Americans for Financial Reform

March 20, 2018

Dear Representative:

On behalf of Americans for Financial Reform, we are writing to urge you to reject six of the bills under consideration at the March 21st House Financial Services Committee markup, because they would dangerously weaken regulatory oversight of Wall Street and the financial industry.[1]

Bills in this markup would weaken regulations that range from rules protecting consumers from predatory lending and unfair debt collection practices, to rules protecting the economy from risky derivatives and proprietary trading at the nation's largest banks. As we have stated previously, this rush to deregulate is not justified by any fair assessment of the economic problems that face our country. With banks showing record earnings, capital markets setting new records for debt issuance, and stock markets reaching new heights, there is no basis for the argument that excessive controls on financial activities are damaging ordinary Americans. The dozens of deregulatory bills passed by the committee over the past few months will benefit only financial sector insiders, not working families. Instead, they will harm consumers, investors, and the economic security of the broader public.

Below, we have laid out specific objections to six of the bills being marked up by the Committee. The bills are addressed in numerical order.

CONCERNS ABOUT SPECIFIC BILLS

HR 4659 would require federal prudential banking regulators to revise leverage capital requirements by deducting initial margin provided by a client against a centrally-cleared derivative from the denominator of the leverage ratio. This bill would reduce the risk absorbing capital held against losses by the giant Wall Street banks who are clearing members of major derivatives clearinghouses, and increase the risk of a public bailout of a major derivatives clearinghouse.

When arguing for this bill, the giant banks that do derivatives clearing argue that their commitments to clients to clear derivatives do not expose them to risk due to client-provided margin. But markets shift quickly and client margin can quickly become inadequate. It is critical to the financial system that derivatives clearing banks satisfy their guarantee of performance to major clearinghouses. There is bipartisan concern about the risk of failure of a major derivatives clearinghouse and the possibility that this could lead to a public bailout. Even the Trump

[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/

Administration Treasury Department and the Trump White House have expressed concern about this possibility.[2] Capital held by clearing member banks helps ensure that they can fulfill their responsibilities to the clearinghouse and is an important protection against clearinghouse failure. By reducing this capital, HR 4659 would increase the dangers of a public bailout of the derivatives market due to the failure of a major clearinghouse.

Republican FDIC Vice-Chair Thomas Hoenig has spoken forcefully on the dangers of this proposal. We encourage members to read Vice-Chair Hoenig's detailed letter, which is linked in the footnote below.[3] As Vice-Chair Hoenig points out, this proposal would provide a collateral exemption from leverage capital rules for derivatives transactions that is unprecedented and not reflected for any other type of bank exposure, including small business loans. He also points out that the banks asking for this exemption have provided an open guarantee of performance to clearinghouses that exceeds the level of client margin, and this proposal would remove the capital that supports this guarantee.

Supporters of this bill also argue that making the giant Wall Street banks that do derivatives clearing hold adequate capital to back up their commitments will increase prices for end users of derivatives. This claim would be true for any bank customer – for example, ending risk controls or capital requirements for bank loans would result in lower prices for borrowers. It is not an excuse for increasing the likelihood of a public bailout or an economic crash due to the failure of a systemically significant bank. HR 4659 should be rejected.

HR 4790 would undermine the implementation of the Volcker Rule (Section 619 of the Dodd-Frank Act) by giving sole rulemaking authority for the Volcker Rule to the Federal Reserve, and by exempting banks under $10 billion from the rule.

Delegating sole rulemaking authority to the Federal Reserve would cut the Federal Deposit Insurance Corporation (FDIC) entirely out of the implementation of the rule. Yet a core purpose of the Volcker Rule is to prevent deposit insurance funds from being used to finance speculative trading. The FDIC is the custodian and institutional protector of the deposit insurance fund, but HR 4790 would entirely eliminate their role in writing and interpreting the rule. This would greatly weaken the interpretation of the rule and its enforcement. The FDIC does not directly oversee any of the largest trading banks or trading desks, so eliminating the FDIC's role in rulemaking would effectively eliminate them from implementation of the Volcker Rule.

