers and investors from Wall Street exploitation and the economy from financial risks created by too-big-to-fail megabanks. It would expose consumers, investors, and the public to greatly heightened risk of abuse in their regular dealings with the financial system, and our economy as a whole to a far greater risk of instability and crisis.

This nearly 600-page bill is a radical piece of legislation. Not only does it eliminate numerous major elements of the Dodd-Frank protections passed in the wake of the disastrous financial crisis of 2008, it would also weaken regulatory powers that long pre-date Dodd-Frank. If this bill passed, it would make financial regulation significantly weaker than it was even in the years leading up to the 2008 crisis.

Proponents of the CHOICE Act claim that certain portions of the bill actually improve financial protections. This claim is deeply misleading. In fact, the so-called protections in the bill are in many cases simply more disguised deregulation. For example, the bill exempts banks that meet a ten percent leverage capital ratio from a broad range of risk controls that have been part of bank regulation since the 1950s, if not before. While an increase in leverage capital would be a positive development, banks which took advantage of this provision could still pose major risks to the financial system, risks which would not be adequately addressed by a leverage capital ratio of just 10 percent. By exempting these banks from almost all other regulatory controls, the CHOICE Act would strip regulators of their ability to address such risks.

This legislation is crammed with deregulatory gifts to every kind of financial institution, including giant mega-banks who want to return to the excessive borrowing and risky practices that led to the financial crisis, private equity and hedge funds who want to manipulate the financial system and exploit investors, lenders who want to sell predatory subprime mortgages, payday lenders pushing products that trap consumers in a cycle of ever-increasing debt, and more. Among other changes, the Wall Street's CHOICE Act would:

- Create unprecedented barriers to regulatory action that would effectively give large financial institutions veto power to overturn or avoid government oversight.

[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 coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/.

- Practically eliminate the powers of the Consumer Financial Protection Bureau to act forcefully against unlawful practices in consumer lending markets.

- Eliminate critical elements of regulatory reforms passed since the crisis, including restrictions on subprime mortgage lending, the Volcker Rule ban on banks engaging in hedge-fund like speculation, restrictions on excessive Wall Street bonuses, and more.

- Increase the ability of "too big to fail" financial institutions to hold up taxpayers for a bailout by threatening economic disaster if they failed.

- Weaken investor protections and accountability in the capital markets, including the elimination of crucial new fiduciary protections for retirement savers.

Evidence is lacking that any significant deregulatory measures are called for, let alone the radical assault on financial oversight contained in this bill. Since the passage of Dodd-Frank in 2010, the U.S. economy has grown twice as fast as the other advanced economies like the European Union and Japan which had a weaker regulatory response to the financial crisis.[2] Over the past three years, real (inflation adjusted) commercial bank loan growth has been almost 6 percent, much higher than the historical average of 4 percent annual growth in commercial bank lending.[3] Loans at community banks have been growing even faster, with community bank loan growth exceeding loan growth among larger banks for each of the past two years.[4] The capital markets have also thrived since the passage of the Dodd-Frank Act – according to recent research by the New York Federal Reserve, bond issuance and trading volume have shown strong growth and end-user trading costs have declined significantly since 2010.[5]

In contrast to the lack of evidence for negative effects of post-crisis measures to improve financial regulation, we know exactly how disastrous failures of financial oversight can be. Non-partisan sources such as the Federal Reserve Bank of Dallas and the Government Accounting Office have estimated that the financial crisis cost from $6 to $14 trillion in lost economic output

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[2] Americans for Financial Reform, *Dodd-Frank And Economic Growth*, Fact Sheet, January 2017. Available at http://ourfinancialsecurity.org/wp-content/uploads/2017/01/Dodd-Frank-and-Economic-Growth-Final.pdf.

[3] AFR analysis of total loans and leases in bank credit, deflated using Implicit Price Deflator for Gross Domestic Product. Long run average calculated using all data available since 1973. Source Federal Reserve Board Release H.8, Assets and Liabilities of Commercial Banks In The United States. Available at https://fred.stlouisfed.org/series/TOTLL; GDP deflator U.S. Bureau of Economic Analysis. Available at https://fred.stlouisfed.org/series/GDPDEF/.

[4] Federal Deposit Insurance Commission, "Quarterly Banking Profile", Various Dates. Available at https://www.fdic.gov/bank/analytical/qbp/.

[5] Adrian, Tobias, Michael Fleming, Or Shachar, and Erik Vogt (2016), "Market Liquidity After the Financial Crisis", Federal Reserve Bank of New York Staff Reports No. 796, October, 2016. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr796.pdf?la=en.

alone.[6] This figure does not incorporate the full human cost of millions of jobs lost and the millions of families who lost their homes due to foreclosure.[7] Extensive research also shows that the negative economic impacts of such major financial crises drag on for years, slowing recovery from recession.[8] Eliminating safeguards against these kinds of catastrophic outcomes is profoundly short-sighted.

Below, we provide additional discussion of some of the major ways in which the CHOICE Act attacks the ability of regulators to hold Wall Street accountable to the public. We provide selected examples but do not address all of the objectionable provisions in this massive bill. We then examine why claims that the CHOICE Act will improve industry accountability are deceptive and false.

