ASSESSING THE IMPACT OF THE DODD–FRANK ACT FOUR YEARS LATER

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

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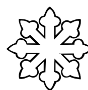

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ASSESSING THE IMPACT OF THE DODD–FRANK ACT FOUR YEARS LATER

Wednesday, July 23, 2014

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

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

Members present: Representatives Hensarling, Royce, Lucas, Capito, Garrett, Neugebauer, McHenry, Bachmann, Pearce, Posey, Fitzpatrick, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hurt, Stivers, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Cotton, Rothfus, Messer; Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Hinojosa, Clay, McCarthy of New York, Lynch, Scott, Green, Cleaver, Moore, Ellison, Perlmutter, Himes, Carney, Sewell, Foster, Kildee, Delaney, Sinema, Beatty, and Horsford.

Chairman HENSARLING. The committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

This hearing occurs 2 days after the fourth anniversary of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Today, we will examine its impact on our capital markets and the American economy and our citizens more generally. I now recognize myself for 4½ minutes for an opening statement.

Dodd-Frank has always been based upon a false premise that somehow deregulation or lack of regulation led us into the crisis. However, in the decade leading up to the crisis, studies have shown that the regulatory burden on the financial services industry actually increased.

There were few industries that were more highly regulated: FDICIA, FIRREA, Sarbanes-Oxley, the list goes on. We hear a lot about Wall Street greed. I could not agree more. I am just curious at what point was there not greed on Wall Street. So I am wondering how that could necessarily be the determining factor.

What I do know is that affordable housing goals of Fannie Mae and Freddie Mac on steroids and other policies helped incent, cajole, and mandate financial institutions into loaning money to people to buy homes who ultimately could not afford to keep them.

My Democratic colleagues at the time said, "Let's roll the dice on housing." They did. And the economy imploded. It wasn't deregulation. It was bad regulation that helped lead us into this crisis.

And so, if you get the wrong diagnosis, you get the wrong remedy. Dodd-Frank has been the wrong remedy, adding incomprehensible complexity to incomprehensible complexity.

Now, frequently in Washington—I say frequently, but regrettably, it is the rule as opposed to the exception—laws are evaluated by their advertised benefits, not by their actual benefits or actual cost.

So at the time Dodd-Frank was passed, we were told it would "lift the economy," "end too-big-to-fail," "end bailouts," "increase financial stability," and, "increase investment and entrepreneurship."

And instead, what have we learned? We have learned that it is now official that we are in the slowest, weakest recovery in the history of the Nation: tens of millions of our countrymen are now unemployed or underemployed; there has been negative economic growth in the last quarter; business startups are at a 20-year low; and 1 out of 7 people are dependent upon food stamps.

Again, increasing entrepreneurship, I don't think so. Ending too-big-to-fail, we have had this debate before. We had it yesterday. We will have it today. We will have it tomorrow. Dodd-Frank codified too-big-to-fail into law, and it is now demonstrable 4 years later that the big banks have gotten bigger and the small banks have gotten fewer.

Financial stability, I suppose that is a debatable proposition. Financial stability is now defined by the unelected and unaccountable bureaucrats.

I don't know if you increase concentration, though, in our larger financial institutions, whether one can say we have achieved financial stability. But what I do know is that it comes at an incredible cost.

Thanks to Dodd-Frank, it is now harder for low- and moderate-income Americans to buy a home. Again, thanks to Dodd-Frank, there are fewer community banks serving the needs of small businesses and families.

Thanks to Dodd-Frank, Main Street businesses and farmers faced higher costs in managing their risk and producing their products, which is impacting every single American at their kitchen table.

Thanks to Dodd-Frank's Volcker Rule, our capital markets are less liquid than before, making it more expensive for companies to raise working capital, which harms Americans who are saving for retirement, and for childrens' education.

Thanks to Dodd-Frank, services that bank customers once took for granted, like free checking, are being curtailed or eliminated.

It is one of the reasons that the House Financial Services Committee has moved numerous regulatory relief bills, a number of which have actually passed with bipartisan support, and none of which I recall being taken up by the Democratic Senate.

By the time this Congress is over, the House Financial Services Committee will have addressed Dodd-Frank's greatest sin of omission, housing finance reform, and worked alongside our friends at the Judiciary Committee, who are developing a bankruptcy alternative to the Orderly Liquidation Authority.

Before the end of this Congress, we will also have addressed Dodd-Frank's greatest sin of commission: codifying too-big-to-fail and a taxpayer-backed bailout fund.

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

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

I would like to welcome all of today's witnesses.

And I, too, want to acknowledge and welcome the former chairman and long-time veteran of this committee, Mr. Barney Frank, and I am so pleased that he has agreed to be the Democratic witness today.

Barney, I have had your portrait hanging over me for just about a year now and during that time, I have concluded that just seeing Barney Frank without hearing him is no Barney Frank at all.

I am pleased we all will be able to hear you today, and I hope to hear you remind my Republican colleagues about just how close to the brink we came in 2008 and about why Congress and the President responded forcefully with your namesake legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act.

I am hoping you will recount the incalculable widespread human suffering that was inflicted upon millions of Americans, suffering that still continues to this day, and how years of deregulation, lax enforcement, and zero accountability for the Nation's financial institutions destroyed more than $13 trillion in economic growth, $16 trillion in household wealth, and led to millions of foreclosures and devastating unemployment.

In the aftermath, Democrats and some Senate Republicans passed Dodd-Frank, which provided oversight to Wall Street, gave regulators the tools to end the era of too-big-to-fail entities and taxpayer bailouts, and eliminated loopholes that allowed risky and abusive practices to go unnoticed and unregulated.

And, most importantly, it restored responsibility and accountability to our financial system, giving Americans confidence in a system that works for and protects them.

Chairman Frank, I am proud to have worked so closely with you on this important legislation, and I am even more proud of the law's remarkable progress in just 4 short years.

The Consumer Financial Protection Bureau is up and running, already returning $4.6 billion to 15 million consumers who have been subjected to unfair and deceptive practices.

The Volcker Rule has been finalized, which is forcing banks to limit the practice of trading to make money for themselves and refocusing them on making investments in the real economy.

Shareholders of the U.S. corporations now have a say on pay and can better hold executives accountable by voting down excessive compensation or golden parachutes.

And thanks to loaner authorities given to the Securities and Exchange Commission, one of Wall Street's top cops, more than $9.3 billion in civil penalties has been recovered from bad actors since 2011.

But before these accomplishments were evident, in fact before the ink on President Obama's signature was dry, Republicans immersed themselves in an aggressive unrelenting campaign to repeal, weaken, and pressure regulators to return us to the time before the crisis.

They incorrectly blame the financial crisis on government efforts to house the poor and disadvantaged, despite the fact that private market securitizations built on predatory markets and loans started the crisis.

Exotic over-the-counter derivatives exacerbated it, and poor corporate governance and risk management allowed it to flourish. And just as they may diagnose the causes, they misunderstand the cure.

Republicans have pushed proposals to cut regulated funding and subject their rulemakings to constant implementation hurdles and core challenges. Democrats have tirelessly fought GOP efforts to render Dodd-Frank toothless or risk returning the financial services industry to the opacity, risk, and deregulation that caused the crisis.

They make hyperbolic claims about the effects of regulation. These assertions are as old as time. Indeed, the same salvos can be heard from opponents of the 1933 Securities Act which was passed in response to the crisis of 1929.

And though they are the loudest critics, Republicans have never offered an alternative, no alternative to protect consumers, no way to wind down large, complex banks, and no capacity to pass reforms of Fannie Mae and Freddie Mac.

I continue waiting for my Republican colleagues to acknowledge, as Mr. Greenspan has, that they have found a flaw in free market ideology.

Mr. Chairman, the 4-year anniversary of the Dodd-Frank Act is an important milestone. We should look back and assess how far we have come and where we need to go.

And today, I, for one, look forward to correcting the record and getting some facts straight about this historic law and its contribution to the renewed vibrancy of our Nation.

I welcome the witnesses' testimony. And I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, Mrs. Capito, chairwoman of our Financial Institutions Subcommittee, for a minute and a half.

Mrs. CAPITO. Thank you, Mr. Chairman.

And welcome back, former Chairman Frank.

This past Monday marked the fourth-year anniversary of the passage of Dodd-Frank, with more than 2,300 pages, 400 new rules, of which 298 have been finalized, and still 24 percent are yet proposed.

I think we see now that this legislation is having a detrimental impact on our Main Street businesses and community lenders and consumers.

As many of you know, for the past 3 years I have had numerous hearings in the Financial Institutions and Consumer Credit Subcommittee, highlighting the challenges facing community lenders and small businesses. One of my fears during the drafting of Dodd-Frank was that it would limit the ability of community lenders to tailor their products to their clients' needs. And, unfortunately, we are seeing this become a reality.

Later this morning, I will share several accounts from a West Virginia lender of cases where they no longer are able to provide

West Virginians with tailored products to meet unique financial circumstances and challenges because of the new regulations.

These cases bring to light one of the central flaws of Dodd-Frank, which is the premise that lending decisions are best determined by Washington bureaucrats rather than local lenders. Lenders need flexibility to tailor their products. Removing this critical flexibility is a detriment to rural communities like those that I represent in West Virginia.

Unfortunately, the consequences of Dodd-Frank are not limited to access to credit. Life insurance policyholders could potentially see increases in premiums if life insurers are forced to capital levels designed for a lending institution.

I will continue to work with both Chairman Hensarling and Chairman Neugebauer to resolve this unintended consequence. And I yield back.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentlelady from New York, Mrs. Maloney, the ranking member of our Capital Markets Subcommittee, for a minute and a half.

Mrs. MALONEY. Thank you, Chairman Hensarling, and Ranking Member Waters.

And welcome, Chairman Frank. We miss you. It is great to see you. This legislation bears your name and was the most sweeping overhaul of our financial regulation since the Great Depression.

History shows that financial reform is a work in progress and will improve and solidify with time. When the Investment Company Act of 1940 was passed, it was called at the time, and I quote, "the most intrusive financial legislation known to man or beast."

That same intrusive financial legislation is now the cornerstone of the large and thriving U.S. mutual fund industry. It is also important to remember that even the post-depression financial reforms took a very long time to implement.

While the Securities Act of 1933 is a landmark reform of our securities markets, the SEC didn't adopt the 1933 Act's main antifraud rule, Rule 10b-5, until 1948, over 15 years after the 1933 Act was passed.

In sum, financial reform, done properly, takes time. It requires flexibility on the part of regulators, the industry, and Congress.

So I look forward to our witnesses today and will respond by saying that when President Obama entered office, we were losing 700,000 jobs a month. We have had 52 months of private-sector job growth, last month over 288,000, resulting in the Dow being the highest ever, 17,000, with the stock market. We are moving in the right direction. Financial reform is a part of our financial growth and stability.

Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Housing and Insurance Subcommittee, for 1 minute.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

The Dodd-Frank Act was the most far-reaching financial reform legislation since the Great Depression. Put in perspective, if you took the Securities and Exchange Act of 1933, the Securities and

Exchange Act of 1934, Gramm-Leach-Bliley, Sarbanes-Oxley, and every amendment you tacked on since then, you would still need 600 pages to have the same amount of pages as the Dodd-Frank Act: 398 rulemaking requirements compared to 16 for Sarbanes-Oxley. Just in the first of 225 rules, 24 million man-hours per year are required to comply with it.

What does this mean? It means that we have institutions now that are hiring more compliance officers than loan officers, and it is beginning to hurt small businesses all across the country.

The SBA recently said that the microloans have declined every year since the passage of Dodd-Frank. It climbed over $170 billion to 2008, from $170 billion to $138 billion. Recently, we had a loan banker here saying he is hiring more compliance officers than loan officers.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from New York, Mr. Meeks, the ranking member of our Financial Institutions Subcommittee, for a minute and a half.

Mr. MEEKS. Thank you, Mr. Chairman.

I want to thank all of the witnesses for your testimony today, but I want to especially say that it is with great pleasure that I welcome back Chairman Frank.

Very few individuals who serve on this committee will experience the great honor of having their picture on the wall of this hearing room. This honor speaks volumes to the great influence and impact, Mr. Chairman, that your leadership had within these walls and, by extension, to our financial services industry and our great country.

Many have forgotten how far we have come. You led when the country needed strong leadership, when our most prized financial institutions were collapsing and when average Americans were helplessly losing their jobs and retirement funds.

Four years later, Mr. Chairman, we can proudly say that we have made great progress not only in restoring confidence in our financial markets, but also in safeguarding and preventing the excessive risky behaviors of the past.

Four years later, Mr. Chairman, more Americans are returning to work, confidence and trust has returned to our financial institutions and markets, and our banks and credit unions are starting to lend again, but they are doing it more carefully this time.

While there is no bill that is a perfect bill, Dodd-Frank has given us a foundation to build upon to make sure that there is strict transparency in our markets and that Americans can continue to live the American dream.

I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back the balance of his time.

The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, the vice chairman of our Financial Institutions Subcommittee, for 1 minute.

Mr. DUFFY. Thank you, Mr. Chairman.

And thank you, witnesses, for being here today.

It is widely believed that the financial crisis resulted from a lack of regulation, but today the regulations that resulted from the 400

new mandates included in Dodd-Frank do not provide any more security to our financial markets. All they do is provide less choice for consumers and, in some cases, expose them to more dangers.

In fact, the Dodd-Frank Act was supposedly created to end too-big-to-fail, but all it has done is make it harder for small community banks and credit unions to serve the American people.

Take, for instance, the Consumer Financial Protection Bureau (CFPB). Protecting consumers is a noble goal and a mission that I support, but you don't protect consumers by taking away or limiting products like the CFPB does through the qualified mortgage rule, limiting credit options, or claiming disparate impact based on numbers that don't exist.

And the additional dangers that the CFPB is exposing consumers to through their data collection is absolutely unacceptable. The Dodd-Frank Act has not made the American consumer safer, and it has failed to end too-big-to-fail. As we celebrate the Dodd-Frank birthday, I think the American people realize there is not much to celebrate.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 2 minutes.

Mr. HIMES. Thank you, Mr. Chairman.

And I, too, welcome the panel, especially former chairman and my friend, Barney Frank. It is a real pleasure to have you back here.

I want to make an observation about the 80-page reflection that the Majority produced on Dodd-Frank. I read it closely and carefully, and what is most interesting to me about that and this opportunity on the fourth-year anniversary of the passage of Dodd-Frank—what is most interesting to me about that 80-page report is the dog that didn't bark.

It has for 4 years, of course, been the practice of the other side to abide by the idea that if you don't have something nasty to say, say nothing at all. And the 80 pages on this fourth anniversary are related exclusively to Title I and Title II, 2 titles of a 16-title bill.

The reflection in the 80 pages makes no mention of the CFPB and the billions of dollars that have been returned to some pretty badly abused consumers, no mention of the fact that the CFPB is stopping the selling of its toxic mortgages to American families, no mention of the first meaningful regulation of the massive derivatives market, a market which was at the very center of the meltdown of 2008.

And, of course, there is no mention in either that 80 pages or any of the opening statements from my friends on the other side about the fact that the financial markets today are thriving, in many cases, as they never have before. And, as we all know, the banks are remarkably profitable. These are facts that completely belie the predictions of chaos and catastrophe that we have heard for 4 years from the other side.

Instead—and this is a compliment to my friends on the other side—they do focus on the fascinating question of too-big-to-fail, where, of course, the reality is none of us know whether we have

put in place the tools to address the failure of a systemically important institution.

Sheila Bair thinks that perhaps we have. Tim Geithner thinks that perhaps we haven't. This is a terribly important question and one that I think is worthy of good, strong bipartisan consideration and debate.

And, with that, Mr. Chairman, I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from Indiana, Mr. Stutzman, for 1 minute.

Mr. STUTZMAN. Thank you, Mr. Chairman, and thank you for calling this hearing.

And thank you, witnesses, for taking the time to speak with us today.

As we will hear today, Dodd-Frank has failed in bailouts and failed to lift the economy, as the President promised. In practically every way, Dodd-Frank puts regulators ahead of taxpayers and consumers. Still, no one believes the economy has been made safe from future bubbles or bailouts.

What the lenders in front of us do know is that 4 years of Dodd-Frank have left lending more expensive and loans harder to come by for consumers. For 4 years, Senate Democrats have blocked this committee's push for even minor changes to the law.

One perfect example is my bill, the Bureau Guidance Transparency Act, which this committee passed on a bipartisan basis. It only requires the CFPB to declare its new restrictions on lending in a slightly more transparent way. Yet, no one expects Senate Democrats to notice.

Today, I am looking forward to real-world lenders, not regulators, to explain how this law is impacting the American people.

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

Chairman HENSARLING. We will now turn to our witnesses, each of whom I will introduce briefly.

First, we welcome Mr. Dale Wilson, chairman and CEO of the First State Bank of San Diego, Texas.

Next, we welcome Mr. Anthony Carfang, a partner at Treasury Strategies, a firm that counsels businesses on Treasury management strategies.

And now, with a lot of sincerity, I welcome back Chairman Frank.

I haven't had an opportunity to shake your hand and greet you personally. We will remedy that situation after the hearing.

Selfishly, I welcome the chairman back for two reasons: one, I won a bet that the ranking member would call him as the Democrat witness to defend his law, and it is always good to win a bet; and two, I have a vested interest in ensuring that former chairmen are treated well by this committee because I intend to be one someday. But to the chagrin of my Democratic colleagues, I am not planning for that to be one day soon.

Next, we welcome Mr. Thomas Deas, Jr., vice president and treasurer of the FMC Corporation in Philadelphia. His testimony today is on behalf of the Coalition for Derivatives End-Users.

Last, but not least, Mr. Paul Kupiec is a resident scholar at the American Enterprise Institute. He has previously held a variety of positions with the FDIC and other public-sector and private-sector institutions.

Without objection, each of your written statements will be made a part of the record.

For those who have not testified before—and I am somewhat uncertain whether Chairman Frank has ever testified from the table, but I know he knows the system—we have a green, yellow, and red lighting system. Green means go, yellow means wrap it up, and red means stop.

And we have not improved the audio system since Chairman Frank's day. So you will need to take the microphone and bring it very, very close to your mouth so that all can hear you.

Mr. Wilson, you are now recognized for a summary of your testimony.

STATEMENT OF DALE WILSON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FIRST STATE BANK, ON BEHALF OF THE TEXAS BANKERS ASSOCIATION

Mr. WILSON. Thank you, Chairman Hensarling, and Ranking Member Waters.

My name is Dale Wilson. I am the CEO of First State Bank of San Diego, a rural community bank serving a small South Texas town. I appreciate the opportunity to be here to present the views of the Texas Bankers Association on the impact of the Dodd-Frank Act.

Let me start by thanking my own Congressman, Ruben Hinojosa, who serves on this committee. We had the pleasure of hosting Congressman Hinojosa at my bank in South Texas, and we appreciate his service to our community.

During the last decade, the regulatory burden for community banks has multiplied tenfold. Dodd-Frank alone has already added nearly 14,000 pages of proposed and final regulations. Managing this tsunami of regulation is a significant challenge for a bank of any size, but for a small bank with only 17 employees, it is overwhelming.

Today it is not unusual to hear from bankers who are ready to sell to larger banks because the regulatory burden has become too much for them to manage. Since the passage of Dodd-Frank, there are 80 fewer Texas banks. These banks did not fail. Texas has one of the healthiest economies in the country. We call it the "Texas miracle."

These are community bankers—and I have talked to some of them personally—who could not maintain profitability with regulatory costs increasing between 50 and 200 percent. These are good banks that for decades have been contributing to the economic growth and vitality of their towns, but whose ability to serve their communities is being undermined by excessive regulation and government micromanagement.

The real costs of the increased regulatory burden are being felt by small-town borrowers and businesses that no longer have access to credit. When a small town loses its only bank, it loses its life-

blood. It is more difficult to improve schools, health care facilities, and other infrastructure projects.

I know it was not the intent of Congress when it passed Dodd-Frank to harm community banks, but that is the awful reality. One issue in particular that has hindered the ability of community banks to serve their communities is the new qualified mortgage rules.

As a result of the qualified mortgage rules, our bank no longer makes mortgage loans, as the cost and the risks are just too high. Make no mistake, the true cost is felt by my community. I used to make mortgage loans that averaged $50,000, and I made them to borrowers who would not otherwise qualify for secondary market loans.

I am not the only bank in South Texas to exit the mortgage business. Other banks in my county have stopped, as well as community banks in adjacent counties. This is occurring in Texas and across the country.

The real victims here are the working-class and middle-class prospective homeowners. Banks want to make safe, profitable mortgage loans. Denying mortgage loans to borrowers otherwise considered creditworthy goes against every sound business instinct a banker has.

Accordingly, we support H.R. 2673 and H.R. 4521. These bills would exempt any mortgage held on a bank's balance sheet from the ability-to-repay requirements and exempt loans held by small creditors with less than $10 billion in assets from the escrow requirements imposed by the Dodd-Frank Act. No bank is going to hold a loan it doesn't believe the borrower has the ability to repay.

In conclusion, I ask this committee to look at the unintended consequences of the Dodd-Frank Act and to make changes so that community banks can go back to what they have always been good at: meeting the credit needs of local individuals and small businesses.

Unless major changes are made, compliance costs will continue to drive massive consolidation within our industry and limit the ability of our Nation's community banks to drive Main Street growth across the country.

Thank you very much.

[The prepared statement of Mr. Wilson can be found on page 141 of the appendix.]

Chairman HENSARLING. Mr. Carfang, you are now recognized for your testimony.

STATEMENT OF ANTHONY J. CARFANG, PARTNER, TREASURY STRATEGIES, INC.

Mr. CARFANG. Good morning, Chairman Hensarling, and Ranking Member Waters. I am pleased to be here today.

My name is Tony Carfang, and I am a partner with Treasury Strategies. We are a consulting firm that consults for businesses and financial institutions, including health care organizations, higher education, and municipalities. We have been doing this for about 40 years. And we appreciate the opportunity to be here today.

First of all, we would like to let the committee know we fully support any activity to improve the safety and soundness of the

U.S. financial system, and we support the objectives of the Dodd-Frank regulation.

Unfortunately, as we sit here 4 years later, we are only beginning to see some of the impact of that regulation. The verdict is not good. The regulations created an atmosphere of fear, uncertainty, and doubt.

The delayed implementation is creating a tremendous uncertainty on the part of America's businesses and financial institutions. The ambiguities in the regulation, the inconsistencies, some of the vague language, things like "know your customer," systemically important whatever—whatever, that lack definition, are creating a tremendous uncertainty that will drag on the economy.

Let me just point out two things at a conceptual level. One is that institutions are mandated to fund themselves with longer liabilities, which, yes, they are more stable, yet, at the same time, investment managers are being mandated to invest in shorter-term instruments because they can be turned over more quickly and they're less risky, but you can't do both.

There are similar inconsistencies in terms of too-big-to-fail. Yes, we think an organization should not be too-big-to-fail, but by designating them as systemically important, you are, in fact, telling depositors, "Put your money in there because you will be protected. They are too-big-to-fail."

So here we are 4 years later only beginning to see some of the impacts. What is the verdict? Let's list through the items in the preamble of the Act and see how we have done.

First is we want to improve the safety and soundness of the U.S. financial system. Well, U.S. capital markets are by far the most robust and the deepest markets in the world.

Before Dodd-Frank, U.S. companies operated with cash on their balance sheets equal to about 9 percent of U.S. gross domestic product. That is an example of efficiency. The European number, by the way, is 21 percent.

But now that we are beginning to see the beginning impacts emerge, that 9 percent is growing to 12 percent. We are clearly moving in the wrong direction.

Hundreds of billions of dollars have been simply sidelined on U.S. balance sheets as a precaution against the uncertainty of the regulation.

If you were to reach the 21 percent level of the European capital markets, that would sideline an extra $1 trillion. So on that objective of Dodd-Frank, we miss.

Transparency. Yes, there are certain banking activities that are now more transparent and they come under the microscope, but the important thing and the real issue is risk. It is the risk of the banks that is key.

Risk can only be created or destroyed. It can only be transformed and it can only be shifted. So by taking them off of the—away from the visibility of a bank's balance sheet, we are, in fact, making the risk less transparent, and more difficult to manage. So on that point, we fail as well.

Too-big-to-fail. I addressed this—or I alluded to this earlier. Since the passage of Dodd-Frank, U.S. GDP, even including infla-

tion, is up 14 percent. Bank assets are up 25 percent. The banks are getting bigger.

Eliminating bank bailouts—taxpayer bailouts—is one of the objectives. I point to the balance sheet of the Federal Reserve Bank, which has grown from $1 trillion to $4.3 trillion since the enactment of Dodd-Frank.

This is a huge concentration of risk, which, by the way, is invested in longer-term assets, unlike—the rest of the balance of the bill includes, and is funded by overnight bank reserves. What we have here is the next taxpayer bailout in the making.

Finally, Dodd-Frank wants to eliminate abusive practices. We are eliminating a lot of practices, as Dale alluded to, in terms of mortgages.

Inconsistencies in the law are causing banks to close accounts of diplomats because of anti-money laundering concerns. They are no longer dealing—big banks are no longer dealing with community banks because of normal customer concerns.

We would recommend that, to remedy the situation: first, we eliminate FSOC, which is a regulator comprised of regulators, so you have redundancy of double jeopardy in the system; second, we encourage you to eliminate ambiguities in the regulation and in the terminology; and finally, we encourage you to carve out some protections for the 99.999 percent of all American businesses and financial institutions that have nothing to do with this regulation.

To wrap up in just a second, 2 years ago I testified before this committee, and I asked the question, "When a business calls its bank for financial services, will anybody be there to answer the phone?"

Now I know the answer to that, and the answer is "yes." The compliance officer will be there, not the loan officer. Ladies and gentlemen of the committee, that is no way to run the best economy in the world.

Thank you very much.

[The prepared statement of Mr. Carfang can be found on page 80 of the appendix.]

Chairman HENSARLING. Again, Chairman Frank, welcome back home. You are now recognized for your testimony.

STATEMENT OF THE HONORABLE BARNEY FRANK, FORMER MEMBER OF CONGRESS AND FORMER CHAIRMAN, HOUSE COMMITTEE ON FINANCIAL SERVICES

Mr. FRANK. Thank you, Mr. Chairman.

I apologize that my written statement was not in the form for the chairman. It was a last-minute thing. And then I—on the other hand, I think any problem with the element of surprise is probably not a problem here. I don't think any of the members of the committee will be surprised by what I say.

I want to begin with the too-big-to-fail question. And the issue, I think, is an interesting one because, first of all, as I said in what I did write, I was surprised myself by how bipartisan the committee's report was, for instance, in saying that this whole problem started with Ronald Reagan in 1984 with Continental Illinois.

The committee report said that this began with Ronald Reagan and Continental Illinois and then it was continued by Bill Clinton

with Alan Greenspan taking the lead in long-term capital management, but the report clearly puts most of the blame on George W. Bush and his aides, Mr. Paulson and Mr. Bernanke, because it said this really became a problem with Bear Stearns.

And while I recognize that is a very bipartisan thing for a Republican committee to do, to put major blame on those two Presidents, I think you are being a little unfair to them. And I think the need to respond there shows that was a problem which had to be dealt with.

On the other hand, I was struck by your bipartisan effort to embrace Tim Geithner, but I think you got it wrong. You misunderstand Mr. Geithner in that report. Mr. Geithner does say we still have a too-big-to-fail problem, but the problem he sees is exactly the opposite of what I think most Republicans think.

There is this argument that we are going to have bailouts. Tim Geithner's explicit point is that we did too good a job in preventing bailouts. I urge people to read his book when he has this conversation with Larry Summers. He objects that we shut down too many of these ways to do it.

So Mr. Geithner is one who believes—look, everybody understands that there are going to be institutions that are too-big-to-fail. Everybody else understands that when I move my hands, you hear the shutters.

What Mr. Geithner has said is that given the size of banks—yes. And everybody understands that from Ronald Reagan in Continental Illinois—The question is how do you deal with that as long as they are that size.

And what Mr. Geithner says is he believes inevitably there is going to be the need at some point for Federal taxpayer intervention and we did too good a job in shutting that down. So, when you cite Mr. Geithner, you will understand that is what you are citing.

The other argument that I think is more reasonably—why did we not do too-big-to-fail? There are two arguments, one, that we have made being designated a systemically important financial institution very attractive.

That is interesting because every institution which has been threatened with being named has reacted very violently and very negatively. For people who tell me you are supposed to listen to the businesses, how come you haven't heard that the businesses hate the idea of being designated, that instead of it being an advantage, they think it is a curse.

When you talk about, oh, this is a great advantage and you ignore what the businesses themselves say about this, those who could be designated, I think that is a very Marxist analysis.

But the Marx in question is Chico, when he said in one of his movies, "Who are you going to believe? Me or your own eyes?" Who are you going to believe? Your own viewpoint or what the financial institutions tell you?

The other argument on too-big-to-fail is that, oh, well, even though the law says the Fed should not give money to insolvent institutions and the Secretary of the Treasury should not do what was done in the past, give them the money and keep them alive to pay their debts, they will violate the law.

I have heard the most astonishing argument that political pressure in this country will force the Secretary of the Treasury, the President, and maybe the head of the Fed, to violate Federal law by advancing money to keep these people in business.

What the law says is you may have to pay some of their debts, as Ronald Reagan recognized in 1984 with Continental Illinois, but, first of all, you put them out of business, you put them in receivership, and, secondly, you get the money back.

Finally, I was very struck by the, frankly, schizophrenic approach that the Majority seems to be taking on subprime loans or loans to poor people.

I was astonished again—I get astonished a lot these days; I am out of the business—that there is a criticism that under the bill, fewer loans are being made to low-income people. Yes. That was part of what I thought everybody wanted to do. I thought there was a consensus that too many loans were being made to those people.

And then, when you blame the Community Reinvestment Act, I would just like to cite the testimony of our banker from Texas who says community banks didn't make bad loans. I agree. And guess what? They are all subject to the Community Reinvestment Act. So if the Community Reinvestment Act was so distorting, that is a problem.

Finally, I would say I look forward to congratulating you, Mr. Chairman, on a fourth anniversary coming up. I know that this committee passed a bill on Fannie and Freddie, but it hasn't even passed the House.

So I think we are about to see the fourth anniversary of your party being in control of the House and not doing anything about this problem that you say is such a serious one.

[The prepared statement of former Chairman Frank can be found on page 97 of the appendix.]

Chairman HENSARLING. Mr. Deas, you are now recognized for your testimony.

STATEMENT OF THOMAS C. DEAS, JR., VICE PRESIDENT AND TREASURER, FMC CORPORATION, ON BEHALF OF THE COALITION FOR DERIVATIVES END-USERS

Mr. DEAS. Thank you, Mr. Chairman.

And good morning to you, Ranking Member Waters, and the members of this committee.

I am Tom Deas, vice president and treasurer of FMC Corporation and, also, immediate past chairman of the National Association of Corporate Treasurers (NACT).

FMC and NACT are members of the Coalition for Derivatives End-Users representing thousands of companies across the country that employ derivatives to manage day-to-day business risks.

First, let me sincerely thank both the chairman and the ranking member along with the distinguished members of this committee for doing so much to protect end users from the burdens of unnecessary regulation.

The press often portrays Capitol Hill as paralyzed by gridlock while, when it comes to the needs of Main Street businesses, the members of the committee have worked together to get things done.

You have supported the end-user margin bill, H.R. 634, championed by Representatives Graham and Peters, and the centralized Treasury unit bill, H.R. 677, which Representatives Moore and Stivers have done so much to move forward. We are hopeful that a version of that bill modified through discussions with the chairman's and the ranking member's staffs will soon come to the House Floor.

As you oversee implementation of the Dodd-Frank Act, I want to assure you that, in my experience, end users comprising less than 10 percent of the derivatives markets were not and are not engaging in the kind of risky speculative derivatives trading activity that became evident in 2008.

We use derivatives to hedge risks in our day-to-day business activity. We are offsetting risks, not creating new ones. We support the transparency and the derivatives market that the Dodd-Frank Act attempts to achieve.

We also believe it is sound policy and consistent with the law to exempt end users from provisions intended to reduce the inherent riskiness of swap dealers' activities.

However, at this point, 4 years after passage of the Act, there are several areas where the regulatory uncertainty remaining compels end users to continue to appeal for legislative relief.

Among areas of concern, I would like to invite your attention to two. First, margining of derivatives. FMC Corporation, an innovator in the chemical industry, was founded almost 130 years ago. This is our 83rd year of being listed on the New York Stock Exchange. When we went to that market in 1931, the NYSE was the largest pool of capital to grow our business.

Today, using derivatives, we have an additional and even larger market that is the cheapest and most flexible way for us to hedge everyday business risks of foreign exchange rate movements, changes in interest rates, and global energy and commodity prices.

Our banks do not require FMC to post cash margin to secure mark-to-market fluctuations in the value of derivatives. To do so would divert cash from funds we would otherwise invest in our business.

The proposals by the banking regulators—mandating collection of margin from end users—are not only out of sync with the CFTC, but also with the European regulators as well.

Further, an imposition of margin requirements on end users would effectively negate the benefits of the end-user clearing exception, which Congress included in the text of the Dodd-Frank Act.

We believe end users and their swap dealers should remain free to negotiate mutually acceptable margin arrangements instead of having regulators impose mandatory daily margining with its uncertain liquidity requirements.

The Coalition also recognizes the efforts of the CFTC to provide relief on centralized Treasury units. But as a recent Coalition survey shows, it doesn't work for most end users.

End-user treasurers have long used widely accepted risk induction techniques to net exposures within their corporate groups so they can reduce derivatives outstanding with banks.

However, the internal centralized Treasury units they use are set to be designated as financial entities subject to mandatory clearing

and margining even though they are acting on behalf of non-financial end-user companies otherwise eligible for relief from these burdens.

Although I have focused here on two main issues, end users are concerned about the web of, at times, conflicting rules from U.S. as well as foreign regulators that will determine whether we can continue to manage business risk through derivatives.

Our fear is that cross-border regulatory uncertainty and conflict could put FMC and other American companies at an economic disadvantage.

The end-user exemptions for margining and clearing we thought would apply are still uncertain, confronting us with the risk of foreign regulatory arbitrage and potential competitive burdens that could limit growth and ultimately our ability to sustain and even grow jobs.

Thank you again for your attention to the needs of end-user companies.

[The prepared statement of Mr. Deas can be found on page 91 of the appendix.]

Chairman HENSARLING. Mr. Kupiec, you are now recognized for your testimony.

STATEMENT OF PAUL H. KUPIEC, RESIDENT SCHOLAR, THE AMERICAN ENTERPRISE INSTITUTE

Mr. KUPIEC. Chairman Hensarling, Ranking Member Waters, and distinguished members of the committee, thank you for convening today's hearing and for inviting me to testify. I am a resident scholar at the American Enterprise Institute, but this testimony represents my personal views.

The primary goal of the Dodd-Frank Act was to end the perception that the largest financial firms are too-big-to-fail and remove the risk that a large institutional failure could create financial instability unless the government protects investors from loss.

After 4 years of implementation, Dodd-Frank has imposed a host of new regulations that are depressing economic growth, but it has failed to meet its primary objectives.

Regulatory data on bank funding costs showed that in the years prior to the financial crisis—2005, 2006, and 2007—the largest banks, banks with assets greater than $100 billion, did not enjoy a subsidy on their funding cost. Instead, their average cost of funding was higher than the cost incurred by smaller banks, but the difference was not statically significant in any year.

In post-crisis, post-Dodd-Frank data—2012, 2013, and 2014—the largest banks have lower average funding costs compared to smaller banks. In each year after the passage of Dodd-Frank, large banks have enjoyed a funding cost subsidy of more than 22 basis points, and in each year this subsidy estimate is highly statically significant.

The passage of Dodd-Frank has not eliminated too-big-to-fail, but, instead, it coincides with the emergence of a sustained large bank funding cost subsidy that did not exist before the financial crisis.

It is not hard to understand why investors might still believe in too-big-to-fail. In the financial crisis, the government demonstrated

that it would not let the largest financial institutions fail, and Dodd-Frank has not diffused these expectations.

After Dodd-Frank, the large institutions are subject to enhanced prudential supervision and regulation by the Federal Reserve Board of Governors. They must meet risk-based capital and leverage requirements, file detailed annual orderly resolution plans, and pass the Board of Governors' annual micro-economic stress test examination.

These new prudential standards are so intrusive that it is not a stretch to say that the largest institutions are now being run, at least in part, by the Federal Reserve Board.

The Federal Reserve Board closely monitors the largest institutions and, after Dodd-Frank, it has the power to acquire a wide range of changes in these institutions' operations if, in the Fed's judgment, changes are needed to prevent failure or financial instability. When one of these institutions experiences a serious hiccup, the Fed will at least be partially responsible.

So given these changes, why wouldn't a rational investor conclude that these institutions are too-big-to-fail? Dodd-Frank is supposed to eliminate the government's ability to use taxpayer guarantees and bailouts to prevent financial instability when a large institution fails.

Designated institutions must file orderly resolution plans or blueprints for a speedy reorganization using Chapter 11 bankruptcy, and these plans must not cause financial instability.

The Board of Governors and the FDIC must approve these plans, and they have the power to require operational changes or even divestitures if, in their judgment, the plans do not facilitate an orderly bankruptcy.

Advertised as prepackaged bankruptcies, these plans are nothing of the sort. The key to a prepackaged bankruptcy is creditor acceptance of the debt restructuring plan before entering bankruptcy, but creditors did not approve Dodd-Frank or the resolution plans and, indeed, firms are not even obligated to follow these plans should they enter bankruptcy.

If Title I doesn't do the job, Dodd-Frank has Title II, a backup mechanism for resolving large failing financial institutions. It is supposed to remove the risk that the failure of a large institution will cause financial instability without using government guarantees or bailouts.

Only Title II really doesn't do this. Using the FDIC single-point-of-entry strategy, a Title II resolution will maintain financial tranquility by ensuring all of the liabilities of the failing institutions' subsidiaries. In most cases, one of these subsidiaries will be a large failing bank.

Here, Title II extends a full government bailout to all of the bank's uninsured liabilities. In other words, Title II will fully protect investors who otherwise would have lost almost everything in an FDIC bank resolution and a bank holding company bankruptcy.

Title II reduces bankruptcy systemic risk by extending a larger government guarantee and bailing out investors who would not have taken a loss in bankruptcy.

In the midst of a crisis, the FDIC will have to use its unseasoned judgment to decide how large the government bailout must be to

maintain financial stability. If receivership proceeds in a Title II resolution do not fully cover the government's bailout costs, the largest financial institutions would be assessed to recover expenses, but the Dodd-Frank requirement to repay Title II bailout costs without the use of taxpayer funds is less binding than it seems.

For example, what if Title II had been used in the past crisis? In the last crisis, the Federal Reserve began paying banks' interest on their excess reserves, and they earned quite a lot on that. These payments channel taxpayer funds directly into banks.

There is nothing in Dodd-Frank that precludes the government from using this channel to provide the largest institutions with the funds they need to reimburse the Orderly Liquidation Fund, surely less than a transparent taxpayer bailout, but a taxpayer bailout nonetheless.

Thank you. And I look forward to your questions.

[The prepared statement of Mr. Kupiec can be found on page 105 of the appendix.]

Chairman HENSARLING. I thank all of our panelists.

The Chair now yields himself 5 minutes for questions.

Mr. Wilson, I am especially happy that you are here because I care deeply about the future of community banking. In my district in Texas, half the district is rural.

So your voice is an important one, but I have to tell you that yours is not a solitary voice, because rarely does a week go by that I don't hear about the plight of community banking from some banker.

We heard from a banker in El Paso, Texas, who said, with respect to the regulatory burden of Dodd-Frank, "We will see community banks continue to decline. We simply cannot afford the high cost of Federal regulation.

"And as one banker, I will tell you my major risk is not credit risk, risk of theft, risk of some robber coming in with a gun in my office. My number one risk is Federal regulatory risk."

I heard from a banker in Gothenburg, Nebraska, about the Dodd-Frank Act: "These pressures are slowly, but surely, straining the traditional community banks, and handicapping their ability to meet the credit needs of their community."

Another banker from Linn, Missouri: "The more expense for the bank, the less that is available to loan to our primary customer base, which is small businesses, farmers, and folks who are just trying to get by in these difficult times."

I heard from a banker in Temple, Texas: "Reluctantly, we are working to downsize our consumer lending program, especially in the small loan area. Over the years we have provided thousands of small loans to our customers in what was a simple, straightforward process. Certainly, this is no longer the case.

"And many customers are now going to other sources with their credit needs where they can get a loan without the hassle that comes with bank compliance.

"There is no question these rules will reduce the availability of credit to many creditworthy borrowers and markets of all size."

And I could go on and on and on.

So one banker used the word "strangle." Mr. Wilson, is Dodd-Frank, in your opinion, strangling community banks?

Mr. WILSON. Yes, sir. There are lots of challenges for us. And we have 17 employees. And so the—just when you have the changes to regulation, it is retraining staff, it is retraining systems. And so anytime there is significant regulatory change, it is difficult on small organizations.

Chairman HENSARLING. I also understand—the data that I have seen is that there are roughly 800 fewer community banks post-Dodd-Frank than pre-Dodd-Frank and now they have a smaller market share.

Have you seen this study or similar studies, Mr. Wilson?

Mr. WILSON. I have heard those numbers. Yes, sir.

Chairman HENSARLING. Again, it's a sad situation as far as the plight of community banking goes. And, also, although it wasn't advertised that Dodd-Frank would somehow lift the plight of low- and moderate-income people, I believe that quite the opposite has happened. Although not advertised, it has hurt low- and moderate-income people.

