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THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE MORE STABLE?

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

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CONTENTS

	Page
Hearing held on:	
July 9, 2015	1
Appendix:	
July 9, 2015	69

WITNESSES

THURSDAY, JULY 9, 2015

Atkins, Hon. Paul S., Chief Executive Officer, Patomak Global Partners LLC; and former Commissioner, U.S. Securities and Exchange Commission	6
Calabria, Mark A., Director, Financial Regulation Studies, Cato Institute	7
Silvers, Damon A., Director of Policy and Special Counsel, American Federation of Labor—Congress of Industrial Organizations (AFL-CIO)	10
Zywicki, Todd J., Foundation Professor of Law and Executive Director of the Law and Economics Center, George Mason University School of Law	11

APPENDIX

Prepared statements:	
Beatty, Hon. Joyce	70
Atkins, Hon. Paul S.	74
Calabria, Mark A.	87
Silvers, Damon A.	104
Zywicki, Todd J.	111

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Ellison, Hon. Keith:	
Forbes article entitled, "The Highest-Paid CEOs Are The Worst Performers, New Study Says," dated June 16, 2014	119
Himes, Hon. James:	
Chart entitled, "The Five Years Since Dodd-Frank"	122
Messer, Hon. Luke:	
American Action Forum article entitled, "From Free Checking to the Financial Fringe: A Tale of Two Regulations and Low-Income Families," July 8, 2015	123
Written responses to questions for the record submitted to Todd Zywicki	128
Stivers, Hon. Steve:	
Written statement of the Association for Corporate Growth	130

THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE MORE STABLE?

Thursday, July 9, 2015

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Royce, Lucas, Garrett, Neugebauer, McHenry, Pearce, Posey, Fitzpatrick, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hurt, Stivers, Fincher, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus, Messer, Schweikert, Guinta, Tipton, Williams, Poliquin, Love, Hill, Emmer; Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Clay, Lynch, Scott, Green, Cleaver, Moore, Ellison, Himes, Carney, Sewell, Foster, Kildee, Murphy, Delaney, Sinema, Beatty, Heck, and Vargas.

Chairman HENSARLING. The Financial Services Committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "The Dodd-Frank Act Five Years Later: Are We More Stable?"

Before proceeding, I wish to yield to the gentleman from Indiana for a very special introduction. The gentleman is recognized.

Mr. MESSER. Thank you, Mr. Chairman. This is unanticipated, but I would like everybody here to meet my son Hudson Messer—stand up, Hudson—who is joining us today. It is his first time at a Financial Services Committee hearing. Thank you.

[applause]

Chairman HENSARLING. Welcome, Hudson. Take very careful notes. We are not always sure your father does.

Mr. MESSER. He was watching the debt clock, though. He was very impressed by that.

[laughter]

Chairman HENSARLING. He will have to pay for it. I now recognize myself for 3 minutes to give an opening statement.

Five years ago this month, Dodd-Frank was signed into law. Undoubtedly, it is the most sweeping and dramatic rewrite of banking and capital markets laws since the New Deal. Weighing in at 2,300 pages, with 400 new rules, it is clearly, clearly dramatic.

Whether fan or detractor, this committee would be negligent if we weren't vigilant in our oversight of both the impact and the implementation of Dodd-Frank. Negligent we will not be.

So today marks the first of three hearings to be held on the Dodd-Frank bill, posing three different questions. Five years after Dodd-Frank, are we more prosperous? Five years after Dodd-Frank, are we more free? And the focus of today's hearing, five years after Dodd-Frank, are we more stable?

I frankly believe it remains an open question as to whether we have achieved greater stability. I fear the answer is "no," but were the answer to be "yes," when you look at the damage Dodd-Frank has done to our economic growth, to family finances and to consumer freedom, I am rather doubtful it would be worth the cost.

Clearly, balance sheets have improved post-Dodd-Frank and banks have delevered. This is a necessary and good thing, and I strongly suspect that market forces would have brought about these actions regardless of Dodd-Frank.

Regulators already possess the powers to have set more prudent capital and leverage standards. Still, Dodd-Frank very well may have been helpful in this regard.

What is undebatable is the fact that since the passage of Dodd-Frank, the big banks are now bigger, and the small banks are now fewer. In other words, even more banking assets are now concentrated in the so-called too-big-to-fail firms. Pray tell, how does this improve financial stability?

Dodd-Frank has codified too-big-to-fail into law and provided a taxpayer-funded bailout system in Title I and Title II of the Act. This simply leads to even greater moral hazard and to greater instability.

According to the Richmond Federal Reserve, the explicit Federal guarantees of financial sector liabilities have increased to a whopping 60 percent post-Dodd-Frank. When private investors and depositors and counterparties expect a bailout, their incentives to monitor risk clearly wane.

Regulatory micromanagement is no substitute for market discipline. By this measure, Dodd-Frank has clearly made our financial system riskier.

Part of the extension of the Federal backstop has been the creation of a whole new class of too-big-to-fail institutions, namely centralized clearinghouses for derivatives. Here, Dodd-Frank didn't lessen risk. It just centralized it and placed it on a taxpayer balance sheet.

Next, Dodd-Frank's Volcker Rule, along with the Basel accords, have caused a massive drop in corporate bonds inventories. Many economists now believe the next financial crisis could very well result from the illiquidity and volatility in our bond market.

Senator Dodd of Dodd-Frank said, "No one will know until this is actually in place how it works." Five years later, we have a clue, and we are learning that our financial system may very well be less stable under Dodd-Frank.

I now yield 5 minutes to the ranking member for an opening statement.

Ms. WATERS. Thank you, Mr. Chairman. Today's hearing is the first of two scheduled in recognition of the fifth anniversary of the Dodd-Frank Wall Street Reform Act.

It is important to remember that the 2008 financial crisis was not a natural disaster. Instead, it was the result of deliberate

choices, choices on the part of some on Wall Street who put their own short-term interests ahead of the long-term economic health of our Nation's investors and consumers.

As a result of choices on the part of some of our regulators, we failed to respond as vulnerabilities and illegalities in our financial system emerged. These choices had tremendously damaging consequences. Our Nation became plagued by small business closures, large drops in the stock market, stunning job losses, rising foreclosures, and fears of a looming repeat of the Great Depression.

In the 6 months before President Obama took office, our economy hemorrhaged nearly 4 million private sector jobs, an average of 650,000 per month. Nearly $16 trillion in household wealth simply disappeared. The retirement accounts of many hardworking Americans were swept away.

Around 9 million individuals were displaced from their homes, many of whom may never again have the opportunity for home ownership.

Once the economy was stabilized, Democrats worked diligently on legislation to restore responsibility and accountability to our financial system and instill confidence that we have the tools in place to protect Americans from another crisis.

Since Dodd-Frank was enacted 5 years ago, the American economy has added nearly 13 million private-sector jobs and unemployment has fallen by 4.7 percent points, its lowest level since September 2008. The housing market is recovering, with home prices rising, negative equity falling, and measures of mortgage distress improving.

Retirees' investments are recovering as well. The S&P 500 has risen more than 250 percent since February 2009, and the average 401(k) balance has reached a record high in 2014.

But even as we celebrate our success at avoiding a second Great Depression, it is important to recognize that the events of 2008 have cast a long shadow over our Nation's growth and prosperity, one which has not been shared equally by all.

Research from Cornell University found that the foreclosure crisis has resulted in an increasing level of resegregation in many urban areas. Several institutions confirm the foreclosure crisis likely had substantial negative impacts on child well-being, with multiple moves and marital discord leading to anxiety, depression, and poor performance in school.

The crisis also exacerbated what was already an unacceptably large wealth gap between white and minority households. The Pew Research Center found that the current wealth gap between African-Americans and whites has reached its highest point since 1989. The current white-to-Hispanic wealth ratio has reached a level not seen since 2001.

We must go further to address these lingering challenges. But make no mistake, we made progress. Most notably, in Dodd-Frank we created a Consumer Financial Protection Bureau that in just a few years has already returned $5.3 billion to 15 million consumers who have been subjected to unfair and deceptive practices.

We have worked with the Bureau to create rules of the road to make sure predatory mortgages never again strip wealth from American families and endanger our economy.

And we worked with regulators to institute rules to protect retirees and other investors from the practices that wreaked havoc on savings in 2008.

But Mr. Chairman, too much time has been wasted in Congress by the majority bent on austerity policies that leave workers, retirees, and minority communities behind, while ignoring the substantial progress we have made toward deficit reduction.

Too much energy has been spent trying to re-litigate the causes of the 2008 crisis, which at this point everyone should recognize is settled.

Finally, far too much effort has been spent by the Republicans to weaken our regulatory apparatus, whether through underfunding our regulators, relentlessly pursuing or pressuring them to go soft on rules, or injecting unrelated Wall Street giveaways into must-pass government funding bills.

I am tired of the Republicans' death-by-1,000-cuts strategy to roll back the significant gains we have made since Dodd-Frank enactment. Five years later, I urge my colleagues to take stock of where we were and how far we have come.

And I suggest they recognize that much like the recent Supreme Court decisions to uphold the Affordable Care Act, and the disparate impact standard to prevent discrimination in housing, Dodd-Frank is settled law.

Thank you, and I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, chairman of our Oversight and Investigations Subcommittee, for 2 minutes.

Mr. DUFFY. Thank you, Mr. Chairman. When Dodd-Frank was enacted 5 years ago this month, Senator Elizabeth Warren and President Obama promised Americans that this law would lift the economy, that their hard-earned money would be safer, that markets would be more stable and that no one institution would threaten the safety and soundness of the global financial system.

As we have seen this law implemented, it has left much to be desired. In large part, the 2008 financial crisis was a result of Federal financial regulators failing to do their job, and their inability to anticipate the looming issues in the subprime mortgage market.

Dodd-Frank rewarded incompetency with more responsibility. The law has created new areas of risk concentration, enshrined too-big-to-fail institutions, made it more difficult for small banks to compete, and done damage to the economy that is still too difficult to quantify.

The law of unintended consequences has never been more apparent than when we look at Dodd-Frank. The pursuit of financial stability has come at a cost. While the goal may be worthy, we must look at the collateral damage along the way and ask ourselves if we are going down the right path.

Compliance burdens are crushing small institutions. And though banks may be better capitalized, we are now seeing negative market impacts stemming from these new regulations.

The FSOC and Treasury Secretary Lew don't really want to admit that Dodd-Frank may be at the center of illiquidity that was seen in the bond market. With banks having to hold on to more capital and pulling out of market-making activities, these markets

are left withering in the wake of Dodd-Frank and other international regulations.

Another product of Dodd-Frank is the Consumer Financial Protection Bureau, the CFPB, which was tasked with protecting consumers of financial products and services from discrimination. Ironically, it has the worst track record of all Federal financial agencies of EEO complaints, proving the agency is inept at best, or negligent at worst, at protecting its own employees from discrimination and retaliation.

Further, sources of small dollar credit products that millions of Americans rely upon are now in the crosshairs of the Bureau. The government-knows-best mentality, the nanny-state mentality, has gone too far. Americans are capable of choosing products and making decisions that they know are in their best financial interests.

The CFPB is eliminating consumer freedom and imposing political agendas that I just don't think work, Mr. Chairman. This is the Gruber mentality, along with—well, I will go there later. I will yield back.

Chairman HENSARLING. Notwithstanding the fact the gentleman was on a roll, the time of the gentleman has expired.

[laughter]

Today, we welcome the testimony of our distinguished panel. I will introduce them at this time.

First, Mr. Paul Atkins is the CEO of Patomak Global Partners. He is a former Commissioner of the U.S. Securities and Exchange Commission, appointed by President George W. Bush. I also note that he is a fellow member of the TARP Oversight Panel.

Before his appointment to the Securities and Exchange Commission, he served on the staff of two SEC Chairmen, and worked as an attorney in private practice. He is a graduate of the Vanderbilt University School of Law, and Wofford College.

Dr. Mark Calabria is the director of financial regulation studies at the CATO Institute. Before serving at CATO, he served on the staff of the Senate Banking Committee, and as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development. He owns a doctorate in economics from George Mason University.

Mr. Damon Silvers is director of policy and special counsel at the AFL-CIO where he has advised on a range of financial services matters before the Treasury Department, the SEOC, and the PCAOB. I also note he served as the Deputy Chair of the Congressional Oversight Panel, another fellow alum. I think we are maybe two shy of a full reunion. At this time, we might leave it that way.

Professor Todd Zywicki is a foundation professor of law and an executive director of the Law and Economics Center at George Mason University. He was previously an attorney in private practice, and a law clerk for Judge Jerry Smith, U.S. Court of Appeals for the 5th Circuit. He is a graduate of the University of Virginia Law School, Clemson University, and Dartmouth College.

Each one of you gentlemen, I know, has testified before our committee. So I trust you do not need a remedial tutorial on our lighting system of red, yellow, and green.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Mr. Atkins, you are now recognized for 5 minutes to summarize your testimony.

STATEMENT OF THE HONORABLE PAUL S. ATKINS, CHIEF EXECUTIVE OFFICER, PATOMAK GLOBAL PARTNERS LLC; AND FORMER COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. ATKINS. Thank you, Mr. Chairman. Good morning, Chairman Hensarling, Ranking Member Waters, and members of the committee, and thank you very much for inviting me to appear at the hearing today.

Given my background, I am going to focus my remarks on the impact of Dodd-Frank on the U.S. capital markets. I think the single largest problem of the Act is Title I, titled "Financial Stability."

The conceit of the authors of Dodd-Frank is that if you get enough smart people in a room with enough data, they can bring stability to the marketplace. But just as human beings cannot be counted on to be predictable and stable, those of us who spend a lifetime engaged with the capital markets know that they also are not always stable because human beings with other foibles make up markets.

Ultimately, though, the freedom of individuals to make their own decisions is not a curse, but a benefit.

A little over a year ago, I testified before this committee on the FSOC's embarking on a misguided effort to apply bank prudential regulation to the capital markets by designating asset managers as systemically important financial institutions, or SIFIs.

After much pushback, including by many of you on this committee from both sides of the aisle, both the FSOC and the International Organization of Securities Commissions now indicate that they are moving away from designating asset managers as SIFIs. But that decision is not carved in stone.

Take the Financial Stability Board, which seems not to have changed its course to designate funds and asset managers as global SIFIs, even though the only funds and managers that meet their materiality threshold are American. That raises serious competitive implications for the United States just as the European Union embarks on an initiative to encourage Pan-European capital markets.

In short, the story of attempted prudentialization of capital markets is not going away. I fear that the U.S. capital markets, which have been the driver of economic growth and job creation in this country for decades, will be the collateral damage in the elusive quest for, as I say, stability "uber alles."

Another Dodd-Frank provision that is emblematic of a flawed legislative process is the Volcker Rule. Despite not being included in either the House or the Senate bill, and without any substantive hearing to consider the specific language of the Rule, potential effects or unintended consequences of the provision, the Volcker Rule became law.

Basically, the Volcker Rule is aimed at banning proprietary trading in commercial banks. Because it is easier to blame Wall Street

in excessive risk taking for the financial crisis than the Federal Government's own housing policies, many have trumpeted the Volcker Rule as the best reform of Dodd-Frank.

But even former Chairman Volcker himself has acknowledged that, "proprietary trading in commercial banks was not central to the crisis." Yet, the statute and implementing regulations turned regulators into amateur psychologists. They might as well have a Ouija board to determine intent under the rule.

Rather than risking running afoul with regulations, banks have reduced their market-making activities. Combining the Volcker Rule with higher capital requirements at home and abroad has literally sucked essential working capital out of the market-making activities of banks.

Banks no longer act as principals in trading any more, but as agents. That decreases market liquidity on a daily basis.

Even though Secretary Lew—who by the way does not have a financial background—refuses to acknowledge it, the Volcker Rule is the needless regulation that has caused and will continue to cause harm to issuers and investors.

As the chairman quoted at the outset, former Senator Dodd famously said, "No one will know until this is actually in place how it works." Five years later, the full effects of Dodd-Frank are still unknown. But the costs certainly have been borne not just by Wall Street but by ordinary investors and businesses of all shapes and sizes who are no safer today than they were in 2008.

Indeed, small investors will suffer more pain if the Administration goes through with the proposed changes to the ambit of fiduciary duty under ERISA. To say nothing of the myriad special interest provisions in Dodd-Frank that had absolutely nothing to do with the financial crisis such as conflict minerals certification, mineral extraction disclosure, and the CEO pay disclosure.

Moreover, until Congress claims some of the authority that it gave regulators under Dodd-Frank, particularly the authority given the FSOC and the Federal Reserve under Titles I and II, the greatest risk to the U.S. capital markets remains that government, and not the markets, will ultimately choose winners and losers.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Atkins can be found on page 74 of the appendix.]

Chairman HENSARLING. Thank you.

Dr. Calabria, you are now recognized for your testimony.

STATEMENT OF MARK A. CALABRIA, DIRECTOR, FINANCIAL REGULATION STUDIES, CATO INSTITUTE

Mr. CALABRIA. Chairman Hensarling, Ranking Member Waters, and distinguished members of the committee, thank you for the invitation to appear at today's important hearing.

I will note that it has been almost a year since I appeared before the committee, and I was starting to wonder if I had worn out my welcome. So, it is a delight to be back, and of course an honor to be part of such a distinguished panel.

The subtitle of today's hearing raises what I believe is probably the single most important question in financial regulation: Are we

more stable? Let me cut the suspense and give you my answer. I think it is "no." Now, let me tell you why.

I will note that there have been improvements. And I don't think anybody would disagree with that. In my written testimony, I talk about the improvements we have seen in bank capital. But my own opinion is that the net improvements have been outweighed by the net downsides.

This is also an extremely broad topic. I touch on a number of things in my written testimony, which I will be delighted to discuss later, but I am only going to focus on a few right now.

Let me first focus on what I believe is one of the more important contributors to financial instability, which is the moral hazard created by both implicit and explicit guarantees of risk taking.

The chairman mentioned the Richmond Fed's Bailout Barometer. As he noted, this is up to a full 60 percent of our financial system liabilities, either explicitly or implicitly backed by the Federal Government. I will note this is higher than both before Dodd-Frank and before the crisis.

Part of the measure of the implied too-big-to-fail is the too-big-to-fail subsidy of our largest banks. For reasons I detail in my written remarks, I do not believe that Dodd-Frank has ended too-big-to-fail. I will note that according to recent polling, neither does a plurality of the American public believe that either.

Some would claim that Title II's orderly liquidation process ends bailouts. I will note that I worked on a similar mechanism created under the Housing Economic Recovery Act for Fannie Mae and Freddie Mac. And so let us not forget, we had the tools to resolve Fannie and Freddie without a dime of cost to the taxpayer. Those are on the books. Those were not used.

So maybe I will characterize my concern this way. The ranking member mentioned choices. We are faced with that next time.

Regulators will have the choice whether they resolve an institution without relaying to the taxpayer, without taxing the rest of the financial services industry, or whether they impose losses on creditors. So let me emphasize that while I agree that Dodd-Frank's Title II offers a path to imposing losses on shareholders and creditors, I could not overemphasize, it is a choice.

One of the reasons I believe that choice will not be taken is if you simply compare an institution like Freddie Mac, which is smaller and less complex than an institution like Citibank, it suggests to me that it is very hard to believe that we would actually let Citibank fail.

There are a number of other institutions that we may let fail, but I don't think some of them would work.

I appreciate and commend the FDIC's attempts towards its single point of entry to try and improve upon that process. Setting aside its questionable legality, I would also emphasize that it is an optional approach. Whether it is actually followed or not is an open question.

Were it credible, markets would price holding company debt and subsidiary debt differently. Recent research from the New York Federal Reserve shows that this is not happening. So apparently, the markets don't even believe the single point of entry is going to be effective.

I will note that a handful of studies have found that designating systemic entities as "systemically important," as is done under Title I, leads market participants to view these entities as too-big-to-fail.

I will remind the committee that in this very room in 1984, when the Comptroller of the Currency told us that the 11 biggest institutions were too-big-to-fail and they were going to be heavily regulated, we still ended up bailing out some of those institutions.

So, it is bad enough that unfortunately the implied guarantees of our largest banks have been further backed. We also have extended that privilege, as the chairman noted, to financial market infrastructure such as clearinghouses.

Another important driver of instability is monetary policy. Years of negative real interest rates incentivize all sorts of reckless behavior, such as that which helped inflate the housing bubble. I am certain that we are currently massively distorting our financial markets with our current monetary policy.

Let me be very clear in my opinion that the Fed's current policies will be very painful when they unwind. Most of us agree that mortgages play an important role in the crisis.

Dodd-Frank has indeed attempted to address problems in the mortgage market. As I detail in my written testimony, I believe these attempts have fallen short, and in many instances have done more harm than good.

I believe the evidence is overwhelming coming from such neutral parties as GAO that loan to value and borrower credit are the main primary drivers of default, yet these have been ignored.

I remind the committee that Congressman Frank sat at this table last year and testified that he clearly meant that downpayments should be a part of QM and QRM. The regulators have gutted these provisions, making them worse than useless.

Perhaps worst of all is that Dodd-Frank has helped drive almost all of the mortgage risk in the United States on the backs of the taxpayer. Fannie, Freddie, and FHA all hold essentially zero capital. When the housing market turns, which it will, the taxpayer will face a very large bill.

Even the IMF, no lover of free markets, highlighted earlier this week the instability risks from our housing finance system. If we continue along this path, I estimate that at least a million families will lose their homes in the next downturn from the reckless underwriting practices of the FHA alone.

Mr. Chairman, I commend you for calling today's important hearing. As we painfully learned over the last decade, financial crises are extremely costly and painful, both for the economy and for American families.

Had Dodd-Frank brought more stability to our financial system, I would be the first to applaud it. I do believe it has not.

Without sufficient reform, I believe we are almost certain to see another painful crisis within the next decade. Sadly, the warning signs were ignored before the last crisis.

I urge Congress not to ignore the warning signs this time around.

[The prepared statement of Dr. Calabria can be found on page 87 of the appendix.]

Chairman HENSARLING. Thank you.

Mr. Silvers, you are now recognized for your testimony.

STATEMENT OF DAMON A. SILVERS, DIRECTOR OF POLICY AND SPECIAL COUNSEL, AMERICAN FEDERATION OF LABOR—CONGRESS OF INDUSTRIAL ORGANIZATIONS (AFL-CIO)

Mr. SILVERS. Good morning, Chairman Hensarling, Ranking Member Waters, and members of the committee.

My testimony today is given on behalf of both the AFL-CIO, and Americans for Financial Reform, a coalition of over 200 organizations.

The Dodd-Frank Act passed in the wake of a financial crisis that cost the United States $22 trillion, according to the GAO. In the course of that crisis, 10 million families were thrown out of their homes and tens of millions lost their jobs. That is what we are trying—the statute was seeking to prevent occurring again.

But the Dodd-Frank Act was a compromise. It did not place size limits on financial institutions, it did not restore the Glass-Steagall Act, and it did not fundamentally change the incentives in the executive compensation system of our financial firms to take on excessive risk.

Rather than making these fundamental structural changes, the Act gave regulators the possibility of making structural change. This goes back to Dr. Calabria's point about choices.

What Dodd-Frank did do was resurrect fundamental principles of financial regulation that had been forgotten in the race to deregulate in the 1980s and 1990s. Most of all, the Dodd-Frank Act created a clear, workable alternative to the bailout of systemically significant institutions.

The resolutions process, contemplated in Title II, places the responsibility for first-hour losses and distress situations clearly where it should be, on the too-big-to-fail firms, their equity holders, bond holders, and executives. However, I would associate myself with Dr. Calabria's comments that this requires the regulators to actually choose to use it.

The U.S. financial regulatory system prior to the Dodd-Frank Act was a Swiss cheese system, full of holes allowing financial actors to evade both capital and transparency requirements for the price of a lawyer. The Act closed many, but not all, of these loopholes.

Five years later, among the clear results of these changes is a reduction in the credit market's perception that the government will bail out the Nation's largest banks if they get into trouble. GAO found that while there was a very large subsidy—in the credit markets for too-big-to-fail banks in 2009 and 2010.

Between 2010 and 2014, that subsidy fell to near zero as regulators showed through the progress of living wills, the adoption of single point of entry and the refinement of stress tests that they were serious about enforcing the provisions of Title II.

But the Dodd-Frank Act was not simply about protecting the financial system from itself. Its explicit purpose was to make financial markets less of a rigged game from the perspective of consumers and investors.

Here, the track record is impressive and expanding. For example, the CFPB has returned $5.3 billion of improperly obtained fees and penalties to over 15 million consumers and their families. And the Securities and Exchange Commission recently has begun using the Act to uncover widespread abuses of investors by private equity and hedge fund managers.

However, the Act necessarily depends on regulators to implement and enforce it, and all too often over the last 5 years regulators have succumbed to political pressures not to, particularly in the area of executive compensation.

And then, there was the recurring impulse in Congress to weaken financial regulation, that same impulse that brought us to crisis in the first place. We saw this on display in the Cromnibus negotiations last winter where Congress worked with the Obama Administration to repeal the hard-fought derivatives push out provisions and once again relink the derivatives market to the deposits of American families.

Efforts to weaken the Dodd-Frank Act have involved the use of a series of spurious arguments, including "cost benefit analyses" that looked only at the costs and not at the benefits. These sorts of arguments only have weight because of the political and economic power of the people making them.

And this brings us back to the issue of too-big-to-fail banks. The truth is that because Dodd-Frank was a compromise, because it largely left to the regulators the question of structural change, it has proven to be vulnerable to the continuing political power of the handful of too-big-to-fail banks that continue to dominate our financial system and exert a disproportionate influence on our politics.

In this sense, the unfinished agenda of financial reform is inextricably intertwined with the ability of the regulatory system to effectively implement the Dodd-Frank Act as it is to ensure the financial system does its job of efficiently transforming savings into investment and to protect the U.S. economy and the American public from a costly repeat of the financial crisis that began in 2007.

My answer, Mr. Chairman, to the question posed in the title of this hearing, is that the Dodd-Frank Act has definitely helped make our financial system more stable, but unless we deal with the too-big-to-fail problem more directly, the Dodd-Frank Act itself is not stable.

Thank you.

[The prepared statement of Mr. Silvers can be found on page 104 of the appendix.]

Chairman HENSARLING. Thank you.

Professor Zywicki, you are now recognized for your testimony.

STATEMENT OF TODD J. ZYWICKI, FOUNDATION PROFESSOR OF LAW AND EXECUTIVE DIRECTOR OF THE LAW AND ECONOMICS CENTER, GEORGE MASON UNIVERSITY SCHOOL OF LAW

Mr. ZYWICKI. Thank you, Chairman Hensarling, Ranking Member Waters, and members of the committee. I am a scholar of consumer credit, a former FTC senior staffer, and as a result, I was especially disappointed that Dodd-Frank had squandered an oppor-

tunity to modernize our financial consumer protection system, to a regime that would promote competition, consumer choice, and innovation.

If you look back at the record over the past 5 years, instead Dodd-Frank has substituted the judgment of Washington bureaucrats for American families with respect to the financial products that will make their lives better; thrown a blanket of uniformity over the consumer credit market, strangling innovation and crushing community banks; raised prices; and reduced consumer choice with respect to financial services.

And by reducing access to financial services, and because many small businesses use personal credit in their own businesses, it has dampened the economic growth and recovery. And I think most tragic of all, Dodd-Frank has done little to increase consumer protection for American families, but by driving millions of consumers out of the mainstream financial system, and into the hands of payday lenders, check cashers, pawn brokers, and all of the other alternative financial providers, it has actually made life worse for the most vulnerable members of society.

At the heart of Dodd-Frank was the Consumer Financial Protection Bureau, which is both the most powerful and unaccountable bureaucracy in American history, with the ability to regulate virtually every consumer credit product under vague and poorly defined standards.

If we look at the track record of the CFPB, and the way in which Dodd-Frank has been implemented, we see a sweeping amount of damage to American families as a result of this law.

First, Dodd-Frank has destroyed free checking for millions of Americans. Prior to Dodd-Frank, 76 percent of Americans had access to free checking; since Dodd-Frank was enacted, that number has fallen to 38 percent. Bank fees have doubled as a result of Dodd-Frank, driving approximately a million, if not more, consumers out of bank accounts and into the alternative financial sector.

With respect to credit cards, by interfering with the ability of credit card issuers to accurately price their risk, it is estimated that 275 million credit card accounts were closed, and $1.7 trillion in credit lines were eliminated, and again, those who bore the brunt of this were the lowest income consumers. According to the Federal Reserve, the number of—lowest quintile households with credit cards fell by 11 percentage points in the period since Dodd-Frank was enacted, taking credit cards out of the hands of American families, and forcing them to turn to payday loans and other alternatives to try to pay the rent, and to try to prevent eviction.

With respect to mortgages, Dodd-Frank has raised the cost and risk of lending, and continued to slow the housing recovery and access to mortgages.

Yet by doing nothing about downpayments and many of the other factors that led to the financial crisis, Dodd-Frank is doing little to prevent the next financial crisis.

Perhaps most notably, Dodd-Frank's rules, by throwing this blanket of uniformity and bureaucratic underwriting over the mortgage market, have driven community banks out of the mortgage market. According to a Mercatus study, for instance, 64 percent of commu-

nity banks have changed their mortgage offerings as a result of Dodd-Frank and the CFPB, and by creating this new de facto plain vanilla rule, they have eliminated the ability of community banks to compete on what they do best, which is relationship lending.

One other area I would like to flag is this extraordinary data mining operation that the CFPB has undertaken with respect with consumer data. While—and perhaps this evidence is best, the dangers of creating a super unaccountable bureaucracy like the CFPB that—and the sort of egregious behavior that this leads to. For those not familiar with this, it is estimated that the CFPB is routinely scooping up 600 million credit card accounts, 22 million mortgages, and 5½ million student loans, all without the knowledge and consent of American consumers.

And that is still not enough. They want 95 percent of credit card accounts. According to one estimate, this is 70,000 percent more data than the CFPB needs in order to effectuate its regulatory purposes. This is especially worrisome in light of the fact that the Director of the CFPB himself has admitted that this data could be reverse engineered in the light of recent data breaches at the IRS, OPM, and elsewhere.

Thank you.

[The prepared statement of Mr. Zywicki can be found on page 111 of the appendix.]

Chairman HENSARLING. Thank you.

The Chair now yields himself 5 minutes for questions.

Mr. Atkins, in your testimony, on page 8, you posit one undisputed effect of the Volcker Rule has been a reduction in corporate bond inventories of primary dealers. Next time you posit that, I might suggest that you offer the caveat, "unless you are an economist employed by the Federal Reserve or the Financial Stability Oversight Council." They seem to be the only ones in the world who can't connect the Volcker Rule with this undisputed reduction.

Even the Financial Stability Board, as you point out in your testimony—Governor Mark Carney of the Bank of England warned that the Volcker Rule "could reduce global financial resilience rather than increase it."

So you cited in your testimony, I believe it was a 77 percent drop in primary dealer inventories of corporate bonds since the crisis. Can you expound on your views of how this could create greater instability in our markets?

Mr. ATKINS. Thank you, Mr. Chairman.

Basically, because of the regulatory apparatus and the uncertainty that the Volcker Rule has created with respect to banks operating as—with their own money in the marketplace as market makers, banks have tended to back away from doing any propriety trading, because they feel that is only going to get them in trouble.

And so, because of that, that just means on a day to day basis, there is that much less participation by the banks in the marketplace. So that creates a question with respect to liquidity and a decrease of that on a day to day basis.

Chairman HENSARLING. On page 4 of your testimony, you speak of the potential for asset fund managers to be designated as systemically important financial institutions under the Dodd-Frank

regime, and you question what this could do to risk management or liquidity in the market.

If that takes place and fund managers are found to be SIFIs, or in deference to you, SCIFIs—

Mr. ATKINS. Right.

Chairman HENSARLING. —give me your views about how this impacts market stability?

Mr. ATKINS. The real fear is the extension of prudential bank-type regulation into the capital markets. Prudential regulation grew up by the banking regulators, because their mission is safety and soundness of the banking system. Whereas, on the capital market side, we have created the goose that lays the golden egg here in the United States where innovation and competition really has made a very dynamic marketplace that truly is the envy of the world.

Not too long ago, I was at dinner with the head of a multilateral international lending operation, a government type of lending operation. And he told me he could not believe what the United States is doing to its capital markets, which, he said, of course, with Asia and Europe, is truly the envy of the world.

So that is really the ultimate worry, is that, because of the Fed and the FSOC began able to have prudential regulatory authority over the capital markets, that there will be less activity there, and they will ultimately be able to direct—either tell people not to trade or to acquire certain securities.

Chairman HENSARLING. Dr. Calabria, you mentioned this in your testimony, and Professor Zywicki spoke about our housing markets.

On page 15 of your testimony, you mentioned that Dodd-Frank could very well result in an increase in the level of mortgage defaults during the next housing bust. So, we have just have come off a rather painful housing bust.

Could you expound on your views of how Dodd-Frank might just bring us full circle?

Mr. CALABRIA. Sure, I would be happy to. Let me set aside issues that might reduce defaults and talk about some of those in the legislation that might increase defaults.

A number of scholars have found that the longer you delay the foreclosure process, for instance, the more people who end up in delinquency. And of course, a number of provisions in Dodd-Frank extend the length of the foreclosure process, and of course, things like letting borrowers know that they—if you are in a non-recourse State, that they could walk away. If it had any effect at all, it will be to encourage those borrowers to walk away.

So there are a number of provisions that, to me, will drag out the foreclosure process, resulting in larger foreclosures. I would hope that one of the lessons we would take away from the crisis, and for instance, if you compared judicial to non-judicial foreclosure States, is that if you make it very hard to foreclose, you get more foreclosures, in terms of the reaction of borrowers.

Chairman HENSARLING. In attempting to set precedent, I will not go over my time.

The Chair now yields 5 minutes to the ranking member.

Ms. WATERS. Thank you very much, Mr. Chairman.

Before I get to one of the main questions, I would like to ask, I think it is Mr. Atkins, do you agree that the Consumer Financial Protection Bureau has returned $5.3 billion to 15 million consumers who have been subjected to unfair and subjective practices?