THE CHOICE ACT'S ASSAULT ON WALL STREET OVERSIGHT

H.R. 10 Eviscerates the Consumer Financial Protection Bureau, and Returns to an Era of Fractured Consumer Regulation that Allowed Abuses to Flourish.

The first six years of the CFPB's history has vindicated the decision that Congress made in the Dodd-Frank Act to create a strong, independent agency to protect consumers from fraud and abuse in the financial marketplace.

Before the CFPB was established, consumer financial protection was split among several prudential banking regulators as their secondary mission. These regulators prioritized bank revenues over consumer protection. They systematically failed to address predatory mortgage lending abuses that contributed to the 2008 financial crisis, despite years of warnings from consumer advocates.[9] In fact, some bank regulators, such as the Office of the Comptroller of the Currency (OCC), even intervened to prevent state regulators from addressing abuses at banks.[10] This seeming inability to act forcefully on consumer issues continues even today at prudential banking regulators, as shown by the admitted failure of the OCC to control recent consumer

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[6] United States Government Accountability Office, "Financial Regulatory Reform: Financial Crisis Losses and The Potential Impact of the Dodd-Frank Act", GAO 13-180, January 2013. Luttrell, David, Tyler Atkinson and Harvey Rosenblum, "How Bad Was It? The Costs and Consequences of the 2007-2009 Financial Crisis and Its Aftermath", Federal Reserve Bank of Dallas Staff Paper No, 20, July, 2013.

[7] Americans for Financial Reform, "Costs of the Crisis," Briefing Paper, Updated July 2015.

[8] Reinhart, Carmen and Kenneth Rogoff, "Recovery From Financial Crises: Evidence From 100 Episodes", American Economic Review, Volume 104, No.5, 2014. Available at http://scholar.harvard.edu/files/rogoff/files/aer_104-5_50-55.pdf.

[9] United States Congress, House Committee on Financial Services, Subcommittee on Monetary Policy, *Hearing on Regulatory Restructuring: Safeguarding Consumers and The Role of the Federal Reserve*, Statement of Lauren Saunders, National Consumer Law Center and Americans for Financial Reform, July 16, 2009. Available at http://archives.financialservices.house.gov/media/file/hearings/111/saunders_testimony.pdf.

[10] Elizabeth Renuart and Margot Saunders, *Banking Activities and Operations; Real Estate Lending and Appraisals,* OCC Docket No. 03-16, Oct. 6, 2003. Available at http://www.consumerlaw.org/issues/preemption/10_6_occ.shtml.

abuses at Wells Fargo.[11] Moreover, these prudential banking agencies lack jurisdiction over non-bank financial companies – which have been and continue to be among the worst actors.

The American public paid a severe price for the failure to enforce consumer protections. In the wake of a destructive financial crisis and millions of unnecessary foreclosures, Congress addressed the problem of fragmented and ineffective consumer protection by creating a single agency, the CFPB, which has the clear mission and comprehensive jurisdiction needed to protect consumers. By exercising its rulemaking, supervision, and enforcement authorities over all large actors – banks and non-banks – the CFPB has made major strides in making the financial marketplace fairer to consumers. The CFPB has successfully resolved more than 100 cases and secured more than $11.8 billion in relief for 29 million consumers who suffered a financial loss due to a financial company's lawbreaking.[12] There remains much important work for the CFPB to do, including significant ongoing rulemakings that this legislation would totally block.

The changes to CFPB authority in the CHOICE Act would demolish all the progress made toward the establishment of a rational and effective framework for consumer protection. This legislation makes consumer protection authority even more fragmented and confusing than it was before the 2008 crisis, and returns key authorities back to the very same regulators who proved themselves ineffective in the past. By depriving the CFPB of supervision of banks, its power to stop unfair, deceptive, and abusive acts and practices, and dramatically scaling back its other authorities, the CHOICE Act creates an unworkable consumer financial protection scheme that would be even weaker than the one which allowed devastating mortgage abuses to flourish in the lead up to the financial crisis. These changes are sensible only if you are trying to make it easier for Wall Street and predatory lenders to profit from cheating the public.

H.R. 10 Eliminates the CFPB's Supervision Authority for Large Banks.[13] This legislation would end the CFPB's ability to examine large banks. Instead, the bill would disperse that supervision authority to a set of other agencies that failed to use it effectively in the past and are much more likely to act in an uncoordinated fashion and to provide opportunities for firms to play one regulator off against another. As previously discussed, that was a root cause of the regulatory failure that contributed to the financial crisis – and the central problem the CFPB was created to solve. The recent internal report by the OCC on its dramatic failures in examining Wells Fargo in the many years before the CFPB and the Los Angeles City Attorney led a joint action against the bank for opening some 2 million fake accounts provides yet another compelling example of the irreplaceable importance of CFPB's consumer-focused supervision.[14]

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[11] Office of the Comptroller of the Currency, "Lessons Learned: Review of Supervision of Sales Practices at Wells Fargo", Enterprise Governance Supervision, April 19, 2017. Available at https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-wells-fargo-supervision-lessons-learned-41917.pdf

[12] Consumer Financial Protection Bureau, *Consumer Financial Protection Bureau: By the Numbers*, Fact Sheet, January, 2017. Available at http://files.consumerfinance.gov/f/documents/201701_cfpb_CFPB-By-the-Numbers-Factsheet.pdf

[13] Section 727, H.R. 10.