What I have seen is that an analysis of credit cost for those people pre- and post-Dodd-Frank—credit cards are now, on average, 224 basis points. That is over 2 percentage points greater. On residential mortgages, jumbo, 45 basis points greater; conforming, 14 points greater; small unrated corporate debt, 41 basis points.

Here is an interesting one. Auto financing, 17 basis points less. Isn't that interesting, since auto dealers were exempt from Dodd-Frank's CFPB.

We also know that the Fed has shown in their study on QM, once fully implemented, without exempting the 95 percent of mortgages handled by the GSEs, that one-third of Blacks and Hispanics will not be able to obtain a mortgage due to DTI. I am still waiting to see the outrage on the other side of the aisle. CoreLogic is again imported and fully implemented. Only half of today's mortgage originations will meet QM.

Before Dodd-Frank, 76 percent of banks offered free checking. Now, only 39 percent do. And it continues to drop. There has also been a 21 percent surge in checking fees post-Dodd-Frank. The list could go on.

Mr. Wilson, I am going to go back to you. You obviously bank a lot of low- and moderate-income people. Is Dodd-Frank hurting low- and moderate-income people?

Mr. WILSON. Yes, sir. In our market, that was probably the main niche we had on the housing side. Our census tracks are low to moderate income for our community. And so, those who do not have access to that credit from us, it is hurting them.

Chairman HENSARLING. I now yield to the ranking member.

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

To Barney Frank, who worked so very, very hard to bring about protection for consumers and who spent a considerable amount of time paying attention to community banks—I kind of resent Mr. Wilson's testimony here today that talks about QM without him even understanding that his bank, under QM, a bank under $2 billion—you can keep all of your loans and portfolio as long as they are not predatory loans, no-documentation loans, those kinds of loans, and you have some protection under safe harbor.

So I am going to go to Barney Frank. Just talk about what we have done and what you have done to be of assistance to small banks and community banks.

Mr. FRANK. A couple of things. First, on the point you raise, I am again very surprised to hear my Republican friends now say our problem is that we have toughened up the standards for banks loaning to people. I thought there was pretty general agreement that was part of the problem. Although this does—there is this myth that somehow the Democrats were pushing for these loans.

In fact, during the period from really the mid-1990s, it was people on our side who were trying to restrict these abusive subprime loans and were restricted. We passed the Homeowner Equity Protection Act. Mr. Greenspan wouldn't use it. A number of States, including the State of Georgia, passed laws to restrict subprime lending abuses, and the Bush Administration preempted it and said, no, no such laws.

And then I was working with Spencer Bachus, and Mel Watt and Brad Miller from the Democratic side. As Sheila Bair notes in her book, we were trying to put legislation through to regulate subprime loans, and the Republican leadership said, shut it down. And on the day that this committee, once the Democrats were in control, began to regulate subprime loans, it was over the objection of several of the Members here who said subprime loans were good, and Wall Street Journal objected and said, look, these are good loans; 80 percent of them are paying on time, which didn't seem to me to be a great statistic.

And, in fact, what happened was this: People on the conservative side were generally pushing these loans until the crisis hit, and then they needed an alternative victim—a villain to blame for the crisis. So they retroactively became opposed to these kind of loans. And now they have reverted. So there was a period where they were blaming us.

Again, I think there is this great inconsistency between saying the Community Reinvestment Act caused the problem by forcing these people to make these loans to poor minority people and now complaining that we have regulated and somewhat restricted those loans.

As to the community banks, let me say this: I would be in favor of saying that people who kept loan portfolio should not have these problems. I, on the other hand, think what is important, and this is the one criticism I have of the regulators, I believe risk retention is the best way to go about this, because risk retention leaves the decision in the hands of the market. And I agree, and I think Mr. Carfang says, you can't get away from the responsibility—you can't get away from this; you can shift it.

And this goes also, I would say, to the question about regulation. Yes, there was some regulation before the crisis started, but it wasn't regulating—there wasn't regulation for two very important things: financial derivatives. Mr. Deas—and I agree with much of what he says about the end user, and I also appreciated him acknowledging—not acknowledging, noting that there was irresponsible, speculative activity in derivatives, which the CFTC was legislatively prevented from dealing with. But the biggest problem was the model for a lot of loans in the mortgage area shifted from the

kind that Mr. Wilson makes and keeps in portfolio to those that are made and then securitized. And securitization, I think, is a great example of what Mr. Carfang said, not getting rid of risk, but passing the risk off.

So one of the things I wanted to do in the bill was to require that if people were going to securitize loans, the securitizer has to have a 5 percent risk retention. That was weakened somewhat in the Senate, and I would prefer a situation in which there was risk retention if securitization took place, and then you could be much easier if people kept things in portfolio.

But, again, I emphasize, Mr. Wilson's bank and the community banks have always been covered by the Community Reinvestment Act, and it is inconsistent, again, to talk about what a good job they did and blame the Community Reinvestment Act for messing things up.

As for small banks, yes, we did, as he acknowledges, reduce the premiums, and we did exempt them from being examined by the CFPB, and there were some other areas. People raise with me the question of showing compliance with the Volcker Rule or with their forms of compensation. Dan Tarullo made a suggestion that they be specifically exempted from those since they don't apply.

I think that would be a good way to not weaken the regulation and ease their compliance, because apparently some banks feel they have to spend money to show they are not violating the Volcker Rule or having this kind of stock-based compensation. I think for banks below a certain level to simply be exempted from those rules since they never use them anyway would ease the problem. And bills need further correction. Those are two small ones that I would be for.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, Mrs. Capito, chairwoman of our Financial Institutions Subcommittee.

Mrs. CAPITO. Thank you, Mr. Chairman, and I want to thank the witnesses for their testimony.

I would like to ask, Mr. Chairman, for unanimous consent to enter into the record a very detailed description from a community banker in my district with 10 very specific examples on how the new ATR/QM rules have had a negative impact on West Virginia consumers.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. FRANK. I almost said yes, Mr. Chairman.

Mrs. CAPITO. Mr. Wilson, we are kind of singing from the same hymn book here in terms of the value of community bankers. Obviously, I live in a rural State, West Virginia, which is principally served by community banks. But I think it is also important to distinguish that by a community bank, which is similar to FDIC's description, reports that community banks loaned—48 percent of small business loans are issued by U.S. banks; 15 percent of residential mortgage lending; 43.8 percent of farmland lending; and 34 percent of commercial real estate. So that is very significant particularly in the areas where you do your business and where I live.

And so when you say that you have gotten out of the mortgage business, is the reason for that, even if you can hold them on portfolio, are the rules too constrictive? Is it that you are finding that

the QM box is something you can't lend in? Are you worried about examiner oversight in this area? Specifically, why would you get out of that business in terms of the Dodd-Frank regulations?

Mr. WILSON. Thank you.

The mortgages we originate were all balloon-type mortgages, and so that was really discouraged. We—in my 35 years of banking, I have never sold a mortgage. And so we originate those for our customers, and we keep them in the bank. So the qualified mortgage, if you look at those, like the debt to income—

Mrs. CAPITO. Right.

Mr. WILSON. —we use 50 percent debt to income. So the bulk of those people we served in our market would not have met the, I believe it is 43 percent, debt-to-income limitations in the QM rules.

Mrs. CAPITO. And I guess in your prior practice of issuing mortgages under those parameters, would you say that the customers that you have been serving would be in a low, moderate—you said $50,000 was your average mortgage. Obviously, that is on the lower end of the scale. How else would these folks ever be able to purchase a home that they could call their own?

Mr. WILSON. Many of them I would encourage to go try to get a permanent fixed-rate mortgage for the life of their mortgage, no balloons, would be in their best interest. But those who, because their credit scores weren't high enough—

Mrs. CAPITO. Right.

Mr. WILSON. —or for some other reason, we were able to help them—and I will just confess that we do not have any problems in our real estate mortgages, the ones that we underwrite and keep, but they just didn't fit for some reason. They may have been small business owners who had Schedule C tax returns instead of a W-2.

Mrs. CAPITO. Okay.

Let me ask another question on another line that you—when you talk about community banks and the constriction on the numbers and the different mergers and acquisitions, what kind of effect do you think that will have in rural America? Obviously, your business model's relationship banking in the bigger and larger institutions as they grow moves away from that model, for obvious reasons. How would you express that concern?

Mr. WILSON. So in our particular instance, we have no branches. We are in San Diego. We have a board of directors who live in that area. We have a president of the bank. We have senior vice presidents. In the branching environment, if we were to sell to a megabank, you would have tellers and maybe someone to open a new account. All of those positions would be eliminated.

Mrs. CAPITO. Right.

Mr. Kupiec, let me ask you this. You didn't really address this in your statement, but something I mentioned in my opening statement is that there are still many, many rules and regulations that are yet to be written concerning Dodd-Frank. What kind of impact do you think that has, moving forward?

Mr. KUPIEC. The regulatory burden of Dodd-Frank has been significant. I think just a week or two ago, it was reported that JPMorgan was laying off thousands of people, but hiring thousands

of compliance staff, so something like 7,000. So compliance staff, that is to meet the regulatory burdens of Dodd-Frank.

In terms of community banks, there is a lot of evidence. There is a Mercatus study that came out that I cited in some testimony in March that showed that the study has—

Mrs. CAPITO. I think I have run out of time here. Thank you.

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

Mrs. MALONEY. Chairman Frank, we seem to hear a lot from the other side of the aisle on this committee about how Dodd-Frank's resolution authority for large financial institutions somehow "enshrines bailouts," because the FDIC would use money borrowed from Treasury to facilitate a wind-down if you needed it.

But I remember that when the financial reform bill was in this committee, it was the Democrats on the committee who wanted to avoid the need for the FDIC to borrow from Treasury by creating an upfront resolution fund paid through assessments on financial institutions rather than taxpayers. But I also remember that it was the other side of the aisle who demanded that the upfront resolution fund be removed because they claimed it was—you guessed it—a bailout fund.

Now, I would like you to go back to the financial bailouts of 2008 and 2009 and tell us if there was any such action that we did back then that we could do now under the new rules of Dodd-Frank. Dodd-Frank actually said that there is no legal authority to use public money to keep a failing entity in business. The law actually forbids it, and it repeals the power that the Federal Reserve had to extend funds to any financial institution, as what has happened with the bailouts with AIG.

So would you go back to this point, because this is a point we hear over and over again, how Dodd-Frank resolution authority protects taxpayers' dollars.

Mr. FRANK. Thank you.

I would like just to say preliminarily, to comment on something Mr. Kupiec said, to the extent that we were responsible for JPMorgan Chase beefing up its compliance staff, I am not embarrassed. Frankly, if they had done that earlier, they would have saved themselves I don't know how many—in the tens of billions of dollars for noncompliance. And I admire Jamie Dimon, I think he has done a good job, but they were not overcomplying by any means beforehand in a number of areas.

The gentlewoman from New York is absolutely right. We did have a fund, and there has been a fundamental difference between the two parties on whether or not we should assess large financial institutions, not community banks, $50 billion or more. In fact, when we were in conference on this bill in 2010, and our position was, with the Senate, that when the CBO said it was going to cost $20 billion over a 10-year period, that we should get that from the large financial institutions, those of $50 billion and over, and that would have included everybody, whether or not they were SIFIs, et cetera, the Republicans objected in the Senate. There weren't that many Republicans voting for it, but the Senate Republicans who were going to vote for the bill objected, Senators Brown, Snowe and

Collins, and made us take that out because they wouldn't have given the Senate the 60 votes they needed and instead put it on the taxpayers. So, in fact, we had this history where the Republicans objected to an assessment on the large financial institutions and instead do it for the taxpayers.

Similarly here, the Federal Reserve could not do AIG under this law. Now, it is true, people say, they can set up a broadly applicable facility, but under this law, and I think Mr. Sherman had a role in this, they have to guarantee that it is a solvent institution with a very high percentage of probability. So we have specifically prevented the Fed from doing what they did with AIG.

Now, the argument, as I understand it, is that even though the law says—and the other difference is no money can—we do all recognize, as I said, going back to Ronald Reagan and Continental Illinois, that some institutions are so large that you can't just let them not pay their debts without having reverberations. So the question is, what do you do about it?

Under the law now in place, that effort to deal with their debts can't happen until they have been put into receivership. The boards have done away with it. Shareholders are wiped out. So as I said, it is death panels but for the large institutions. And then any money that is spent beyond what was available from the owners has to come back from an assessment, and the Secretary of the Treasury is mandated—not authorized, mandated—to recover it.

So the argument is that—and I have heard this from people—oh, in a political crisis, a financial crisis like that, there would be overwhelming political pressure on the Secretary of the Treasury to ignore Federal law and use public money indefinitely to keep an institution in business. I don't know in what universe people have been living if they think—I think there would be enormous political pressure not to do anything at all.

So, yes, I cannot think of any of these past efforts that would now be legal under our bill.

Mrs. MALONEY. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

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

Mr. GARRETT. I thank the chairman for a very timely hearing. And I think only former Chairman Frank could reference Secretary Geithner's book and Chico Marx all in one breath. It reminded me of Groucho Marx's statement: "From the moment I picked up the book until I put it down, I was convulsed with laughter. Someday I am going to read the book."

So let me go first to Mr. Kupiec.

No, maybe I will go first to the Congressman. Was it your intention that FSOC designates a nonbank—when they do designate a nonbank SIFI, that it would be regulated as a nonbank SIFI into perpetuity?

Mr. FRANK. No. As a matter of fact, I—

Mr. GARRETT. Thanks, because I didn't think it was.

Mr. Kupiec, is there a problem with the way that the Fed is handling that right now? Because I look and see—

Mr. FRANK. Mr. Garrett, may I state—you are cutting me off.

Mr. GARRETT. No, thanks. I appreciate—

Mr. FRANK. There was a premise in your question to which I did not agree, and you imputed me agreeing to it. In fact, I am very skeptical of designating nonbank institutions as SIFIs. It seems to me that the question assumed that I agreed that they should do that. I have been very skeptical of them doing that.

Mr. GARRETT. Oh, great. I appreciate that.

Mr. FRANK. I sent a comment to the FSOC to that effect.

Mr. GARRETT. I appreciate that.

And so, Mr. Kupiec, then, in your testimony, you pointed out that FSOC makes it nearly impossible for companies to know what steps they can take to avoid the designation as a SIFI. That makes no sense; for them not to be able to make that fact clear makes no sense to me. So I agree with you. Can you just jump off of what the Congressman just stated, and I guess you would agree with him that they should not be making these designations as well, and as long as they are, that they are inadequately telling us how they will not be in perpetuity?

Mr. KUPIEC. I completely agree. And I thought there was some intention that the designation should be reviewed annually anyway. But since the designations themselves don't explain why the institution—what the specific characteristics that make it a SIFI are, and what they would have to do to become undesignated, the process is really broken.

Mr. GARRETT. Right. So I guess we have an agreement on that point.

Also, I did catch your one comment, Congressman, earlier. You said you mentioned some areas that needed to be changed in Dodd-Frank, and I think you said there were other areas that also need further correction. The Senate recently unanimously passed one, which is call the Collins fix, to ensure the Fed can appropriately—those are my words, not theirs—regulate nonbank SIFIs. I assume, then, that you agree with that unanimous change to—

Mr. FRANK. I am not familiar with the bill. I don't have to read them all these days.

Mr. GARRETT. Okay.

Mr. FRANK. But can I say, Mr. Garrett, if I might, this whole conversation that the three of us have had starts from the standpoint that being designated a SIFI is an unpleasant thing, and that institutions should be empowered to resist it, which I think undercuts the point that being named a SIFI is such a great benefit, and being in that category is something that helps you. If it did, why would they all fight it so hard?

Mr. GARRETT. We only have limited time.

Mr. Kupiec, do you want to go to that point?

Mr. KUPIEC. The problem with that reasoning is if you truly are a systemically important firm, and you are going to get the bailout, then you have a very big benefit by not having any of the regulations because you are going to be bailed out in the end anyway. So you would fight. You would fight even—so that it is—if you are systemically important, you are systemically important, in the end the government has to bail you out. And your best bet is to diffuse any regulation anyway. So they would fight like crazy even if the too-big-to-fail is a benefit.

Mr. GARRETT. And I think that is an important point. So let's just give a hypothetical. Someday in the future, when a megabank, a SIFI, does go down, and that will happen again, part of the cost of that whole process, the resolution process, will be borne by whom? By the rest of the SIFIs, right?

Mr. KUPIEC. If it goes through a Title II.

Mr. FRANK. Not just SIFIs; any institution of $50 billion or more.

Mr. GARRETT. Okay. So, then, the question is now we have designated these nonbank SIFIs, FSOC has recently done, including potentially for asset managers, right? So these asset managers will now be one that could be—or would be bearing some of the brunt of the bailout. Now, asset managers do not have a lot of capital. So where will the bailout actually be paid for? Won't it be paid for by the retired widow who has funds in the asset manager? The retired widow will be paying for the reckless conduct of these SIFIs.

Is that correct, Mr. Kupiec?

Mr. KUPIEC. Yes. The asset management companies will have to get the money from somewhere, so the fees would have to go up. It would have to recoup it somewhere.

Mr. GARRETT. Was that your intention, Congressman, that—let me restate the question. Is it your intention that retired widows and designated entities would be the ones who would bear the brunt if they were part of the resolution?

Mr. FRANK. Mr. Garrett, if it was a serious question, you wouldn't ask it with no time left. So I will wait for someone else to ask me that question so I can answer it in a reasonable way.

Chairman HENSARLING. The time of the gentleman has expired.

Mr. GARRETT. It is a very serious question and a very serious problem.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman Frank, as you have seen here today and you hear, we continue to hear that the Dodd-Frank Act is having a negative impact on the economy. Yet the stock market is reaching all-time highs, job creation is on the rebound, and access to capital for small businesses is the best it has been in 4 years.

Now that you are in the real world out there, do you think that Main Street is buying this rhetoric that is not in line with the reality?

Mr. FRANK. I think Main Street is not, and, as you know as Chair of the Small Business Committee while we were writing the bill and as a member of this committee, you added very significant input, and I think we tried very hard to deal with that.

By the way, the argument the Republicans gave at the time, remember, there was a bill that we worked on that Treasury had asked us to do to encourage lending to—

Ms. VELAZQUEZ. Small business.

Mr. FRANK. —from community banks to small business, and the Republicans opposed it, and they said, the problem is not that banks won't lend, it is that the small businesses don't want to borrow because the economy is so bad. So they consistently argued that the problem was on the borrower and not the lender.

And if I could briefly just use your time to respond to the last-minute question or last-second question that I got before, the fact is that when we wrote the law talking about who would have to assess, we took into account the different levels of financial activity, and, in fact, asset managers are not exempt from contributing at all, but by formula they would contribute a much smaller share of what they have. And, in fact, I don't think they should be included as SIFIs. That doesn't determine they don't contribute.

But there is a formula that would minimize their contribution, and I would say, and I was proud to represent Fidelity and Putnam and other institutions, but if they had to make a contribution along with all the others, they would not have to go after old widows or even young widows. There are ways that they could do that out of the very considerable profits that they made.

But to go back on—even on community banks, we also increased the deposit limit to $250,000, which the community banks wanted, and in our bill in the House, we indefinitely extended transaction account guarantees. So, again, many small banks said to us, we want to do business with small businesses, but they need to keep more than $250,000 around for their transactions. We said yes to it. Unfortunately, it was later terminated in the new Congress.

I do agree that—and I think, frankly, sometimes it is the lawyers' fault. I have talked to some people, because I did not recall many provisions in the bill other than the mortgage one, and I understand that, that affected smaller banks. And one of the things I found was some lawyers were persuading community banks that they had to go to great efforts to show that they were compliant with the Volcker Rule or with the compensation pieces.

That is why I agreed with Mr. Tarullo, Governor Tarullo, and we were just making clear that if you don't do those things, you are exempt from them. And I think in some cases people have overlawyered to try to prove that. But, yes, we tried very hard to be respectful of the community banks, and I was pleased when the independent community bankers said they thought the bill was okay.

Ms. VELAZQUEZ. Thank you.

Mr. Carfang, you mentioned the uncertainty facing the financial sector due to the delays in rulemaking. Would you agree that the Federal regulators should expedite Dodd-Frank implementations to bring certainty to the industry?

Mr. CARFANG. Ma'am, I am absolutely in favor of certainty. And if there can be an expedited process to all of this, or a date certain in which this ends, and we have a period where we know what the rules are and can operate, that would be a very good thing, yes.

Ms. VELAZQUEZ. Okay. Thank you.

Thank you, Mr. Chairman.

Chairman HENSARLING. The gentlelady yields back.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Housing and Insurance Subcommittee.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Kupiec, in your testimony you said that 4 years after the passage of Dodd-Frank, there is no evidence that it really ended too-big-to-fail, and indeed, Dodd-Frank has probably reinforced investors' expectations that the largest financial institutions actually

benefit from government safety net protections that are not available to smaller institutions.

Can you kind of quickly tell me what advantages did you see that those institutions have over smaller institutions like Mr. Wilson's?

Mr. KUPIEC. I think that the perception that the government is so closely watching them, and they are subject to much, much tighter regulation and supervision gives investors the impression that they will be protected by the government; that the Federal Reserve, who is intrusively involved in their operations, is responsible for not letting them fail.

And I think there is the system set up where the intrusive regulation has replaced the market discipline that you usually see in banking markets, and so the cost of funding for these institutions, the largest institutions, is now much less than the cost of funding. It is more than 20—on average, about 25 basis points; 22 is the smallest year, 32 is the biggest in the years I looked at. So there is a definite cost of funding advantage to being a large bank.

Mr. NEUGEBAUER. Mr. Frank mentioned several times that he felt that the larger financial institutions actually didn't benefit from Dodd-Frank, that it was more onerous on them. And I wanted to quote some things that some people who run some of these financial institutions say. Lloyd Blankfein, for example, said that Goldman Sachs would be one of the biggest beneficiaries of this reform. Jamie Dimon even pointed out that while margins may come down, the market share may increase due to a bigger moat. And so several CEOs have said that Dodd-Frank solved—for example, Wells Fargo said that I don't think Dodd-Frank got it right or solved the issue.

So the question is, we have gone through all these gymnastics of doing this, but, in fact, the bigger financial institutions have gotten bigger, and we have seen—

Mr. FRANK. First—

Mr. NEUGEBAUER. I didn't ask you a question.

Mr. FRANK. Oh, sorry.

Mr. NEUGEBAUER. So the question is the bigger financial institutions have gotten larger, and we have seen a lot of consolidation in the smaller institutions, community banks. We have seen a number of consolidations. If we continue without making some changes to Dodd-Frank, do you think that is the direction that we continue to go, that the larger financial institutions with that advantage get larger at the expense, in many cases, of the smaller institutions?

Mr. KUPIEC. Yes. I think very definitely that the changes in Dodd-Frank will change the—will increase the consolidation in the industry and tend to make assets and deposits be concentrated in the largest institutions.

There is a number of features, and it is not just the regulation of the largest institutions. Dodd-Frank had a big impact on Subchapter S banks, which most small banks are. It doesn't allow you to pay dividends if you get below a capital threshold. And this is the means by which you get money out of a Subchapter S so they can't pay their owner's dividends. It stopped the trust preferred se-

curities (TRuPs), it eliminated TRuPs, which was a major source of funding for the smallest banks.

So I think it has shut down—and the large deposits, if you are a large corporate or municipal, you are going to go to the largest banks where you think things will be protected here in a Title II resolution. And so I think there is a lot that tilts the whole system over the long run towards the larger banks.

Mr. NEUGEBAUER. Mr. Wilson, sometimes when you are competing for deposits in your marketplace, particularly if it is a large deposit, do you find it difficult to compete with some of the larger financial on, say, your CD rates or money market rates?

Mr. WILSON. We have challenges in that, but we are in a market that is pretty much awash in deposits right now, part of the oil field activity in our area.

Mr. NEUGEBAUER. But with your cost—you said you had 17 employees. With your cost, and you add additional compliance costs, it is putting some pressure on your margins in what you could pay on deposits based on what your loan rates are?

Mr. WILSON. Yes, sir, our margins have squeezed considerably over the last 4 years.

Mr. NEUGEBAUER. With that, Mr. Chairman, I will yield back.

Chairman HENSARLING. The gentleman yields back his 10 seconds.

The Chair will now recognize the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman.

To set the record straight, this $50 billion we are talking about was originally $10 billion in the bill, and some of us had to fight very hard to raise that. The original approach was that the SIFIs get the bailout, and the medium-sized institutions are among those paying for it, even though the medium-sized institutions never could have gotten the bailout.

The problem we have is twofold, and these problems continue: first, the existence of entities that are too-big-to-fail; and second, the credit rating agencies. As to the existence of entities that are too-big-to-fail, we are told that the current law prohibits using taxpayer money to bail them out. I was here in 2008; law prohibited using taxpayer money to bail them out. We passed a new law. And one would suspect, in fact, the markets are convinced that is exactly what will happen again.

And that is why Mr. Kupiec testifies that these giant institutions enjoy a 22 basis points benefit. I have submitted to the record of previous hearings that it is closer to 80 basis points of benefit. And as Mr. Kupiec points out, the sweet spot is to be a SIFI, but not to be classified as a SIFI. So if the markets believe that you are so big that you will take down the whole economy, they will loan you money at a lower rate knowing that Congress acted in 2008 and would probably act the same way again. The solution to too-big-to-fail is not to have institutions that can take down the entire economy.

Mr. Chairman, and I mean the current chairman who has just left the room, the Republican report that we are here having a hearing on identifies that there are only two legislative answers that have been put forward to deal with this. One is Mr. Capuano's

bill that would require additional capital to be held by those that are enjoying this subsidy; and then there is my bill and Bernie Sanders' bill to say too-big-to-fail is too-big-to-exist.

Since the purpose of this hearing is to focus on solving problems that haven't been solved, the biggest problem is we may be asked to bail out institutions again, and there are only two legislative proposals to deal with the problem identified in the Republican report. I don't know if the current chairman can speak for the permanent chairman of the committee, but I would look forward to asking him why we can't mark up the only two legislative proposals identified in the Republican report to deal with the problem that we are talking about here.

I have a question for Mr. Wilson, and that is, as you already know, the regulators are crafting—the regulators are currently crafting the QRM rule. Do you agree that this rule needs to be issued promptly and closely track the language of the QM rule to ensure a transparent secondary mortgage market?

Mr. WILSON. I am an advocate for if the bank keeps the mortgage in his portfolio, those rules should not apply to the bank. That is 100 percent risk retention.

Mr. SHERMAN. That is, I think, a different issue.

Mr. Carfang, do you have a different—

Mr. CARFANG. Risk retention is very important. That is how capital gets allocated appropriately.

Mr. SHERMAN. Okay.

Mr. Chairman, I was addressing you while you weren't here, so I will repeat myself.

Chairman HENSARLING. Then I didn't hear you.

Mr. SHERMAN. What?

Chairman HENSARLING. Then I didn't hear you.

Mr. SHERMAN. And that is why I will use my last half a minute to ask you a question, which is since the Republican report says we have a huge problem, the too-big-to-fail institutions might be bailed out, since your report indicates there are only two legislative proposals to deal with that problem, Mr. Capuano's bill and mine, is there any chance that instead of just talking about how bad some prior bill is, that we would actually consider the only two legislative proposals identified in your report and mark them up?

Chairman HENSARLING. Perhaps the gentleman missed the Chair's opening comments when he said we will mark up too-big-to-fail before this Congress is over.

The time of the gentleman has expired.

The Chair now recognizes the gentleman from Oklahoma, Mr. Lucas, chairman of the House Agriculture Committee.

Mr. LUCAS. Thank you, Mr. Chairman. And I would like to move over to the subject of Title VII and the derivatives markets.

And, Mr. Deas, your testimony is more than a little familiar to me. As chairman of the Agriculture Committee, my committee and I have held 17 oversight hearings on the Commodity Futures Trading Commission, the derivatives market, and the implementation of Dodd-Frank over the last 4 years. Your testimony asking for greater oversight to the implementation process and concern that end users are being treated like large Wall Street banks is something

that this committee and the Agriculture Committee have heard dozens of times from dozens of witnesses.

Now, that is why just about every issue you raised in your testimony, we addressed in my legislation to reauthorize the CFTC, H.R. 4413, the Consumer Protection and End User Relief Act, which passed the House last month with a large bipartisan majority. And you are correct, Mr. Deas, that end users did not create the financial crisis in 2008 and should not be regulated like they did. End users are the job creators and should be putting resources into research and development of the projects to grow their businesses and should not be required to put valuable resources in margin accounts.

As you mentioned, the House has twice passed the Business Risk Mitigation and Price Stabilization Act with large bipartisan majorities, 141 votes last year. Unfortunately, the Senate, that other body, has not acted on this bill, so I included the prohibition on charging end user margin in the CFTC Reauthorization Act.

Tell us, Mr. Deas, can you quantify the cost that FMC would incur in possible job losses if this protection is not enacted into law and FMC has to post marginal in its derivatives transactions? Could you expand on that for a moment, please?

Mr. DEAS. Yes, sir. Thank you for that question. FMC is also a member of the Business Roundtable, which is itself a member, along with FMC, of the Coalition for Derivatives End-Users, and we surveyed the other nonfinancial members of the Business Roundtable and found that on average, for FMC and those other nonbusiness members, it would be $269 million that would need to be set aside for meeting these margin accounts, and that was only assuming a 3 percent initial margin without allowing for any variation margin.

And so that would be a direct subtraction of funds that we would otherwise use to invest in capital equipment, to expand our business, in inventory to support higher sales, in research and development to innovate new products, and ultimately, we hope, to grow our employment.

Mr. LUCAS. It seems that Senate action on H.R. 4413 therefore would be an important thing to help the economy.

Mr. Chairman, if I could note for just a moment that on this fourth anniversary of Dodd-Frank, like a number of Members in this room, having been a part of the legislative action in the committee and across the Floor and the conference committee, time tends to modify our memories about how things are done. But as I remember it, the derivative section of what would ultimately be the Dodd-Frank Act started as a very bipartisan piece of legislation in the House Agriculture Committee, with support from both sides of the aisle.

As I remember it, when we got to this committee, there was input from the Minority, this side of the aisle presently, but at that time the political minority. As I remember, the bill went across the Floor with a number of supportive votes from all sides of the room. When we got to conference, the decision was made by the conference committee chairman to set the House work product aside and take up Senator Dodd's product. And from that point on, as my memory goes, it was not too much of a bipartisan process.

I just note to all my colleagues that serving on several committees, some with a very strong tradition of bipartisanship, that we began Dodd-Frank, whatever the end result was, I think, in a fashion that was appropriate for what we were trying to accomplish, but by the end I don't remember the Minority having that much input, Mr. Chairman. Maybe you remember things differently.

With that, I yield to the chairman, and I yield back to his conclusion.

Chairman HENSARLING. I think that the gentleman's memory is quite vivid, notwithstanding the fact I recall being there for about 24 hours. But, yes, the gentleman's memory is correct.

Does the gentleman yield back?

Mr. LUCAS. A bill only reflects how it is put together.

Thank you, Mr. Chairman, I yield back.

Chairman HENSARLING. The gentleman yields back the balance of his time.

The Chair now recognizes the gentleman from New York, Mr. Meeks, ranking member of our Financial Institutions Subcommittee.

Mr. MEEKS. Thank you, Mr. Chairman. And I appreciate the gentleman's last line of questioning. But I also—because listening to the testimony of the witnesses thus far, I do want to see whether or not there is anything that we can agree upon. So I will ask, I guess, Mr. Wilson first: Do you agree that it was bad behavior by some financial institutions that created the problem that we had with reference to the financial crisis?

Mr. WILSON. There was no bad behavior on my part.

Mr. MEEKS. No, not your bank. I said some financial institutions, the larger ones in particular.

Mr. WILSON. Some of those guys did something—financial institutions and nonfinancial institutions did something that got us in that—

Mr. MEEKS. Somebody did something.

Mr. WILSON. Yes, sir.

Mr. MEEKS. Something went astray, and things went bad; is that correct?

Mr. WILSON. Yes, sir.

Mr. MEEKS. And I ask the same question to Mr. Carfang.

Mr. CARFANG. Sure. There were a number of contributors, and large financial institutions were—

Mr. MEEKS. So somebody did something wrong. On their own, we didn't have anything covering it, but somebody did something wrong. A lot of people did something wrong to cause the crash. Is that correct?

Mr. CARFANG. Absolutely. Sure.

Mr. MEEKS. Okay.

Mr. Deas?

Mr. DEAS. Sure, yes, there were financial institutions which engaged in risky activities, and those risks blew up in 2008.

Mr. MEEKS. And Mr. Kupiec?

Mr. KUPIEC. Yes, there were lots of guilty parties. Regulation was very subpar. The regulators missed all kinds of warning signs. There were consumers all over the country who took out loans trying to profit by low rates and flipping houses, and they were taken

advantage of, or they were facilitated by the financial institutions, but it was not just financial institutions that caused the problem. It was widespread. Blame is widespread.

Mr. MEEKS. Let me go back. So then, now, from what I am hearing, and I have heard from a lot of my colleagues especially on the other side of the aisle, is basically what they want to do is get rid of Dodd-Frank. If I listen to what they are saying, they are basically saying the cause of the problem and the problems we are having now is Dodd-Frank. Dodd-Frank didn't exist when the problem was caused. Dodd-Frank is as a result of the problem.

So now, I don't know whether individuals have tried to get rid of Dodd-Frank altogether. So the next question is, is there anything in Dodd-Frank that you agree with? Mr. Wilson?

Mr. WILSON. Yes, sir.

Mr. MEEKS. Mr. Carfang?

Mr. CARFANG. Sure.

Mr. MEEKS. Mr. Deas?

Mr. DEAS. Yes, sir.

Mr. MEEKS. Mr. Kupiec?

Mr. KUPIEC. I think the goals of Dodd-Frank to eliminate too-big-to-fail and the problems that arise from that are admirable goals, and I support those goals. I just don't think Dodd-Frank does it very well or does it at all.

Mr. MEEKS. Mr. Frank, would you tell us the problems and how you arrived at the fact, going to the last question, that Dodd-Frank came into existence, and what it did do to help save the economy and put us where we are today?

Mr. FRANK. There are two areas—and the chairman mentioned that there had been a lot of regulation including some increased regulation. Mike Oxley did Sarbanes-Oxley in a bipartisan way. President Bush signed it. There were other things. But there were two innovations, and I think the problem was not so much that we deregulated as a society, but that we did not have new regulations to keep up with new activity.

And there were two. One was the financial derivative business, and I noted what Mr. Deas said, and I agree with him essentially on the end users, and I said that. But there was risky speculative activity that became evident in 2008 basically from people who were using that as an end in and of itself. It wasn't connected to helping the productive economy.

Secondly, and most troubling, was securitization of loans. And what happened was people thought they had found a way to get rid of risk. I think Mr. Carfang correctly said you don't get rid of risk, you shuffle it off.

And so one of—in those two areas, these new financial derivatives—remember, Congress actually in 2000 enacted legislation that says to the CFTC, stay away from derivatives. And we did have, we thought, in the Homeowners Equity Protection Act to mandate to the Fed to regulate subprime, they said they wouldn't do it. Many of my conservative colleagues said we should stay away from regulating subprime, that was a good thing.

The problem was with securitization, people were making loans, and essentially the incentive became to make a quantity of loans and not quality. And that is why two important parts of the bill—

too-big-to-fail, if we get to too-big-to-fail, then things have failed. We don't want the institutions to fail. By stopping these irresponsible loans and making people stand behind the financial derivatives, you hope very much to make it unlikely that people will fail.

If there hadn't been bad loans, and AIG hadn't sold credit default swaps to people who had bought securities from these bad loans with no idea of how much they owed, we wouldn't have that kind of a problem.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, vice chairman of our Housing and Insurance Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I appreciate the opportunity for all the good folks to be here today and listen to their concerns. And it is interesting, as somebody who is involved in the community banking industry, and has been on both sides of the table as an examiner and as a banker before, and then seen the regulatory onslaught that has come as a result of the Dodd-Frank bill, it is mind-boggling to see the effect of what has happened. When I go talk to community bankers, the first thing they talk about is the amount of regulation that is coming out of Washington.

Mr. Carfang, you talked about the fear and uncertainty and ambiguity. And, man, I hear that every time I talk to a bankers group. I just got done with one a minute ago. Another group of them were here. It is this uncertainty that causes them to not want to go out and invest. And the local community, the business people themselves, have this same fear and ambiguity and uncertainty from the standpoint of not being able or not wanting to risk their hard-earned blood, sweat, and tears business by expanding.

And I have had a banker tell me before that—I asked him, "How are things going?" He said, "Last week, I had three people come in for whom I had approved the loans for their businesses over the past 2 weeks, and all three came in and sort of pushed themselves away from the table and said, no, we are going to wait. We are concerned about the economy. We are concerned about this regulatory environment coming out here. And obviously, the President's health care law is a big problem, but also, it comes down to Dodd-Frank and the accessibility of funds, the cost of those funds and of the uncertainty that it causes within our economy."

So, Mr. Wilson, you talked about—basically, I think, my view is that community banks were not the problem, yet they have been roped in as part of the solution. As a result, you talked a while ago about less flexibility and less ability to serve the unique needs of the communities that you sit in. I would like you to expound on that just a little bit from the standpoint of what goes on with a community bank and how you fulfill those unique needs.

Mr. WILSON. We were in a market that is 85 percent Hispanic, and the mortgage loans that we would originate were somewhat creative, you might say, but they were 5-year balloons. They were not high-risk mortgages. We have very little losses in those portfolios, but we were able to uniquely tailor that loan to meet that customer's needs. And I might say during the lifetime of that loan,

we were very flexible if a crisis happened in those families in working with those customers.

Mr. LUETKEMEYER. One of the things that I think has happened, and as somebody who comes from a rural part of the country, I go back home every weekend, and you see that there is another bank that is sold out to a competitor, a neighbor or a larger institution, and you guys have alluded to it this morning about the cost of compliance. And it is not that it is a bad economy, the economy is stagnated, but at some point, there is not a particular law or particular rule that caused it to happen, but it is an accumulation effect that at some point it is kind of like the straw that breaks the camel's back, that says, we can't take any more. We can't continue to spread these costs out over our entire business.

And you see this consolidation going on. I know that yesterday in The Wall Street Journal there was an article about some of the banks getting close to the $50 billion mark with regards to being designated as a SIFI. And, I have a bill to try and say, hey, look, it is not the size; it is the size, complexity, interconnectivity, and the risk that the bank is taking. That should be what determines a SIFI, not necessarily just the size, wherein all these rules and regulations kick in.

So I was kind of curious, Mr. Carfang, you have a lot of expertise in this area. What do you think about the situation that we need to do something about this SIFI designation to be able to protect some of the midsize banks as well?

Mr. CARFANG. One of the fears of the whole SIFI is that brings you under the jurisdiction of FSOC. And FSOC is an organization that essentially creates double jeopardy for everyone in the sense that FSOC steps in when it believes another regulator has failed and therefore creates another level of uncertainty, another bite at the apple, if you will.

And that creates a lot of concerns on the part of financial institutions, but to the customers, the business borrowers, they are concerned about whether their banks will be fully compliant or fully able to make loans when the businesses need them.

Mr. LUETKEMEYER. It was interesting yesterday, the article talked about two banks in particular. One of them, as it hit the $50 billion mark, its stock went down 15 percent. There is another bank that is approaching the $50 billion mark. Its stock is down 7.4 percent this year, not because of anything they have done, but because of their size. That is an unintended consequence of this situation that can't be allowed to continue.

Mr. Chairman, I will yield back.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. CAPUANO. Barney, do you miss us?

Mr. FRANK. No.

Mr. CAPUANO. I don't blame you.

Mr. FRANK. And I am not under oath. I could have said—I could have fudged.

Mr. CAPUANO. I think the gentlemen of the panel and body has seen this again. This is another one of these show-and-tell hearings

with apparently no purpose to it. And for me, I am actually kind of tired of them. If it wasn't for Barney, though I love you all, I would have left, because this seems to be going nowhere. And it is going nowhere.

Mr. Wilson, you already made a proposal. I would sign on to this tomorrow. For a small community bank holding their own mortgages at 100 percent, you shouldn't be subject to QM. Sign me up. That is easy. But we don't want to talk about that. We want to talk about how bad Dodd-Frank is. We don't want to talk about the things we can come to an agreement on to fix some of the things. We all think we can fix them, not a problem. Instead we need to light candles at the alters of outside ideologue think tanks. That is what we have to do.

We can't talk about too-big-to-fail. Many of us think that we did a pretty good job with too-big-to-fail. But I for one think, fine, if we can do more, let's do it. What is the problem? So I put a bill in, others have a bill in, H.R. 2266, I can't get the ideologues to support it or even to look at it unless we repeal Dodd-Frank.

How are we going to get to an end? How are we ever going to get any of these things addressed if we simply sit here and say, oh, we hate this, we love that, here are my speaking points for my campaign. Fannie and Freddie, does everybody here realize that the U.S. Government has made money on Fannie and Freddie? Mr. Wilson, do you know that?

Mr. WILSON. Yes, sir.

Mr. CAPUANO. Mr. Carfang, do you know that?

Barney, I know that you know it.

Mr. Deas, do you know it?

Mr. DEAS. No, sir. It is all I can do to keep up with derivatives and how they affect end users.

Mr. CAPUANO. Fair answer. But a lot of those derivatives are tied to Fannie and Freddie, so you should know who you are paying, because those derivatives are actually costing you money so that we can take money out of Fannie and Freddie.

Mr. Kupiec, did you know we are making money on Fannie and Freddie?

Mr. KUPIEC. I knew.

Mr. CAPUANO. Here we are, we are making money, we are actually costing homeowners more than they should be charged so that we can use it as a piggy bank, yet we can't have an honest discussion on how to fix it. Instead we have an ideologically based bill that gets out of this committee, sits on the Floor—I have never seen a major bill sit on the Floor for as long as that proposal has—because they can't get it passed.

