

**FOSTERING ECONOMIC GROWTH: THE ROLE OF  
FINANCIAL COMPANIES**

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**HEARING**  
BEFORE THE  
**COMMITTEE ON**  
**BANKING, HOUSING, AND URBAN AFFAIRS**  
**UNITED STATES SENATE**  
ONE HUNDRED FIFTEENTH CONGRESS  
FIRST SESSION

ON

EXAMINING THE STATE OF THE ECONOMY, THE SERVICES PROVIDED  
BY FINANCIAL COMPANIES TO CONSUMERS AND MARKET PARTICI-  
PANTS, AS WELL AS CONSUMERS' AND MARKET PARTICIPANTS' FI-  
NANCIAL NEEDS AND THE STATE OF ECONOMIC DEVELOPMENT IN  
COMMUNITIES ACROSS AMERICA

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MARCH 28, 2017

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# FOSTERING ECONOMIC GROWTH: THE ROLE OF FINANCIAL COMPANIES

TUESDAY, MARCH 28, 2017

U.S. SENATE,  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,  
*Washington, DC.*

The Committee met at 9:34 a.m., in room SD-538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

## OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. This hearing will come to order.

This morning we are holding a hearing on “Fostering Economic Growth: The Role of Financial Companies”. One of our witnesses has been held up in traffic, but we are going to go ahead and start, and he will join us as traffic allows.

A strong, vibrant economy is important for American consumers, businesses, and the stability of the financial sector.

Financial companies of all sizes and forms provide critical services to businesses and consumers, helping businesses manage operations, entrepreneurs get funding to start companies, and average citizens buy a first home or deal with a financial crisis.

As policymakers, we must diligently and frequently study the state of our economy, our regulatory framework, the use of capital, and provision of financial services.

According to recent studies, since the crisis, large businesses are experiencing a more robust recovery than small firms and entrepreneurs. One of the main drivers of underperformance by new and small firms compared to their larger counterparts is their limited access to credit.

There are direct links between post-crisis regulation and restricted finance. Data from the St. Louis Federal Reserve shows that a mere decade ago, small banks made more business loans compared to larger banks. That is no longer the case.

Consumers, many on the periphery of mainstream banking, are seeing certain products and product features disappear. For example, one product line, short-term, small-dollar credit, is expected to see a 60- to 70-percent decrease in market size—according to the CFPB—with virtually no other avenue for product users to access credit.

These are a few examples that support the need for a thorough review of our regulatory framework and the role of financial companies in the country. I have been encouraged by President Trump’s Executive orders and memoranda on regulations and core

principles for regulating the financial system. The Treasury Department has begun its review, and I look forward to seeing the recommendations it puts forward on how well existing laws and regulations promote or inhibit economic growth.

In addition, last Monday, Senator Brown and I announced a formal process to receive stakeholder proposals that will help consumers, market participants, and financial companies responsibly participate in the economy in a more effective and efficient manner.

And last Tuesday, the Federal banking regulators released their EGRPRA report, which sought to identify regulations or laws that are outdated, unnecessary, or unduly burdensome. Taken together, these actions will provide a clearer picture of what is working and what is not working within our financial regulatory framework.

Today this Committee will study how financial companies participate in the economy, with a goal of better understanding their role in fostering economic growth. Our witnesses have diverse backgrounds, and I look forward to hearing their unique perspectives on this issue.

For example, why are community financial institutions important in local communities? And what happens when communities begin losing financial institutions?

What services do financial companies provide businesses of all sizes? And are services being deployed in an effective, efficient manner?

How can large financial companies help U.S.-based companies compete in global markets?

Senator Brown and I have started working together on a bipartisan basis to hear the thoughts and concerns of various stakeholders and Members of the Committee. It is my hope that Members will find this to be a thorough, inclusive process, and one that is structured for success.

Senator Brown.

#### **STATEMENT OF SENATOR SHERROD BROWN**

Senator BROWN. Thank you, Mr. Chairman, for holding this hearing. I appreciate the 9:30 start time today, too. And I appreciate the process that you have put in place that you referenced in your opening remarks for the Committee to discuss economic growth. I hope that with the Committee's call for proposals we will be able to put some new ideas on the table that would gain broad and bipartisan support.