[14] Office of the Comptroller of the Currency, "Lessons Learned: Review of Supervision of Sales Practices at Wells Fargo," Enterprise Governance Supervision, April 19, 2017. Available at

In addition, placing supervision authority with one set of regulators while leaving principal enforcement authority with the CFPB creates a recipe for bureaucratic gridlock that will make consumer protection less effective.

H.R. 10 Sharply Curtails CFPB Supervision of Non-Banks.[15] With regard to non-banks, the bill takes the particularly nonsensical step of eliminating the CFPB's authority to begin examinations of nonbank financial companies it does not currently examine, while permitting it to continue to examine those it examines now. This means that any new or growing credit reporting agency, debt collector, student loan servicer, remittance provider, or auto lender, or non-bank entities in new consumer markets, would be forever exempt from CFPB examinations regardless of size or significance. This would create an un-level playing field and allow fraud and abuse of consumers by newer companies to go undetected and undeterred. Non-bank entities are not subject to comprehensive consumer protection examination by any other federal regulator, so they would go totally unsupervised. This structure would of course also incentivize firms to artificially reconstitute themselves to evade regulation. Regular examination or audits check that companies are following the law and addressing compliance issues before they cause consumer harm or require enforcement action. They also allow the Bureau to comprehensively see and understand market developments. The CFPB employs more examiners than any other job category, demonstrating the centrality of examinations to the CFPB's work.[16]

H.R. 10 Repeals CFPB Authority To Stop Unfair, Deceptive, and Abusive Acts and Practices.[17] The CFPB has used this authority to stop Wells Fargo from opening fake accounts in their customers' names,[18] stop lenders from making false threats in debt collection,[19] and require refunds to consumers tricked into paying for worthless credit card add-on services and fake protections.[20] The bill totally eliminates the Federal prohibition on *abusive* acts and practices, taking a major step backwards on an important principle of consumer protection.

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https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-wells-fargo-supervision-lessons-learned-41917.pdf

[15] Section 727(a)(4), H.R. 10.

[16] CFPB, "Office of Minority and Women Inclusion Annual Report to Congress," March 2017, p. 17. Available at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201703_cfpb_OMWI-2016-annual-report.pdf

[17] Section 735, H.R. 10.

[18] Summary and legal documents available at https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/

[19] See, e.g., summary and legal documents available at https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-navy-federal-credit-union-pay-285-million-improper-debt-collection-actions/.

[20] Summaries and legal documents available at https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-bank-of-america-to-pay-727-million-in-consumer-relief-for-illegal-credit-card-practices/; https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-citibank-to-pay-700-million-in-consumer-relief-for-illegal-credit-card-practices/; https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-chase-and-jpmorgan-chase-to-pay-309-million-refund-for-illegal-credit-card-practices/.

In the case of unfair and deceptive acts and practices (UDAP), it strips the CFPB of the power to enforce these standards or to write rules to define them. Three-fifths of the CFPB's enforcement cases, accounting for 93 percent of consumer recoveries, included deception counts.[21] Under H.R. 10, only the prudential regulators and that Federal Trade Commission (FTC) would have the essential consumer protection authority to prevent unfair and deceptive practices. Consequently, enforcement cases would be severely hamstrung by the legislation's division of authority to enforce the consumer protection laws.

In addition, the FTC would be the only agency able to write UDAP rules that apply to non-banks and the only agency able to trigger uniform UDAP rules.[22] But, as a practical matter, no such rules would be written because of unique and unworkable requirements for FTC rulemaking.[23] This would leave important areas of consumer protection, such as first-party debt collection by non-banks (i.e., collection by lenders themselves), without comprehensive and uniform rules.

Besides stripping the CFPB of fundamental areas of its authority, the bill also undermines the independence and other structural features of the Bureau that have allowed it to stand up for consumers:

- The bill would end the CFPB's status as an independent agency, allowing the President to fire the Director without cause, effectively requiring the CFPB to answer to White House political staffers. It would also specifically require CFPB rules – unlike the rules of the other independent banking agencies – to be reviewed by non-experts in the White House, directly politicizing consumer financial protection.[24]

- The bill would further undermine the agency by subjecting it to the appropriations process.[25]

- The bill would also mandate the creation of a new, unnecessary, duplicative bureaucracy within the agency,[26] while eliminating the CFPB's market monitoring functions that

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[21] Christopher L. Peterson, *Consumer Financial Protection Bureau Law Enforcement: An Empirical Review*, 90 TULANE L. REV. 1057, 1095 (2016).

[22] Section 736, H.R. 10.

[23] For a description of these requirements and their effects, see AFR Letter Opposing HR 5112, May 20, 2016. Available at http://ourfinancialsecurity.org/wp-content/uploads/2016/05/OppoLetterHR5112-5-12-16-1.pdf.

[24] Section 711(a)(1)(D), H.R. 10; Section 712, H.R. 10.

[25] Section 713, H.R. 10.

[26] Section 717, H.R. 10 (establishing an Office of Economic Analysis). For a detailed discussion of these harmful provisions, see Letter to Congress: AFR Opposes H.R. 5211, Legislation to Weaken the CFPB (June 21, 2016), http://ourfinancialsecurity.org/2016/06/letter-congress-afr-opposes-hr-5211-legislation-weaken-cfpb/.

allow it to gather information and base its actions on responsible data collection.[27] The bill would also threaten the advisory boards that help the Bureau's work be informed by consumer advocates, academics, community banks, and credit unions.[28]

- The bill would also weaken the CFPB by requiring it to pay its employees less than employees of all other federal financial regulators,[29] undermining the agency's capacity to attract and retain highly-qualified financial professionals.