And that is just one of them. We are having trouble with TRIA. We can't do it with the Highway Trust Fund. We can't do it with immigration, because we are lighting candles at the ideologue altar.

Help me find a way to get to these points.

Mr. Wilson, can you talk to some of your friends over there to let us do what we can do? Because I love them all, but they won't listen to me because I am from Massachusetts, I guess, and we are too liberal to be listened to. Could you get them to listen to us on some of these things?

Mr. WILSON. I am excited that we have consensus on addressing the needs of community bankers.

Mr. CAPUANO. The independent community bankers actually supported H.R. 2266. The American Banker wrote that it was a brilliant idea. And by the way, it wasn't my idea; it was a professor at BU, Con Hurley's, idea that I simply put into legislation.

I guess I don't really have any questions because the truth is I already know some of the things that need to be done, and I am happy to work with any of you or anybody else who actually wants to address some of the problems in a bipartisan way. But I have to be honest, I am getting tired of the regular hearings that we have simply stating political points over and over and over.

Dodd-Frank has done a very good job at containing the crisis that we had, putting us back on the footing. Can it be improved? Of course, it can. Barney will be the first one to tell you he didn't get everything he wanted. The 5 percent retention, I think it should be higher. There are others who would like to change some of these things. Those are changes to a bill that already works. It is not just throwing it out and pretending that we did something terrible.

Gentlemen, I am sorry I had no questions for you, but the truth is, I can only suffer this so much.

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

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

And I suppose in part in response to Mr. Capuano, let's see if we can't find something that we can actually accomplish. I was struck by the chairman's opening comments, the stories he heard from his bankers in Texas, the story that Mr. Wilson told about his compliance costs going up as a result of Dodd-Frank.

And I am reminded of a story that I heard when I was in Charleston, South Carolina, with a small community bank, and they had been through their first or second examination after Dodd-Frank. And the examiner—they told the story, the examiner had asked them at the end, how you are finding the new regs? How are you finding the new environment? And the banker, it is a small community bank, said, it is killing us. We have 18 employees, and we had to hire 3 people last year just to fill out paperwork, and it is just killing us. And he said that the response of the examiner was outrageous, that the response from the examiner was this blank look of nonrecognition when the examiner said, I don't understand; then it is working because you have created three jobs. And if you have a complete misunderstanding of how you create wealth and how you create jobs, then maybe that part of Dodd-Frank is a success for you.

And I think Mr. Kupiec mentioned that the stories coming out that JPMorgan Chase said, I think, earlier this year they are going to hire 3,000 more compliance officers this year on top of 7,000 compliance officers last year, yet total employment at JPMorgan will go down by 5,000 people.

So we are moving away from this concept of a productive financial sector into a compliant financial sector, and I am fearful that

may be part of the long-term legacy of this particular piece of legislation.

But if we go to Mr. Capuano's point about focusing on things that maybe we can agree on, I am encouraged by his comment, by Mr. Frank's comments that perhaps community banks, especially those that are holding loans, should be exempt from QM. I think maybe that is a move in the right direction. Let's see if we can build on that and maybe agree that this $50 billion arbitrary threshold is a bad idea; and that maybe picking a number—I was surprised to hear Mr. Sherman say, because I wasn't here at the time, that number was originally $10 billion, which means that we are actually contemplating a regime where a bank, a financial institution with $11 billion would be treated essentially the same as one with $1 trillion, which is just absurd.

So I will start with you, Mr. Kupiec, and I will go down the line.

Mr. FRANK. Could I just add one point?

Mr. MULVANEY. I will give you a chance, Mr. Frank. I promise. You know that I will.

But I want to start with Mr. Kupiec as to whether or not he thinks it would be better to replace the $50 billion threshold with, say, something that actually looks at the complexity of the business, not just the raw size, but the actual business model and what the financial institutions are engaging in.

Mr. Frank, I will ask you the same question afterwards.

Mr. KUPIEC. It is an excellent question, and there are two aspects to it. On a positive note on what you can do to fix too-big-to-fail in Dodd-Frank, Title I should have been used to direct the FDIC in their regular bank resolution process to be required to split up large banks that fail rather than to sell them to another large bank in a whole bank resolution. That is how we got the biggest too-big-to-fail banks, and Dodd-Frank didn't do that.

So it would have to modify the FDIC Act so that the FDIC did not have to do a least cost resolution, so that the whole notion that the FDIC handles bank failures well under the existing rule is nonsense. That is how we got the big banks we got. But if you fix that, then many of the regional banks, the banks between, say, $50 billion and $250 billion, don't really pose a systemic risk to the economy. The systemic risk they pose is if they fail and they go through an FDIC resolution.

The FDIC is just going to sell them whole to another bank, and pretty soon you have a $100 billion bank and then another $300 billion bank. So the resolution process built up a too-big-to-fail industry structure. That is what Dodd-Frank should have fixed. It should have addressed that flaw, and it didn't even touch it. Ordered resolution plans don't speak to that at all. It is all about a bankruptcy proceeding and everything else. It never recognized the resolution process that was in place. A regular FDIC resolution process is broken when it comes to a large bank, and it doesn't have to be.

Mr. MULVANEY. We will come back to my point, Mr. Kupiec, which is this $50 billion arbitrary number, it just sells, doesn't it?

Mr. KUPIEC. It doesn't come from anywhere. There is no science that came up with $50 billion. The problem with having this potpourri of things and turning it over to the FSOC is there is nothing

that constrains the FSOC. So if you turned it over to the FSOC and said, okay, $50 billion is out, but the FSOC has to consider complexity, interconnectedness, size, I don't know, whatever else you want to care about, the FSOC could sit there, and it is full of bank regulators, and they could look at it real hard and say, oh, yes, we looked at these; $50 billion is where it stays. There is nothing that fixes the problem if you kick it to the FSOC.

Mr. MULVANEY. And I apologize, Mr. Frank. I did intend to ask you the same question. Maybe someone else will give you their time to—

Mr. FRANK. If I could just clarify. I think you may have misunderstood Mr. Sherman because you weren't here. The notion that it was once $10 billion, it was never—nobody ever thought about $10 billion as maybe it was SIFI. The $10 billion was the number at which you would have to contribute if there had been a bailout. So some people proposed it—

Mr. MULVANEY. I wasn't suggesting it was a SIFI. It is just a heightened level of scrutiny whether or not—

Mr. FRANK. That was not about regulation. That was about contributions.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. CLAY. Thank you, Mr. Chairman, and I welcome back Mr. Frank.

Just going along with that line of questioning, Senator Warren of Massachusetts has advocated reinstating Glass-Steagall in order to address the issue of too-big-to-fail. What are your thoughts on that, Mr. Frank? Should we go back and address—

Mr. FRANK. No. I voted against the repeal of Glass-Steagall at the time because I thought it did not help benefit the new regulation. Glass-Steagall is a 70-year-old bill. I think the thing that I talked about as having caused the problem, the invention of the financial derivatives without backing, credit to false swaps, insurance not regulated in the way insurance should be regulated, securitization of mortgages, Glass-Steagall wouldn't have stopped any of that. You could have still made all of those bad mortgage loans.

Then the question is, do you break up the banks? And I did agree with Mr. Luetkemeyer that complexity is part of the issue. I agree with that, and that is one of the things that we asked them to look at with regard to those where there is a discretion about being a SIFI. That, by the way, is why I think the Volcker Rule is very important and why I changed my own position on the question of the push-outs. I originally didn't agree with Senator Lincoln's proposal about pushing out the derivatives. But there are ways of reducing the complexity, and I think it is not just size, it is complexity, and having them do less of the derivative area is a very good way to diminish the complexity.

The other problem is people said, the banks are too big. My question is, what is the level at which you have to get them down? Remember, the precipitating event to the questions in 2008 was the failure of Lehman Brothers, so presumably, if you think the answer is no bank should be too big so that its disappearance would cause

a tremor, then the big issue to be is Lehman Brothers was at the time. And then the question is, how do you get there? How does the Federal Government order this dismantlement?

I do think that the complexity issue of the Volcker Rule and the push-outs help. There was also a bill—an amendment to our bill that was adopted, authored by Paul Kanjorski when he was here, which does give the Fed the power to order the divestiture of any particular segment of any particular institution if it believes that it has gotten out of hand and isn't showing—doesn't have appropriate control.

So I do think there is room for subtlety in that, but I don't think Glass-Steagall does it. As I said, if Glass-Steagall had been in effect, it wouldn't have affected AIG. Nothing in Glass-Steagall would have kept AIG from coming to the Fed and saying, we owe $170 billion in credit to false swaps, and we have no—we didn't know how much we owed, and we know how to pay it off, and it wouldn't have stopped people from 100 percent securitization and making bad mortgage loans. These were new things that needed to be regulated in a new way, which I think is what we tried to do in the bill.

Mr. CLAY. Thank you for that response.

The housing market has seen some signs of recovery with foreclosure rates declining, home sales rising, and equity creeping upward. Do you think the Dodd-Frank Act had an effect on the housing market, and just over time the housing market has corrected itself?

Mr. FRANK. We have had an effect, and, as I said, I am surprised some people lament it. There are fewer loans available for very poor people. And I wish there weren't poor people, but lending the money when they cannot afford to pay it back isn't doing anybody any good. Then the lending institution—unless they managed to securitize and pass it off on some other entity.

I think, to the extent that we have seen the stabilization of the economy in general, that has helped the housing market. I think that the accommodation of things that have helped turn around this very serious recession have been helpful.

Let me just comment on one thing, and I appreciate that people have talked about the uncertainty, et cetera. Some of that is inevitable. It has taken longer than it should have, probably because I think we have had a problem with funding for the CFTC, but transitions are painful. We were in a situation until 2009 where a lack of regulation of some things, a whole set of practices that had grown up that had outstripped regulation, were causing problems, and I think it was necessary to go to a new set of rules. And it is painful to go through the transition. So I accept the fact that there is some uncertainty now, but I do believe that 3 or 4 years from now, that part of the problem will be over.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, vice chairman of our Financial Institutions Subcommittee.

Mr. DUFFY. Thank you, Mr. Chairman.

Listen, to Mr. Frank's recent comment, I agree that we should not be making loans to borrowers who can't pay them back. That is a good thing. But I would argue that the pendulum has swung

too far over, that traditionally there is a group of people who could get loans and could pay them back who now can't get loans because of Dodd-Frank. And so it is where that pendulum has swung that concerns me where people who are not of the highest income, but now can't get loans because of Dodd-Frank.

I know when this bill passed, I was not in Congress. I had the privilege of viewing this from my home couch in Wisconsin, but the claim was made that this ended too-big-to-fail, and I think the jury has come back: Dodd-Frank has not ended too-big-to-fail. We have larger institutions which partook in the crisis, new rules and regulations have now come out, and those rules and regulations, that the intent was to stay with the larger banks, have now come down to our community banks and our credit unions, making it more difficult for community banks and credit unions to make loans across Main Street America.

And if you are a large institution, and you look at the new regulatory regime, you would applaud it. You would think this is fantastic because you have economies of scale. You can deal with the rules and regulations far better than your smaller competitors. These rules, you might say they are bad, but really, they benefit you because now you have a competitive advantage.

It helps the large institutions and crushes the small institutions, and this is what I hear from my smaller banks, my community banks all across Wisconsin. It is making it harder for them to compete, harder for them to do their job, which means it is harder for families to access capital. It is harder for businesses to expand or for that young entrepreneur who has an idea, to access a loan and get a bank to take a risk on him in rural America.

But I want to pivot to the Consumer Financial Protection Bureau. We have a very powerful agency that I would argue, and I think many would agree, is unaccountable. I don't know if that was the—and this was all due to Mr. Frank—intent of Dodd-Frank. I don't think it was, but I think that is the reality on the regulatory side.

But in regard to the Consumer Financial Protection Bureau, you now have an agency that is collecting anywhere from 600 million to 850 million credit cards and the data off those credit cards. They are partnering with FHFA on a mortgage database, collecting information on race, religion, GPS coordinates to your home, credit scores, the number of children that you have, and the ages of your children, and the agency is out of control.

You have an agency that has been involved in racism, in sexism, and in spending $250 million on a renovation. I know Mr. Chairman has asked this question. It is not taxpayer money, but if it is not taxpayer money, I don't know where they get it. I haven't figured that one out yet. But it is an agency that is out of control, and I know that some of my friends across the aisle think that is a good thing that only an agency that doesn't have any input and insight from Congress can protect consumers. But, listen, all—whether they are individuals or organizations, through the history of humanity, they claim to do really good things for people and for society, but it is under the auspices of those claims that they have sometimes nefarious purposes, and to think that this Congress doesn't have oversight, whether it is with the purse strings or

through a commission of some sort that is bipartisan to help direct this agency, is of great concern for us.

I know there has been a debate that goes on right now with regard to what happens with the President, who now believes he has the authority to waive and suspend laws that were rightfully passed by the Congress. It is concerning. I think there is going to be a push on the other side of the aisle that says there is no need for Congress. We just have to have an all-powerful executive and all-powerful agencies.

But we will get to a question here. Mr. Wilson, do you believe that the CFPB rules, though they are intended for larger institutions, have had an impact on community banks?

Mr. WILSON. Absolutely. I am appreciative that we are not examined by them, but we are not exempt from their regulatory reach.

Mr. DUFFY. And how is that?

Mr. WILSON. When they pass regulations, we have to comply with those. The FDIC will continue to examine us, but we have to comply with those rules.

Mr. DUFFY. So you are not exempt. You get a little bit on examining, but you still follow the rules that are put out by the CFPB. So there is no firewall between you and the rules that come from the CFPB; is that right?

Mr. WILSON. Yes, sir.

Mr. DUFFY. All right. My time has expired, and I yield back to the chairman.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentlelady from New York, Mrs. McCarthy.

Mrs. MCCARTHY OF NEW YORK. Thank you.

I would like to remind my colleagues that with the poll numbers that are out there, we are not liked by anybody, so maybe we should all retire.

Barney, welcome back. It is good to see you. I think a lot of people here, especially some of the new Members, don't remember that we were having meetings almost every day. It took us over a year to come up with the—I call it the Frank bill. I still don't like putting "Dodd" on there, mainly because all of the headaches or an awful lot of the headaches that we have have come about because of the "Dodd" part of it.

With that being said, there are many things in the Dodd-Frank Act that we had wanted, we couldn't get it in, then things have changed. Certainly, I am one who was fighting for the community bankers. Barney knows that. Many of us here were trying to do that. We also felt with the business model of the insurance companies, that really had nothing to do with a very large extent of the collapse. But I think that one of the things that we have to keep reminding people, not only with the financial industry, but some that had nothing absolutely to do with the collapse killed—my small businesses in town all collapsed. A lot of people are still hurting even from then; unemployment. And yes, it was the fault of an awful lot of corporations.

Now, someone has to start taking responsibility for that, because here we are, and things are coming back, but it took a long time, and a lot of people did lose their homes. And I believe with Bar-

ney—when I got my first mortgage, you had to go through some kind of background check, and you had to make sure how much you had. And remember, gentlemen, when I went for a mortgage, they weren't giving them out to women. It just was the case.

With that, Barney, I am giving you the time because I keep seeing you writing down things, and I have been blessed to have you as my chairman when I first got onto the committee, you taught me a lot, but I also know when you are writing things down, you have a lot of answers that you want to give. And to me, you have been a wonderful teacher to all of us, and so if you have something that you want to answer back on the questions, please take that time.

Mr. FRANK. Thanks very much. I have to say Chris Dodd is not the whole Senate, so there were things that I don't like that he didn't like. Somebody mentioned the TruPS. That was Senator Collins from Maine, and she was the 60th vote, and she insisted on the—certainly any TruPS stuff.

I did want to get back to this question of whether or not it is some boon to be designated a SIFI, and I have to say, I think Mr. Kupiec has been a little inconsistent on this. He can respond.

I cite the fact that any institution over which there is discretion has vigorously resisted being named a SIFI as a sign that it carries more negative than positive by far. I accept their own judgment. His response was, they don't want to be designated, but they get the benefit of being a SIFI without the supervision. But he also said at one point, the fact that they are closely supervised by the Fed is one of the signals to the community. So the fact that they don't want to be closely supervised by the Fed, if it is simply their size alone that does it, then there is nothing you can do about it unless you want to break up Fidelity or break up—

Mr. KUPIEC. Thanks for asking.

So banks bigger than $50 billion don't have a choice, so they are not—they are—

Mr. FRANK. That is not—

Mr. KUPIEC. —not in the fight.

Mr. FRANK. I am sorry, this is my time. If you want to talk—

Mr. KUPIEC. I thought you asked me.

Mr. FRANK. No, I didn't ask you about banks over $50 billion. We know that.

Mr. KUPIEC. Okay. But is it—

Chairman HENSARLING. Believe it or not, the time belongs to the gentlelady from New York, and she can allocate it.

Mr. FRANK. The question I had to ask you is this: Why do they not want to be designated? You said the fact of designation and co-supervision is what leads people to think that they won't be allowed to fail, so why would they then not want to be designated? That is the question.

Mr. KUPIEC. Do I get time?

Chairman HENSARLING. Again, the time belongs to the gentlelady from New York. She can referee or swap.

Mrs. MCCARTHY OF NEW YORK. I would rather hear the discussion between the two of them, and the majority of people here on both sides are all taking too long to explain the question.

Chairman HENSARLING. So, Mr. Kupiec, you are recognized.

Mr. KUPIEC. So I am allowed?

Mrs. MCCARTHY OF NEW YORK. Yes.

Mr. KUPIEC. Banks are off the table. I agree with that. So here you have designation. You have AIG, which was a ward of the government and had no choice, so they were silent. The other insurance companies are going to be subject to heightened designation that is not mentioned anywhere. They are going to be treated like a bank. That can't—they are going to be treated—they are going to have to do stress tests just like they are a bank. They are gong to have capital just like a bank. Neither the FSOC nor the Board of Governors has specified what rules are going to—

Mr. FRANK. We agree, you shouldn't be designated, and they don't want to be designated, which you make that as a bad thing.

Mr. KUPIEC. Because they have no clue what will happen to them. They have no clue, so they wouldn't want to be designated.

Chairman HENSARLING. The time of the gentlelady has expired.

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

Mr. ROYCE. Thank you. Thank you, Mr. Chairman.

The derivatives market is global, and trying to get an efficient global derivatives market should be a priority, I think, of this committee. In order to meet that goal, our regulators have to fully understand how Europe and Asia are going to implement derivatives reform and sort of do things in concert here and not end up with incompatible guidance and rules that could harm our competitive position of our companies and liquidity of our markets.

So here is my point. As Mr. Deas outlined in his testimony, while the SEC adopted a formal rule, the CFTC adopted guidance that has been subject to changes of interpretation and a resulting lawsuit also. In late May, then-CFTC Chairman Mark Wetjen stated: "I don't think it was the right decision to change the guidance, and equally comparable comprehensive regulations in Europe should allow for substituted compliance in this situation."

So my question to Mr. Deas and Mr. Carfang is, the businesses that use derivatives to manage their risk need certainty, they need that liquidity, they need those willing counterparties with which to trade, whether located here or in Europe or Asia. Do you believe that the failure to have one joint rule to govern how Title VII of Dodd-Frank will be applied outside of the United States is harming the ability of end users to manage their risk?

Mr. CARFANG. Sure. The jurisdictional issues, the conflict, and the inconsistencies among the various derivative regulations around the world is harming the ability of U.S. companies to basically get a handle and appropriately hedge their risk, time their risk, and get—frankly, get visibility of those risks.

You create imperfect markets, corporate CFOs were allowing the market to give signals, to give economic signals, and to the extent that those signals are muted or quieted, the corporate treasurers are more reluctant to make investments simply because they don't have the economic clarity that they need to move forward.

Mr. ROYCE. Commissioner Deas?

Mr. DEAS. Yes, sir. Thank you.

There is uncertainty in several areas or potential bad outcomes from the lack of harmonization. The lack of the harmonization be-

tween the CFTC and the banking regulators has created this uncertainty that we thought was clear in the bill that end users should be exempted from having to post margin, and I indicated earlier that for the average nonfinancial member of the Business Roundtable in a coalition study we did, that was $269 million that represents a diversion of funds that would otherwise be used for business investment.

The other element—and the European regulators have been much more clear that they view the derivatives activity by end-user companies that is actually risk reducing, and so they have—they appear not only to be exempting end users from having to post margin, but from exempting the bank counterparties to a derivative end user from having to retain a higher capital level against that derivative exposure because of the risk-reducing nature.

We fear that this—

Mr. ROYCE. If I could—

Mr. DEAS. —aspect could put American companies at a disadvantage if—

Mr. ROYCE. If I could—I understand your point. If I could quote Michel Barnier on this, the EU Commissioner, he says, "If the CFTC also gives effective equivalence to third-country clearinghouses, deferring to strong and rigorous rules and jurisdiction such as the EU, we will be able to adopt equivalence decisions very soon. In other words, we will treat you as you treat us."

I did want to ask Chairman Frank a question. It is good to see you, Mr. Chairman. It was mentioned to me that you had discussed exempting smaller banks from Volcker, and as memory serves, you are not of the opinion that asset managers should be designated as SIFIs. I was going to ask you, give you the floor here, on other issues that regulators are pursuing, do you find some there that were not intended, in your view, by Dodd-Frank?

Mr. FRANK. With regard to asset managers, to clarify, I don't think as a general rule they should be. AIG could have, should have been. I don't think insurance companies should be, but AIG is the kind that likes to complain. So it is not 100 percent, but the assumption would be no.

My biggest problem with the regulators, frankly, is they are equating the two kinds of mortgages. I think there should be risk retention. I agree with Mr. Wilson. You keep it in the portfolio, fine, but the flipside of that has to be strong risk retention, and I am not happy with what the regulators are doing there.

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, and I thank the members of the panel, especially Mr. Frank. It is good to see you again. Welcome back.

I did see a good article yesterday in The Wall Street Journal by Victoria McGrane and Julie Steinberg, and a few of the takeaways from their article, the address is really how Wall Street is adapting to the new regulatory regime and Dodd-Frank. And they talk about the fact that profits are up, number one; that banks are cutting ties with subsidiaries that are more risky. They are also shoring up

their capital reserves in case of an upset in the economy, and they are deleveraging and becoming less complex institutions.

They go on to say that Goldman Sachs last week announced it trimmed $56 billion from its balance sheet during the second quarter. That is the sharpest quarter, a quarter reduction in a very long time, and they are proactively trying to comply with Dodd-Frank.

It talked about Morgan Stanley. They have cut assets by one-third since the 2008 crisis and downsized their fixed-income trading operation, and they are focusing on less risky operations.

Citigroup has shed nearly $700 billion in noncore assets, including the sale of more than 60 businesses that they viewed as more risky. And Bank of America Corporation has shed more than $70 billion worth of businesses and other assets since 2010, including those that are more risky, and require the bank to hold a lot of capital against them. It has also eliminated 746 legal entities, a 36 percent reduction.

So Dodd-Frank, in part, is doing its job. It is working to reduce the risk and also the likelihood that these banks will fail in the first place.

Now, Mr. Frank, I want to ask you about—you talked a little bit about this earlier with Mr. Garrett. I want to go to the issue of asset managers. Now, they had a—as you know, the Dodd-Frank Act recognizes each financial institution and company differently, and it should be reviewed with its unique characteristics in mind. The fact as outlined, as we know in Dodd-Frank, include the amount of leverage that the institution has, the off-sheet balance—the off-sheet balance sheet exposure of the company, and the degree to which the company is already regulated by the primary regulator.

Now, that seems to suggest that these asset managers are not the folks that we intended to go after on the risk side, and I am just wondering, do you believe that designation as a SIFI is the appropriate way to address that industry?

Mr. FRANK. No, absolutely not. I agree with them that it would be a mistake. Again, I reiterate if being designated—there has been an argument on the Republican side that being designated a SIFI gives you this advantage, that those that are recognized as SIFIs have a funding advantage, yet every institution over which there is discretion has vigorously resisted, and the fact is that being a SIFI could mean more regulation, and the notion that it is a benefit is belied by their response.

There was one other factor that I think was in there, Steve, I don't know if you read it, about the breadth of ownership which was relevant. The more widely owned it is, the less likely it is to need to be in there.

Mr. LYNCH. And I think that was a good example of that.

Mr. FRANK. And I don't think that—if that is your major—if that is all you do is asset management or sell life insurance, I don't think you should be a SIFI. For one thing, I think they have enough other things to do, and there is no sign of their causing problems.

Now, you did have an issue with money market funds, and there, by the way, I think the FSOC has shown its value, because we are going to get some regulation to money market funds now because

of the FSOC, which intervened when the SEC wouldn't do anything. People will disagree about the specifics, but I think it is a good thing that they move forward. But I do not believe that the asset managers, absent some other form of activity, pose a systemic threat.

Mr. LYNCH. Okay. Thank you very much, and I yield back.

Chairman HENSARLING. The gentleman yields back.

The Chair now yields to the gentleman from Pennsylvania, Mr. Rothfus. Would the gentleman yield to the Chair for a brief moment?

Mr. ROTHFUS. Yes, Mr. Chairman.

Chairman HENSARLING. I just want to point it out, because I have heard Chairman Frank make the point a couple of different times, I don't frankly know if the SIFI designation is a net benefit or a net cost, but, again, Lloyd Blankfein of Goldman Sachs says it "would be among the biggest beneficiaries of reform." Jamie Diamond said, "While margins may come down, market share may increase due to the bigger note." AIG called the SIFI designation "a Good Housekeeping seal of approval."

So I think some of the biggest banks might respectfully disagree with our former chairman.

I thank you, and I yield back to the gentleman from Pennsylvania.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Western Pennsylvanians are frustrated by the one-size-fits-all decisions coming out of this town. These rules and regulations are not helping businesses in the communities I represent grow and create jobs. They are not helping an out-of-work person get a job. Banks in western Pennsylvania are telling me the same thing. They are telling me that the regulations coming out of this town are stifling their ability to lend and offer products to businesses and families in our communities.

Mr. Wilson, has your institution or are there institutions you know of who have stopped offering a product because of the regulatory cost associated with it? If so, what does this mean for customers?

Mr. WILSON. As I have mentioned, I am very sad that we no longer serve that segment of our community who did not have access to credit because of the requirements of Dodd-Frank.

Mr. ROTHFUS. But that was with mortgages. Are there other areas also?

Mr. WILSON. No, sir.

Mr. ROTHFUS. A recent study from the Mercatus Center found that small banks are spending more in compliance in the wake of Dodd-Frank, and that more than 80 percent of respondents had their compliance costs rise by more than 5 percent since 2010. Statistics like this are why I am of the belief that any regulation should have to undergo a rigorous cost-benefit analysis, including a review of whether it would actually cost jobs and harm wages.

Mr. Wilson, can you quantify for us the cost that your institution has incurred to comply with Dodd-Frank regulations in terms of dollars?

Mr. WILSON. My estimation is we spend about three full-time equivalents dealing with regulatory requirements in our—

Mr. ROTHFUS. And that is on an annual basis?

Mr. WILSON. Yes, sir.

Mr. ROTHFUS. And about how much would that be?

Mr. WILSON. The bulk of that is—a big piece of that is my time trying to read the regulations, trying to interpret them, getting training on what they are. Some of those are not clear, and they conflict with other regulations.

Mr. ROTHFUS. This is time that you would not be spending with a customer trying to help that customer—

Mr. WILSON. That is correct.

Mr. ROTHFUS. —access a credit product that could help him or her grow a business, get into a mortgage.

Mr. WILSON. I would much prefer to be calling on customers and offering them credit solutions.

Mr. ROTHFUS. I have also been concerned about the consolidation that we are seeing and Dodd-Frank's effect on consolidation of the banking industry. I spoke to a group of bankers in Pennsylvania, small community banks, about 20 of them, and I asked a question of whether or not in 10 years they thought they would be independent still, or might they have to merge or be acquired, and every hand went up, because there is a lot of concern, and we are seeing that certainly with the numbers. That is one statistic that in the 4 years prior to Dodd-Frank, 510 new bank charters were granted, and after Dodd-Frank, only 15 new charters have been granted.

Mr. Wilson, what does this suggest to you? Are you concerned that we will see further consolidation of the banking industry once regulators get around to implementing the rest of Dodd-Frank?

Mr. WILSON. I think it would be a tragedy; however, I see that happening, and I feel that pressure myself trying to keep up with the pace of change and the complexity of these changes, and if they are not issues that we have caused or been a part of, I hope that the Congress will exempt us from those sorts of regulations.

Mr. ROTHFUS. Thank you.

Chairman Frank, on December 11, 2009, your bill, the Wall Street Reform and Consumer Protection Act of 2009, was brought to the Floor. That bill provided for the creation of a consumer finance protection agency. It also provided for the conversion of that agency to a commission. Section 4103, subsection A, said on the agency conversion date, "There shall be established a commission that shall, by operation of law, succeed to all the authorities of the director of the agency." And further in subsection B, it said, "The commission shall be composed of five members who shall be appointed by the President by and with the advice and consent of the Senate."

You sponsored that legislation, and then you voted for that, correct?

Mr. FRANK. Oh, yes, I voted for that bill on the Floor.

Mr. ROTHFUS. Thank you.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

First let me say, Chairman Frank, that we really miss your intellect, your intelligence, your wit, and your charm. Never did we need it more. Never did we need it more than at that moment of crisis, and throughout history, moments of greatness shine at their most brilliant at moments of crisis.

This Nation was on the brink of a depression, unemployment was ratcheting up at 12 and 13 percent, we had AIG failing, we had Lehman Brothers, even General Motors, the worst economic conditions since the Depression, and you were, sir, the right person at the right time doing the right job, and we are grateful for that, and America is grateful for that.

And I do want to say that the folks in Atlanta, Georgia, are still talking about that wonderful time we had when you came down and were there at the Ritz Carlton. I think you remember that. I am hoping that is one of the highlights of your career. It certainly was of mine.

Let me ask you, I want to go back to a couple of things. I think the genesis of the Dodd-Frank bill is the essence of the too-big-to-fail, and in there has been pointed out the threshold of $50 billion being that point and above where we designate the systemically important financial institutions, which brings upon additional Federal regulation.

But let me ask you, should a bank's systemic importance be based strictly and solely on their asset size?

Mr. FRANK. At some point, yes. That is, if you get to half a trillion dollars, I suppose, but I do think $50 billion is—look, any number is arbitrary, obviously, in the nature of the case. I agree, Governor Tarullo always talked about moving that, and I think that is a reasonable thing to do. And basically I think what you ought to do is to set a fairly high number as the automatic cut-off and then allow for inclusion if there are further kind of complications. And then on that question, and I want to—I was frankly pleased that the chairman felt sufficiently stung by the notion that nobody wants to be a SIFI to read those other comments, but they are really not relevant.

Mr. SCOTT. Right.

Mr. FRANK. Jamie Dimon and Lloyd Blankfein never had the option. It was obvious that Goldman Sachs and JPMorgan Chase were going to be there, and AIG, as the poster child for irresponsibility, didn't.

The fact remains, and it is not controversial, that every single entity over which there would be discretion—it is not JPMorgan Chase or Goldman Sachs—has vigorously resisted being included. They hire lobbyists to fight it. They appeal the decision. We had a panel of regulators on that subject when I was still here, and we asked them, has any institution told you they would like to be a SIFI, or has any institution failed to object if there was discretion, and every single one of them said the institutions fight it because it is much more of a burden than not.

But yes, I do think that it is reasonable to look at this. I also believe on the point is that complexity is obviously—could be an additional risk factor, and I would reiterate, I think, as I look at it now, the Volcker Rule and the push-out, even though I had skepticism about it originally, accomplished that.

If I could just comment on the question of the gentleman from Pennsylvania. He seemed to think he had scored some great victory by getting me to admit that I actually voted for this bill. I didn't think that was that much of a secret, but, in fact, I preferred it to be a single director of the CFPB. We had the votes, we had to give in, and—

Mr. SCOTT. Mr. Frank, I only have 40 seconds. I have to ask you this last point because it would be clearer.

Mr. FRANK. I apologize.

Mr. SCOTT. No problem. But I remember distinctly—a lot of people are watching this. C-SPAN's ratings are probably up because you are here. So I want to make sure that the Nation knows that it was you. It was you who insisted that no taxpayer money be used for a bailout. It was you who provided that. That is important. And I want to go back, and Mr. Garrett raised this point. I want to make it clear. Then who, under your bill, in your estimation, pays for that bailout?

Mr. FRANK. Institutions with more than $50 billion in assets, but there is a formula so that asset managers, et cetera, widely held will pay much less than a Goldman Sachs or a JPMorgan Chase.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Virginia, Mr. Hurt, vice chairman of our Capital Markets Subcommittee.

Mr. HURT. Thank you, everyone here. And thank you, Mr. Chairman.

I want to thank the witnesses for being here. It is kind of interesting that there seems to have developed among some of the Members here that the costs of some of these regulations and the red tape that has resulted from these regulations, a lot of which has been testified to by Mr. Wilson, is either not real, or if it is real, it is really not having an impact, it is not significant.

In fact, it seems that we are heralding that this is a good bill because Wall Street has hit all-time highs, and I would suggest that may be true, but it really does not properly reflect the overall economy, and it certainly doesn't reflect the reality that the folks that I represent are feeling. And I represent Virginia's Fifth District. It is a rural district. We have 23 counties and cities. It is mostly Main Street America. We have had, in the last 6 years, unemployment in parts of our district as high as 20 percent, north of 20 percent. There are still localities in our district where we have unemployment almost as high as 10 percent.

Our economy is struggling, and we need jobs, and we need the capital, we need access to capital that creates those jobs. And, we talk about the recovery, and we talk about the full-time jobs that were created. There weren't any full-time jobs created. There were part-time jobs created in June, and I think that is important.

So working families are paying more for gas, groceries, electricity, and health care, and it is costing them more to access credit, and they have fewer choices. So while this bill may be good for Wall Street, I would suggest to you that it is having a much harder impact on folks in the rural communities. Basically our community banks are a major part of providing that capital.

And so I guess my question is—I have two questions. The first would be for Mr. Kupiec, Mr. Carfang, and Mr. Wilson, and that

is dealing with the issue of too-big-to-fail, which, of course, is the Wall Street reform part of the Dodd-Frank Act. It strikes me that since 1984, there are 18,000 community banks. Now there are fewer than 7,000. The chairman indicated that since 2008, we have lost 800 community banks. These are important banks to our communities, and with that kind of consolidation, it seems to me that not only hurts access to capital in rural areas, but it also poses itself a systemic risk. And I guess, just with Mr. Kupiec, I would ask you, are community banks important to providing access to capital in our small, rural Main Street communities, and are they—and by this consolidation, are we, by its very nature, promoting systemic risk, two things—something that this Act purportedly tried to prevent?

Mr. KUPIEC. Absolutely. There was an FDIC study a year or two ago when I was still there where they looked into the community bank issue, and community banks are especially important in rural areas, in small towns, and in places where large banks don't want to branch. You need a big enough customer base before a large bank is willing to go there, and in many cases community banks are the banks that service places where large banks don't feel it is competitive to expand. So when we lose community banks in those places, and we are, it is very bad for the economy.

The consolidation is ongoing, and certainly the regulatory burden—and I provided testimony to a subcommittee in March on that—of the estimates of the cost to the regulatory burden associated with compliance under the Dodd-Frank Act, and I used some estimates by a Federal Reserve Board Governor about how many people it would take for the size bank, and then I multiplied it by the average earnings per bank, and it was significant. It puts a lot of banks in a negative earnings position, the extra compliance costs. So this is huge, and I think it does force—the compliance costs force banks to have to be of a bigger size or they are just not going to survive the costs.

Mr. HURT. Thank you.

Mr. Carfang, do you want to comment on that, then Mr. Wilson?

Mr. CARFANG. Three premises of sound banking are to make loans to those who have the capacity, who have the collateral, and who have the character. Community banks are best able to judge the character of the borrowers in their local community.

In addition, though, the problem is actually larger than that because we have moved away from relationship banking to compliance banking today, and that takes character out of the equation. So we are now coloring by the numbers here, and we are losing a lot of the judgment and a lot of the flexibility that really needs to happen to fund innovation and risk-taking at the most elementary levels.

Mr. HURT. Thank you.

Mr. Wilson, I suspect I know what your answer would be. Thank you. My time has expired.

Chairman HENSARLING. Indeed. 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 would like to welcome you back again, Chairman Frank. It was an honor to serve in Congress under your leadership when I was a neophyte, and I must tell you that it is also an honor to serve under the leadership of the Honorable Maxine Waters. You left the committee in capable, competent, and qualified hands, and I believe she is following in the tradition and doing an outstanding job.

With reference to several things, we talk about community banks quite a bit, Mr. Frank, and when we talk about community banks in terms of the aid, and assistance, and the changes necessary to make them effective, we use small banks, but when we start to generate legislation, the size becomes very large. In fact, we have had testimony from at least one or two bankers who indicated that $30 million, $40 million, $50 million is a community bank.

Mr. Wilson, we all support what you want in trying to help you, but when we try to get a definition of a community bank, it becomes very difficult when we reach the size of $30 billion, $40 billion, $50 billion; not "million" dollars, "billion" dollars. So therein, lies a small problem. But for today, let's deal with some other issues.

Mr. Frank, I would like for you, if you would, to come back to the question of a single director as opposed to a commission, because I don't think you had an opportunity to finish your answer, and this is something that we have litigated here at the committee level quite a bit.

Mr. FRANK. Thank you.

Let me just say with regard to the community bank problem, obviously it is a problem, if I could just interject, to have them diminish. I don't think that adds to systemic risk. There is a loss of social function of economic activity. A lot of the losses of community banks have been going more to the regional banks, of the midsized banks, so I don't think that is a systemic risk problem; it is a social problem that I would like to work on and a local service problem.

As far as the single director, yes, the Member from Pennsylvania plainly made the point. I originally wanted it to be a single director. The intraparty votes in the House, the Energy and Commerce people wanted it to be a commission, so we compromised. We went to the Senate, and the Senate also wanted a single director, and I didn't put up that tough a fight for the House position. That was in the conference.

People have alluded to other things, and there has been this notion that there is something unique about the CFPB because it doesn't go through Congress. Neither does the Federal Deposit Insurance Corporation. Neither does the Federal Reserve System. Neither does the Office of the Comptroller of the Currency. In fact, none of the bank regulators are subject to the appropriations process, and I believe that what you have is an anti-consumer activism issue here, not a process issue, because when I was here, and an amendment was offered to subject the Consumer Financial Protection Bureau to the appropriations process, I offered an amendment to do the same for the Federal Reserve. I would think people worried about accountability would think it was a greater problem that the Federal Reserve wasn't subject to the appropriations process, and, after all, the CFPB gets its money from the Federal Reserve.

Now, I will tell you that caused great palpitations at the Federal Reserve, but, in fact, they were able to count on the fact that the Republicans didn't want to have a consumer bureau running amok without any congressional appropriations to draw, but with a much more powerful Federal Reserve, that was fine. So the committee voted down my amendment when the Republicans were in the Majority. So I think that underlines that we are talking about these limitations.

Mr. GREEN. Accountability, would you address it for just a moment, please, because there seems to be the notion afoot that the CFPB is totally unaccountable, that it can make rules that cannot be overturned, that they simply have this inordinate amount of power with no restrictions. Would you kindly—

Mr. FRANK. Yes. In the first place, it is one of the most popular things Congress has done. And I know the chairman said that the financial reform bill is as damaging as the health care bill. My recollection is that this Republican Congress votes on a fairly regular basis to repeal the health care bill. Where is your bill to repeal the financial reform bill? If you have the courage of your convictions, let's bring it on. I think the problem is that the public is, in fact, much more supportive of it, and particularly of the CFPB.

And as to accountability, I don't know how many hearings I was summoned to when we were in the Minority, oversight hearings by this committee, in which the topic was the lack of oversight of the Consumer Financial Protection Bureau. I never spent so much time in oversight hearings complaining about an absence of oversight, and I think the public—and here is the final point. They don't like it, and they complain that it is not subject to appropriations, but nobody has pointed to any abuse of practice that I can see. No one has pointed to any unfair intrusion into the business models.

Mr. GREEN. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Florida, Mr. Ross.

Mr. ROSS. Thank you, Mr. Chairman.

And I thank the panelists for being here. I think that the testimony today, and especially that of Congressman Frank, has illustrated that there are some lingering problems with the implementation of the Dodd-Frank Act. Even the rules that have yet to be promulgated create an even greater uncertainty in the environment. And while we talk about a recovery, I can only wonder what the recovery would have been like had there been more certainty in the markets for financial institutions.

It seems that the Affordable Care Act, also known as Obamacare, and Dodd-Frank put together have been too behemoths of legislation that have created some serious problems and may not have been totally thought out.

In my district, of course, we have community banks, Mr. Wilson, that I empathize with you that no longer do residential mortgages. Credit unions are in the same arena. Businesses feel that there is a regulatory environment, and when you couple that with Operation Choke Point that is now saying that you have a reputational risk, and DOJ says you will or will not do business with certain people, it creates a very unhealthy environment for the flow of commerce.

And I am reminded that I think the fastest-growing occupation in this country right now is compliance officer, which does nothing to the bottom line of our financial institutions, and even does more egregious harm to the bottom line of our consumers and our citizens back home.

Just as if a patient will never get better if not taken off bed rest, we have to give some sense of certainty to an overregulatory environment, and I understand that there are some flaws in the SIFI, and I think even Chairman Frank testified to that earlier in questioning from Mr. Garrett.

Mr. Kupiec, you speak at length in your testimony about the fact that you have concerns regarding overregulation. In fact, you think that Dodd-Frank was a trade-off between economic growth and the probability of periodic recessions. Why do you say that?

