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November 30, 2017

Honorable Chairman Mike Crapo
Honorable Ranking Member Sherrod Brown
U.S. Senate Banking Committee
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Honorable Senators,

On behalf of the more than 400,000 members and supporters of Public Citizen, we oppose S. 2155, which is slated for a committee vote Dec. 5, 2017. Described as promoting economic growth, the bill seems to ignore the economic growth that has occurred since passage of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Since that reform package has gone into place, lending has rebounded,[1] unemployment has declined, and the stock market is setting record highs.

This bill would take us in the wrong direction by removing important safeguards that protect the markets and consumers from some of the nation's largest banks.

Supporters of the bill claim it will bolster community banking, and point to the declining number of smaller banks. However, decline in the number of community banks has largely been caused by mergers that sprang from the law permitting interstate banking, and has nothing to do with Dodd-Frank, and beyond that, those banks that remain are more profitable than ever. FDIC-insured institutions reported a 10.7 percent increase in aggregate net income in the second quarter of 2017 as well as the highest average return on assets in ten years.[2]

Bankers have complained about Dodd-Frank since it became law. But bankers complain about regulations on their own industry as a matter of course. For instance, in the years leading to the financial crisis, a time when regulation and supervision proved woefully inadequate, leading bank trade associations nevertheless called for fewer rules. For example, in 2006, as the mortgage bubble inflated, Zions Bancorporation CEO Harris Simmons testified on behalf of the

[1] Gregg Gelzinis et al, "The Importance of Dodd-Frank, in 6 Charts" CENTER FOR AMERICAN PROGRESS, (2017), https://www.americanprogress.org/issues/economy/news/2017/03/27/429256/importance-dodd-frank-6-charts/.
[2] Quarterly Banking Profile: Second Quarter 2017, FEDERAL DEPOSIT INSURANCE CORPORATION, (2017), https://www.fdic.gov/bank/analytical/quarterly/2017-vol11-3/fdic-v11n3-2q2017.pdf.

American Bankers Association against stricter capital standards stating: "Recent proposals by the regulators, while well-intended, have the potential to reduce the availability of affordable credit, adversely affect competition among banks, increase risk, and add to the already heavy costs of compliance."[3] Had regulators supervised more diligently, had rules been stricter, the financial crisis might have been averted. Instead, bankers called for looser rules. It's what they do: Bank trade associations lobby against rules, in good times and bad.

When Senator Crapo became chair, he proposed an open process, and he invited proposals for economic growth. This drew scores of thoughtful proposals. Public Citizen advanced two ideas: one to establish an office at the Securities and Exchange Commission to promote employee concerns in the market; and another to restore the Glass-Steagall separation of commercial and investment banking, a policy endorsed by both Republican and Democratic platforms. Since then, however, the committee has failed to consider these ideas in hearings.

We applaud the committee for its hearings on pressing problems, such as the scandals at Equifax and Wells Fargo. But we are disappointed that the legislation now before the committee fails to address needed reforms to protect regular Americans from the types of harms these institutions perpetrated. Instead, this bill would roll back the safeguards put in place after the crash to help those same consumers.

We review the bill in two parts, addressing sections that we believe are some of the most problematic. First, we look at provisions undermining systemic risk safeguards; we then turn to sections reducing consumer protections.

**Removing Systemic Risk Safeguards**

Less than a decade removed from a major taxpayer bailout of dozens of financial institutions, this bill would roll back important safeguards established by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act.

**Section 401** raises the threshold for applying enhanced supervision to banks by 400 percent, from $50 billion to $250 billion in assets. This will mean that 25 large banks will face less scrutiny. Together, these institutions represent $3.5 trillion in assets, and received $48 billion in bailout funds from the Troubled Asset Relief Program (TARP). Cases in point: Ally Financial, which would escape enhanced scrutiny, received more than $16 billion from TARP. Zions, which lobbied against stricter rules a year before the financial crisis, would also escape enhanced scrutiny, and it also received bailout funds.

Proponents offer no justification for this, including no argument that removing these banks from enhanced supervision would contribute to economic growth. Reducing supervision, instead, could imperil the banks along with taxpayers who might be called upon to bail them out again.

[3] Harris Simmons, on behalf of American Bankers Association, *Testimony before House Committee on Financial Services*, AMERICAN BANKERS ASSOCIATION (Sept. 14, 2006) https://www.aba.com/archive/Testimony_Archive/Testimony%20Document%20Archive/simmons-financial-instituions-credit-91406.pdf

The Federal Reserve currently applies enhanced supervision to banks with more than $50 billion (under Section 165 of Dodd-Frank) so as "prevent or mitigate risks" to the nation's financial stability. Dodd-Frank already grants the Federal Reserve latitude to tailor its rules. Where the bank does not threaten such risk, the Fed may tailor rules accordingly. By changing this threshold to $250 billion, this bill will impede the Federal Reserve from executing its basic prudential responsibilities. The bill declares that banks with less than $250 billion in assets from this provision are free to engage in riskier activity.