In addition to dramatically weakening the CFPB across-the-board, the bill also specifically blocks CFPB efforts to protect consumers in a number of key specific areas:

- The bill would eliminate all CFPB jurisdiction over payday and title loans.[30] This provision would not only stop the rule the CFPB is working on now to take on the unaffordable lending that is at the heart of the payday debt trap, but also prevent the CFPB from taking action against payday lenders for violating existing consumer protection laws and rules.[31] To make matters worse, the bill includes a provision expanding preemption of state interest rate caps.[32]

- The bill would prevent the CFPB from finalizing its proposed rule against forced arbitration clauses.[33] These clauses deny consumers access to the courts when financial institutions break the law. It is particularly notable that this legislation, which does so much to assist large financial companies in using lawsuits to overturn rules, would block consumer access to the courts.

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[27] Section 724, H.R. 10.

[28] Section 726, H.R. 10.

[29] Section 723, H.R. 10.

[30] Section 733, H.R. 10.

[31] Consumer Financial Protection Bureau, "CFPB Takes Action Against Money Tree For Deceptive Advertising and Collection Practices," December 16, 2016. Available at https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-moneytree-deceptive-advertising-and-collection-practices/ & Consumer Financial Protection Bureau, "CFPB Takes Second Action Against Military Credit Services," December 20, 2016. Available at https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-takes-second-action-against-military-credit-services-improper-contract-disclosures/

[32] Section 581, H.R. 10.

[33] Section 737, H.R. 10. *See also* Letter to Congress: Reject Proposals That Interfere with CPFB's Authority on Mandatory Arbitration (May 19, 2016) (AFR and 70 organizations), http://ourfinancialsecurity.org/2016/05/letter-congress-2-2/.

- The bill would end the release of information about consumer complaints,[34] eliminating an important public resource for understanding and avoiding consumer abuses.

The legislation would also undermine enforcement of anti-discrimination laws:

- The bill seeks to stall the CFPB's enforcement of anti-discrimination laws in the auto industry, thereby allowing racial discrimination in auto lending to go unchecked.[35]

- The bill would scale back data collection under the Home Mortgage Database Act, weakening a critical tool to fight redlining.[36]

- The bill would abandon the effort required by Dodd-Frank to learn more about small business lending through systematic data collection,[37] undermining enforcement of the Equal Credit Opportunity Act and missing a badly needed opportunity to better understand the small business lending market and help small businesses access credit.

In aggregate, these provisions would leave the CFPB powerless to achieve its mission of protecting consumers.

H.R. 10 Disempowers All Financial Regulators By Creating Unprecedented Legal and Analytic Hurdles Before Regulators Can Act

This legislation contains a set of drastic new analytic, legislative, and legal requirements that financial regulatory agencies must fulfill before engaging in oversight of financial institutions or practices. These requirements go far beyond any reasonable attempt to improve regulatory procedures and create unprecedented roadblocks to effective action. Indeed, in combination these changes would reduce the effective authority of Federal financial regulators to its weakest point since prior to the Great Depression.

By mounting a lawsuit based on an agency's failure to comply with these extensive new requirements, regulated financial institutions could stop agency action dead in its tracks. The new roadblocks to action include:

- A requirement that regulators complete dozens of additional analyses prior to issuing any new regulation, guidance, or interpretation. Required analyses include broad and vague mandates such as measuring all "direct and indirect" costs and benefits of a regulation

[34] Section 725, H.R. 10.

[35] Section 734, H.R. 10. *See also* Letter to Congress: AFR, 65 Organizations Urge Congress to Stand Against Discriminatory Auto Lending and Reject HR 1737 (Nov. 16, 2015), http://ourfinancialsecurity.org/2015/11/letter-to-congress-afr-65-organizations-urge-congress-to-stand-against-discriminatory-auto-lending-and-reject-hr-1737/.

[36] Section 576, H.R. 10.

[37] Section 561, H.R. 10.

and assessing "all available alternatives" to a regulation. The adequacy of any of these analyses could be challenged in court.[38]

- A requirement that both houses of Congress approve any major regulation, guidance or interpretation, or any rule for which measured quantitative benefits did not exceed measured quantitative costs.[39] This would vastly increase the delay and complication of regulatory action.

- The legislation empowers financial institutions to stop agency action in court by eviscerating longstanding precedents requiring courts to defer to experts in regulatory agencies. Instead, courts would be encouraged to evaluate technical issues "de novo," ignoring agency judgement and allowing the judge to substitute their views for those of subject matter experts at the agency.[40]

Collectively, these new mandates would create enormous barriers to completing any new rulemaking, interpretation, or guidance that was opposed by any financial interest with the resources to mount a lawsuit or lobby Congress to halt a rule.

H.R. 10 Eliminates Protections Against Unaffordable Mortgage Lending

At Congress' direction, the CFPB has enacted a series of reforms to make mortgage loans fairer and simpler, and reduce the risk of default and foreclosure. These "Qualified Mortgage" rules are designed to ensure that mortgage loans are not made to home buyers who cannot afford them, and that loans do not include "tricks and traps" that lead to loans that cost far more than the should or that borrowers expect they will.