Rolling back Wall Street reform clearly does not fit the bill. Our financial system is more stable because of Wall Street reform, banks are better able to handle losses, and consumers are better protected from the types of predatory loans that led to the crisis. Too many Americans still have not recovered from the 2008 financial crisis—and this is important to remember—when 9 million workers lost jobs, 5 million homeowners were foreclosed upon, people lost trillions of dollars from their retirement saving. Remember that: 9 million lost jobs, 5 million homes foreclosed on, people lost trillions from their retirement savings.

This crisis came on top of economic policies that, since the 1970s, have shrunk the middle class. Minority communities, particularly African Americans, were hit even harder by the crisis and have

had the most difficulty rebuilding wealth and buying homes and saving for retirement and reentering the labor force.

I understand why so many Americans are angry. Nearly a decade after the financial crisis, the wealthy have pocketed almost all of the gains, but wages for most Americans have been stagnant. Wall Street is once again making record profits, and many indicators—stock prices, business lending, consumer lending—are at pre-crisis levels or higher.

Wages of Wall Street employees have increased 70 percent since the 1980s when they were comparable to the wages of those in other industries. During that same period, good financial jobs disappeared as a result of trade and tax policies that favored investors over workers. Even within the financial sector, the gains have been far from even. Bank workers at the low end of the pay scale saw their real wages decline from 2000 to 2013. One-third, fully one-third, of bank tellers working for banks are on Government assistance. One-third of bank tellers working for banks where executive compensation has skyrocketed, one-third of them are on Government assistance. The CEOs of the top five banks make 470 times—a ratio of 470 times—the annual salary of the median front-line bank worker.

Hard work is not paying off for so many Americans the way it used to. It is true for all workers across industry at any income levels. Whether you punch a time sheet or you make a salary or you rely on tips, whether you are a contract worker or a temp, whether you work in a call center or a factory floor or in a bank, one of the best ways financial services companies can help economic growth is to pay their workers a living wage and provide decent benefits. It should come as no great shock the demand for housing and other goods and services is tepid—the demand for those services is tepid. Too many Americans are struggling to make ends meet.

The response from this Administration is not encouraging. It has been stocked with Wall Street executives who want to do a number on the law that holds their former firms accountable. Its budget would eliminate much of the Federal efforts to promote economic development opportunities in communities both rural and urban across our country. So far, there is no sign of the promised, much heralded \$1 trillion infrastructure program extolled at almost every stop by Candidate Trump.

If Americans do not have reliable housing or transit systems to get to work or even access to meals, how do we expect to have a healthy and productive workforce? How will we get to a growing economy? Financial companies have an important role to play in our economy to the extent that they support the rest of the economy.

Finance is a means to an end, not an end in itself. Trading paper among a few large financial companies or making the wealthiest 1 percent of Americans even wealthier simply does not grow our economy.

Earlier this year, in Columbus at the John Glenn School, I outlined a broad plan to restore the value of work in four key ways: one, raise wages and benefits; two, give workers more power in the workplace; three, make it easier for more workers to save and employers to make matching contributions for retirement, something

Senator Crapo and I as members of the Finance Committee have partnered one and worked together on; and, four, encourage companies to invest in their workforce.

When we talk about economic growth, we need to talk about policies that help Americans' pocketbooks, their savings, their job security, empowering the middle class and those who aspire to the middle class.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you very much, Senator Brown.

We will proceed with our testimony from the witnesses at this point.

First, we will receive testimony from the Honorable Robert Heller, former Governor of the Federal Reserve.

Next we will hear from the Honorable Donald Powell, former Chairman of the Federal Deposit Insurance Corporation.

He will be followed by Mr. Thomas Deas, Jr., chairman of the National Association of Corporate Treasurers.

And then we will go to Deyanira Del Rio, who is the codirector of the New Economy Project.

And Mr. Spriggs will go last if he is able to make it here. He is a professor economics at Howard University and chief economist at the AFL-CIO.

Mr. Heller, you may proceed.

**STATEMENT OF ROBERT HELLER, FORMER GOVERNOR,  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Mr. HELLER. Chairman Crapo, Honorable Member Brown, and Senators, thank you very much for inviting me to speak and to testify on the contribution made by financial institutions to foster economic growth and the role of these organizations in that context.

Economic growth tends to parallel financial growth, and a strong economy needs to be supported by a dynamic financial system, just like a healthy body needs to be nurtured by vigorous blood flow.

Two important changes occurred in the 1980s and 1990s that modernized our banking system and brought it up to world standards. First of all, there was the Riegle-Neal Interstate Banking legislation which allowed nationwide branching; and then the Gramm-Leach-Bliley Act, which removed the barriers between commercial and investment banking, thereby allowing for greater product diversification.