Mr. KUPIEC. Financial intermediation is important. It is one of the most important things that causes economic growth. If you think about it, if you have an economy that has a single bank, and the bank gets into trouble, there is no way for savings to be translated into investment any longer if the bank fails. Financial intermediation is the way the economy collects savings, and it puts it into investment.

So what Dodd-Frank does is it tells the regulators to—it gives them and empowers them and it says there are certain kinds of bad financial intermediation that could cause systemic risk. We are not sure exactly what those are. It is up to you. You go figure out what financial intermediation you think is bad, and go out and regulate it.

The problem is the goal is to create financial stability, but financial stability is the absence of a crisis. A crisis—you can have a very stagnant economy with very little growth, and there is financial stability. There nothing in the Dodd-Frank Act that tells regulators that they have to take a trade-off between the growth effects of stopping financial intermediation and this weeding out bad financial intermediation, and many times they don't get what is bad intermediation right.

From 2005, all the way up to 2008, the Federal Reserve ran a study for the Financial Stability Board where they looked over and over and over again at securitization and credit risk transfers, and the same people who are regulating banks now, that same group of individuals—the ones who haven't retired—looked at intermediation securitization of subprime mortgages, credit derivatives, and they said, these are a great thing for the banking system. This is good financial intermediation. And now we are coming back and saying really what we need to do is give those guys more powers with no constraints and let them pick out the bad financial intermediation.

It didn't work last time; I just can't see how it is going to work next time.

Mr. ROSS. I appreciate that.

Mr. Wilson, I know you are not a health care expert, but you are an employer, and you also have to not only comply with the regulatory environment in administering your bank, but you also have to comply with health care requirements now under the Affordable Care Act as an employer. Would you say that the combination of

these two regulatory behemoths has created a greater burden on your institution, and if so, has it been to the benefit of your employees or your customers?

Mr. WILSON. No, sir. We have always provided health care to our employees. The benefit of the health care act is since we are small, if we provide insurance, we get a tax credit.

Mr. ROSS. Right.

Mr. WILSON. This year I am struggling because the IRS is telling me one thing, and my accountant is telling me another thing about buying on the exchanges, and so I have spent considerable time on that issue. And the financial institution regulations involve not only complying with what is past, but just think of 14,000 pages—

Mr. ROSS. Do you think the recovery could be better without that regulatory burden?

Mr. WILSON. It would free me up to do other things and—

Mr. ROSS. Make you available to those who you think—

Mr. WILSON. Yes, sir.

Mr. ROSS. —would be qualified to use it to encourage an even stronger and thriving economy?

Mr. WILSON. Yes, sir.

Mr. ROSS. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Wisconsin, Ms. Moore.

Ms. MOORE. Thank you so much, Mr. Chairman.

I am so very glad to see you, Chairman Frank. Just let me say that you have left the position of ranking member in the hands of Ms. Waters, and she has taught us, set up meetings with us in the Library of Congress. We have had speakers, heads of agencies, journalists, and she has not yelled at us either.

I read every single word of your testimony. This is such a boring subject to so many people who may be watching, but you certainly make it exciting. I read every single word, and I noticed that you didn't wax on and on about too-big-to-fail and how big the banks are, and, oh, there are more of them than there ever were before, and they have merged.

Instead, the nugget—and I want you to clarify this for me—that you have given me as a cautionary note is that instead of being distracted by just the size of the banks, we ought to be looking more closely into what is happening in the D.C. court rulings where this cost-benefit analysis is hampering the ability of the CFTC and the SEC to operate, the appropriations process is starving the CFTC and the SEC, regulating risk retention out of statutes, no skin in the game, and we need to learn lessons from history or be doomed to repeat it. I would just like you to sort of elaborate on your testimony with regard to that.

Mr. FRANK. I will try to speak softer.

Chairman HENSARLING. Chairman Frank, I don't think your microphone is on.

Mr. FRANK. I said I was speaking softly, too softly. I was promising not to yell.

Chairman HENSARLING. You are certainly free to turn it off, Mr. Chairman.

Mr. FRANK. If all I turn off today is a microphone, I will feel it was a pretty good day.

Which issue did you want me to address? Let me—

Ms. MOORE. The cost-benefit analysis and the district court.

Mr. FRANK. Yes. Let me—and I sympathize very much with the uncertainty. I do think, look, if you are in a situation where you think things are wrong, and you want to correct them, there is an inevitable period of uncertainty. So the only way to avoid uncertainty, it is like with—on the stability argument, is to perpetuate it. I am disappointed that things have taken too long. In particular, I think we have had a problem in the derivative area, and I, again, agree with Mr. Deas. He acknowledges there have been some problems in the expansion area; it hasn't done well enough to the end users.

If I had one magic wand I could wave, I would have merged the SEC and the CFTC. It makes sense that if you start a new country, you would have one. But they represent deeply enriched—deeply rooted economic and social and cultural divisions, and it would be very difficult to do that.

Sometimes people forget America is a more complex country. One of the reasons we have a multiplicity of bank regulators is we have the dual banking system. We have State-chartered banks and national-chartered banks. There was a proposal by Senator Dodd to give all the regulation of the banks to the OCC, and the State-chartered banks, many of the community banks, said, no, we don't want to be in there with the big banks. We want to stay with the Fed because we want a regulator that pays attention to us and isn't overly influenced.

The problem is this—and one of the best things that happened, from my standpoint, for regulation going forward was Senator Reid's getting the Senate to say we are not going to allow judges to be filibustered, because you had a very conservative, imbalanced court in the circuit in D.C.; you had a lack of funding—and I think the single biggest problem has been the incredible underfunding of the CFTC. The CFTC was given the biggest grant of real authority, derivatives, very complicated. They are wildly underfunded, and I guess that is why people regret that we didn't let the CFPB be in that situation. What many of my friends here would like to do is to throttle the CFPB with underfunding the way they have done with the CFTC. And then you have the financial industry loading all these comments on the agency, which they have the right to do, and then you have the court requiring a very specific analysis and then saying, oh, no, that is not good enough.

We had an example. The CFTC put out a rule in accordance with the bill's clear language regulating speculation that basically said if you don't use oil except in your salad and your car, please don't go out and buy a whole amount of it, which could have an impact on the price. The court threw that out and said Congress didn't mean it. We did.

Ms. MOORE. So, Barney, because of my time, are we—is this the sneaker risk thing that is happening to us?

Mr. FRANK. The what?

Ms. MOORE. With your indulgence, please. He didn't hear the question before—

Mr. FRANK. If I could have one—it is an indirect attack from people who don't want to bring it to the Floor and are trying to repeal it because it is too popular.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Illinois, Mr. Hultgren.

Mr. HULTGREN. Thank you, Mr. Chairman.

I would like to thank all of you for being here today in this week of—this grim anniversary of Dodd-Frank, especially Mr. Carfang. It is good to have you here from Chicago, Illinois, my home area. I'm glad you made it all the way out here.

It is increasingly clear that Dodd-Frank is doing real damage to our economy and stalling the economic recovery that we all want. Dodd-Frank spans 2,300 pages, imposes 400 government mandates, and creates vast new bureaucracies, but despite this, it has not corrected the problems arising out of the financial crisis. This includes the problem of too-big-to-fail and the need for a regulatory system that decreases systemic financial risk instead of increasing risk.

Now, some on the other side of the aisle, including the Obama Administration and most Senate Democrats, view Dodd-Frank like I view the Ten Commandments: inerrant; unchanging; and demanding our complete devotion. With all due respect to Chairman Frank, I suspect even he would agree that Dodd-Frank did not come down from on high, nor was it written in stone.

Thankfully, many on both sides of the aisle in this committee recognize that some parts of Dodd-Frank can be fixed, especially those relating to the community banks, credit unions, and the mortgage industry. After all, Dodd-Frank has had a disproportionately negative impact upon those institutions. These smaller financial institutions help people access the American dream by extending credit necessary to own homes, start a business, or to preserve a family farm. They provide at least 48 percent of small business loans and serve 1,200 rural counties with otherwise limited options, and they lend based upon personal relationships and local knowledge of the community, not just statistical equations.

Unfortunately Dodd-Frank too often forces these vital institutions into regulatory straightjackets that are designed for big banks, causing them to reduce lending, merge with competitors, or shut down. My constituents in the 14th District of Illinois demand answers to this problem, which is why I am really grateful for this panel here today.

With that in mind, I want to address my first question to Mr. Wilson and ask about how Dodd-Frank is impacting your community bank's bottom line. I heard from many financial institutions about how high costs imposed by a growing mountain of additional rules, regulations, and compliance burdens are being faced by the industry. Are you concerned that these regulations could force your bank to limit its offering of certain financial products to consumers generally, and low-income consumers specifically, and what about the impact that these regulations as well as their subsequent enforcement have on the availability and affordability of credit for small businesses and consumers?

Mr. WILSON. Congressman, our market is low- to moderate-income people. The community we serve is 65 percent Hispanic. The

withdrawal of us offering home mortgages is not good. There are products that we have looked at and chosen not to offer at this time until we figure out the risk. We are a little behind the curve on some of the new technologies. So that is the impact of the risks that we try to face each day.

Mr. HULTGREN. I want to get back to a few more questions with you, but I do want to just remind this committee where this all started from. I want to go back to September 25, 2003.

At a Financial Services Committee hearing here, Chairman Frank, you had said on the record, "I do not want Fannie and Freddie to be just another bank. If they were not going to do more than another bank, would because they have so many advantages, then we do not need them.

"And so, therefore, I do not think—I do not want the same kind of focus on safety and soundness that we have at the OCC and the OTS. I want to roll the dice a little bit more in this situation towards subsidized housing."

In the GSE Act, Congress initially specified affordable housing goals of 30 percent of mortgage purchases by the GSEs. That goal is continually raised over the years to 42 percent, 50 percent, finally, 56 percent. More than 70 percent of subprime and all-day mortgages that led to the crisis were backed by Freddie and Fannie, FHA, and other taxpayer-backed programs. If you have to point to a root cause of the financial crisis, that is it. Absolutely, that is it.

Mr. Wilson, I want to get back to you. In September 2012, an ICBA survey found that 55 percent of bankers decreased their mortgage business or completely stopped providing higher-priced mortgage loans due to the expense of complying with escrow requirements for higher-priced mortgages that took effect in 2010.

I wondered if your bank still does offer and issue mortgages. And, if so, have you decreased the number of mortgages you issue because of regulatory uncertainty?

Mr. WILSON. Yes, sir, most all of our mortgages would have fallen into the higher-price mortgage, and we do not have the staff capabilities to escrow insurance and taxes.

Mr. HULTGREN. Again, last few seconds. Thank you so much all of you for being here. We do want to figure this out. We need to clean this up. And, ultimately, I want to see community banks that are vibrant in our communities again.

With that, I yield back, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

Somebody mentioned the incredible cost of Dodd-Frank to the system, but I just want to start with, before Dodd-Frank, summer of 2008 to January, February 2009, the stock market lost 6,000 points at $1.3 billion per point, $7.8 trillion. Home values dropped by 25 percent across the country, trillions and trillions of dollars. Millions of jobs lost.

Since Dodd-Frank, the stock market has increased 10,500 points, 10 million jobs have been gained, and housing prices have rebounded. Now, whether there is a direct cause and effect, I don't

know, but certainly the economy has improved dramatically since before its passage.

Mr. Kupiec, I am just going to mention a few things because I disagree with your basic premise that the primary goal of Dodd-Frank was too-big-to-fail.

And having sat on the front lines of this thing, I know we were dealing with credit rating agencies, derivatives, mortgage lenders with their no-docs, no-down mortgage servicing, appraisals, foreclosures, leverage generally across the system, disclosures, Ponzi schemes—Madoff and Stanford—hedge funds, swaps, say-on-pay executives basing—pumping up their stock prices when it wasn't deserved, credit cards, transparency, money markets, the Securities Investor Protection Corporation, whistleblowers, securitization, accounting standards, and the CFPB.

Each of those was an important goal and is found in Dodd-Frank. So you describe it as the primary goal. I disagree with you. That wasn't. We had a whole range of things we had to address.

I want to enter into the record the article that Mr. Lynch was describing from the Wall Street Journal dated July 21st. And a Bank of America executive said, "Dodd-Frank certainly catalyzed substantial amounts of simplification, and we are moving well beyond that through our own initiatives." That was what we did. And if I could add it into the record.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. PERLMUTTER. Thank you, sir.

So, Mr. Frank, I would like to now see if any of these things triggered thoughts on your behalf and—

Mr. FRANK. Yes. Let me say this is a discussion I have had with the chairman.

I am pleased that Mr. Dimon, Mr. Blankfein and Mr. Moynihan at Bank of America recognize the value of the bank. It wasn't because they were glad to be designated SIFIs. That was never in question with them.

I recognize they believe that we brought some stability—I don't think every piece of it, but that we brought some stability. And, among other things, it gave them some protection.

We had a situation where—this was articulated by Chuck Prince at Citi. I asked him once why they hadn't put structured investment vehicles on his balance sheet. He said, "Because if I do, I will be at a disadvantage vis-a-vis Goldman."

We had some common rules. And there is no question. And as to being the main purpose, the main purpose of the bill was to not get to the point where institutions failed by not having the bad loans and not having these irresponsible derivative practices that caused it.

But I also am sorry that the Representative from Pennsylvania had so little time to spend with us because his distortions of the history with Fannie and Freddie were pretty egregious. It is true that in 2003, I did say that we should roll the dice with regard to subsidized housing, by which I meant very specifically, the phrase we used, multifamily housing built with Federal subsidies. In fact, that has done well with Fannie and Freddie. But it is also the case that was 2003.

And he referred to me as "Chairman Frank." Mr. Cheney in his book said, "Chairman Frank stopped it." Well, I wasn't chairman in 2003, because Mr. Cheney always had problems with things happening in 2003, like weapons of mass destruction.

But the fact is that we were in the Minority. The Republican Party controlled the House from 1995 through 2006. It was entirely their decision not to pass any legislation regulating Fannie and Freddie. I was against it in 2003. By 2005, I switched my position.

The gentleman from Pennsylvania alluded to an increase in the affordable housing goals. Yes. When George Bush pushed it up over 50 in 2004, I objected.

And, in fact, as you can read in Hank Paulson's book—President Bush's Secretary of the Treasury—it wasn't until 2006, when we were on the verge of taking over, that he talked to me and we got Fannie and Freddie legislation.

So the Republican Party has been very consistent. From 1995 through 2006, they did nothing legislatively about Fannie and Freddie.

Mr. PERLMUTTER. And I would remind the chairman that Mr. Oxley, the chairman, said that the White House gave him a—

Mr. FRANK. George Bush gave the—

Mr. PERLMUTTER. —one-finger salute—

Mr. FRANK. —one-finger salute.

Mr. PERLMUTTER. —on dealing with Fannie Mae and Freddie Mac.

Mr. FRANK. But we then in our 4 years, we did put them into conservatorship. And, since then, the Republican Party has once again, in their control of the House, done nothing about Fannie and Freddie.

Mr. PERLMUTTER. I yield back for the Chair.

Chairman HENSARLING. It is not a one-finger salute, but the time of the gentleman has expired.

The Chair now recognizes the gentleman from Kentucky, Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman. I appreciate the opportunity to examine the impact of the Dodd-Frank Act on its fourth anniversary.

Chairman Frank, I appreciated your earlier testimony that your intention in crafting the mortgage reform provisions of the law were directed to encourage more risk retention.

I have a bill, H.R. 2673, and that bill is a portfolio lending bill that would encourage more risk retention on the part of mortgage lenders, small banks, like Mr. Wilson's bank.

And, in fact, not only was that bill marked up out of this committee, several of my colleagues on the other side of the aisle, including Mr. Perlmutter, voted in favor of it.

And my question to you is, would you support such a proposal to give a QM safe harbor status to portfolio loans in which the mortgage originator retains the risk?

Mr. FRANK. I would have to look at the specifics. I am generally in favor of that, although, I would write—and you said you would encourage this. I think we ought to give in to the Senate and loosen the risk retention.

I would like to have portfolio allowed to be whatever—not below some certain objectionable level, but then also have stronger risk retention.

Mr. BARR. I appreciate your general inclination toward risk retention and your general favorability towards that.

Mr. Wilson, I want to direct your attention, as a small community banker, to the slide here. The ranking member earlier alluded to the fact that you should have no problem originating mortgages now because you are $2 billion or below in assets.

This is a slide from the Consumer Financial Protection Bureau. This slide shows what it required—the chart—in order to qualify for the safe harbor protection.

It is not just that you have to be $2 billion or below. It is loan features. It is balloon payment features. It is underwriting. It is points and fees. Then, there is the portfolio provision.

Does this slide explain why you and other community banks have exited the mortgage loan business?

Mr. WILSON. The fact that it is so complex on its summary page here is part of the problem. We did balloon mortgages. And so—I don't know. I would have to go through this complex—

Mr. BARR. Let me just cut to the chase. If we had a bill like the one that I was referring to earlier where, if you could portfolio your mortgage and hold it and retain the risk, hold it in portfolio, would you reenter the mortgage lending business?

Mr. WILSON. Yes, sir. I would love to be able to serve that sector.

Mr. FRANK. Mr. Barr, could I ask you one question about that bill?

Mr. BARR. I have limited time. I would love to talk to you after—let's talk afterwards.

Really quick, I want to just go really, really quickly to another point, which is that Dodd-Frank was sold under the premise that if community banks played ball and had a seat at the table, they would be protected from its new regulatory regime, in particular, jurisdiction under the CFPB.

In fact, thanks to reporting in the Washington Post, we know that Chairman Frank had a strategy of selling Dodd-Frank as a bill that protected community banks because they would be exempt from supervision by the CFPB.

In fact, the reporting says that—Mr. Frank, in communicating with the community bankers, said that, "There is going to be a bill—this is Mr. Frank talking to the community bankers, according to the Washington Post—and either you are going to have to get on the bus or be run over by it. I don't expect you to support the consumer agency—now the CFPB—in public, but what is it going to take to get you to be neutral?"

The community banker representative says, "Well, Mr. Chairman, that is going to take a lot. We don't want to have examination forces from this bureau coming into our banks, given all of the other regulators that are in our banks. And we only have 20 or 30 employees in each of these banks, and they are being eaten alive by exams."

They jockeyed back and forth, settling on a standard. This is Chairman Frank and the community bankers.

"The CFPA's—that is what they called it then—supervision would extend only to banks whose assets exceed $10 billion."

And then, according to the Washington Post, again, Chairman Frank said, "I am not asking you to come out and support this, but will you stay silent?"

The community banker lobbyist says, "I can make that work. We have a deal. I reached across the desk and shook his hand."

The Washington Post then reported that this deal was one of the most important made in the path of what would 9 months later become the law known as Dodd-Frank.

Mr. Wilson, given that recounting of a critical deal made to get Dodd-Frank to the finish line, and given the regulatory maze that you have to go through in order to avoid these regulatory burdens, do you believe that Chairman Frank lived up to his end of the bargain in terms of exempting small community banks from the regulatory burdens?

Mr. WILSON. We are subject to those regulations. We were not subject to examination by another agency. But when they make changes to the regulations, it changes my whole process, and it changes my training of my staff. And so, it is very complex.

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

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Minnesota, Mr. Ellison.

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

Chairman Frank, out of all of the things in the Dodd-Frank Act, is there one piece of the legislation that you are particularly pleased that we were able to get through?

Mr. FRANK. May I begin by responding to that outrageous suggestion that I broke my word?

I lived up exactly to that deal, as the gentleman on my right implicitly said. It was that they would not be supervised. There was never any suggestion that they would be exempt from the rules.

And your question, I would say to Mr. Barr, did I live up to my deal? The answer is: I did. And Mr. Fine, with whom I made the deal, would affirm that.

So, no, I don't think you and I will be talking about your bill, Mr. Barr, because I won't have my motives improperly impugned and a suggestion made that I am not good to my word when there is absolutely no basis for it.

As far as the bill is concerned, to me, the most important piece is one of the things that I now worry about, which is risk retention in mortgage lending, I really believe that the single biggest cause was, and it was an intervention and it wasn't regulated because it was new.

You had regulation of mortgage lending pretty good up through the 1980s, because most mortgages were made by banks and banks are regulated. And even if we don't have QM, the FDIC, the OCC, will still regulate the loans that Mr. Wilson's bank gives. And I am satisfied with that. That is, there is a general need to be reasonable.

But what happened was banks, through money coming in from outside the banking system—and, yes, the banks were unfairly maligned, particularly the smaller banks.

Most of the bad stuff happened outside the banks because all of a sudden money became available—not all of a sudden. There was liquidity available. You didn't have to go to depositors. When you went to depositors, you got regulated.

But there was all this liquidity from oil countries and Asian countries with large balances of payment. So, a whole lot of lending shifted to outside of the banks.

At the same time, thanks to intellectual property innovation, it was now possible to make thousands of loans, bundle them into a security and sell them.

So the ability to take the risk without having the responsibility for it proliferated, and I believe that was the root of the problem: the ability to make those loans.

And I think there has been an inaccurate argument, oh, the Federal Government forced people to make them. Well, the CRA didn't force Mr. Wilson to make bad loans then or now. And some of the agencies facilitated it, like Fannie and Freddie, but a lot of private people did it, too.

People did it because they could make money, and they could make money in a way—and Mr. Carfang said it right, I think—they thought they could—as far as they were concerned, the risk disappeared.

It didn't disappear. It just went into other places, the people who bought the security, the people who issued the credit default swaps against those securities, like AIG.

And so that is why I am troubled by a suggestion that there won't be full risk retention. And I think somewhere they may get it backwards.

They are tougher on loans that are going to be held in portfolio and softer on loans that are going to be securitized. And that is why I see these as flip sides of the same coin.

I would like them to be softer, easier, defer—and, in both cases, there is a common theme. You are deferring to the business judgment of the lender or the securitizer. That is, let Mr. Wilson make loans if he is willing to stand by that and keep them in his portfolio.

On the other hand, if I want to securitize those loans, let me do that, as long as I stand behind them with risk retention. So that was the single biggest issue, it seemed to me, and I am a little nervous about what is happening to it.

Mr. ELLISON. Yes. Mr. Wilson, do you want to respond to that?

Mr. WILSON. I just wanted to plead with former Chairman Frank to support community banks as in House Rule 2673, not to say he won't support that because of something that was said here, but to support community banks as in the exemption from those mortgages we hold in our portfolio and from the escrow requirements to support that concept.

Mr. FRANK. I will certainly work for that end. I was simply saying I can't negotiate with someone who thinks I am a liar.

Mr. ELLISON. I do have one quick question I want to ask before I lose my time.

One of the things that has happened here is not just the bills that sort of, I believe, erode Dodd-Frank, but the lack of funding for critical agencies that are supposed to carry it out, like the SEC and the CFTC.

Do you have anything to say about that?

Mr. FRANK. Yes. I am proud of the fact that we insulated the Consumer Financial Protection Bureau from that strangulation by non-appropriation that has happened to the CFTC.

And, again, I think—I started answering and Ms. Moore ran out of time. I think the Republican's chairman says it is as bad as the health care bill. But the reaction of the Republican Party to these two bills has been very different.

There has been no bill, to my knowledge, to repeal the whole of the Financial Reform bill or even any substantial part of it.

There have been some things at the margins, some of which I think are good, some of which aren't. But there has been no attack on the whole thrust of it, and they do it by funding.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger. Would you yield a brief moment to the chairman, please?

Mr. PITTENGER. Yes. I will yield.

Chairman HENSARLING. I think it was Leo Durocher who said, "Kid, you have third base so screwed up nobody can play it." So we are going to take a little time in this committee and get it right.

And, again, we have already dealt with Dodd-Frank's greatest sin of omission in dealing with the GSEs, and we will soon deal with too-big-to-fail. And I look forward to having former Chairman Frank support a number of our community bank regulatory relief provisions.

I thank the gentleman for yielding.

Mr. PITTENGER. Thank you, Mr. Chairman.

And thank each of you for your testimony.

Mr. Wilson, I certainly sympathize with a lot of what you said today. I served on the Community Bank Board for a decade.

And in Charlotte, where I live, we have had a number of consolidations of banks that just could not address the continued requirements and obligations, cost, compliance issues, and it has been bad for consumers and bad for the banking system.

Mr. Carfang, I would like to take a look at some of your remarks and just get a little bit more insight into what you provided today. You have mentioned that banks are focusing on the safe segments, those outside the regulatory cross hairs.

Could you elaborate on that?

Mr. CARFANG. Sure. Banks are afraid of making mistakes in this environment. And so they are looking for the customers that are the—

Chairman HENSARLING. Mr. Carfang, can you move the microphone a little closer to you, please?

Mr. CARFANG. I'm sorry. Excuse me.

So banks are looking for customers to provide stable deposits. Companies with seasonal activity are actually finding themselves at a disadvantage in actually finding a bank to take their deposits.

Banks are now responsible—in addition to “know your customer,” they are now responsible to know your customer’s customer.

And that extension is getting a lot of banks out of the corresponding banking business. So major banks are no longer banking banks like Mr. Wilson’s bank, and he then doesn’t have access to upstream services to provide to his customers.

Banks—a simple example, electronic benefit cards for welfare payments are a very efficient and effective and safe and secure way of providing benefits, yet under the “know your customer” rule, as it is being interpreted, banks are responsible to do all of the due diligence on the holders of their card, which is obviously an impossibility, and banks are exiting that business.

We have retailers exiting the courtesy check-cashing business because of vague fears about anti-money-laundering, believe it or not, check cashing in a grocery store or pharmacy.

These are some consequences, not necessarily that they have been regulated and are illegal, but they are falling into a gray area because of some of the—just the vocabulary in the rules that continue to be written.

Mr. PITTENGER. Thank you.

Other outcomes that you have mentioned were that deposits were being discouraged because of higher fees and lower interest and there was a restriction of credit to all but the most well-documented borrowers.

Give us some more thoughts on that as well.

Mr. CARFANG. Sure. Because banks now have to limit the size of their balance sheets, some to stay under the $50 billion limit and others for other regulatory reasons, credit, in effect, has to be rationed.

And because banks are afraid of making a bad loan, a lot of the judgment has come out of this that—so we are down to checklists, so do you have all of your W-2s, and are they lined up, and can you show in your brokerage statement where your deposit came for your mortgage and things like that.

All of those add cost and complexity and, frankly, cause banks much larger than Mr. Wilson’s bank to scale back to simply the most credit-worthy or the most well-documented borrowers.

Mr. PITTENGER. Thank you very much.

Another implication. You said that, due to extended interpretations of the “know your customer” rule to include your customer’s customer, banks are exiting certain electronic benefit card segments, and these concerns are also resulting in the scaling back of the corresponding bank services within community banks.

Mr. CARFANG. Yes. And I would like to address the issue of the systemically important designation and the lack of screaming about that.

In fact, the benefit of being a designated SIFI is lower deposit cost. So banks would not be screaming bloody murder about SIFI.

But the nonbanks, the insurance companies and the asset managers who don’t gather deposits are, in fact, screaming bloody murder because the benefit is not going to them at all.

Mr. PITTENGER. Thank you, sir.

I yield back.

Chairman HENSARLING. The gentleman yield backs.

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

Mr. HIMES. Thank you, Mr. Chairman. And I really do want to thank you for the focus on the question of too-big-to-fail. I know we disagree over the relative merits of Dodd-Frank.

I am a real believer that the creation of the CFPB and the fact that American families will be protected from some of the more predatory and toxic products that have beset them for a long time is a real step forward. I also think the regulation of the notional value trillions of dollars derivative market is a real victory.

But none of us really know, Mr. Chairman, the answer to the question of whether we ended too-big-to-fail. None of us really know if there is, in fact, a funding advantage for those large institutions.

I have looked carefully at the statistical analysis offered by Mr. Kupiec. The statistical significance of his analysis is pretty small. It is also—Mr. Kupiec understands, of course, the difference between correlation and causality.

There are a lot of things that impact the funding costs of a bank, including the fact that they are international, they have diversity of businesses. A large money center bank looks almost nothing like Mr. Wilson's bank.

Nonetheless, nobody really knows whether we have ended too-big-to-fail. Mr. Frank made the point that simply reasserting Glass-Steagall probably wouldn't do it.

One thing that is for sure is that we took a whack at it in Title I and Title II. The right question, I think, is not did we end too-big-to-fail. We are not going to know that, frankly, until a systemically important institution is on the ropes. Then, we will see.

Sheila Bair, whom I happen to trust on these matters, says that she thinks that sort of institution can be resolved. But we are not going to know until we see one of these institutions hit the skids.

So I guess what I really want to do is continue this line because I actually think it is a really useful line of analysis. And I am going to ask Mr. Frank and Mr. Carfang, and if I have more time, I will open it up.

But what I am really interested in is: We have established tools for regulators to both monitor—very aggressive tools—to change the nature of the businesses of systemically important institutions and a whole set of procedures to resolve those institutions in the case of them running into trouble. That may or may not be adequate. Anyone who says they know the answer to that, of course, is not being honest.

So my question is—and I will start with Chairman Frank and then go to Mr. Carfang—what more could we and should we do to make sure that we never see a repeat of—

Mr. FRANK. Obviously, that is a central question.

And one of the things we should do is this. Brad Sherman said that what he thinks will happen is, if we have another crisis, Congress will vote to give them money.

Well, no Congress can bind a future Congress. If that is the theory, then nobody can do anything in a bill that stops the future Congress.

My own view is that nothing could be more unlikely, given the current political mood. And that is the point I would like to start with, to Mr. Himes.

People say, "Oh, it will work. If we have a crisis, there will be a bailout." How? I want to know how they think that is going to happen.

Will the Federal Reserve ignore the rule that says they can only lend money to an institution that is solvent? Will the Secretary of the Treasury violate Federal law and give people money? I don't understand the scenario. The political pressure would all be the other way.

So my view is the best thing we can do—one thing is just there is a self-fulfilling prophecy. People say, "Oh, the big banks that are too-big-to-fail, they are getting all these benefits because people believe that they will be bailed out."

They benefit from people saying that. People have a right to say what they want, but that is, I think, an inaccurate, self-fulfilling prophecy about what will happen.

Again, I do not foresee a situation in which there would be political pressure on the Federal Government to ignore the law that says you don't give them money and allow them to keep acting.

The only other thing you can do is—and I thought Mr. Perlmutter's questions were right—we want to keep them from failing. But we tried everything we could.

I guess the other thing to do would be to mandate smaller banks. But, again, Lehman Brothers precipitated a crisis, and I don't know what it would take to get everybody $1 smaller than Lehman.

Mr. HIMES. Thank you, Mr. Chairman.

Mr. Carfang?

Mr. CARFANG. There is no clear definition of "systemically important." And if we knew what we were trying to regulate in order to strengthen the economy, we would be much better able to do that.

The United States is the largest economy in the world. No U.S. bank ranks in the top 5 largest banks in the world. Only three in the top 20. Systemically important is really a function of interconnectedness, complexity, and things of that nature.

I agree with Representative Frank that at some absolute size—if you are $1 trillion on your own balance sheet, yes.

But if you are an asset manager or insurance company where you are not even holding the cash, you are simply a custodian for part of the people's cash, that is absolutely—not only is it ludicrous, it is chilling, because it tells everyone else, "Gee, behave, because you might be designated systemically important."

And if you are not a deposit-taker to take advantage of that deposit subsidy by being designated systemically important, you are at a serious competitive disadvantage.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Delaware, Mr. Carney.

Mr. CARNEY. I want to thank the chairman and the ranking member for holding the hearing today and thank all the panelists for coming, bringing your expertise and your opinions, particularly former Chairman Frank for—notwithstanding the fact that you

don't miss us here, that you are coming back. And we certainly miss you.

You were very helpful to me, as a junior Member, a freshman Member in the last Congress, and now I feel like you are looking over my shoulder at everything I say and ready to slap me on the side of the head with your hand extended.

Recently my father passed away, and recalling all the wonderful things that he did for me and my family, I recall that he, when I got my first home, signed the loan for the mortgage for my brother and me. And it was a 30-year fixed-rate mortgage because that was the only way that he and I could afford the monthly payments.

And I know, Mr. Wilson, that a lot of first-time homebuyers and people with modest means use the 30-year fixed-rate mortgage to get that first home and to be able to build up equity. You mentioned that your bank doesn't do many of those, but you are here on behalf of the Texas Bankers Association. I read through your testimony. There is a lot of concern in there about housing finance reform.

Former Chairman Frank, on a regular basis, in my first term, would talk about the unfinished business of GSE reform. I have been fortunate enough to work with Mr. Himes and Mr. Delaney on a bill that we think addresses a lot of the concerns and would preserve the 30-year fixed-rate mortgage: H.R. 5055. And in the Texas Bankers—on their Web site, they mention GSE reform as a priority.

One of the concerns they have is that the compensation paid to the GSEs previously and now for what amounts to a full government backing is simply not priced correctly and that it becomes a barrier for entry for private capital.

Our bill would do that. We believe it would place that risk appropriately. It would give an explicit government guarantee, the same terms as the private capital.

Are the Texas bankers concerned about the availability of the 30-year fixed in proposals to reform GSEs?

Mr. WILSON. The 30-year fixed rate is a viable—it is not a product I have ever offered, although I would offer a 20-year amortization with a 5-year balloon. But, yes, the access to credit is important to Texas bankers.

Mr. CARNEY. So that is the primary goal of our piece of legislation, to preserve that instrument of affordability, and we think that we do it.

Chairman Frank, you have said a number of times this morning you are concerned about securitization, and that being a significant problem.

What are your concerns going forward as we look at reform and particularly reform of Dodd-Frank?

Mr. FRANK. I think it is time to get rid of Fannie Mae and Freddie Mac. As I said, we were the first ones in 2007 to put them into severe constraints and stop the bleeding, and they began to make some money.

I think there was this question: Do we want to preserve the option of a 30-year fixed-rate mortgage? And I am convinced by people I have talked with in the banking industry, the real estate industry, and the homebuilding industry, that absent some govern-

ment involvement, that is not sustainable, because nobody is going to lend—or very few people are going to make a 30-year fixed-rate loan with no protection against interest rate, that there needs to be some protection not against credit risk—that should not be a public function—but against interest rate risk.

Mr. CARNEY. And, by the way, that has been the testimony of all the people who have come before—

Mr. FRANK. Yes. So I think your approach, the approach in the Senate with Senator Crapo—Corker-Warner, Crapo and Johnson, and—I think, frankly, that is where we are.

And Chairman Hensarling said, "We are going to do Fannie and Freddie." But the fact is that bill hasn't gone to the Floor. I understand it was a real chairman's job to get it through. I know what those are like.

But we have about, what—you have about 3 or 4 weeks left in the total session, or 5 weeks. I think it's pretty clear that bill couldn't pass the House because it represents a viewpoint that is a valid, intellectual viewpoint, but that is a minority, that more people agree with you, Mr. Carney, that you need to have some involvement to protect people against the credit risk on a 30-year fixed-rate mortgage.

So my prediction is that the Republicans are going to complete their fourth year in a row of controlling the House and having passed no legislation in the House on the GSEs. I wish that weren't the case.

Mr. CARNEY. I would be interested—my time is running out, but I would be interested in the panelists' views on the various bills that are before this committee.

We have had a lot of discussion today about differentiating banks by regulations. So Chairman Tarullo has come up with some thoughts, and I would like to explore that with several of you.

Thank you very much, Mr. Chairman.

Chairman HENSARLING. The Chair wishes to make an announcement that it is the Chair's intention to recognize the Members who are currently in the room. Those who may be monitoring this in their offices, tough luck. This has the blessing of the ranking member.

Mr. FRANK. And of the former chairman.

Chairman HENSARLING. Well, I am always happy to have the gentleman's opinion.

The Chair now recognizes the gentleman from New Mexico, Mr. Pearce. Would you yield to the Chair for just a brief moment?

Mr. PEARCE. Yes.

Chairman HENSARLING. I thank the gentleman for yielding.

Apparently, the Democratic-controlled Senate might be having a little problem with their GSE bill. I would like to note that for the record.

And we have a disengaged President on the subject as well. I look forward to him changing his mind, perhaps, in the last 2 years of his Administration.

I thank the gentleman for yielding.

Mr. PEARCE. Thank you, Mr. Chairman.

And at this time, I would appreciate if we would post the chart that everyone has in front of them.

Mr. Wilson, your testimony aligned most closely with the people in my district because we have a very rural district, with a lot of small community banks, and they are telling us similar stories.

And we were told that Dodd-Frank was only for the big banks, in other words, there was this bifurcation that would cause small banks not to have to go through everything.

Now, it is my understanding that you would have to go through each step of this chart. First of all, you have to fit the small creditor qualifications, then look at the loan features, then the balloon payment features, the underwriting features, the points and fees, portfolio, and then the type of compliance presumption, the higher price—on the higher-price loan.

Is that pretty well the regulatory process that you would have to go through to originate a loan?

Mr. WILSON. Yes, sir.

Mr. PEARCE. Yes. And so you have 17 employees at the bank.

How many employees would it take for you to accomplish all of this?

Mr. WILSON. I have—

Mr. PEARCE. Don't go over 100 or anything.

I understand it is—you would not be able to accomplish it with the number of people that you have right now.

Mr. WILSON. Yes, sir.

Mr. PEARCE. Yes. And so we are led to believe that there are two different kinds of regulators that are going to come in and, if you are a big institution, they use one set of values.

Are you finding that they actually come in, or do they just enforce the same set of values all the way down to the small guys?

Mr. WILSON. The regulations apply to us in the—we have always been regulated by the FDIC and they—and our Texas Department of Banking, and they have done a really good job of regulating us.

The problems that are being addressed in Dodd-Frank, a lot of those occurred by nonregulated people. And the CFPB, I would argue, ought to be regulating those folks and leave us with the guys that have always regulated us.

Mr. PEARCE. So the problems did not originate on Main Street, but we transferred the punishment down to Main Street and actually left out Fannie and Freddie—two of the bigger offenders left completely out—and Wall Street itself has more capabilities than to perform the regulatory tasks than do the small banks.

And that is the reason that—you said you have lost 80 banks out of the State of Texas?

Mr. WILSON. Yes, sir.

Mr. PEARCE. That is an amazing number.

Now, if you consider—let's say that in your small town of San Diego, Texas, that there are—along the spectrum there are people with better means and people of lesser means.

Now, which group is going to be most punished by shutting down local community banks? Do the people on the low end of the income ladder in San Diego understand where else they could go for a loan? Do they have the capability, the wherewithal, to go to Dallas or Houston or Hobbs, New Mexico, or somewhere like that?

Mr. WILSON. No, sir. But there are some payday lenders there in San Diego, but for the smaller piece of that.

Mr. PEARCE. Yes. So what we are going to do is leave a vacuum there and people who are not monitored, who are not regulated, are going to show up and fill that vacuum.

Is that the way you would read it?

Mr. WILSON. Unfortunately.

Mr. PEARCE. And you said that you don't give mortgage loans anymore just because of the high risk.

What risk do you find involved in giving mortgage loans?

Mr. WILSON. There is the compliance risk and it is the—being told what kind of mortgages I can make and then going through and trying to do the qualified mortgage—

Mr. PEARCE. Yes. That whole list of things, the full two sheets.

Mr. WILSON. —the escrowing—having to escrow taxes and insurance. We are just not staffed or equipped for that type. I have never in my 35 years done that.

Mr. PEARCE. And so, again, we are going to make it harder for people in the rural areas, especially on the lower-income spectrum, to get loans for houses or trailer houses.

Do you ever find any competition coming in from Wall Street to loan money for houses in your district?

Mr. WILSON. No, sir.

Mr. PEARCE. Yes. So, basically, what we are telling rural America with Dodd-Frank is that if you live in the rural part of the country, you are just going to be up the creek without a paddle or—there are other descriptions we could use, but we will probably leave it to that one.

Mr. Chairman, I yield back the balance of my time.

I appreciate, Mr. Wilson, that you are providing a service that is desperately important for the low-income part of this Nation. Thank you very much.

Mr. WILSON. Thank you.

Chairman HENSARLING. The gentleman yield backs.

The Chair now recognizes the gentlelady from Alabama, Ms. Sewell.

Ms. SEWELL. Thank you, Mr. Chairman. I want to thank you and Ranking Member Waters for bringing this panel and all of our guests who are here today.

I wanted to continue the line of questioning that Congressman Carney started with respect to SIFI—the designation for SIFIs and I wanted to know, Chairman Frank, is there some magic to the $50 billion number or would you—there are lots of bills that are floating around, including one that I am signed on to with Mr. Luetkemeyer, and it suggests maybe a $100 billion capitalization size-wise would be preferable.

And I wanted to know your thoughts on—

Mr. FRANK. As I said before you were able to get here, I do agree that there is room for that. I was at the meeting at the Chicago Federal Reserve conference when Governor Tarullo talked about doing that, talked about exempting the smaller banks from—

Ms. SEWELL. Sure did.

Mr. FRANK. —Volcker and the compensation explicitly. I think that is a very good set of ideas. And, yes, I think that should be revisited.

I think you find some absolute number below what you can't go and then you look at some other factors. You don't want too much uncertainty, I think, or you run into the problems Mr. Carfang has talked about.

But, yes, I think—you said is it a magic number. No. But you always have to have a number. Is 21 the magic number for voting? Is 435 the magic number for the House of Representatives?

You always have to pick a number, and it will always be somewhat arbitrary. Calling it a magic number denigrates the process that is inevitable.

But, yes, I think that we should look at that $50 billion again, although, again, the problem was here, Lehman Brothers started the last thing.

And, Mr. Carfang raised a good question about what is it that we are talking about when we say "systemically important." And it is a degree of interconnectedness. It is a degree to which, if you can't pay your debts, that is going to reverberate throughout the economy. And that is the focus, I think, of the analysis.