The CHOICE Act would greatly weaken these protections by exempting all mortgages held on bank portfolios – including those originated by the largest Wall Street banks – from these new rules.[41] The justification for these changes is that banks will not have an incentive to make predatory or exploitative loans if it continues to hold the loan rather than selling it to another party. But experience shows this to be false. Washington Mutual and Wachovia—two large regional banks—failed in the aftermath of the financial crisis because of the significant losses in mortgage loans held in their own portfolios. The bill would allow large financial institutions to return to those practices and strip consumers of any meaningful legal recourse. In addition, the bill would further weaken protections against hidden fees and other traps by changing the calculation for determining a Qualified Mortgage and high-cost loan protections, making it easier

[38] Section 312 and Section 317, H.R. 10; additional analytic requirements for banking agencies are included in Section 546, H.R. 10.

[39] Subtitle B of Title III, H.R. 10; Section 312(b)(4) in Subtitle A of Title III of H.R. 10

[40] Subtitle C of Title III, H.R. 10.

[41] Section 516, H.R. 10. For a detailed discussion of this provision, see Letter to Congress: Oppose HR 1210, the "Portfolio Lending and Mortgage Access Act," July 27, 2015. Available at http://ourfinancialsecurity.org/wp-content/uploads/2015/07/Oppose-HR-1210-Barr-Portfolio-with-sign-ons-final-7.27.15.pdf.

for predatory mortgage loans to be made.[42] The bill also would subject vulnerable homeowners with higher-priced mortgages to deceptive mortgage marketing by allowing many lenders to exclude escrow payments from the loan.[43]

Separately, the bill would also eliminate a wide range of consumer protections for home buyers who borrow to purchase manufactured housing, including by permitting higher interest rates in this market before basic consumer protections applied.[44] These loans are generally made to lower income people, and there is a record of both past and recent abuses in this market.[45]

The bill would also eliminate the independence of the Federal Housing Finance Agency, giving the White House direct control over the conservatorships of Fannie Mae and Freddie Mac, which finance 46% of the home mortgages in the United States. [46]

H.R. 10 Attacks The Capacity To Do Basic Supervision of Big Banks

The legislation contains a number of provisions that would extend crippling procedural requirements to prudential bank supervision. While some of these supervisory activities were mandated by the Dodd-Frank Act, they fall squarely within safety-and-soundness authorities that have been broadly accepted powers of bank regulators for many decades if not centuries. H.R. 10 would sharply restrict these supervisory powers, in the following ways:

- When regulators do "stress tests" – forward-looking analyses of whether big banks have enough resources to absorb potential future losses – they would be required to release in advance for public comment the exact models used to test the banks portfolios and predict losses.[47] Like showing a test to students in advance, this would permit big banks to game the system by rigging their portfolios to match the models. Banks could also sue in court to challenge any detail of the regulatory oversight model that was used, taking advantage of ways in which the CHOICE Act facilitates industry lawsuits.

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[42] Section 506, H.R. 10. For a detailed discussion of this provision, see Letter to Congress: Oppose HR 685, March 18, 2015. Available at http://ourfinancialsecurity.org/wp-content/uploads/2015/04/CRL-Oppose-H.R.-685-Mortgage-Choice-Act-3.18.15.pdf

[43] Section 531, H.R. 10.

[44] Sections 501 & 502, H.R. 10. For a detailed discussion of these provisions, see Joint Letter: AFR Joins 15 Organizations in Supporting Low Income Families, Opposing HR 650 (Feb. 26, 2015), http://ourfinancialsecurity.org/2015/02/joint-letter-afr-joins-15-organizations-in-supporting-low-income-families-opposing-hr-650/.

[45] Baker, Mike and Daniel Wagner, "The Mobile-Home Trap: How A Warren Buffet Empire Preys on the Poor," Seattle Times / Center for Public Integrity*,* April 2, 2015. Available at http://www.seattletimes.com/business/real-estate/the-mobile-home-trap-how-a-warren-buffett-empire-preys-on-the-poor/.

[46] Section 352, H.R. 10. Urban Institute, "Housing Finance At A Glance: Monthly Chartbook," March 2017. Available at http://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-march-2017/view/full_report

[47] Title I, Section 151(b)(6)(J), H.R. 10.

- The CHOICE Act would permit a bank to appeal any important supervisory determination made during a bank examination to an independent ombudsman. Since hundreds of such determinations can be made during a bank examination, this process would permit banks to stonewall supervisory authority for long periods of time. In addition, supervisors would be banned from making independent assessments of bank underwriting for commercial loans.[48]

- As discussed further below, the CHOICE Act exempts banks that meet a 10 percent leverage capital ratio from a wide range of supervisory rules and authorities.[49] Regulators would be effectively unable to address major risks in such banks, even though a 10-percent leverage ratio alone is inadequate to ensure that a bank is not taking irresponsible risks that threaten the bank's solvency or the broader financial system.

Especially in combination with the new legal and analytic barriers to every financial agency rulemaking, guidance, and interpretation (as described above), these restrictions on supervision would make basic safety and soundness supervision of regulated banks more restricted than it has likely ever been since prior to the New Deal, if not before.