Mr. ATKINS. I don't know the exact number, but from the paper, they are even having trouble identifying supposedly who has been harmed in some of those cases. So they collect money from their settlements where people feel over the barrel that they have to pay to get the regulator off of their back, but the query is, who is being harmed, and how do you show who is being harmed?

Ms. WATERS. Mr. Silvers, as Deputy Chair of the Congressional Oversight Panel created in order to oversee the Troubled Asset Relief Program (TARP), you had a front-row seat to our government's response to the crisis, starting with the Bush Administration placing Fannie and Freddie into conservatorship, and continuing with then-Treasury Secretary Hank Paulsen injecting billions of dollars of capital into our Nation's largest banks in order to forestall economic chaos.

Can you take us back to that time, and again, you have done some of this in your testimony, but remind the committee just how bad the economy was during the depths of the crisis. And can you again remind us what was happening to American workers in terms of home foreclosures, small businesses closures, and 401(k) plans being decimated?

Mr. SILVERS. Ranking Member Waters, I am happy to do that. It gives me a moment also to recall the time that I spent with the chairman in that work, and to reflect on a lot of the bipartisan things we did together, which I think is all too rare in our time.

The story you asked me to tell is one that we don't have time for the full horror of, but just a few anecdotes. I remember then-Deputy Treasury Secretary Bob Steele, in the fall of 2007, saying to me, we are going to have a big problem. We might have as many as a million foreclosures. This is the number that Dr. Calabria is worried about.

Of course by the time we were done, we had 10 million. That is 40 million people set out in the street. The median net worth in the course of that process of African-American families fell from $18,000 to $6,000. It has never recovered.

We had as many as 25 million Americans out of work. We had the economy contracting in the fall of 2009, according to Paul Volcker, at a rate greater than it was contracting during the depths of the Great Depression.

We put several hundred billion dollars into the Nation's largest banks, being told at the time by the Treasury Department that they were all solvent.

And it is my belief that—it has become quite clear that at least two of them, CitiGroup and Bank of America, were certainly insolvent at the time that they were given the money. And it is unclear that if the money had not been given, that any of them were solvent. We provided the money on terms that were only 60 cents on the dollar to the American public.

Later, Treasury Secretary Geithner asserted that we got our money back, but that statement assumed that the listener was extraordinarily naive. We propped the banks up and then we didn't

get the upside. That is what those numbers meant. The upside went to the people who caused the problem in the first place.

I think we need to recognize in looking through this history a couple of things. One of them is that had nothing been done, we would certainly have been in a prolonged situation like the Great Depression, and that—this will seem like a strange thing for me to say, but the Bush Administration and the Democratic Congress, and in particular Hank Paulsen, deserve great credit for acting. But the failure then to restructure our banks, the failure to restructure home mortgage debt devastated our economy.

And although my fellow witness, Mr. Atkins, feels that our capital markets are the envy of the world, and they may well be now, at that time they were widely seen as having initiated—our capital markets were widely seen as having initiated a global financial crisis that cost the world economy $60 trillion and destabilized democratic societies around the world. That is a heavy indictment.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, the chairman of our Monetary Policy and Trade Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate that.

And gentlemen, it is good to see you all again. Mr. Silvers, we have something that we agree on. I heard you say that the Dodd-Frank bill was a compromise piece of legislation, and by that I assume you mean a compromise between Senator Dodd and Representative Frank, because there weren't any Republican votes for that during that time.

But I do want to touch on a couple of quick issues that Mr. Atkins had touched on, and I am going to go in a little different direction because of some of the work that we have been doing on the committee.

The first one is pay ratio. The rule is expected to come out, I believe next month, from the SEC. I had an opportunity to question Chair White back in March of this year, and her quote from an October 2013 speech was that seeking to improve safety of—I'm sorry, it is my next question.

The pay ratio rulemaking, really the SEC didn't have any experience or expertise in this. At the time, it seemed the SEC doesn't know exactly where it is going, whether it is going to include part-time employees, contract employees which may be temporary workers, it may be the cleaning crew who comes in, who gets hired to come in, much less overseas employees.

So if you would maybe quickly touch base on that pay ratio provision that is required, and what you expect as a former SEC Commissioner, what might happen.

Mr. ATKINS. I think it is an unfortunate diversion, frankly, from what the SEC should really be focused on. It was a sop to special interests who have their own ax to grind in that regard.

And then as you touched on definitionally, it is very difficult to implement. So I know the staff at the SEC is struggling with how exactly to put this thing together, and I expect that will be yet another divided vote.

Up until the time I left the SEC in 2008, I don't think during my time there was any rulemaking divided vote upon partisan lines. And unfortunately, that number has skyrocketed—

Mr. HUIZENGA. And that has been very common, correct?

Mr. ATKINS. Exactly. Under this Administration, it has been very common.

Mr. HUIZENGA. I do want to quickly move on to something else that has had great impact on manufacturers like Watts in Michigan. I am very tied to the automotive industry. We have a tremendous number of tier 1, tier 2, and tier 3 automotive suppliers that are dependent on rare earths for their products and products that are put in.

This is where in an October 2013 speech Chair White had said, "I may wholeheartedly may share some of the compelling objectives as a citizen, but as Chair of the SEC I must question as a policy matter the use of Federal securities laws and the SEC's power of mandatory disclosure to accomplish these goals." She is talking about the conflict minerals.

I had an opportunity just yesterday to meet with the Rwandan Ambassador, Mathilde Mukantabana, minister of mines, Mr. Imena, and a mine owner, Emery Rubagenga, who came to my office expressing grave concern. The $20 million that the government of Rwanda spends on its mining operations, $2 million of that is spent for exploration and surveying, $5 million to $6 million of that is spent on trying to comply with Dodd-Frank conflict mineral rules.

And my fear is that there is a huge impact on our manufacturers while other manufacturers throughout the world are not subject to the same rules, and it is having little or no positive effect on those it was intended to help.

This committee had a subcommittee hearing, I guess a term or two ago, where we had some folks from the Democratic Republic of Congo in, expressing that exact same thing.

I think it is imperative upon us—again, I would agree with Chair White. Very laudable goals and objectives are missing the mark because they are not truly helping those who are trying to escape that conflict. And they are certainly not helping the United States and our manufacturers as we are trying to compete in the world economy.

Mr. Atkins, you had touched on that, so maybe a couple of seconds on that?

Mr. ATKINS. Yes, I agree. I think it is really unfortunate that Congress foists on the SEC these disclosure provisions that have nothing to do with materiality with respect to public issuers. That is the basis of the 1934 Act, the Securities and Exchange Act.

And to go off and to try to do social engineering through the securities laws and disclosure, I think is really unfortunate.

Mr. HUIZENGA. Thank you, and I will mention that her response to a letter is, the SEC has spent over 21,000 hours and approximately $2.7 million on that particular provision, and to what end?

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, the ranking member of our Capital Markets Subcommittee.

Mrs. MALONEY. Thank you, Mr. Chairman, Ranking Member Waters, and all of the panelists for your testimony today.

We need to remember that Dodd-Frank was a sweeping overhaul of our entire financial regulatory system that was brought on by the largest financial disaster in our history, where we lost, according to the GAO, independent, $22 trillion.

Tens of millions of people lost their jobs. Millions were out of work, and the economists who testified before this committee and others said that this had economic shocks that were 3 to 5 times stronger than the Great Depression, and it was caused by mismanagement of the financial system. And it was the only financial crisis that was totally self-inflicted.

I don't want to go through it again, so I am proud of any effort to stop any type of financial abuse. But one of the principal goals of Dodd-Frank was to improve the safety and soundness of our core banking system, and it was a response to a crisis which showed that many of our largest banks did not have nearly enough capital or nearly enough liquidity.

So it is important to point out that 5 years later, the biggest banks have more than doubled the amount of capital they hold. In fact, they now hold more than $1.1 trillion in capital, and the biggest banks have also nearly doubled their liquidity since the crisis, and they go through now a required annual stress test by the Federal Reserve that the IMF calls state-of-the-art.

So I believe that Dodd-Frank has successfully achieved its goal of shoring up safety and soundness of our banking system that serves our people and serves our country, making it stronger and more resilient. And this will make future financial crises less likely. And I am proud of that achievement.

Now I would like to ask Mr. Silvers about an important financial reform that we passed before the crisis—during that crisis—that I authored, and worked on for 4 years.

It was called the Credit Cardholders' Bill of Rights. Now, some on the panel have claimed that it harmed consumers. But there were two important studies. And I would like to put them into the record. I don't have them with me today. One was done by the Pew Foundation, which said this bill alone saved the American consumers $10 billion a year.

A joint report from New York University, Columbia and another university claimed it saved a whopping $20 billion a year. I call it the "Maloney Stimulus Package" because I for one would like to keep that money in the hands of consumers and not in institutions that by all accounts were performing—not all of them—unfair, deceptive, abusive, and anti-competitive practices.

So I would hear stories. It was hard to walk 2 feet without hearing a credit card story. One man was promised $8,000 on your interest. You can buy a car. He bought a car. Two months later, the financial institution raised his interest rate to 30 percent a year—30 percent. He was trapped in debt.

He paid off the car 2 or 3 times. He couldn't get out of debt. And so the Credit Card Bill of Rights cut out lies, cut out abusive practices, and made it fair. Now, banks tell me and the Consumer Financial Protection Bureau that they get very few complaints on credit cards.

People are not complaining because they are fair and that is what we want. We want fair practices in our financial system. So I don't—I would like to ask Mr. Silvers about the CARD Act. By the way, Rahm Emanuel told me that it continues to poll better than anything the Administration ever did because it touched every consumer in this country.

And I would say that this was a bill that passed with support from both sides of the aisle overwhelmingly.

Do you think the Credit Card Bill of Rights is abusive to American consumers? Do you think keeping their money in their hands is an abusive practice? I would like you to expand on this, if you would, Mr. Silvers.

Mr. SILVERS. I have 17 seconds to do so.

Mrs. MALONEY. We can take your written testimony.

Mr. SILVERS. I will just say this, what I think it is not as important as what people who have done peer-reviewed academic research think. And what they—and what the premier study in this area, done by a team at the University of Singapore and the University of Chicago—found that for lower income credit cardholders, those with FICO Scores with credit ratings under 600, the Act and the banning of the tricks and traps you were talking about reduced credit card cost by 5.3 percent of balances, a very big number, and did so without impairing access to credit in any way they could detect.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from North Carolina, Mr. McHenry, vice chairman of the committee.

Mr. MCHENRY. Well, happy anniversary. America has been saved. We are just living with the consequences of that savior, Dodd-Frank. And the consequences of that are lower growth, and impaired lending for community institutions and large institutions as well.

It means we have less job creation than we otherwise would have. And historically, Dodd-Frank is an anomaly in how Congress is legislated. And so, Dr. Calabria, I want to ask a little bit about this.

If you look at the last major crisis that my Democrat colleagues point to and say that this was an analogous situation we have lived through and that is the Great Depression. So out of the Great Depression, you have the Pecora Commission that reviewed the finite causes of what they were experiencing.

You had Congress in a bipartisan way—did they not write securities law, but the 1933 and 1934 Acts, right? These were not partisan endeavors as a result of that great crisis. Is there some context you could provide to that, Dr. Calabria?

Mr. CALABRIA. I appreciate the gentleman's point. First, let me respond to an earlier point. We all agree the crisis was bad. I don't think anybody here disagrees with that, certainly not on the panel. I think we all agree we would like to avoid future crises. I don't think there is any disagreement on that.

I think we all agree that in the crisis we should have done something. The question is, what should it have been? I would have preferred debt to equity swaps that would have imposed losses on creditors to recapitalize the banks very quickly.

I will not—we certainly didn't do nothing during the Great Depression. Lots of things were done, many things in my opinion that made it a longer, while we do not know what the counter factual would have been had we done other things, I am always puzzled by the argument of, it was really bad, so I am glad we did this. Well, maybe it wouldn't have been so bad if we hadn't.

Personally, I think and again this is not a partisan issue because I think when a Republican President and a Republican Treasury Secretary go on TV and say, "If you don't pass 'X' by Monday, we won't have an economy." If that doesn't cause panic, I don't know what will.

So, again, I think we need to get away from the keeping score. I think it is unfortunate to me. Certainly, you go back and S&L crisis, things like FDICIA and FIRREA passed with large bipartisan numbers.

I do think it was possible to get a very good bill that would have gotten say 80 votes in the Senate. It would have been very bipartisan here if we had gone that path. I think that was doable. It would look very different. Some of the things that to me don't have to do with the crisis like the pay ratio are—there is literally more discussion in Dodd-Frank about payday lenders than there is about Fannie Mae.

Who thinks payday lenders caused the crisis? Whatever you think about them, really? Okay. Thank you. My point is, I think we could have done this in a better way. It would have been narrower. I think there are a number of things that are still off the table.

But again, this is not about wanting to relive—nobody wants to relive this again. It is really a question of, did we do something that was effective? Let me end with saying, I worked on the Housing Economic Recovery Act, and I'm proud of my efforts on it.

We failed to avoid the failures of Fannie and Freddie in that Act. I will own up to we didn't get that bill done right. Too little, too late. I am willing to lay that on the table. I think if we could all own up to the mistakes we made, I will actually to anybody who looks at it. I have done a couple of blog posts on mistakes I made. So I am willing—

Mr. MCHENRY. All right. Regarding—okay. I am reclaiming my time, Dr. Calabria. Although, you are rolling, I am sorry to interrupt. But I do want to get to a couple of other points, which is Dodd-Frank didn't eliminate risk in the financial system. It moved risk. The claim is that it mitigated risk, but there was movement into a different array of new risky institutions.

So financial market utilities, very important—even more important post-crisis than pre-crisis. And there is a grave concern that there is—there is a new group that will need a bailout going—in the event of another crisis. So in that regard, Dr. Calabria, not to interrupt your train of thought, but the concerns there that we have global clearinghouses that are so important here. What does that look like?

Mr. CALABRIA. I very much fear that we will have to provide assistance, if not actually have to bail out a clearinghouse. As we know, Dodd-Frank allows access to the Federal Reserve discount window for clearinghouses.

It is important to keep in mind that there are essentially two risks: the instrument risk; and the counterparty risk in derivatives. What we essentially did was centralize that counterparty risk. It did not go away. It didn't go "poof." It just went all in one place. Again, I would say we should learn from the lessons of Fannie and Freddie, when you concentrate all the risks in a few nodes, you really do make systemic risk greater, not less.

Mr. MCHENRY. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. And I want to also thank Ranking Member Waters. Professor Zywicki, in your testimony you stated that the CFPB was to blame for a decline in new business starts.

Are you aware that the Small Business Administration is on track this year to having the highest record of small business lending since Dodd-Frank was enacted? And also, the NFYV in the latest report of small businesses shows that the optimism index is the highest since Dodd-Frank was enacted.

You even cited a report by the Brookings Institution, and I have it here. I read that report and there is no mention, sir, of the CFPB as a cause for that decline. In fact, the authors say that allowing more highly skilled immigrants into the United States may reverse this downward trend.

By the way, I should tell Mr. Donald Trump that he should read this document and get the story since he said the Latinos are going to love him because he is going to be the President creating jobs. Well, this is the answer to creating jobs.

Instead of dismantling the one Federal agency that looks out for consumers and has refunded them $5.3 billion, don't you think we should instead focus on immigration reform to help spur small business revival as the authors actually stated? Since you brought up this study, I think it is a fair question.

Mr. ZYWICKI. I would focus on immigration reform as well as fixing Dodd-Frank. And I totally agree with the idea of more immigration. Legal immigration for highly skilled workers is undeniably, in my view, a boon to the American economy, in my own personal opinion.

Ms. VELAZQUEZ. Right. So that is the central point of this study. It wasn't that Dodd-Frank and the CFPB was the cause.

Mr. ZYWICKI. What the study shows—what we know about it—according to a paper in, I think 2009, by Tom Durkin, a former Federal Reserve economist, he documents the number of small businesses that rely on personal credit in order to start and grow their businesses—credit cards, home equity loans, and even in my own research auto title loans, things like that.

And that people rely on these—for these kitchen table businesses, landscaping businesses, handyman businesses. They use their own personal credit to do this and he—and I don't remember the exact estimate, but he documented the fact that drying up access to personal credit would damage small business growth and creation.

The Brookings study that I point to notes that for, I think it was 2 years ago for the first time in American history, more businesses were destroyed than were created. That is what that Brookings study shows and a lack of access of consumer credit for small businesses I think is undeniably a contributor to that.

Ms. VELAZQUEZ. Well, sir, there is no mention of the CFPB in this study.

Mr. Silvers, as you know, the Dodd-Frank Act was a complex framework to shore up the financial sectors to prevent future economic collapse.

Five years later, can you tell us what work remains in terms of fulfilling the original intent of Dodd-Frank?

Mr. SILVERS. Congresswoman, there are significant regulatory steps that remain to be taken. In my view, one of the most significant is the Federal Reserve issuing the rules around executive compensation and excessive risk taking within financial institutions that have been delayed since 2011.

And similarly, the SEC issuing the executive pay ratio rule to median employees which is an important source of information and check on excessive executive pay in public companies has been mandated by Congress and not issued.

On the statutory side, as my testimony went through, there are a series of structural changes that are necessary if we want our financial system to do its job, including to provide credit to small business.

The key ones that have been identified over and over again by financial regulatory experts are the separation of investment, of stock market activities and derivatives from federally insured commercial banking, essentially the restoration of a modern Glass-Steagall Act, a more aggressive approach to regulatory capital on a size basis and a financial transactions tax.

Chairman HENSARLING. The time of the gentlelady has expired.

Ms. VELAZQUEZ. Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, the chairman of our Capital Markets Subcommittee.

Mr. GARRETT. I thank the chairman for holding this very important hearing. The ranking member started out by saying the crisis of 2008 was not a natural disaster, and I agree that it was inflicted—as a matter of fact, the ranking member of the Capital Markets Subcommittee said it was self-inflicted, which I tend to agree with as well. But who was doing the infliction, is the question.

Mr. Silvers, you indicate that there was a failure of regulation and failure by the regulators. And I would agree with that. But you also said that they did not have the authority to prevent the crisis. That is factually incorrect based upon the multiple hearings that we had in this room.

Seven years ago, after 2008, Chairman Barney Frank at the time had multiple hearings, brought in the regulators at the time and I and others specifically asked each and every regulator, "Knowing now what happened, did you have the authority in your area?" They all said, "Yes, we did."

"Did you actually have personnel stationed in the banks that failed?" "Yes, we did." So they had people, staff members working in these very banks that failed, that involved themselves in these risky trades and what have you, but they had the authority, at least they testified it to us repeatedly at that time.

Now, back to that period of time, my predecessor as chairman at that time was Paul Kanjorski, a Democrat from Pennsylvania. He said what we really needed was to—and he said this many times—have greater market discipline.

I don't know, I see some nodding heads by the panel here that that would have been a good thing then, and I see nodding heads that it would probably be a good thing now. The question is, how do you go about getting that?

Let's see, do you get more market discipline by increased regulation? Again, Mr. Silvers, you told us in your testimony just now that the regulators are still not doing their jobs. I will just throw a question out. Mr. Atkins, which Administration appointed the current SEC Chair?

Mr. ATKINS. The current Administration.

Mr. GARRETT. Which Administration appointed the current Federal Reserve Chair?

Mr. ATKINS. The current Administration.

Mr. GARRETT. Which Administration appointed the head of the CFTC currently?

Mr. ATKINS. The current Administration.

Mr. GARRETT. And how about the CFPB?

Mr. ATKINS. The same.

Mr. GARRETT. So if Mr. Silvers is correct that the current regulators are not doing their job, which Administration is responsible for appointing all of those regulators?

Mr. ATKINS. The current one.

Mr. GARRETT. Oh, okay. So the solution then perhaps is not looking to this Administration for additional regulation or additional regulators; of course, as Mr. Silvers pointed out, they are not doing their jobs still.

And if Mr. Kanjorski is correct that additional market discipline is the answer—I will throw this out to Mr. Atkins—additional regulations, is that the solution or is it additional market discipline?

Mr. ATKINS. Yes, I think, I agree with you, additional market discipline. I think it is really not correct to say that there was no regulation or deregulation, especially in the wake of Sarbanes-Oxley and that sort of thing.

Mr. GARRETT. Okay.

Mr. ATKINS. There is enough to fill a big rulebook.

Mr. GARRETT. That is true because the ranking member also started out her testimony by saying, "It was death by a thousand cuts" what is happening now, she is asserting. Would you suggest that the reason we have the doldrums in the economy and the fact that we are in a morass as far as job creation and the rest is actually death by thousands of pages of regulation?

Mr. ATKINS. Yes. That is true. It is costly to comply.

Mr. GARRETT. And does anyone—I will throw this out to the panel as well, does anyone actually know the total cost of all these

regulations based upon the testimony that we have heard in this hearing previously?

And does anyone actually know the implications of the overlap capital requirements of these regulations? I will throw out to Mr. Calabria or Mr. Atkins, I guess.

Mr. ATKINS. Well, I will say one thing really quickly is that it is not just the out-of-pocket expense to comply, but it is also the uncertainty and all the latitude that the regulators have to second-guess.

Mr. GARRETT. Right. We had hearings on this. We asked the head of the Fed. We asked the head of the Treasury Department, do they actually know the cost? And Secretary Lew's response was, "No." And he said it was our job to figure that out.

But I will close on this in 29 seconds. Mr. Atkins then, since even the people, the regulators whom we are told are not doing their jobs, and even though they tell us they can't compile the total cost to the economy of Dodd-Frank, are you able to make an assessment of whether it is a positive or a negative impact?

Mr. ATKINS. Oh, I completely think that Dodd-Frank has a negative impact.

Mr. GARRETT. And it is a negative impact on liquidity, credit availability, and job creation?

Mr. ATKINS. All of those, yes.

Mr. GARRETT. I yield back.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman. And thank you, Ranking Member Waters. I get confused sometimes, but I think I heard Mr. Calabria say that he agreed that we did have a crisis in this country. Is that correct?

Mr. CALABRIA. Yes. I am not sure anybody disagrees with that.

Mr. MEEKS. Because I want to make sure, does anybody disagree with the fact that there was a major crisis in this country? Okay. So when we had this crisis, we who are Members of Congress represent this country. We take an oath to try to do the best that we can in this country. So something should be done when you had this crisis because we were in freefall.

If I recall—I can recall individuals coming to tell me that if we didn't do something and do it quickly, our whole financial structure would be in failure, and as a result of that, not only would we be devastated, but the financial institutions across the world would be devastated.

That is how bad it was. In fact, I can recall that we first voted to do nothing and then we had to come back because—we hear the stock market fell about 800 points and everything was going in and it was panic. And so—and at that time it wasn't, I heard some people say, well, under President Obama, President Obama wasn't here yet. So he didn't cause this crisis. Can we all agree on that?

Mr. CALABRIA. Nobody here is blaming the crisis on President Obama.

Mr. MEEKS. Okay. So this crisis happened. Things were done and at that time, the regulations that you are talking about that are costing a lot of money now, we didn't have anything in place then.

And so, that was—things were starting to fall and we are going down. Now, we passed Dodd-Frank. And I am the first to say that I don't know since I have been in Congress now close to 18 years. I don't know of any perfect bill, so I am not claiming that Dodd-Frank is a perfect bill. But I do know that as we put things in place in regards to Dodd-Frank and I do know that there were some Republican ideas.

Maybe we didn't get a single Republican vote, but I do know that Mr. Frank worked across lines and got Republican ideas and put those ideas into the Dodd-Frank legislation.

So it was, in fact, not just Democrat ideas in Dodd-Frank. It was both Democrat and Republican ideas in Dodd-Frank, but politics dictated that no Republican vote for it.

But it was a fact when you look at the document itself. So here we are now 5 years later, and I look at the title of this hearing, "Dodd-Frank Act Five Years Later: Are We More Stable?" And from what I am hearing from all of you where we were then, we were not stable at all. We were headed downhill into catastrophic areas. So I think that just by the very logic of the hearing itself that any logical person would have to say 5 years later, we are more stable with Dodd-Frank than we were without Dodd-Frank because Dodd-Frank didn't exist 5 years ago and we were in bad shape.

And we are in better shape now, so there is no question that we are more stable now than we were then. And in fact, from what I hear, especially with private sector jobs, I understand that the private sector has created over 12.8 million new jobs over 64 consecutive months of job growth.

And I know before then we were losing 400,000 to 500,000 jobs per month. So we have to be in better shape now and more stable now than we were then just based upon sheer numbers. Normal household net worth has grown by about $30 trillion exceeding the pre-crisis levels.

So you may have your issues with Dodd-Frank, but you can't tell me Dodd-Frank is what caused some—we have problems because of Dodd-Frank, because without it we were in catastrophic problems.

With it, we are moving in a better direction and yes, I will grant to you, it is not a perfect bill and maybe there need to be some fixes we can work together on, but to say as I have heard from some, "Let's do away with Dodd-Frank," to me that says, "Let's go back to 2008," and that we cannot do.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Financial Institutions Subcommittee.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Zywicki, you spent quite a bit of your time on your academic research on consumer credit issues, and I have a bill, H.R. 1266, which would take the CFPB from a single director to a five-person commission, which I think would make that a more stable and sustainable organization. Could you elaborate on how that would help make it a more consistent and stable organization, if it was a five-person commission?

Mr. ZYWICKI. I would strongly endorse that legislation, which is that the fundamental problems of the CFPB go back to this fundamental defect in the way in which it is structured, which is no budgetary appropriations, a single director supposedly removable only for a cause. We have decades of academic studies on bureaucracies and how bureaucracies behave when they are not subject to Democratic accountability and the CFPB is basically a poster child for how that operates.

So I think over time we have learned that there are two ways that we can structure agencies, as an executive agency like a department accountable to the President through the democratic process, or a bipartisan agency. And I think for an entity like this, the Federal Trade Commission is exactly the model we need. The Federal Trade Commission has been around for 100 years. It is a bipartisan agency, on budget, and it does more or less exactly the same thing as the CFPB.

And I think that the FTC has proven the test of time as an agency that is responsive, that takes into account the impact on the economy, questions like competition and consumer choice with respect to any product. And I think that is not only a good idea for this agency, but really the only way that we are going to get this agency back on track and really looking out for the American consumers rather than their own narrow bureaucratic empire-building.

Mr. NEUGEBAUER. Well, the—

Mr. CALABRIA. I was going to just simply remind the committee that the original proposal for the CFPB introduced by Senator Kennedy, written by Elizabeth Warren, was a five-member bipartisan position in the appropriations process. So, you go back and look at that bill, it is not some radical free market proposal.

Mr. NEUGEBAUER. Yes. And I think when we—the purpose of this hearing is to talk about, are we more stable. And one of the things that when you look at consumer credit, that, how you design consumer credit or restrict or enhance consumer credit has long-term replications, doesn't it, for the economy in the long term?

Mr. ZYWICKI. Absolutely. It is the engine for the economy first. But more important to me, it is the engine by which people make their lives better. It is the way—if you need—you cannot wish away the need for credit. If you need $500 to fix your transmission to get to work on Monday or you lose your job, you need $500 regardless of whether you have it in the bank or not.

People use consumer credit to make their lives better. And when we shut off access to consumer credit, when we take credit cards out of people's hands, when we take bank accounts out of people's hands, when we take mortgages out of people's hands, we are making their lives worse. And I think that is a real tragedy not only for the economy at large but for every single American family.

Mr. NEUGEBAUER. Mr. Atkins, you served on the SEC, which is a commission. Did you find that was a productive organizational structure?

Mr. ATKINS. There are benefits and detriments to it. But I think the problem with the CFPB is, of course you can work on procedure and organization, but you also have to look at other aspects of it. I think the current construct of it has constitutional problems. The

appointments cause issues, separation of powers issues and those sorts of things.

And then also just the substance of the statutes, Dodd-Frank that empowers it and has sort of vague statutory provisions like abusive practices and how that is defined. I think those substantive aspects are important as well.

Mr. NEUGEBAUER. In that interaction with really, and sometimes different political viewpoints, different opinions, you didn't always get things the way you wanted, it looks like it promoted dialogue and some negotiation, whereas in the current structure there is no negotiation.

Mr. ZYWICKI. Right. As I mentioned before, back when I was doing the work, I don't think there were any divided bipartisan lines on rulemaking. And that just shows that I think there was a lot of give-and-take between the different sides.

Mr. NEUGEBAUER. Mr. Silvers, is the AFL-CIO governed by an executive committee?

Mr. SILVERS. The AFL-CIO has a president who has day-to-day management authority.

Mr. NEUGEBAUER. But is he responsible to a board of directors?

Mr. SILVERS. Yes, he is responsible to the executive council of the federation, which meets twice a year.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. Chair now recognizes the gentleman from Massachusetts, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman. Mr. Chairman, I have heard a lot of interesting philosophical talking points this morning, but I have heard them before and I am sure I will hear them again and again and again and again. But I haven't heard too many figures. From the panel, it was one statistic, which is that there are fewer people with free checking than there used to be. My God, what a terrible crisis that is. People have to pay for a service. That is complete ruination to our system.

Yet some other statistics I have show some things from the day of Dodd-Frank, July 21, 2010. The Dow Jones was at 10,120.53. As of yesterday, it was 17,776.91, and today it is up a little more. That is a 76 percent increase and that is true about all the markets, Dow just being one, but it is true about S&P, NASDAQ, and all of them, all of them are.

The unemployment rate in July 2010 was 9.4 percent. The most recent one in June was 5.3 percent, the lowest it has been since before the crash. The average house price in July 2010 was $252,100. Today, as of May 2015, it is $337,000. That is $84,900 more, a 34 percent increase. The GDP in July 2010 was $14,784,000,000. Today, it is $16,288,000,000, a trillion five increase, a 10 percent increase.

Housing starts. In July 2010, there was 604,000 in calendar year 2014. It was 1,046—I am sorry—1,046,000, 442,000 more, 73 percent increase in housing starts. Total construction value also a 19 percent increase and on and on and on.

Could Dodd-Frank be better? Yes. As a matter of fact, I have a proposal, because I agree with some of my friends that too-big-to-fail, I think we did some good work, but I think we didn't go far

enough. I would love some of my colleagues on the other side to join me in reinstituting Glass-Steagall. I voted against the repeal of Glass-Steagall. Join us. Bring it back. If you don't want to do that, join us in trying to deal with other issues.

I have a proposal, H.R. 888, that not a single Republican will join, yet it is supported by the community bankers, the people you say you care about. They are looking for a Republican co-sponsor. We can't find one.

And, by the way, it is not my idea. I simply took the idea of an economics professor from Boston University and a scholar at AEI who happened to be the former Chief Counsel to Ronald Reagan. Not my idea, but yet can't do it, can't touch it. We can only talk about repealing Dodd-Frank and how bad certain sections of it are.

Why don't we get to fixing the problems we have. I have had my fights with the CFPB. I have certainly had my fights with the SEC and the Fed. Mr. Garrett and I have a bill to deal with some of the issues we have with the Fed. Now, if Scott Garrett and I could agree on an issue, we can find common ground with everybody over there. But yet, it can't be done. Why? Because if you actually try to fix the problems you identify as opposed to pontificate about them, you don't get any points with the outside groups.

Fixing a problem is a problem in and of itself. We are here to pontificate and we do a heck of a good job. So for me, all very interesting, but numbers don't lie. The numbers are almost all good. Are there a few bad ones? Yes. Can we do better? Sure, we can. Are we going to do better by simply nitpicking at everything? Now, nitpicking is not a bad thing, but nitpicking is what you do once you have fixed your other problems. There has not been one substantive proposal to deal with too-big-to-fail from the other side, not one, yet we still love to complain about it.

With that, Mr. Chairman, I yield back. I actually thought I wouldn't take the whole 5 minutes, but I am glad I did.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, chairman of our Housing and Insurance Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

One of the things I want to talk about is the Financial Stability Oversight Council (FSOC.) We are talking about, are we more stable as a result of Dodd-Frank?

FSOC was a creation of Dodd-Frank that was supposed to judge the stability of our economy and how we are doing. And one of the things that they were empowered to do was to identify different risks within the financial system, in particular banks and non-bank, non-financial institutions if they are systemically important.

At this point, FSOC has evaluated and designated three insurance companies and one finance company as systemically important, such that if it goes down, the entire economy goes down.

Dr. Calabria, would you like to comment on that? Is that possible?

Mr. CALABRIA. First of all, let me say, I think often we are given, to me, the false choice of bailout or liquidate. Many of these institutions can be restructured, can be reorganized.

Again, my proposal during the crisis was to do a debt equity swap as a recap that wouldn't have cost the taxpayer. So I am of

the view that no one institution is so special that we need to put taxpayer money in and can't be resolved without a reasonable bankruptcy framework.

That said, insurance companies are very different than banks. They don't have short run runable—some of the analysis you see, particularly the MetLife case, is just ridiculous.

For instance, the FSOC asserts that because State regulators can place stays on policyholder redemptions, the State regulatory system for insurance is itself a source of systemic risk.

So it seems like if you go back and read these justifications, quite frankly, they all look like they are made up. And if I could channel the good gentlemen who left the room, no numbers, no statistics, all just opinion.

Mr. LUETKEMEYER. Yesterday, we had a hearing with regard to systemically important financial institutions that we are looking at, the mid-sized and regional banks. And it is interesting because there are a lot of folks in order to be able to—I have a bill to try and define that rather than have criteria for it versus a strict threshold. And it is interesting because they are trying to redefine what supposedly was in Dodd-Frank, which was to define those entities that would be able to bring down the entire system, and other trying to redefine it as something that would happen on a regional basis or whatever.

So, it really strikes to me at the heart of the ability of FSOC and other entities within this to be able to adequately point out risk. And I would ask along that line, we had Secretary Lew here a couple of weeks ago. He gave us the official report, the 2015 annual report of FSOC. And there are 11 different risks that he pointed out. They were important to be able to be aware of and watch and take very special note of.

And one of them that was noted that very same day that he presented this report to us was the CBO came out with a scathing report that talked about our debt. Could you believe that debt was not even listed as a risk to our economy? It strikes at the very heart of what I believe is the credibility of FSOC to be able to even analyze what is wrong with our economy.

Professor Zywicki, would you like to comment on that?

Mr. ZYWICKI. I don't think I have anything to add other than it seems obvious to me that you are correct.

Mr. LUETKEMEYER. Director Calabria?