By rule, the Fed has established a number of numerical guardrails for these large banks to date. Specifically, banks between $50 and $250 billion must hold up to an additional 2.5 percent of (Tier I) equity capital. This is the ratio of the firm's equity capital next to its risk-weighted assets.

We have welcomed the Federal Reserve's increased capital requirements, but find them well short of what we believe is safe. Public Citizen believes that the difference between assets and liabilities should be 20 percent of assets. Excusing major banks from even the modest 2.5 percent increase established under the enhanced supervision standard moves in the wrong direction. Arguments that capital somehow ties up resources or is idle are specious. It is simply the part of funding for a loan or other bank activity that is accounted for as bank equity. Increasing capital standards does not reduce loan-making. Even as banks have built their capital following the crash and regulatory mandates, loan making has grown. Bank loan portfolios swell and shrink, but this happens because of market demand, not because of changing capital requirements.

Bank executives prefer less capital to boost their own compensation. For example, at Zions Bank, which would escape certain capital standards under this bill, senior bank manager pay turns on the equity or stock price. With less equity capital, profits are concentrated on lesser capital, and the price of the stock rises faster than if there were more capital.[4]

Instead of increasing the threshold from $50 billion, the committee would be better advised to reduce it. One of the largest hits on the deposit insurance fund managed by the FDIC came from the failure of IndyMac, with $32 billion in assets. IndyMac cost the insurance fund $8.9 billion, more than 20 percent of the value of the entire insurance pool designed to backstop some $10 trillion in insured deposits.[5] When banks fail, deposit insurance costs can rise, and it is not in the

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[4] Here's how Zions explains it to shareholders: "The long-term awards . . . make up approximately two-thirds of total incentive compensation) are focused on future performance. The grant mix of these long-term incentives to [senior executives] varies by position. Overall, the target mix in 2016 was 46% multi-year cash incentive units, or Value Sharing Plan units, 43% restricted stock or restricted stock units, and 11% stock options. <u>The actual compensation ultimately earned from these awards is highly dependent upon future stock price and financial performance.</u>" [Emphasis added] Schedule A, Proxy Statement, ZIONS BANCORPORATION (April 20, 2017) https://www.sec.gov/Archives/edgar/data/109380/000010938017000086/proxystatement2017.htm#s6B6C0DB7360B5F4AEDD129120AEEC04E

[5] Karey Wutkowski, *FDIC says IndyMac Failure costlier than expected*, REUTERS (August 26, 2008) https://www.reuters.com/article/indymac/fdic-says-indymac-failure-costlier-than-expected-idUSN2637860820080826

best interest of the banking industry, including community banks, to pay additional premiums to backstop large banks operated with degraded capital standards as permitted by this section.

**Section 203** would eliminate all Volcker Rule restrictions on proprietary trading for banks with less than $10 billion in assets. The Volcker Rule, which is Section 619 of the Wall Street Reform Act, created Section 13 of the Bank Holding Company Act. It establishes the principle that banks that receive taxpayer-backed deposits insured through the Federal Deposit Insurance Corp. should not use these funds for short-term speculation. High risk gambling with taxpayer backed money contributed to the financial crash of 2008. According to Basel Committee on Banking Supervision, "Since the financial crisis began in mid-2007, the majority of losses and most of the build-up of leverage occurred in the trading book. Losses in many banks' trading books during the financial crisis have been significantly higher than the minimum capital requirements."[6] The "trading book" is the accounting term for assets held for a short term. Many assets were connected to bad loans packaged in securities such as collateralized debt obligations.

Some smaller firm bankers have complained that compliance with the Volcker Rule is burdensome as they do not engage in speculative trading. However, current law already allows regulators to tailor its regulations to reduce compliance burdens for smaller banks. Section 203 eliminates the rule altogether for this class of banks.