In addition to these provisions, other elements of the bill would eliminate the long-standing practice of independent funding for banking regulators.[50] This practice helps to shield financial regulators from the political pressures that can be brought to bear by well-funded financial interests through the appropriations process. Subtitle F would also impose major new barriers to international coordination between regulators.

H.R. 10 Destroys Other Protections Against "Too Big To Fail" and Financial Instability

During the 2008 financial crisis, regulators provided unprecedented assistance to the largest Wall Street financial institutions, using the excuse that they lacked the necessary tools to liquidate a failing financial firm without creating unacceptable economic fallout. Title II of the Dodd-Frank Act removed this excuse by creating an Orderly Liquidation Authority (OLA) under which the FDIC could take a large financial firm into receivership, liquidate the firm while limiting economic fallout using a temporary Treasury credit line, and hold the executives, directors, and officers of the firm responsible for reckless decisions leading to the firm's failure.

The CHOICE Act completely eliminates the Dodd-Frank liquidation authority and with it critical tools to prevent large financial institutions from again holding the economy for ransom.[51] The bill would replace OLA with a bankruptcy procedure that is unrealistic to the point of being

[48] Subtitle H of Title V, H.R. 10.

[49] Section 602 of Title VI, H.R. 10.

[50] Subtitle E of Title VI and Section 312, H.R. 10.

[51] Subtitle A of Title I, H.R. 10.

unworkable. [52] It assumes an insolvent trillion-dollar financial entity could be safely reorganized over the course of a weekend, with no special provisions for liquidity assistance, simply by converting some long-term debt into equity. Furthermore, this procedure would grant numerous special privileges to large financial institutions and their key directors, including potentially immunizing top executives for the consequences of actions that contributed to the failure of the firm.[53] Replacing liquidation authority with an unworkable bankruptcy procedure simply sets the stage for more ad hoc bailouts of large financial institutions.

Other provisions in the legislation would enormously weaken the Financial Stability Oversight Council (FSOC), which was established in response to the grave failures of regulatory coordination revealed in the 2008 financial crisis. The purpose of the FSOC is to provide a mechanism for cooperation so regulators do not again fail to identify and take action to stop an emerging crisis. This includes ensuring that large non-banks are properly supervised. However, H.R. 10 would cripple the FSOC and other mechanisms for regulatory cooperation:

- It would strip the Financial Stability Oversight Council (FSOC) of most of its powers. The Office of Financial Research, which is the FSOC's tool for monitoring risks to financial stability, would be completely eliminated. Even more importantly, the bill eliminates the FSOC's power to designate large non-banks such as the insurance giant AIG for increased regulatory oversight. During the 2008 financial crisis, AIG received the largest public bailout in U.S. history.[54]

- H.R. 10 would also cripple the capacity of different financial regulators to cooperate effectively in market oversight by opening up any meetings between personnel of different financial regulators to dozens or even hundreds of outside attendees, including numerous Congressional staff of both parties.[55]

- H.R. 10 would eliminate Dodd-Frank provisions for increased oversight and joint monitoring of giant financial market utilities such as derivatives clearinghouses, which are crucial to financial stability.[56]

H.R. 10 Would Once Again Permit Big Banks To Speculate Like Hedge Funds

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[52] Subtitle B of Title I, H.R. 10. *See Also* pp. 16-21 in United States Congress, House Committee on Financial Services, *Hearing on Making A Financial Choice*, Statement of Adam J. Levitin, Georgetown University Law Center, July 12, 2016. Available at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba00-wstate-alevitin-20160712.pdf

[53] See United States Congress, House Judiciary Committee, *Hearing on Financial Institution Bankruptcy Act of 2017*, Statement of Bruce Grohsgal, University of Delaware, March 23, 2017. Available at https://judiciary.house.gov/hearing/subject-h-r-financial-institution-bankruptcy-act-2017/

[54] Subtitle E of Title I, Section 151(a), H.R. 10.

[55] Subtitle E of Title I, Section 151(b), H.R. 10.

[56] Subtitle D of Title I, H.R. 10.

A crucial reform included in the Dodd-Frank Act is the Volcker Rule, which bans banks from acting like hedge funds and taking proprietary financial gambles with depositor and customer money.

During the 2008 financial crisis some failing investment banks, such as Bear Stearns, were brought down directly by their hedge fund investments. All of the big Wall Street banks bailed out by the public held enormous internal trading inventories stuffed with subprime mortgage securities, which amounted to a hedge-fund like market bet that eventually created enormous losses. Big banks used their privileged position at the center of the financial system not to serve customers but to exploit them. Not only did they make destructive proprietary trading bets, but they engaging in conflicts of interest by designing and selling their own toxic securities which banks themselves knew would fail and harm investors.

The CHOICE Act would simply repeal the Volcker Rule, leaving the door open for banks to resume proprietary trading. It would also repeal rules against banks betting against securities that they sell their own customers.[57]

H.R. 10 Would Eliminate Limits on Out-of-Control Wall Street Bonuses

Numerous investigations have found that the practice of giving giant bonuses to Wall Street traders based on short-term performance contributed to irresponsible risk-taking that helped crash the economy.[58] This "take the money and run" bonus culture led traders at big banks to take risks that paid them huge rewards in the short term but in the long term led to significant losses for the bank and eventually for the public as a whole.