Defining the Federal Reserve as the sole rulemaking agency would also have the effect of significantly speeding up and facilitating the Trump Administration's announced agenda of weakening Volcker Rule restrictions on proprietary trading. Make no mistake, cutting the FDIC

[2] Smialek, Geanna, "Gary Cohn Calls Derivatives A New Systemic Problem", Bloomberg News, October 15, 2017. https://bloom.bg/2hYM8cD

[3] FDIC Vice Chairman Thomas Hoenig, Letter to Chairman Conway and Ranking Member Peterson on margin and leverage, November 30, 2015, available at https://www.fdic.gov/about/learn/board/hoenig/hoenigletter11-30.15.pdf.

out of Volcker Rule rulemaking and giving sole authority to the Federal Reserve is meant to serve the agenda of the largest trading banks such as Goldman Sachs and JP Morgan, who wish to see the Volcker Rule weakened.

HR 4790 would also entirely exempt banks with under $10 billion in assets from the Volcker Rule. While the great majority of community banks do not engage in proprietary trading, it simply does not make sense to say that community banks may trade for their own account with publicly insured deposits while larger banks may not. As FDIC Vice-Chair Thomas Hoenig has said in opposing this policy change, “I think this would be a loophole. It does open a door, if you are oriented to use deposits to speculate.”[4] Instead of an exemption, smaller banks should be granted a rebuttable presumption that they are not proprietary trading – an assumption that they do not require a bureaucratic compliance regime for the role, but which could be overturned if regulators found evidence that the bank was actually proprietary trading.
We urge you to reject HR 4790 and preserve the Volcker Rule’s protections against the use of public funds to finance speculative trading.

HR 4861 would exempt bank payday loans (also called “deposit advance products”) from the Consumer Financial Protection Bureau’s (CFPB) payday loan rule, and it would also nullify the Federal Deposit Insurance Corp.’s (FDIC) deposit advance product guidance. The overall effect of this bill would be to pave the way for banks to return to abusive 200% to 300% APR balloon-payment bank payday loans that trap consumers and seniors on Social Security in a cycle of debt.

A few years ago a small number of banks were making payday loans that differed little from the payday loans offered by traditional storefront lenders. Wells Fargo, U.S. Bank, Fifth Third Bank and Regions Bank offered so-called “deposit advance products,” short-term, balloon-payment loans that were automatically repaid from the next deposit. The typical annual percentage rates (APR) for these loans were 225% to 300%.

The Consumer Financial Protection Bureau found that these deposit advance products were just as toxic as their storefront payday loan cousins.[5] Borrowers typically had an outstanding balance at least nine months of the year. Despite claims that deposit advances were a way to avoid overdraft fees, the study found that deposit advance borrowers were nearly five times more likely to incur overdraft or nonsufficient funds (NSF) fees, in addition to the extremely high fees charged for the loan itself. Bank regulators also found that bank payday loans harmed consumers and were a form of predatory lending. According to the findings of both the FDIC and OCC:

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[4] Tracy, Ryan, “Exempting Small Banks From Volcker Rule is Popular, but Not With Their Regulator”, Wall Street Journal, December 26, 2017. http://on.wsj.com/2EMDBPG

[5] Consumer Financial Protection Bureau, Payday Loans and Deposit Advance Products: Initial Data Findings, April 24, 2013. http://bit.ly/2DIHLao

> "…deposit advance customers may repeatedly take out loans because they are unable to fully repay the balance in one pay period while also meeting typical recurring and other necessary expenses (e.g., housing, food, and transportation). Customers may feel compelled to take out another loan very soon thereafter to make up for the shortfall. This is similar to the practice of ''loan flipping,'' which the OCC, the FDIC, and the Board have previously noted to be an element of predatory lending." [6]

In response to these findings, banking regulators required that banks take into account consumer ability to repay the loan in a timely manner when making short-term, small dollar loans. A variety of exemptions permitted responsible small dollar lending to continue with reasonable terms and interest rates.

HR 4861 would exempt bank payday loans from the CFPB's payday lending rule and nullify the FDIC's small dollar lending guidance, opening the door for banks to return to this form of predatory lending. While the bill instructs bank regulators to issue regulatory standards for short-term, small dollar loans, it does not require any consideration of consumer ability to repay, excessive fees, or debt traps. Congress should reject HR 4861 and instead support actions that prevent banks from engaging in predatory lending.