Mr. CALABRIA. If I could add, while I have some skepticism about the Office of Financial Research (OFR), if we are going to have it, it should be independent of Treasury. I have read these reports and they are very dismissive of concerns about the treasury market. And ultimately, the OFR has essentially been set up to be a political research outfit for the Treasury Department, which by its very nature is a political animal.

Mr. LUETKEMEYER. Okay.

Mr. CALABRIA. We want independent research of the financial system. It needs to be independent of politics.

Mr. LUETKEMEYER. Along the lines of what I was talking about with regard to the credibility of the FSOC and some of the concerns with regard to debt, Dr. Calabria, in your testimony a while ago, you talked about the explicit and implicit guarantees and extreme

amount of liabilities that our government has as a result of the Richmond Fed study. Would you elaborate just a bit on that very quickly—I have about 30 seconds left here—about how important it is to have all of this data and look at the big picture of what kind of risk in system and actual stability we have with regards to all that?

Mr. CALABRIA. Absolutely, sir. And, first, I will direct anybody if you are curious to go to the Richmond Fed's website whether a bailout barometer is there. And what they try to measure is the explicit guarantees we know about such as the expense and deposit and service.

I mentioned in my testimony that we have $2 trillion more in insured deposits than we did before Dodd-Frank without expansion. And they also try to estimate the implied guarantees. And, of course, we have no way of knowing the exact number, but these are the potential guarantees that the taxpayer is on the hook.

And as was mentioned in the chairman's opening statement as well as in mine, about 60 percent of financial liabilities in the financial sector are either explicitly or implied to be backed by the taxpayer.

Mr. LUETKEMEYER. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Clay, the ranking member of our Financial Institutions Subcommittee.

Mr. CLAY. Thank you, Mr. Chairman. And I thank the ranking member for calling this hearing today to celebrate the fifth anniversary of Dodd-Frank.

Let me start with Dr. Calabria about the housing crisis. You say in your testimony that you don't believe we have sufficiently addressed the distortions in the housing industry.

Let me ask you about mortgage modifications. Do you think that will help our economy—how do we help those homeowners who are underwater and give them hope—homeowners who, for the most part, were steered into high-cost predatory loans. Do you have any—

Mr. CALABRIA. First of all, the first thing to do about trying to help underwater homeowners is not to get them underwater in the first place.

So for instance, historically, one in four FHA borrowers left the closing table underwater. If that is not reckless, I don't know what is.

And as Congressman Frank said here last year at this very table, he intended for downpayments to be part of the Qualified Mortgage (QM) Rule.

As I mentioned in my testimony, regulators completely gutted that provision, so that the two factors that matter most in terms of keeping a household out of foreclosure, which is the downpayment, which gives you a cushion when prices fall, and of course trying to make sure borrowers are actually ready, by us and not getting people with very low FICO scores, who are not ready to go into homeownership.

I think we need to be a little more responsible. But that said, first, try not to get into that problem in the first place.

If you are in the problem, that is a different issue, and so, let's talk about that, because I know that is the more immediate concern. The immediate concern would be, how do we address the triggers that get you in that problem?

One of the things we know, and there is tons of data on this, is that the primary reason that somebody cannot pay their mortgage is because they have lost their job.

Congressman Frank, during his last year here, I believe, had a proposal that would have provided assistance in the mortgage modifications if people have lost their job.

So I think we need clear thinking about what are the drivers here, address those drivers directly, obviously a growing economy that creates jobs that goes with that as well.

Mr. CLAY. Let me share with you a situation in my district for instance, in Missouri, where we have entire communities who were steered into these high-cost loans when normally they would have qualified for conventional mortgages.

Do we write down principal—or how do we address that to help these homeowners to keep them from foreclosing, to keep them in their homes, and to keep neighborhoods together? How do we do that?

Mr. CALABRIA. Again, it is hard for me to speak to any individual case without looking at the case—where people were defrauded, they need to be made whole by the people who defrauded them; which in my opinion, the taxpayer did not defraud, they need to be made whole by the institutions that defrauded them.

Mr. CLAY. Sure.

Mr. CALABRIA. So that is number one.

I would remind us that there is nothing specifically about being underwater that triggers a foreclosure. There is nothing in the mortgage documents that says, oh, you are underwater, so we can come and take your home. In fact, it is quite the opposite. They don't want your home if it is underwater, if anything.

So we do need to think clearly about what are the factors—as I had mentioned, again, unemployment is a big driver. There might be unexplained healthcare expenses. We will see whether healthcare fixes that or not. But you have to deal with the life events that cause this sort of foreclosures. All that being underwater does is change your incentive, whether to walk away or not. And quite frankly, I don't think we should reward that.

Mr. CLAY. Let me ask Mr. Silvers, can you share any solutions to the housing crisis and how we get people whole who happen to be underwater in their mortgages? Have you all addressed it?

Mr. SILVERS. Yes, Congressman Clay, you are pointing to the—one of the critical problems in the way in which we addressed the housing crisis which led—which slowed down our economic recovery and led the cost of the recovery to be borne by the people who could least afford to do so with devastating social impact.

The failure to write—the failure to restructure debt in the housing market and to instead insist that poor people pay the banks a hundred cents on the dollar when every American businessperson in commercial real-estate in a similar situation never does, right, is how we gutted the median net wealth of African-American households from $18,000 to $6,000.

The solution is simple. It is to restructure those loans around what the real value of that property was. If we had done so, and as my colleague, Dr. Calabria, has said, if we had done so and forced the banks to restructure their capital at the same time, we would not have a too-big-to-fail problem. We would have a healthy housing market and a healthy small business consumer credit market.

Mr. CLAY. Thank you. My time is up.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, chairman of our Oversight and Investigations Subcommittee.

Mr. DUFFY. Thank you, Mr. Chairman. I just want to make a quick comment in regard to one of the championed agencies of Dodd-Frank, the Consumer Financial Protection Bureau. I am not sure if any of the witnesses are aware of a hearing we had a couple of weeks ago, which was a takeoff of a hearing that we had a year ago in regard to racism and sexism at the CFPB.

Angela Martin testified a year ago, and a couple of weeks ago, Florine Williams testified. We have had a pretty robust debate about racism in America over the past several months. And I have to tell you, I am astounded that Barack Obama hasn't said anything about racism and sexism at the CFPB.

That Richard Cordray still has his position at the CFPB is amazing to me. That Senator Elizabeth Warren, who is the champion of this agency that brought Richard Cordray in, his protege—that she is saying nothing about racism and sexism.

Their silence is deafening, stunning. But that's a side note.

I want to talk about the crisis—I think my friends across the aisle want to talk about markets and market failure. But if we look at the root causes of the crisis, wasn't there an issue with subprime mortgages?

Wasn't there an issue with Fannie and Freddie, Mr. Atkins?

Mr. ATKINS. Absolutely. And you have to remember that I think the figure of $22 trillion was thrown around as far as losses in the financial crisis. I don't know if that is correct or not. But you have to remember it was a bubble. It was a bubble created by Federal housing policies, so most of that stuff was illusory.

Mr. DUFFY. Federal housing policy by Fannie and Freddie, right?

Mr. ATKINS. Right. Among others.

Mr. DUFFY. Among others. And did we deal in the—in your review of Dodd-Frank, did we deal with Fannie and Freddie reform in Dodd-Frank?

Mr. ATKINS. Not at all.

Mr. DUFFY. So one of the root causes of the crisis isn't even addressed in the Dodd-Frank Act. And we note that regulators were on the beat and they didn't see this looming crisis. And so instead of faulting regulators, we have given regulators more power and authority.

They didn't get it right in 2008. What makes us think they are going to get it right in the next crisis?

I would also just note that as Dodd-Frank, as I watched on the sidelines as this bill was passed 5 years ago, there was a lot of conversation about the fact that we have to end too-big-to-fail. It has to go away. We have to protect the American taxpayer.

But I don't know if you have noticed there has been a change of tone from my friends across the aisle because now they say, "We actually haven't ended too-big-to-fail." Sweeping, massive Dodd-Frank reform, right, and too-big-to-fail still exists.

Actually, Elizabeth Warren just came out with a new bill to say, guess what, sweeping industry reform and you still haven't addressed too-big-to-fail. So now, she has new legislation, am I right, Mr. Atkins?

Mr. ATKINS. That is being introduced, yes.

Mr. DUFFY. Yes. They admit that with all of this massive reform, they didn't get it right.

There is still more to do.

But I do want to move to the lack of liquidity, fixed income markets, the Volcker Rule regulation. You see that as a problem, yes?

Mr. ATKINS. Absolutely. Yes.

Mr. DUFFY. Do you think the cause of the crisis or the cause of the lack of liquidity is the Volcker Rule?

Mr. ATKINS. Up to a large part, the Volcker Rule and other associated regulations, and increased capital requirements also.

Mr. DUFFY. And does that lack of liquidity create more risk in the market?

Mr. ATKINS. Yes, it means there is less cushion there and less information as far as pricing.

Mr. DUFFY. So, do smaller shocks have bigger impacts when there is less liquidity, Mr. Calabria?

Mr. CALABRIA. Absolutely. And I would note that even though the authors of Dodd-Frank recognized the liquidity constraints by purposely exempting treasuries and agencies from the provisions of the Volcker Rule, let's not forget that a number of institutions in history have done themselves in by bad bets on the treasury market.

Mr. DUFFY. Does time heal this issue? If you see banks because of Volcker getting out of their market-making game, is someone else going to step in and take that role? Do we just have to wait a little bit longer? How does this play out, Mr. Calabria or Mr. Atkins, either one of you?

Mr. ATKINS. There is a lot of capital we—asset managers and just basic everyday people who are investing money in the markets are there, so these fixed-income products are being held. It is just a question of, what is the market, what is the everyday liquidity of the marketplace?

Mr. DUFFY. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. I want to thank the panelists as well. You have all been very helpful with the committee.

I do want to just respond to my friend, the gentleman from North Carolina, who said earlier in this hearing that, and I will quote him, "Dodd-Frank is an anomaly," an anomaly, of course, being something that deviates from what is regular or expected or what is standard.

The only reason that Dodd-Frank seems like an anomaly is because that is the last time Congress did anything, passed anything

significant. And so, if you are in an environment that is inertia, a do-nothing Congress, and you look at something that actually moved, that seems like an anomaly. But it is just the illusion that motion causes when you are standing still.

I want to talk about—if we are going to go back to the crisis and sort of do some of this analysis on what went right and what went wrong, I actually opposed the bailout, the $700 billion in bailout we gave to the banks.

About 25 percent of people in my district don't even have bank accounts. I have a very diverse district. And so, we went and took their money, their tax money, and gave it to these banks, $700 billion.

And, it just—if we are going to go back and look what at we did, why don't we go back and look at that? Why don't we go back—and I am not just saying—I am not saying that some folks on Wall Street should go to jail; I will leave that to a judge and jury.

But some of their conduct seemed criminal, it really did. And we ended up taking taxpayer money, $700 billion, giving to the banks and like in the case of AIG I remember $9 billion of—we gave them $70 billion to help out AIG. But the $9 billion that we gave, the taxpayer money, was directly to satisfy the debt obligations that were held by Goldman Sachs.

So, it was just a pass through. It went right in one door of AIG and then right to Goldman Sachs—$9 billion. And it paid bonuses to a lot of people who were at the heart of this, like I said, I am not saying they should go to jail but I would say we should be revisiting the bonuses that we paid to folks who caused a lot of this mess.

And we are not talking about any of that. We are talking about dismantling Dodd-Frank. We are talking about dismantling the one and only consumer protection agency that we created. So, we have all these agencies out there, we have one, the CFPB, the only agency that we have created to protect the consumer.

And we look back at the problem of the crisis and we say, my God, the thing we have to do is get rid of that CFPB, the one agency that is actually protecting the consumer. It astounds me that is how we view this problem in retrospect.

I think that we would better serve the people whom we represent if we try to figure out ways to help them. And, sure, the CFPB is not perfect. It needs tweaking. We need to help it to be more effective and we need to address some of the concerns that the gentleman just raised regarding their treatment of employees and the disparate impact of some of their policies.

But, Mr. Silvers, in this last minute that I have, would you think that there are other priorities that we could focus on in terms of really trying to get at the root of what originally caused the—oh, the other thing that strikes me is getting rid of the Volcker Rule—allowing the banks to go back and do what they were doing before they got us into this whole mess, trading on their book of business, it doesn't make sense.

But, Mr. Silvers, if you have any other suggestions on how we might re-establish priorities here that would actually help the American consumer and the American people, I would love to hear them.

Mr. SILVERS. Congressman, I think that for starters, you have to stop telling lies about what happened in the past.

Mr. LYNCH. Right.

Mr. SILVERS. And the notion, for example, that insurance companies had nothing to do with this—my memory is that AIG was an insurance company, right? The notion that Fannie and Freddie caused this crisis? They contributed to it.

What caused it was the very thing that Mr. Garrett was referring to earlier, which was that the Federal Reserve had the power to act and let subprime providers of mortgages funded by our largest banks destroy our communities and then hand us the bill.

Until we stop telling lies, I don't see how we can move forward.

Chairman HENSARLING. The time of the gentleman has expired.

Mr. LYNCH. Thank you very much. Thank you, Mr. Chairman.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Mexico, Mr. Pearce.

Mr. PEARCE. Thank you, Mr. Chairman. I appreciate the lively discussion going on here. If we were to pursue this last thought here that the subprime lenders are the ones that destroyed the communities, I would kind of like to investigate that—Mr. Capuano said we ought to be digging a little deeper into it. And Mr. Lynch had some good points about looking at the situation.

So, Mr. Atkins, you said in response to Mr. Duffy that Fannie and Freddie had something to do with it, among others. Who might the among others be?

Mr. ATKINS. Well, you had a long history of both Congress and—

Mr. PEARCE. Anybody close to this room, because Congress itself—

Mr. ATKINS. Congress itself.

Mr. PEARCE. —Congress itself was expressing a tremendous desire that everyone should own a home, that homeownership was not a responsibility but a right. Is that somewhat correct? I am sensitive to what Mr. Silvers said, that we shouldn't be telling lies here.

So, did Congress led by Mr. Frank himself, suggest that the agencies led by Fannie and Freddie should loosen the standards by which they repurchased on the secondary market, wasn't that occurring?

Mr. ATKINS. Oh, that was Federal policy.

Mr. PEARCE. So, would it be a truth that the financial institutions could not have continued to lend to borrowers who could not afford it, they couldn't have done the liar loans, they couldn't have done the no-doc loans, if those loans hadn't been repurchased into the secondary market, is that more or less correct, Dr. Calabria? Would you like to comment on that?

Mr. CALABRIA. Let me first as an aside say that none of this would have happened without essentially a Federal Reserve-driven bubble—the amount of liquidity the Fed just pushed into the system in the mid-2000s was simply nothing short of insane.

And so, prices drove a lot of this. But to get back to the point of we know during the crisis for instance that at the top of the market Fannie and Freddie bought about 40 percent of the private label mortgage-backed securities in subprime. And to echo what my

friend Damon said, they were a contributor. I don't—I would never say that they were the sole cause by any extent of the imagination.

Mr. PEARCE. Could the subprime lenders have done much without the secondary market, and could the rest of the secondary market have dropped its underwriting standards without Fannie and Freddie dropping theirs?

Mr. CALABRIA. They could have not have.

Mr. PEARCE. So, at the end of the day, Fannie and Freddie weren't just kind of innocent bystanders or bystanders I think—that was not a correct characterization of Mr. Silvers' comments, but they were more central than any of our friends on the other side are willing to say.

The description is that the problem—and, again, I think that as Mr. Capuano said, if we don't analyze exactly why the problem came up, we are not going to get the right answer. And one of the fundamental things was that the underwriting standards by which the secondary market operated took bad loans away from the banks. They weren't given any incentive then to make the loans good, and that just seems like a very fundamental problem. Is that more or less correct?

Mr. CALABRIA. That is absolutely correct.

Mr. PEARCE. Okay. Mr. Silvers, would you like to comment on that?

Mr. SILVERS. Yes. Thank you for the opportunity. There is a subtlety to this that the conversation is missing. The subprime loans that triggered the crisis were largely in the private market and were largely securitized through private offerings.

That created competitive pressure on Fannie and Freddie that had been privatized and whose executives wanted to hit the profit margins that would inflate their pay packages.

Mr. PEARCE. You are saying the competitive pressure—with all due respect, sir, didn't the head of Fannie Mae, Mr. Johnson, take about $100 million? Wasn't he beginning to change the standards of accounting? Didn't Franklin Raines take a $29 million bonus out of that?

That feels like they were driving the process themselves. In fact, if you read the book where Mr. Johnson was coming in here lobbying this group in order to change the rules and change the laws to where he could go ahead and make more—could bring more of the product in to his market, that seems far different than kind of a nuance.

Mr. SILVERS. No, the nuance is not the fact that the executives of those companies sought to make a lot of money in disreputable ways. I fully agree with you. The nuance is is that they were latecomers to the crisis. Fannie and Freddie bought bad securities at the very end that had been issued in the private markets. That is how they bankrupted themselves.

Mr. PEARCE. If that is correct—we are running out of time—how did Mr. Johnson make his $100 million? He was way ahead of the time. And Mr. Raines was in that period.

I yield back, Mr. Chairman. Thanks for your—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, ranking member of our Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you, Mr. Chairman, and Ranking Member Waters.

No matter what our ideology is, political affiliation or fussiness, facts tend to be extremely obstinate. They just are finicky like that. They just want to remain what they are. And so, in this environment up on this Hill, we have become in a sense a fact-free environment.

Or in other words, if the facts don't fit, then bit by bit we refit the facts. It is so frustrating when you think about how the CFPB has returned $5.3 billion to 15 million victims of unfair and deceptive practices.

Dr. Calabria, do you believe that is a fact?

Mr. CALABRIA. To the best of my knowledge. I haven't verified the number so it sounds about right.

Mr. CLEAVER. In Missouri, the number is about almost 4,000, I think, and which is a fact incidentally. And I am a little concerned, for example, I Chair the Congressional Black Caucus, and I receive complaints almost every single day from every agency in the Federal Government, from the Capitol Police to the people who work for the Forest Service.

I would have done nothing as the Chair but talk about discrimination if I had tried to just pour it out every day and so, the President can't—if the President says I have a black suit on, he is going to be criticized in a few hours of bringing out the race card, if he says Black Sunday, black market, anything.

And so, I think we need to really be careful on this whole issue of who attacks bigotry because there are problems in every single agency. I am speaking experientially.

Now, one of the things I wanted to ask you, Mr. Calabria, is do you believe that the CFPB has in fact been responsive and flexible?

Mr. CALABRIA. Maybe the satisfactory answer is, it depends. It certainly seems like they have listened to a lot of people in the industry on some subjects. So, have they necessarily beat up on Goldman Sachs, not that I can tell.

Have they gone after Main Street lenders? It looks that way. So, again, I think it is important to keep in mind it is not all one homogenous response. It has been different by industry.

I do want to bring up a point. And first of all, let me very clearly say consumers who are defrauded should be made whole by the people who defrauded them. No debate about that. And we should be aggressive about that.

The question over whether certain products should be available, that is a whole different matter. But I also think it is important to keep in mind whether somebody was taken advantage of by a debt collector can be a bad thing, you should deal with it.

It is not at all clear how that is necessarily connected to the massive housing boom we had. So, you can have a fairer society that is less stable. You can have a fairer society that is more stable. They are connected but they are not necessarily the same thing.

Mr. CLEAVER. So, a fact, was there a Federal agency that was responding to consumer concerns and complaints and offenses against consumers?

Mr. CALABRIA. In the finance world before—

Mr. CLEAVER. Before Dodd-Frank.

Mr. CALABRIA. The financial rate—first of all, as a former staffer for the Banking Committee, I had a lot of complaints and helped a lot of people. I am very proud of that. And—

Mr. CLEAVER. No, sir. That is not the question I asked of you.

Mr. CALABRIA. —the Federal Reserve, the OCC, HUD, I ran the RESPA office at HUD and we spent a lot of time—

Mr. CLEAVER. That is not the—

Mr. CALABRIA. Oh, yes, were there—okay, there were agencies. If the question is, is consolidating these things a good thing, that may well be, depending on how you look at it.

Mr. CLEAVER. I know you are answering your question that you want me to ask.

Mr. CALABRIA. My apologies.

Mr. CLEAVER. My time has run out. You wouldn't answer my question. You are a nice person though. I am not mad at you.

Chairman HENSARLING. The time of both nice gentlemen has expired.

The Chair now recognizes the gentleman from California, Mr. Royce, chairman of the House Foreign Affairs Committee.

Mr. ROYCE. Thank you very much, Mr. Chairman. As we examine the Dodd-Frank Act 5 years later and if I were to go down a checklist with the panel here, too-big-to-fail continues. In fact, Dodd-Frank institutionalized it.

Our secondary mortgage market remains in limbo with Fannie Mae and Freddie Mac CEOs set to make $4 million salaries on the backs of the American taxpayers who had bailed out Fannie Mae and Freddie Mac.

Insurance regulation remains fragmented. Securities regulatory arbitrage is still possible, but with the SEC and the CFTC as competing regulators. So, I think the answer to the question, is our financial system more stable, as Dr. Calabria succinctly put it, I think the answer to that is "no."

Dodd-Frank abolished one failed regulator, the OTS, and gave us three more—the CFPB, the OFR, and the FSOC. So, the Office of Financial Research was set up to look around corners and identify potential systemic risks, to improve standardization of financial data and fill gaps in data collection, and support the FSOC in its work. That was the concept.

And, Mr. Atkins, as you know, the OFR performed an analysis of the asset management industry at the request of the FSOC in order to determine whether asset management firms should be designated as SIFIs and subjected to oversight by the Federal Reserve.

The OFR's conclusions were described by SEC Commissioner Gallagher as, in his words, "fundamentally flawed." And the inevitable results of the OFR not only inaccurately defining and describing the activities and participants in the asset management business but also "analyzing the purported risk posed by asset managers in a vacuum instead of in the context of the broader financial markets."

Mr. Atkins, do you think the work of the OFR was flawed?

Mr. ATKINS. Absolutely. I thought it was a travesty actually of—I couldn't even describe it as scholarship; it was riddled with errors.

Mr. ROYCE. Last year, Congressman Murphy and I put forward a bipartisan bill, the Office of Financial Research Accountability Act. Members of this committee on both sides of the aisle have heard constant criticism about the quality of research at the OFR and the lack of real coordination between the Office and Federal financial regulators.

The bill would address these issues, I think in a very thoughtful way. The bill as drafted would require the OFR to submit for public notice and comment an annual report that details the Office's work for the upcoming year.

Additionally, the bill would require the OFR to coordinate with financial regulators when they conduct future studies, and I would ask you—I know you and I both might want to go further on reforms of the OFR but would you support these balanced bipartisan reforms to the Office?

Mr. ATKINS. Yes. That is a great start.

Mr. ROYCE. And I will ask Mr. Calabria this same question.

Mr. CALABRIA. I would say that I have been here too long to think anything other than the devil is in the details. So let me say, conceptually it sounds good, but without having read the bill, I would want to take a look at it before I would say anything stronger.

Mr. ROYCE. I appreciate your support at least for the conceptual concept behind it. And I will yield back the balance of my time to the Chair. Thank you, Mr. Chairman. And thank you, panel.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentlelady from Wisconsin, Ms. Moore, ranking member of our Monetary Policy and Trade Subcommittee.

Ms. MOORE. Thank you so much, Mr. Chairman. And I want to thank the witnesses for coming here and bringing their tremendous expertise to this committee.

I guess I will start out with the Honorable Paul Atkins and talk to you a little bit about your testimony and your role at the SEC. In your testimony, I think you make a lot of excellent points with regard to some of the misaligned incentives that people have just generally in financial markets.

And then you go on and on and on to indict various provisions of the Dodd-Frank Act up to and including the fact that Dodd-Frank is 2,319 pages long.

The bill that we got from Mr. Paulsen was like 4 pages long, asking us for $700 billion, I just want to remind you of that. But I guess the question that I have is that I agree with a lot of points you make here and I am going to commit to really reading this in some depth.

But I guess what I feel confused about is, or I have a question about is, while you seem to indict the free market, just laissez-faire, you don't really give us any prescription of what you would have done to prevent this crisis other than to just indict the "housing market," the purchasers of homes.

People purchase their homes; it is like a one-time event for most people. And you don't seem to have much criticism for all of the guys in the fancy suits, the appraisers, the underwriters, the credit rating agencies, the private label mortgage originators, Lehman Brothers, Countrywide.

And so I am interested in hearing how you square that with housing policy. Countrywide and Lehman Brothers, for example, were not subject to CRA and bowers that came in were—as I said people who do this once in their lives, they were not the appraisers, they were not the underwriters.

Mr. ATKINS. Thank you. Clearly, there were a lot, there is not just one thing that led to the financial crisis and you have to remember a lot of the foreclosures had to do with speculators who were buying houses to flip them and that was all encouraged by regulatory policy and other things as well.

But I will point to one thing that when I was at the SEC, I pushed for a number of years, and that was reform of the credit rating agency aspect. And I think that was one of the big drivers frankly of the crisis because people put way too much store in the AAA ratings and all of that from those rating agencies.

And back in 2006, Senator Shelby pushed through a bill that, of course, was enacted, the Credit Ratings Agency Reform Act. And so, that was at least a start. But the real problem was at the SEC where there was no real process to allow for competition among credit rating agencies, and basically the big three, their word was taken as gospel and that was a real fundamental problem that—

Ms. MOORE. And a misalignment of incentives. People had to pay the credit rating agencies so they would give them a good credit rating and nobody is going to jail. I know people in my district who have gone to jail for writing bad checks for $1,000 and yet these people are still walking around.

Let me ask you Mr. Zywicki, you say that Dodd-Frank has pushed consumers into payday lending and other non-traditional financial services? I guess I am not familiar with the data which indicate that is the case.

I am not in love with non-traditional financial providers myself, but I wonder if that means that you welcome the activity of the CFPB to protect these consumers? I think my good friend, Mr. Cleaver, indicated that the CFPB has returned about $5 billion to 15 million consumers. And so, I am wondering how you think the free market would do a better job of protecting these financial consumers than the CFPB?

Mr. ZYWICKI. What we know is that you can't wish away the need for credit. We have known that forever. But we have tried that in the past where we tried usury ceilings, that sort of thing, and we know how that ends.

So in the 1970s or in 1968, the United States Senate did a report and they found that the second largest revenue source of the Mafia was loan sharking.

When Anthony "Fat Tony" Salerno, the head of the Genovese crime family was indicted for loan sharking and breaking people's legs in 1973, he was running $80 million a day on the streets of New York City. Why? Because we had a regulatory regime that pretended like people didn't need credit.

We are reliving this in fast motion really. We have taken away credit cards. We have taken away bank accounts. People still need money. They are going to check cashers, they are going to payday lenders, and of course, the next thing we see in the sights are they going after the payday lenders.

And we know what happens when we take away payday loans, people bounce checks, people get evicted, people get their utilities terminated.

Mr. HUIZENGA [presiding]. Excuse me, Mr. Zywicki, the time of the gentlelady has expired. As entertaining as "Fat Tony" is, the time has expired.

Mr. ZYWICKI. Thank you, sir.

Mr. HUIZENGA. And we do need to move along. So, with that, the Chair recognizes the gentleman from Florida, Mr. Ross, for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman, and witnesses, I appreciate you being here, specifically Commissioner Atkins. You addressed something that I think is very important when we talk about systemically important financial institutions, especially as it relates to asset managers.

I think what is even more compelling is that your pronunciation of the acronym for systemically important financial institutions as "sci-fi" is just that when it comes to asset managers—science fiction. And I think that this is an unintended consequence of Dodd-Frank. What risk do asset managers have?

They are essentially agents, they are not leveraged, and yet here we are looking at making them a systemically important financial institution as I understand it in your testimony would then make that asset manager as a SIFI or sci-fi jointly and separately liable for any other SIFI or sci-fi that might have a need for liquidity, is that correct?

Mr. ATKINS. Yes, under Dodd-Frank—even for the bailout fund.

Mr. ROSS. Yes, exactly. And what you have here is you have a non-leveraged asset manager now responsible, which really is not him, it is his investors who are responsible. And who makes up those investors? Mutual fund holders, pension funds, grandma and grandpas, people living on fixed incomes.

So I guess what I am getting at is here we are trying to find out if too-big-to-fail is really something that has been put to an end with Dodd-Frank, but in fact it hasn't, and not only has it not, but it has given an incentive for another source of liquidity to bail out those that are deemed systemically important financial institutions, would you agree?

Mr. ATKINS. You can certainly ascribe.

Mr. ROSS. And now, would you believe that just a couple of weeks ago our Secretary of the Treasury, Jack Lew, was sitting there, and I asked him the question of whether a SIFI would be jointly and severally liable for other SIFIs if they were deemed so, and he denied that.

He looked back at his staff and denied it. And so, I give you credit in your opening statement to not only recognize that as a plain anomaly, if you will, of Dodd-Frank, but also to cite the fact that it is found in 12 USC Section 5390.

Mr. Calabria, let's talk about insurance just for a quick second. Now, we have in place probably one of the best systems of regulatory environment for insurance companies, and that is our State-regulated systems, would you not agree?

Mr. CALABRIA. Absolutely.

Mr. ROSS. And now, you have FSOC coming in there and saying that there might be some gaps, we need them, we have a Federal Insurance Office. It doesn't have any regulatory control, but, yes, we want to make sure everything is in sync.

Would you have an opinion as to where there are some gaps there that would require a system better than what we have in place on behalf of our consumers?

Mr. CALABRIA. Certainly, you can make some improvements in the State-based system. I don't think anybody would argue with that. I do worry that labeling these institutions as systemically important will create really bad incentives.

So, let's give you a contrast where, say, JPMorgan's balance sheet is 40 percent long-term debt, MetLife's is only about 4 or 5 percent, and we know that being labeled systemically important unfortunately seems to send signals to the debt markets that you will be rescued and it encourages you to be more highly leveraged.

So, to me, I think by putting insurance companies under this framework, we risk making them actually more leveraged and more dangerous.

Mr. ROSS. More leveraged, greater capital requirements, more detriment to the consumer or to the insured, which also gives unfair competitive advantage maybe even to those internationally in the insurance markets. Which leads me to my next point with the the International Association of Insurance Suppliers (IAIS). Do you feel the FSB is making enough effort as an advocate to protect our interest in those negotiations?

Mr. CALABRIA. I don't think they are, and I think the suggestion that some have offered that our representatives, the U.S. representatives should not declare any institution systemic until FSOC has already acted to me is the right approach rather than trying to back the FSOC into a corner.

Let me say that one of the problems is the argument that somehow we need to subject asset managers or insurance companies to bank-like regulation assumes that bank-like regulation works well.

Mr. ROSS. Well put, and it would work well in an industry that is not bank-like. So, Mr. Zywicki, quickly, since the recession in 2008, have we seen a great deal of capital reformation?

Mr. ZYWICKI. Not that I have seen, but these gentleman may know better than I.

Mr. ROSS. Could somebody answer that? Have we not seen a greater increase in capital with the formation of capital?

Mr. ATKINS. With a zero interest environment, you would expect I think—

Mr. ROSS. And have we seen since in the last 5 years any greater access to that capital?

Mr. SILVERS. I think, sir, that you are asking a question about whether or not our banking system is doing its job since—

Mr. ROSS. Or our capital markets.

Mr. SILVERS. Our capital markets and our banking system are somewhat different questions.

Mr. ROSS. But what we are doing is we are seeing more and more private capital being formed, but we are not seeing access to that capital being allowed to the consumers as a result of Dodd-Frank.

Mr. SILVERS. No, well essentially, I think you are pointing to the wrong cause. We didn't restructure our banks so our banks didn't do their job.

Mr. HUIZENGA. The gentleman's time has expired.

Mr. ROSS. Thank you.

Mr. HUIZENGA. With that, the Chair recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Thank you. I am one of those who was here when Dodd-Frank was written. I am here to report that it was written in this room, not on Mount Sinai, nor was it written by Beelzebub in the nether regions.

It is not sacrosanct but that does not mean it should be discarded. We need to improve it, not dismantle it. And in spite of its great length, it lacks a whole lot of specificity.

It gives tremendous power to the regulators. And God forbid if we get an Administration of the other party, we will see just how much discretion it is; a well-drafted statue means the same thing whether you elect a Democrat to administer the law or a Republican to administer the law.

I think if we ever get a Republican Administration, heaven forbid, we will find out how much latitude there is in that statute and how Congress should have been more specific.

As to SIFIs, I join with the gentleman from Florida who should be praised at length except he is not here anymore about designating money and mutual fund managers as SIFIs, as I bored some of my colleagues with before Lehman Brothers didn't cause a problem because it had too many assets.

If you are trying to determine whether an entity is a problem, you say, what are its liabilities, who loses if it doesn't pay its debts? And a mutual fund doesn't have any debts in almost every case.

So the idea that we would designate mutual funds as SIFIs because Countrywide made bad mortgages seems rather extreme. Mr. Atkins, I want to focus with you on these credit rating agencies.

You put forward the idea that the fault is the people who pay attention to the credit rating agencies, who rely on the credit rating agencies.

Let's say you are an ordinary consumer, you have $50,000 to invest, and you are trying to compare the Vanguard bond fund with the T Rowe Price bond fund.

And they both have the exact same portfolio in ratings, 20 percent AAA, 30 percent AA, 40 percent, exactly the same and one is yielding 10 basis points more than the other. How would you, knowing that you have $50,000 to invest, which means you can't hire Deloitte and Touche to give you a report. How would you decide to forego the extra point 1 percent of return when you see the only way you have of evaluating those two bond portfolios is how the individual bonds are rated by the credit rating agencies? How

would you take your own advice and not rely too much on the credit rating agency?

Mr. ATKINS. You make a good point, but what I was trying to refer to before was to government regulators who actually should have known better. And to the SEC where—

Mr. SHERMAN. We all should have known better when they gave AAA to alt-A, when they gave the highest rating to liars' loans.

But how are they ever going to stop doing that when they are selected and paid by the issuer? We dealt with that in the Frank and Sherman amendment to Dodd-Frank, but it went into conference, and it got diluted just enough that the SEC could wiggle its way around it and issue a report saying they don't want to do anything.