The Dodd-Frank Act established new limits that required banks to end "take the money and run" pay practices and instead reward bankers and traders in ways that tied their salaries to the long-term success of their choices. The CHOICE Act would entirely repeal this section of Dodd-Frank, eliminating the mandate for regulators to act to control these kind of bonuses that encourage excessive risk-taking.[59]

H.R. 10 goes even further by gutting Dodd-Frank provisions that require bonus payments to be clawed back when they are based on erroneous information or misstatements of earnings, unless the person receiving the bonus actively conspired in such misstatements. [60]

H.R. 10 Gravely Weakens Accountability in Capital Markets

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[57] Title IX, Section 901(a)(3) and 901(a)(5), H.R. 10.

[58] See discussion of the role of bank pay practices in United States Senate, Permanent Subcommittee on Investigations, "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse," April 13, 2011. Available at https://www.hsgac.senate.gov/imo/media/doc/Financial_Crisis/FinancialCrisisReport.pdf. Financial Crisis Inquiry Commission, "Financial Crisis Inquiry Report," February 25, 2011. Available at https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf

[59] Section 827(a)(26), H.R. 10.

[60] Section 849 of Title VIII, H.R. 10.

Not only does the CHOICE Act significantly weaken oversight of large financial institutions, it also contains a host of provisions that would eliminate key protections for investors and for the integrity of capital markets and corporate governance. A few examples include:

- The legislation repeals new protections for retirement investors that are designed to ensure that those providing investment advice put the best interests of their clients first.[61] Repealing these protections would cost ordinary retirement savers tens of billions of dollars a year.[62]

- The legislation would exempt private equity funds from parts of the Dodd-Frank Act that require these funds to observe stronger investor protection duties and to register with the SEC to ensure compliance with rules.[63] Exercising these Dodd-Frank powers has led the SEC to find numerous violations of securities laws that harmed private equity investors.[64] H.R. 10 eliminates these powers.

- H.R. 10 contains numerous provisions that would harm the ability of regulators to enforce securities laws. For example, one section would forbid the SEC to automatically prohibit "bad actors" (those convicted of felonies or otherwise found guilty of serious regulatory violations) from participating in securities markets.[65] Other examples include provisions that would prevent the SEC from levying fines in administrative proceedings where there were findings of wrongdoing, a provision greatly expanding pre-emption of state securities enforcement, and a provision that deprives regulators of key information needed to monitor potentially fraudulent offerings.[66]

- Other provisions eliminate needed investor protections in cases of risky investment products. For example, one section deregulates risky "crowdfunding" offerings, increasing investment caps so ordinary investors can risk potentially unlimited amounts on these very risky offerings, while simultaneously eliminating key investor protections

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[61] Section 801, H.R. 10.

[62] United States Department of Labor, *Regulating Advice Markets: Conflicts of Interest – Retirement Investment Advice, Regulatory Impact Analysis for Final Rule and Exemptions*, April, 2016. Available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf

[63] Section 858, H.R. 10.

[64] *See* SEC Director of Enforcement Andrew Ceresney, "Remarks at the Securities Enforcement Forum West; 2016 Keynote Address – Private Equity Enforcement" (May 12, 2016), available at: https://www.sec.gov/news/speech/private-equity-enforcement.html; Nili, Yaron, "Takeaways from the Past Year of SEC Private Equity Enforcement," Harvard Law School Forum on Corporate Governance and Financial Regulation, available at: http://blogs.law.harvard.edu/corpgov/2014/12/17/takeaways-from-the-past-year-of-sec-private-equity-enforcement/

[65] Section 827, H.R. 10.

[66] Section 823, H.R. 10; Subtitle S of Title IV, H.R. 10; Section 466, H.R. 10.

such as public disclosures of the details of the company.[67] Another provision would double the amount of leverage permitted to Business Development Companies (BDCs), increasing the chance of large losses in this rapidly growing product segment, and also greatly expand the range of their permissible investments.[68]

H.R. 10 also weakens or repeals numerous provisions of Dodd-Frank aimed at addressing weaknesses in the capital markets revealed during the financial crisis.

To take just one example, the financial crisis revealed major conflicts of interest at the large credit rating agencies such as Moody's and S&P -- critical capital market gatekeepers. These ratings agencies certified tens of thousands of "toxic" bonds based on subprime mortgages as high-quality, investment grade assets that were safe to hold for investors and banks. Such bonds in fact had massive losses, and later Justice Department investigations found that the ratings agencies misrepresented risks due to their desire to preserve revenues from the securities issuers who paid them.[69] The Dodd-Frank Act required the SEC to institute a stronger inspection regime for these ratings agencies, a mild response given the magnitude of the issues revealed in the crisis. But the CHOICE Act significantly weakens even this inspection regime, lowering the number of inspections and eliminating requirements that ratings agencies executives personally attest that their companies are following the rules.[70]

CLAIMS THAT THIS LEGISLATION WOULD IMPROVE WALL STREET ACCOUNTABILITY ARE FALSE

Advocates of the Financial CHOICE Act falsely claim that several sections of the bill would actually improve Wall Street accountability. For example, Title VI of the bill proposes to exempt banks that meet a 10-percent leverage capital ratio from a broad range of supervisory risk controls. Proponents of the bill claim that maintaining a 10-percent leverage ratio will be so effective in protecting against irresponsible bank risk-taking that other risk controls will not be necessary and can thus be eliminated. This is deeply misleading.