These two innovative congressional acts allowed banks to serve their retail and wholesale customers better and increased bank safety by allowing for greater diversification along geographic and product lines.

The banking crisis of 2008-09 was primarily triggered, as was pointed out, by irresponsible and excessive subprime mortgage lending and resulted in a major economic crisis, validating the strong nexus between financial and economic activity.

In response, the Dodd-Frank Act enacted hundreds of new regulations that imposed virtual straitjackets on the banks. As a result of these regulations, as well as the prolonged zero interest rate policy by the Federal Reserve, new bank formation came to a virtual standstill. It is no surprise that the economy experienced the slowest recovery on record since World War II.

I think there are two ways in which banks can be made safer: through tighter regulation and by holding more capital. Based on my experience, as the Chairman of the Committee on Bank Supervision and Regulation at the Fed, and my banking experience, I would argue that strong capital requirements are generally more effective and efficient than a myriad of detailed regulations.

Regulations are a straitjacket that constrains each and every banking activity and by the imposition of inflexible rules that are more appropriate for a rigid, centrally planned command economy.

Moreover, regulations call for an army of supervisors to enforce all the rules, as well as an expensive compliance staff on behalf of the banks. In contrast, capital requirements are a flexible buffer that can protect the shareholders, depositors, and taxpayers alike. And at the same time, it provides an incentive to engage only in economically rewarding activities. Thereby it kills two birds with one stone.

An innovative case to ease the regulatory burden for financial institutions is proposed in the Financial CHOICE Act. It rewards banks that are well managed and protected through high levels of capital with considerable regulatory relief.

Let me close with one more suggestion that will considerably lower the costs to the banks as well as to the Government and the taxpayers, and that is the elimination or consolidation of overlapping regulatory agencies in the financial sector.

Among the Federal regulators alone, we have the Federal Reserve System, the Comptroller of the Currency, the FDIC, the SEC, the newly formed CFPB, and the CFTC. In fact, there are now so many regulators that there are even agencies to coordinate the regulators. For instance, the FFIEC, of which I was a member in my days at the Federal Reserve, is tasked with coordinating the rule-making and examination processes by the various agencies.

So I think the time has come to simplify this regulatory jungle. If we need special councils to coordinate the regulators, we have a few regulators too many, and one layer of bureaucracy should be eliminated.

Thank you very much, Mr. Chairman, for inviting me and giving me the opportunity to express my views on this important topic.

Chairman CRAPO. Thank you, Mr. Heller.

Mr. Powell.

**STATEMENT OF DONALD POWELL, FORMER CHAIRMAN,  
FEDERAL DEPOSIT INSURANCE CORPORATION**

Mr. POWELL. Chairman Crapo, Ranking Member Brown, Members of the Committee, thank you for the opportunity to testify.

I have spent 40 years plus working in the financial services industry. My experience includes serving as an employee, CEO, owner, and board member of various small- and mid-sized banks. Additionally, I have served as a banking regulator as Chairman of the FDIC. Furthermore, I have served on the board of one of the world's largest financial institutions.

All of these experiences have caused me to understand and respect the critical role a bank has in the success of a community, State, and in our Nation. The quality of life in a community has a direct link to the bank's activities and services, including the cre-

ation of jobs, the caliber of education, the excellence of health care, and the general prosperity of a community. The bank is the alter ego of a community. Banks, both large and small, contribute to the well-being of a community. Most banks have a culture that demands that all of its employees participate and provide leadership in all that is good within the community.

The data is overwhelming as to the role banks play in economic activity, and when banks are not engaged in lending or in providing other services, the local, State, and the national economy suffers and economic growth becomes anemic. Thus, it is important that the Nation have viable, safe, and sound banks serving this great country. Part of the confidence placed in banks is a result of the depository protection offered by the FDIC and of the supervision of each insured institution. Confidence in the soundness of an institution is critical to the success of the banking system and, thus, the free enterprise system.

During my career, I have experienced good and bad economic times and have observed the various reactions to these cycles by the marketplace, policymakers, regulators, and other stakeholders. I have studied the cause and effect of each downturn. After each downturn, Congress, as well as banking regulators, have attempted to address the issues attributed to the slump in our banking system. All of the banking supervisors have reacted by creating more stringent rules and a tougher oversight process.