And so now, we have pretty much the same system we had before. That is to say, you can make a million bucks by giving somebody a good grade. And if you give them a good grade, somebody else will hire you to give them a good grade.

I don't think that it will be mortgage debt which causes the next crisis, or at least not in the next few years, because we have some sort of memory, slightly longer than goldfish. And we won't let that mistake happen right away.

But whether it is corporate bonds, whether it is sovereign debt, there are so many opportunities people have—put together a package of debt, buy a good rating, sell it, and then you as an investor almost have to buy it.

And the money—and imagine yourself working for T Rowe Price or working for Vanguard, would you put together the bond portfolio that had 10 basis points less yield but had the same ratings as your competitor knowing that you as the investor would choose not to invest in your fund?

I would say the credit rating agencies cannot be ignored. They are not ignored by investors. They cannot be ignored by money managers. And as long as they are selected by the issuer, we are just waiting for the next crisis. I yield back.

Mr. HUIZENGA. The gentleman's time has expired. With that, the Chair recognizes the gentleman from North Carolina, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman. I would like to respond to Mr. Capuano's references earlier. He was lauding the merits of the Dodd-Frank Act and attributes of it and what it had done on behalf of our economy and our housing market.

I am from Charlotte. Charlotte is one of the better economic regions of the country. According to a Metro Study, which is a nationwide data company, in 2006 we had 24,415 housing starts. In 2014, we had 9,238 housing starts.

We are up 40 percent from where we were. And I think stats are relative. You can convey a stat in whatever way that you want to make them sound good, and I would compliment Representative Cleaver that we need the facts and those are the facts.

So while I always appreciate the enthusiasm of Mr. Capuano, I think we need to be clear that we have not seen the return in the market, in the housing market which my former company was involved in for 25 years in, throughout the country.

Access to capital is critical, and it is not there. The impediments in getting that capital are clear. These developers had to go outside. They had to go private equity and other firms that are much more costly.

So for clarification, I felt that was prudent.

Dr. Calabria, as you know, the insurance companies are under extensive supervision by the States. State laws or regulations are designed to do three things: stop serious financial distress in an insurance company from ever developing; redress material financial distress when it occurs; and limit the scope and impact of a stress event by facilitating interstate coordination and remedial action.

Do you believe that there exist gaps and regulation of insurers than have made FSOC designation of insurers necessary?

Mr. CALABRIA. I do not.

Mr. PITTENGER. Well, if no gaps exist, why do you believe FSOC has moved forward with the designation of insurers—

Mr. CALABRIA. What I would submit and this has been a really consistent theme under both Republican and Democrat treasuries is there has long been a suspicion of the State insurance regulatory system, one of the few things that for instance Treasury Secretary Paulsen did before the crisis was issue a report on how bad the State insurance system was.

And so Treasury has long had this viewpoint of, we need to get rid of State regulation of insurance. I don't think they have been shy about it and I think FSOC has largely followed it.

Let me also say you have raised a very important point in regard to Congressman Capuano's points, which is, of course, is that what we should be doing is comparing this recovery to previous recoveries.

The argument that if we had not done Dodd-Frank or the stimulus of this, that we would have been stuck in a hole and people would stop going to work and living in caves or whatever, that is not the case; economies recover.

Mr. PITTENGER. Thank you. Are you concerned that firm-specific non-bank designations of insurance companies could create competitive imbalances in the insurance market?

Mr. CALABRIA. Yes. As I mentioned in my earlier remarks about, to me, I worry that the designation would encourage insurance companies to look more like banks.

And in my opinion, the largest insurers are far more better capitalized and in far better shape than the typical larger bank. So, I don't want MetLife to look like Citi; I think that would be a gross mistake.

Mr. PITTENGER. Professor Zywicki, do you have a comment on that?

Mr. ZYWICKI. I don't have anything more to add than what Mark said.

Mr. PITTENGER. Very good. Mr. Atkins?

Mr. ATKINS. Yes. I agree with that, and I think you have to look no further than the President's own appointed insurance expert on FSOC, who completely slammed not only in really harsh terms frankly, not only the designation of Pru, but also the designation of MetLife as being—he said that was unfounded basically.

Mr. PITTENGER. Thank you. I yield back.

Mr. HUIZENGA. The gentleman yields back. Just to let our Members know, there has been a motion to adjourn, a vote call. It is a 15-minute vote. So with that, we are going to continue with some questioning here, but if it is all right with our panel, I believe we will shortly take a break to go vote and then reconvene.

The Chair recognizes Mr. Ellison of Minnesota for 5 minutes.

Mr. ELLISON. I want to thank the Chair and the ranking member and also the panel. Mr. Silvers, one of the requirements of Dodd-Frank was publicizing the ratio of CEO pay to median worker for publicly traded firms.

I just want to point out that back in 1980 when I was a sophomore in high school, the ratio was about 42:1. In 2014, CEOs received about 373 times the average employee.

I guess my question to you is, why is this important knowledge for investors, and how does this knowledge further our discussion of addressing economic stability and even equity?

Mr. SILVERS. There is—what that information is about obviously is internal equity within the firm, and there is a substantial body of research most recently developed and focusing on retail stores which suggests that there is a correlation between essentially internal equity within the firm and long-term firm performance.

Contrary to what my colleague on the panel, Mr. Atkins, suggests, the securities laws from their very inception were designed to ensure that the public had material information about the management of public corporations. It is very clear, the public would very much like to know this, what this ratio is and know it accurately for all public companies. But the more fundamental question is, it is the law of the land. Congress passed that statute and the public is entitled to have it enforced, which it hasn't been so far.

In terms of the larger issue of economic stability, underneath the economic crisis that began in 2007 was a generation of wage stagnation. It created the political and economic circumstances in which a wide variety of people in both parties were tempted to substitute credit for wages.

I think if you listen closely to my colleague Professor Zywicki's testimony, he is in favor of that kind of substitution; I am not. I think that substitution profoundly destabilized our economy and threatened not just our long term prosperity, but it threatens us with repeated and increasing severity of financial crises.

The pay ratio rule is designed to put valuable information in the hands of both investors and the public that is relevant to that problem.

Mr. ELLISON. Mr. Chairman, I also want to ask for unanimous consent to introduce into the record an article from Forbes dated June 16, 2014, which says, "The Highest Paid CEOs are the Worst Performers."

Mr. HUIZENGA. Without objection, it is so ordered.

Mr. ELLISON. Yes, so there you go.

I would also like to point out, just for the record too, that the reality about mortgage loans made during the financial crisis and prior to it, is that about 66 percent of the loans are equity stripping refinances. And these were cash-out refinancing of homeowners with substantial equity. Too often, loans on predatory terms. I just want to point that out as well.

And Mr. Zywicki, I wonder if I could ask you a question, sir. In your testimony you complained, or you pointed out that the CFPB is engaged in a massive data mining program. You said it collects data from hundreds of millions of consumers and credit records, which "far exceed any reasonable regulatory purpose."

And then you cite Mr. Newt Gingrich in a footnote to support your claim. Are you aware that Mr. Gingrich is on retainer from the U.S. Consumer Coalition?

Mr. ZYWICKI. I cited that because—

Mr. ELLISON. Are you aware?

Mr. ZYWICKI. No. I wasn't aware, but—

Mr. ELLISON. Are you aware that is a 501(c)(4) organization, which according to its founder Brian Wise is dedicated to trying to undermine the CFPB? Did you know that?

Mr. ZYWICKI. I am not aware of that.

Mr. ELLISON. So you cited a source and you don't know the terms upon which that citation was made?

Mr. ZYWICKI. I do know the terms because I know those data are accurate, because I have seen similar numbers elsewhere and I just cited that as the most immediate data on hand.

Mr. ELLISON. You cited Gingrich. You didn't mention that he was paid by the U.S. Consumer Coalition. Did you?

Mr. ZYWICKI. No. I didn't know that.

Mr. ELLISON. You didn't mention he was compensated for his advocacy?

Mr. ZYWICKI. No.

Mr. ELLISON. You didn't mention that?

Mr. ZYWICKI. No. But the data is out there and the data has been reported elsewhere. That was just the most recent source.

Mr. ELLISON. So a compensated source to advocate a particular line of argument, you don't think it was worth the public's time to know that? No, you don't.

Okay, my time is over.

Mr. HUIZENGA. The gentleman's time has expired.

Mr. ELLISON. I have no further questions for this witness.

Mr. HUIZENGA. The gentleman's time has expired.

With that, we are going to go to our last questioner before we take a brief recess.

And the Chair recognizes Mr. Rothfus of Pennsylvania for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Mr. HUIZENGA. Sorry, we won't start the clock yet, but just so that everybody is clear, the game plan will be that we will recess briefly, go and vote, and return immediately and continue with the hearing.

And with that, Mr. Rothfus?

Mr. ROTHFUS. Thank you, Mr. Chairman. And I thank our panel for being here this afternoon.

It is always good to take stock on anniversaries. So we are at 5 years now for Dodd-Frank. I would like to go back though 7 years before Dodd-Frank, just to set the record straight. We have heard a lot about Fannie and Freddie. I want to remind people what was going on in the early 2000s, an attempt to reform what was going on at Fannie and Freddie.

Indeed, this committee held a hearing on September 25, 2003, on whether there needed to be some reforms with the way things were being done at Fannie and Freddie. Regarding these entities and its regulator, Barney Frank made a number of really striking statements, including this one, "I do think I do not want the same kind of focus on safety and soundness that we have in the Office of the Comptroller of the Currency or the Office of Thrift Supervision for the Fannie and Freddie regulator. I want to roll the dice a little bit more on this situation toward subsidized housing."

Dr. Calabria, any reaction to rolling the dice?

Mr. CALABRIA. I guess, first of all, I note that the OCC was the primary regulator of Citibank, so even OCC level of regulation apparently wasn't very good.

But that said—let me, if I can, and certainly not—personal push back a little bit, lots of people across the aisle were wrong on Fannie and Freddie, and so I do think that is worth remembering.

I think if we could put aside—

Mr. ROTHFUS. But they are wrong on Fannie and Freddie.

Mr. CALABRIA. They are wrong on Fannie and Freddie. A number of people were—

Mr. ROTHFUS. And it was a big contributing factor to what we saw?

Mr. CALABRIA. Absolutely.

Mr. ROTHFUS. With Dodd-Frank. Now let's—I want to talk a little bit about Dodd-Frank and how it was marketed as a way to end too-big-to-fail.

Prior to its passage, then-Secretary Geithner claimed the law would end too-big-to-fail. And yet at the signing ceremony for the Dodd-Frank Act, President Obama proclaimed the following, "After taking office, I proposed a set of reforms to empower consumers and investors to bring the shadowy deals that caused this crisis into the light of day, and to put a stop to taxpayer bailouts once and for all. Today, those reforms will become the law of the land."

Of course, we know that Secretary Geithner backtracked from his suggestion that this would end too-big-to-fail. In 2014 the question came up, and he said, "Of course, it didn't end too-big-to-fail."

Dr. Calabria, I would like to go through the list that the President talked about and get your thoughts on whether the reforms that the President claimed have in fact been achieved. Specifically, has Dodd-Frank empowered consumers and investors, or has it resulted in fewer and more expensive choices for consumers, and reduced upward mobility, particularly for those economically disadvantaged groups who have historically had the most difficulty accessing credit?

Mr. CALABRIA. I think the numbers are fairly obvious that it has been a burden in that regard.

Mr. ROTHFUS. Has Dodd-Frank eliminated shadow lenders, or has the avalanche of regulations that is imposed on our financial institutions actually led consumers to less regulated areas?

Mr. CALABRIA. That certainly seems to be the case.

Mr. ROTHFUS. And finally, did Dodd-Frank put an end to taxpayer bailouts once and for all, or did it rather enshrine too-big-to-fail into law, resulting in an expansion of the Federal safety net and increasing the probability of future crises and bailouts?

Mr. CALABRIA. So again, to clarify my earlier statements, I do believe that Dodd-Frank offers a path to ending bailouts, I just note that it is an optional path, and I think it is highly unlikely that regulators will ever choose it—and one of the reasons I believe so is because there are similar powers that were put in place for Fannie and Freddie and they were not used at that time.

So, as long as we have the Tim Geithners or the Hank Paulsens at the seat, to me, I think you should bet your money on that the creditors are going to get bailed out.

Mr. ROTHFUS. Professor Zywicki, earlier this week the IMF released its annual review of the U.S. economy. The report found that some key vulnerabilities in the U.S. financial system have yet to be addressed, notably the housing finance system.

The IMF also found that the Federal Reserve's extraordinary loose monetary policy and low interest rates have encouraged firms to take on additional risks in search of better returns.

Finally, the report expressed concern about consolidation within the banking sector, particularly that large and interconnected banks dominate the system even more than before.

I find this report to be particularly troubling given that it was bad government housing policy and Fed monetary policy that helped set off the last financial crisis. Furthermore, there is much evidence out there that Dodd-Frank regulations and the SIFI designation process is actually encouraging additional consolidation rather than eliminating it.

What do you say to these concerns and those identified by the IMF?

Mr. ZYWICKI. I agree with all of that, which is, big banks are getting bigger, and smaller banks are getting crushed. We have done nothing to deal with the incentives that consumers have to walk away from homes that are underwater such as requiring higher downpayments, doing the State anti-deficiency laws. And we are seeing exactly the same phenomenon we saw earlier.

And I don't want to overlook something that Dr. Calabria mentioned early, which is, the fuel that drove this fire was the Federal Reserve's crazy monetary policy from 2001 to 2004 and thereabouts. And we are doing exactly the same thing now and we are inflating another bubble probably in the housing market in a lot of areas.

Mr. ROTHFUS. Thank you, Mr. Chairman. I yield back.

Mr. HUIZENGA. The gentleman yields back.

And just so that everybody is aware, we have 2 minutes and 40 seconds left in this 15-minute vote, and so we will recess at this time, and until immediately after votes, when we will return. Thank you.

[recess]

Chairman HENSARLING. The committee will come to order.

The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman. And thank you to the panel.

I really appreciate this opportunity to reflect after 5 years on the effectiveness of Dodd-Frank. I was here when it was put together and I participated in the many discussions around its creation. And

I remember the extravagant, not to say apocalyptic warnings about how this was going to be what everything else, the Democrats proposed at that time, a job-killing bill.

That it would represent—what has generated some echoes here today, a lack of freedom for consumers, and all sorts of other things. And of course—and this caught my attention, it was to devastate, and again, the language was beyond apocalyptic. It was to devastate a key American competitive advantage, our capital markets.

A lot of that criticism has begun to fade such that we hear echoes of it today. It is hard to call all that stuff job killing when you have been through 12 million new jobs created in on average 250,000 jobs added per month. It takes some sting out of that accusation.

The question of the capital markets, though, caught my attention. I have the privilege and sometimes challenge of representing a district which is very, very dense with people who work in the financial services industry. And I am the first to recognize that there was both individual and institutional crazy, if not to say criminal, behavior in the industry.

But it is also true that these capital markets are essential to Main Street, to borrowing for mortgages and student loans and consumer lending, and of course for our businesses. So I thought I might just take a look at the facts around what has occurred in the capital markets in these last 5 years and just together some facts which are displayed there.

And I would ask the Chair for unanimous consent to make this a part of the record.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. HIMES. Businesses and people borrow and access capital. On the upper left there, you see the commercial and industrial loans since Dodd-Frank, a very strong rise up 60 percent.

Small businesses, its access venture capital—in the upper right, you see venture capital investments up over 100 percent. People and companies benefit from the stock market.

At the lower left, you see the behavior of the Standard & Poor's 500, up almost 100 percent in the 5 years since Dodd-Frank. That is a pretty darn nice return for some people who got badly hurt in the crisis and of course represents, if nothing else a real vote of confidence for those capital markets that we were promised would be devastated by Dodd-Frank.

Lower right, what about people, consumer credit. Again, we have been hearing a lot today about a reduction in freedom in terms of the products that are available to consumers. The graph in the lower right would suggests that if even if there is a reduction in freedom there and a reduced reduction in choices there has certainly not been reduced consumption of consumer credit.

So I think it is fair to say that the facts demonstrate that Dodd-Frank, far from having a catastrophic effect on the capital markets, actually contributed to the restoration of those markets and something that we consider a key competitive advantage.

We now hear the criticisms reduced to the abstract and academic notion that those things could have been better. If only others had been in charge we would have had a more robust economy or perhaps those charts, which are pretty dramatically in their north-eas-

terly direction, would be somehow more northerly in their direction.

But those facts are important. And they are important because we see efforts to eliminate an awful lot of the protections which I would argue would perhaps turn those graphs around.

I did want to make that point, and that reflection at this 5-year anniversary, but I do have a question. Again, representing as I do the district for whom the financial markets are pretty important, I have always recognized that while a very important and good step forward, Dodd-Frank is far from perfect. And there are in fact changes that should be made. So in the very limited time I have left, I would just love to get from each of you, very quickly, if you could make one change, the change that would draw agreement on the part of peer-reviewed academics and others, if you could make one change to Dodd-Frank, what would it be?

Let me just quickly go from left to right.

Mr. ATKINS. It is hard to pick out of all 15 titles, but I would start with Title I, for sure. And address the potential of the FSOC and the Fed bringing in bank regulated.

Mr. HIMES. Thank you.

Mr. Calabria?

Mr. CALABRIA. I reiterate that there is a lot to choose from, but if you want to talk where there is most robust agreement, I think most of the academic literature does suggest that Title I of designating entities sends the wrong signal to the marketplace.

Mr. HIMES. Thank you.

Mr. Silvers?

Mr. SILVERS. I would restore Glass-Steagall.

Mr. HIMES. Restore Glass-Steagall, meaning force a separation of commercial banking activity from brokerages?

Mr. SILVERS. And obviously I wouldn't literally take the words of Glass-Steagall. I would try to enforce that concept in modern context.

Mr. HIMES. Thank you.

Mr. Zywicki?

Mr. ZYWICKI. I would make the CFPB into a bipartisan commission and put it on budget, and remove its role in safety and soundness checks.

Mr. HIMES. Okay. So two Title I's, one CFPB, and Glass-Steagall. Thank you. I appreciate it.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Indiana, Mr. Messer.

Mr. MESSER. Thank you, Mr. Chairman.

I would like to start with Mr. Calabria, and talk a little bit about some of the unintended consequences of Dodd-Frank. As you heard from our colleagues on the other side of the aisle today apologists for Dodd-Frank are fond of saying that the law struck a direct blow against Wall Street, remade the financial systems so that those firms no longer enjoy the privileges that made them too-big-to-fail, and gave rise to the taxpayer bailouts of 2008 and 2009.

In reality though, the biggest Wall Street firms are the beneficiaries, not the victims, of Dodd-Frank, both because the law ce-

ments them as too-big-to-fail, and because the massive regulatory dragnet they cast over the financial system makes it difficult for smaller firms to compete.

There is no mystery to this. Goldman Sachs CEO Lloyd Blankfein and JPMorgan Chase CEO James Dimon have both said that Dodd-Frank gives them some competitive advantages because of the broad scope of regulatory cost associated with the law.

Harvard University released a study recently that confirms this. And just anecdotally, we all know you can count on the fingers of one hand, the number of new banks that have been chartered since Dodd-Frank was enacted.

So, Mr. Calabria, whom should we believe? Our colleagues on the other side of the aisle and the Obama Administration who loudly proclaim Dodd-Frank administers harsh medicine to Wall Street or the CEOs of those same firms who tell us they are actually the competitive beneficiaries of this law?

Mr. CALABRIA. Certainly, I think the evidence is pretty overwhelming that concentration has increased since both the crisis and since Dodd-Frank. I would be the first to say lots of causes go in there just as there are lots of causes with the market going up, I would, for instance, suggest that maybe 6 years of negative real short-term rates might have actually inflated the equity markets a little bit. And we will see what happens when those things turn around.

But I think absolutely there is no doubt in my mind that you have seen growing concentration both on the commercial banker side and on the broker-dealer side.

Mr. MESSER. Mr. Zywicki, you are nodding?

Mr. ZYWICKI. I agree completely which is we have known for decades that regulatory structures fall harder as small businesses. What we have done is created this monolith, this huge regulatory structure then imposed at our community banks who obviously didn't cause the problem here.

And just the regulatory compliance cost is killing these businesses, not to mention, as I said, on products such as mortgages. It has gotten rid of their competitive advantage, which is relationship lending and sort of knowing about their customers. And so it is absolutely, in my view, accelerated consolidation of financial industry and further destabilized the financial system.

Mr. MESSER. Thanks.

Really quickly, Mr. Atkins, we would like to raise with you an issue that is actually beyond the scope of Dodd-Frank and deals with the liquidity coverage ratios under Basel III.

It came to my attention, and you are probably well aware, that Federal banking regulators have excluded all American municipal bonds from being treated as highly liquid assets under the LCR rule, which creates a remarkable situation where certain German bonds qualify as these sorts of assets when most American municipal bonds don't—all American municipal bonds don't—that it obviously disincentivizes banks from investing in those assets and potentially raises borrowing costs.

We all know that aside from U.S. treasuries for America municipal bonds, securities are some of the safest investments available with State and local governments having about a zero default rate.

To help ensure that we change that, I have authored, with Congresswoman Maloney from New York, legislation that would essentially direct the FDIC, the Federal Reserve, and the OCC to classify investment-grade American municipal bonds as level 2A securities and highly liquid assets.

Everyone that I have talked to tells me that these investments are some of the safest in the world. Can you help me understand why it would make sense to allow German bonds to qualify as that kind of asset and not allow American municipal bonds?

Mr. ATKINS. Yes. The problem with Basels I, II, and III basically is that they categorize these various investments in buckets. And there is always an incentive then to choose the riskiest, therefore the highest yielding ones, in each of those buckets and not to have a real market-based type of valuation to it.

It is really the regulators choosing winners and losers, if you will. So, I think there is a fundamental flaw in all of that design.

Mr. MESSER. Just a simple question: Do you think if a bank needed to sell investment grade municipal bonds, they could do that, and could they find buyers if we were at a time of financial stress?

Mr. ATKINS. For a bank to—

Mr. MESSER. Yes.

Mr. ATKINS. Yes, I would think so.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Green, ranking member of our Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman. And I thank you for your service on this committee as well.

It is my understanding that some of the Members today have opened the door to talking about invidious discrimination, and while we are talking about Dodd-Frank, I think that it is appropriate that we mention some aspects of invidious discrimination, because there are some things that Dodd-Frank does not do to the extent that I think that it should. So, I agree with those who contend that Dodd-Frank is an imperfect piece of legislation.

Let's just talk about some of the things that I would like to see us impact by way of the work of the committee.

I have a statement here indicating that minority business owners paid interest rates that were 32 percent higher than what whites paid for loans in 2012. This is by way of the Federal Reserve, by the way. This is what the Fed says. Dodd-Frank doesn't do enough to address this kind of invidious discrimination. I am pleased that someone brought it up today. Otherwise, I might not have put this on the record.

According to The Wall Street Journal, in 2013 only 4.8 percent of loans made to buy homes were made to blacks. However, blacks comprised 13.2 percent of the total population in 2013. Now I know that we can rationalize that and say, blacks don't make as much, they probably don't have the credit history, there are all kinds of ways to rationalize it. But one of the best things that we can do is investigate and find out why blacks are at this number.

In 2013, only 7.3 percent of loans made to buy homes were made to Latinos. However, Latinos comprised 17.15 percent of total popu-

lation in 2013. Dodd-Frank doesn't do enough to help us, and I hope that the committee will.

According to CNN, 2013 HMDA data, the conventional mortgage load denial rate was 10.4 percent for whites; by comparison, however, the denial rate stood at 27.6 percent of blacks, 21.9 percent for Hispanics, and 13.3 percent for Asians.

The information goes on and on and on but I will move now to the Washington Post. Between 2004 and 2008, black borrowers were 54 percent more likely to have a high interest rate mortgage, black borrowers. Latino borrowers, 45 percent more likely to have a high interest rate than similar white Borrowers, I might add, and Asian-American borrowers were 7 percent more likely.

Now, these are things that we can investigate, things that I think the committee should investigate. I think that on the heels of what we have just seen in South Carolina, where we are eliminating symbolism, it seems to me that we have an opportunity to actually get into the invidious discrimination that still takes place. And my hope is that we will look after these things at the committee level. We are currently examining the CFPB, and of course until 1968, we were known as the Banking Committee.

These lenders bear a look being taken at them. My hope is that we will do it because we tell people to pull themselves up by their bootstraps.

These loans, these mortgages are bootstraps. In my last 9 seconds, I appeal to the committee to please, it is an appeal, let's look into this. I thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Colorado, Mr. Tipton.

Mr. TIPTON. Thank you, Mr. Chairman. I appreciate the panel's time for being able to be here as we listen to our colleagues' comments from the other side of the aisle. They want to be able to interpret that Dodd-Frank has helped bring the economy back.

I think it is worthy to note that we have the lowest labor participation rate in 4 decades. For the first time, I think you have mentioned this, the Brookings Institution report coming out saying we have more small businesses shutting down than there are new business startups in this country. We are suffering under two trillion dollars worth of regulatory costs which is driving up cost, if you care about people who are on fixed incomes, young families who are trying to be able to get a start, increasing their cost by inhibiting their ability to have access to capital.

We have talked about Dodd-Frank today and too-big-to-fail. Unfortunately, it has become apparent both anecdotally and empirically that the legislation has failed to be able to live up to its goals. Banks in my district and across the country have told me time and again that the compliance costs brought on by one-size-fits-all regulatory schemes made it impossible for them to be able to lend to creditworthy Main Street businesses.

Instead of working with the community, small banks and credit unions are working to comply with rules and regulations that were intended to curb Wall Street banks. Delta Bank in Delta, Colorado, told me that they don't know how much longer they are going to

do it because they feel that they are no longer working as a bank, they are working for the Federal Government and for regulators.

Large banks do have the economy of scale to be able to deal with additional compliance costs but smaller banks simply cannot compete. Instead of promoting healthy growth in the financial system, the rate of decline in community banks' market share has doubled since Dodd-Frank was enacted. For this reason, I introduced the Taylor Act of 2015, legislation that directs Federal regulators to consider the risk profile and business model of an institution promulgating regulations.

Regulations will be tailored in order to be able to limit compliance costs when the regulation is considered not necessary or appropriate for the institution. This piece of legislation which has the support of over 55 State banking and credit union associations is a crucial step toward limiting the regulatory burden for those banks and credit unions that are struggling to be able to operate in our Main Street communities because of the burdens placed on them by Dodd-Frank.

Mr. Zywicki, you had commented several times during your testimony about the destruction of the relationship between community banks and the customers that they were designed to serve. Can community banks survive in this new regulatory framework if they can no longer rely on that traditional banking relationship?

Mr. ZYWICKI. It is hard to see how and it isn't just that they are exiting the mortgage market, as I said, 64 percent of community banks said they have changed their mortgages because of Dodd-Frank, 15 percent said they completely exited or are considering exiting the market, and 70-plus percent have said that the cost and everything has changed the way that they do business.

I don't see how in the current regime they can possibly survive under that sort of regime, and I think it was perfectly summarized by the bank you reference which is that their customer now is the Federal Government, not their customers.

They are looking over their shoulder constantly rather than looking at the person across the desk from them and I think that is terrible. I will add one other thing, it is not just mortgages, it is also, according to the Kennedy study, agriculture loans.

These big banks aren't going out to rural communities and making agricultural loans and that sort of thing. These community banks serve an important function in the American banking ecosystem, a lot of consumers prefer it, and I think it is a shame that they are being competed out of the market not because they can't—because they just aren't allowed to compete on a fair footing because of the regulatory cost.

Mr. TIPTON. You just spoke to two things that are near and dear to my heart. I represent a rural district in Colorado, agricultural interests and small businesses. Are we inherently seeing, because of Dodd-Frank, small businesses, small banks literally now being almost forced into a position where they are going to have to be able to merge, be bought up by a larger institution and that the impacts that is obviously going to have in terms of that relationship?

Mr. ZYWICKI. That is obviously what we are seeing, that they are being forced to—they are either disappearing or being forced to

merge and it is an unbelievably ironic consequence of Dodd-Frank that the big banks are getting bigger. That we are getting more consolidation of the banking system when the whole idea was to get rid of too-big-to-fail. The big banks are getting bigger.

Mr. TIPTON. And so we are just codifying too-big-to-fail as we continue to pursue an overzealous regulatory regime that is impacting us at the local level.

I think it is important. Oftentimes, we talk about the rules, regulations, the laws that are passed, but what you are speaking to is something that I believe we need to be focusing on. These are the people at home. The Hopscotch Bakery in Pueblo, Colorado, is a very small bakery. The owner came to me and she said that the big issue for her was access to capital with a local community bank who wanted to be able to make the loan, but regulatorily was not going to be able to make that loan. Do we need to focus more on the outcome of the law and how it is impacting Americans?

Mr. ZYWICKI. Absolutely. And we hear those stories from all over the country.

Mr. TIPTON. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman, for holding this hearing today, and I want to thank all of you for being here.

I wanted to switch gears a little bit and discuss how the CFPB under Dodd-Frank has continued to expand its influence into areas where it has no authority. That is something even Director Cordray told me himself that the law doesn't address. Of course, I am talking about the auto industry. I am a car dealer. I am one of them. Okay.

So Mr. Zywicki, I would like to ask you about the CFPB settlement with Allied Financial in which CFPB got Allied to pay $98 million by accusing the company of discrimination against car buyers based on disparate impact statistics.

I have said this in previous hearings but I think it is worth repeating today, as a car dealer myself, the idea that I would charge different prices to my customers based on race, religion or the color of one's skin is offensive not only to me but to my industry. In fact, if I was doing that, I don't think I would be very successful.

So, it has been a year-and-a-half since the Allied settlement. Do you know if the CFPB has paid any of the $98 million to consumers whom the CFPB said were discriminated against?

Mr. ZYWICKI. Thank you, Congressman Williams, because I think this example of what they are doing with the auto dealers is one of the most egregious examples of regulatory empire building I have ever seen.

Dodd-Frank makes it very clear that they can't regulate auto dealers, and so instead what they have done is essentially strong-armed indirect auto lenders and they essentially forced them to become arms of the Federal Government to enforce this agenda. What is this agenda? It is an agenda that has been written about extensively which is sort of disparate impact on steroids.

There is an amazing study that the American Financial Services Association published by Marsha Courchane which uses as Bayesian Improved Surname Geocoding and whatever the term is

to try to identify the so called plaintiffs and it is a joke. It has no verifiability in doing it. They finally entered into this settlement for Allied under who knows what conditions and they don't have any real—they don't actually have any victims.

They have statistical victims. They have created this claim form that seems to be completely on the honor system where people don't have to prove they were overcharged, they don't have to prove anything, they can just write in and get some money.

And so maybe the CFPB is going to distribute money to people, but there is no indication that they are distributing to actual victims of discriminatory practices.

Mr. WILLIAMS. With that being said, in fact I had my staff pull up the form. This is it right here, that they would have discriminated buyers fill out. In my opinion, it is ripe for fraud, and you have agreed with me.

If you look at this form, it basically says if you took out a loan that Allied later financed in a certain period of time, the CFPB will assume you were discriminated against. I am in the business but I have bought two cars and financed them through Allied, so I wonder if I should fill this form out and send it in.

Now, Mr. Zywicki, in the interest of time, just a quick yes-or-no answer to the following question if you don't mind. Do you think the process the CFPB set up that we are talking about is designed to determine—

Chairman HENSARLING. Wait, I'm sorry, would the gentleman suspend and hold the clock? Apparently, we have one vote on the Floor, and might I suggest that the gentleman from South Carolina—have you voted on this?

Mr. MULVANEY. I have not.

Chairman HENSARLING. Perhaps we can avoid a recess if the gentleman from South Carolina and the gentleman from Maine would quickly go vote and return back to the committee room. Perhaps we can avoid a recess here.

I thank the gentleman for yielding, and we yield back to the gentleman from Texas.

Mr. WILLIAMS. Thank you, Mr. Chairman. Do you think the process we talked about is designed to determine whether borrowers were actually discriminated against?

Mr. ZYWICKI. No. I don't see that.

Mr. WILLIAMS. And what about the CFPB restitution form we just mentioned? Do you think it prevents fraud?

Mr. ZYWICKI. No. I don't see any indication it does.

Mr. WILLIAMS. And do you see anything that would indicate that the CFPB is even asking whether borrowers paid a higher interest rate than other loans?

Mr. ZYWICKI. I don't see that either.

Mr. WILLIAMS. Not on there. Mr. Calabria, for you. Under Section 1022 of Dodd-Frank, the CFPB was given a broad authority to exempt financial services providers from its rules based on asset size, volume, et cetera.

As you know, the CFPB has used this authority sparingly, often creating an exemption so small that it doesn't actually help those credit unions or community banks that are hurting because of overregulation. I am saying this really quick because I am working on

a proposal that would exempt community banks and credit unions under $10 billion in assets from CFPB rules, going forward.

Effectively, it turns the exemption on its head and forces the CFPB to consider the impact on smaller financial institutions and make an affirmative finding that community banks and credit unions are indeed the intended targets of these rules. So, my question to you is this, do you think Section 1022 B of the law is clear?

Mr. CALABRIA. Absolutely. Yes.

Mr. WILLIAMS. Thank you. And shouldn't the CFPB be doing analysis and affirm that smaller financial institutions actually need or don't need to be included in the rules they are writing?

Mr. CALABRIA. Yes. I think they would be better allocating their resources on larger entities.

Mr. WILLIAMS. Mr. Chairman, I yield back. Thank you very much.

Chairman HENSARLING. Sorry, the gentleman yields back, since we are trying to kill a little time here before the other gentlemen return from the House Floor. At this time, we yield to the gentleman from Kentucky, Mr. Barr, whom I trust will take his full 5 minutes.

Mr. BARR. Yes, Mr. Chairman, I would like to take even more with this great panel. But I appreciate the recognition, and I thank the panel for your testimony.

This has been a fascinating hearing as we examine the impact of the Dodd-Frank law 5 years since its enactment. And let me start with Professor Zywicki. I am particularly concerned about the impact that the Consumer Financial Protection Bureau is having on access to consumer credit. For many of my constituents in central and eastern Kentucky, and I too have heard that, the unfortunate stories of creditworthy borrowers who are no longer able to access a mortgage or get a credit card or an auto loan or maybe short term credit.