Currently, the six largest U.S. banks have an average leverage capital ratio of less than 7 percent, so it is accurate that a 10-percent leverage ratio would require them to raise a moderate but still significant level of additional capital.[71] That would be a positive development.

[67] Subtitle P of Title IV; H.R. 10

[68] Subtitle H of Title IV; H.R. 10. *See Also,* AFR Letter to Congress on HR 3868. Available at http://ourfinancialsecurity.org/wp-content/uploads/2015/11/AFR-Oppo-Letter-HR-3868-1.pdf

[69] Department of Justice, *Justice Department and State Partners Secure $1.375 Billion Settlement With S&P For Defrauding Investors,* Office of Public Affairs, February 3, 2015. Available at https://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-1375-billion-settlement-sp-defrauding-investors

[70] Sections 850 to 856, H.R. 10; Section 857(a)15-22, H.R. 10

[71] Supplementary leverage ratios drawn from Q4 2016 earnings reports of JP Morgan, Bank of America, Wells Fargo, Citibank, Goldman Sachs, and Morgan Stanley.

However, leverage ratios are not adjusted to take account of the riskiness of bank assets or activities, so banks could still take potentially very large financial risks while maintaining a 10 percent leverage ratio. Indeed, it is precisely those banks which desire to invest in such risky assets that will have the greatest incentive to choose a somewhat higher level of capital while gaining immunity from all other supervisory risk controls. A leverage ratio of 10 percent, which continue to permit banks to borrow nine dollars for each dollar of hard capital, is far too low to provide protection against the incentives toward irresponsible risk taking that would be created by offering banks the option of immunity from regulatory supervision.

For this reason, even advocates of a "choice-based" approach to increased bank capital have called for much larger minimum capital ratios than 10 percent. For example, the Heritage Foundation, no friend of Dodd-Frank regulations, has argued that banks should be required to attain a leverage ratio of 20 percent, twice the capital level proposed in the CHOICE Act, in order to qualify for any regulatory exemptions.[72]

Exemptions in this bill strip regulators of effectively all the tools they use to address the significant bank risks that could remain even if banks maintained 10% leverage.[73] For example:

- Bank regulators would be forbidden to require additional capital for especially risky bank activities that might create higher losses. They would be forbidden even to require forward-looking stress test analyses to determine if risks could materialize in the future.

- Regulators would be forbidden to impose any liquidity requirements at all, even though liquidity failure (the lack of cash to meet current obligations) directly causes bank failure.

- Regulators would be required to let even the riskiest banks pay out capital to stockholders, rather than reserving it to cover potential losses, even if they saw that banks were undertaking activities that risked large future losses.

- Regulators would actually be *banned* from taking into account the risk the bank's activities posed to the financial stability of the United States. Regulators would also be forbidden from preventing bank mergers that led to the creation of "too big to fail" entities or had an unacceptable effect on competitiveness in the banking system.

Exempting banks from such a wide range of risk-related rules would leave bank examinations as the only possible tool for addressing risks at major banks. But as discussed above, other sections of H.R.10 would also gut the authority of bank examiners to take action on risk-related issues.[74]

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[72] Kevin Dowd, "A Simple Proposal to Recapitalize the U.S. Banking System", Chapter 2 in Prosperity Unleashed: Smarter Financial Regulation, Heritage Foundation, February 28, 2017. Available at http://www.heritage.org/prosperity-unleashed

[73] Section 602 (Title VI), H.R. 10.

[74] Subtitle H of Title V, H.R. 10. See also AFR Letter to Congress Opposing the Exam Fairness Act (June 10, 2015), http://ourfinancialsecurity.org/wp-content/uploads/2015/07/AFR-HR-1941-Letter-Final-7.28.15.pdf.

While we support higher leverage capital ratios for banks, it is absurd to believe that the leverage requirement included in this bill would protect the public from risks to the financial system under a regulatory regime where regulators were systematically barred from taking action to control bank risks.

Other Elements Of The Bill Would Not Substantially Increase Wall Street Accountability

Title II of the bill, which increases maximum civil monetary penalties for various types of financial misconduct, is also held up as an example of increased financial sector accountability under the Financial CHOICE Act. It is a positive step to increase these penalties, as current statutory penalties are significantly outdated. But other elements of the bill will work against any increased accountability by reducing the ability of regulatory agencies to hold wrongdoers accountable through rulemakings or administrative proceedings.

For example, as discussed above, the changes to the authority of the Securities and Exchange Commission (SEC) elsewhere in the bill would greatly weaken the agency's ability to win administrative cases and levy civil monetary penalties in the first place. The bill would allow a defendant to opt-out of the administrative process in favor of court enforcement,[75] making it much more difficult and cumbersome for the SEC to impose civil monetary penalties at all. It would also greatly narrow the SEC's ability to bar individuals found guilty of wrongdoing from working in a wide range of Wall Street jobs.[76]

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In sum, the Financial CHOICE Act would be an unprecedented blow to effective oversight of the nation's financial sector and to the protection of ordinary consumers, investors, and members of the public who depend on the fairness, transparency, and stability of the financial system. We urge you to reject it.

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

Sincerely,

Americans for Financial Reform

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[75] Section 823, H.R. 10.

[76] Sections 825 & 827, H.R. 10.