Today's examination and supervisory process includes, as expected, more focus on threats to our way of life and to treating every potential customer in a fair, transparent, and forthright manner. Laws and supervision oversight may be fluid depending upon the latest threats, risk, and conditions within the banking industry.

There has been discussion, supported by data, that banks today, especially smaller banking institutions, are not the vehicle that breathes economic life into a community because of the unnecessary burden of the examination process and of certain regulations. Often, after a downturn, the tone, attitude, and trust between banks and regulators become strained, which results in negative energy and a nonproductive environment. It is important to understand the cost of regulation and to distinguish between sound policy and unnecessary rules, laws, and policies that stifle economic activity. The overriding issue is how does this policy, law, or regulation support economic activity without burdening the consumer, small business owner, or other business ventures?

I remain active in the financial services industry and have direct knowledge of the supervisory process and would offer some guiding principles rather than specific regulations, policies, and laws that are valid in all seasons. Without these principles, laws, policies, and regulations might be neutered or weakened.

One, every banking regulator must be fiercely independent and cannot be politically influenced. The independence includes no political agenda, and activity must follow the mission established by law. Accountability is balanced with term limits and oversight from an independent Inspector General. Regulators should not be intimidated by any force of direct or indirect influences and should not be a political tool for any agenda.

Second, leadership at the various regulator agencies is critical. As with any enterprise, leadership sets the tone and mood for the entity. The ability to work with all stakeholders without compromising the mission should be a tenet for all leaders. Obviously the confirmation process should measure leadership that is validated by life's experiences.

Three, disputes must have a due process path. Without a trustworthy, reliable, and transparent due process, an American core principle is lost. There is not a valid due process existing today to resolve disputes between regulator and banker. I have offered a solution, and the paper is attached for the record.

Four, rulemaking should be transparent, and common sense and judgment should prevail. Experience is vital to an understanding of the banking industry, and the process should be deliberate and seek input from all interested parties. Rulemaking does not include making laws or incorporating a political agenda into the regulation.

Five, accountability follows authority and a vigorous review process is important; proper oversight by a responsible IG is important.

While there are certain core principles to a safe and sound banking system, banking cannot be commoditized as every community market is different and judgment must be part of the process. Banking laws and regulations must be followed, but policymakers must understand the cost, burden, and intention of these laws and amend them when necessary. Today's data indicates that there is more emphasis on compliance than on safety and soundness. It is important to understand that without the soundness of a bank, a community cannot thrive. We must get compliance with laws, safety and soundness all collaborated to the benefit of the community.

Finally, after experiencing several banking crises firsthand and participating in mistakes and questioning myself and industry leaders, my conclusion is that there will continue to be cycles and new risks will emerge. But these common themes are present in those entities that survive: sufficient capital, liquidity to support the apparent risk and the unexpected events, and management that understands risk and provides oversight with the proper balance between serving the community, return on capital, and commitment to the basics without complexity.

Thank you.

Chairman CRAPO. Thank you, Mr. Powell.

And before we go to Mr. Deas, I want to welcome Mr. Spriggs here. We understand the traffic is terrible out there today. As you had not quite made it yet, I told Ms. Del Rio she would go after Mr. Deas, and so we will let you go cleanup after Ms. Del Rio. Thank you very much.

Mr. Deas.

**STATEMENT OF THOMAS C. DEAS, JR., CHAIRMAN, NATIONAL ASSOCIATION OF CORPORATE TREASURERS**

Mr. DEAS. Chairman Crapo, thank you very much, Ranking Member Brown, and the other Members of this Committee. Thank you for the opportunity to testify at this important hearing focusing on our country's future economic growth. I am Tom Deas, recently retired vice president and treasurer of FMC Corporation and the current chairman of the National Association of Corporate Treas-

urers. NACT is an organization of treasury professionals from several hundred of the largest public and private companies in the country. I also represent NACT on the Steering Committee of the Coalition for Derivatives End Users. The coalition is comprised of several hundred companies whose treasurers employ derivatives to manage risks in their day-to-day business activities.

At the outset, I would like to thank you, Chairman Crapo, for your efforts to make sure that end users are able to engage in prudent risk management activities without facing costs that would make such activities prohibitively expensive. We appreciate your efforts to move a bill, enacted in the last Congress, to exempt end users from unnecessary margin requirements.