The example that you gave about the gentleman who needs a $500 transmission change just to get to work but no longer has access to short-term credit or a payday loan really does have a negative impact not just on the broader economy but on these families. And it is really sad.

But let me ask you a follow-up to Chairman Neugebauer's proposal, which was a proposal to reform the Bureau to a commission structure, a bipartisan commission structure. I also have a reform bill called the Taking Account of Bureaucrats' Spending Act (TABS).

This would place the Bureau under the appropriations process like many other regulators in the Federal Government. What impact would that have in terms of effectuating the Congress' power of the purse in holding the Bureau accountable?

Mr. ZYWICKI. I think that would definitely increase the responsiveness and the ability of the CFPB to do its job. Which is, too much independence, just bureaucrats left to their own devices, do their thing, right? What we have learned over time is that checks and balances actually work, that Congress' role in being able to control the power of the purse and actually supervise with some strength over executive agencies, makes the agencies better for the consumers.

Mr. BARR. Now, let me ask you an out-of-the-box question because we have these reform ideas that are actually consistent with the original design of the Bureau. But I was interested in your testimony and your former service at the Federal Trade Commission and its focus on the mission of promoting competition and choice as a core of consumer protection.

My question to you is, would it be something that you would entertain as a positive idea to actually fold into the mission of the Federal Trade Commission the functions of the Bureau, if the Bureau continues to fail the American people?

Mr. ZYWICKI. I agree completely, which is I actually agree with the idea of having one agency that would regulate consumer credit.

I don't think the old system did work. I thought we could have just given it to the FTC, if we don't, we should model it after the FTC, and I have written a long law review article where I urge exactly what you are suggesting, Congressman Barr, which is combining a mission of competition and consumer protection and understand the consumer's benefits not just from consumer protection narrowly defined but also from innovation, competition, choice, lower prices and all those sort of things.

Mr. BARR. I want to read your law review article because I totally agree that competition, choice, and innovation is the best consumer protection.

Let me turn to Mr. Atkins, and I appreciate your service and your expertise. Secretary Lew testified in front of this committee a few weeks ago and we talked about changes in the capital markets after Dodd-Frank. Some of the illiquidity that we are seeing in the fixed-income markets as a result of the Volcker Rule in particular—and I appreciate your testimony about the concerns you have with the Volcker Rule, especially since proprietary trading really wasn't the cause of the financial crisis.

My question to you is, when Secretary Lew was asked about illiquidity, he disclaimed responsibility from regulations in Volcker, and his answer was that he thought changes in market structure were to blame for the liquidity problems. And Dr. Calabria, I think you mentioned that there could be some changes in fixed-income market structure.

And he also mentioned high frequency trading. My question to you is, could you comment on Secretary Lew's refusal to assign any blame whatsoever to Volcker and other regulatory pressures?

Mr. ATKINS. I don't know exactly what he said then, but to ascribe everything to market structure changes, or you know, some people have said to increased transparency in the market has led to that, I think that is not accurate. I think you have to lay blame at the Volcker Rule because basically, you have to have people trading in the markets to set price.

Mr. BARR. As I mentioned, the Volcker Rule is forcing banks to divest of AAA paper that hasn't defaulted in 20 years, and there was really not much response from the Secretary on that.

Finally, let me conclude with Dr. Calabria, we talked about consolidation and SIFI designation in OLA, and this new safety net as contributing as opposed to detracting from too-big-to-fail. Can you comment on what—those factors, is Dodd-Frank, the cause of these large six megabanks, Wall Street banks getting bigger? And I un-

derstand economies of scale and the need for large institutions to service complex customers, but could you briefly comment on that?

Mr. CALABRIA. Let me say, rather than cause, I think it is best to think of that as a contributor.

Mr. BARR. Yes, thank you. I yield back.

Chairman HENSARLING. The Chair wishes to inform Members that the Chair did not know there were two votes on the Floor as opposed to one. I am going to yield to the gentleman from New Hampshire, Mr. Guinta for 5 minutes, at which point he will recess the hearing until after the completion of the second vote.

Again, we appreciate the indulgence and patience of the panel. The Chair recognizes the gentleman from New Hampshire.

Mr. GUINTA [presiding]. Thank you, Mr. Chairman, and thank you for your indulgence relative to our voting schedule this afternoon.

I first want to thank the panel for being here. It is clear to me and there has certainly been debate about this, but I have clearly seen the harmful effects of Dodd-Frank and the effects that it has had on community financial institutions, and most importantly, those consumers and users of those products.

The Mercatus Center of George Mason University recently released a paper, actually back in February 2014, which showed that small bank have eliminated or are planning to discontinue certain products or services as a result of Dodd-Frank, that is indisputable fact.

Nearly 64 percent of the banks surveyed anticipate making changes to the nature or assortment and volume of mortgage products and services as a result of this new regulatory action. The study also showed that roughly 10 percent anticipate discontinuing residential mortgages due to Dodd-Frank. And approximately 5 percent have already done so. Residential mortgages or mortgage servicing, home equity lines, credit, and overdraft protection are among the most likely products and services to be cut.

In New Hampshire, where I represent, we have about 30 community banks that offer a wide array of products and services to Granite Staters. However, due to severe regulations, I continue to hear from my community banks that they have had to limit products. They have had to limit loans and services to my constituents, to their customers and consumers. I personally do not see that as a favorable response to Dodd-Frank; maybe others disagree.

But I wanted to ask Professor Zywicki, would you agree that consumer choice in products and services is important for overall well-being for consumers? Or do you think that more choice in products and services harms those very consumers?

Mr. ZYWICKI. I think—

Mr. GUINTA. It's a very simple and straightforward question.

Mr. ZYWICKI. I think American families are a much better judge of what financial products are appropriate for their lives than Washington bureaucrats. And I think that consumers unquestionably benefit when they get to choose the institution or the products that they think will make them better off.

Mr. GUINTA. Do you think that Dodd-Frank regulatory changes negatively affected community financial institutions' ability to offer

products and services to consumers more than it affected larger institutions?

Mr. ZYWICKI. Absolutely. Yes, as we have mentioned, we do see community banks shrinking, we see community banks retrenching in the products that they are offering. Some leaving very important—completely leaving very important market such as mortgages, simply because they can't deal with the regulatory costs associated with Dodd-Frank.

Mr. GUINTA. And since Dodd-Frank has been implemented, has consumer choice increased or decreased in products or services?

Mr. ZYWICKI. Consumer choices unquestionably decreased, and I must disagree with the Congressman from Massachusetts, Congressman Capuano, who started to ridicule the idea that consumers are now paying—the consumers who have lost access to free checking are paying higher bank fees.

We are talking about a million people who lost bank accounts because now they have to pay for bank accounts that used to be free. Those are the poorest, the most vulnerable Americans who were thrown out of the banking system because they couldn't afford to pay the higher accounts.

And whether it is higher rates on credit, less access to credit cards, less access to mortgages, or less access to home equity loans, across-the-board, we have seen consumer choice restricted and prices have gone up and consumers have been made worse off as a result.

Mr. GUINTA. The gentleman from Massachusetts and I have similar districts in terms of some of the characterizations and categories of people we represent. I am from Manchester, New Hampshire, the State's largest City. I used to be mayor—110,000, 115,000 people, average median income, family income about $54,000.

You go to the south end of Manchester, and you ask somebody, are they happy by paying $5 to $10 per month for the privilege of banking with their institution that they had banked with for the last 15 years, they would say arguably, no. But it is not just that issue, and this is where I think we have differences of opinion amongst the panel and the members of this committee.

I look at cost of living, I look at the cost of groceries, I look at the cost of home heating oil. I look at the cost to do banking. I add those up, and I look to the people I represent who are struggling in this economy. It was mentioned that there is a 5.3 percent unemployment rate, that is true. But the average weekly wage in this country has not increased dramatically from 2008 to today—and I see my time has expired. I would like to recognize Mr. Mulvaney for 5 minutes.

Mr. MULVANEY. Do you want to go vote?

Mr. GUINTA. Yes.

Mr. MULVANEY. Okay. Do you want me to sit over there or are you going to do that?

Mr. GUINTA. I would invite you to take over as the Chair.

Mr. MULVANEY [presiding]. Okay. Gentlemen, thank you very much, and I recognize myself for 5 minutes.

Thank you for doing this, I know it has been a long day, and I know at least some of you been here enough to know how this

works. But for those of you who have not done—I consider how often you have been here before. We mean no disrespect by our coming and going, I can promise you that. And the questions that you get at the end, I hope are just as important as the questions you get at the beginning, since Mr. Emmer and I are the ones asking them at the end.

I wish Mr. Meeks was here because he said something earlier today that caught my attention about stability and about how he was pleased with stability in the financial services markets since Dodd-Frank went into place.

That sort of got my attention, because stability can be a really good thing, and then too much stability can be a problem. The banks in Greece today are really, really stable because they are closed. And my guess is they won't be nearly as stable next week if they open again, but stability for the sake of stability is not necessarily a good thing but it is certainly something to pursue.

And with that in mind, Dr. Calabria, you and I have talked in the past about other ways to get to stability, that if the goal of Dodd-Frank was to bring stability to the market to make sure banks could not fail or weren't too-big-to-fail, or all the rhetoric we have heard, there are other ways to do that, which might be much, much simpler. And that would be to simply require banks to hold a higher level of capital. Would you like to talk to about that for a few minutes, sir?

Mr. CALABRIA. Absolutely. I think we can have at the same time stronger regulation that is simpler regulation. And capital certainly is very much the regard—earlier, some comments were made about the Basel system of capital, and I would actually suggest that the United States just pull out. I think Basel has been a disaster, and the complexity does not work very well.

I will note for the committee that for instance, probably Citibank, the most troubled bank during the crisis, its tier one risk-weighted capital never fell below 8 percent during the crisis. So that tells you that either something is wrong with our system of capital or maybe we didn't need the TARP and all these things anyhow, or both rather.

So I do think we need a simpler system and I think simpler does not mean weaker. I think that simpler could be stronger. And I do think we can get rid of a lot of the unnecessary costly regulations while actually having regulations that make us stronger.

Mr. MULVANEY. There were things that discussed with one of your predecessors of Cato was this concept of the simpler system that will require a much higher level of capital. You can opt in or out. If you wanted to operate as a traditional bank, you wanted to have proprietary training, you wanted to do all the things that the Goldman Sachs of the world do. And if you want to maintain your 6 or 10 percent capital, that is fine. And that option might be available to you.

But if you wanted to be a community bank, and you didn't want to deal with derivatives and interconnectivity, all you wanted to do was lend money so people in your neighborhood could buy cars and houses, maybe there could be a different system that would be set up for you at a higher level of capital. Do you have any thoughts as to what that level might be?

Mr. CALABRIA. So, and again, I would emphasize the need—I think that first of all it cannot be something that is risk-weighted, because I think that minimizes the transparency, it has to be a pure simple leverage ratio. I think something in the neighborhood at 15, 17 percent is something that will get you a tremendous amount of stability.

I will emphasize in my opinion the tradeoff should not simply be—you hold 15, 17 and you get out of Dodd-Frank, it needs to be broader than that. I think there is a tremendous amount of costly regulations that predate Dodd-Frank—

Mr. MULVANEY. But there are certain things that immediately will become surplusage if I had 15 percent capital, right? Such as what?

Mr. CALABRIA. Absolutely. Some of the examination process, certainly, you want to make sure the capital is real, but I do think you can give some differences for institutions in terms of safety and soundness prudential regulations because ultimately what we want to have is that the bank's owners have their money at risk. And I think that is what we want to substitute for.

Mr. MULVANEY. Fair enough. Mr. Silvers, I am going to take advantage of the fact that I am here and nobody else is, which is a lot of fun. What do you think of that? It is probably the first you have heard of it. What are your thoughts? And again, I am committing a cardinal sin here, I am asking a question that I don't know the answer to. But I would be curious to know what the Democrat witness thinks of, basically that kind of idea. I'm not asking you to support it or oppose it, I'm just curious as to your thoughts.

Mr. SILVERS. Congressman Mulvaney, I have heard similar ideas, but I haven't heard Dr. Calabria's version. I think that in general, the basic notion that a straight capital test, that is not risk-weighted, it is a very important and good idea. It is a real problem in the Basel system that they keep going—that they keep going back to risk-weighted capital tests that allow for game playing in various ways. And that when you look at the straight capital test, it is very low.

Mr. MULVANEY. And for lay people, which includes me, the risk weighting bias might for example encourage banks to hold sovereign debt versus corporate, is that right?

Mr. SILVERS. It could encourage any number of things you might not want to encourage.

Mr. MULVANEY. Okay.

Mr. SILVERS. And it presumes something that—it has turned out not to be true over and over again which is that those particular regulators are good at picking what is risky and what isn't.

The question of whether or not you could do that with community—it is a kind of—you have heard me before talk about Glass-Steagall—you are proposing a kind of Glass-Steagall. Meaning that you are proposing a different set of regulations and a different set of capital requirements depending on whether banks are active in the securities markets, derivatives markets, and various other exotic things.

So I am inherently sympathetic to that. The caveat I would offer to you is this, during the subprime bubble, a lot of the loans that were made were actually not made by the banks that were financ-

ing them. They were made by smaller institutions, generally nonbanks that were conduits.

The main issue with a different regime for small banks is that question, are they going to be conduits for big things, that are going to move through without reference to capital. And thereby be vehicles for—what I would be concerned about is vehicles for exploiting consumers in various ways as turned out during the subprime crisis. That is the kind of thing you have to watch out for in these types of ideas.

The notion that we should have banks to do the business of providing credit to businesses and consumers, and banks that play in secondary markets and they should have different rules perhaps different capital requirements, and that it should matter what the size is, I agree with all of that.

Mr. MULVANEY. That is interesting. I wish you were here yesterday. We just had a hearing on the SIFI designation of bright-line rule of $50 billion, and it would have been interesting to have that insight.

Mr. SILVERS. If you don't mind, I would be happy to say something about that. A lot of the discussion about SIFIs it seems to me, you really don't want—you want the ability to look at what—what firms are actually doing. So that for example, the discussion that all mutual funds are not systemically significant doesn't match what happened in 2008.

It is very clear that money market mutual funds are systemically significant. The same thing is true with insurance companies. If you have a pure life insurance company, the odds that it is going to be systemically significant may not be very great, but on the other hand, if you have an entity on the side here that is dealing in derivatives very extensively, that is a subsidiary of an insurance holding company which was AIG, that can be a very, very dangerous thing, as we learned.

The $50 billion—in my view, the $50 billion test is—it is certainly the case that institutions that have more than 50—that have $50 billion in assets can, depending on what they are doing could be systemically significant.

Mr. MULVANEY. But the simple fact they are $50 billion doesn't make them so.

Mr. SILVERS. I am not convinced that is the right number, but I will tell you this, I am definitely convinced that saying that by definition mutual funds are or insurance companies are not systemically significant, that is a mistake.

Mr. MULVANEY. Gentlemen, just to show you who actually runs the place, I am the only Member of Congress here and I am being told by staff on both sides that I have to stop now.

And I will respect it because it comes from the Democrat staff—if it was coming from these folks I would ignore them. But I will close by saying this. Dr. Calabria and Mr. Silvers, the other gentleman, I am sorry I didn't get a chance to ask you gentlemen the same question because I would be curious to know what your thoughts are.

But Mr. Hill, Mr. Schweikert, and I have a bill that at least starts to try and begin a conversation about an alternative banking

system, something that would operate outside of Dodd-Frank and be different for different types of banks, smaller, simpler banks.

And don't be surprised if you get something from our offices in the next couple of days to ask you to weigh in on that because I am very curious to know what a lot of folks think about it. So I appreciate your time.

With that, we are going to recess for a few minutes. The second vote has not started yet. So my guess is as soon as the second vote starts, you will see people starting to trickle back in. I cannot imagine we will be in recess longer than 10 minutes.

So if you gentlemen would like to take a break, this is a really good time, and we will stay in recess for approximately—until, let's call it 2:00. Thanks, gentlemen.

[recess]

Chairman HENSARLING. The hearing will come to order.

I recognize the gentleman from Minnesota, Mr. Emmer.

Mr. EMMER. Thank you, Mr. Chairman, and thanks to the panel for your patience in being here. In the short time, there are just a couple of areas I want to cover which have been covered in some respects today.

But I just want to make it clear because I have some things from my district that I want to share with you. Why don't we do—Mr. Zywicki if you would, I think others have already given this testimony but could you just confirm? Do you believe that Dodd-Frank is actually harming the ability of financial institutions to make loans and offer credit to people in businesses?

Mr. ZYWICKI. Absolutely, yes.

Mr. EMMER. And does this include minority-owned businesses?

Mr. ZYWICKI. Yes.

Mr. EMMER. In fact, would you agree that Dodd-Frank is having a disproportionately negative impact on Americans of modest means in minority communities?

Mr. ZYWICKI. Absolutely. And we see that especially with the disappearance of free checking. Upper-middle-class people, for instance, haven't really noticed that. But it is low-income people who are the ones who can't afford these fees, who can't afford the higher minimum monthly balances to be able to get free checking.

They are the ones who are losing it. It is also these same people who have lost access to credit cards over the past years. It is the same people who can't get access to mortgages. Disproportionately, it is lower income people who are bearing the brunt of Dodd-Frank.

Mr. EMMER. I am going to quote, there are a couple of CEOs—the Goldman Sachs CEO has said, "More intense regulatory and technology requirements have raised the barriers to entry higher than at any other time in modern history. This is an expensive business to be in if you don't have the market share in scale. Consider the numbers of business exits that have been announced by our peers as they reassessed their competitive position and relative returns."

And then JPMorgan Chase's CEO has referred to the post-crisis regulatory regime as creating a "bigger moat that protects his bank and other too-big-to-fail firms from competition by new entrance in small firms that cannot internalize the cost of the Dodd-Frank regulatory requirement."

Dr. Calabria, we have met, I apologize for butchering your name. Do you agree with these CEOs?

Mr. CALABRIA. First of all, I think the evidence is pretty clear that concentration has increased and I think this always has to be a concern, so on one hand, regulation always bears a little heavier on smaller institutions.

But I think it is also important to keep in mind that a lot of these regulations are essentially intended to be barriers to entry. And so, I do think we have to ask the question, are the institutions that are essentially kept out of the market—the good or the bad players. So I do think that—I guess, I should emphasize too, you will know coming from Econ 101, you reduce competition, you have to end up having higher prices for consumers.

Mr. EMMER. Right. And basically, what they are telling us is that the bigger guys are able to survive; it is the smaller ones who are taking on these increased costs created by this extreme regulatory environment are suffering.

And I am going to give you a couple for the record. In my district, this is from a banker who will remain anonymous, "We are a small community bank with three locations, compliance has always been a cost. This is just a part of our business.

"However, since Dodd-Frank this cost has expanded greatly. For example, within the last year, we had to hire a full-time compliance director at a cost of $60,000 plus benefits, and this is in addition to training two outside compliance firms, one assists our staff with deposit compliance and one with the loan compliance at an annual cost of about $40,000 per year.

"In addition to this, we have several members of our staff whose jobs have changed, so that instead spending time on revenue-generating activities, they are spending time on compliance. Unfortunately, since there is no offsetting revenue for this expanding cost, we are forced to consider passing the cost on to our customers with additional fees."

It is also changing the way they do business. And the credit that they can offer to start-up businesses and consumers who are trying to buy their first home or buy an automobile.

In my last couple of seconds, Dr. Calabria, again, the Office of Financial Research and the Financial Stability Oversight Council are funded through assessments on bank holding companies. Effectively, this means that Congress has no appropriation mechanism to perform necessary oversight over these agencies. Do you think it would be wise for Congress to have more oversight of OFR and FSOC?

Mr. CALABRIA. Absolutely. I am of the opinion that every single Federal agency out there should be part of the appropriations process.

Mr. EMMER. Anybody disagree? Mr. Atkins?

Mr. ATKINS. Not at all. I agree with you 100 percent.

Mr. EMMER. All right. I see my time has expired. I yield back, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. Currently, there are no other Members remaining in the queue, thus, I would like to thank our witnesses for your testimony today.

And again, I thank you for your patience with the schedule of Floor votes today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing stands adjourned.

[Whereupon, at 2:15 p.m., the hearing was adjourned.]

A P P E N D I X

July 9, 2015

STATEMENT FOR THE RECORD

CONGRESSWOMAN JOYCE BEATTY (OH-03)

The House Financial Services Committee

Full Committee Hearing on
"The Dodd-Frank Act Five Years Later: Are We More Stable?"

July 9, 2015

Thank you, Mr. Chairman, and Ranking Member Waters.

Thank you witnesses for being here today.

Later this month, I along with many of my colleagues will commemorate the 5th anniversary of the enactment of the most sweeping financial regulatory reform in the United States since the 1930s – the Dodd-Frank Wall Street Reform and Consumer Protection Act – signed into law by President Obama on July 21, 2010.

This legislation, revered by many on one hand, and criticized by many on the other, is a monumental law that has affected almost every segment of both: (1) the financial markets and its participants in how risk and reward is perceived, and (2) how market participants interact with regulators and the market itself.

Enacted in response to the twin crises in housing and finance between 2007 and 2009, the Dodd-Frank Act was designed to improve stability in the financial markets, eliminate taxpayer-funded bailouts, end the concept of "too-big-to-fail," and protect American consumers from predatory financial practices.

In fact, since Dodd-Frank's passage in July 2010, the overall American economy has experienced vast improvement in private sector jobs with nearly 12 million added, a lower unemployment rate, down to 5.3 percent from the peak of 10.0 percent in October 2009, and a recovering housing market.

However, like all comprehensive reform bills, Dodd-Frank is not perfect.

There are a few areas that I think that can be improved.

Nonetheless, I think that we cannot let the perfect be the enemy of the good.

And we, on the Financial Services Committee have a responsibility to improve this legislation when needed.

One area of concern for many stakeholders in my district and across the country is the manner in which Dodd-Frank requires the Federal Reserve to subject bank holding companies with more than $50 billion in consolidated assets to enhanced regulatory supervision.

For the record, I fully believe that the enhanced supervision mandated by Dodd-Frank is warranted for the largest bank holding companies.

If we are going to subject smaller, regional bank holding companies to the same or similar supervisory requirements, then we should do so in a way that balances our nation's financial stability without placing excessive burdens on non-systemically important institutions.

Right now, I don't think Dodd-Frank strikes that balance.

That is why, last Congress, I introduced legislation that would change the designation of bank holding companies as systemically important from a simple asset-size test, to a more deliberative assets-and-activities-based test and this Congress, I cosponsored legislation that focuses on internationally accepted standards that more accurately measured systemic importance – scope, size, scale, concentrations and interconnectedness.

This is at the top of my priority list for change.

While change is not always welcome, I believe it will ensure proper oversight and consumer protections.

One other area of concern lays in the development of diversity assessment standards under Section 342 of Dodd-Frank.

Due to misinterpretations of congressional intent, I am concerned that almost five years after the Dodd-Frank Act was enacted, Section 342, which established the Office of Women and Inclusion for the six federal financial regulators, has not made the disclosure of diversity data mandatory for financial institutions, which would provide much needed transparency to this industry regarding the promotion of diversity in its workplace.

Finally, I support the Consumer Financial Protection Bureau and the crucial role it has played in protecting consumers from unscrupulous actors in the financial system, but I have a watchful eye on its needing improvement in diversity and assuring it is an environment that creates a level playing field for consumers and its employees

I applaud the achievements of the Dodd-Frank Act over the last five years and look forward to working with my colleagues to find the appropriate tweaks and fixes to further facilitate its smooth

implementation and positive lasting effect on the financial markets and American consumers.

Testimony of

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Before the

United States House of Representatives
Committee on Financial Services

"The Dodd-Frank Act Five Years Later: Are We More Stable?"

9 July 2015

Good morning. Thank you very much, Mr. Chairman, Ranking Member Waters, and Members of the Committee, for inviting me to appear today at your hearing.

I am Paul Atkins, CEO of Patomak Global Partners. For six years ending in 2008, I served as a commissioner of the U.S. Securities and Exchange Commission (SEC), and from 2009 to 2010, I was a member of the Congressional Oversight Panel for TARP, where I had the pleasure of serving with the Chairman. I am testifying this morning on my own behalf.

* * *

As you all know, the Dodd-Frank Act is now almost five years old. Given the breadth of the Act, which is 2,319 pages long and contains demands for more than 500 new rules and studies, one could write a book about the various problems with the statutory text and implementation. Given my background, I am going to focus my remarks mostly on the impact of the Dodd-Frank Act on the U.S. capital markets. I want to focus specifically on five aspects of the Act: (1) the FSOC and the SIFI designation process, (2) the standard of care for broker-dealers and investment advisers, (3) the Volcker Rule and the impact on bond market liquidity, (4) the lack of coordination in implementing Title VII, and (5) the grab-bag of public company disclosure provisions contained in Titles IX and XV.

Title I: Financial Stability

I want to begin by focusing on what I view as the single largest problem of the Act—Title I, which is entitled "Financial Stability." This is the leitmotif of the Dodd-Frank Act. To help achieve the goal of financial stability, the Act established the Financial Stability Oversight Council (FSOC), which is a non-transparent, not-well-known group consisting of the heads of nine financial services regulatory agencies plus one insurance regulatory expert appointed specifically for this task by the president, as well as five non-voting members.

This gaggle of regulators has substantial power to drive the regulatory agenda at its member agencies like the SEC. It has little accountability to Congress or to the American people. It has broad power to gather information and then is supposed to think deep thoughts, peer into its crystal ball, identify bubbles, and then prick them before they grow.

The conceit of the authors of the Dodd-Frank Act, which is carried on to this day, is that if you get enough smart people in a room with enough data, they can bring stability to the marketplace. But, just as human beings cannot be counted on to be predictable and stable, those of us who have spent a lifetime engaged with the capital markets know that they also are not always stable—because human beings ultimately make up markets. At its base, a market needs a willing buyer and a willing seller. But, we all know that people from time to time are motivated by all sorts of virtues, including enlightened self-interest as Adam Smith noted, as well as vices, such as anger, greed, envy, fear, pride, and just

plain passion. To suggest that the government can control human action is naïve, egotistical, and simply wishful thinking.

In his last book, *The Fatal Conceit: The Errors of Socialism*, Friedrich Hayek, the Austrian-born economist, labels as the "fatal conceit" the idea that "man is able to shape the world around him according to his wishes."[1] Hayek argues: "To act on the belief that we possess the knowledge and the power which enable us to shape the processes of society entirely to our liking, knowledge which in fact we do not possess, is likely to make us do much harm."[2]

But the Financial Stability Oversight Council is embarking on this very mission. It has the authority to designate entities within the financial services industry as "systemically important financial institutions," abbreviated S-I-F-I. The FSOC may also recommend regulatory action to other federal agencies for "activities and practices" that the FSOC deems to be potentially risky to financial stability.[3] Should the federal agency decide not to follow the FSOC's recommendation, it must submit its reasons in writing to the FSOC.

About two years ago, the FSOC, the Federal Reserve, the Department of the Treasury, and foreign regulatory groups started focusing on asset management, beginning with money market mutual funds and now implicating activities beyond that. Even though the SEC possesses the subject-matter expertise to address asset management, the FSOC has stepped in to try to force the SEC's hand.

What is the consequence of this determination that entities, activities, or practices are systemically risky? The FSOC is authorized to subject the designated firms to enhanced prudential supervision by the Federal Reserve and to recommend additional regulation for systemically important activities and practices, in the interest of promoting the safety and soundness of the U.S. financial system.

Once under the Federal Reserve's regulatory umbrella, systemically important firms can expect to be subjected to bank-like capital requirements. Where in the asset management industry would one impose capital requirements? On a fund or separate account? That's investor money. On the adviser? But, the adviser acts only as agent for its clients—imposing capital requirements on the adviser seems to imply that the adviser is somehow a guarantor of market investments. What if the FSOC instead designates asset management as a "systemically important" activity? If the activity is the issue, rather than an institution, then size does not matter. There is no limiting factor. Moreover, in what form would this capital requirement or other regulation take shape? Withdrawal fees? Redemption gates? The Federal Reserve having the ability to dictate what securities can be bought and sold in times of financial distress? These scenarios indicate that the science fiction aspect of SIFI treatment may be a 21st century reality.

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[1] Friedrich Hayek, The Fatal Conceit: The Errors of Socialism (W. W. Bartley III ed., 1988).
[2] *Id.*
[3] *See* 12 U.S.C. § 5330 (2010) (Dodd-Frank Wall Street Reform and Consumer Protection Act § 120).

Therein lies the problem: Dodd-Frank's—and thus the Federal Reserve's—regulatory toolkit is drawn from bank supervisory requirements and practices. One cannot simply assume, however, that an enhanced supervisory structure designed to stabilize very large banks is equally well suited to other areas of the financial services industry with radically different structures and risk profiles. Indeed, given the considerable differences in how these other businesses are structured and operate, one should expect that applying the same regulatory standards would yield at least some unexpected and undesirable outcomes. I want to stress that that fact is just as true if you are a proponent of the various initiatives taken in the Dodd-Frank Act as if—like me—you are not.

There is simply nothing in the Federal Reserve's 100-year history that even begins to suggest that applying prudential standards to capital market participants would be a benefit—or that the Federal Reserve would in any sense be an effective capital markets regulator. It is just not what the Federal Reserve does. Further, there is nothing in the 70-plus year history of asset management regulation that suggests that such Federal Reserve oversight is necessary or appropriate.

And what could the individual investor saving for retirement reap from this situation? First, higher costs and lower returns. Were the Federal Reserve to impose capital requirements on SIFI-designated funds or advisers, or were the FSOC to recommend additional regulation for investment activities that have been designated systemically risky, investors—ordinary individual investors who are saving for retirement through their 401(k) plan or for a down payment—would have to pony up. The same would be true as to any fees imposed, just as it would if funds were to seek to raise capital some other way. Likewise, if capital requirements were imposed on investment advisers, investors would ultimately pay in the form of higher fees or decreased choice. Further, if *any* systemically designated firm—including in industries not related to asset management—were to fail, designated asset management firms or their funds would be assessed the costs of that entity's rescue.[4] In other words, ordinary savers—Main Street investors—would pay to bail out failing banks. Was not that precisely what Dodd-Frank was designed to prevent?

Most worrisome to me is that the Federal Reserve could constrain investors' ability to redeem their investments upon request. For example, if the Federal Reserve deemed the redemption right in mutual funds that investors have had for over 70 years to somehow be systemically risky, it could impose a delay on the effectiveness of an investor's redemption decision or elect to require fund managers to remain in positions they would otherwise have elected to exit. It could instruct asset managers that they should not dispose of a particular kind of security, despite the judgment of the adviser that it is its fiduciary duty to sell, or despite the wishes of the client to sell.

The basic message is: Take one for the team. If you think that this is far-fetched, look at the TARP program, with which I am all too familiar, in which the government

[4] *See* 12 U.S.C. § 5390 (2010) (Dodd-Frank Act § 210).

demanded that good banks take the TARP funds so as not to call out the bad banks and raise the prospect of a run. That, after all, is the bank regulator's prudential model of favoring safety and soundness of the banking system over investors' interests. It is also one reason the authors and supporters of Dodd-Frank created the Bureau of Consumer Financial Protection: because they believed that the safety and soundness mission of the bank regulators too often ignored consumers' interests. Whether or not that was the situation, in this case it would be the average American investor who is taking the hit: the pensioner hoping to have investments like a 401(k) plan supplement Social Security in a zero-interest rate environment (which has devastated savers and many investors in fixed income securities) and other investors putting hard-earned money aside for a rainy day, college tuition, or a new house. So, why should any of you—proponents or detractors of Dodd-Frank—support this latest initiative of the Federal Reserve and FSOC?

Moreover, regardless of fund or investor interests, SIFI-fund managers could be forced to finance banks or other counterparties, to remain exposed to particular markets, to avoid exposure to specified issuers, or to hold excess cash or cash equivalents. What would this do to risk management or even to liquidity in the market? How would market participants price this uncertainty regarding the potential disposition of securities? If anything, this uncertainty would make markets more unstable and much more unfair for the average investor in troublesome times. All of this would be novel and none of it would provide any advantage to the fund's investors. To the Federal Reserve's end game, however, it might at least stabilize the banking system.

To date, the FSOC has designated four non-bank financial companies and eight financial market utilities as SIFIs, subjecting them to the Federal Reserve's prudential supervision. Implicit in these designations, as well as in the statutory authority from which they stem, is a theory that large financial companies share characteristics that would make the Federal Reserve's prudential supervision and capital adequacy requirements a helpful and effective regulatory approach.

The trouble with that theory is that non-bank financial companies and banks are, in fact, fundamentally different from each other. Just listen to the pointed comments made by the FSOC's two insurance experts in dissenting from the FSOC's designation of MetLife as a SIFI.

The voting insurance expert, Roy Woodall, slammed the FSOC's basis for designating MetLife a SIFI, stating that the FSOC "relies on implausible, contrived scenarios as well as failures to appreciate fundamental aspects of insurance and annuity products," and, ultimately, "concludes that the origin of the company's systemic risk would stem from a sudden and unforeseen insolvency of unprecedented scale, of unexplained causation, and without effective regulatory responses or safeguards."[5]

[5] Roy Woodall, Views of the Council's Independent Member Having Insurance Expertise (Dec. 18, 2014), http://www.treasury.gov/initiatives/fsoc/designations/Documents/Dissenting%20and%20Minority%20Views.pdf.

The non-voting insurance expert, Adam Hamm, similarly criticized the FSOC's basis for designation. He said: "Identifying outer boundaries of exposures and claiming they could impact a nebulously defined market is not robust analysis; it simply means the [FSOC] has identified a very large company."[6] All in all, the two insurance experts call out the speculation and feeble analysis conducted by the FSOC in its designation process. It certainly seems as though the FSOC had a predetermined outcome in mind, before the matter was brought to a vote. As Mr. Hamm stated in his dissent: "Saying it does not make it so."[7]

Indeed, MetLife has sued the FSOC to contest its designation—the first SIFI to do so. If FSOC's cavalier treatment of the insurance industry is any precedent, we should all be extremely concerned that equally misguided and uninformed treatment of the asset management industry is soon to follow.