Ms. SEWELL. Can you elaborate a little bit—I was here when you were talking about nonbanks being sort of caught in that definition of SIFIs. Your thoughts about asset management companies—

Mr. FRANK. I will again repeat what I said. I said a comment to the FSOC, saying, as a general principle that I don't think asset managers or insurance companies that just sell insurance, as it is traditionally defined, are systemically important. They don't have the leverage. Their failure isn't going to have that systemic reverberatory effect.

On the other hand, you had AIG, which was an insurance company, and the insurance business was so good they made more money literally than they knew what to do with.

And, with AIG—and you go about the causes—the Federal Reserve—Mr. Bernanke came to us in September of 2008 and said, "I have just given $85 billion to AIG." We have changed the law. He couldn't do that again because they weren't solvent. And, therefore, he could not have done that under our current bill.

But a week later they were telling us that they needed so much for the TARP, and they included another $85 billion for AIG. We said, "You already told us that." They said, "No. That is an additional $85 billion for AIG." AIG not only didn't have the money to pay off, they had no idea how much they owed.

But that is my view on that. Asset managers' insurance, as a general rule, no, but there might be activities they engage in that say yes.

Ms. SEWELL. What would you say to the line of conversation that Mr. Wilson just had with my colleague about rural America not being able to benefit from Dodd-Frank and being—

Mr. FRANK. It is not what I would say. It is what I have said, again.

I do think I would like to see a very sharp distinction in loans. I would like the main safeguard against bad loans to be risk retention, because that leaves the decision in the hands of whomever's making the loan or securitizing it. And I would give much more leeway for portfolio loans.

Again, if you say that portfolio loans aren't subject to some of these rules, you are not saying they are unregulated. Banks still have to go to their primary regulator. But I think, if people would hold loans in portfolio, that would be fine.

When we had the Fannie-Freddie fight, I was one of the ones who said, "Make them keep their loans in the portfolio. Don't have them securitizing much." By 2005, I was convinced that we had to pass legislation and change it.

Ms. SEWELL. Yes. The reason I ask is because I represent a large swath of rural Alabama and wanted to thank you for your leadership when you were chairman on manufactured housing as an option for maintaining affordable housing.

And I yield back the rest of my time.

Mr. PEARCE [presiding]. The gentlelady yields back.

The Chair now recognizes the gentleman from Georgia, Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

Dr. Kupiec, we have heard from financial regulatory agencies that they conduct thorough cost-benefit analyses as they implement Dodd-Frank.

You have been on the front lines of this effort because you led the FDIC's Office of Financial Research under Chairman Bair.

Do you feel the FDIC and other domestic and global regulators have objectively measured the cost and benefits of the Dodd-Frank reforms they implement?

Mr. KUPIEC. Absolutely not. The FDIC, to the best of my knowledge—and I was the line officer for all the economists—never did any cost-benefit analysis for any rule internally, and they were scared to death that it would become a requirement.

The Federal Reserve on Basel, I never saw any cost-benefit analysis that came out of the Federal Reserve, nor did I see any that came out of the OCC.

I was the chairman of the Basel Research Task Force for the last 3 years. When the Basel Committee put out its cost-benefit analysis on the effects of adopting Basel III, I was on the group who was going to write the paper.

The paper assignment came from the chairman of the Basel Committee right before the Icelandic volcano erupted in March of that year and the meeting was canceled. There was no meeting of the group ever held.

A draft paper arrived in my email box in June. I was not involved in any of the analysis. I don't know where the analysis came from.

I provided comments, which were very critical in the analysis, not knowing where it came from and knowing very many holes in the analysis. The comments were ignored.

And a final draft came in my mailbox in August for me to sign off on because they wanted my name on the paper because I have some academic standing as a well-known banking economist and I was chairman of the Basel Research Task Force.

I refused to put my name on the paper because I did not know where the analysis came from. It was not supported. It was built off of six or seven different modeling approaches cobbled together

all over the world with no data analysis provided to anybody on the group.

I declined to put my name on the paper, which subsequently caused me significant difficulties in the FDIC.

Mr. WESTMORELAND. Dr. Kupiec, let me ask you: Who stopped you from doing this analysis and—

Mr. KUPIEC. There was never a meeting to plan how there would even be an analysis of how the implementation of Basel III should even be measured. A fully drafted paper appeared in my mailbox in June for me essentially to agree to. I don't work like that.

Mr. WESTMORELAND. So would you say that they were trying to inflate the benefits and underestimate the—

Mr. KUPIEC. Oh, absolutely. And I could give you many specific examples of that if you wanted to go into details, and my comments were exactly to that effect.

And it is interesting that subsequently, in the fall, when there was a negotiation among the Basel Committee membership to try to figure out what the capital ratio should be in the final rule, Chairman Bair was trying to get the Fed to get the ratio higher than they wanted. The Fed wanted a lower, more lenient ratio, and Chairman Bair referred to this Basel study as evidence that it didn't hurt things to raise the ratio.

And Governor Tarullo and Pat Parkinson actually called Chairman Bair and presented my critique of the paper, asking her how she could use that discussion to strong-arm for higher capital when her own banking economist who is on the committee wouldn't sign on to the result. So I do not think this was done, in general.

Mr. WESTMORELAND. Thank you very much.

And I want to read something into the record. The American Action Forum places the price tag for annual compliance with the Dodd-Frank Act at $21.8 billion and 60.7 million paperwork-burden hours, the equivalent of 30,370 employees working full-time to complete annual paperwork. These burdens are up from $15.4 billion and 58.3 million hours last year. That is an increase of 41 percent for the cost and a 4 percent increase for the paperwork hours.

The Bureau of Labor Statistics and Occupational Outlook Handbook said employment of financial examiners is projected to grow 27 percent from 2010 to 2020, faster than the average for all occupations. And it is hard to say that this does not create any burden on our financial institutions.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. STUTZMAN. Thank you, Mr. Chairman.

And thank you to the witnesses for being here today and for sharing with this committee.

I would like to, first of all, say, Mr. Chairman, that I know, for Hoosiers back home who are having to deal with the rules from Dodd-Frank and the new standards that they have to be held to, it is definitely a burden to them in ways that they have never seen before.

Mr. Chairman, I am sure you remember the young man who is here and—a couple of months ago that the gentleman from Kentucky, Mr. Barr had invited, who was a fifth-generation banker,

shared with this committee how that a small bank in Central Kentucky, fifth generation—he was the fifth generation, had survived the Civil War, had survived World War I and II, survived the Depression, wars in between, the Recession, but didn't know that this bank would survive Dodd-Frank.

And I think that sums it up in a lot of ways in what small banks, community banks, mid-sized banks, are dealing with today and that we are seeing a consolidation in a way that I don't believe should have ever been the intention of any policy passed here in Washington.

I know that, as we look—I heard from others on the other side of the aisle about how Washington saved our economy from going over the brink.

And I will tell you there are a lot of folks back in Northeastern Indiana who felt like they did go over the brink, that they never were able to recover, they still haven't recovered.

And the fact that food stamps are at an all-time high today should reflect on the policies that this Administration—that Congress in 2009, 2010, passed, part-time labor is at an all-time high.

What Dodd-Frank has done to not only just rural America, but to urban America, suburban America, has tied the hands remarkably in ways that many people don't even understand. They just know that things are not getting better.

And when they go to their bank in LaGrange, Indiana, and all of a sudden they can't get a loan when before they were able to—they paid their bills, always made sure that their credit was solid—they are trying to figure out what has happened.

I would like to touch a little bit on the Volcker Rule. What does that do? How do I explain to people back home the effects of the Volcker Rule?

And, Mr. Carfang, there was a study done by Oliver Wyman which states that the impact of the Volcker Rule will be similar to the financial crisis, which disrupted liquidity and credit availability.

Can you describe how the Volcker Rule will have—what impact it will have on liquidity and credit availability? Will it be a positive or a negative impact?

Mr. CARFANG. The Volcker Rule will reduce the amount of proprietary training done by a bank—or, actually, eliminate proprietary trading or ring-fence that so that the depositors are protected.

What you have, then, is less liquid markets. So there is less trading in the securities. There will be a wider bid-and-ask spread.

So when you go to sell, there are fewer buyers; and, therefore, you will sell at a lower price. When you go to buy, there are fewer sellers and you will buy at a higher price.

This would be—in Indiana, the same is true in farming. If there is not a big market in the product, the spreads are wider when you buy and sell.

Mr. STUTZMAN. What will be the combined impact? Can you talk about that a little bit on interest rates? What other effects could we see?

Mr. CARFANG. I have actually testified to this committee on that topic, and I likened it to an experiment—a chemical experiment

where we are putting in Basel III, we are putting in bank capital requirements, we are putting in the Volcker Rule and a number of other things.

And, frankly, we don't know what the outcome will be except that it is a deer in the headlights on the part of corporate treasurers and medium-sized and small bankers.

Mr. STUTZMAN. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The last Member to be recognized is the gentleman from Ohio, Mr. Stivers, and he is recognized now.

Mr. STIVERS. Thank you, Mr. Chairman.

I want to thank the chairman for holding this hearing.

I want to thank all the witnesses for bearing with us through what has been a long hearing.

The first question I have is for Mr. Deas. But before I give you a question, I want to thank Gwen Moore for her leadership on the Centralized Treasury Unit. She and I have worked together to try to get that issue fixed.

Can you tell me what will happen if we don't actually get that bill fixed today? I know there are no action letters. There has been some regulatory relief. But what happens if we don't actually get that passed for end users like you?

Mr. DEAS. It will increase the—so it just increases the uncertainty of the end-user margin exemption. To the extent that then those transactions would be ineligible for the exemption, then companies like my own would have to post cash margin, which would subtract from money we would otherwise invest in our business.

Mr. STIVERS. And if you had to do that, would you continue to manage your risk in a centralized way that is smarter and allows you to offset risks that offset each other or would you probably move to a less active form of risk management?

Mr. DEAS. We would either have to do that in a completely different way with uncertain costs or we would have to retain the risk ourselves. Either way would likely cause an increase in cost.

Mr. STIVERS. And risk for your business.

Mr. DEAS. And risk.

Mr. STIVERS. Thank you.

The next question I have is for Mr. Kupiec. This issue has been beat several times, but I think it is really important to hit it again.

The Dodd-Frank Act set the asset level of systemically important institutions at $50 billion. Do you know if there is any relevance to the selection of this arbitrary number? Is it cross-referenced anywhere else?

Mr. KUPIEC. No. It is an arbitrary number. There is no scientific basis for $50 billion.

Mr. STIVERS. I think Congressman Luetkemeyer did a great job of talking about the American Banker article yesterday that talked about two banks that are now approaching $50 billion and what has happened to their stock price, what has happened to them just as a result of potentially moving closer to that number.

Even Governor Tarullo—and I know that Ms. Sewell referenced this—has said that a $100 billion number would be acceptable to him.

But isn't there now an acceptance that $50 billion is absolutely too low among almost everybody who is out there?

Mr. KUPIEC. $50 billion, I think, is too low for all the intrusive regulations that come along with it. My recollection—and it could be a bit fuzzy—was that the $50 billion came out because, at the time, CIT, which was a nonbank financial institution, decided not to bail out, and it was slightly below $50 billion.

And I think, if my recollection is—that tied people's hands at the time, that they couldn't go. So they said, "That has to be bigger than CIT. So let's call it $50 billion."

But I think it is reasonable to think that regional banks, if you fixed the resolution mechanism so that didn't cause bigger banks if they fail—that you could exclude regional banks.

And regional banks, ones that do primarily commercial banking, are as big as $200 billion right now. You would need to leave some growth room.

So I personally, knowing a fair bit about banks, wouldn't be shy at all and would shoot for some number like that.

If it was a regional regular run-of-the-mill commercial bank with not a lot of capital markets, not a lot of the risky operations, I don't think that would be unusual at all.

But I think you need to fix the resolution process so that if they do get in trouble, if they fail and they are broken apart, that has to be fixed in the FDIC Act.

Mr. STIVERS. That was clear in your comments earlier and your original testimony. So I appreciate that testimony.

So, essentially, every witness here today, even Chairman Frank, has agreed that $50 billion is too low a number.

And, by the way, congratulations on the beard, Mr. Chairman. It is coming along fine. Five or ten more years—

Mr. FRANK. It has grown more than I had hoped it would in this hearing.

Mr. STIVERS. So—you know, and I know that—my other question to all of you is—and I think Chairman Frank acknowledged it earlier—while we have to pick some number, that is absolutely true, but it is the risk that these—the activities that these institutions engage in that create risk, not necessarily the asset size that makes that happen. But I understand there has to be some number.

Does everybody agree that it is really activity that generates risk?

Mr. FRANK. Not just that—activity generates risk, but impact is generated by interconnectedness.

Mr. STIVERS. Absolutely.

Mr. FRANK. To both sides of the equation.

Mr. STIVERS. And that is why the five standards created for nonbank financial institutions really focuses on interconnectedness, and that is what the Luetkemeyer bill really focuses on. You are absolutely right.

But I guess my point in my last 8 seconds is these regional banks that have been pulled into this are really a lot like Mr. Wilson's bank. They just got a little bigger. And they do exactly what Mr. Wilson's bank does. They serve Main Street. And I hope we can fix it.

I yield back my nonexistent time, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

I would like to thank all of our witnesses for their testimony 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.

The hearing stands adjourned.

[Whereupon, at 2:01 p.m., the hearing was adjourned.]

A P P E N D I X

July 23, 2014

Testimony of Anthony J. Carfang, Partner

Treasury Strategies, Inc.

July 23, 2014

Before the Committee on Financial Services

U.S. House of Representatives

Good morning Chairman Hensarling, Ranking Member Waters, and members of the Committee. It is an honor to be invited to testify at today's hearing: ***Assessing the Impact of the Dodd-Frank Act Four Years Later***. This is a timely hearing that goes to the heart of the stability of the financial system and I am pleased to be able to contribute to the discussion.

I am Anthony J. Carfang, a partner of Treasury Strategies, Inc. Treasury Strategies is the leading consultancy in the area of treasury management, payments and liquidity. Our clients include CFOs and treasurers of large and medium sized corporations as well as state and local governments, hospitals and universities. We also consult with the major global and regional banks that provide treasury and transaction services to those corporations.

I am here today on behalf of Treasury Strategies and the hundreds of businesses and financial institutions to whom we consult.

Overview

Let me first state that Treasury Strategies and our clients fully support well thought-out efforts to improve economic efficiency and to reduce the likelihood of another systemic failure. We advocate pro-growth measures that stabilize and strengthen the financial system. The objectives of Dodd-Frank to improve accountability and transparency, reduce systemic risk, end "too big to fail", protect consumers and put an end to taxpayer funded bailouts are laudable. We applaud you for tackling such important issues.

However, we feel strongly that the rollout, rule writing and implementation of Dodd-Frank created a **climate of uncertainty** of enormous proportions. In turn, this has led to a **culture of indecision** that is choking the U.S. economy and paralyzing American businesses and financial companies that had nothing at all to do with the financial crisis.

Two years ago in testimony to this committee, I posed the question: "When a business's treasurer calls a bank to raise the cash needed to meet payroll or pay the bills, will someone be there to answer that phone call?" We now know the answer is "Yes, the compliance officer." This is no way to create robust economic growth.

It is important to remember that banks are financial intermediaries. They are conduits between depositors and borrowers. Regulation resulting in higher costs and reduced flexibility for banks ultimately results in higher costs and reduced flexibility for depositors and borrowers. That is what we are here to discuss today.

How High are the Stakes?

Businesses operating in the U.S. are the most capital efficient and productive in the world. Highly liquid means of raising capital allow treasurers to keep less cash on hand and use a just-in-time financing system that allows companies to **meet payroll**, **pay bills** and **raise the capital** needed to **grow** and **create jobs**.

Thanks to our financial institutions and existing banking frameworks, businesses and the U.S. economy benefit greatly from:

- The broadest, deepest and most resilient capital markets
- The best risk management products and tools
- The most robust liquidity markets
- Technologically advanced cash management services
- The most efficient and transparent payment systems

Unfortunately, because of the climate of uncertainty created by the poor rollout of Dodd-Frank, capital efficiency in the U.S. has declined, as evidenced by increased corporate cash buffers. The sad trend line is that corporate cash has swelled from 9% of U.S. GDP to nearly 12% of GDP, idling hundreds of billions in cash. Companies are keeping more precautionary cash to deal with the regulatory uncertainty.

Consider the following Treasury Strategies analysis: companies doing business in the U.S. operate with approximately $1.9 trillion of cash reserves. If the current climate of uncertainty resulting from this legislation

were to push U.S. cash holdings to the Eurozone plateau of 21% of GDP, the resulting corporate cash level would be $3 trillion. Stated differently, CFOs and treasurers would need to set aside and idle an additional $1 trillion of cash. To put that in perspective, that $1 trillion is:

- Greater than the entire TARP program
- More than the stimulus program
- Greater than the Federal Reserve's quantitative easing program

To raise this extra $1 trillion cash buffer, companies would have to postpone expansion and defer capital investment, downsize and lay off workers, reduce inventories and curb growth. Obviously, the economic consequences would be huge.

The Nature of Financial Risk

I would like to add a statement about managing financial risk. A common understanding among our clients is that, like energy, risk can neither be created nor destroyed but only transformed. So when you consider ways to reduce banking system risk, do not be tricked into thinking that risk disappears. It simply moves elsewhere.

To truly minimize the probability of future financial crises, we must understand how this risk transforms and where it will show up next. Risk is managed most efficiently when it is transparent, properly understood and the market responds with robust, efficient and liquid solutions.

Climate of Uncertainty

The long and unbounded rule-writing process across multiple regulatory bodies creates many challenges and introduces new risks for our clients. Compliance and audit now replace prudent decision-making and sound judgment. Vague and ambiguous terminology such as "systemically important", "proprietary trading", "know your customer", "too big to fail", "shadow banking" and "abusive practices" only add to the confusion. For example, mandates requiring banks to fund with longer-term instruments conflict directly with mandates requiring investment managers to invest in shorter-term instruments. Combined with an explosion of astronomical fines imposed by U.S. regulatory bodies, the conclusion on the part of most of our banking and corporate clients is to wait until (if) the dust settles before making major capital investment decisions or significant hiring decisions.

Climate of Risk and Fear

The Dodd-Frank implementation, only partially complete, is already having a chilling effect on business. One element of that is its creation of two ultra powerful authorities, the Financial Stability Oversight Council (FSOC) and the Consumer Financial Protection Bureau (CFPB). These largely unaccountable agencies are designed to operate outside of the constitutional framework of checks and balances. Indeed, they even operate outside the Congressional budget processes.

For our clients, the FSOC especially, with virtually unconstrained resources, introduces new regulatory and political risks. The result is businesses and financial institutions need to operate with checklists and to seek out safe harbors, rather than to find ways to meet the needs of their customers. As a **regulator comprised of regulators**, FSOC creates double jeopardy for financial institutions. Thousands of banks, hundreds of insurance companies and hundreds of asset managers have been placed in straight jackets. They are now forced to become compliance auditors, not growth partners, of America's businesses.

Concentration of Assets in the Banking System

By declaring certain institutions as "systemically important", Dodd-Frank enshrines rather than eliminates "too big to fail". This concentrates financial activity into what was an already swollen banking system. As depositors believe that systemically important banks will enjoy special protections in a crisis, they shift assets from other investments and into banks.

Since the financial crisis, banking assets have grown by 25%. During that same period, nominal GDP (including inflation) is up only 14%. As assets move out of other investment instruments and into the banking system, overall liquidity in instruments such as commercial declines. The underlying capital flows are well into the hundreds of billions of dollars and simply exacerbate the uncertainty to the economy.

Concentration of Assets in the Federal Reserve System

Most worrisome is the explosion in the size of the Federal Reserve Bank's balance sheet, in part a consequence of the Dodd-Frank implementation. The total consolidated assets of the Federal Reserve now top $4 trillion. That is up from less than $1 trillion just before the financial crisis. It is now 40% the size of the entire U.S. banking system. Such huge concentration is causing large-scale distortions to the economy, asset allocations, interest rates and the shape of the yield curve. Absent these independent and sound market signals, our clients are reluctant to make long-term investments since even a small change in Fed policies would have considerable impact on markets and rates.

To fund this balance sheet, the Fed began paying interest on bank reserves. In effect, the Fed is paying banks to divert funds away from their customers and their local markets. In early 2008, banks in the aggregate maintained roughly $40 billion on reserve with the Fed. That number now stands at $2.6 trillion, a sixty fold increase. Again, our clients view the concentration of this magnitude as yet another risk to their well-being and a drag on their willingness to invest in the growth of their businesses.

Unlike the mandates to its member institutions, the Federal Reserve's balance sheet is comprised of long-term investments funded largely by overnight or one-week term bank deposits. ***Indeed, we could be looking at the seeds of the next taxpayer funded financial bailout.***

Less Business and Consumer Access to Financial Services

Although the impact of the Dodd-Frank rollout is still in its early stages, we are already seeing a contraction in the availability of financial services and transaction services. Here is a partial listing of some of the dislocations we at Treasury Strategies are already seeing; we learn of new restrictions and prohibitions almost weekly:

- Banks are focusing on the "safe" segments, those outside the regulatory crosshairs
- Many are discouraging deposits with higher fees or lower interest
- Many are restricting credit to all but the most well-documented borrowers
- Because of the ambiguities of various anti-money laundering (AML) requirements, one bank closed the accounts of foreign diplomats in the U.S.
- Due to extended interpretations of the "know your customer" (KYC) rule to include your customers' customer (KYCC), banks are exiting certain electronic benefit card segments
- KYCC concerns are also resulting in a scaling back of the correspondent banking services with community banks, limiting services those banks can offer to their local customers
- Because of increased documentation and process audit requirements inconsistently applied, all but the very largest banks are discontinuing product development; the fixed regulatory costs of introducing a new product are prohibitive

- Because of unclear interpretation of AML requirements, some banks are reducing the services they offer to retailers who provide courtesy check cashing services to their retail customers

As I mentioned, this list grows with each passing week.

Summary

The ambiguity surrounding the rollout of Dodd-Frank is already having a chilling effect on precisely those banking services that account for U.S. competitiveness, capital efficiency and financial stability. This is an issue for U.S. businesses, large and small.

Some of the unintended consequences, in addition to a general slowdown in economic activity, include:

- Impaired market liquidity and reduced access to credit
- Higher costs and less certainty for borrowers
- Restricted trading in proper and allowable businesses
- Competitive disadvantage for U.S. businesses and financial institutions
- Increased compliance costs for non-financial businesses
- Higher bank fees for consumers and businesses
- Less access to capital for small businesses and start-ups
- Shifting of risks to other sectors of the economy
- Capital flows into offshore markets

Because of the protracted rule writing process, many rules have yet to be written. Of those rules already promulgated, most have a phased implementation. Thus the true costs of the rules have yet to be seen.

Finally, it is important to add that these rules are being introduced against a backdrop of massive Federal Reserve quantitative easing (QE). QE injects substantial liquidity into the banking system and the bond markets. Ominously, the true consequences of the Act will not be fully known until these artificial supports are withdrawn.

Conclusion

I appreciate the opportunity to appear before you today on behalf of Treasury Strategies and our hundreds of business and financial services clients.

Let me reiterate that we applaud the objectives of the Dodd-Frank Act but decry its implementation. We feel strongly that the Dodd-Frank Act, as currently implemented, will not reduce systemic risk nor improve economic well-being. We believe that the lack of clarity in many of the bill's provisions, along with lack of a precise definition of terms and the inconsistencies resulting from multiple regulatory rule writing bodies has introduced significant new uncertainty and risk for America's business and financial institutions. We believe that it will make U.S. capital markets less

robust, U.S. businesses less competitive and ultimately reduce underlying economic activity.

We strongly encourage Congress to put this regulation back on the right track. That means, at a minimum:

- Dissolving the FSOC and eliminating that double jeopardy for America's businesses and financial institutions
- Eliminating the ambiguity, inconsistency and vague terminology in the rules
- Instituting protection for those businesses and financial institutions that had nothing to do with causing the crisis

I am delighted to discuss these issues further and answer any questions you may have.

Respectfully,

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Hearing before the Committee on Financial Services

U.S. House of Representatives
Room 2128 Rayburn House Office Building
Washington, DC 20515

"Assessing the Impact of the Dodd-Frank Act Four Years Later"

Testimony of Thomas C. Deas, Jr. – Vice President & Treasurer, FMC Corporation

July 23, 2014

Good morning Chairman Hensarling, Ranking Member Waters, and members of the Financial Services Committee. I am Thomas C. Deas, Jr., Vice President and Treasurer of FMC Corporation and Immediate Past-Chairman of the National Association of Corporate Treasurers ("NACT"), an organization of treasury professionals from several hundred of the largest public and private companies in the country. FMC and NACT are part of the Coalition for Derivatives End-Users (the "Coalition"). Our Coalition represents thousands of companies across the United States that employ derivatives to manage business risks they face every day. Hundreds of companies have been active in the Coalition, which has sought to inject the voice of end-users into the debate over derivatives regulation. I am also privileged to serve as the current Chairman of the International Group of Treasury Associations of which NACT along with the national treasury organizations of approximately 30 other countries are a part. Our message is straightforward: financial regulatory reform measures should promote economic stability and transparency without imposing undue burdens on derivatives end-users. Thank you very much for giving me the opportunity to speak with you today about the impact of derivatives regulation on end-user companies.

<u>End-Users' Concerns with Derivatives Regulation</u>

The Coalition supports your efforts to oversee the implementation of the Dodd-Frank Act. We very much appreciate the strong bipartisan efforts by the Members of the Committee on Financial Services on behalf of American companies who use derivatives to manage many of the risks they face in running their businesses every day.

The Dodd-Frank Act sought to prevent problems with derivatives experienced during the financial crisis in 2008 from recurring now or in the future. I want to assure you that FMC and other end-users were not and are not engaging in risky speculative derivatives transactions out of which some of that turmoil arose. End-users comprise less than 10 percent of the total over-the-counter ("OTC") derivatives market and do not significantly

contribute to systemic risk. Hence, we should not be subject to regulations designed for Wall Street, not Main Street.

We believe there is broad agreement with the concept that end-users should not be subject to regulations designed to reduce the risk of swap dealers and others who maintain open or systemically significant derivatives positions and engage in market-making activities. At the time of passage of the Dodd-Frank Act, we understood from a plain reading of the legislative language as well as from letters and colloquies by the principal drafters, that end-users would be exempted from certain provisions intended to reduce the inherent riskiness of swap dealers' activities. In addition, recognizing the potential adverse consequences on the competitiveness of American business and ultimately on jobs here in the United States, regulators vowed to keep their actions in sync with those of our international trading partners and not impose any undue regulatory burdens on U.S. end-users.

However, at this point four years after passage of the Dodd-Frank Act, there are several areas where continuing regulatory uncertainty compels end-users to appeal for legislative clarifications to actions we believe will raise costs unnecessarily and hamper our ability to manage business risks with properly structured OTC derivatives. Among several areas of concern, I would like to invite your attention to three in particular:

- Margining of uncleared swaps;
- The application of clearing requirements to centralized treasury units; and
- Cross-border concerns.

Margining of Uncleared Swaps

Please allow me to illustrate end-users' use of derivatives with a specific example from my company. FMC is the world's largest producer of natural soda ash, the principal input in glass manufacturing, and is one of the largest employers in the state of Wyoming. We are also developing innovative new chemically related applications that scrub sulfur compounds from flue gases of factories and power plants. We can mine and refine soda ash products in southwestern Wyoming, ship them to South Asia, and deliver them at a lower cost and with higher quality than competing Chinese producers. Energy is a significant cost element in producing soda ash and FMC protects against unpredictable fluctuations in future energy costs by using OTC derivatives to hedge natural gas prices. These derivatives are executed with several banks, all of which are also supporting FMC through their provision of over $1.5 billion of credit. Our banks do not require FMC to post cash margin to protect against mark-to-market fluctuations in the value of derivatives, but instead price the overall transaction to take this risk into account. This structure gives us certainty so that we do not have to post cash margin while the derivative is outstanding. However, if we are required by the regulators to post margin, we will have to hold aside cash and readily available credit to meet those margin calls. Depending on the extent of price movements, margin might have to be posted within the trading day as well as at the close of trading. Because failure to

meet a margin call would be like bouncing a check, and would constitute a default, our corporate treasury would act very conservatively in holding cash or immediately available funds under our bank lines of credit to assure we could meet any future margin call in a timely fashion and with a comfortable cushion.

Now following the financial crisis, it is time to reassess whether end-user companies should be subject to margin and clearing requirements. End-users did not cause the financial crisis. And end-users do not contribute to systemic risk because their use of derivatives constitutes prudent, risk-mitigating hedging of their underlying business. Forcing end-users to put up cash for fluctuating derivatives valuations means less funding available to grow their businesses and expand employment. The reality treasurers face is that the money to margin derivatives has to come from somewhere and inevitably less funding will be available to operate their businesses.

A recent Coalition survey of chief financial officers and corporate treasurers, released on March 26, 2014, underscores the urgent need for the end-user provisions contained in your reauthorization bill. More than two-thirds of respondents to the Coalition's survey indicated that a margin requirement on uncleared OTC derivatives would have a moderate or significant impact on capital expenditures and 86% of respondents indicated that fully collateralizing OTC derivatives would adversely affect business investment, acquisitions, R&D and job creation.

Let me give you a direct example of why our bank counterparties have agreed that cash margin is not necessary for FMC's derivatives trades. Because we are always hedging an underlying business risk, if a current valuation of a derivative is underwater, then the risk we are hedging must be in the money, resulting in a net neutral position. To continue with our natural gas hedging example, as the price of gas fluctuates, the valuation of the derivative changes by an equal and opposite amount in relation to our natural gas purchases. If the price of gas falls by 10 percent, then the value of the derivative is out of the money by the same amount. This results in no net gain or loss when the derivative and the underlying exposure are valued together at any point in time. Although we have to pay the bank an amount equal to the 10 percent fall in gas prices for the agreed volume hedged, we owe that much less for the gas we are buying. FMC benefits from not having unpredictable demands on liquidity. For this balanced structure, we agree to a small markup payable at maturity of the derivative transaction I have just described. This is far more cost-effective than if we had to keep idle cash or immediately available credit to meet cash margin postings and undertake significant information systems investments. Customized OTC derivatives allow us to operate with predictable energy costs, thereby reducing our business risk.

By forcing end-users to post cash margin, the regulators will take the balanced structure I have just described and impose a new risk. Treasurers will have new and unpredictable demands on their liquidity. Swap dealers are market makers who take open positions with derivatives and we agree central clearing and margining are appropriate for them. However, since end-users are balanced, with derivatives exactly offsetting underlying

business risks, forcing them into the swap dealers' margin rules by requiring them to post and exchange margin adds the considerable risk for end-users of having to fund frequent and highly variable daily cash margin payments. This will introduce an imbalance and new risks onto transactions that are matched and will settle with offsetting cash payments at maturity. Further, the imposition of margin requirements on nonfinancial end-users would effectively negate the intended benefits of the end-user clearing exception to those same entities.

As the Members of this Committee well know, the Prudential Regulators – consisting of the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency – have proposed rules that would subject end-users to uncertain future margining requirements. This position puts these regulators out of step not only with proposed margin rules from the Commodity Futures Trading Commission ("CFTC"), but also with internationally agreed-upon standards from the G-20 Working Group on Margining Requirements ("WGMR"), which was formed to develop internationally harmonized standards which it released in September 2013. The WGMR concluded that nonfinancial end-users need not be subject to margin requirements. In April 2014, European regulators proposed margin rules that would exclude from margin requirements nonfinancial end-users that do not pose risk to financial stability.

The Coalition commends the bipartisan efforts of Members of this Committee to redress the problem for American industry through support for such bills as H.R. 634, the *"Business Risk Mitigation and Price Stabilization Act,"* which passed the House last year by a vote of 411-12, and which clarifies that Dodd-Frank Act does not authorize the Prudential Regulators, the CFTC and the SEC to impose margin requirements on risk-mitigating hedges of nonfinancial end-users. Because the Prudential Regulators have concluded that the statutory text of the Dodd-Frank Act obligates them to impose margin on all market participants – including nonfinancial end-users – the clarification reflected in H.R. 634 is necessary to permit the U.S. to conform with international standards.

Centralized Treasury Units ("CTUs")

Throughout the legislative and rulemaking processes surrounding the Dodd-Frank Act, the Coalition has advocated for strong regulatory standards that enhance financial stability while avoiding needless costs. Many nonfinancial end-users utilize CTUs as a risk-reducing, best practice to centralize and net the hedging needs of affiliates. In fact, nearly half of the Coalition's survey respondents use CTUs to execute OTC derivatives.

While the CFTC has recognized the undue burdens clearing requirements would place on corporate end-users and has attempted to ease the burdens through no-action relief, the relief is highly conditional and difficult to implement. Moreover, corporations may

be uncomfortable relying on no-action relief, because that relief only stipulates that agency staff will not undertake enforcement action for violations of the law; it does not change the law. The Coalition survey found that of those respondents that utilize a CTU structure, 69% do not qualify for the CFTC's no-action relief or are unsure about whether they could rely on the relief. Additionally, in Europe, CTUs are not treated as financial entities. The treatment of CTU as a financial entity is unique to U.S. law, which encompasses any entity that is "predominantly engaged in activities that are financial in nature." Consequently, European law does not apply clearing and other such requirements to CTUs of nonfinancial end-users.

Treasurers of nonfinancial end-users who operate CTUs that serve the risk-mitigating function of aggregating exposures on the books of an affiliate within their corporate group, netting the inter-affiliate exposures, and then entering into smaller and fewer derivatives with a bank or other swap dealer counterparty for the net amounts, could have to wind down those efficient units or meet burdensome new regulatory requirements that will be hard to justify. The remaining alternative would be to retain more risk because hedging would no longer be cost-effective. As pointed out above, these CTUs are subject to designation as financial entities, in which case they would be denied the end-user clearing exception despite the fact that they are only executing trades for nonfinancial end-user affiliates, which would otherwise be able to elect the end-user clearing exception.

The Coalition strongly supports H.R. 677, the *"Inter-Affiliate Swap Clarification Act,"* as amended by and incorporated in the Customer Protection and End-User Relief Act (H.R. 4413) which passed the House of Representatives last month, which would clarify that certain swaps with CTUs of nonfinancial end-users are eligible for an exemption from clearing requirements.

Cross-Border Concerns

The Coalition appreciates the important efforts being undertaken by U.S. and foreign regulators to resolve differences in the circumstances in which regulations apply to cross-border transactions. Applying derivatives reform rules in a global marketplace is an inherently complex undertaking. Unlike most stock market transactions, derivatives create an ongoing relationship between parties that is not severed once the transaction has been consummated. Thus, many transactions exist between parties in different jurisdictions for many years. While the United States has completed many of its derivatives rules first, other regulators around the world – particularly those in Europe – have now finalized and implemented many of their rules. Consequently, derivatives end-users now find themselves simultaneously subject to multiple regulatory regimes. Understanding and implementing compliance structures for derivatives rules across multiple jurisdictions is a significant and costly undertaking. Accordingly, end-users are subject to incentives to avoid complication by limiting their transactions to

counterparties located in their same jurisdiction. This duplication ultimately causes fragmented and less efficient markets for end-users, and raises the cost of delivering stable prices to consumers. It is critical that regulators move quickly to recognize equivalency and substituted compliance with foreign regulatory regimes when the objectives of foreign regulations are designed to achieve comparable objectives to the Dodd-Frank Act.

Summary

Let me take a moment to summarize our principal concerns with the application of derivatives regulation to end-users:

- First, we are concerned that the proposed regulations relating to margin requirements, particularly those of the Prudential Banking Regulators, will impose unnecessary margin requirements on nonfinancial derivatives end-users that did not contribute to the financial crisis and do not create systemic risk. Such margin requirements could potentially divert billions of dollars from productive investment and job creation into a new regulatory levy.
- Second, the imposition of clearing requirements on CTUs that execute swaps on behalf of nonfinancial affiliates denies those companies the benefits of risk-reduction embodied in what the treasurers of U.S.-based multinational companies overwhelmingly consider to be best practice.
- Finally, international harmonization is of great importance and is particularly relevant for derivatives end-users, as many have affiliates located across the globe in several different jurisdictions. Inconsistencies lead to increased costs, confusion and duplication that could lead end-users to abandon efficient hedging practices or cause them to not hedge at all. U.S. regulators should continue to find equivalency with foreign regulatory regimes using an outcomes-based analysis.

Conclusion

Thank you again for the opportunity to testify today on these important issues.

We are very concerned that an impending regulatory burden on end-users of derivatives will result in higher costs to Main Street companies that will limit their growth, harm their international competitiveness, and ultimately hamper their ability to sustain and, we hope, grow jobs.

The consequences of getting derivatives regulation wrong will be borne by American business and ultimately our fellow citizens.

I will do my best to respond to any questions you may have.

Testimony of the Honorable Barney Frank before the House Committee on Financial Services

Assessing the Impact of the Dodd-Frank Act Four Years Later

July 23, 2014

I was pleasantly surprised by the bipartisan tone of the Republican Staff report. I do believe that it was excessively critical of the actions of President Ronald Reagan and President George W. Bush, and I believe that the authors of the report are mistaken in thinking former Secretary Tim Geithner agrees with their interpretation of the Too Big To Fail (TBTF). Geithner's objection is that we made bail outs impossible, not that we continued to allow them. That is, I believe their reading of the law is the exact opposite of his.

In addition to this question of the laws TBTF provisions I am including the expressions of my views on two other central parts of the bill: the regulation of derivatives and the restriction on irresponsible mortgage practices. Additionally, I have added my views that Asset management firms should not automatically be designated systemic. And I believe the FSOC should be very clear in explaining its position on this, as the letter from my former colleagues Mike Capuano and Steve Lynch, correctly argues.

I am responding to on the proposal to equate QRM with QM.

I believe this is a grave error, and contrary to the assertion that it would best carry out the statutory intent, significantly repudiates it. Readers of the proposal will have a very hard time understanding why Congress would have created two separate categories, in two separate parts of the statute, if it intended they would be treated identically.

The statutory intent was to create 3 categories of mortgages: those that fell below QM standards and were subject to various legal constraints; the QM mortgages which would meet minimum standards and be subject to risk retention; and a separate sub-set of mortgages that were virtually certain to be repaid and would therefore be given an exemption from risk retention. The agency's main proposal renders the concept of an "exemption" from risk retention meaningless. The result would be two categories-those that fell below standards and

probably shouldn't be made, and those that could be made and would not be subject to risk retention.

I am reinforced in the view that regulating the concept of risk retention out of the statute and out of the mortgage business is a mistake by the proposals acknowledgement "that the direct costs incurred by a sponsor for funding the retain portion should be small." The citation of "plausible estimates" that the additional cost would range from "0-30 basis point" argues for some category of mortgages being subject to risk retention, given the agencies acknowledgement that this does incentivize better practices. I am wholly unpersuaded by the agency's then citing "indirect cost" as a reason for regulating risk retention out of existence, especially since the proposal concedes that these are "difficult to quantify", even though in what frankly appears to be a reach for cover, the document does say that they "have the potential to be large." Reference to unquantifiable costs suggests that there are people who don't like risk retention and are looking for a way to justify its de facto abolition. Adding that they "have potential to be large" adds no weight to the proposal. Many things have the "potential" to be large; public policy should be grounded in what is likely, not what is merely possible.

I am not surprised that the overwhelming majority of commenters who are interested in building, selling or promoting the sale of housing to lower income people, support effectively abolishing risk retention I should note that if all of these people were correct in their collective judgment, we would not have had the crisis that we had. More importantly, what their arguments reflect, and what I believe unfortunately is carried over in proposal, is the view that things must always be exactly as they are today, I understand that since risk retention is a new concept, people in various phases of the business of housing are unused to it, and do not like the changes it will force in their operation. But the very purpose of the statute was in fact to bring about changes in a number of areas in our financial life, residential mortgages foremost among them.

Nothing in the agency's discussion-nor our experience-demonstrates that the people in this business are incapable of adjusting to a rule whose genesis was the reality of unwise mortgages

that resulted from the ability to do 100% securitizations. This is especially true if loans made under the new rules set forth for mortgages are in fact as safe as they should be. Retaining the risk of mortgages that are highly likely to be paid in full over time is likely not to cost very much.

I am particularly troubled by the notion that QM/QRM should be merged. The statue calls for three classes of mortgages rather than the two that are effectively represented in the agency's proposal. The logic of the statute dictates that we retain the ability to treat these two categories of mortgages as distinct.

I earlier expressed my opposition to a flat 20% down payment requirement, I continue to believe that that is too rigid, but I also believe that the level of down payment and other factors, including loan to value, have a role to play in distinguishing between QM and QRM.

Finally, it is relevant to note that recent unrebutted newspaper reports demonstrate that the credit rating agencies which were so much a part of the problem in the past are reverting to those dangerous practices. That is, any notion that we can rely on the credit rating agencies to substitute for risk retention incentivizes good mortgage practices has no more justification than it did before. Those of us working on the legislation were eager to find ways to correct the credit rating agencies behavior, but I also confess that we were not very successful in doing that.

In summary, nothing in the discussion of the agency's proposal leads me to reconsider the views that I had when we drafted the legislation-mainly that we should have three categories of mortgages, not two, and that risk retention should be the rule, and 100% securitization the exception, only to be granted for mortgages far above the norm on the safety scale.

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I share the frustration that many feel about the rate of progress in adopting regulations and implementing the financial reform bill, but not the angst that often accompanies it. With the re-

election of President Obama, and the filling of vacant regulatory slots, I have no doubt that a complete—and appropriate-set of rules will be in place in sufficient time. And by sufficient, I mean before the abuses the bill seeks to minimize cause serious problems.