The financial system is critical to the day-to-day business activities of end-user companies. As a corporate treasurer, I can tell you that I interacted with our financial counterparties every day through such critical tasks as collecting payments from our customers; concentrating cash collections in a secure depository institution; sending cash safely from where it was collected and concentrated to wherever it is needed to meet the company's day-to-day business obligations; also borrowing or investing to meet temporary or longer-term cash shortfalls or surpluses; managing the company's capital structure with adequate committed credit and appropriate amounts of debt and equity capital; and also identifying and hedging the company's financial risks from exposures to such factors as changes in interest rates, foreign exchange rates, and commodity prices.

Let me give you a real-world example, if I may. Companies use commodity derivatives to help structure cross-border bartering transactions. Consider a U.S. agricultural chemicals company selling into Brazil. With financial markets far less developed in Brazil, the U.S. company can access the derivatives market in ways unavailable to the Brazilians. The customer in Brazil needs crop protection chemicals at planting time, but can only pay 6 months in the future, at harvest time. During this period, the Brazilian farmer has commodity price risk and currency risk. The U.S. manufacturer arranges a barter trade where the Brazilian farmer agrees to pay in bushels of soybeans 6 months in the future at harvest time for the chemicals it needs to apply at planting time. The farmer has thereby transferred the price risk to the U.S. chemicals manufacturer, which can lay off that risk in a customized commodity derivative locking in the U.S. dollar price 6 months in the future, thereby hedging its risk.

By reducing the overall volatility of its business results, the end-user corporate treasurer contributes to the stability and predictability of his business. But we cannot do this without our bank counterparties, and we also cannot do it if the pricing is too high. And while I and the end-user community support smart regulation of financial services, we are concerned about overregulation, which can increase our costs and make risk management activities prohibitively expensive.

European policymakers, for example, have implemented capital charges on derivatives positions significantly more favorable to their end users than have the U.S. prudential banking regulators. The European approach recognizes that end-users' hedging activi-

ties are, in fact, risk reducing and, accordingly, exempts end-user derivatives transactions from the credit valuation adjustment, which would otherwise require the bank counterparty to hold additional capital to mitigate counterparty credit risk in a derivatives transaction. The absence of a U.S. exemption puts American companies at a meaningful competitive disadvantage compared to our European competitors. In fact, the CVA charge may force end users to post collateral to offset banks' CVA capital requirements, subtracting from funds available for business investment. This is an example of overregulation harming end users while benefiting foreign competitors.

We need a regulatory system that allows Main Street companies to use the financial system to hedge day-to-day commercial risks, securely manage their cash-flows, fund their businesses in the most cost-effective way, and play on a level field with their foreign competitors. By having a regulatory system that allows businesses to improve their planning and forecasting, manage unforeseen and, indeed, at times uncontrollable events, offer more stable prices to consumers, end users can more readily contribute to economic and employment growth.

Thank you. I will do my best to answer any questions you may have.

Chairman CRAPO. Thank you, Mr. Deas.

Ms. Del Rio.

**STATEMENT OF DEYANIRA DEL RIO, COEXECUTIVE  
DIRECTOR, NEW ECONOMY PROJECT**

Ms. DEL RIO. Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the invitation to testify today at this hearing. My name is Deyanira Del Rio, and I am the codirector of New Economy Project. We are an economic justice center based in New York City, and for more than 20 years, we have worked with community, labor, civil rights, and many other groups throughout New York to press for fair lending and economic inclusion, as a matter of racial justice and equitable neighborhood development. I am pleased to share our experiences and perspective about the vital role that responsible financial institutions play in fostering economic growth and opportunity, but also the devastating and destabilizing impact that abusive and unregulated lending has on communities and the economy.

My testimony is additionally informed by my 15 years as a board member and currently the board chair of the Lower East Side People's Federal Credit Union. We are a not-for-profit regulated credit union and Treasury-certified community development financial institution that primarily serves a membership of low-income and immigrant New Yorkers.

I have two overarching points to frame the testimony that I am delivering today. First, we believe that eliminating barriers to fair banking and credit access is critical to ensuring economic inclusion and opportunity for all. And, indeed, unequal access to credit has historically fueled housing segregation, racial disparities in homeownership and business ownership, and vast deepening wealth inequality across the country.

Although affordable and appropriate financial services is critical to a healthy economy, as you heard, we reject the notion that consumer credit and credit in itself is a solution to deeper structural inequities in our economy. Exploitative credit and debt, as we have seen, can worsen these inequities, as we saw with subprime mortgages that led to the foreclosure crisis and undid, wiped out hard-won gains in homeownership for families of color, as well as payday loan debt traps that exploit working families that struggle to make ends meet, and rather than help them make ends meet, they throw them a brick to entrap them in debt. So in terms of the short-term and small-dollar loans known as “payday loans” decreasing, we would say that that would be something to celebrate. And the point of all of that is to say that regulations and policies that address root causes of economic insecurity are fundamental and cannot be replaced by simply providing credit to help people cover expenses that they should be able to cover through fair wages and other kinds of protections.