Elimination of the Volcker rule for proprietary trading for smaller entities would be an invitation for speculators to enter the market and operate a shell bank as a taxpayer subsidized hedge fund. The section provides that up to 5 percent of assets can be devoted to speculation, meaning that a $10 billion bank could operate a $500 million proprietary trading desk. While speculation can be profitable, it can also lead to precipitous losses. Since bank capital at smaller firms only amounts to about 5 percent of assets, a loss nearing 5 percent in the proprietary trading desk can render the firms insolvent. We are further concerned that what must be a drafting oversight could lead to ambiguity about the overall application of this Volcker Rule exemption. This section makes reference to depository institutions. This could mean that a bank holding company of any size, including those with more than $1 trillion in assets, could establish multiple depository institutions with less than $10 billion each, and establish hedge fund divisions in each. We assume that even the supporters of this provision wish to avoid this evasion.

**Section 204** would amend the Volcker Rule to permit investment funds to use a variation of the name of its parent investment advisor that is, in turn, a subsidiary of a bank holding company. The Volcker Rule permits a small investment in these funds, but prohibits the bank from using its name (or a variation) or the name of investment advisor for the funds. The purpose of divorcing names is to reduce the incentive for a taxpayer-backed bank to bail out a faltering fund, which it might do for reputational reasons. In some cases, the name of the investment advisor may be sufficiently different that clients may not associate it with the bank holding company. In the case of Bank of America's Merrill Lynch subsidiary, this ownership relation is well known. Bank of America may feel compelled to bail out a fund with a variation of the

[6] *Reducing procyclicality arising from the bank capital framework*, JOINT FSF-BCBS WORKING GROUP ON BANK CAPITAL ISSUES (2009) http://www.fsb.org/2009/04/r_0904f/

Merrill Lynch name for reputational reasons. We believe that the current statute and interpretation is sound. Banks should not be tempted to bail out failing funds for reputational reasons and investors should not be misled that a high risk fund enjoys the backing of a bank or affiliated investment advisor.

**Curbing Consumer Safeguards**

Wells Fargo, Equifax, and the enduring hardship from the financial crash all emphasize the importance of consumer safeguards in financial transactions. Yet this bill removes a number of protections for consumers, especially impacting those already vulnerable because of income status, race or gender.

**Section 107** eliminates an important safeguard for purchasers of manufactured housing, also known as mobile homes, or trailers. Specifically, the section permits sales agents and other employees of manufactured housing makers to steer customers to loan-makers.

The financial crisis revealed that mortgage originators steered unwary borrowers into high cost loans, even helping to fabricate documents that masked the borrowers inability to pay. That generated fees for the originator, with no risk when the borrower ultimately proved unable to pay. In manufactured housing, some sales agents may steer customers to certain lenders that provide financing, and a sale for which the agent receives a commission, even where that sales agent may know the borrower lacks appropriate financial means. Manufactured home buyers have been especially vulnerable in this market, prey to higher priced loans, according to a study by the Consumer Financial Protection Bureau[7] and another by the Seattle Times.[8]

This section would help retailers steer buyers to specific lenders and loan products that may be inferior to those that the buyer could find independently. And though the bill says that the sales agent cannot receive compensation for recommending a specific lender, retailers could reward sales agents indirectly, such as through promotions, or sharing in bonuses based on in-housing financing goals. This bill would harm some of America's most vulnerable citizens by making legal already objectionable practices.

**Section 104** would let lenders who make less than 500 mortgages escape reporting under the Home Mortgage Disclosure Act. HMDA was enacted in 1975, and helps enforce anti-discrimination based on race and gender. The act requires certain financial institutions to provide the public, with mortgage data to determine if financial institutions are properly serving the communities in which they are located. Following the passage of the Dodd-Frank Act, rulemaking authority for HMDA was transferred to the CFPB. The CFPB revised HMDA to require community banks and credit unions to collect data points on loan applications and share that information with the federal government. The data is already collected by all banks and even non-banker lenders. The only cost for reporting this is in setting up the reporting systems. If firms that make less than 500 mortgages annually fail to report, this would exempt about 85

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[7] *CFPB Finds Majority of Manufactured Housing Borrowers Have Expensive Loans*, CONSUMER FINANCIAL PROTECTION BUREAU (Sept. 30, 2014)

[8] Mike Baker, Daniel Wagner, *Minorities exploited by Warren Buffet's Mobile Home Empire,* SEATTLE TIMES/BUZZFEEDNEWS (Jan 13, 2016) /

percent of all lenders.[9] This bill would represent negligible compliance relief for smaller banks, while potentially leading to discriminatory lending, and certainly depriving policy makers and the general public of important lending information.