Some of the factors responsible for the slowness were inherent in the task. Some critics have complained that we overloaded the circuits of the agencies by a law that was too long, comparing its length unfavorably with the thirty pages of Glass-Steagall. But the bill covered many more subjects than G-S.

The accurate comparison is with that law establishing, the FDIC law; the laws establishing and mandating the SEC; the Investment Company Acts, and many others. We decided to cover all of the interrelated set of issues in a financial system vastly more complex than that existing in the 1930's, and to do it in one bill that treated the system as an integrated whole.

A second complaint is that we left too much to the regulators. Trying to be specifically prescriptive would have required setting in statutory concrete rules that should be able to evolve with experience. And specificity without regulatory discretions would have been an invitation to evasion on the part of creative financial engines.

A third criticism is both wholly valid and was wholly unavoidable-the division of responsibility for regulation of derivatives between two separate agencies: the Securities and Exchange Commission, and the Commodity Futures Trading Commission. This division of responsibility is both irrational, and so deeply embedded in American social, economic, and political history as to be impossible to fix without a major, separate legislative fight that was beyond our ability to resolve while dealing with so many controversial substantive matters. The good news is there is a growing bipartisan interest in taking on this task. Until that is done, much important regulation will require two five-member commissions to agree on a single set of rules. But if the new SEC Chair is quickly confirmed, the requisite decisions will be made soon.

This brings us to the set of obstacles to filling out the rule book that represent not inherent difficulties, but decisions by opponents of increased regulation.

The first of these is the resistance by the financial community. This should be abating. The clear preference of many businesses new rules was not to have any, and from the signing of the bill in 2010 until last November, many hoped that a Republican President would rescue them from compliance, with that hope gone, their rational self-interest isn't getting rules adopted, as opposed to continued limbo. This will mean a shift from efforts to filibuster the administrative process to working seriously for the adoption of appropriate rules, of course with an effort to lighten them.

But this still means a heavy paper flow from regulatees to the regulators, and this has given those opposed to the new law (for a combination of partisan and ideological reasons their leverage.)

With Republican control of the House—which we had not anticipated when passing the bill, combined with defective right-wing Republican control of the DC Circuit Court of Appeals, regulators have been hit with what readers of the old Lil' Abner comic strip will recognize as the double whammy. The SEC and the CFTC, receive vast amount s of comments for each proposed rule, while the Republican House Appropriations Committee starves them of funding. This is possible because unlike the bank regulators, the SEC and CFTC have no independent funding, but are subject to annual appropriations.

This is where the DC Courts comes in. Not only do these agencies have to process vast amounts of comments, the Court then grades their work with a strictness that belies conservatives professed lop position to 'judicial activism'. On several occasions DC Courts have strickened SEC and CFTC rules, not because of any constitutional problem, but because the conservative judges think the agencies have given too little deference to the financial industry's argument. Documenting decisions to the degreed the Court requires would be difficult in any circumstance. Doing so with the lack of staff and other resources resulting from Republicans underfunding is impossible.

This was in part what was at stake when the Republican Senate minority filibustered to death an Obama appointee to the DC Circuit and it will be exacerbated the House Republicans blocking funding for the agencies going forward. (The amounts are too small to be caused by

deficit concern. The CFTC funding is in the hundreds of millions of dollars, and the CFTC brings the Treasury in fines and fees as much as it costs.)

The rules will be completed—before any major crisis that they are intended to prevent, but later than they should be for the certainty that financial institutions deserve. But the fault for that will rest with Republican appropriators withholding adequate funding and Republican Senators filibustering to maintain the DC Circuit as a right-wing bastion.

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The legislation we supported in 2010 does create death panels. But they found them in the wrong place. The Federal Government now has the power to terminate the lives of large, heavily indebted financial institutions, not frail, gravely ill old people.

Nearly five years ago, Treasury Secretary Paulson and Fed Chairman Ben Bernanke informed the leaders of Congress, including us, that they needed hundreds of billions of taxpayer dollars to stave off a global economic meltdown. With the homes, retirements and jobs of millions of American at stake, we took action. But we also set out to reform our antiquated regulatory system and develop a new framework that provided regulators with the tools they needed to help prevent any future economic crisis, and end taxpayer bailouts and the concept of too big to fail.

The Dodd-Frank Act is clear: not only is there no legal authority to use public money to keep a failing entity in business, the law forbids it.

First, it repeals the power the Federal Reserve had possessed to extend funds to any financial institution. It was this authority that the Fed used to advance 85 billion dollars to keep AIG alive. That power no longer exists.

Second, we recognized that the failure of a large financial institution to pay its debts could cause problems in the economy, as the collapse of Lehman Brothers did. And we allow Federal regulators to deal with this.

But the first step they must take under the new law is to begin the process of liquidating the institution. The Board of Directors is abolished; the Executives are fired; and the entity is put into receivership, run by the Federal Deposit Insurance Corporation, which has experience putting insolvent banks out of their—and our—misery. The assets of the institution including all the equity of the shareholders are at the FDIC's disposal in winding things down.

If those assets are insufficient, the FDIC's only recourse is to draw from the Orderly Liquidation Fund the law established, which consists entirely of money raised from other large financial institutions.

Despite these explicit provisions, some critics complain that somehow we have left too big to fail in existence. We issue them two challenges.

First, go back to the financial bailouts of 2008 and 2009, and find any such action that is possible under the new rules. Second, explain to us how public money could be used under these rules to keep a highly indebted institution alive?

We have heard two rebuttals. One, which completely ignores political reality, is that should a large bank falter, the President would come under overwhelming pressure to find some way to avoid the law's provisions, and bail it out.

Is it seriously argued that a Congress which resists the routine job of paying our past debts would somehow adopt legislation reversing the anti-bailout restrictions to save a large, indebted, and very unpopular bank?

The other argument is that if several institutions were to fail simultaneously, we would be swamped, and a massive, multiple bail-out would be required. Even in the crisis of 2008, it wasn't true. Indeed, Secretary Paulson essentially had to compel several of the largest banks to accept TARP money even though some did not need it or want it, lest the intuitions that did require help be stigmatized.

Dodd-Frank includes many more provisions to deal with institutional failure. It blocks the granting of mortgage loans with a high likelihood of default; regulates derivatives trading with requirements of margin, capitol and transparency; requires securitizers of loans made by others to retain some of the risk of default; significantly increases capital requirements for these companies, and the large institutions whose failure might endanger stability are required to draw up plans to facilitate their liquidation.

We believe this combination of preventive measures—a comprehensive list that explains the bill's length—will work to avert disaster. But no one can be sure that the firms will not find other ways to get in trouble. If they do, the death panels take over, and the institutions die, with no taxpayer burial costs.

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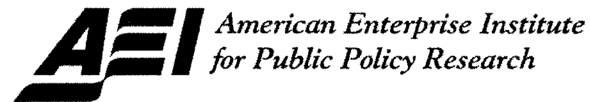

Statement for the United States House of Representatives, Committee on Financial Services:

"Assessing the Impact of the Dodd-Frank Act Four Years Later"

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The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

What Makes a Bank Systemically Important?

Chairman Hensarling, Ranking Member Waters, and distinguished members of the Committee, thank you for convening today's hearing, "Assessing the Impact of the Dodd-Frank Act Four Years Later" and thank you for inviting me to testify. I am a resident scholar at the American Enterprise Institute, but this testimony represents my personal views. My research is focused on banking, regulation, and financial stability. I have years of experience working on banking and financial policy as a senior economist at the Federal Reserve Board, as a Deputy Director at the IMF and most recently, for almost ten years, as Director of the FDIC Center of Financial Research where I served a three-year term as chairman of the Research Task Force of the Basel Committee on Bank Supervision. It is an honor for me to be able to testify before the subcommittee today.

The theme of my testimony is that the Dodd-Frank Act has failed to achieve its stated goals of ending too-big-too-fail and reducing the fragility of the U.S. financial system. Instead, the balance of accumulating evidence suggests that Dodd-Frank has reinforced investor's perceptions that the largest financial institutions enjoy an extended government safety net. Rather than ending too-big-to-fail, Dodd-Frank's provisions create new uncertainties around the resolution process for large financial institutions.

Dodd-Frank's mandatory enhanced supervision and prudential standards for the largest institutions discourage investor due diligence and monitoring since government regulators are now intimately involved in the management of the largest designated financial institutions. Dodd-Frank's intrusive rules and supervision impose undue regulatory burdens that are constraining economic growth without providing any clear measureable stability benefits. Dodd-Frank's enhanced prudential supervision and regulation do not provide a guarantee against a large institution failure nor can they prevent a future financial crisis since the exercise of most of these new powers are based on regulatory judgment alone. There is no proven economic science to guide the identification of "systemic risk" let alone pin-point regulations that can mitigate it.

Ironically, Dodd-Frank's heightened expectations of a government's commitment to remove the possibility of a future financial crisis may increase the probability that such a crisis will occur and require government support for the largest financial institutions that have been identified as too-big-to-fail. The future under Dodd-Frank is foreshadowed by the famous words of the Irish philosopher Edmund Burke, who said, "Those who don't know history are destined to repeat it." Prior to the last financial crisis, many nations had in place institutions and practices similar to

Dodd-Frank's Financial Stability Oversight Council and macroeconomic stress tests that were designed to identify and prevent financial instability, and yet none did.

A guide to the remainder of my testimony follows. Section I provides empirical evidence based on large bank funding costs that Dodd-Frank did not end too-big-to-fail. Section II discusses how the Dodd-Frank combination of vague policy goals and unchecked grants of new regulatory powers creates a bias for over-regulation of the financial sector that reinforces investor perceptions that the largest institutions are too-big-to-fail. Section III discusses the trade-off between financial safety and soundness regulation and economic growth and how over-regulation of financial institutions reduces economic growth. Section IV discusses Title II Orderly Resolution Powers and the FDIC Single Point of Entry Resolution Strategy.

A high-level summary of my testimony follows:

- Four years after its passage, there is no evidence that the Dodd-Frank Act has ended too-big-to-fail, indeed Dodd-Frank has probably reinforced investor expectations that the largest financial institutions benefit from government safety net protections that are not available to smaller institutions.
- Dodd-Frank grants financial regulators, especially the Board of Governors, the Financial Stability Oversight Council and the FDIC, extensive new powers with few constraints while assigning them the duty to ensure financial stability, a concept that is never defined in the legislation. The absence of objective guidelines and restricted judicial and Congressional review allows regulators to exercise their new powers based on their judgment alone.
- In the current environment, the mix of ill-defined duty and unconstrained regulatory power is a recipe for over-regulation and slower economic growth.
- A Dodd-Frank Title II resolution using the FDIC's single point of entry (SPOE) strategy does not fix the too-big-to-fail problem.
    - In order to keep subsidiaries open and operating to avoid creating financial instability, the SPOE extends government guarantees to subsidiaries. In many cases, these guarantees will be far larger than those that would be provided under a bankruptcy proceeding and Federal Deposit Insurance bank resolution.
- The Title II and SPOE create new uncertainty regarding which investors will be forced to bear losses when a bank holding company fails. This increased uncertainty will undermine investor confidence and financial stability and could create a political crisis.

  - Title II creates a conflict of interest between contributors to the deposit insurance fund and contributors to the orderly liquidation fund.
  - Title II and SPOE alter investor property rights without prior notice, compensation, or due process and with little scope for judicial protection.
- Dodd-Frank does not amend deposit insurance laws to require the FDIC to break-up large banks in a resolution and prohibit whole bank purchase resolutions. Such a change is needed to stop the FDIC resolution process from creating new too-big-to-fail institutions.

I. Dodd-Frank has Not Fixed Too-Big-To-Fail: Evidence from Large Bank Funding Costs

One of the primary goals of the Dodd-Frank Act was to end investor's perceptions that the largest financial institutions are too-big-to-fail (TBTF). The recent financial crisis confirmed investor perceptions that the largest financial institutions will benefit from government support in a financial crisis while smaller institutions will be allowed to fail and impose losses on their investors. Large institutions were extended extraordinary government support that shielded many of their investors from loss while hundreds of small financial institutions were allowed to fail. A primary goal of Dodd-Frank is to reduce if not completely remove investor expectations of TBTF.

TBTF benefits are reflected in the largest institutions' funding costs. Institutions that are perceived to be TBTF will have lower funding costs compared to smaller institutions, holding constant other important factors such as the risk of an institution's assets, its leverage, and the intensity of regulatory monitoring.

Following the financial crisis, there has been a lot of economic research focused on estimating bank TBTF funding cost subsidies. Many studies find that the largest institutions enjoy a funding cost advantage that was especially pronounced during the financial crisis. There is on-going debate about whether the funding costs advantages that have been identified reflect a subsidy conveyed by an implicit government guarantee, or whether other technical factors can explain its existence and magnitude.

Instead of reviewing technical details of studies that estimate too-big-to-fail funding cost subsidies, I will provide some new simple data analysis that clearly demonstrates that Dodd-Frank did not erase or even reduce large-banks' funding cost advantage. Indeed this statistical evidence shows that, on average, after Dodd-Frank, the largest banks enjoy a statistically significant funding cost advantage that they did not enjoy before the financial crisis. A large bank funding advantage is clearly evident in multiple years since the passage of Dodd-Frank, and this advantage was not apparent in the data during multiple years before the passage of Dodd-Frank. While this evidence does not prove that TBTF is the source of the funding advantage, it does show that post -Dodd-Frank, there is a pronounced funding cost advantage for the largest banks that was not there before Dodd-Frank.

I use FDIC public data (Statistics on Depository Institutions) and calculate the average interest rate on banks' liabilities through the end of June for multiple years before the crisis, and multiple years after the passage and partial implementation of the Dodd-Frank Act. The average interest cost is defined as banks' reported interest expense, divided by their reported liabilities (multiplied by 100). I exclude banks that report zero interest expense and a dozen or so banks in each year that report exceptionally large interest costs. In all cases, the "outlier" banks that are omitted from the sample are small banks and omitting these institutions has only a tiny effect on the sample size. It is important to recognize that banks' reported interest expense is the total year-to-date interest expense through the end of the reporting quarter. So the expense recorded for June is only half of the annual interest expense should a banks' contractual interest rates and outstanding liabilities remain approximately the same for the balance of the calendar year.

After calculating each bank's average interest rate, I separate banks into two groups: banks with total assets larger than $100 billion, and banks with total assets below $100 billion. I use $100 billion as the cut off for the large bank group because this threshold designates at least 11 banks as potentially "TBTF" banks in each year I examine. While 11 banks is not a large sample, if I set the threshold higher $100 billion, there are even fewer large bank observations that can be used to make statistical generalizations.

It is also important to recognize that I am using individual bank data, not consolidated data for bank holding companies. I use bank data because most of the liabilities issued by a consolidated bank holding company are issued by the insured depository and not the parent holding company.

Moreover, if small banks face higher costs of funds, the use of holding company data will bias the results since a large number of small bank holding companies must be omitted from the analysis because small bank holding companies are not required to file bank holding company regulatory reports. In contrast, all banks regardless of size must file quarterly regulatory reports that include their total liabilities and interest expenses.

Using $100 billion asset size as the sample partition, I statistically test to see whether the average interest cost of bank liabilities is lower for the large bank group in 2005, 2006, 2007, years before the crisis and Dodd-Frank, and again in 2012, 2013, and 2014, years following the crisis and the passage of Dodd-Frank. Independent estimates are made for each year, and the results of the statistical test are reported in Table 1. The dotted line in Table 1 separates estimates of the funding costs difference between the largest banks and smaller banks pre-Dodd-Frank, and post Dodd-Frank.

Table 1: Funding Advantage for Large Banks Before and After Dodd-Frank

Date of Sample	Number of banks with >$100 billion in assets	Estimated difference between average interest rate (large banks-small banks)	Level of statistical significance*
June 2005	11	+5.59	NSS
June 2006	11	+15.68	NSS
June 2007	16	+6.88	NSS
June 2012	19	-16.28	0.001
June 2013	20	-11.68	0.001
March 2014	22	-5.68	0.001

* NSS indicates not statitically significant at convention levels of the test. The March estimate is for 3 months of interest expense; it must be multiplied by 2 to make it comparable to June estimates. June 2014 data are not yet publically avalable.
Source: author's calcualtions using data from FDIC Statistics on Depository Institutions http://www2.fdic.gov/sdi/index.asp

The results in Table 1 show that in every pre-crisis pre-Dodd-Frank year, the largest banks paid more for their liabilities on average, but the difference in the average interest rates paid by large banks relative to small banks is not statistically significant. Post Dodd-Frank, the situation is very different. After Dodd-Frank, the largest banks pay a lower average interest rate on their

liabilities, and the difference between the average rate paid by the largest banks and small banks is highly statistically significant.

Whatever Dodd-Frank accomplished, it clearly did not erase any funding cost advantage that was enjoyed by the largest banks prior to the crisis. Instead, the evidence suggests that after Dodd-Frank, the largest banks have a consistent funding advantage of more than 20 basis points on an annual basis.[1]

Why post Dodd-Frank do the largest banks enjoy a statistically significant and stable funding cost advantage? In the following sections I will argue that the provisions of Dodd-Frank creates a rational perception among investors that the largest institutions are TBTF, and should these institutions become distressed, the government will likely provide guarantees that will shield investors from loss.

Political rhetoric aside, it is completely rational for investors to conjecture TBTF status on the largest institutions for two important reasons. First, the Dodd-Frank Act explicitly designates the largest financial institutions as "systemically important," and imposes on them much higher prudential standards and intrusive government monitoring and supervision. For these institutions, government regulators are supposed to closely monitor the risks that are being taken by these institutions. Regulators have a duty and powers to mitigate any risks these institutions might take that, in their judgment, would endanger these institutions' liquidity and solvency. Second, should these institutions become distressed, Dodd-Frank Title II creates a resolution mechanism that is designed to guarantee most of the liabilities issued by the largest financial institutions while the resolution mechanism for small banks historically has imposed large losses on uninsured bank liabilities. Rather than fix too-big-to-fail, Dodd-Frank institutionalizes it.

II. Dodd-Frank's Emphasis on Heighted Supervision and Regulation Increases Investor Expectations that Designated Firms Have a TBTF Guarantee

The Dodd-Frank Act requires financial regulations to undertake extensive supervision and regulation of the largest financial firms. Most of the new regulatory powers are based on the

[1] Because interest expense is reported as the cumulative expense in a calendar year, June estimates are doubled to estimate annual benefits; the March estimate must be multiplied by 4.

premise that financial regulators can identify and stop the largest institutions from engaging in risky activities that might increase the risk that they will fail and the risk that their failure could have spillover effects on the financial system and economy more generally.

The problem with Dodd-Frank is that tries to accomplish an ill-defined goal without identifying any specific activities or establishing any specific thresholds for regulators to follow to achieve its ill-defined goal. Dodd-Frank grants regulators vast new powers that are at best only weakly constrained, and financial regulators are instructed to use their best judgment to exercise these wide-ranging authorizes in ways that that promote "financial stability," a goal with characteristics that are also set by the regulators' judgment. The regulators are given almost complete discretion to use their new powers to change the financial system in ways that the regulators themselves deem apprpriate, and the regulators decide when the changes they mandate have achieved "financial stability." In the post-crisis environment, this is a clear recipe for over-regulation.

For example, the Dodd-Frank Act uses the phrase "systemic risk" 39 times in directing the financial regulatory agencies to identify, mitigate, and minimize "systemic risk," but the Act never defines systemic risk. This is not an accident or oversight. The Act is vague because there is no widely-accepted definition of systemic risk.

Much of the post-crisis banking and finance literature is focused on theoretical models that try to explain aspects and potential origins of systemic risk or empirical approaches that purport to measure an institution's potential for creating systemic risk should it fail. However, this literature is at an early stage of development, and it has produced no practical guidelines that can be used to positively identify systemic risk or a systemically important institution. But the lack of a proper economic foundation has not constrained regulators from acting as if they can identify and control systemic risk.

Thus far, the academic literature has created many theoretical models that can explain why a failing institution might create financial instability. The potential channels identified are largely consistent with the designation factors identified in Section 113 of the DFA. These theoretical channels identify an institution's size, its over-use of collateralized borrowing, and financial network interconnections as possible sources of systemic risk. At the current stage of

development, few if any theoretical models focus on an institution's complexity as a separate source of systemic risk.

Most economists would probably agree that an institution's size is directly related to its potential to create financial instability should it fail. Many economists would likely also agree that the failure of a very large institution that makes heavy use of short-term collateralized lending could create liquidity stresses and systemic risk in the form of "asset fire sales" should it default on its secured funding. In contrast, financial network models have not yet provided much insight into systemic risk. Network models are less prone to generate failure contagion than many economists initially anticipated.

Because the term "systemic risk" is ambiguous, Dodd-Frank provides the regulatory agencies with wide discretion to interpret their new powers. The DFA directs agencies to draft and implement rules to control and minimize "systemic risk" without requiring the agencies to identify specifically what they are attempting to control or minimize. Instead of legislating appropriate measures to attain clear goals, the Dodd-Frank Act essentially defines financial stability as the absence of systemic risk and then assigns regulators the responsibility of ensuring U.S. financial stability.

The overall effect is to promote a naïve strategy for promoting financial stability: identify and restrict any financial intermediation that regulators perceive as a potential source of systemic risk. Dodd-Frank encourages regulators to separate "good" financial intermediation from "bad" financial intermediation and to impose rules to stop bad intermediation. The problem with this strategy is that it is unclear that any person or agency has the capacity to distinguish good intermediation from bad intermediation, and stopping financial intermediation has negative consequences for economic growth.

While this problem is inherent to some degree in any form of financial regulation, Dodd-Frank's extensive new regulatory powers can be exercised without any requirement that regulators recognize the cost on economic growth. The Dodd-Frank approach for ensuring financial stability sets up a clear bias for over-regulation.

Post Dodd-Frank, if we do not achieve "financial stability," the public and many in Congress may conclude that the financial regulators failed because they did not stop enough "bad"

intermediation. Facing the possibility of public disgrace if their heightened prudential supervision and regulation fails to prevent the next financial crisis, and no explicit cost for over-regulating the financial sector, regulators will favor over-regulation to protect their reputations. Under the incentive structure created by Dodd-Frank, regulators face no costs from over-regulation but are harmed should too little regulation lead to unanticipated financial instability. In the current environment, regulators will clearly prefer to over-regulate even if over-regulation imposes costs on society in the forms of lower economic growth.

A. *Section 113: Regulators are Given the Power to determine their Own Jurisdiction*

The bias in favor of over-regulation created by the Dodd-Frank mix of new unconstrained powers and vague policy goals is already apparent. In Section 113, Dodd-Frank empowers the FSOC to designate non-bank financial institutions for enhanced prudential supervision and regulation by the Board of Governors. Section 113 includes a laundry list of factors that the Council can consider in making the designation. The primary standard for designation is an FSOC judgment that the firm's bankruptcy would be a potential source of financial instability. Other factors can also be taken into consideration, but all of the standards rely entirely on regulator judgment; there are no objective quantitative thresholds to constrain the designation process.

For example, under Section 113, the FSOC is not obliged to identify specific issues or features that mandate designation, nor must it demonstrate how the designation will mitigate risks. Title I of Dodd-Frank includes a requirement that, once designated, firms must file an annual orderly resolution plan that explains how they can be reorganized in a commercial bankruptcy without creating financial instability. However, Section 113 does not require the FSOC to request a so-called Orderly Resolution Plan as part of the designation process.

The ambiguity of the designation standards provides the FSOC with virtually unlimited discretion. For example, under what conditions should the consequences of failure be evaluated: when the firm fails in isolation, or when the firm fails in a recession during which many other financial institutions are also distressed? Two very different standards that may generate very different FSOC conclusions, and yet Dodd-Frank is silent on the issue.

One particularly egregious Dodd-Frank shortcoming is that it allows the FSOC to make designations without knowing what heighted prudential regulatory standards will apply to designated firms. Not only has the FSOC designated nonbank firms without knowing the consequences of designation, but the justifications it has issued are so broad that companies are not provided with any guidance on how they might avoid designation.

In practice, Section 113 guidelines merely restrict the FSOC's designation discussion and the case (if any) the FSOC makes to support its decision, but the designation outcome is completely governed by the Council vote. Moreover, since the directive lacks objective standards for designation, the criterion used to designate firms will almost certainly change over time with changes in administrations. Without objective minimum quantitative standards for designation, there is little scope for continuity over time or for a designated firm to use data, analysis, or case precedent to avoid or overturn an opinion rendered by the Council.

Given these clear defects in Dodd-Frank, it should not be a surprise that financial regulators are exercising their new powers without constraint. For example, all of the Council's designations to date have been made without any Council recommendations for specific heightened prudential standards and before the Federal Reserve has revealed how it will supervise designated non-bank financial institutions or what heightened prudential standards the designated firms must satisfy. Once the Council has taken an interest in designating an institution, there is little or no objective information the target institution can use to proactively modify its operations, capital, or organizational structure to reduce its "systemic risk" to acceptable levels.

In summary, the legislation that guides the designation process for non-bank financial institutions gives targeted financial firms little or no ability to protect themselves against an arbitrary designation by the Financial Stability Oversight Council. By a simple vote, the Council can decide which financial firms will be subjected to enhanced supervision and regulation by the Board of Governors. It is not necessary to objectively prove that a designation will improve "financial stability" or otherwise reduce financial sector risk. The Council has the sole power to judge whether designation is warranted.

B. *The Federal Reserve Gets Unconstrained Power to Regulate Designated Firms*

Section 165 directs the Board of Governors to establish heighted prudential standards that apply to bank holding companies with consolidated assets in excess of $50 billion and non-banks financial firms designated by the Council. The Board of Governors is required to set heightened prudential standards for risk-based capital requirements, liquidity requirements, concentration limits, risk management requirements, resolution plans and credit exposure reports. The Board of Governors is also empowered to set standards for short-term debt limits, contingent capital requirements, enhanced public disclosure, or other standards the Board of Governors deems appropriate to mitigate or prevent risks to financial stability that may arise from the distress of a designated company.

Section 165 also requires the Board of Governors to administer annual stress test to bank holding companies with consolidated assets in excess of $50 billion and designated non-bank financial institutions and to publically report on the results. The Board of Governors may use the results of the stress test to require designated institutions to modify their orderly resolution plans. In addition, Section 165 requires that all financial institutions or holding companies larger than $10 billion with a primary Federal regulator must conduct annual stress tests similar to the Board of Governors stress test and report the results to their primary Federal regulator.

Section 165 also provides the Board of Governors and FDIC with the powers to impose heighted prudential standards on designated firms that do not submit resolution plans that, in judgment of the Board of Governors and the FDIC, provide for a rapid and orderly resolution under Chapter 11 Bankruptcy in the event the designated firm suffers material financial distress or failure.

These new Section 165 powers raise a number of important issues. I will discuss some of these issues in the remainder of this Section.

1. *When does a bank become systemic and require heighted prudential standards?*

There is no science evidence that supports a threshold of $50 billion for subjecting bank holding companies to heightened prudential standards. While the factors that are mentioned in Section 165 as potential indications that an institution may be a source of systemic risk—size, leverage

riskiness, complexity, interconnectedness and the nature of the institutions financial activities—are reasonable features to consider, there is no economic research that supports the use of specific thresholds for any of these individual factors to indicate a need for heightened prudential regulation.

As of March 2014, the U.S. has 39 bank holding companies with consolidated assets in excess of $50 billion. Of these, 4 had consolidated assets greater than $1 trillion, 4 had assets between $500 billion and $1 trillion (and none of the 4 are primarily commercial banks), 8 had assets between $200 and 500 billion (5 of these are specialty banks), and 23 had assets less than $200 billion. Of the 23 banks with under $200 billion in consolidated assets, most are almost exclusively involved in commercial banking and many might be characterized as "regional" banks.

There are huge differences in the characteristics of the 39 bank holding companies that are subjected to enhanced prudential supervision by the $50 billion limit imposed under Section 165. Very few of these institutions can truly be considered systemically important. Moreover, for the vast majority of these institutions, their failure could be handled using an FDIC bank resolution if the appropriate planning were undertaken using Title I orderly resolution planning authority. There should be no need to invoke Title II. The DFA $50 billion threshold set for enhanced prudential standards is a clear example of over-regulation.

2. Enhanced capital and leverage requirements for designated companies

The enhanced capital and leverage requirements that have been implemented by the Board of Governors are associated with the US implementation of Basel III. These requirements have been designed for use by banks and bank holding companies. They are not appropriate for non-bank designated firms who are also subject to the heightened prudential requirements under Section 165.

Section 165 seems to give the Board of Governors the discretion to modify these enhanced prudential requirements and tailor them to more closely fit the businesses of non-bank designated firms. Thus far, the Board of Governors has not modified any of these enhanced prudential standards and argued that the Collins amendment imposes Basel I capital requirements as a minimum standard on all designated companies. Legislation clarifying that the DFA Collins

amendment does not apply to insurance companies has passed the Senate and been introduced in the House of Representatives.

The issue of the applicability of Section 165 enhanced prudential standards highlights fundamental weakness in the drafting and implementation of the Dodd-Frank Act. The Financial Stability Oversight Council has designated a number of non-bank financial institutions without either knowing what enhanced prudential standards will apply or assuming that non-banks will have to meet the same standards as bank holding companies. In either case, it is doubtful that the Council's deliberations considered how designation would improve U.S. financial sector stability.

3. A two-tiered system of bank regulations will stimulate the growth of large institutions

A second issue raised by the imposition of enhance prudential standards on the largest institutions in the banking system is that a two-tiered system of regulations officially recognizes two distinct types of banks: (1) those that are small and can be allowed to fail without social cost; (2) those that are very large and create large failure costs that must be avoided by stricter regulation. Under this system, the smaller banks may benefit from less burdensome regulation, but investors understand that these institutions will be allowed to fail and softer regulations seemingly makes their failure more likely. In contrast, large banks have added regulatory burden, but they also have been explicitly identified by the government as so important that they need additional regulation to ensure their continued existence.

The differences in capital and leverage regulations between small and large banks mandated by Section 165 and implemented as Basel III are mechanical and are exercised without imposing additional regulatory judgments about critical firm operations. However, the Board of Governors stress test and the resolution plans (joint with the FDIC) mandated by Section 165 include very intrusive correctional powers where the Fed or the FDIC can require extensive operational changes or additional capital at the largest institutions. For the largest institutions, post Dodd-Frank, it is not hyperbole to say the Board of Governors (and to a far lesser extent the FDIC) now have a direct and important role managing the largest banks and designated financial holding companies.

When the government is intimately involved in planning and approving large bank operations, investors will rationally conjecture that their investments are safer in the largest banks. The enhanced prudential standards imposed by Section 165 contribute to investor perceptions that the largest banks are too big to fail.

Over time, the two-tiered approach to banking regulation will erode the ability of small banks to compete for uninsured deposits and reduce their ability to issue unsecured liabilities. Since Dodd-Frank also prohibits the use of trust preferred securities, small bank options to fund growth beyond their retail deposit bases are severely limited. As a consequence, Section 165 requirements are likely to encourage additional consolidation in the U.S. banking system. Deposits and assets will further migrate into the institutions that are required to meet enhanced prudential standards.

4. Limits on the use of short-term debt will raise the cost of borrowing

Section 165 gives the Board of Governors the power to require designated financial firms to extend the maturity of their funding debt (except for deposits, which are exempted from the rule) and restrict the use of short-term collateralized funding including the use of repurchase agreements. Curiously, the deposit exemption is not restricted to fully insured deposits. Banks may issue uninsured deposits without restrictions even though this source of funding is among the most volatile and the first to run.

Short-term debt restrictions limit one of the most visible symptoms of a financial crisis—the inability of financial firms to roll-over their maturating debt. Regulators are now empowered to alleviate this problem by requiring that firms have, on average, a longer time buffer before they face the inevitable maturing debt roll-over. But all going-concern debt eventually becomes short-term and must be refinanced.

The idea for short-term debt restrictions is popular in many post-crisis academic papers that argue that there is an underlying market failure that can be fixed by short-term debt limits. Banks gain private benefit from funding short term because they have a monopoly on issuing demandable deposits and an implicit guarantee advantage in issuing other short-term deposit-like liabilities. The bank benefit is that short-term funding is usually the cheapest source of finance.

The market failure arises when there is a liquidity shock and investors for some reason become unwilling to roll-over banks' short-term liabilities and banks are forced to sell assets to meet redemption requirements. Because many banks are using "excess" short-term funding because of the apparent interest cost savings, they must all shed assets, and this depresses the market price of assets, causing a so-called "fire-sale" decline is asset prices. The decline is asset prices must be recognized by all institutions, even ones that may not be funding with excess short term-debt. And so the lesson from these models is that "asset fire sales" are an externality attached to the over-use of short-term debt, and if regulators restrict bank's ability is fund short term, then the externality can be controlled.

While restrictions on the use of short term debt may reduce the probability of "asset fire sales," the restriction will also impose real economic costs that are not recognized in these models.

First, all debt eventually become short term, so limiting the amount of short-term credit banks and other financial firms issue does not remove the issue that all debt must eventually be rolled over regardless of maturity.

The economic models that demonstrate "fire sale" externalities are highly stylized and static. In these models, if banks fund long term (in the third and final model period) they do not have to refinance in the second period when the fire sale occurs. By forcing banks to issue claims in the "last" period of the model, the claims magically never have to be refunded in the horizon examined. While this solves the fire sale problem in these simple economic models, it does not fix the real life problem that seemingly far-off future periods have a habit if turning into tomorrow, and debt that was once long-term, becomes short term and must be rolled over.

The "fire sale" models of short-term debt also ignore a large literature in corporate finance that argues that short-term debt is cheaper because it is a mechanism for controlling the risk that the managers of a financial institution (or any corporation for that matter) take. If the manager of a corporation is faced with the discipline of continuously rolling over a significant share of the corporation's funding, then the manager must ensure that the corporations finances are always sound and its debt holders are never surprised by the firm's is investments.

Short-term debt is a bonding device. The need to roll over debt helps to keep the manager from investing in longer-term risky investments with uncertain payoffs unless debt holders are fully

aware and approve (i.e. are already compensated) for such investments. If the manager conveys that the firm investments are short term and relatively safe activities, should debt holders learn otherwise, they may refuse to roll over the debt at existing rates and the manager will be forced to abandon longer term investments before they can (possibly) produce the desired high payoff.

When short-term debt controls the risks the manager takes, investors can charge lower interest rates. Thus, short-term debt provides cheaper funding in part because it limits borrower risk-taking. Indeed many academic papers argue that, before deposit insurance, banks funded themselves with demandable deposits because depositors required the demandable feature to discipline the bank, since the soundness of the bank's assets could not otherwise be verified by depositors. Deposit insurance largely destroys the risk control benefits of demandable deposits. I say largely because there is evidence that some insured deposits still run.

Thus, there are sound economic reasons for arguing that short-term debt restrictions on designated financial firms may be less advantages than they might at first seem. Short-term (noninsured deposit) debt controls risk taking, and the current wave of theoretical economic models that produce "asset fire sales" do not consider the risk control benefits of short-term debt. If financial firms are forced to fund themselves using longer-term debt, their cost of debt will increase, and either the institutions will absorb these costs and be less profitable or pass these cost on to customers in the form of higher loan rates and lower returns on deposits. Section 165, and indeed the current wave of macroprudential economic models, do not recognize that short-term debt restrictions are likely to have real economic costs for borrowers.

5. Mandatory Board of Governors annual stress are being used to run the largest banks

Section 165 Board of Governor stress tests are perhaps the most problematic form of enhanced prudential supervision required by the Dodd-Frank Act. The value of these exercises for identifying and mitigating financial sector excesses is highly questionable, and yet the Federal Reserve System spends an enormous amount of resources on this activity. Indeed senior Federal Reserve officials have argued that Basel regulatory capital rules should be suspended, and the Board of Governors annual stress test should be formally recognized as the means for determining minimum capital requirements for large bank holding companies.

Aside from the confidence expressed by senior Federal Reserve officials, there is no evidence that coordinated macroeconomic stress tests will be effective in preventing future financial crisis. Already, these stress tests have missed the "London Whale" at JPM Chase and a multibillion dollar hole in Bank of America's balance sheet. Fannie Mae and Freddie Mac both passed severe government-designed macroeconomic stress tests right before they failed in September 2008. Even before the financial crisis, many countries produced financial stability reports that included bank stress tests and none anticipated or prevented the crisis. Prior pan-European EBA stress tests failed to identify a number institutions that become problematic in short order. Based on the track record to date, stress tests have a pretty poor record for detecting "problem" institutions.

A stress-test based approach for setting bank capital has two gigantic measurement problems. First, the macroeconomic scenario must actually anticipate the next financial crisis. And secondly, regulators must be able to translate the macroeconomic crisis scenario into accurate predictions about actual bank profits and losses.

Few regulators possess the prescience necessary to accomplish this first step. Rewind your clock to 2006 and ask yourself if the Board of Governors would have used a scenario that predicted the housing crisis. It was less than 2 years away, but the Fed did not see it coming. The New York Fed's staff was publishing papers that dismissed the idea of a housing bubble and the Federal Reserve Chairman's speeches argued—worst case—there may be some "froth" in local housing markets. Even as the subprime bubble burst, the new Fed Chairman publicly opined that the economy would suffer only minor fallout.

Even if the Board of Governors stress scenario correctly anticipates a coming crisis, the crisis must be translated into individual bank profits and losses. The problem here is that bank profits and losses are not very highly correlated with changes in macroeconomic indicators. Quarter-to-quarter bank profits do not closely follow quarterly changes in GDP, inflation, unemployment, or any other macroeconomic indicator. The best macroeconomic stress test models explain only about 25 percent of the quarterly variation in individual bank profits and losses, meaning that more than 75 percent of the variation in bank profit and losses cannot be predicted using GDP, unemployment, or other business cycle indicators.

Because of these measurement issues, bank loss predictions from macroeconomic stress tests have very little objective accuracy. Even using the best models, there remains a great deal of

uncertainty surrounding how each bank may actually perform in the next crisis, presuming the stress scenario anticipates the crisis.

These issues are real and serious and they make macroeconomic stress testing more of an art than a science. There is no formula or procedure that will lead to a single set of stress test bank loss estimates that can be independently calculated by different stress test modelers. Thus, it is not surprising that the Board of Governors and the U.S. banks rarely agree on stress test results. The Fed uses its artistic judgment to produce large losses while the banks' aesthetics favor smaller loss estimates. Both the bank and the Fed are probably wrong, but the Fed's judgment always prevails when it comes to the stress test capital assessment.

The stress test process requires the Board of Governors to be intimately involved in modeling the operations and exposures of each large banking institution. It also requires the Federal Reserve Board to use its own judgment to set each large bank holding company's "stress tested" capital plan. What if the Board of Governors is wrong? How can they let an institution that they are essentially managing fail? When regulations get so intrusive that the regulator virtually "runs the bank," it becomes difficult for the government to impose losses on the institution's shareholders and bondholders if the institution fails. This precarious situation could easily encourage the Board of Governors to over-regulate the largest institutions to ensure that there is never a failure on its watch. This outcome is a recipe for permanently slower economic growth and stagnant financial institutions.

It may not be widely appreciated, but the coordinated macroeconomic stress test approach to regulation also encourages a "group think" approach to risk management that may actually increase the probability of a financial crisis. Stress test crisis scenarios have to be specific so that banks and regulators can model the same event. Moreover, the Board of Governors imposes some uniformity in loss rates across all designated banks by using its own stress test estimates. The Board of Governors is very much like a coach or a central planner that tries to ensure some coherence in each designated firms estimates and capital plans. Unintentionally perhaps, by requiring all firms to approach the stress test problem in a Board of Governors' approved way, the process is encouraging all large institutions to think and operate the similarly. What happens when all the largest banks are steeled against the wrong crisis scenario? Could the financial

losses generated by a different an unexpected crisis actually be made worse by the coordinated stress test exercise?

The finial Section 165 issue I will discuss is related to the requirement that designated firms must file an annual orderly resolution plan. Section 165 directs the Board of Governors and the FDIC to determine whether designated firms' orderly resolution plans are credible or whether they would fail to facilitate an orderly resolution of the company under Title 11 of United States Code. However, Section 165 does not provide any specific guidance that constrains the agencies' judgment. There are no specific criteria specified that can be used to identify a credible plan; there are no objective standards that must be met. The credibility of a plan is entirely based on subjective judgments by the Board of Governors and the FDIC.

6. Orderly Resolution Plans are not Pre-Packaged Bankruptcies

The recently released report from the House Financial Services Committee on Too-Big-to-Fail Four Years after Dodd-Frank identifies a number of shortcomings associated with Dodd-Frank's requirement for designated firms to file Orderly Resolution Plans. While these so-called "living wills" have been advertised as pre-packaged bank bankruptcy plans, they are nothing of the sort. Pre-packaged bankruptcy agreements are agreements negotiated between creditors and the distressed firm's shareholders that will allow the distressed firm to recapitalize and emerge from bankruptcy as a liquid and solvent firm. First and foremost, these agreements must be approved by the distressed firm's creditors before they are taken to the court for approval if they are to successfully avoid a lengthy judicial proceeding.

Orderly liquidation plans are drafted by designated financial institutions and reviewed and (potentially) approved by the Board of Governors and the FDIC. They are kept secret and never shared with the designated firm's creditors. Should the firm become distressed, there is no basis for assuming creditors would accept these bankruptcy plans as a pre-packaged bankruptcy and indeed there is no requirement that a firm must follow the Orderly Liquidation Plan it files with regulators.