The FSOC is not the only actor in this space. An even less transparent, non-accountable group of regulators is the Financial Stability Board. A creature of no statute or treaty, it is a club of regulators that claims its remit from the meetings of the heads of state of the G-20. Through its meetings and policy pronouncements, it evidently drives policy decisions in the United States.

Contemporaneously with these events in the United States, the FSB has been studying the asset management industry. It issued a consultation on potentially systemically significant mutual funds,[8] and the only mutual funds that met the materiality threshold in the consultation were American—Europe's historic policy of favoring the banking sector over the capital markets means that it does not have such markets to the same scale as in the United States.

There is no transparency or accountability with respect to official American participation in the FSB process—these meetings and activities are closed. In fact, an American governor of the Federal Reserve sits on the FSB and even chairs its working group that is focused on the asset management industry. From my experience with bodies of international regulators and their inherent emphasis on achieving "consensus," there is no way that the FSB would be doing any of this activity—especially calling out American firms and practices—without the acquiescence of the Federal Reserve, especially of the chief American representative to the FSB.

Thus, the widespread suspicion is that the Federal Reserve is using the FSB as a bootstrap to build a framework and momentum to accomplish through opaque, back-room processes what it may not be able to do alone in the United States. That pattern

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[6] Adam Hamm, View of Adam Hamm, the State Insurance Commissioner Representative (Dec. 18, 2014), http://www.treasury.gov/initiatives/fsoc/designations/Documents/Dissenting%20and%20Minority%20Views.pdf.

[7] *Id.*

[8] *See* Financial Stability Board & International Organization of Securities Commissions, Consultative Document: Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (Jan. 8, 2014), http://www.financialstabilityboard.org/wp-content/uploads/r_140108.pdf.

unfolded in the insurance area, with the FSB designating Prudential and MetLife as globally significant and the FSOC then pointing to that designation to justify in part its own designation process.

Last summer, in the face of bipartisan criticism from Congress, the FSOC announced that it was not looking to designate specific asset managers as systemically important, but rather looking at activities and products. But the FSB is still plowing ahead, and it recently took a big leap forward (or backward, depending on how you look at it) when it put out a new consultation that contemplated the potential SIFI designation of not just individual funds but also asset managers—and again, the only asset managers that met the materiality threshold were four American managers.[9] This, of course, raises serious competitive implications for the United States, just as the EU embarks on an initiative to try to encourage the growth of pan-European capital markets.

Yet, the FSB appears to continue on its mission single-mindedly, even though its consultation partner, the International Organization of Securities Commissions (IOSCO), has stated that it is moving away from designating asset managers as systemically important and that it hopes to exercise more influence over FSB policies on shadow banking and global asset managers.[10] The IOSCO Chairman has announced that he plans to conduct a comprehensive review of risks posed by asset managers' activities and products to assess whether they are systemic at all.[11] He also has stated explicitly, "[w]e don't regulate funds the way we regulate banks."[12]

The story of the attempted prudentialization of capital markets is not going away. Whether it be through designation of firms or activities or practices, the Dodd-Frank Act has set in motion a very dangerous train that is the search for financial stability. I fear that the U.S. capital markets, which have been the driver of economic growth and job creation in this country for decades, will be the collateral damage in the quest for "stability über alles."

Section 913 – Standard of Care for Broker-Dealers

Section 913 of the Dodd-Frank Act gave the SEC the authority to require a uniform fiduciary duty for investment advisers and broker-dealers and directed the SEC to study whether such a standard was needed.

Unsurprisingly, the resultant SEC study did indeed recommend the adoption of a new uniform standard of care. Then-SEC Commissioners Kathleen Casey and Troy Paredes correctly criticized the study for recommending "the adoption of a new uniform fiduciary duty standard . . . without adequate articulation or substantiation of the

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[9] *See* Financial Stability Board & International Organization of Securities Commissions, Second Consultative Document: Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (Mar. 4, 2015), http://www.financialstabilityboard.org/wp-content/uploads/2nd-Con-Doc-on-NBNI-G-SIFI-methodologies.pdf.
[10] *See* Huw Jones, UPDATE 2-Global Regulators Throw Spanner Into Planned Asset Manager Rules (June 17, 2015), http://www.reuters.com/article/2015/06/17/iosco-markets-review-idINL5N0Z32P620150617.
[11] *See id.*
[12] *Id.*

problems that would purportedly be addressed via that regulation."[13] They went on to state that the study did not "adequately recognize the risk that its recommendations could adversely impact investors."[14]

Now, more than four years after the Section 913 study was published, the SEC appears to be turning to a rulemaking in this area. As it does so, it should be mindful of the different needs of different investors. It is important to remember that not all investors are the same. Some investors want and perhaps need a fiduciary who possesses intimate knowledge of their financial condition and can advise accordingly. On the other hand, some investors would prefer to have a true broker who is engaged on a transaction basis and is compensated accordingly. These two kinds of activities logically should have different standards of care—and costs—attached to them.

While we do not know for certain when the SEC will act or what the regulations will entail, the Department of Labor (DOL) has already re-published a proposed rule that aims to increase the ambit of fiduciary duty within the context of ERISA plans. Unfortunately, despite claims to the contrary from the Secretary of Labor, the rulemaking does not seem to be coordinated with the SEC and it would have profound effects for the retirement plan market and the availability of product offerings. One need only look at what has happened in the United Kingdom to see the dangers of the DOL's rulemaking.

Since 2013, the United Kingdom's Financial Conduct Authority (FCA) has enforced rules to prohibit broker-dealers from receiving commission payments, thereby forcing all brokers to adopt fee-based compensation models.[15] According to a report commissioned by the FCA, from April 2013 until March 2014, 310,000 customers stopped being served by their brokers because their wealth was too small for the broker to advise profitably.[16] During the same period, brokers turned down an additional 60,000 applicant investors due to their low-balance accounts. The report found that some brokers have started accepting only customers with more than £50,000 (about $78,000) in savings, shutting out large numbers of lower- and middle-class investors.[17]

Supporters of the DOL's fiduciary rulemaking argue that the U.S. proposal will not suffer from the same pitfalls as the U.K rule due to the "best interest contract exemption," which theoretically allows brokers to continue receiving commissions if certain conditions are met. The compliance burdens required to qualify for the exemption, however, are almost prohibitively costly. Realistically, very few brokers will be able to receive commissions under the DOL's proposal. This would be a tragic outcome for millions of small savers. Under the fee-based model—in which advisers charge a fixed rate (say 1 percent) of a client's total assets—advisers often have little incentive to serve lower- and middle-income investors, as evidenced by the U.K.'s experience.

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[13] Kathleen L. Casey & Troy A. Paredes, Statement Regarding Study on Investment Advisers and Broker-Dealers (Jan. 21, 2011), https://www.sec.gov/news/speech/2011/spch012211klctap.htm.
[14] *Id.*
[15] *See* Eur. Econ., *Retail Distribution Review Post-Implementation Review* (Dec. 16, 2014), http://www.fca.org.uk/static/documents/research/rdr-post-implementation-review-europe-economics.pdf.
[16] *See id.*
[17] *See id.*

Unfortunately, the DOL and the Obama Administration seem intent on moving forward with a rulemaking regardless of the real potential for negative impacts on small investors. If, however, their goal is truly to serve lower- and middle-class investors, they should go back to the drawing board to develop a proposal that accomplishes their goal of protecting investors without preventing them from accessing the advice and products they need to save for retirement.

Section 619 – The Volcker Rule

At its core, the Volcker Rule is aimed at banning proprietary trading in commercial banks. And because it is easier to blame Wall Street and excessive risk-taking for the financial crisis than the federal government's housing policies, many have trumpeted the Volcker Rule as one of the most meaningful and significant reforms in the Dodd-Frank Act. That view, however, is contradicted by both former Treasury Secretary Tim Geithner as well as the provision's namesake, former Federal Reserve Chairman Paul Volcker. Then-Secretary Geithner stated that "most of the losses [in the crisis] did not come from [proprietary trading] activities [but from] classic extensions of credit."[18] Similarly, Chairman Volcker has stated that "proprietary trading in commercial banks was . . . not central" to the crisis.[19] Despite this, the Dodd-Frank Act gave us the Volcker Rule and consequently, 950 pages of additional regulations. Indeed, the Volcker Rule was sprung on the drafters of what became Dodd-Frank and, as with so many other provisions of Dodd-Frank, hardly any sort of substantive hearing was held to consider the specific language, the potential effects, or unintended consequences of the provision.

Unfortunately, not only did the Volcker provisions of Dodd-Frank fail to address a key part of the financial crisis, but the rule as implemented may have serious negative consequences for investors, job creators, and the U.S. economy. In fact, Mark Carney, the Governor of the Bank of England and the Chairman of the Financial Stability Board, warned that the Volcker Rule "could reduce global financial resilience rather than increase it."

One undisputed effect of the Volcker Rule has been a reduction in the corporate bond inventories of primary dealers. This reduction is the result of both a flawed statutory mandate and flawed implementation of that mandate, including a vague and unclear definition of "market making" that makes it more difficult for banks to act as market makers. The statute and implementing regulations turn regulators into amateur psychologists – a "Oui-Ja" board might prove most effective for bank examiners in determining intent under the rule. Since 2007, primary dealer inventories of corporate bonds have decreased 77 percent (from $235 billion to $53 billion),[20] even as the U.S.

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[18] Comm'r Daniel M. Gallagher, Remarks Before the U.S. Chamber Center for Capital Markets Competitiveness (Jan. 16, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1365171492034.

[19] Kim Dixon & Karey Wutowski, *Volcker: Proprietary trading not central to crisis*, Reuters, Mar. 30, 2010, http://www.reuters.com/article/2010/03/30/us-financial-regulation-volcker-idUSTRE62T56420100330.

[20] MarketAxess, *Primary Dealer Corporate Bond Inventory*, http://www.marketaxess.com/research/market-insights (last visited July 7, 2015).

market has increased 50 percent (from $5.3 trillion to nearly $8 trillion in outstanding debt) during the same time period.[21] These statistics have caused some to raise legitimate questions about bond market liquidity and volatility. Others, however, seem to be rushing to reach conclusions without actually identifying a problem.

Policymakers need to have some perspective on these issues. A rush to judgment is, after all, what led to many of the harmful provisions in the Dodd-Frank Act. For example, some people seem to be equating primary dealer inventories with lower liquidity. While those statistics may in fact be related, they are not the same thing. We simply do not know how the primary dealers will respond under this new regime in a time of stress. Thus, before embarking on the discussion of how to solve the coming "liquidity crisis," regulators and policymakers need to first establish the actual likelihood of a "liquidity crisis," and then if one exists, study the issue, define the problem, and tailor a solution for the fixed income markets as a whole.

One focus of the hand-wringing underway concerning bond markets seems to be the role that asset managers play in the markets. Aside from creating a narrative to allow the FSOC to focus on this aspect of the capital markets, this concern seems misplaced and misguided. Mutual funds and exchange-traded funds are both buyers and sellers of securities. They currently hold approximately 10 percent of the securities of the U.S. bond market and 17 percent of the U.S. corporate bond market.[22] To focus solely on the role of asset managers is to ignore 80 to 90 percent of the market. That is why a broader review of fixed income market structure is the more appropriate path forward.

The relentless drumbeat of liquidity angst has not been lost on the managers of these funds. As they do in times of impending market volatility, asset managers have been preparing on numerous fronts: holding additional cash and cash equivalents, reviewing intra-fund lending agreements and lines of credit for adequacy, and educating their investors on the bond markets. Because of efforts like these, long-term mutual funds simply have never had the large-scale pressures on liquidity that doomsayers predict.

Moreover, over the last couple of decades, several of us former and current SEC commissioners have voiced concerns about various aspects of fixed income market structure. In light of changes in the marketplace, new regulations, initiatives of market regulators, and the effect of prolonged zero interest rates and aggressive open market operations of the Federal Reserve, it is long overdue for the SEC to address the issues. Fortunately, the SEC and its staff recently have been focusing on fixed income fund liquidity risk. For example, in January 2014, the Division of Investment Management issued guidelines on risk management in changing fixed income market conditions, and the Office of Compliance Inspections and Examinations ("OCIE") has been examining fixed income funds, with an emphasis on their liquidity and liquidity risk management. The SEC also is considering proposing new requirements for mutual funds relating to

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[21] Sec. Indus. & Fin. Mkts. Ass'n, *U.S. Bond Market Issuance and Outstanding*, http://www.sifma.org/research/statistics.aspx (last updated July 6, 2015).
[22] Inv. Co. Inst., *2015 Investment Company Fact Book* (55th ed. 2015).

their management of liquidity risk. These inquiries are appropriate actions by the capital markets regulator and other regulatory bodies should appropriately defer to the SEC's expertise.

Title VII – Derivatives Regulation

Despite a once-in-a-lifetime opportunity to streamline our crazy quilt of financial services regulators, the Dodd-Frank authors blew it. They created, depending on how you count, at least 15 new offices and agencies, eliminating only one, the hapless Office of Thrift Supervision, which had no one left to regulate, anyway. Most notably, they failed to merge the SEC and CFTC to create one markets regulator,[23] and instead provided the SEC and CFTC with joint responsibility to implement the new derivatives regulations contained in Title VII. Unfortunately, the implementation of Title VII has been plagued by a lack of regulatory coordination.

Title VII split the regulation of the over-the-counter derivatives markets between the SEC and the CFTC, depending on whether the instrument in question is a "swap" or a "security-based swap." As a result, coordination among those agencies in adopting the myriad rules implementing Title VII is critical. Further, these instruments are traded globally, and coordination with global regulators also is of paramount importance. Sadly, this necessary cooperation quickly devolved into turf battles and unworkable regulations for market participants, particularly on the part of the CFTC and its former leadership.

The lack of coordination is two-fold, as there has been a lack of coordination both between the SEC and CFTC as well as between U.S. regulators and foreign regulators. A lack of global coordination results in non-U.S. counterparties becoming increasingly reluctant to transact with U.S.-based entities, so that the global swaps markets are fragmenting into separate trading and liquidity pools for U.S. and non-U.S. persons, resulting in less liquidity and more volatile pricing. According to the International Swaps and Derivatives Association, volumes between European and U.S. dealers have already declined 77 percent since the introduction of the CFTC's rules implementing the "swap execution facility" regime.[24]

The rules for swaps dealers and major swap participants concerning their capital, margin, and segregation requirements also differ meaningfully depending on whether one looks to the SEC's current proposal (dating from 2012) or to other regulatory bodies. Working together, the Basel Committee and IOSCO developed a framework for margin requirements for non-centrally-cleared derivatives[25] that is designed to achieve the goals of the Dodd-Frank Act and G-20 countries in reforming the derivatives markets. Following agreement, the CFTC, U.S. banking regulators, and European regulators

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[23] If only Barney Frank had not waited until two and half years after the passage of the Dodd-Frank Act and mere weeks before he retired to introduce a bill to merge the CFTC and the SEC.

[24] Int'l Swaps & Derivatives Ass'n, *Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-Year 2014 Update* (July 24, 2014), http://www2.isda.org/functional-areas/research/research-notes.

[25] Basel Comm. on Banking Supervision & Bd. of Int'l Org. of Sec. Comm'ns, *Margin Requirements for Non-Centrally-Cleared Derivatives* (Sept. 2013), http://www.iosco.org/library/pubdocs/pdf/IOSCOPD423.pdf.

proposed changes to their rules to conform to the framework. The SEC, however, has remained strangely silent on its intentions, and its margin framework is inconsistent with those of other regulators. Failure to coordinate in this critical area would lead to regulatory arbitrage in the swaps markets and undermine the goals of this reform effort.

Titles IX and XV – Public Company Disclosures

One major negative impact of Dodd-Frank has been the increased politicization of regulatory agencies, especially the SEC. Of course, what else would one expect from a huge bill with so many flaws that was pushed through Congress on essentially a party-line vote? Believe it or not, there were no 3-2 votes along partisan lines on rulemakings from 2000 to 2008 at the SEC. There were 3-2 votes on rulemakings, but commissioners were split by other than party lines. Since 2009, the beginning of this Administration, there have been more than 20 3-2, party-line votes.

Rulemakings from the Dodd-Frank Act are the culprit, as rather than addressing the causes of the financial crisis, such as government housing policy, the Act instead includes numerous provisions that are neither related to the last crisis nor likely to prevent a future crisis, and that are merely political sops to special interests.

For example, the ink was barely dry on the Dodd-Frank Act when former SEC Chairman Mary Schapiro pushed through an ill-fated shareholder proxy access rule, which was later vacated by the DC Circuit. Rather than leaving this corporate governance issue to private ordering, to be worked out by shareholders at individual issuers as has happened in the past couple of years, that rule was completely political and not tied in any way to fixing anything alleged to have caused the financial crisis. That rulemaking was followed quickly by other rules that had nothing to do with the root causes of the financial crisis, such as conflict minerals certification, mineral extraction disclosure, and so forth. Unfortunately, there are still more to come, such as required disclosure of the ratio of a CEO's pay to the median pay of the company's employees.

While these provisions may seem minor, they place real burdens on public companies and their shareholders who ultimately pay the costs of making these immaterial disclosures that provide no benefit to economically-driven investors. As the Securities Exchange Act of 1934 requires of the SEC, Congress should adhere to that statute's philosophy and require companies disclose *material information*, instead of attempting social engineering through the federal securities laws. Otherwise, there is no limiting principle as to disclosure, as the Supreme Court has repeatedly held.[26]

Unfortunately, the same groups that pushed for many of the harmful corporate governance provisions contained in the Dodd-Frank Act are at it again in their push to try to pressure the SEC into adopting a rule requiring corporations to disclose their so-called

[26] In *TSC Industries v. Northway*, 426 U.S. 438, 449 (1976), Justice Thurgood Marshall wrote for the Court: "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good."

"political" expenditures on trade associations and lobbying. Federal and state elections laws already cover these disclosures with respect to political giving, but the groups continue to pressure the SEC to require companies to disclose such non-material information because they have failed in Congress, at the Federal Election Commission, and everywhere else. Shareholders vote down proposals regarding this sort of disclosure by overwhelming margins at annual shareholder meetings. The groups have even put up advertisements in Union Station and handed out flyers with commissioners' pictures on them. The SEC has properly resisted this campaign, but it is indicative of a perception by some that the process can be manipulated by political agitation.

* * *

After the bill that was to become Dodd-Frank was reported out of the Conference Committee, Chris Dodd famously said, "No one will know until this is actually in place how it works."[27] Five years later we still do not know the full effects the Dodd-Frank Act will have on U.S. capital markets. We do know, however, that the costs of Dodd-Frank have been borne not just by Wall Street, but by ordinary investors and businesses of all shapes and sizes. Moreover, until Congress reclaims some of the authority it gave regulators in the Dodd-Frank Act, most notably the authorities given to the FSOC and Federal Reserve under Titles I and II, the greatest risk to the U.S. capital markets remains—that government, and not the markets, will ultimately choose winners and losers.

[27] David Cho, Jia Lynn Yang & Brady Dennis, *Lawmakers guide Dodd-Frank bill for Wall Street reform into homestretch*, Wash. Post, June 26, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/06/25/AR2010062500675.html.

Testimony of Mark A. Calabria, Ph.D.

Director, Financial Regulation Studies, Cato Institute

Before the

Committee on Financial Services

United States House of Representatives

Hearing entitled "The Dodd-Frank Act Five Years Later: Are We More Stable?"

July 9, 2015

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Chairman Hensarling, Ranking Member Waters, and distinguished members of the Committee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a non-profit, non-partisan public policy research institute located here in Washington, D.C. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official positions of the Cato Institute. In addition, outside of my interest as a citizen and taxpayer, I have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

The Committee probably does not need reminding that the recent financial crisis, like crises in general, was quite painful, both to the overall economy and to individuals and their families. While it is difficult to disentangle the relative effects of the crisis was the recession that followed the housing bust, we should not forget that unemployment rose to 10 percent in the fall of 2009, with almost 9 million workers losing their jobs in the recent downturn. This has been

by almost every measure a weak, slow and painful recovery. It has fallen far short of previous recoveries. The Federal Reserve Bank of Dallas estimates that the cost in lost economic output could be as high as $14 trillion, close to a full year's GDP.[1] The fiscal costs have also been tremendous as both stimulus programs and corporate rescues added to the deficit.

Scholars have found that this pattern is all too common in the wake of financial crises. Adding to that urgency is that financial crises are often followed by poor and sometimes harmful public policy choices. For instance most economists recognize today that many of the New Deal policies implemented in the 1930s slowed the recovery and added to unemployment.[2] Although harder to quantify, an important reason to avoid financial crises is to avoid the policy mistakes that sometimes follow in their aftermath. Accordingly I hope we all share the goal of minimizing both the severity and frequency of financial crises. This is not something we ever want to repeat again.

Let me also add that unfortunately financial crises are less rare than is commonly portrayed, at least in the United States. Reinhart and Rogoff estimate that since around the founding of the United States, we have spent approximately 13 percent of the time in a financial crisis or its aftermath.[3] That's a crisis about every 8 years. And of course many members of this Committee recall the Savings and Loan Crisis. We should not fool ourselves into believing that 2008 was just a "hundred flood".

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[1] *Assessing the Costs and Consequences of the 2007-09 Financial Crisis and Its Aftermath.* http://www.dallasfed.org/research/eclett/2013/el1307.cfm

[2] See: http://www.cato.org/blog/did-new-deal-help & http://newsroom.ucla.edu/releases/FDR-s-Policies-Prolonged-Depression-5409

[3] Carmen Reinhart and Kenneth Rogoff. 2009. *This Time is Different: Eight Centuries of Financial Folly*. Princeton.

Dodd-Frank

In 2010 Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Many of the stated purposes of Dodd-Frank, such as a desire "to promote market discipline", are ones I believe most, if not all, of us share. Stated goals and purposes, however, are not the same thing as achieving said goals and purposes. Good intentions are not sufficient. We must closely evaluate effectiveness and do so setting aside any pre-existing biases. Before turning to Dodd-Frank, let me very clearly state that the alternative to Dodd-Frank was not "doing nothing". I do not believe the pre-2010 financial system was either sound or safe. In fact I had spent much of the years preceding the crisis trying to enact measures to avoid it.

Public Opinion

While public opinion can be, and quite often is, wrong, it is nevertheless a useful place to start. This is particularly true in finance, where public confidence in our financial regulatory system is a crucial component of its success. A Morning Consult poll conducted earlier this year queried respondents as to whether believed our financial system was stronger today than it was five years ago.[4] A plurality (42%) did not believe our financial system was safer. Even among Democrats, slightly more (35% v. 34%) believed our system was less safe. Among Republicans and Independents it was not even close, with an over 20 percentage point gap between those who felt our system was less safe than those who believe it is safer. In sum, the public continues to exhibit considerable skepticism regarding the soundness of our financial system.

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[4] For poll results, see http://morningconsult.com/polls/finance-104/

Crises Drives

Whether any particular remedy is effective depends crucially on the diagnosis and the underlying malady. The weight of the evidence suggests to me that recent crisis was driven largely by a boom and bust in our nation's property markets, particularly housing, and that our current system of financial regulation linked the performance of the housing and mortgage market to our capital markets in such a manner as to result in a significant disruption when the value of housing and mortgages declined. Key ingredients of this crisis were: exceptionally loose monetary policy, supply rigidities in our property markets, extensive international capital flows into the US (and US mortgage market), extensive policy encouragements for both high corporate and household leverage and extensive moral hazard created by various government guarantees. I do not believe we have sufficiently addressed these distortions. Accordingly we should expect these forces to result in future crises. It is not enough to just "do something" – we must do the correct things.

Moral Hazard and Too-Big-To-Fail

There is perhaps no issue that drove the passage of the Dodd-Frank Act more than the public perception that certain large institutions enjoyed the backing of the federal government. A situation commonly called "too big to fail" (TBTF). Not by coincidence the first two titles of Dodd-Frank are aimed at addressing the too-big-to-fail status of our largest financial institutions. Here I raise a number of concerns and observations that merit meeting the claim of ending TBTF with considerable skepticism.

One reason that debates over TBTF are often so heated is that there is no actual explicit subsidy provided on-budget for such purpose. We can (and should) debate the merits and effects of deposit insurance, for instance, but we don't debate its existence. It is there. Whether TBTF is real or not is a far trickier question. We are left with no choice but looking for "clues".

The first clue is the actual text of Dodd-Frank. There is, of course, language about "eliminating expectations…that the Government will shield" parties from losses "in the event of a failure". But vague purposes do not constrain explicit authorities. And Dodd-Frank is quite explicit. Section 204, for instance, is quite clear that the Federal Deposit Insurance Corporation (FDIC) can purchase any debt obligation at par (or even above) of a failing institution. If rescuing a creditor at par is not the very definition of TBTF, I'm not sure what is. Section 201 goes even further by allowing the FDIC to pay "any obligations…" it believes are "necessary and appropriate". Yes Dodd-Frank does offer a path for ending TBTF without cost to the taxpayer or the rest of the financial industry. But that path is clearly an optional one. We should not forget that JP Morgan CEO Jamie Dimon called for such a resolution mechanism in 2009.[5] It seems unlikely he'd call for something that would undermine the value of a firm he spent so much effort building.

If Congress does not see fit to repeal these titles of Dodd-Frank, at a minimum they should be amended to limit the ability of regulators to rescue creditors.

One reason I do not believe ending TBTF will be the path taken is that this was also an option with Fannie Mae and Freddie Mac. The Housing and Economic Recovery Act of 2008 created a mechanism similar to Dodd-Frank's Title II resolution process. It could have been used

[5] http://www.washingtonpost.com/wp-dyn/content/article/2009/11/12/AR2009111209924.html

to keep Fannie and Freddie functioning without a dime of cost to the taxpayer. Instead the taxpayer was tapped. Recall that Freddie is actually smaller and far less complex than CitiBank. Defenders of Dodd-Frank have yet to offer a reason why Citi would be allowed to fail, when Freddie was not.

Much of the debate over TBTF has revolved around various studies as to the "size" of the subsidy. Such exercises are useful but limited. For instance raw FDIC data suggests that the largest banks enjoy a funding advantage over other banks. Yes that raw advantage has declined since the height of the crisis. One would expect such since bailouts are more likely when policy-makers are panicking. On the other hand that advantage is bigger than it was pre-crisis. Compared to the average funding costs over the last three decades, the largest banks enjoy a funding advantage of around 30 basis points, similar to that enjoyed by Fannie and Freddie pre-crisis. Even if the observed advantage disappeared, such does not mean TBTF is gone. As any first year statistics or science student learns, the absence of a finding is that the same as a finding of absence. During most of the last three decades and even up to 2007, the largest banks actually paid more to borrow than the rest. The data can at best be suggestive.

Recent research from the Federal Reserve Bank of New York suggests even the FDIC's single-point-of-entry approach has failed to convince market participants that TBTF is over.[6]

Estimates from the Federal Reserve Bank of Richmond suggest that taxpayer backing of the financial system has greatly expanded. Based upon actions taken during the crisis, the Richmond Fed estimated that 59 percent of US financial system was either explicitly or

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[6] http://libertystreeteconomics.newyorkfed.org/2015/07/what-do-bond-markets-think-about-too-big-to-fail-since-dodd-frank.html#.VZwev7WYEn8

implicitly backed by the federal government in 2009.[7] Their most recent estimates (March 2015) are that 60 percent of US financial system was either explicitly or implicitly backed by the federal government. By the expert judgements of the Richmond Fed, Dodd-Frank has not resulted in *any* net reduction in the federal safety net for financial institutions.

It is worth noting a significant expansion of the banking safety net is the result of expanded explicit guarantees in the Dodd-Frank Act. For instance Dodd-Frank expands deposit insurance to $250,000 per person per bank. Since the crisis the amount of insured deposits outstanding has risen by over $2 trillion.[8] This is another $2 trillion which the taxpayer directly stands behind. It is also another $2 trillion that is immune from market discipline.

According to the Federal Reserve's Survey of Consumer Finance, the median US household held $4,100 in a checking account.[9] For the less than 10 percent that held certificates of deposit, the median holding was $16,000. So let us be crystal clear, a deposit coverage cap of $250,000 has nothing to do with protecting the savings of typical American families. A cap of say $40,000 (that pre-S&L crisis) would more than adequately cover the vast majority of US households while also greatly improving market discipline on US banks. Even the typical (median) retirement account, not all of which are held at banks, is under $60,000.

When it comes to TBTF a special area of concern is the Federal Reserve's primary dealer system. As the Committee is well, these (currently 22) institutions are the Fed's primary

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[7] https://www.richmondfed.org/publications/research/special_reports/safety_net/bailout_barometer_previous_estimates

[8] https://www.fdic.gov/bank/analytical/quarterly/

[9] http://www.federalreserve.gov/pubs/bulletin/2014/pdf/scf14.pdf

partners in the conduct of monetary policy. Were a significant number of these entities to become stressed, such could hamper the Fed's ability to conduct open market operations. Unfortunately such suggests to me that the Fed will protect these entities in order to preserve its own powers. The Fed (and/or this Congress) should examine the functioning of the primary dealer system with the objective of increasing its ability to withstand the failure of a few primary dealers. Ideally the number of participating primary dealers should be expanded sufficiently to protect against any impact on monetary policy effectiveness from the failure of a primary deader.

Dodd-Frank's push to concentrate derivatives counterparty risk into centralized clearinghouses also runs the risk of creating new TBTF entities, as noted by Treasury's Office of Financial Research.[10]

While much of the disgust expressed regarding TBTF comes from its obvious unfairness, treating some institutions more favorably than others, we should recall that the moral hazard created by these both explicit and implicit guarantees reduces the level of private monitoring of banks. Private parties, with their own money at risk, have strong incentives to monitor bank behavior, while regulators, who never seem to lose their jobs regardless of their performance, have relatively weak incentives to monitor banks. The continued crowding out of private monitoring by financial regulators has likely lead to less monitoring of our financial system, not more.

Implied guarantees (like TBTF) are best viewed as a "dial" rather than a switch. The question is have we moved the dial closer to zero. I believe we have not.

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[10] http://www.reuters.com/article/2015/05/15/us-regulation-summit-berner-idUSKBN0O024O20150515

Monetary Mischief

It is generally accepted among economists (at least outside the Federal Reserve) that extraordinarily loose monetary policy post-9/11 contributed to a boom in property prices, particularly in housing.[11] Given that just three years of negative real federal funds rates contributed to the massive housing boom in the mid 2000s, one could only imagine what six years of negative real rates is doing to our asset and financial markets today. While one can always debate the presence of bubbles, as we did in the mid 2000s, I am most certain that our current stance of monetary policy is creating sizable distortions that will be quite painful when they unwind. One answer to the question of whether our financial markets are more stable today, is a loud "no" given the actions of the Federal Reserve. Unfortunately Dodd-Frank not only failed to address failings at the Federal Reserve but also expanded its responsibilities.

Mortgage Mischief

Most accounts of the financial crisis of 2008 include a prominent role for the U.S. residential mortgage market. Although other property markets exhibited similar boom and bust patterns, the elevated level of defaults and associated costs borne by the taxpayer have brought a particular emphasis on single-family mortgage finance policies.

Dodd-Frank contains a number of provisions impacting the mortgage market. The financial services law firm Davis Polk estimates that Dodd-Frank will require 49 separate rule-makings in the area of mortgage reform alone. Of particular importance are those found in titles IX, X and XIV. Despite the extensive expansion of mortgage regulation under Dodd-Frank, it is

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[11] See John Taylor, *Getting Off Track.*

unlikely that such will significantly reduce mortgage defaults or mitigate future booms and busts in the housing market.

A goal of the Dodd-Frank Act is to eliminate certain products and practices from the mortgage market. So at a very basic level the choices facing mortgage borrowers will be reduced, the difficult question is in gauging how much. At least three independent attempts have been made to estimate the impact of QRM and/or QM on mortgage availability. These three analyses were performed by the United States Government Accountability Office (GAO), the Federal Housing Finance Agency (FHFA) and the private firm CoreLogic.

The three studies yield similar conclusions as to the impacts of QRM. The most restrictive provision of the QRM rule would be the ceiling on allowable debt-to-income ratios (DTI). Most QRM restrictions are likely to have very modest impacts, as their prevalence in the mortgage market was generally low.[12] [13] [14]

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[12] For instance, Both the QM and QRM rules ban negative amortization features, yet according to GAO's analysis "almost 100 percent of [subprime] mortgage originations from 2001 to 2007 did not have negative amortization features." Within the prime market the percent with negative amortization features peaked in 2005 at 9 percent. The average between 2001 and 2010 was closer to 1 percent.

[13] Dodd-Frank also places limitations on mortgages with terms in excess of 30 years. In the prime and near-prime market essentially 100 percent of mortgages were under a 30 year term until about 2005, where longer than 30 year mortgages grew slowly to 4 percent of the market in 2007 before disappearing by 2009. Subprime followed a more unusual situation with nearly 100 percent of subprime being under 30 years until 2005 and 2006, when the share over 30 years peaked at 15 percent of the subprime market.

[14] Another loan feature restricted by Dodd-Frank is the use of balloon payments. Final balloon payments are multiples of the monthly payment. Despite the prevalence of balloon loans before the New Deal mortgage reforms of the 1930s, these products were generally rare, even during the height of the recent boom. GAO reports that almost 100 percent of prime, near-prime and government-insured mortgages lacked any balloon features between 2001 and 2010. Among subprime loans balloon features were also rare, close to zero until 2005 when they grew to about 10 percent of subprime loans in 2007, after which they have largely disappeared from the subprime market.

The Dodd-Frank Act is a response to the theory that "bad" mortgage lending and lenders drove borrowers into default, which ultimately drove the housing market into decline leading to a fall in the value of mortgage-backed securities, resulting in a panic among the holders of mortgage-backed securities.[15] Setting aside that national house prices reached an inflection point almost a year before the inflection point in defaults, one measure of the effectiveness of Dodd-Frank's mortgage rules will be to what extent does it reduce mortgage defaults.

Despite having the largest impact on the number of loans, the proposed QM/QRM restrictions on DTI appear to have very modest impacts on projected defaults.[16] Restrictions on low- or no-documentation loans do appear to have noticeable impacts on defaults in the subprime market. If all but full documentation loans were used, default probabilities, according to GAO's analysis would fall by -1.08, -1.17, and -1.24 percentage points for fixed rate, long-term ARM and Hybrid ARM, respectively.