HR 5051 would increase the number of shareholders that would be permitted in a company before securities laws required that the company register as a public company under the 1934 Act, triggering core disclosure and investor protection requirements. HR 5051 would change current law so that up to two thousand non-accredited investors (investors who did not meet minimum standards for wealth or sophistication) could be shareholders in a company before triggering registration. It would also allow currently public companies to de-register with a larger number of shareholders.

Public company registration is a crucial element of investor protection and the health of the broader financial markets, and has been since the 1930s. HR 5051 is one of many bills that is discouraging public company registration and expanding the scope of purely private companies in U.S. markets. This is the wrong direction to go. Congress should instead encourage more public companies. HR 5051 should be rejected.

HR 5082 would amend the Fair Debt Collection Practices Act (FDCPA) to exempt law firms and attorneys engaged in legal action to collect a debt from the definition of "debt collector." The bill would sharply restrict the CFPB's authority to supervise and take enforcement action against debt collectors when these collectors were law firms or attorneys pursuing a collection

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[6] Federal Deposit Insurance Commission, "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products", FDIC DAP Guidance Final Version, November 21, 2013. http://bit.ly/2G6XCEB

case. As a result, H.R. 5082 would leave consumers vulnerable to deceptive, misleading, and abusive practices by collection attorneys.

For the past thirty years, attorneys engaged in debt collection have been required to comply with the provision of FDCPA. This bill not only eliminates this important protection, but goes further and undermines the Consumer Bureau's ability to stop widespread deceptive practices by debt collection law firms and their attorneys. As dozens of consumer, civil rights, and national and community organizations state in a joint opposition letter to HR 4550, the previous version of this bill, "Passage of this bill would hurt consumers, especially people who have recently lost jobs, had a death in the family, or suffered another type of devastating personal loss, by eliminating critical protections against abusive practices by collection attorneys."[7]

Far from improving the previous version of this bill, HR 5082 has made it even more dangerous by expanding the scope of debt collection activities attorneys could engage in while being exempted from requirements for fair debt collection. Deregulating debt collectors by passing this bill would be especially damaging to individuals who have recently lost jobs, suffered a medical emergency, or a stressful and costly family event. It is simply inexcusable to unleash attorney debt collectors to engage in unfair litigation practices and exploitative means of collecting judgements. We urge you to reject H.R. 5082.

HR 5323, the Derivatives Fairness Act would eliminate critical bank capital requirements for derivatives transactions with commercial end users. The "credit valuation adjustment" (CVA) requirement eliminated in this bill is the portion of capital designed to protect against the failure of a counterparty to pay its derivatives obligations. It is the key additional capital requirement for derivatives that was added in the wake of the 2008 financial crisis.

Capital is the fundamental safety and soundness protection used by banks to protect against the risk of default by a counterparty. No one would suggest that banks should not hold capital against losses when they make a commercial loan to an end user business. Exempting derivatives from key capital requirements simply because the counterparty is an end user would be just as foolish. Derivatives involve an extension of credit, and in fact a particularly risky and unpredictable extension of credit since the counterparty liability may expand almost without limit based on unexpected changes in market prices.

End user derivatives counterparties are already exempted from key risk protections involving clearing and margin protections, due to concerns about their access to liquidity. Since these derivatives are exempted from other routine risk controls, capital is the remaining protection against losses on end user derivatives. It would be irresponsible for Congress to expand end user exemptions to include exemptions from capital requirements.

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[7] See letter from the National Consumer Law Center, "*Groups strongly oppose H.R. 4550 – Practice of Law Technical Clarification Act of 2017,*" January 16, 2018. http://bit.ly/2GKc8QS

An excuse used for this bill is that European rules in some cases exempt non-financial counterparties from CVA capital requirements, subject to certain thresholds. However, we should not use the European banking system – which is generally recognized as significantly undercapitalized compared to the U.S. system – as the standard for our banking and derivatives regulations. In the long run, U.S. banks will be more competitive when they are generally recognized as safe and sound.

If you have questions, please contact AFR's Policy Director, Marcus Stanley, at marcus@ourfinancialsecurity.org or 202-466-3672. Thank you for your attention to this letter.

Sincerely,

Americans for Financial Reform