Second 165 does not include any objective thresholds or standards that the FDIC and Board of Governors must consider when identifying an "acceptable" Orderly Resolution Plan. The acceptability of an orderly resolution plan is based solely on judgments rendered by the FDIC

and Board of Governors. There is no judicial review and essentially no way for a designated firm to challenge FDIC or Board of Governors opinions as to the acceptability of these plans. This is especially problematic because Dodd Frank allows the FDIC and the Board of Governors to require operational changes and even require divestitures if a designated firm does not remedy regulatory objections to its Orderly Resolution Plans within a reasonable period after objections have been raised.

7. Orderly Resolution Plans Should be used to Improve FDIC Resolutions

Historically, when large banks fail, the FDIC arranges a whole bank transaction in which a larger, typically healthier bank, assumes all the deposits and most if not all of the institutions assets. Sometimes the FDIC uses a loss share agreement to partially cover losses on the failed bank assets that are of questionable quality. A whole bank transaction was used to resolve WAMU, the largest bank failure in US history, without cost to the deposit insurance fund.

The problem with whole bank resolutions is that there needs to be a bigger heathier bank to purchase the failing institution, and even when one exists, if a sale is successful, it creates a new larger institution. One step toward fixing the too-big-to-fail problem, is to require the FDIC to break up failing banks when they sell them in a normal FDI Act resolution.

There are costs associated with changing the public policy priorities in an FDIC resolution. Whole bank purchases often impose the least cost on the deposit insurance fund because bidders value acquiring the entire franchise intact. It may be costly and require significant time and resources to separate and market large failing banks piecemeal. For example, it may be difficult to identify all bank operations associated with a single customer relationship, and more difficult yet to package these customer relationships into sub-franchises that are readily marketable. But the added resolution costs are costs that must be born to avoid creating too-big-to-fail banks through the resolution process. Indeed the FDIC SPOE envisions undertaking a similar process in a Title II resolution.

There may be practical ways to reduce the cost of requiring the FDIC to break up large banks in an FDIA resolution. For example, the FDIC could be required to use Title I orderly resolution planning powers to require organizational changes within the depository institution that would allow the institution to be more easily broken apart in a resolution. This may involve organizational changes to information systems, employee reporting lines or other process to

ensure that the bank has the capacity to conduct key operations in house and is not relying on venders or consultants in a manner that would inhibit the break-up of the institution in a resolution process.

There are many complicated, complex, and potentially costly issues that must be solved before a large bank could be successfully dismantled and sold in pieces in an FDIC resolution. However, these issues are a subset of the issues the FDIC must solve if it is to undertake a Title II resolution of the largest, most complex and internationally active institutions and downsize them in the resolution process.

Once large regional banks can be managed and downsized in the course of a normal bank resolution, there would no longer be a case to require these banks to meet heightened prudential capital, leverage, stress test, or other regulatory standards prescribed by Section 165 (excepting the requirement to submit a satisfactory orderly resolution plan). Improvements in the resolution process can substitute for overly-rigorous prudential regulations that limit economic growth.

III. Over-Regulation Stifles Financial Intermediation and Reduces Economic Growth

Since financial regulations are designed around the idea that banks and financial intermediaries play a special role in the economy, it is useful to briefly review the economic functions of banks and financial intermediaries to highlight the link between financial regulation and economic growth.

In many capitalist economies, banks are the only intermediaries that collect consumer savings and channel them into private sector investments. In bank-centric economies, if banks make sound investment decisions, the economy grows, banks profit, and consumers earn interest and their deposits are safe. If banks make poor investment choices, their investments fail, consumers lose their savings and economic growth plummets.

Some economies, including the U.S. economy, also benefit from non-bank financial intermediation, sometimes called "shadow banking" by bank regulators. Non-bank financial intermediation occurs when consumers channel their savings into private sector investments without the intermediation of a bank. In the most common form of non-bank intermediation, firms issue publicly-traded securities that consumers can purchase and own directly, but savers

may also purchase and own securities indirectly through collective investment vehicles like mutual funds, insurance companies, private equity, hedge funds or other non-bank financial institutions. These intermediaries along with broker-dealers are part of the financial infrastructure that makes it possible for consumers to purchase and sell securities and thereby channel their savings into investments without using the banking system as the investing intermediary.

The ability to invest saving using non-bank forms of intermediation generally gives savers more control over their investment decisions as well as the ability retain a larger share of the profit (or the loss) generated by their investment decisions. Non-bank intermediation is typically a cheaper source of funding for firms that have achieved a good reputation among investors by repeatedly honoring the financial claims they have issued in the past and through public disclosures that helps to make their operations and financial condition as transparent as possible to investors. Economists generally believe that economic growth is stronger when consumers can invest their savings using the wide range of invest opportunities available through non-bank intermediation.

Against this background, it is useful to consider a definition for systemic risk. My preferred definition of systemic risk is that systemic risk is the possibility that a disruption in the financial intermediation process could cause a significant sharp reduction in real economic growth.

The Dodd-frank Act operates under the theory that regulators have an ability to identify and stop "bad" financial intermediation, and by eliminating bad intermediation, regulators can remove the possibility that the failure of an institutions could disrupt financial intermediation and cause a recession. But slowing financial intermediation will slow economic growth. So within Dodd-Frank there is an implicit unrecognized trade-off between slowing economic growth in all periods against the benefit of reducing the probability of periodic recessions brought on by a financial crisis.

There is scant evidence to guide policymakers in choosing between financial stability and economic growth. History clearly demonstrates that financial safety and soundness regulations cannot prevent financial crisis. Perhaps financial regulation can reduce the probability that financial crisis occur, but even this is an unsettled issue. Safety and soundness regulations may merely replace investor monitoring with regulatory monitoring with little or no net change in the overall risk control exercised by financial institutions. Alternatively, regulation might replace

investor monitoring with much more restrictive controls on financial intermediary risk taking. Whether additional restrictive regulations benefits society depends in part on consequences of these additional restrictions for economic growth. Too much regulation is a recipe for a financially stable but economically stagnant economy.

A handful of studies have assessed the potential economic impact of Basel III heightened prudential capital and liquidity regulations. Industry studies have argued that the Basel III regulations will increase the cost and decrease the supply of bank credit and ultimately lower GDP growth in non-crisis periods. A 2010 study by the Institute of International Finance[2] offers the most pessimistic impact assessment, arguing that the new Basel III rules will increase the average cost of bank credit by more than 1.5 percentage points, constrict bank lending, and lower real GDP by about 3 percentage points over a 5 year period. A 2013 study sponsored by The Clearing House Association[3] also finds large economic costs associated with Basel III regulations.

In contrast to industry-sponsored studies, pro-regulatory studies commissioned by the Bank for International Settlements (BIS)[4], the Organization for Economic Cooperation and Development,[5] and independent scholars at the Brookings Institution[6] predict much smaller increases in bank loan rates and correspondingly smaller declines in bank lending and GDP growth.[7] For example, the BIS study estimates that Basel III changes will increase average bank lending rates by roughly 50 basis points (bps) which will reduce bank credit growth and reduce steady-state GDP by an estimated 35 bps.

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[2] "Basel III Capital Standards: IIF Preliminary Analysis," Institute for International Finance, December 2010.
[3] The Clearing House Association (April, 2013), "Analyzing the impact of bank capital and liquidity regulations on US economic growth."
[4] See, Angelini, P., L. Clerc, V. Curidia, L. Gambacorta, A Gerali, A. Locarno, W. Roeger, S. Van den Heuvel and J. Vicek (2011). "Basel III: Long-term impact on economic performance and fluctuations," Bank for International Settlements Working Paper No. 338, Basel, CH.

[5] See, Slovik, P. and B. Cournède (2011), "Macroeconomic Impact of Basel III", OECD Economics Department Working Papers, No. 844, OECD Publishing.

[6] See, Elliott, D.J., (2009). "Quantifying the Effects on Lending of Increased Capital Requirements," The Brookings Institution, www.brookings.edu/papers/2009/0924_capital_elliott.aspx. .

[7] Santos, A.E. and D. Elliott, (2012). "Estimating the Costs of Financial Regulation," IMF Staff Discussion Note, SDN/12/11 (September 11) focuses only on estimating the impact of the regulatory changes on bank lending rates. It does not offer predictions on GDP growth.

These Basel III impact assessments use simplistic macroeconomic models and reduced-form relationships to estimate the potential impacts of Basel III regulations on GDP. Basel III regulatory changes are assumed to increase the interest rates banks will charge their customers. The studies differ, however, in their assessment of likely increases in loan rates and the impact that these increases will have on reducing consumption and investment demand, and, ultimately, GDP.[8]

IV. Title II Reduces "Systemic Risk" by Extending New Government Guarantees

Title II creates a special process to "liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard. (Sec. 204 (a))." Title II creates a new administrative resolution process that is similar to the FDIC's administrative process for resolving failed banks, and it assigns systemic resolution authority to the FDIC It includes specific responsibilities that must be carried out in the resolution including a claims priority that must followed when assigning receivership losses. It also allows the FDIC to temporarily charter a bridge financial institution to facilitate a systemic resolution and creates the Orderly Liquidation Fund (OLF) to fund Title II resolutions.

Title II creates a new Orderly Resolution Authority that imposes some broad guidelines on the FDIC but it does not dictate exactly how the FDIC must resolve a company put into Title II receivership. Title II leaves the FDIC with significant discretion to manage a receivership. To provide clarity to the Title II process, the FDIC has released a proposed strategy for executing a Title II resolution. To minimize financial sector disruption, the FDIC's "Single Point of Entry" strategy (SPOE)[9] will take the parent financial holding company into receivership, replace management, keep the operating subsidiaries open and operating and manage them from a newly chartered bridge financial holding company:

> The SPOE strategy is intended to minimize market disruption by isolating the failure and associated losses in a SIFI to the top-tier holding company while maintaining operations at the subsidiary level. In this manner, the

[8] The Clearing House Association (April, 2013) provides a detailed discussion of the assumptions used in these studies.

[9] http://www.fdic.gov/news/board/2013/2013-12-10_notice_dis-b_fr.pdf

> resolution would be confined to one legal entity, the holding company, and would not trigger the need for resolution or bankruptcy across the operating subsidiaries, multiple business lines, or various sovereign jurisdictions. p. 76623.

The parent holding company shareholders and most of its liabilities will remain in the receivership to absorb the failed institutions' losses. Since most holding company liabilities would not be transferred into the bridge holding company, the new bridge company would be predominately equity funded. With the help of government guarantees and OLF funding as necessary, the bridge bank will issue new debt instruments and downstream the proceeds to recapitalize any subsidiaries that suffered losses or replace subsidiary funding to prevent asset "fire sales" to meet redemption demands.

The SPOE is designed to have the equity and debt holders of the parent company absorb all of the losses of holding company subsidiaries, but the FDIC anticipates circumstances when this may not be possible:

> ...if there are circumstances under which the losses cannot be fully absorbed by the holding company's shareholders and creditors, then the subsidiaries with the greatest losses would have to be placed into receivership, exposing those subsidiary's creditors, potentially including uninsured depositors, to loss. An operating subsidiary that is insolvent and cannot be recapitalized might be closed as a separate receivership. Creditors, including uninsured depositors, of operating subsidiaries therefore, should not expect with certainty that they would be protected from loss in the event of financial difficulties (p 76623).

The FDIC's has been actively "marketing" is SPOE strategy since it formally released the proposal in December 2013. Resolution is a very esoteric topic, and so it is not surprising that the SPOE has been subjected to relatively little public debate. However, there are many public policy issues associated with the processes that will take place under a Title II SPOE resolution. I will discuss some of the most important implications of a Title II SPOE resolution in the remainder of this section.

A. *Most large financial firms that might be subject to Title II are primarily banks*

Most of the large financial institutions that might be candidates for a Title II resolution are bank holding companies. For the majority of these institutions, their primary asset is a bank or a subsidiary bank holding company. Figure 1 shows, for all bank holding companies larger than $10 billion in consolidated assets, the share of each parent holding company's equity that is

invested in a subsidiary, affiliated bank, or a subsidiary bank holding company. For most of these institutions, their primary asset is a bank, and even in cases where these institutions have multiple banks or subsidiary bank holding companies, they usually have one large depository institution that holds most of the holding company's consolidated assets and issues most of the holding company's consolidated liabilities. This feature is important because if the bank holding company's largest asset is a big bank, the holding company will only be in financial distress when its largest bank is in distress.

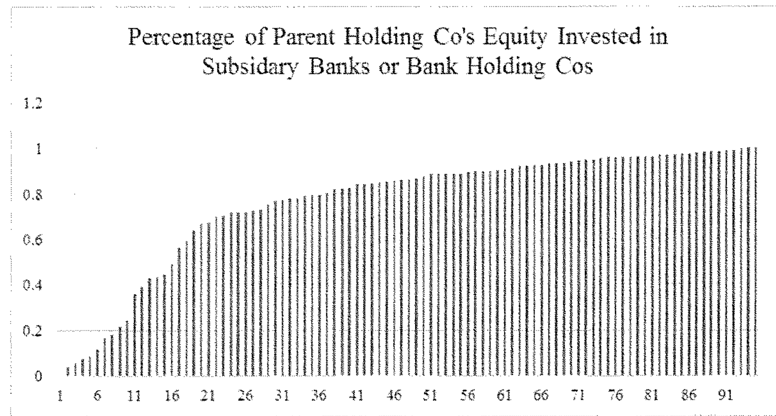

Figure 1: Percentage of parent bank holding company's equity invested in subsidiary or affiliated banks and subsidiary bank holding companies for all bank holding companies largest than $10 billion in consolidated assets. Source: Author's calculation using bank holding company data from the Federal Reserve Board National Information Center. http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx

B. For most Title II candidates, parent equity = consolidated holding company equity

To understand how well the SPOE might work in practice, it is instructive to take a closer look at the equity and liability characteristics of bank holding companies larger than $100 billion, banks that might require a Title II resolution. Table 2 reports March 2014 data on all holding companies larger than $100 billion. Two of these holding companies are savings and loan

holding companies which have less detailed disclosures reported in the Federal Reserve public database. The first important point to recognize in Table 2 is that when the equity in the parent holding company is exhausted by losses in its subsidiaries, then there is, at best, only a tiny amount of equity remaining in the consolidated institution.

Holding Company	Consolidated Assets	Parent Holding Company Total Assets	Parent only Equity as a Percentage of Consolidated Equity	Parent only Liabilities as a Percentage of Consolidated Liabilities
1 JPMORGAN CHASE & CO.	$2,476,986,000	$463,296,000	99.80%	10.80%
2 BANK OF AMERICA CORPORATION	$2,152,533,000	$459,156,000	99.98%	11.83%
3 CITIGROUP INC.	$1,894,736,000	$400,870,000	99.15%	11.42%
4 WELLS FARGO & COMPANY	$1,546,707,000	$292,852,000	99.54%	8.55%
5 GOLDMAN SACHS GROUP, INC.	$915,705,000	$277,360,000	99.65%	23.71%
6 MORGAN STANLEY	$831,381,000	$256,383,098	95.45%	24.87%
7 AMERICAN INTERNATIONAL GROUP, INC.	$547,111,000	$143,344,000	99.44%	8.93%
8 GENERAL ELECTRIC CAPITAL CORPORATION	$516,971,228	$574,047,466	99.48%	113.32%
9 U.S. BANCORP	$371,289,000	$55,108,119	98.39%	3.97%
10 BANK OF NEW YORK MELLON CORPORATION	$368,241,000	$64,103,000	97.48%	7.93%
11 PNC FINANCIAL SERVICES GROUP, INC.	$323,586,973	$45,692,264	96.44%	0.85%
12 HSBC NORTH AMERICA HOLDINGS INC.	$308,847,926	$36,245,589	93.46%	1.97%
13 CAPITAL ONE FINANCIAL CORPORATION	$290,886,180	$54,978,022	100.00%	4.91%
14 STATE STREET CORPORATION	$256,672,720	$30,430,990	99.98%	3.89%
15 TEACHERS INSURANCE & ANNUITY ASSOCIATION OF AMERICA*	$252,936,464	$252,936,464	NA	NA
16 TD BANK US HOLDING COMPANY	$237,493,754	$34,023,813	98.05%	4.37%
17 BB&T CORPORATION	$184,651,158	$33,770,316	99.60%	6.40%
18 SUNTRUST BANKS, INC.	$179,553,408	$28,966,042	99.42%	4.61%
19 AMERICAN EXPRESS COMPANY	$151,497,000	$33,256,685	99.95%	10.10%
20 ALLY FINANCIAL INC.	$148,452,000	$45,224,000	99.99%	22.96%
21 CHARLES SCHWAB CORPORATION	$144,066,000	$12,794,000	100.00%	1.49%
22 STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY*	$132,022,280	$132,022,280	NA	NA
23 FIFTH THIRD BANCORP	$129,654,487	$20,607,584	99.74%	5.04%
24 UNITED SERVICES AUTOMOBILE ASSOCIATION	$127,322,366	$35,300,145	100.35%	9.99%
25 RBS CITIZENS FINANCIAL GROUP, INC.	$127,295,624	$21,021,496	100.00%	1.46%
26 REGIONS FINANCIAL CORPORATION	$118,136,516	$18,363,716	100.00%	2.19%
27 BMO FINANCIAL CORP.	$114,499,474	$19,357,799	99.96%	5.27%
28 SANTANDER HOLDINGS USA, INC.	$109,168,077	$20,992,661	82.90%	3.53%
29 UNIONBANCAL CORPORATION	$107,237,659	$15,228,926	98.29%	0.83%
30 NORTHERN TRUST CORPORATION	$103,832,578	$11,352,157	100.00%	3.55%

* Indicates savings and loan holding company which have limited data collected in regulatory reports.

Table 2: Equity and liability characteristics of bank and thrift holding companies with consolidated assets in excess of $100 billion. Source: Author's calculations calculation using Federal Reserve Board holding company data. http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx

Table 2 shows that, for most of these institutions, once the parent is facing insolvency because losses exhaust its equity, any equity in its remaining solvent subsidiaries would be consumed by the losses in the holding company's insolvent subsidiaries. So if the parent's equity is exhausted

or nearly exhausted when it is taken into a Title II receivership, then parent liability holders must be relied on to bear the receivership losses.

C. *Would the SPOE have prevented TBTF Bailouts in the Last Crisis?*

In the most recent financial crisis, the government rescue of non-bank firms like AIG and Freddie Mac and Fannie Mae involved cancelling shareholder claims, firing management, and taking a controlling interest in the companies' using preferred shares in exchange for access to a massive government line of credit. AIG got access to government funding through a special Federal Reserve 13(3) lending facility whereas the housing GSEs used both the Fed (the Fed bought the agencies mortgaged banked securities) and a direct line of credit with the U.S. Treasury.

In each case, the parent company received a very large amount of government funding that was used to keep the institutions' open and operating. In the case of AIG, government funds provided to the parent were down streamed to subsidiaries where they were used to cover losses on securities lending and meet collateral calls on credit derivatives written by AIG's London Financial Products subsidiary. In the case of the housing GSEs, government funding was used to pay interest and principle due on the agencies' outstanding bonds, to pay indemnities and other contractual obligations related to the mortgage-back securities they had insured and issued, and to raise new funds to continue mortgage guarantee operations.

There is a very close correspondence between the Title II SPOE resolution strategy proposed by the FDIC and the strategy the government used to support non-bank financial institutions in the past crisis. The SPOE explicitly plans to ensure the continuing operation of important activities of the largest financial institutions by keeping the subsidiaries open and operating. In most cases this means that the SPOE would ensure that payments on the subsidiaries' liabilities are fully discharged to avoid entangling subsidiaries in an additional bankruptcy or resolution proceedings. Similarly, the SPOE must meet subsidiary funding needs or risk starving subsidiaries of funding which would cause them to suspend operations.

If the SPOE were employed to resolve AIG, the FDIC would have secured funding from the U.S. Treasury using the Orderly Liquidation Fund. Instead of taking the U.S. Treasury taking a

controlling interest in preferred shares, the FDIC would gain management authority directly by being appointed receiver through the Title II process. The FDIC would secure Treasury funding by pledging the receivership's unencumbered assets as collateral. To keep the institution ongoing, subsidiary liabilities will be fully paid and similarly situated creditors at the parent holding company might be treated differently should the FDIC determine this is necessary to prevent financial instability or to maximize the recovery on the receivership.

Thus, in a repeat case of AIG distress, the SPOE would downstream the proceeds it borrows from Orderly Liquidation Fund to pay collateral calls at AIG Financial Products in London and to cover securities lending losses in other AIG subsidiaries. Management would be replaced and shareholders would suffer losses similar to what happened in the prior financial crisis. In an AIG repeat, the government would decide how broadly it wanted to extend the safety net, and Orderly Resolution Fund assessments would be used to recoup the costs. In contrast, in the prior crisis, the government used high credit line fees the ex post sale of preferred shares were used to recoup bailout costs.

Aside from providing a mechanism to fund the Orderly Liquidation Fund, the only other marginal benefit SPOE may have over the prior government approach is that the senior and subordinated debt holders at AIG's parent company would be required to bear losses. Since most of the emergency funds were used to honor immediate subsidiary liabilities and to keep them open and operating, it is unlikely that imposing losses on the parent company's senior and subordinated debt holders would have made a substantial difference.[10]

D. *Title II and SPOE can provide larger government guarantees than bankruptcy*

To keep a financial firm's subsidiaries open and operating in a Title II resolution, the FDIC will have to guarantee all subsidiary liabilities so that counterparties do not undertake additional insolvency proceedings that would suspend subsidiary operations and tie up their assets in additional (potentially foreign) legal proceedings. If the FDIC guarantees subsidiary liabilities,

[10] AIG's 2007 financial statement indicates it had issued more than $156 billion in total debt liabilities, of which, about $36 billion were issued by the parent. From the materials included in the annual report, it is unclear whether all of the parent's debt liabilities would have been available to absorb losses in a SPOE resolution. About $15 billion of the parents debt are identified as "matched notes and bonds" that appear to be payable to subsidiaries, but this is not completely clear in the financial statement. If these claims do represent borrowings from subsidiaries, they cannot be used to absorb consolidated group losses in a SPOE resolution.

then only the parent holding company's liabilities remain to absorb losses and recapitalize and fund subsidiaries.

The final column of Table 2 shows that, in most cases, the parent's liabilities comprise only a small fraction of the consolidated liabilities in most financial holding companies larger than $100 billion in consolidated assets. This pattern is most pronounced when the holding company's largest assets are held in subsidiary banks. The implication is that a Title II SPOE resolution will extend government guarantees to the large majority of the financial firm's liabilities and impose the losses on only a small share of liabilities issued by the consolidated financial firm. This feature creates a government guarantee that is, in many cases, much larger than the government guarantee that would arise when a bank fails and the holding company goes into a commercial bankruptcy proceeding.

The FDIC and Board of Governors are likely to argue that the paucity of debt in the holding company parent is only a transitory feature of Title II. The Board of Governors and FDIC are reportedly working with the International Financial Stability Board to craft holding company debt issuance requirements that will address this issue.

E. *Holding minimum debt regulations will be as complicated as Basel capital regulations*

Crafting holding company minimum debt requirements is a process that is analogous to the process of setting bank holding company regulatory capital requirements. The development of regulatory capital requirements has taken tremendous resources on the part of both banks and regulators, not to mention more than 15 years of development time. Moreover, holding company minimum debt requirements will also have international competitive implications if large foreign banks do not face similar requirements. This sets up the case for another yet another extensive Basel Committee-type process to set international requirements for holding company debt issuance.

F. *The OLF is a new guarantee fund that conflicts with the deposit insurance fund*

If the parent holding company liabilities are insufficient to support receivership losses and distressed subsidiary recapitalization needs, the FDIC will have to use the OLF to fund the receivership. This will require an FDIC assessment of all financial firms with consolidated assets larger than $50 billion to fund the receivership.

The OLF Title II mechanism sets up a new government guarantee fund. Under the SPOE, it will guarantee all but the parent holding company liabilities of the failing financial firm unless the FDIC decides to put some subsidiaries into default. Unless there are some operational details yet to be released, resources from the OLF will be available to guarantee deposits at a bank subsidiary setting up a potential conflict of interest between banks that support the deposit insurance fund and larger institutions that will pay OLF assessments. This conflict becomes transparent when considering a SPOE resolution for a bank holding company whose primary asset is a single large bank.

Institution	Parent holding company liabilities	Bank liabilities	Parent liabilities as a percentage of bank liabilities
Goldman Sachs	$198,261,000	$84,341,000	235.07%
US Bancorp	$13,054,119	$326,154,482	4.00%
PNC Financial Services	$2,371,454	$274,311,095	0.86%
State Street	$9,158,101	$232,239,094	3.94%
BB&T	$10,311,260	$158,039,434	6.52%
Suntrust	$7,275,141	$153,490,040	4.74%
Ally Financial	$30,765,000	$82,572,057	37.26%
Fifth-Third	$5,781,902	$111,360,115	5.19%
Regions	$2,504,733	$101,004,081	2.48%
Northern Trust	$3,403,814	$96,299,648	3.53%
Key Corp	$3,349,783	$78,597,573	4.26%
Huntington Bancshares	$1,600,186	$54,774,690	2.92%
BBVA	$122,173	$63,120,164	0.19%

Table 3: Selected characteristics of bank holding companies with consolidated asset in excess of $50 billion with a single subsidiary bank. Source: Author's calculations calculation using Federal Reserve Board holding company data http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx and FDIC Statistics on Depository Institutions http://www2.fdic.gov/sdi/index.asp

Among bank holding companies with consolidated assets greater than $50 billion, there are 13 institutions that own a single bank subsidiary. Selected characteristics of these institutions are reported in Table 3. Of these institutions, only Goldman Sachs and Ally Financial have significant investments in non-bank subsidiaries. Subsidiary investments in the remaining 11 holding companies are concentrated in a single bank. If any of these holding companies is in

distress, their bank will also be failing. Then the Secretary of the Treasury and the President must make a decision whether to put the distressed firm through an FDIC bank resolution, or invoke Title II and use a SPOE resolution. This decision has important consequences.

A bank resolution uses the FDIC's long-standing administrative resolution process. Under this process, the failed bank's shareholders and senior and subordinated debt holders bear the institution's losses. Deposit protection, if needed, is provided by the deposit insurance fund, a fund that is built from assessments on all insured depository institutions. Under an FDIC bank resolution, the holding company equity holders will suffer large losses, and the holding company is often forced to reorganize in bankruptcy. Holding company senior and subordinated debt holders may have a better experience, and indeed they may even suffer no loss in bankruptcy.[11]

Under a Title II resolution, the investors that own senior and subordinated debt in the bank will be fully protected under the SPOE strategy. Bank deposits, insured and uninsured, will also be fully protected under a Title II resolution. The SPOE will impose losses on investors in senior and subordinated parent holding company debt if the receivership losses cannot be fully absorbed by the holding company's equity. Any additional losses and recapitalization needs that cannot be covered by the parent holding company debt will be borrowed from the OLF. Repayment of these OLF funds will be assessed against any financial firm with assets greater than $50 billion.

G. With Presidential approval, Title II empowers the Secretary of the Treasury to change property rights without prior notice, public debate, or Congressional action.

The decision to use an FDIC bank resolution versus a Title II SPOE resolution has important consequences for investors. While holding company bankruptcy and FDIC bank resolutions are the presumed status quo where bank debt holders bear losses and bank holding company debt holders have a better chance of recovery, the Secretary of the Treasury and the President can, quickly and without public debate or Congressional approval, change the rules.

If Title II is invoked, losses are shifted onto holding company debt holders while bank deposits, investors in bank debt, and the deposit insurance fund are fully protected against any losses.

[11] For example, the senior and subordinated debt holders in WAMU bank suffered large losses while the senior and subordinated debt in the holding company had a 100 percent recovery on their securities.

Title II allows the President and his appointed Secretary of Treasury to completely change property rights and shift losses among distinctly different investors without prior notice, public debate, or any vote from Congress.

Unless the holding company has characteristics that are uncommon among the largest holding companies, invoking Title II has the potential to provide government guarantees far in excess of those that might be in force under an FDI Act resolution. The last column of Table 3 reports the liabilities of the parent holding company as a percentage of the subsidiary bank liabilities. Except for Goldman Sachs and Ally Financial, a Title II SPOE resolution would impose losses on only a very small fraction of liabilities issued by the consolidated holding company. If the bank subsidiary liabilities were protected by the SPOE, it is probable that a large share of the holding company's losses would be borne by the firms that must contribute to the OLF.

H. Title II provides inadequate funding to prevent asset "fire sales"

The SPOE raises a few additional issues. Under Title II, access to OLF funds are limited to 10 percent of the value consolidated assets of the failed financial firm as reported on its last financial statement. After 30 days, or when the FDIC completes an assessment of the market value of the receiverships' assets, OLF funding can increase to up to 90 percent of the market value of assets available to fund the receivership. The 10 percent cap on SPOE funding raises some important issues.

It is highly unlikely that a large financial institution fails because it prepares its financial statements and discovers that it is undercapitalized. Instead, long before financial statements reflect true distressed values, market investors lose confidence and withdraw funding from the firm. The firm ultimately suffers a liquidity crisis that forces it to find a buyer or to reorganize. In the case of Wachovia and WAMU, somewhere close to 10 percent of their depositors "ran" in the weeks before they failed. Thus, history suggests that a large financial institution that is in danger of failing will have losses that require capital injections, but they will also face funding withdrawals that must be replaced if they are to avoid asset "fire sales."

When the FDIC is required to quickly replace funding withdrawals and inject capital using the OLF, the 10 percent funding cap could become an important impediment. To avoid the cap, the FDIC may have to revalue the receivership assets quickly and then request funds in excess of 10

percent of holding company's initial consolidated assets. In reality, the FDIC does not have the capacity to value receivership assets that quickly, especially if the failure is a surprise. While I believe that the 10 percent funding cap is an example of good Congressional governance on paper, in practice, the FDIC will likely be forced into a speedy and less than rigorous revaluation because it will have to access additional OLF funding in the early days of a Title II receivership.

I. *How will Title II work when and a bank subsidiary is also being resolved by the FDIC?*

Some of my criticisms of the SPOE have been anticipated in the FDIC Federal Register proposal where the FDIC reserves the right to take the subsidiary bank or non-bank subsidiaries into separate receiverships. But it is unclear how such a policy would work when a large financial holding company is predominately comprised of a large bank, especially if the bank is internationally active. The overarching goal of the SPOE's is too keep critical subsidiaries of the holding company open and operating to facilitate global cooperation, prevent "ring-fencing," multiple competing insolvencies, and counterparty reactions that create operational difficulties and systemic risk. Resolving the large bank subsidiary would certainly create the problems SPOE tries to avoid.

The FDIC's SPOE proposal does not explain how a Title II resolution would work when it is paired with a FDIA resolution of a bank subsidiary. It is unclear how losses will be allocated between bank and holding company creditors and between contributors to the deposit insurance fund and the OLF. It is also difficult to envision how the FDIC might be able to close a very large internationally active bank subsidiary, and impose losses on its creditors, while keeping it open and operating and out of extra-national bankruptcy proceedings.

J. *Does Title II work in a true financial crisis?*

The last and biggest issue is how Title II and the SPOE would work when multiple large financial firms are simultaneously in distress. Would SPOE be used to simultaneously to resolve multiple large financial institutions through bridge banks? How different is this from nationalizing banks which could comprise a large part of the U.S. banking system?

Title II and SPOE do not fix the too-big-to-fail resolution problem in a true financial crisis when the distress of large financial institutions is mostly likely to arise. Instead, Title II will complicate and compound the too-big-to-fail issue when a single large institution fails in isolation without providing a practical resolution solution in a financial crisis when many large financial firms are likely to be distressed simultaneously.

July 23, 2014

Testimony of

Dale Wilson

On behalf of the

Texas Bankers Association

before the

Committee on Financial Services

United States House of Representatives

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July 23, 2014

Chairman Hensarling, Ranking Member Waters, my name is Dale Wilson, Chairman and Chief Executive Officer of the First State Bank of San Diego in San Diego, Texas. We are a rural community bank with just under $80 million in assets serving the needs of a South Texas town of approximately 5,000 people. Our local economy is based upon agriculture and energy. Demographically, our community is 85% Hispanic. I appreciate the opportunity to be here to present the views of the Texas Bankers Association (TBA) on the impact of the Dodd-Frank Act. TBA is the voice of Texas banking, representing 500 small, regional and large banks, employing over 150,000 people and providing over $205 billion in loans.

Let me start by thanking my own Congressman, Ruben Hinojosa, who serves on this committee. Congressman Hinojosa has always sought out the views of the community bankers in his district and has even taken time to meet with our Board of Directors. His dedication to the concerns of his South Texas constituents is deeply appreciated.

Community banks make up 95 percent of all U.S. banking organizations and have been the backbone of Main Streets across America. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive.

The sad fact is that over the course of the last decade 1,500 community banks have disappeared. This is why hearings like today's are so important. It is an opportunity to change the dialogue from just talking about how important community banks are to what can be done to stop the rapid decline in the number of community banks and start taking action to assure we have a healthy and vibrant community banking sector.

During the last decade the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years ***before*** Dodd-Frank. Dodd-Frank is already adding to that burden for all institutions with 5,933 pages of proposed regulations and 8,002 pages of final regulations (as of May 29, 2014) and we're only half way through the 398 rules that must be promulgated and is poised to add hundreds more affecting all banks. Managing this tsunami of regulation is a significant challenge for a bank of any size, but for a small bank with only 17 employees, it is overwhelming.

Today, it is not unusual to hear bankers—from strong, healthy banks—say they are ready to sell to larger banks because the regulatory burden has become too much to manage. Since the passage of Dodd-Frank there are 80 fewer Texas banks. These banks did not fail. Texas has one of the healthiest economies in the country – we call it the Texas miracle. These were community bankers – and I have talked to many of them personally – that could not maintain profitability in an environment where the regulatory compliance costs are increasing between 50 and 200 percent.

These are good banks that for decades have been contributing to the economic growth and vitality of their towns, cities, and counties but whose ability to serve their communities is being undermined by excessive regulation and government micro-management. Each bank that disappears from the community makes that community poorer. The real costs of the increased regulatory burden are being felt by small town borrowers and businesses that no longer have access to credit. There are other costs as well. When a small town loses its only bank, it loses its lifeblood. The town finds it more difficult to improve the schools, hospitals and other infrastructure needs like water projects if there is no local bank. I know it was not the intent of Congress when it passed Dodd-Frank to harm community banks, but that is the awful reality.

One issue in particular that has hindered the ability of community banks to serve their communities are the new Qualified Mortgage (QM) rules. I understand the reasoning for a lot of the new mortgage regulations. Ten years ago there were a lot of mortgage lenders originating toxic mortgages, securitizing them and selling them. But the community banks did not engage in any of these activities and I would respectfully urge this committee to consider legislation to exempt banks like mine from a lot of these new regulations. (For example, banks holding loans in portfolio should not have to meet the QM requirements.) It seems to me that community banks are being made to pay for the sins of others.

The QM rules carry significant penalties. If, for example, a bank is found to have made an error in calculating a borrower's ability to repay a loan, the bank could be forced to repay fees to the borrower, and to lose the recourse to foreclose on the loan should the borrower default. This is in addition to whatever penalties the regulators or state attorneys general might seek.

As a result of the QM rules, our bank no longer makes mortgage loans, as the costs and the risks are just too high. Make no mistake, the true cost is felt by my community. I used to make, on average, about two mortgage loans a month averaging $50,000 each. I would first urge the customer to find a lender that would get them a 30 year fixed note because it would be cheaper than the balloon note that I would provide them and hold in my portfolio. Many of these prospective borrowers could not qualify with other lenders and, frequently, I would be able to help them. Under the new regulations I cannot offer balloon notes and these same types of borrowers are being shut out of homeownership because of the Ability to Repay (ATR) rules. I am not the only bank in South Texas to exit the mortgage business. Another bank in my county has stopped as well as a community bank in an adjacent county. This is occurring in Texas and across the country. The real victims here are working class and middle class prospective homebuyers.

Bankers want to make safe, profitable mortgage loans. Denying mortgage loans to borrowers – otherwise considered creditworthy – goes against every sound business instinct a banker has.

Accordingly, we support H.R. 2673, the Portfolio Lending and Mortgage Access Act and H.R. 4521, the Community Institution Mortgage Relief Act of 2014. These bills would exempt any mortgage held on a bank's balance sheet from ATR requirements and exempt loans held by small creditors with less than $10 billion in assets from the escrow requirements imposed under DFA. No bank is going to hold the loan of a borrower it does not believe has the ability to repay that loan.

I would be remiss if I did not mention that there was at least one beneficial aspect of the law. My FDIC insurance premiums were cut in half and I am grateful for that. However, the increased compliance costs for traditional banks far outweigh any cost savings.

I. The Costs To Implement New Regulations Are Substantial, Weighing Most Heavily On Community Banks

Community banks, as do all banks, work hard every day to meet the credit and financial needs of their customers and communities. Community banks have a presence much greater than their

total assets suggests. According to FDIC's Community Banking Study released in December 2012, community banks accounted for just 14 percent of the U.S. banking assets in our nation, but held 46 percent of all the small loans to businesses and farms made by FDIC-insured institutions. In 629 U.S. counties—or almost one-fifth of all U.S. counties—the only banking offices are operated by community banks. Without community banks, many rural areas, small towns and urban neighborhoods would have little or no physical access to mainstream banking services.

The ability to meet local needs has not been easy with the increased regulatory costs and second-guessing by bank examiners. During the last decade, the regulatory burden for community banks has multiplied tenfold and it is no surprise that nearly 18 percent of community banks have disappeared in that period.

Unfortunately, the cumulative impact of years of new regulations and the proliferation of non-bank and non-taxed and subsidized competitors (such as credit unions and the Farm Credit System) are combining into a potent mixture that will surely, if left unchecked, lead to more and more consolidations of small banks.

Make no mistake about it, this burden is keenly felt by all banks, but particularly small banks that do not have as many resources to manage all the new regulations and the changes in existing ones. Besides the real hard dollar costs, there are important opportunity costs related to the products and services that cannot be offered or offered only at higher costs to our customers. In dramatic illustration of this point, a 2011 ABA survey of bank compliance officers found that compliance burdens have caused almost 45 percent of the banks to stop offering loan or deposit accounts. In addition, almost 43 percent of the banks decided to not launch a new product, delivery channel or enter a geographic market because of the expected compliance cost or risk.

Furthermore, research by the Federal Reserve over the years has confirmed that the burden of regulations falls disproportionately on smaller banks. The Federal Reserve Bank of Minneapolis has estimated that hiring one additional employee to respond to the increased regulatory requirements would reduce the return on assets by 23 basis points for the median bank with total assets of $50 million or less. To put this estimate in perspective, ***such a decline could cause about 13 percent of the banks of that size to go from being profitable to unprofitable.***

For the median-sized bank in this country with $173 million in assets and 40 employees, the burden is magnified tremendously. I was shocked to learn recently about a $70 million bank in Kansas that has three and a half FTE compliance employees out of a total of 23 employees. He was

particularly frustrated to have 15 percent of his staff dealing with government regulations that do nothing for lending in his small community. Besides internal audits, banks now have to have outside audits for compliance which is a significant expense for smaller banks. Then, the regulators spend time auditing the audits. Checkers checking checkers is a costly and wasteful exercise that provides no value-added for the safety and soundness of the bank and does nothing to protect the bank's customers.

II. The QM rule limits mortgage lending because the QM guidelines narrow lending parameters and impose high risks on those lending outside of these parameters

The mortgage market comprises a substantial portion of the GDP in our economy and touches the lives of nearly every American household. The new Ability to Repay (ATR) and Qualified Mortgage (QM) rule represent a fundamental change in the housing-finance market. It is critical that these rules make sense and do not end up hurting creditworthy Americans that want to own a home.

Unfortunately, the Ability to Repay/QM rule, however well intentioned, will end up restricting mortgage credit making it more difficult for our nation's community banks to serve a diverse and creditworthy population. Under the ATR rule, underwriters must consider a borrower's ability to repay a mortgage loan, despite having no binding guidance on how to determine ability to repay. Qualified Mortgages are designed to offer a "safe harbor" within which loans are assumed to meet the ATR requirement. However, the definition of QM—which covers only a segment of loan products and underwriting standards and serves only a segment of well qualified and relatively easy to document borrowers—could undermine the housing recovery and threaten the redevelopment of a sound mortgage market.

The problem is three-fold: First, the general non-QM segment is very unclear and compliance is uncertain. More pointedly, the heightened penalties and liabilities applicable in the Ability to Repay rule are tremendously burdensome. Given the legal and reputational risks imposed by this regulation, banks are not likely to venture outside the bounds of the QM safe harbors.

Second, the new rules create a narrowly defined box that consumers must fit in to qualify for a QM-covered loan. Since banks will make few, if any, loans that do not meet QM standards, many American families across the country that are creditworthy but do not fit inside the QM "box," will

be denied access to credit. In practice, this also likely means that less affluent communities may not be given the support they need to thrive. These rules may leave many communities largely underserved in the mortgage space.

Third, even if banks choose to make loans only inside the QM framework, they will still face a number of risks and uncertainties that create disincentives to lend. Some loans that fit within the QM framework are only partially covered by the protections offered by QM. These loans, specifically higher interest rate loans, still carry both higher credit risk and now, under QM's rebuttable presumption, liability risk, and as a result, banks will be hesitant to offer them. This means that banks will be limited to offering loans to only the best qualified borrowers. The end result of this will be limiting credit to credit-challenged communities or demographics. Thus, in practice, the QM box ironically may conflict with fair lending rules and goals of the Community Reinvestment Act.

Conclusion

In conclusion, I would ask this committee to look at the unintended consequences of the Dodd-Frank Act and make changes so that community banks can go back to what they have always been good at: Meeting the credit needs of their local borrowers and depositors. Unless major changes are made, compliance costs will continue to drive massive consolidation within our industry and limit the ability of our nation's community banks to drive main street growth across the country.