GAO's default analysis predicts substantial declines in defaults from reductions in LTV, particularly initials moves below a 100 percent closed LTV. For fixed rate non-prime purchase

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[15] Both the QM and QRM place restrictions upon borrower documentation, particularly in the area of income. A common concern is that no- or low-documentation loans lead to greater levels of fraud and higher losses in the mortgage market than would have occurred otherwise. Whereas the QRM is an obstacle for securitization, the QM standards come with substantial and uncertain liability, so while there is likely to be a market for non-QRM loans; non-QM loans will become rare. By GAO's estimates, the percentage of subprime loans lacking full documentation ranged from 40 percent in 2006 to 20 percent in 2001. A similar, but smaller, trend was witnessed among prime loans, where percent lacking full documentation ranged from around 20 percent in 2006 to almost zero in the early 2000s. The documentation requirements under QM/QRM are likely to impact most self-employed borrowers. As there are over 15 million self-employed individuals in the United States, these restrictions could be significant.

[16] The presence of a DTI in excess of 41 percent increases the probability of default by 0.25, 0.08, and 0.59 for fixed rate, long-term ARM and Hybrid ARM, respectively. Accordingly to GAO's analysis, reducing the prevalence of mortgages with a DTI in excess of 41 will have barely notice effects (although statistically significant in all cases).

loans, moving from a LTV of 100 to under 80 percent reduces projected default probabilities by over 3 percentage points. For hybrid non-prime ARMs, the reduction in projected default probabilities is just over 6 percentage points. Coupled with full documentation and a LTV under 80 percent, one could eliminate over 70 percent of the standardized default risk among hybrid non-prime ARMs. Academic studies have arrived at similar conclusions when examining the drivers of default among subprime mortgages.

The approach of Dodd-Frank's mortgage provisions is to focus on loan characteristics, largely ignoring borrower characteristics or housing market impacts. For instance QM/QRM places no restrictions on borrower credit, other than verification. A number of studies, however, find the largest impact on subprime defaults coming from borrower credit, as measured by FICO score. Increasing borrower FICO by one-standard-deviation, or about 74 points, decreasing default probability by around seven times as much as switching from an ARM to fixed rate. A 74 point increase in FICO also has over twice the impact of moving from a no/low to full documentation low. Studies also find the impact of housing price changes to be magnitudes higher than the provisions of the QM/QRM rule.

As the down-payment requirements of the proposed QRM rule were abandoned, the remaining changes are likely to have modest impacts on default probabilities. The biggest impact would be from the full documentation requirements and the cap on DTI. These two changes combined, however, are projected to lower default probabilities by around 1 percentage point.

A study from University of Minnesota Professor Morris Kleiner finds that states with more stringent licensing requirements for mortgage brokers actually witnessed higher levels of

mortgage default. The hypothesis is that increased barriers to entry reduce underwriting efforts to such an extent that off-sets any improvements in broker quality that result from the licensing scheme. Kleiner's results raise the possibility that Dodd-Frank's Section 1401 originator requirements, coupled with the SAFE Act, actually increase mortgage defaults rather than reduce them, as the statute intends.

The barely noticeable reduction in projected defaults could be more than off-set by Dodd-Frank's impact on the foreclosure process. Dodd-Frank's Section 1413 allows borrowers an additional delay to the foreclosure process. A longer foreclosure process increases the borrower's incentive to default. New regulations relating to mortgage servicing that are likely to extend the ultimate time to foreclosure. Researchers, as well as industry experience, confirm the increase in "strategic default" during the recent crisis. Dodd-Frank's Section 1414(g) notice on anti-deficiency and the increased delays to foreclosure may well increase strategic defaults more than an amount to off-set reductions resulting from the QM/QRM provisions. Scholars have found that delays in the foreclosure process largely extend the process, raising the overall level of loans in foreclosure at any one time, without significantly improving final outcomes for the borrower. Dodd-Frank could very well result in an increase in the level of mortgage defaults during the next housing bust.

If and when those additional defaults occur they will mostly be borne by the taxpayer. Given that Fannie Mae, Freddie Mac and the FHA guarantee the vast majority of today's mortgage market, as that all of those entities lack any real degree of capital, losses will directly hit the taxpayer. Without substantial reform of our mortgage finance system, the next downturn in the housing market will result in even larger taxpayer losses than the last downturn.

Despite complaints from the mortgage industry, underwriting standards do not appear to have greatly improved. According to FHFA, the typical loan-to-value at the peak of the market in 2006 was 76.4, most recently data is 78.5 (May 2015). Over half of FHA's most recent endorsements are to borrowers with FICOs under 680. Almost half a million single-family FHA loans are currently non-performing, or around 6% of insured loans.[17] What's shocking is that this is in an environment of rising home prices. When house prices decline, this number will increase considerably. The two most prominent drivers of mortgage default in the last bust were borrower FICO and LTV. We are essentially back to similar levels for both those metrics. If we continue along this path at *least* a million families will lose their homes during the next downturn due to loose FHA underwriting. The primary constraint on the mortgage market today appears to be households that are rightly skeptical of betting their financial health on rising home prices. Unfortunately far too many policy-makers appear intent on reducing that skepticism.

The recent crisis should also leave us with little doubt that house prices do indeed decline. We have not ended the housing cycle. If anything it has likely become more volatile.

I would note the IMF's recent Financial System Stability Assessment for the United States specifically lists FHA as a concern:

> "One in five loans originated is insured by the FHA, although it falls short of its capital requirements, which creates fiscal and financial risks due to moral hazard, the distorted competitive landscape, and large subsidies for debt-financed homeownership."[18]

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[17] http://portal.hud.gov/hudportal/documents/huddoc?id=FHAProdReport_Apr2015.pdf

[18] http://www.imf.org/external/pubs/ft/survey/so/2015/pol070715a.htm page 32

Bank Capital

Perhaps one of the few relatively bright areas is the increase in capital ratios among banks. Among all banks Tier 1 risk-weighted capital was just under 7 percent of assets at the end of 2006. It now stands just over 9 percent. A small part of this increase is due to banks shifting toward lower risk-weighted assets, which increases risk-weighted capital without actually raising capital. That said, significant capital has been raised. It is worth noting that effort to increase bank capital began before and independently of Dodd-Frank. We would likely have higher bank capital today even if Dodd-Frank had not passed. Perhaps more importantly is the recognition that even the higher levels witnessed today are quite low. Let us not forget that the largest banks, and industry in general, were defined as "well capitalized" during the crisis. At the time of TARP's passage total risk-weighted capital as a percent of total risk-weighted assets was well over 11 percent for industry as a whole. Even Citibank, one of the weakest, remained about 8 percent during the crisis. Either we didn't need the TARP or something is wrong with our system of capital regulation (or both).

Conclusions

I commend the Committee for calling today's important hearing. As we so painfully learned over the last decade, financial stability cannot be taken for granted. Although a few modest improvements have been made to increase financial stability, I believe Dodd-Frank, no net, has reduced financial stability. The reason for such is a combination of both errors of commission and omission. Moral hazard has been increased by Dodd-Frank's expansion of the financial safety net and increased concentration of risk into fewer entities, while the primary

causes of the crisis were largely left untouched. I fear if we continue along our current path, we are almost certain to see another financial crisis sometime in the next decade.

It is also worth observing that one impact of Dodd-Frank has been a growing concentration within the banking industry. Regulatory costs often fall heavier on smaller entities. The preference should be for measures, such as a flat leverage ratio, whose burdens do not increase disproportionately with decreases in size. We should also recognize that the ultimate burden of financial regulations will fall on those entities will less options. Unfortunately this is often low income families and small businesses.[19] If Dodd-Frank had truly achieved significant financial stability, then perhaps these costs would be worth bearing. Unfortunately Dodd-Frank imposes significant costs but provides at best modest benefits.

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[19] See http://www.goldmansachs.com/our-thinking/public-policy/regulatory-reform/who-pays-for-bank-regulation.html

TESTIMONY OF DAMON A. SILVERS

DIRECTOR OF POLICY AND SPECIAL COUNSEL, AFL-CIO

TO THE HOUSE FINANCIAL SERVICES COMMITTEE ON

THE DODD FRANK ACT FIVE YEARS LATER—ARE WE MORE STABLE?

July 9, 2015

Good morning, Chairman Hensarling, Ranking Member Waters, and members of the Committee. My name is Damon Silvers, I am the Policy Director and Special Counsel to the AFL-CIO, and my testimony today is given both on behalf of the AFL-CIO and Americans for Financial Reform, a coalition of over 200 organizations that seeks to ensure the public interest is represented in the financial regulatory process in Washington in decision making about the financial system in Washington.

This hearing marks the occasion of the 5th anniversary of the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the most comprehensive financial regulatory legislation passed in the United States since World War II. The Dodd-Frank Act was passed in the wake of the financial crisis that began in the United States in 2007, reached its peak in the United States in late 2008 and early 2009, but which appears to be ongoing in much of Europe. The economic crisis that resulted cost the United States $22 trillion dollars according to a 2013 GAO study. The crisis resulted in ten million families losing their homes through foreclosures and forced sales, and condemned tens of millions of America's workers to long-term unemployment.

It is important to begin this five year review by noting that the Dodd-Frank Act was a compromise. For those who looked at the financial system as it was in 2008 and saw a need for profound structural change, Dodd-Frank was definitely half a loaf. The Dodd-Frank Act did not place firm size limits on financial institutions, it did not restore the Glass-Steagall Act, and it did not fundamentally restructure the incentives created by the basic structures of executive compensation in the financial system, just to give some salient examples. The Dodd-Frank Act did not give the SEC and the CFTC independent funding,

nor did it address large banks' dominance of regional Federal Reserve boards. Instead, the Dodd-Frank Act gave regulators significant new powers and the discretion to use those powers either to simply increase transparency and make prudential regulation more uniform, or to make structural change.

What Dodd-Frank did do was renovate a financial regulatory structure that had literally become decrepit, and resurrect fundamental principles of financial regulation that had been lost or forgotten in the race to deregulate in the 1980's and 1990's. This renovation has resulted in a U.S. financial system, which while it continues to suffer from structural problems, is no longer as vulnerable to crisis as it was, has a regulatory architecture that has placed the protection of America's families at the center of the regulatory mission, as it always should have been, and has the flexibility to adopt to changing business models within financial firms and markets.

Most of all, the Dodd-Frank Act created a clear, workable alternative to the bailout of systemically significant institutions—the resolution process contemplated in Title II of the Act—that places the responsibility for first dollar losses in distressed situations clearly where it should be—on the too big to fail firm, its equity holders, its bondholders and its executives.

But it is critical to note that in the area of systemic risk and counteracting too-big-to fail, as in almost every aspect of the Act, its effectiveness depends on the willingness of financial regulators to properly implement it. In the area of systemic risk, the public has been well served by the FDIC's insistence that the living wills prepared by systemically significant financial institutions involve genuine simplification of those organization's structures, so that in a crisis they could be resolved. Without this insistence, the promise of Title II that we would end too-big-to-fail would be simply empty words.

However, the full potential of Dodd-Frank's systemic risk provisions have not been realized. For example, Title II gives the bank regulators and the FSOC broad powers both in terms of setting capital requirements and in terms of potentially requiring structural change at systemically significant financial institutions. Among those powers are the power to insist on structural changes in the largest banks as part

of the living will process. Those powers have not been used to anywhere near the extent they could to protect against another bailout of the banks by the public.

At the same time, it was always recognized by those involved in the enactment of the Dodd-Frank Act that it needed to be accompanied by reforms in other areas of the law that involved the financial system—particularly the tax laws and the pension laws. So the continuation of tax subsidies for financial speculation in the form of the carried interest provisions of the tax code and the lack of a financial transaction tax are part of the unfinished business of financial reform. On the other hand, the Department of Labor's fiduciary rule proposal is an example of important forward motion in a key area of consumer financial protection outside the ambit of the Dodd-Frank Act.

The U.S. financial regulatory system prior to the Dodd-Frank Act was a Swiss cheese system—full of holes that allowed financial actors to evade both capital and transparency requirements for the price of a few hours of a lawyer's time. The Dodd-Frank Act closed numerous loopholes, with varying degrees of effectiveness. It eliminated the Office of Thrift Supervision, removing a long time source of regulatory whipsawing. It created registration requirements for the managers of hedge funds and leveraged buyout funds—shining a light on a longtime source of opaque credit risk in the capital markets. The Dodd-Frank Act required increased transparency and safety in the derivatives markets--requiring more transactions to be cleared and traded on exchanges. The Volcker Rule required banks to no longer trade in derivatives on their own accounts. The Act called for higher capital standards for the very largest institutions. The Dodd-Frank Act gave the SEC the power to regulate derivatives that sought to mimic publically traded securities. The Dodd-Frank Act required that over the counter derivatives had to be cleared through clearinghouses that would require both collateral be posted and that somewhat visible records of the transactions be maintained. And the Act made important corporate governance reforms, including requiring advisory Say on Pay votes at public companies, and requiring that public companies disclose the ratio of their CEO pay to the pay of their median employee.

Five years later, the results of these changes are a financial system with greater resiliency, with more transparency and thus a greater ability for regulators to manage systemic risk, and a reduction in the credit market's perception that investments in the nation's largest banks are risk free. For example, the GAO did a study in 2014 using 42 different financial models of the credit subsidy resulting from implicit federal guarantees to the nation's largest banks. They found that while there was a very large subsidy in 2009 and 2010, it fell following 2010 to a level near zero in 2014. In general, the retreat in perception of a subsidy was associated not with the passage of the Act, but with the sense over time, likely associated with the progress of living wills and stress tests, that the bank regulators were serious about enforcing the provisions of Title II.

There is also evidence of these positive effects in the growth rates of different sized bank holding companies. After years of rapid growth, the total risk exposures of the top 6 bank holding companies have stabilized at just over $14 trillion since 2013. At the same time, regional bank holding companies are growing rapidly—with annual growth in the 5-10% range for the same period.

These studies are best understood as measures of directionality—the Dodd-Frank Act has clearly decreased credit markets' perception that the debts of the largest banks are guaranteed by the federal government. However, given the very large size of the nation's eight largest financial institutions—the equivalent of 85% of the U.S. GDP—it would be naïve to conclude that the problem of too big to fail banks is behind us.

But the Dodd-Frank Act was not simply about protecting the financial system from itself. Its explicit purpose was to make financial markets less of a rigged game from the perspective of consumers and investors. Here the track record is impressive and expanding. Most importantly, the consolidation of consume protection functions in the CFPB has been a clear success—the CFPB has been hailed by not just consumer advocates, but by the firms it regulates as a model of regulatory efficiency. The CFPB has returned $5.38 billion dollars of improperly obtained fees and penalties to 15 million consumers.

More recently, the Securities and Exchange Commission has taken steps to use the information the Dodd-Frank Act provided through is registration requirements for managers of private equity firms and hedge funds to determine that a wide range of institutional investors—pension funds providing benefits for millions of people—had been charged improper expenses. The Commission found violations of law or material weaknesses in over 50% of these examinations. These problems would have gone unnoticed but for the provisions of the Dodd-Frank Act.

While the basic principles of the Dodd-Frank Act of transparency, closing regulatory loopholes, and treating consumer and investor protection seriously are becoming more embedded in our financial system with the passage of time, the achievements of the Dodd-Frank Act face several serious threats.

The first is the simple failure of regulators to implement provisions of the Act, including notably in areas that affect executive compensation in the financial sector. Five years later, the Securities and Exchange Commission has not issued regulations implementing the transparency provisions of Dodd-Frank in executive pay, particularly the provision requiring public companies to disclose the ratio of their CEO's pay to the pay of their median employee. And the Board of Governors of the Federal Reserve has failed to issue a final rule implementing Section 956 of the Act requiring the regulators take steps to ensure that large financial institutions stop paying executives in ways that encourage excessive risk taking.

Among the most serious problems here is the erosion of a culture of robust enforcement in financial regulatory bodies. This problem is manifest in the Dodd-Frank context in the routine waivers granted by the Securities and Exchange Commission to the prohibition under Rule 506 on those found guilty of securities fraud from participating in exempt securities offerings. But, as documented by among others, Judge Jed Rakoff, this problem is pervasive at both the Securities and Exchange Commission and the Justice Department and has eroded public confidence in the even-handedness of the enforcement of our nation's laws..

The second threat is the impulse some in Congress seem to have to want to increase systemic risk and to make banks more likely to become too big to fail. We saw this on display most prominently in the Cromnibus negotiations last spring, where Congress worked with the Obama Administration to repeal the hard-fought derivatives push out provisions—once again directly allowing depositors' funds to be used to back derivatives trading businesses—both increasing the risks associated with core banking functions and making resolution of a failed mega institution more difficult.

Since the passage of Dodd-Frank, every legislative session of the Congress has featured a whole range of proposals to weaken the Dodd-Frank Act—most of which are thinly disguised efforts to help too big to fail banks, public company CEO's and the managers of large hedge funds and private equity funds—the wealthiest, most powerful people and institutions in the country. There have been proposals to weaken the CFPB's financing and governance and to limit its jurisdiction, to exempt private equity fund managers from registration, to weaken the derivatives clearing procedures, and to repeal the CEO pay disclosure provisions. More informally, there has been unrelenting pressure on regulators to either not enforce or create loopholes in implementing Dodd-Frank in areas that are critical for protecting our economy such as derivatives regulation.

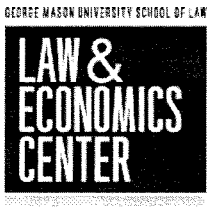
Those who have sought to undermine efforts to protect the American public from the systemic risk in the financial system have made a series of spurious arguments against the implementation of the Act. Among these spurious arguments have been "cost-benefit analyses" that looked only at the costs and not at the benefits, arguments about liquidity that fail to assess (a) whether liquidity is always a good thing, and (b) whether other factors affect liquidity, or raising concerns that derivatives' clearinghouses might have embedded credit risk, and then attacking bank regulators for requiring capital to be set aside to buffer those risks.

These sorts of arguments only have weight because of the political and economic power of the people making them. And this brings us back to the issue of too-big-to-fail banks.

The truth is that because the Dodd-Frank Act was a compromise, because it largely left to the regulators the question of structural change, it has proven to be vulnerable to the continuing political power of the handful of too big to fail banks that continue to dominate our financial system and exert a disproportionate influence on our politics.

In this sense, the unfinished agenda of financial reform is inextricably intertwined with the ability of the regulatory system to effectively implement the Dodd-Frank Act as it is, to ensure the financial system does its job of efficiently transforming savings into investment, and to protect the U.S. economy and the American public from a costly repeat of the financial crisis that began in 2007.

Thank you for the opportunity to testify and I look forward to your questions.



THE DODD-FRANK ACT FIVE YEARS LATER: ARE WE MORE STABLE?

July 9, 2015

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Unites States House of Representatives
Committee on Financial Services

Thank you chairman Hensarling, ranking member Waters, and members of the committee. It is my pleasure to testify this morning on the question of "The Dodd-Frank Act Five Years Later: Are We More Stable?"

An animating premise of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was the belief that a primary source of financial instability was an inadequate consumer financial protection regime at the federal level. Dodd-Frank sought to address those perceived deficiencies by creating the Bureau of Consumer Financial Protection (CFPB) and vesting that new super-bureaucracy wielding an unprecedented combination of vast, vagely defined substantive powers with no democratic accontability.

At the outset, allow me to stress that I personally agreed with the proposal to combine the administration of federal consumer financial protection laws under one agency's roof. The preexisting system was too complicated, too fragmented, and too incoherent.

That Dodd-Frank squandered this historic opportunity to modernize and reform consumer protection laws for the benefit of consumers was, therefore, particularly disappointing. In the five years since the law came into effect it has resulted in higher prices and reduced choice for consumers and has done little to increase consumer financial protection.

Yet while this sorry result for American consumers is tragic, it is hardly surprising. The failure of Dodd-Frank's regulatory agenda to promote the interests of consumers was built in from the beginning.[1] The CFPB, for instance, is vested with extraordinarily broad

[1] Todd J. Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEORGE WASHINGTON L. REV. 856 (2013).

powers to regulate virtually every consumer credit product in America under the vague charge to prevent "unfair, deceptive, and abusive" terms and practices. At the same time, this vast power is vested in an agency with an unprecedented lack of democratic accountability. Under the statute, the president can nominate the director, but once confirmed the director can be removed only "for cause."[2] Furthermore, the CFPB is outside Congress's appropriations power, and is authorized to spend hundreds of millions of taxpayer dollars every year with no accountability to the American people.

Given this extreme lack of democratic accountability, the CFPB has done what all bureaucracies tend to do: it has constantly expanded its power, promoted its own bureaucratic interests at the expense of the public, and trampled under foot other public policies, such as consumer choice and financial innovation.

The impact on American families and the economy from the actions of this unaccountable super-regulator has been disastrous:

- By imposing a regulatory regime that substitutes the judgment of bureaucrats for consumer decisions, Dodd-Frank has raised prices and cut off access to mortgages, credit cards, and bank accounts, harming millions of American families that use credit to improve their lives and depressing economic growth.[3]
- By stripping consumers of mainstream financial products such as mortgages, credit cards, and bank accounts, Dodd-Frank has driven the most vulnerable Americans into the arms of check cashers, pawn shops, and payday lenders, increasing their reliance on those products for which sharp practices are most feared.
- The crushing regulatory compliance cost burden and destruction of community banks' traditional relationship lending model has accelerated consolidation of the retail banking system, making big banks even bigger and further eliminating competition and choices for consumers.
- The CFPB has launched a massive data-mining program that collects data on hundreds of millions of consumer credit cards, mortgages, bank accounts, and other products, an appetite for consumer information that far exceeds any reasonable regulatory purpose. Not only do these data-mining operations impose costs on banks and their customers, the operations' scale creates unprecedented threats to privacy and risks to personal information security.
- Because many small, independent, kitchen-table businesses use products such as personal credit cards, home equity loans, and auto title loans in financing their businesses, the CFPB's powers reach into all of these small businesses as well.

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[2] *But see* Statement of Barney Frank, "Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, U.S. House of Representatives, (Feb. 15, 2012) at p. 8 ("Just a couple of points—first of all, this notion that the director cannot be removed is fanciful. It says in the statute that, yes, the director is appointed for a 5-year term, but can be removed by the president for insufficiency, neglect of duty, or malfeasance. No one doubts that if a change in administration comes, and the new president disagrees with the existing director, he or she can be removed. And proving that you were not inefficient, the burden of proof being on you, would be overwhelming.").

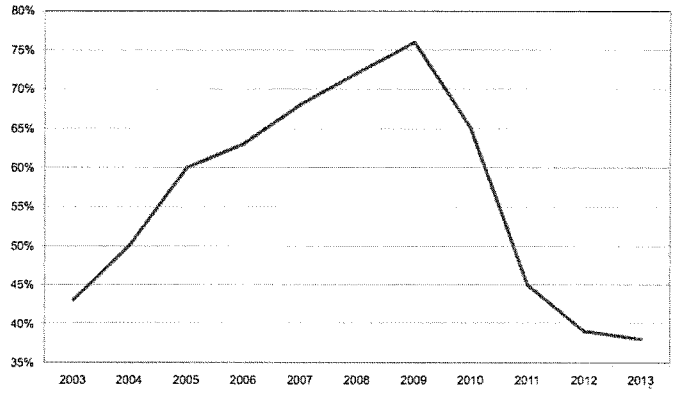
[3] *See* THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN, AND TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY (Oxford, 2014).

> Little wonder then for the first time in American history more businesses are being destroyed than new businesses being started.[4]

After five years, has Dodd-Frank made American families better off? No. Instead, the overall impact of Dodd-Frank has been to slow our economic recovery, raise prices, reduce choice, and eliminate access to the financial mainstream for American families. And low-income Americans have been hit the hardest.

Bank Accounts and The End of Free Checking for Millions of Americans: The years 2001 to 2009 saw one of the most important pro-consumer innovations in the history of retail consumer financial services: the rapid spread of near-universal consumer access to free checking.[5] It is estimated that during that period, consumer access to free checking accounts increased from under 10 percent of all bank accounts to 76 percent. In the years since Dodd-Frank, however, the number has collapsed to half of that amount—38 percent, as shown in figure 1.[6]

Figure 1. Banks Offering Free Checking from 2003 to 2013



Source: Bankrate.com.

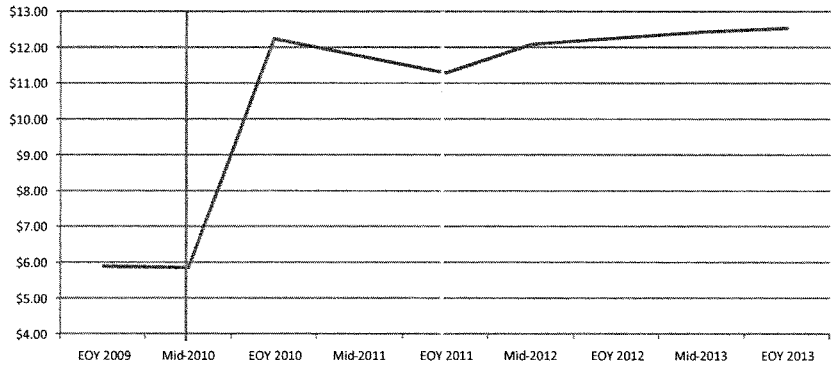
[4] *See* Ian Hathaway and Robert E. Litan, *Declining Business Dynamism in the United States: A Look at the States and Metros*, Brookings Institution Economics Studies (May 2014), http://www.brookings.edu/~/media/research/files/papers/2014/05/declining%20business%20dynamism%20litan/declining_business_dynamism_hathaway_litan.pdf.

[5] Todd J. Zywicki, Geoffrey A. Manne, and Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (June 4, 2014), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.

[6] *Id.* at 6, figure 1.

Not only are more consumers forced to pay fees to maintain their checking accounts, those (and other) fees have soared. Fees are twice as high on average as before Dodd-Frank was enacted, as shown in figure 2.[7]

Figure 2. Monthly Maintenance Fee (Non-Free Checking)



Source: MoneyRates.com.

Most troubling, however, is that low-income and other vulnerable populations have been most adversely impacted by Dodd-Frank's destruction of access to free checking: according to the FDIC, the number of unbanked consumers increased by 1 million between 2009 and 2011 and the number of underbanked consumers increased still faster.[8] Sadly, Dodd-Frank has put bank accounts—once the first rung on the ladder of financial inclusion—out of the reach of millions of young and lower-income Americans, forcing them to rely on alternative financial services such as check cashers and pawn shops.

To strip the most vulnerable Americans of access to bank accounts in order to line the pockets of the shareholders of big box retailers is simply unconscionable.

Credit Cards: Consumers have also suffered a loss of access to credit cards in the post-crisis era, not only because of Dodd-Frank but also the impact of the Credit Card Accountability Responsibility and Disclosure Act—and once again, low-income consumers have suffered the most. According to the CFPB's own estimates, the period between July 2008 and December 2012 saw the closure of 275 million credit card

[7] *Id.* at 8, figure 4. Mid-2010, of course, is when Dodd-Frank was passed into law. EOY 2011 marks the period at which regulations from the Federal Reserve System (Federal Reserve) regulations implementing the "Durbin Amendment" to Dodd-Frank became effective.

[8] FEDERAL DEPOSIT INSURANCE CORPORATION, 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf;

accounts and elimination of $1.7 trillion in credit card line of credit.[9] Overall, the CFPB found a significant decline in the percentage of households that had cards, from 76 percent to 71 percent. But even this figure understates the disproportionate impact on low-income consumers. According to Federal Reserve Board economists Glenn Canner and Gregory Elliehausen, the percentage of households in the lowest quintile of credit scores with credit cards fell from 65 percent in 2008 to 54 percent in 2010.[10] Loss of access to credit cards has forced those consumers into great reliance on higher-cost products such as payday loans and overdraft protection.[11]

Mortgages: The CFPB's "qualified mortgage" (QM) and "ability to repay" rules have dramatically slowed the recovery of the housing market, and fears of government liability have caused even large lenders to lend cautiously, especially to riskier borrowers. As Janet Yellen has noted, "banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores."[12] Despite the heavy regulatory burden imposed by the CFPB's mortgage rules, however, the rules are silent with respect to one of the most important risk factors for mortgage foreclosures—the reduction or elimination of minimum down payment requirements.[13] Nor do the rules address state antideficiency laws or cash-out refinancing by homeowners, both of which have been shown to have materially contributed to the foreclosure crisis.[14] Peter Wallison, former general counsel of the Department of the Treasury, estimated that had the QM rules applied in the period leading up the financial crisis, the default rate on QM–conforming mortgages would have still been 23 percent.[15] The end result is a dramatic increase in the regulatory cost and liability risk of mortgage lending, while doing little to reduce financial instability.

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[9] CONSUMER FINANCIAL PROTECTION BUREAU, CARD ACT REPORT: A REVIEW OF THE IMPACT OF THE CARD ACT ON THE CONSUMER CREDIT MARKET 56 (Oct. 1, 2013).

[10] Glenn B. Canner and Gregory Elliehausen, *Consumer Experiences with Credit Cards* at 10 Table 2, FEDERAL RESERVE BULLETIN (Dec 2013), online at http://www.federalreserve.gov/pubs/bulletin/2013/pdf/consumer-experiences-with-credit-cards-201312.pdf. By contrast, for highest-quintile households, card holding fell only one percentage point (from 91 percent to 90 percent of households).

[11] *See* Robert L. Clarke and Todd J. Zywicki, *Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau*, 33 REVIEW OF BANKING AND FINANCIAL LAW 235 (2013-14).

[12] For example, Janet Yellen, chair of the Board of Governors of the Federal Reserve System, has stated, "Banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores. They mention in meetings with us consistently their concerns about put-back risk, and I think they are—it is difficult for any homeowner who doesn't have pristine credit these days to get a mortgage. I think that is one of the factors that is causing the housing recovery to be slow. And of course, you know, there were a lot of practices in connection with mortgage lending that really needed to be changed, we don't want to go back to those days, but it is important to clarify—for us to work to clarify the rules around mortgage lending to create an environment of greater certainty for lenders to be willing to extend mortgage credit." Federal Reserve Board, *Transcript of Chairman Yellen's Press Conference* at p. 12 (June 18, 2014).

[13] *See* Zywicki, *supra* note 1, at 913.

[14] *See* Todd J. Zywicki and Joseph Adamson, *The Law and Economics of Subprime Lending*, 80 UNIVERSITY OF COLORADO L. REV. 1 (2009) (summarizing studies).

[15] PETER WALLISON, HIDDEN IN PLAIN SIGHT: WHAT REALLY CAUSED THE WORLD'S WORST FINANCIAL CRISIS AND WHY IT COULD HAPPEN AGAIN (2015).

The CFPB's regulatory costs have fallen particularly heavily on smaller and community banks. For example, a study by the Mercatus Center at George Mason University found that 71 percent of small banks stated that the CFPB has affected their business activities.[16] Sixty-four percent of small banks reported that they were making changes to their mortgage offerings because of Dodd-Frank and 15 percent said that they had either exited or were considering exiting residential mortgage markets entirely. Nearly 60 percent of small banks reported that the CFPB or the qualified mortgage rule had a "significant negative impact" on their mortgage operations. Nearly 60 percent said that the CFPB has had a significant negative effect on bank earnings and more than 60 percent said that changes in mortgage regulations had had a significant negative effect on bank earnings.

Moreover, by imposing a one-size-fits-all mechanical underwriting system for mortgages, the QM rule has deprived community banks of their one competitive advantage against megabanks: their intimate familiarity with their customers and their ability to engage in relationship lending with their customers.

According to a study by researchers at Harvard University's John F. Kennedy School of Government, community banks are shrinking at twice the rate since Dodd-Frank's enactment than before, while larger banks have grown in size.[17]

Data Mining: Perhaps the most egregious example of the CFPB's bureaucratic hubris—and subordination of the interests of American consumers to its own narrow bureaucratic agenda—is the agency's extraordinary data mining program of American families' financial accounts. Currently, the CFPB collects and monitors information for some 600 million American credit card accounts, "22 million mortgages, 5.5 million student loans, two million bank accounts with overdraft fees, and hundreds of thousands of auto sales, credit scores, and deposit advance loans."[18] Yet even this vacuuming up of our financial information isn't enough. The CFPB wants to enlarge its portfolio to 95 percent of all credit card accounts—almost 1 billion accounts in total.

Is it necessary for the CFPB to snoop so deeply into our bank accounts and credit card statements in order to further its regulatory agenda? Of course not. In fact, George Mason University economist Thomas Stratman has estimated that the number of credit card accounts for which the CFPB wants to collect consumer information is some 70,000 times greater than is necessary for the agency to execute its regulatory mission.[19]

But the costs of CFPB's demand for information do not fall solely on the banks that must provide it. While the CFPB claims that this data is anonymous, every bit of information

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[16] Hester Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Fairing Under Dodd-Frank?*, Mercatus Center Working Paper No. 14-05 (Feb. 2014).
[17] Marshall Lux and Robert Greene, *The State and Fate of Community Banking*, Harvard Kennedy School M-RCBG Associate Working Paper No. 37 (2015), *available in* http://www.hks.harvard.edu/centers/mrcbg/publications/awp/awp37.
[18] Newt Gingrich, *A Government Snoop That Puts the TSA to Shame*, WALL STREET J. (July 1, 2015).
[19] *See* Letter of Professor Thomas Stratman to Congressman Scott Garrett (Jan. 23, 2014), *available in* http://mercatus.org/sites/default/files/StratmannCFPBStatisticMethods.pdf.

increases the risk to consumers of identity theft and other misuse of their information. In fact, testifying before this committee last year, CFPB director Richard Cordray admitted that the information the CFPB collects is not 100 percent secure and could be hacked.[20] Moreover, according to a recent article in *Science*, using only three months of anonymous credit card data, the researchers were able to reidentify 90 percent of individuals, with women being more readily reidentifiable than men.[21]

While the unnecessary acquisition and retention of troves of Americans' information is troubling enough in itself, it is especially worrisome in light of repeated rebukes of the CFPB's faulty data security systems.[22] Following massive data security breaches and compromising of personal information by the Internal Revenue Service and Office of Personnel Management, it is inexplicable that the CFPB continues to insist on vacuuming up excessive amounts of consumer data without considering the privacy threat to consumers.