**Section 103** would let loan makers for mortgages of less than $400,000 escape liability under the Financial Institutions Reform Recovery and Enforcement Act if they failed to obtain an appraisal after making a good faith effort. This policy is internally illogical, as the exemption does not apply for loans of more than $400,000. That is, if a lender can find an appraiser for a home loan of $401,000, then one can certainly be located for a mortgage of $399,000. Further, even if it is difficult to retain a willing appraiser, this threshold is high. Setting the threshold at $400,000 would cover most mortgages. The median sales prices of existing homes in the United States is $247,000.[10] But even a lower threshold exposes borrowers to the same problem. A home sold for a price well above what an honest appraiser would judge could leave the buyer underwater for years. Appraisal fraud figured in the financial crash. To qualify borrowers for larger loans, generating the mortgage broker a higher commission, appraisers inflated the real value of the home. When borrowers struggled and attempted the sell the home, many found that the value was less than their purchase price. The committee should instead investigate and legislate reforms in the appraisal industry.

**Section 110** removes the three day waiting period for disclosures following the change in terms of a mortgage if the rate has decreased from the previous offered rate. However, the section does not recognize other changes that may accompany a lower rate, such as a change from a fixed rate to an adjustable rate. Borrowers should be afforded the time to consider such changes, as current law provides.

**Section 109** would allow banks with less than $10 billion in assets that make fewer than 1,000 mortgages annually to avoid offering escrow services. Escrow services provide for periodic charges such as home insurance and property taxes to be billed in the monthly payment. In this way, borrowers can better understand the true cost of purchasing a home and making payments. Where charges such as taxes and insurance are not included, the loan may appear cheaper than it actually is. Further, borrowers may not put aside the requisite funds for the charges. Failure to pay property taxes, when they aren't established in escrow, can lead to foreclosures. Banks of any size that make mortgages on a weekly basis, let alone a daily basis, should certainly be able to establish escrow services as fundamental to their operation, to make clear that they are not luring borrowers with deceptive prices.

**Section 202** enables banks to take reciprocal deposits that constitute as much as 20 percent of their total deposits. Reciprocal deposits are way for banks to attract funds from sophisticated institutions or wealthy individuals who seek government insurance for funds that exceed the $250,000 individual account cap set by the Federal Deposit Insurance Corp.  To circumvent this limit, vendors have developed sophisticated networks where participating banks exchange

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[9] Home Mortgage Disclosure Act Final Rule, FEDERAL REGISTER Vol. 80, No. 208 at 66279, (October 28, 2015) https://www.gpo.gov/fdsys/pkg/FR-2015-10-28 .

[10] *Median Sales Prices Of Existing Homes* FEDERAL RESERVE BANK OF CHICAGO (website visited Nov. 27, 2017) https://fred.stlouisfed.org/series/HOSMEDUSM052N

balances in excess of the $250,000 with each other on behalf of clients such that no single account shows a balance beyond the $250,000. For example, Promontory Interfinancial Network advertises that it can help banks "attract, grow, and retain customer relationships by providing customers with access to multi-million-dollar FDIC insurance."[11] These types of brokered deposits may actually promote risky banking because they may fund "unsound or rapid expansion of loan and investment portfolios," according to the FDIC. The agency has found they have contributed to weakened financial and liquidity positions. "The overuse of brokered deposits and the improper management of brokered deposits by problem institutions have contributed to bank failures and losses to the Deposit Insurance Fund." [12]

**Conclusion**

This bill deregulates the financial sector, a dangerous goal that ignores the calamity of the financial crash of 2008, and defies American public opinion, which supports strong Wall Street regulation. The financial crash cost millions of Americans their homes, their jobs and their savings. The conservative Cato Institute issued a poll showing bipartisan support for strong regulation:

- 77 percent believe bankers would harm consumers if they thought they could make a lot of money doing so and get away with it.
- 64 percent think Wall Street bankers "get paid huge amounts of money" for "essentially tricking people."
- Nearly half (49 percent) of Americans worry that corruption in the industry is "widespread" rather than limited to a few institutions.[13]

The American public demands and deserves financial policy that promotes average Americans, not the profits of the financial sector. Public Citizen believes that this is a deregulation bill that harms the public being paraded under the banner of economic growth. We urge you to oppose this legislation.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org.

Sincerely,

Public Citizen

[11] CDARS One-Way Sell, PROMONTORY INTERFINANCIAL NETWORK (website visited Nov. 22, 2017) http://www.promnetwork.com/home/services/certificate-of-deposit-account-registry-service/cdars-one-way-sell
[12] Identifying, Accepting and Reporting Brokered Deposits, FDIC (June 30, 2016), https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf
[13] *Wall Street V. Regulators*, CATO INSTITUTE (September 189, 2017) https://www.cato.org/survey-reports/wall-street-vs-regulators-public-attitudes-banks-financial-regulation-consumer