Steve Brown, AB, CIPS, CRS, GREEN
2014 President

Dale A. Stinton
Chief Executive Officer

GOVERNMENT AFFAIRS DIVISION
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Scott Reiter, Vice President
Jamie Gregory, Deputy Chief Lobbyist

July 23, 2014

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
2228 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
2221 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

As the Committee examines the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), I would like to thank you on behalf of the one million members of the National Association of REALTORS® (NAR) for passing H.R. 3211, the bipartisan "Mortgage Choice Act."

The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®.

H.R. 3211 and its Senate companion, S. 1577, is a bipartisan compromise that reduces discrimination against mortgage firms with affiliates in the calculation of fees and points in the Dodd-Frank Ability to Repay/Qualified Mortgage (QM) rule. The QM rule sets the standard for mortgages by providing significant compliance certainty to QM loans that do not have risky features and meet certain requirements. A key requirement is that points and fees for a QM may not exceed 3 percent of the loan amount. The problem arises from the fact that, under current law and rules, what constitutes a "fee" or a "point" varies greatly depending upon who is making the loan and what arrangements are made by consumers to obtain closing services. As a result of these definitions, many loan originators affiliated with other settlement service providers are not be able to make QM loans to a significant segment of otherwise qualified borrowers.

We are already seeing an impact in the market. Nearly half of respondents to a NAR survey of mortgage affiliates reported that they were unable to close mortgages due to the QM rule. For loans that did not qualify initially due to the 3 percent cap on fees and points, in fewer than half of the cases were lenders were able to gain compliance by reducing fees. Instead 21 percent of loans were simply not originated. In 19 percent of cases services were outsourced initially or at the last minute inconveniencing borrowers and possibly increasing their costs. In the rest either rates were raised or some other option found. Where services were outsourced to unaffiliated third parties and charges known to the lender, nearly half of loans (43.8 percent) reported higher fees as compared to those reporting the same fees (12.5 percent) or unknown fees (43.8 percent).

H.R. 3211/S. 1577 endeavors to restore a competitive market among lenders by clarifying and rationalizing the definition of fees and points to reduce this discrimination. By doing so, H.R. 3211/S. 1577 will ensure that consumers have greater access to mortgage credit and also more choices in credit providers. Without them, both choice and access is reduced, affecting many consumers and those who serve them. Therefore REALTORS® ask that you work with your Senate colleagues to enact this important legislation.

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

In addition to resolving the definition of fees and points in the QM rule, NAR also urges you to ensure that the regulators crafting the Qualified Residential Mortgage (QRM) rule end uncertainty and issue a rule that closely tracks the QM rule. Without this critical rule, there cannot truly be a fully functioning and transparent secondary mortgage market.

Thank you for your time and consideration. If you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

Steve Brown
2014 President, National Association of REALTORS®

cc: Members of The House Committee on Financial Services

IMPACT OF FEDERAL MORTGAGE RULES ON WEST VIRGINIA'S FAMILIES

Ability to Repay and Qualified Mortgage Legislation: Unintended Consequences

Effective January 10th 2014, banks were required to follow various underwriting rules designed to prove that a borrower is qualified for homeownership and has the ability to repay the mortgage debt. The Ability-To-Repay ("ATR") rules must be met by EVERY mortgage. Qualified Mortgage ("QM") rules are not required but provide a safe-harbor from litigation when followed.

[redacted] initial reaction to these rules was that they would **dramatically** restrict credit. For the reasons outlined below, that initial belief has **not** proven to be true. **However,** there have been a number of loans that City has not been able to make as a result of the legislation that would have meaningfully helped our customers, which we would have willingly made prior to enactment of the new legislation. Ten of these loans are described below. Inevitably, the impact has been on **customers that needed help the most**!

While credit has not been dramatically reduced, this is not to say the legislation has been useful. To the contrary, we believe that it is not useful – at least with respect to community banks such as ourselves. The Legislation requires us to jump through many additional hoops prior to originating a loan. These additional steps are very expensive, and the cost of the additional processes have been passed on to the consumer so that credit is now more expensive to obtain. To further add insult to injury, the additional processes that are required have done nothing to improve the lending process from the customer's perspective, or to increase the quality of the loan from the perspective of the financial system. Banks like ours were **already** doing those things necessary to underwrite strong credits as efficiently as possible. What guaranteed that we were doing this correctly – was that the loans were going on our books – and the risk was ours to bear. The legislation should have exempted any loans that remained on the books of the originating bank. Primarily, the problem loans that legislators targeted were loans originated and later sold, with no financial repercussion to the banks that originated the loans.

Our bank originates **NO** loans to customers that are **not** "qualified mortgages" when the customer is in the process of buying a new home (purchase transactions). This does represent a change for us – in the past we did make a few new-purchase loans that today would not be "qualified mortgages." Inevitably, these customers who do not receive the credit are in the most difficult financial circumstances. But, the number of loans that we no longer make is less than 1% of our origination volume.

Our bank makes **MANY** loans secured by a mortgage lien to customers that ALREADY own their home. These situations present themselves in a variety of circumstances. Sometimes they are refinancing the home entirely. Sometimes they are taking out a mortgage on a home they own free and clear in order to finance improvements. Sometimes they are taking a second lien. With respect to these "non-purchase" mortgage loans, we have decided that we **will** make loans that **do not** meet all the "qualified mortgage" requirements. Because of the enormous administrative expenses associated with being a "qualified" mortgage, we determined we either had to make non-qualified mortgages or we would have to increase the costs to our customers to a point that was unacceptable. Rest assured, we still carefully document the mortgage loan in the same manner that we have always done - and we have had very good experience in terms of low loan losses. Let me give an example of the burdensome processes required to be a "qualified mortgage". In order to be a "qualified" mortgage – the lender must confirm the borrower's employment during the loan approval process (which we already did) and **then**, the lender must **again** confirm the borrower's employment prior to closing (which we do **not** do). This additional step insures that the borrower hasn't lost his job between application and closing. The additional confirmation is time consuming and expensive, and, in our opinion, not very useful. (In our opinion, a customer that has lost his job after application but prior to closing has a duty to inform us that he no longer is employed – and would find litigating under the premise he couldn't afford the mortgage and we shouldn't have made it – a difficult case to win if he didn't communicate with us concerning his lost employment.) There are MANY similar steps that are required to be a "qualified mortgage".

And, while we do **not** perform all of the verifications and procedural steps now specified to be a "qualified mortgage" - we have nevertheless tightened our credit approval process as recommended in the legislation to generally only approve mortgages where the customer's total debt payments represent less than 43% of their income. In general,

by the way, we believe that the 43% threshold is a reasonable one. In our experience, most customers with loan payments in excess of 43% of their income would struggle to handle that level of debt. As a result, historically, we generally wouldn't approve loans with high debt-to-income ratios. But – we did approve some! Which is the beauty of allowing profit-seeking businesses to make rational decisions based upon their own self interest. We highlight 10 examples below of customers where our bank would have been willing to extend credit to the customer, but we did not based on our conclusion that the loan was not a "qualified mortgage" and therefore by legislative pronouncement – subject to adverse litigation risk.

Some specific examples how the new ATR/QM rules have had a negative impact on WV consumers:

1) A borrower with a high income made a prudent decision to retire debt as quickly as possible and consolidate debts with a 10 yr. fixed rate equity loan. Shortly after closing the loan the borrower experienced a significant illness and took time off of work causing their income to be reduced. The borrower then liquidated various investment accounts and 401K assets to cover their living expenses and debts until they were able to return to work in the medical field. With his financial assets significantly depleted, he approached the bank about his situation. The obvious request was to restructure the mortgage with a more traditional, and longer, repayment schedule. But, since the borrower isn't working, he does not meet debt ratio requirements. ATR rules do not allow for an exemption when refinancing a "standard" mortgage which prevents us from assisting this borrower with a new loan with terms more accommodating to their needs. So, a customer that behaved very prudently, and conservatively, and then experienced an unexpected turn of events becomes a victim of the new mortgage rules. SOLUTION: Either a) exclude loans held in the bank's portfolio from QM, or b) exclude loans that were pre-existing from being re-written in mutually agreeable ways.

2) A husband and wife had both a mortgage and a home equity line of credit ("HELOC") with our bank. The wife was hit by a drunk driver and was disabled due to her injuries. Subsequently, the husband suffered an illness and died. The combination of these events impacted their income as well as their credit. The wife now receives disability and SSI income and wanted to consolidate her mortgage debt. And it is in her best interest, and the bank's best interest to do this. But, she can't pass the ATR tests, primarily due to credit issues caused by her injuries and the death of her husband. Prior to ATR we would have made this loan and helped the customer meet her borrowing need–at the same time reducing the bank's risk by providing a more affordable payment. Another victim of the new mortgage rules. SOLUTION: Either a) exclude loans held in the bank's portfolio from QM, or b) exclude loans that were pre-existing from being re-written in mutually agreeable ways.

3) Early in 2014 we approved a married couple for a $15,000 HELOC representing a 30% loan to value ("LTV"). After they closed on their HELOC; they applied for a Home Equity fixed-rate loan to pay off their existing 1st mortgage at a competitor. The new loan would have reduced their term by 1 year and reduced their payment by $20 per month (paying off their debt quicker and at a lower rate which would have saved them money). However the debt ratio was close to 50%. Both borrowers were on social security. They disclosed additional income on their W2; however, the additional income came from a self employed house cleaning service, and the source had changed frequently; thus, it could not be documented to be compliant with ATR requirements. Because the couple had demonstrated the ability to make their existing payments, and the proposed structure would have actually improved their situation, our bank would have made this loan prior to enactment of the legislation. It is worth noting, that while the couple has been able to service this debt, under the new mortgage rules it is unlikely that they would have ever been able to purchase a house in the first place. SOLUTION: Exclude loans held in the bank's portfolio from QM.

4) An applicant with good credit applied for a $5,000 home equity loan. The applicant had owned their home for 17 years, had been employed as a teacher for 15 years, and had demonstrated an ability to pay their property taxes and insurance for at least 17 years. ATR required tax and insurance expenses to be added into the debt ratio calculation which made their debt ratio over 43% and prevented the loan from being approved. SOLUTION: Exclude loans held in the bank's portfolio from QM.

5) Joint applicants with good credit, who had owned their home for 35 years, applied to refinance the balance of their existing adjustable rate mortgage ("ARM") loan. The credit report indicated a satisfactory pay history since 1986. Their debt ratio exceeded 43% when their existing ARM loan was originally made and they have had a history of supporting a debt ratio of 43% or higher since 2006. The refinance would have made their debt ratio 47% and their loan was not approved. Prior to the legislation, the bank would have made this loan based upon the borrower's demonstrated ability to service the existing debt and the fact that the refinancing terms would have lowered the customers payment. SOLUTION: Allow profit-seeking businesses to make rational decisions regarding loans without classifying those loans as "non qualified" and thus subject to likely litigation if they fail to perform.

6) A retired applicant applied for a ARM equity loan to consolidate two existing retail loans currently both outstanding at our bank. The LTV was low and the credit was good. The debt ratio was high (above 43%). When the borrower was asked if there was any other income, they offered to include the spouse who had additional income that could be considered. On review of the additional applicant's credit as required by ATR, they had exhibited an inability to repay on two credits and struggled with two other credits before paying off. Prior to the implementation of ATR this request would have passed our underwriting standards due to the original applicant's credit rating, low LTV and low combined income debt ratio. The legal risk was determined to be too great due to the joint applicant's credit history. SOLUTION: Either a) exclude loans held in the bank's portfolio from QM, or b) exclude loans that were pre-existing from being re-written in mutually agreeable ways.

7) Joint applicants applied to refinance their existing first lien mortgage with an ATR-applicable loan. They had successfully repaid their mortgage with no late payments since 1987. The request included cash out for home improvement purposes which caused their debt ratio to be over 50%. There were no other compensation factors and the legal risk was considered too great to make an exception and approve the loan. SOLUTION: Either a) exclude loans held in the bank's portfolio from QM, or b) exclude loans that were pre-existing from being re-written in mutually agreeable ways.

8) Joint applicants who owned their home for 25 years with a good pay history applied to refinance their existing 1st lien and 2nd lien loans with additional cash out. Their debt ratio exceeded 43%. There were no other compensating factors and the legal risk was considered too great to approve the loan. SOLUTION: Either a) exclude loans held in the bank's portfolio from QM, or b) exclude loans that were pre-existing from being re-written in mutually agreeable ways.

9) An individual applied to refinance his 1st mortgage debt and lower his payment at a lower interest rate. He shared a residence with his brother who was recently deceased and who was the legal owner of the residence. The home was left to the surviving brother who applied to refinance the existing mortgage debt in order to keep the residence. His debt ratio was greater than 43% and the legal risk was considered too great to approve the loan. SOLUTION: Either a) exclude loans held in the bank's portfolio from QM, or b) exclude loans that were pre-existing from being re-written in mutually agreeable ways.

10) An applicant who had owned his home for 45 years with a history of some slow payments (not always made on time) applied for an ATR-applicable loan to consolidate his mortgage debt and credit card debt. Prior to ATR we would mitigated the slow payments with other compensating factors but in this case the slow pay on the existing mortgage can be interpreted as an inability to repay. It was determined the legal risk was considered too great to approve the loan. SOLUTION: Exclude loans held in the bank's portfolio from QM.

July 23, 2014

Statement for the Record:
For the Hearing entitled, "Assessing the Impact of the Dodd-Frank Act Four Years Later"

How Dodd-Frank Misses the Mark and Fails to Put $3 Trillion of Collateral to Work to Spur Lending and Create Jobs

Chairman Hensarling, Ranking Member Waters, and Members of the Committee:

M•CAM®[1] (Mosaic Collateral Asset Management) is a global financial institution that advises corporations and investors on corporate finance and asset allocation by underwriting intellectual property (IP) and intangible assets (IA). From its roots in providing financial products enabling lenders to use IP and IA as regulatory acceptable collateral for lending, M•CAM®'s capital solutions address the financial needs of businesses and investors in the Knowledge Economy.

M•CAM® has been providing capital markets solutions to financial, sovereign, and corporate institutions since its inception in 1998. In addition to our commercial use across the global equity and debt markets, our platform has placed us as an advisor to help to set regulatory, audit, compliance and risk standards for intangible assets both domestically and internationally.

Our advanced collateral underwriting systems allow us to measure and quantify the market consequence, commercial fitness, and obsolescence risk of intangible assets such as executory contracts, patents, trademarks, copyrights, exploration contracts, development rights, licenses, permits, long-term supply contracts and other intangible assets.

I. Capital Flow in the Knowledge Economy

Market pricing incentives for stimulating the development of new enterprises, products and services is a feature common to economic history. From the insignia of guilds to the trademarks of Japanese merchants to the conductive coatings for flexible semiconductors, conveying attributed value, quality assurance and price controls has been linked to intangible rights for thousands of years. In recognition of the societal value of rewarding the originator of innovation, numerous anti-competitive rights have

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been established. The ability to transfer, assign, or license these rights has also been an essential utility in the flow of capital.

While many think of intangible assets as a modern contrivance due to the popularity of the subject in the press, we are no more focused on them now then a century ago. Edison and Westinghouse locked horns in intractable conflict over the innovation rights to the use and distribution of electricity. J.P. Morgan and his International Mercantile Marine Co. were the ultimate beneficiaries of intellectual property rights conveyed in the bank liquidation of the liens on the White Star Line by the Royal Bank of Liverpool in 1868 - innovations which powered the ships that transported the Pacific gold rushes of Australia and the Yukon. The Allies secured German patents and innovations as reparations of war covering chemical dyes, materials sciences, and magnetic tape - the basis for the computer age. From plows to sewing machines to nanotechnology, the importance of technical innovation assets have been constant. These assets share a common attribute. They allow the holder of rights to control the profit margin on goods or services for a period of time thereby securing economic benefit and delaying competitive forces which would force commodity dynamics.

Financing intangible asset rich enterprises has involved a variety of interventions. In 1942, the United States Congress passed the Smaller War Plants Corporation Act which heralded the modern economic focus on what is called "small business" today. Combining bank loan guarantees and procurement preference incentives, this program set in motion a national effort that has sought to provide efficient credit access to enterprises that lack sufficient property and tangible collateral. These two interventions (credit guarantees and procurement preference) remain as integral financing mechanisms for small, innovative companies now defined under the U.S. Small Business Administration, the European Small Business Act, and their international equivalents. These historical market manipulations introduced two unfortunate misconceptions. First, that innovation and intangible assets were uniquely the domain of "small business" to which banks could not lend due to collateral inadequacy. Second, that government sanctioned market controls (intangible assets) required government-funded capital concessions for financing or growth.

These two misconceptions have fueled seven decades of increasingly inefficient interventions which have driven the cost of capital up (venture capital) and increased the economic incentive for business failure (tax-loss harvesting). Additionally, until the last decade, little credible attention was paid towards understanding intangibles for their true market effect - namely, the marginal control of cash-flows. Rather, accounting and market treatment of these were largely focused on ephemeral considerations of "goodwill". To date, bank regulators still overlook trillions of dollars of fungible cash-flowing assets pledged in borrower liens while protesting the value of bank owned intangibles.

Realizing that the majority of assets supporting global businesses are intangible assets, traditional cash, tangible asset, and credit-based risk rating leaves considerable risk

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exposure unquantified in today's market.[2] This leads to unnecessary volatility. While no accounting standard setting body in the world has been able to establish financial disclosure guidance generally applicable to intangible properties and their derivative risks or benefits (outside of limited guidance for business combinations and impairment), the European Commission and Parliament have concluded that the International Accounting Standards 36 and 38 "meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management."[3]

Recognizing that the Global Financial Crisis of 2007-2008 was exacerbated by abuse of non-transferrable tangible collateral in banking, the banking industry is becoming acutely aware of the importance of understanding collateral. Without any capacity to confirm transferrable rights in intangible assets, despite their accepted importance in the management of enterprise profits and resulting credit quality, banks and their regulators have ignored the chief assets of our current economy to the detriment of industry and the global economy.

Dodd-Frank did nothing to address this issue. In fact, it failed to address the concept entirely. Over $3 Trillion of privately held collateral could have been, and still could be, used to stabilize the banking system and kick-start productive lending. Rather than build unnecessary regulation through Dodd-Frank, it would be prudent to use the rules and assets already in place to stabilize and grow the banking sector. In addition, using this mechanism to expand credit would demand far less quantitative easing.

As stated in "Failing to End 'Too Big to Fail:' An Assessment of the Dodd-Frank Act Four Years Later," we agree that FSOC and OFR are unable to identify every instance of systemic risk. Even worse, these entities are constructed to explicitly ignore risks and benefits from one of the largest and fastest growing asset classes. Redundant regulatory bodies will not solve a problem that previous redundancies failed to address. The pre-Dodd-Frank bodies and regulation could effectively address the adverse effects of excessive risk loading so long as oversight is employed to identify, manage, and appropriately account for the collateral which is being overlooked. While appropriate oversight of collateral can have stabilizing effects, Dodd-Frank does not effectively address the run away, non-collateral backed derivatives which caused TBTF issues. As best stated by Greg Gonzales of the Conference of State Bank Supervisors in the November 29, 2012 House FSC hearing, "Bringing awareness to the importance of liquid

[2] Speech by Alan Greenspan, Chairman, U.S. Federal Reserve, Stanford Institute for Economic Policy Research Economic Summit, Stanford, California, February 27, 2004.
2 cont. "It is, thus, no surprise that, as a result of the increasing conceptualization of our GDP over the decades, the protection of intellectual property has become an important element in the ongoing deliberations of both economists and jurists." "If our objective is to maximize economic growth, are we striking the right balance in our protection of intellectual property rights? Are the protections sufficiently broad to encourage innovation but not so broad as to shut down follow-on innovation? Are such protections so vague that they produce uncertainties that raise risk premiums and the cost of capital? How appropriate is our current system--developed for a world in which physical assets predominated--for an economy in which value increasingly is embodied in ideas rather than tangible capital?"

[3] European Financial Reporting Advisory Group (EFRAG), June 4, 2004.

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collateral in banking would do more to address systemic risk issues. Most of traditional banking follows the fundamentals: character, repayment ability, and collateral protection. If we want to effectuate change, it should be focused on risk management and consistent with how the bank operates[4]."

II. Summary, Background, and History: Structure and Underwriting Process and What We Are Doing to Address the Issue

Within every senior secured credit facility, a General Intangibles Lien secures all intangible assets into the collateral pool for the benefit of the creditor. Historically structured to enable a bankruptcy trustee to transfer operating businesses, this lien embraces patents, copyrights, trademarks, licenses and many contractual rights, but *provides no monetary or risk amelioration value* within credit risk metrics. During the industrial economy when companies owned physical real estate, raw materials and inventory, these assets were seen as ancillary. However today, these assets represent the ***majority of enterprise value yet are precluded from being used by our banking system in any fashion***.

In partnership with U.S. and European regulators and the U.S. Small Business Administration, M·CAM® developed a collateral enhancement – an insurance product that guarantees a purchase of intangible assets in the event of foreclosure – for small business lending. This inaugural product was structured with counterparty risk supported by SwissRe. Built as a loan origination product, M·CAM®'s program provided commercial loans to credit-worthy, tangible collateral deficient borrowers. This private sector solution required ***no government appropriation and no legislative reform***. It provided a bank an already accepted property and casualty insurance product which guaranteed the purchase of borrower intangible assets in the event of foreclosure at a predetermined price. Upon exercise, the bank would simply credit-bid the liened assets, put those assets to the insurer, be paid the insured amount in cash, and transfer the salvage rights to the insurer.

- Marketable assets supporting Collateral security on a loan is preferable to a loan made with no security.

- Collateral positions serve their intended purpose as secondary means of repayment only if liens on the collateral are perfected.

- Marketable, cash-flowing assets in pledged collateral decreases the overall riskiness of a loan.

- Virtually all senior secured bank loans include a blanket "General Intangibles" lien on all of the intangible assets of a borrower at the time the loan is made. Commercial and Industrial (C&I) loans in particular encumber a significant number of intangible assets. Intangible Assets (e.g., anything covered under a

[4] http://financialservices.house.gov/uploadedfiles/hhrg-112-ba15-ba04-wstate-ggonzales-20121129.pdf

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UCC Article 9 definition of an "intangible asset") generally include executory contracts, permits, licenses, patents, trademarks, copyrights, and essentially any exclusive government-issued right. Banks currently have no pathway with which to receive regulatory capital credit or risk-weighted asset calculation credit for the intangible asset collateral that they hold in the General Intangibles Lien.

- Intangibles Assets are subject to lien assignment under U.C.C. Article 9 and are used in Bankruptcy U.C.C. § 9-501 (1) & 11 U.S.C. Specific laws governing the assignment and transferability of intangible assets including: (Patents) 35 U.S.C. § 261; (Copyrights) 17 U.S.C.; (Trademarks) 15 U.S.C.; and (Contracts) U.C.C. §9-102 liens, are already in place.

- To be clear, a General Intangibles lien is a lien taken against borrower intangible assets. General Intangibles liens are essentially ubiquitous in C&I lending.

- Our definition of intangible assets in this proposal excludes goodwill in all cases and refers specifically to the intangible assets of the borrower, not those of the bank lender.

- Bank intangibles also include items such as the "Brand" of a bank. These assets, as well as goodwill, MSAs and DTLs are all specifically separate from borrower intangibles encumbered in General Intangibles liens. Our definition of intangible assets does not include the bank's own intangibles, including the bank's brand, goodwill, MSAs, or DTLs. Instead, our definition of intangible assets only refers to borrower intangible assets held in 'General Intangibles liens'.

- In current practice, no bank lender is given any monetary value, risk amelioration, or credit by their respective regulators for the intrinsic value of the borrowers' intangible assets encumbered by a General Intangibles lien. However, in many distressed credit situations, intangibles (held in that lien) act as the primary assets sold in recovery. For example, when Nortel entered bankruptcy, it recovered USD $4.5 billion from the sale of its patents, representing over 85% of the entire recovery from the estate.[5]

- Prior to the bankruptcy, neither Nortel's lender, nor Nortel itself, received any regulatory credit for what proved to be over 85% of the final recovery from the bankrupt estate due to the sale of the liened collateral assets. The Federal Reserve itself identified the "... exclusion of more than $3 trillion of business intangibles..." in a 2006 study and has done nothing to include cash-flowing, transferable assets in this class in bank oversight or stress testing.[6] In addition,

[5] http://www.reuters.com/article/2011/07/11/us-nortel-patents-idUSTRE76A51Y20110711
[6] Corrado, Carol, Charles Hulten and Daniel Sichel, "Intangible Capital and Economic Growth (2006)." *Finance and Economic Discussion Series,* Division of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington DC, 2006-24: http://www.federalreserve.gov/Pubs/feds/2006/200624/200624pap.pdf

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this $3 trillion of business intangibles is in addition to the intangibles 'captured' in General Intangibles Liens.

- Therefore, significant latent value is "trapped" within the liened collateral of banks' C&I loan portfolios. The collateral is currently fully impaired but not currently accorded tier 1 capital treatment nor used to reduce the risk-weighted asset calculation of banks.

- Intangible assets represent more than 78% of the S&P 500's value (PriceWaterhouseCoopers)[7]. Recent example - Google's $12.5 billion purchase[8] of Motorola's patent portfolio.

III. Background of the Certified Asset Purchase Price™ (CAPP™):

In its initial iteration, the Certified Asset Purchase Price™ program or CAPP™ was launched in December of 1999 and featured in the Winter 2000 Region Focus publication by the Richmond Federal Reserve[9]. In collaboration with the Small Business Administration (SBA), Richmond Federal Reserve, Federal Deposit Insurance Corporation (FDIC) and Bank of America, M·CAM® formed a collateral enhancement program. Using the significant latent value "trapped" within the liened collateral of banks' loans, M·CAM® offered purchase agreements (fully backed by reinsurance provider Swiss Re) for the intangible collateral held in these liens. The collateral was fully impaired but not afforded any regulatory capital treatment by the banks. In 2008, M·CAM® was approached by Treasury to investigate if it was possible to expand this program to a money center banking scale. M·CAM® developed a process to underwrite the large portfolios of borrower intangible assets held in General Intangibles Liens. M·CAM® then entered a significant reinsurance due diligence process to confirm the efficacy of this risk-transfer product at the money center scale.

The following is a description of the CAPP™ structure and the process for how a CAPP™ would be executed:

- The bank selects a pool of performing, under-collateralized senior secured loans. In our terminology, these loans are under-collateralized from a traditional GAPP view. However, these loans are receiving no credit for any of intangible assets held by the borrower but liened by the lender.

- In each of these loans, the General Intangibles lien will be detected. To reiterate, nearly every senior secured bank loan has a blanket lien over all the

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[7] BusinessWire. Intellectual Assets Account for 78 Percent of Total Value of S&P 500, PricewaterhouseCoopers Analysis Finds. April 17, 2000.
[8] http://money.cnn.com/2012/05/22/technology/google-motorola/index.htm
[9] http://www.m-cam.com/downloads/10012000.PDF

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intangible assets (e.g., anything covered under a UCC Article 9 definition of an "intangible asset") of a borrower.

- M·CAM® and its risk transfer partners in the regulated insurance and reinsurance sectors will then identify and underwrite the intangible assets taken as collateral within the identified loans. Upon completion, M·CAM® will determine the price it would be willing to pay the bank (on any given date over an agreed upon period of time) to purchase the intangible assets should the bank come into control and ownership of the identified assets through the foreclosure process.

- M·CAM® will then issue an irrevocable, springing forward purchase contract (essentially a "put" contract) to the bank lender for specified intangible assets. The purchase price will always be the lesser of: 1) the time–adjusted amount identified in the put contract as a result of underwriting and 2) the outstanding loan balance. This amount is known as the Asset Liquidation Value (ALV).

- The put contract obligation will be defeased through a combination of insurance capacity and cash, as required by the applicable regulator.

- The insurance is paid on a "credit bid" bank sale of foreclosed collateral at the time of foreclosure and the insurer acquires the salvage value of the collateral.

IV. Overview of the CAPP™ underwriting process

- M•CAM®'s underwriting standards involve several layers of austerity to arrive at an Asset Liquidation Value (ALV). To begin, M•CAM® requires a minimum of three (3) identifiable and confirmable exit strategies ("Industry Comparable Values (ICV)") based on actual cash-flow transactions in the form of: an asset sale, an M&A transaction, R&D, a license or any other form of a cash transaction related specifically to the intangible asset(s) being underwritten.
  - One of these ICV's must be orthogonal to the primary sector in which the borrower currently deploys the intangible asset.

- Upon manually confirming the appropriateness and validity of the ICV, based on both the nature of the identified transaction (e.g., M&A, R&D, License) and the corporate finance activity within the sector, a haircut of 30-90% is applied to each of the pathways.

- The amount of the put contract is then tied to a depreciation curve dependant on the obsolescence/innovation cycle of the intangible asset.

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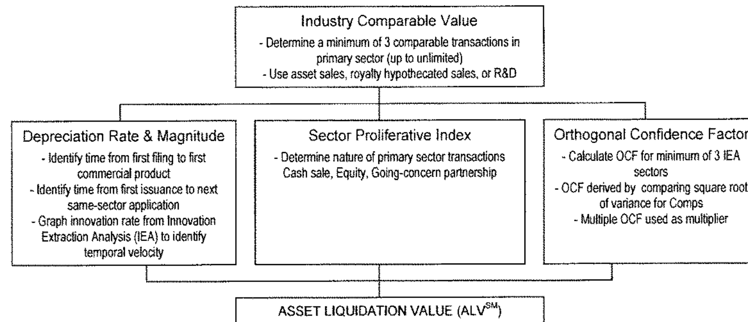
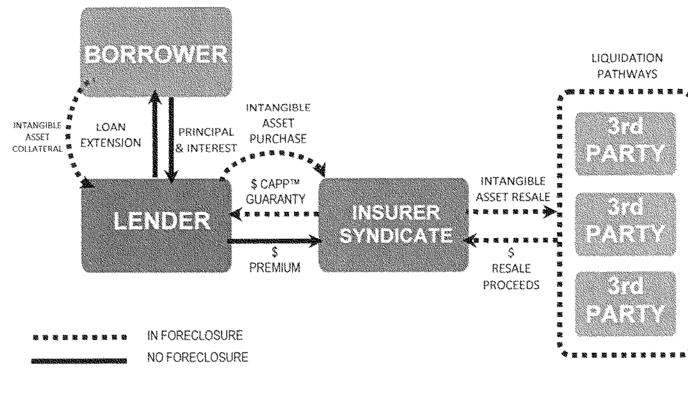
Figure 1: Critical M·CAM® CAPP™ Underwriting Factors



M·CAM® has reviewed a portfolio of USD $128 billion in senior secured C & I loans syndicated by a group of the largest U.S. and European money center banks. That review has produced a total of USD $28 billion in cash-flow associated, underwritable intangible assets, which control actual multiple (more than three distinct market revenue sources) cash-flows and possess full transferability.

Figure 2. Schematic flow chart of the CAPP™ collateral enhancement structure

ENHANCEMENT STRUCTURE



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Examples: Corporate finance – the innovative use of intangibles as security

Ensuring a healthy rate of new-firm creation, growth, and where necessary demise, is a widespread policy concern. Many of the most promising companies of all sizes today depend on intangible assets. It has been claimed that such firms face obstacles in obtaining bank credit, owing to difficulties in posting intangible assets as collateral. It has also been asserted that intangibles-based firms will experience difficulties in obtaining equity finance, in part because accounting conventions fail to recognize certain internally generated intangibles as assets.[10] However, while far from a mature phenomenon, many innovations have occurred in recent years in intangibles-based lending and equity investment. For instance:

- Royalty financing arrangements, particularly in the pharmaceuticals and biotechnology sectors, are increasingly used as sources of securitization. Such deals take a variety of forms. Some use existing royalty streams (for instance, so-called "Bowie Bonds" were issued in 1997, backed by the stream of royalty payments generated by the catalogue of David Bowie's music).
- In 1999, Citizens & Farmers Bank in Virginia issued the first M•CAM® insured intangible asset collateralized loan to the manufacturer of specialty infant formula bottle liners. This transaction set the precedent for a program that offered intangible asset collateral insurance through a partnership between Bank of America, SwissRe, and M•CAM®.[11]
- In June, 2004, the General Electric Corporation paid Motorola $50 million for certain patents and royalty payments arising from Motorola's patents licensed to the MPEG-LA. This transaction included patent underwriting by M•CAM®.
- Investment banks and boutique private equity (PE) firms have also raised and invested funds targeted on intangible assets and intellectual property.

Final Summary:

1. No new documentation or approval from a borrower is needed.

   NOTE: Lenders already have broad UCC Article 9-defined intangible assets (e.g., patents, trademarks, executory contracts, and so forth) encumbered within their seasoned loan pools through the "General Intangibles" lien or specific liens on explicitly identified intangibles. This collateral currently receives no regulatory credit.

[10] However, it is evident that not all firms intensive in the use of intangibles face binding constraints in access to equity finance. Companies such as Cisco Systems, Microsoft and Google possess relatively little tangible capital (at the start of 2009, physical assets accounted for only about 5% of Google's worth) and have nevertheless managed to prosper. Indeed, some analysts argue that capital markets function well in financing innovative, knowledge-based firms (see Skinner, 2007).

[11] http://www.m-cam.com/downloads/Wall_Street_Journal.pdf

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2. The Certified Asset Purchase Price™ (CAPP™) contract and its accompanying insurance instrument is new collateral added to the borrower's security.

   NOTE: We are not asking regulators to accept intangible assets as regulatory accepted collateral. We are asking them to accept regulated, creditworthy risk-transfer counterparties for banks just as the Federal Reserve Board already does with other risk transfer products.

3. The CAPP™ contract represents a creditworthy (counterparties are rated 'A' or better) and a committed, irrevocable purchase offer in the event of foreclosure and the lender credit-bidding the assets from the bankrupt estate.

Figure 3: Exemplary CAPP™ Transaction

	Loan Day 0	Loan Day X (Event)	Notes
Loan Outstanding	$500M	$500M	
Building	$500M	$250M	Building Loses Value - Collateral Decrease
IP	$0	$0	Intellectual Properties Still Recorded at $0
Insurance	N/A	$250M	CAPP™ - Adds New Highly Rated Collateral

4. The Fed itself estimates intangible assets to be worth more than US $3+ trillion

   NOTE: A recent example of a liquid and fungible transaction is Nortel at approximately $4.5 billion (representing more than 85% of the bankruptcy recovery).

We hope this overview and the supporting documents will facilitate your deliberations. As always, if you should need any additional guidance or if you have any additional comments, questions, or requests, please do not hesitate to reach out to M·CAM®

Sincerely,

Kenneth Dabkowski, M•CAM®

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MARKETS

Wall Street Adapts to New Regulatory Regime

Big Banks Shed Assets, Shore Up Defenses to Comply With Dodd-Frank

By VICTORIA MCGRANE And JULIE STEINBERG

July 21, 2014 10:04 a.m. ET

Regulators point to the changes at Wall Street's big banks since the Dodd-Frank law was signed as evidence their efforts to suck risk out of the financial system are working. *Bloomberg News*

Four years after the Dodd-Frank financial law became reality, Washington's regulatory machine is altering Wall Street in fundamental ways.

Banks are selling off profitable business lines, pulling back from the short-term funding market, cutting ties with businesses that could attract extra regulatory scrutiny, and building up defenses to help weather future crises. While profits are up as firms slash costs and reduce funds set aside to cover future losses, their traditional profit engine—trading—is showing signs of weakening as banks step away from some activity amid regulatory pressure.

Dodd-Frank : **Four Years On**

Five Ways Dodd-Frank Is Reshaping Wall Street
Barney Frank to Testify on Dodd-Frank
House Republicans Take Aim at Dodd-Frank
Law Still Not Finished

Last week, Goldman Sachs Group Inc. announced it trimmed $56 billion, or roughly 6%, from its balance sheet during the second quarter, the sharpest quarter-over-quarter reduction since the depths of the financial crisis. Chief Financial Officer Harvey Schwartz described it as Goldman moving "proactively to comply with regulatory developments," including the Federal Reserve's annual "stress test" process in which banks must prove they can weather tough economic times.

Morgan Stanley has cut assets by one-third since the 2008 crisis, downsized its fixed-income trading operation and increasingly focused on wealth management, where firms collect fees from retail investors rather than put

their balance sheets at risk by investing, lending and making trades. Citigroup Inc. has shed nearly $700 billion in noncore assets, including the sale of more than 60 businesses and recently said it would sell its consumer businesses in Spain and Greece.

Bank of America Corp. has shed more than $70 billion worth of businesses and other assets since 2010, including those requiring the bank hold a lot of capital against them. It has also eliminated 746 legal entities—a 36% reduction since the end of 2009. Among the assets jettisoned: private-equity investments, some credit-card businesses and big chunks of its mortgage business.

Dodd-Frank | A work in progress

Completed SEC rules

Systemic risk	**Private-fund regulation**	**Clearing, settlement**	**Municipal advisers**
Volcker rule prohibition on banks making risky bets with own money	SEC registration for advisers to hedge funds and private-equity funds	Risk standards for market middlemen	Oversight for advisers to states and localities that raise cash in municipal-bond market

SEC rules in progress

Asset-backed securities	**Derivatives**	**Credit-rating firms**	**Corporate governance**
Greater transparency of loan-level data	Capital, margin and other rules for portion of swaps market overseen by SEC	Stricter controls to ensure firms adhere to ratings standards	Enhanced compensation disclosures for public-company chief executives

Other key provisions

Made final	**Unfinished language**	**Stalled by courts**	**Accomplished by act**
CFTC rules for trading and clearing of derivatives; creation of council to spot systemic risks; heightened standards for mortgage lenders	Provisions to make sellers of mortgage-backed securities keep 5% of credit risk; move banks' swap-trading activity; risk rules for nonbank financial firms	Provisions that limit speculative positions in commodities; new rules on debit-card fees; ease ousting of corporate directors	Provisions that give oversight of thrifts to the Office of the Comptroller of the Currency and restrict emergency lending by the Federal Reserve

The Wall Street Journal

"Dodd-Frank certainly catalyzed substantial amounts of simplification, and we're moving well beyond that through our own initiatives," said James Mahoney, a Bank of America spokesman.

The new regulatory regime is also prompting banks to add thousands of staffers to help ensure compliance. By the end of this year, J.P. Morgan Chase & Co. expects to have added 13,000 employees focused on regulatory, compliance and control efforts, Chief Executive Officer James Dimon said in his annual shareholder letter. John Gerspach, Citigroup's chief financial officer, told investors last week the company will likely end the year with 30,000 people dedicated to regulatory and compliance efforts, a 33% increase from 2011, even as Citigroup cuts its overall headcount.

Bank regulators point to the changes on Wall Street as evidence their efforts to suck risk out of the financial system are working. "Really we're in a substantially different place, and a much improved place," said Thomas Curry, comptroller of the currency.

But the banks' efforts are not enough to damp worries among some policymakers and lawmakers that the broader economy remains vulnerable to the potential collapse of a large, interconnected financial firm. Banks' are getting hungrier for risk as they try to compensate for sluggish economic growth, ultra-low interest rates and higher regulatory costs though appetites remain subdued compared to pre-crisis levels.

U.S. leveraged syndicated lending totaled $1.244 trillion in deal volume in 2013, up from $893 million in 2012 and surpassing the 2007 peak of $1.191 trillion, according to data from Dealogic. Banks provide the vast majority of the leveraged loans to fund buyouts.

President Barack Obama earlier this month stoked the debate, saying policy makers need to consider additional changes to ensure "we have a banking system that is doing what it is supposed to be doing to grow the real economy, but not a situation in which we continue to see a lot of these banks take big risks." Mr. Obama made the remarks during a radio interview, suggesting "restructuring the banks themselves" as a possible change.

Lawmakers from both parties remain convinced more drastic measures are needed to end the problem of "too big to fail," or banks so large and interconnected that the government would need to bail them out or risk crashing the broader financial system. Legislative proposals endorsed by members of both parties include breaking up megabanks, raising capital requirements beyond the higher levels embraced by regulators and imposing a tax on the biggest financial firms.

"It's definitely changed but not enough," said Sen. Elizabeth Warren (D., Mass.), who has written a bill to reinstate Depression-era laws separating commercial- and investment-banking activities. Big banks have successfully lobbied to weaken some of the Dodd-Frank rules and loaded up on new risks that aren't appropriate for banks backstopped by taxpayers, she said, adding, "They pose a very real threat to the economy."

Wall Street analysts and bankers say Washington risks layering on too many additional rules, which could force banks to back away from key activities like lending that help fuel economic growth.

"It's almost hypocritical to complain about banks not facilitating more growth while at the same time saying banks have to further de-risk," said CLSA bank analyst Mike Mayo. "One way for banks to have no losses is to make no loans."

Among the top 25 U.S. commercial banks, lending was up nearly 2% in June from a year earlier, according to an SNL Financial analysis of Fed data.

Already, big banks are backing away from participating in one of Wall Street's primary funding engines—the repurchase, or "repo," market where banks and investors swap securities for trillions of dollars in short-term loans. Among the reasons: A new leverage ratio that requires big banks to hold extra capital against all assets on their books—not just those deemed risky—making it harder to turn a profit in what was a low-margin, high-volume business before the crisis, bankers and analysts say. Goldman analysts estimate the repo market shrank by $350 billion, or 7%, just after regulators floated the new leverage rule last July, and has continued to decline since.

Global revenue from trading in fixed income, currencies and commodities at the 28 largest banks fell to $112 billion last year, down 16% from a year earlier and 23% from 2010, according to Boston Consulting Group. While the drop is partly driven by tepid global markets, some analysts and bank executives believe the slowdown reflects a fundamental shift resulting in part from the new regulatory regime.

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