Bureaucratic Overreach: Finally, despite Dodd-Frank's broad grant of authority to the CFPB to regulate every consumer credit product in America, even that broad reach has proven insufficiently expansive for the agency. For example, Dodd-Frank expressly prohibits the CFPB from regulating loans made by auto dealers—yet through the rubric of enforcing fair-lending laws the CFPB has essentially deputized banks and other indirect auto lenders as de facto arms of the federal government. Moreover, recognizing that the information necessary to implement such a scheme simply does not exist, the CFPB has instead turned to a scientifically dubious methodology (Bayesian Improved Surname Geocoding) to try to impute the alleged race of each loan applicant.[23] The CFPB has also given itself authority to regulate third-party sellers of cell phone apps[24] and for-profit colleges, and it has even required a land developer to improve the condition of the roads in a housing development.[25]

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[20] *See* Richard Pollock, *Federal Consumer Bureau Data-Mining Hundreds of Millions of Consumer Credit Card Accounts, Mortgages*, WASHINGTON EXAMINER (Jan. 29, 2014), *available in* http://www.washingtonexaminer.com/consumer-bureau-data-mining-hundreds-of-millions-of-consumer-credit-card-accounts-mortgages/article/2543039.

[21] Yves-Alexandre de Montjoye, Laura Radaelli, Vivek Kumar Singh, and Alex "Sandy" Pentland, *Unique in the Shopping Mall: On the Reidentifiability of Credit Card Metadata*, 347 SCIENCE No. 6221 536-39 (Jan. 30, 2015).

[22] *See* Government Accountability Office, *Consumer Financial Protection Bureau: Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced* (Sept. 2014); Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Office of Inspector General, *Security Control Review of the CFPB's Cloud Computing–Based General Support System*, 2014-IT-C-010 (Washington, D.C.: July 17, 2014).

[23] *See* Arthur P. Baines and Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market*, Charles River Associates (Nov. 19, 2014), http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf.

[24] *Consumer Financial Protection Bureau v. Sprint Corp.*, Civil Action 14-9931 (Dec. 1, 2014), *available in* http://files.consumerfinance.gov/f/201412_cfpb_cfpb-v-sprint-complaint.pdf.

[25] *In the Matter of International Land Consultants, Inc., et al.*, Administrative Proceeding File No. 2015-CFPB-0010 (May 1, 2015) (consent order), *available in* http://files.consumerfinance.gov/f/201505_cfpb_consent-order-international-land-consultants.pdf.

Scholars of the regulatory process have long understood that agency imperialism is a predictable tendency of bureaucracies, as they seek to enlarge their power and influence over policy. Given the absence of meaningful internal or external institutional controls on the CFPB, it is hardly surprising that the CFPB has aggressively sought to expand its reach into all of these areas, from telecommunications services to the provision of higher education.

Looking back on the last five years, it is disappointing that Dodd-Frank squandered the historic opportunity presented by the financial crisis to create a modern and coherent consumer protection regime—one that would not only protect consumers from sharp practices but promote competition, innovation, and consumer choice. Even worse, Dodd-Frank imposed a regime that instead has led to higher prices, less innovation, and less choice in consumer credit products, while doing little to improve consumer protection. By taking away preferred choices for consumers, such as mortgages, bank accounts, and credit cards, Dodd-Frank and other laws have increased consumer dependence on less preferred products like payday loans, pawn shops, and check cashers. Most tragic of all, low-income and younger consumers—who already had the fewest choices—are those who have suffered the most from Dodd-Frank's regulatory onslaught.

Thank you.

Forbes

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Susan Adams Forbes Staff
6/16/2014 9:59AM

The Highest-Paid CEOs Are The Worst Performers, New Study Says

Across the board, the more CEOs get paid, the worse their companies do over the next three years, according to extensive new research. This is true whether they're CEOs at the highest end of the pay spectrum or the lowest. "The more CEOs are paid, the worse the firm does over the next three years, as far as stock performance and even accounting performance," says one of the authors of the study, Michael Cooper of the University of Utah's David Eccles School of Business.

The conventional wisdom among executive pay consultants, boards of directors and investors is that CEOs make the best decisions for their companies when they have the most skin in the game. That's why big chunks of the compensation packages for the highest-paid CEOs come in the form of stock and stock options. Case in point: The world's top-earning CEO, Oracle billionaire Larry Ellison, took in $77 million worth of stock-based compensation last year, according to The New York Times, after refusing his performance bonus and accepting only $1 in salary (he made a stunning total of $96 million in 2012). But does all that stock motivate Ellison to make the best calls for his company?

The empirical evidence before fell on both sides of that question, but those studies used small sample sizes. Now Cooper and two professors, one at Purdue and the other at the University of Cambridge, have studied a large data set of the 1,500 companies with the biggest market caps, supplied by a firm called Execucomp. They also looked at pay and company performance in three-year periods over a relatively long time span, from 1994-2013, and compared what are known as firms' "abnormal" performance, meaning a company's revenues and profits as compared with like companies in their fields. They were startled to find that the more CEOs got paid, the worse their companies did.

Another counter-intuitive conclusion: The negative effect was most pronounced in the 150 firms with the highest-paid CEOs. The finding is especially surprising given the widespread notion that it's worth it to pay a premium to superstar CEOs like Jamie Dimon of JPMorgan Chase (who earned $20 million in 2013) or Lloyd Blankfein ($28

million) of Goldman Sachs. (The study doesn't reveal individual results for them.) Though Cooper concedes that there could be exceptions at specific companies (the study didn't measure individual firms), the study shows that as a group, the companies run by the CEOS who were paid at the top 10% of the scale, had the worst performance. How much worse? The firms returned 10% less to their shareholders than did their industry peers. The study also clearly shows that at the high end, the more CEOs were paid, the worse their companies did; it looked at the very top, the 5% of CEOs who were the highest paid, and found that their companies did 15% worse, on average, than their peers.

How could this be? In a word, overconfidence. CEOs who get paid huge amounts tend to think less critically about their decisions. "They ignore dis-confirming information and just think that they're right," says Cooper. That tends to result in over-investing—investing too much and investing in bad projects that don't yield positive returns for investors." The researchers found that 13% of the 150 CEOs at the bottom of the list had done mergers over the past year and the average return from the mergers was negative .51%. Among the top-paid CEOs, 19% did mergers and those deals resulted in a negative performance of 1.38% over the following three years. "The returns are almost three times lower for the high-paying firms than the low-paying firms," says Cooper. "This wasteful spending destroys shareholder value."

The paper also found that the longer CEOs were at the helm, the more pronounced was their firms' poor performance. Cooper says this is because those CEOs are able to appoint more allies to their boards, and those board members are likely to go along with the bosses' bad decisions. "For the high-pay CEOs, with high overconfidence and high tenure, the effects are just crazy," he says. They return 22% worse in shareholder value over three years as compared to their peers.

Yet another surprising finding: The high-paid CEOs did poorly for themselves when it came to cashing in their options. Among the bottom-paying firms, 33% of the CEOs held onto their options when they could have cashed them in for a profit, which the paper calls "unexercised in-the-money options," while more than twice as many high-paid CEOs, 88%, held onto their options when they could have made money selling.

What can be done about all those negative numbers? The paper doesn't venture to say but Cooper notes that some finance experts have suggested so-called claw-back provisions. In a CEO pay contract, there would be an item that says, if the firm does poorly compared to its peers, the CEO loses a share of his compensation. "That proposal hasn't gone over real well," says Cooper. "There is another school of thought,

that CEOs are just too highly paid, period," he adds. "The U.S. is pretty egregious as far as the ratio between median pay and what the CEO makes."

Though four years ago the Dodd-Frank law instituted a requirement that firms divulge the ratio between CEOs and median pay, the SEC has yet to issue a final rule ordering it, and companies have been less than forthcoming. But Bloomberg compiled data last year showing that the average multiple of CEO compensation to that of rank-and-file workers was 204, up 20% since 2009. At General Electric, with its star CEO Jeffrey Immelt ($28.2 million in 2013), the ratio was 491, according to Bloomberg.

The Occupy movement, labor unions and some members of Congress have pushed companies to divulge more information about pay ratios, and complained about excess CEO pay, while boards have pushed so-called say-on-pay provisions that would allow them to vote on executive compensation packages. Now those groups have some new empirical evidence to support their positions.

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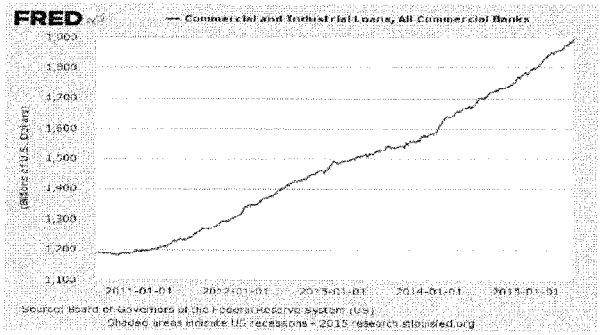
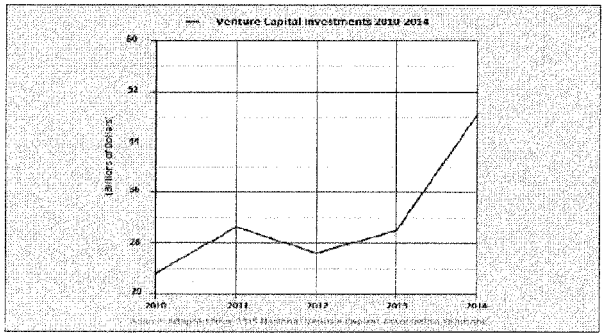
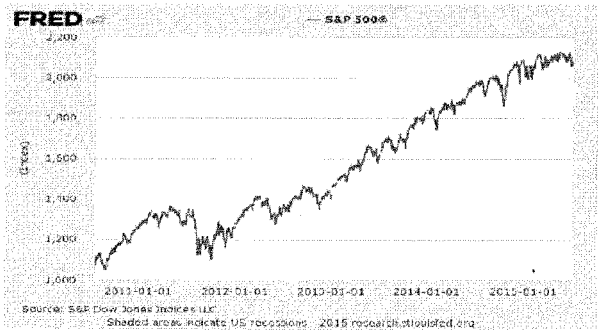
The Five Years Since Dodd-Frank



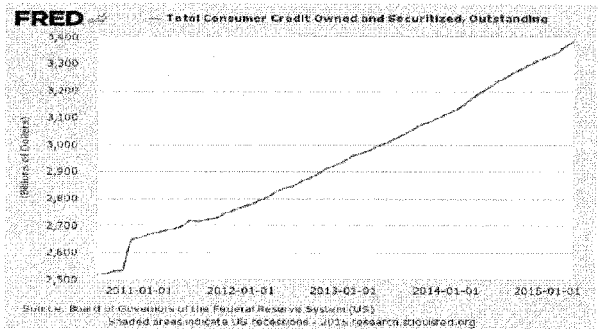
Commercial and Industrial Loans - Up 60%



Venture Capital Investments - Up 107%



S&P 500 - Up 94%



Total Consumer Credit - Up 34%

Research

From Free Checking to the Financial Fringe: A Tale of Two Regulations and Low-Income Families

By Meghan Milloy
July 8, 2015

Summary

- Ensuring low-income individuals and families adequate access to transactions services is a perennial policy goal, whether that access is traditional banking (checking accounts) or newer innovations like prepaid cards.

- The Durbin Amendment to the Dodd-Frank Act raised the cost of checking accounts and associated debit cards which led to the unintended consequence of dramatically limiting free checking in the United States.

- Low-income individuals and families migrated away from now-expensive checking accounts toward prepaid cards and other services. Recently-proposed Consumer Financial Protection Bureau (CFPB) rules would likely eliminate these options as well.

The Durbin Amendment and the Demise of Free Checking Accounts

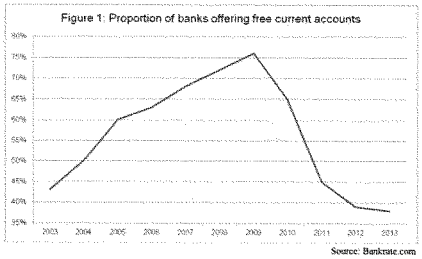
New technology, like Apple Pay and other forms of contactless payment, is reigniting old arguments over the Durbin Amendment. For anyone who may have forgotten about this small yet vastly consequential regulation, the Durbin Amendment to the Dodd-Frank financial reform law set a limit on interchange fees charged to retailers when a customer makes a purchase using a debit card. These so-called "Durbin fees" are generally less than two percent of the total purchase price, and the fee revenue is split between the card-issuing bank, the card company (Visa, MasterCard, etc.), and the retailer's merchant account provider. Durbin argued that limiting these fees would reduce retailers' costs and that those savings would be passed on to consumers.

In its wake, among other things, retailers promised to lower the costs of essentials, and hotels promised to charge lower rates to customers using debit cards. Not surprisingly, those promises never came to fruition. In fact, Dodd-Frank author Barney Frank, an unexpected opponent of the Durbin Amendment, warned that "[he] believe[d] that a free market approach in this area will be better for the economy and all concerned parties…"

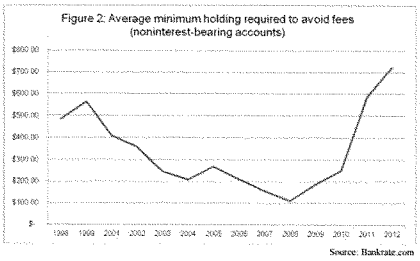
Frank called for the repeal of the Durbin amendment in 2011 citing "unintended consequences for consumers." The unintended consequences are costs being shifted from those customers who use bank cards to everyone with a bank account, thereby increasing costs for everyone and pricing many low and middle-income bank customers out of maintaining a bank account.

To put it in practical terms, banks previously relied on revenues from interchange fees to cover the costs related to debit

card operations. Since the Durbin Amendment took effect, banks are experiencing losses between $6.6 billion and $8 billion annually and are no longer able to cover the costs of debit card operations through interchange fees. As a result, banks are increasing fees to consumers and drastically cutting down on services, like checking accounts, that were previously free. One study shows that in 2009, before Durbin, 76 percent of all bank accounts were free, charging no usage fee to the consumer. However, in 2013, a mere 38 percent of bank accounts are offered free of charge.



Banks also began requiring higher minimum balances on their free or low-fee accounts as well as charging higher card replacement and other administrative fees. JPMorgan Chase estimated that these increased minimum balances and ensuing fees would result in as many as five percent of its banking customers getting pushed out of the banking system. This five percent drop is reasonable considering that Durbin has mainly impacted individuals and families at the lowest end of the income spectrum.



Low-Income Families and Loss of Access to Free Checking

Even by taking a conservative approach to JPMorgan's five percent estimate, the Federal Reserve in a 2011 consumer impact study said, "We would expect that a significant portion of the customers that would abandon checking accounts would be lower-income households since those are the ones most likely not to be able to want to pay for the more expensive accounts. To get an understanding of the potential significance of these closures we note that a one percent decline in checking accounts would result in the loss of checking access for roughly 1 million households; an increase in the number of households by 1 million would increase the percent of unbanked individuals by 12 percent."

Select Demographic Groups	Percent Unbanked	Percent Underbanked	Percent Fully Banked
All households	8.2	20.1	68.8
Blacks	21.4	33.9	41.6
Foreign-born non-citizens	22.2	28.9	45.8
Households experiencing unemployment	22.5	28.0	47.5
Lower-income households (less than $15,000)	28.2	21.6	47.6
Unmarried female family households*	19.1	29.5	48.4
Hispanics	20.1	28.6	48.7
Households with householders under age 24	17.4	31.0	49.7

* The Census Bureau classifies households into different household types. For example, a family household is a household that includes two or more people related by birth, marriage, or adoption and residing together, along with any unrelated people who may be residing there. Single mothers are an example of female family households. For more detail, refer to the Technical Note (Appendix E).

The Growing Use of Alternative Financial Services

As a result, these unbanked and underbanked households are forced to turn to alternative financial services (AFS) to carry out their day to day transactions. AFS may be divided between transactional AFS and credit AFS, the former representing non-bank money orders, non-bank check cashing, and non-bank remittances and the latter representing pay day loans, pawn shops, rent-to-own stores, and refund anticipation loans. According to a 2012 Federal Deposit Insurance Corporation (FDIC) study on unbanked and underbanked households, nearly two-thirds (64.9 percent) of unbanked households have used at least one AFS product in the last year and close to half (45.5 percent) have used AFS in the last 30 days. Over 60 percent (62.1 percent) have used a transactional AFS product in the last year while 16.8 percent have used an AFS credit product. Only 29.5 percent of unbanked and underbanked households have not used any AFS in the past year which points to their reliance on cash usage and other informal transactions. Among unbanked and underbanked households that have used AFS, 61.2 percent have used it within the past 30 days which suggests that these households rely on AFS regularly and often.

Prepaid and Payroll Card Use	All Households					Banking Status											
						Unbanked			Underbanked			Fully Banked			Underbanked Status Unknown		
	Number (1000s)		Pct of Col		Estimated Difference	Pct of Col		Estimated Difference	Pct of Col		Estimated Difference	Pct of Col		Estimated Difference	Pct of Col		Estimated Difference
	2009	2011	2009	2011		2009	2011		2009	2011		2009	2011		2009	2011	
Prepaid Cards																	
Has ever used	11,781	12,119	9.9	10.1	0.2	12.2	17.8	5.6*	16.4	17.4	1.0	8.1	7.3	-0.8*	6.8	3.3	-3.5*
Has never used	105,000	105,000	87.9	87.0	-0.9*	81.3	75.7	-5.6*	82.6	81.7	-1.2*	91.5	92.3	0.8*	47.2	29.3	-17.9*
Unknown	2,600	3,542	2.2	2.9	0.6*	6.5	6.5	-0.0	0.7	0.9	0.2	0.4	0.4	0.0	45.9	67.4	21.5*
Payroll Cards																	
Receives wages on payroll card	3,588	3,891	3.0	3.2	0.2	3.2	5.5	2.3*	4.2	5.3	1.0*	2.7	2.5	-0.3	1.6	0.5	-1.1*
Does not receive wages on payroll card	113,000	113,000	95.0	94.1	-0.9*	90.1	88.4	-1.7*	95.3	93.9	-1.4*	97.1	97.4	0.3	51.9	33.4	-18.5
Unknown	2,405	3,223	2.0	2.7	0.7*	6.7	6.0	-0.6	0.5	0.8	0.4*	0.2	0.1	-0.0	46.5	65.1	19.6*

Notes:
* Indicates differences that are statistically significant at the 10% level.
Figures do not always reconcile to totals because of rounding.
2009 data revised September 2012. Refer to 2009 and 2011 FDIC National Survey of Unbanked and Underbanked Households and Technical Notes for terms, definitions, and methodological discussion.

The average income of the more than 90 million underbanked Americans is $25,500, less than half of the median income in the United States. Of that $25,500, the underbanked population spends about 10 percent each year – approximately the same amount they spend on food – simply gaining access to their funds through AFS. In recent years in an effort to avoid both the fees and minimum balances from traditional bank accounts as well as the high fees and services charges related to AFS, unbanked and underbanked households have increasingly been turning to prepaid debit cards and payroll cards. In fact, the Federal Reserve found that they are the fastest growing form of non-cash payment.

Regulating – and Limiting Access to – Alternative Financial Services

Unfortunately for those households who rely on prepaid cards as an alternative to bank accounts, the Consumer Financial Protection Bureau (CFPB) is proposing new regulations that would have a significant impact on the availability of prepaid cards as well as the benefits they bring. In the 870 page proposal on prepaid cards, including 156 pages of actual proposed rules, the CFPB seeks to mandate new disclosures on behalf of the card companies, new error resolution procedures, consumer liability limits for unauthorized transactions, fee limits, and added requirements for cards with overdraft or credit features.

The proposed rule covers "prepaid accounts" which is defined as "a card, code, or any other device that is capable of being loaded with funds, is not otherwise an account under [the proposed] Regulation E (such as a deposit account), and is redeemable upon presentation at multiple unaffiliated merchants for goods or services, or usable at either ATMs or for person to person transfers." For those accounts, the proposed rule would require a short-form and long-form fee disclosure along with other information at the time a consumer acquires a prepaid account. Issuers also would be required to deliver statements and both electronic and paper account histories dating back at least 18 months. Additionally, the rule proposes to require overdraft and credit extension features on prepaid cards, thus subjecting these prepaid accounts to the Credit Card Accountability Responsibility and Disclosure (CARD) Act requirements, as well as CFPB's vast authority over any cards with credit features as it applies to their reporting, marketing, and disclosure rules. The rule also sets standards for error resolution and limits consumer liability.

Costs of Regulation and the Impact of Cost-Shifting

Buried 700 pages into the proposed rule, CFPB admits the hefty time and dollar burden it believes will come as a result of the new requirements. For Regulation E alone, CFPB estimates a one-time burden of 35,398 hours and an ongoing or annual burden of 10,376 hours to the prepaid card providers. Even at a conservative $33 per hour, that's a one-time compliance cost of $1,168,134 and an annual compliance cost of $342,408 to these prepaid card companies. And that's just one regulation. The proposal also estimates costs of $17 million simply to dispose of and replace the prepaid cards currently in stores in order to comply with the pre-acquisition disclosure requirements. If we've learned anything about government-mandated costs to providers of financial services, it's that they will, in one way or another, get passed onto the consumers. It's hard to imagine that these would be any different.

In its 46 page comment letter submitted in response to CFPB's proposal, the American Bankers Association (ABA) raises several concerns, most of which center around the way the proposal's treatment of overdrafts on prepaid cards. Among other problems, the proposal would treat overdrafts as an extension of credit, which categorically violates the Truth in Lending Act (TILA). In short, TILA conveys a right to defer payment to credit account holders, but anyone who overdrafts on a prepaid card is not afforded such a right even though CFPB seeks to equate those overdraft allowances with credit extensions. CFPB is attempting to paint prepaid cards with a broad brushstroke, and instead should be defining these prepaid accounts more narrowly. Without a more narrow definition, the proposal would effectively ban overdraft services or credit extension on the cards because the card issuers will be faced with unsurmountable compliance costs and risks.

ABA's summary closing paragraph is a compelling argument – one supported by both numbers and precedent: "In short, the cumulative operation and compliance costs and risks of the proposal will significantly hinder banks' ability to offer prepaid cards. The result will be the suppression of a promising option to move people without bank accounts into financial products offered by insured depository institutions. Thus, rather than creating guardrails, the proposed overdraft services treatment, coupled with other onerous provisions, will create regulatory potholes and barriers to needed and valuable financial products."

Conclusion

It's bad enough that millions of Americans are left unbanked or underbanked as a direct result of government action through the Durbin Amendment, but now CFPB wants pull the last rug out from under their feet and impose high regulatory costs that will result in higher fees for consumers or constrict their options. Prepaid card companies and their users were doing just fine (apart from being forced to use prepaid cards as a bank alternative) without CFPB's intervention. CFPB

should be reminded that if it ain't broke, don't fix it.

Disclaimer

Meghan Milloy
Director of Financial Services Policy

Meghan is the Director of Financial Services Policy at the American Action Forum.

Related Research

The State Share of Unfunded Regulations: Nearly $35 Billion, 75 Million Paperwork Hours
By Sam Batkins on June 4, 2015

Regulatory Impact on Small Business Establishments
By Ben Gitis, Sam Batkins on April 24, 2015

2014: Year of Action, Year of Regulation
By Sam Batkins on January 6, 2015

Primer on DOL Fiduciary Standards: Impact & Outlook
By Andy Winkler on March 24, 2015

The Honorable Luke Messer
Committee on Financial Services Hearing
Assessing the Impact of the Dodd-Frank Act Five Years Later: Less Prosperous, Less Free, and Less Stable
July 9, 2015

Questions for Professor Zywicki:

Mr. Chairman, I'm very concerned about the impact government action has on the low-income Americans. Various government programs make the cost of everyday life more expensive which disproportionately impacts the low-income families. Much ink has been spilled on the issue of income inequality but not enough attention has focused on the impact laws and regulations have on the cost of ever day necessities like fuel, food, housing, and even banking

Mr. Chairman, I ask unanimous consent that a recent report titled "From Free Checking to the Financial Fringe: A Tale of Two Regulations and Low-Income Families," be included in the record.

This report concludes that the Durbin Amendment to Dodd-Frank, which placed an artificial cap on interchange fees and was sold as a vehicle to lower consumer prices, has actually harmed the low-income families. Specifically, the report details the decline in free checking which is leading to a greater number of people being unbanked.

Professor Zywicki, do you agree that the Durbin amendment has disproportionately and adversely impacted the poor and do you agree that the decline in free checking has led to a greater number of unbanked Americans?

Answer: Yes, I do. The evidence is compelling that by reducing revenues generated by interchange fees from debit cards, banks subject to the Durbin Amendment have responded by reducing access to free checking and raising bank fees. Overall, according to Bankrate.com free checking has fallen from 76% of all bank accounts to 38%. Moreover, this loss of access to free checking has been concentrated solely in those banks subject to the Durbin Amendment, those with assets of over $10 billion. Smaller banks that were not subject to the Durbin Amendment have not evidenced any reduction in access to free checking, which suggests that the primary cause of the loss of free checking was because of the Durbin Amendment and not other, more general forces, such as the banking crisis or subsequent recession.

Middle-income and wealthier Americans have been able to largely avoid the impact of these higher bank fees by raising their average monthly balances or using other bank services (such as mortgages or auto loans). Lower-income consumers, by contrast, have minimal ability to avoid the impact of higher bank fees. As a result, many have been forced out of the banking system and

have been forced to increase their reliance on products such as pawn shops, prepaid cards, and check cashers.

Furthermore, the report notes the increase in unbanked and underbanked households turning to alternative financial services like non-bank money orders or checks cashing or pay day loans.

The report concludes that the CFPB's proposed regulations relating to alternative financial services will have significant impact on the availability of prepaid cards. Do you agree that this proposed rule will have a disproportionate negative effect on the low-income Americans as the Durbin amendment did?

Answer: Yes, I agree. The negative impact of the prepaid card regulations will be especially painful for low income consumers because many low-income consumers who lost access to bank accounts have turned to prepaid cards as an alternative. Prepaid cards can provide many of the same services as a traditional bank account, such as providing a safe place to save money, to make electronic payments, and to engage in online shopping and bill payment. By increasing the regulatory burden and reducing the usefulness of prepaid cards to consumers, the proposed regulation will harm those consumers who use these cards, especially the increasing number of Americans who use them as an alternative to a (now unavailable) bank account. In addition, prepaid cards hold the potential to evolve over time into simplified mobile banking platforms that could provide low-frills bank services to many low-income consumers at a low price.

Moreover, it should be noted that the Durbin Amendment itself has proven harmful to the development of the prepaid card market. Under the terms of the Durbin Amendment, if a prepaid card issued by a covered institution contains certain characteristics (such as recurring bill payment) it is classified for purposes of the regulation as a debit card and is thus subject to the Durbin Amendment's price controls. As a result, several of the least-expensive and most user-friendly prepaid cards issued by large banks cannot offer full functionality to consumers because of the Durbin Amendment.

July 9, 2015

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

RE: House Financial Services Committee Hearing Titled "Dodd-Frank Five Years Later: Are We More Stable?"

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the Association for Corporate Growth (ACG) and our 14,500 members and the 26,000 "Main Street" businesses they operate, thank you for holding the hearing entitled "Dodd-Frank Five Years Later: Are We More Stable?" ACG strongly believes that examining the effects of the Dodd-Frank Act is critical to understanding its impact on the economy and the middle market.

Founded in 1954, ACG is an organization with 46 chapters in the United States representing professionals from private equity firms, corporations and lenders that invest in middle-market companies, as well as from law, accounting, investment banking and other firms that provide transaction-related and other advisory services. ACG's mission is "driving middle-market growth."

ACG represents more private equity firms than any other association in the United States. Virtually all of ACG's private equity members are private partnerships and almost exclusively invest in privately-held small and middle-market companies. Importantly, from 1995-2013, U.S. private equity backed-companies grew jobs by 83.7 percent, adding 760,000 new jobs across the U.S. Well over three-quarters of those new jobs stem from the middle-market.

The 2010 Dodd-Frank Act was enacted to regulate those institutions that pose a systemic risk to the U.S. financial system and prevent another financial crisis. As a result of Dodd-Frank having eliminated the "private adviser" exemption under Section 203(b) of the Investment Advisers Act of 1940 ("Act"), advisers to private equity firms with more than $150 million of assets under management are now generally required to register under the Act. This has resulted in a significant increase in the regulatory burden on middle-market private equity firms, even though these firms were not the cause of the financial crisis and do not pose a systemic risk to financial systems.

The principal reasons that middle-market private equity firms do not pose a systemic risk is that they are not leveraged; they are not deeply interconnected; they make long-term investments and debt is generally collateralized. The Act was not designed to regulate private equity funds. As a result, many of the Act's requirements are not relevant and do not make sense for the private equity business model and do not provide a corresponding benefit to the sophisticated investors in private equity, or to the public. This results in significant regulatory burdens, accompanied by high costs with minimal benefit to the public or investors.

125 S. Wacker Drive | Suite 3100 | Chicago | IL | 60606 | 1-877-358-2220 | membership@acg.org | www.acg.org

Middle-Market Private Equity Business Model

In response to the challenges of complying with the regulations mandated by Dodd-Frank, ACG formed its Private Equity Regulatory Task Force (PERT), comprised of middle-market private equity chief compliance, chief financial and in-house legal officers. The goals of PERT are to help educate lawmakers and regulators about the middle-market private equity business model and explain why certain regulations that have come about as a result of Dodd-Frank do not accomplish the intended goals of the law, namely increased investor protections and reduction of global systemic risk to financial systems.

Investors in middle-market private equity funds are highly sophisticated. Virtually all are accredited investors, and substantially all are qualified purchasers and/or institutional investors. These investors perform robust due diligence and/or have outside gatekeepers who perform robust due diligence before making a commitment to invest in a private equity fund. Middle-market private equity funds make long term investments in operating companies and, unlike hedge funds or other registered investment advisers, do not buy or sell publicly traded securities in the open market.

Benefits of Dodd-Frank and IAA Registration for Middle-Market Private Equity

Emphasizing and reinforcing a culture of compliance and disclosure has been a positive for the 1,000+ middle-market private equity firms represented by ACG. Having a robust compliance program in place and ensuring that limited partnership agreements, disclosure documents and corresponding communications are clearly written with accurate and complete disclosure has benefited both fund managers and the investors in these funds. In addition, the culture of compliance has encouraged private equity employees to better understand their industry, their fiduciary and compliance obligations and be accountable for their actions and behavior. However, ACG and its members believe that the outcomes could have been achieved without unduly burdensome regulations, which do not make sense and are not intended for an industry that does not pose systemic risk.

Aggregate and Ongoing Regulatory Expenses

As a result of having to register under the Act, ACG's members have spent tens of millions of dollars (more than $100 million as an industry) to comply with initial registration requirements. These compliance costs include software and other necessary compliance applications/subscriptions; filing, reporting and regulatory fees; third-party compliance professionals, mock audits & analysis; legal and accounting fees; and travel and related expenses.

Ongoing compliance and reporting fees typically cost a middle-market private equity firm, on average, approximately $100,000 annually. These compliance costs include legal and accounting fees; software and other necessary compliance subscriptions; filing, reporting and regulatory fees; and compliance seminars, conferences, travel and related expenses. The above estimates do not include the compensation costs borne by the private equity firms to hire a chief compliance officer, which in many cases is a one-person compliance department. Furthermore, compliance officers (many of whom already serve as the chief financial officer) may also soon need to take on the role of chief technology officer, based on current expectations related to cybersecurity.

The regulatory requirements of the Act have a disproportionate cost and impact on middle-market private equity firms. Any reporting requirements for private equity firms should be more carefully calibrated so that burdens are proportionate to the size of the firm. The current regulatory environment makes it increasingly more difficult for small and mid-sized firms to provide capital to small and middle market businesses. Because such costs are disproportionate, the unintended consequence of the Act is that it will make it much harder for smaller private equity firms to stay in

business. Because smaller firms invest in smaller companies, this will eventually have a negative impact on middle-market companies and job creation across the United States.

Staff Time and Expenses Do Not Add Value

Navigating the regulatory framework for a newly registered investment adviser has been challenging and, using a cost-benefit analysis, a poor use of time and money. In many instances, middle-market private equity firms have had to move staff resources away from investment-related activities in order to fill compliance roles. This results in firms needing to divert scarce resources away from the firm's primary objective: delivering outstanding returns for investors, many of which are public pension funds.

Duplicative & Contradictory Compliance Regimes

Some middle-market private equity firms have multiple types of funds, including SBICs. In these cases, ACG members now have regulatory oversight from two different bodies – the U.S. Securities and Exchange Commission and the Small Business Administration. In some cases, the regulations make no sense given the PE model, forcing ACG members to hold securities with a custodian at substantial additional costs, despite the fact that such securities are not transferable and are not publicly traded.

Committed Funds – Application of the Act

Dodd-Frank eliminated the old "private adviser" exemption under the Act, thereby requiring private equity funds to register under the Act. Yet it exempted "venture funds" from having to register under the Act. Venture funds are "committed" funds, which means that although an investor commits to invest capital in a venture fund, the investor provides funds only when the fund calls capital to fund an investment. Private equity funds are committed funds and are structured in a fashion similar to venture funds. Pure middle-market private equity funds, like venture funds, should be exempt from the Act.

Thank you again, Chairman Hensarling and Ranking Member Waters, for the opportunity to share ACG members' perspectives on the five-year anniversary of Dodd-Frank. We look forward to ongoing dialogue to share ways to improve Dodd-Frank and to achieve meaningful regulation that allows middle-market investors to focus their time and capital on investing in and growing small and midsize businesses. If you have any questions, please feel free to contact Amber Landis, ACG's senior director of public policy, at alandis@acg.org or (312) 957-4272.

Sincerely,

Gary LaBranche, FASAE, CAE
President and CEO
Association for Corporate Growth

Cc: Members of the House Financial Services Committee