It must also be said up front that efforts by this Administration and Congress to dismantle our financial reform laws, if successful, will inevitably lead to new crises and further erode Americans’ trust in the financial system, which we have seen firsthand is already pretty low. We believe it is critical to preserve existing reforms and consumer protections and begin to work toward fundamental change in our system so that we can create a financial services sector that serves the real economy and not a financialized economy that is extractive and often exploitative.

Three quick points.

One, the financial crisis inflicted enormous costs on communities, the economy, and on responsible financial institutions—with repercussions that continue today. Communities of color are especially hard hit and continue to reel from the crisis.

Just a couple of statistics are that fully half of the collective wealth of black families and two-thirds of the wealth of Latino families was lost in 3 years, from 2007 to 2010. And the big banks, it needs to be reminded, fueled this wave of predatory lending through securitization and creating the market that fueled subprime loans and allowed that sector to reach crisis proportions.

Just a note about the impact on responsible regulated financial institutions like my credit union, which played no part in the crisis, in creating the crisis. We were not spared the effects, nor were our communities. And one of the reasons that our institution has supported financial regulation at the State and Federal level and we supported and have weighed in on the Consumer Financial Protection Bureau and its rulemaking and enforcement is because we feel like we have learned that the effects, the cost to our institutions and our communities of not having sound regulations that prevent wealth stripping in our communities has presented to our institution far greater risks than the marginal and short-term costs of compliance with new regulations.

A second point. Again, strong prudential regulation and consumer protections—including a robust and independent CFPB—is crucial to avert future crises. Congress enacted Dodd–Frank in the wake of undeniable regulatory failure and destructive lending and created requirements that include such basic tenets of responsible

lending as that lenders must assess a borrower's ability to repay loans. And the fact that that is controversial, something that our institution and many others, my credit union, believe is just basic to responsible underwriting and lending has been lost shows the need for these regulations.

The CFPB has so far returned \$12 billion to 29 million Americans and has brought payday lenders, credit reporting agencies, and other powerful sectors under meaningful supervision for the first time. The fact that banks and others are pushing relentlessly to weaken the CFPB to us demonstrates its effectiveness and its independence.

Finally, community development financial institutions have played vital roles in meeting credit and financial services needs in communities as banks become more consolidated and further removed from communities across the country. The proposed gutting of the Federal CDFI Fund, the elimination of its budget, puts these institutions, which are supporting economic growth in the real economy—would be greatly harmed by these cuts, and we hope that they are promptly restored.

I know I am out of time, so I am happy to elaborate on anything else in the Q&A and to answer any questions. Thank you again. Chairman CRAPO. Thank you.

Mr. Spriggs.

**STATEMENT OF WILLIAM E. SPRIGGS, PROFESSOR OF ECONOMICS, HOWARD UNIVERSITY, AND CHIEF ECONOMIST, AFL-CIO**

Mr. SPRIGGS. Thank you, Chair Crapo and Ranking Member Brown, for the this invitation to speak today, and I do apologize, Chair, that I was running behind and missed some of the earlier testimony and your opening remarks. I apologize for that.

My name is William Spriggs, and I am here representing the AFL-CIO, which is America's house of labor. It represents the working people of the United States. I am also here as a professor of economics at Howard University. Howard has produced three U.S. Senators. We are very proud at the Department of Economics of the third one because Senator Kamala Harris is a graduate of the Department of Economics at Howard.

I want to take my testimony in a slightly different direction than what you have just heard. Clearly, sound financial systems are necessary for growth. When you look at U.S. economic history prior to the Glass-Steagall Act, you see episode after episode after episode of financial crisis, bank failures, and the type of event that did not take place between the Glass-Steagall Act and 2008.

So we understand that having a sound fiscal system can do away with very great variations and downturns, and it is important so that we can continue a progress of growth. But, more importantly, I want you to focus on the real growth. Growth actually occurs in the real economy. And if we really are concerned about business formation, if we really are concerned about economic growth, then we have to think about labor force growth, labor force productivity, an we have to think about investment and productive capital that increases the productivity of those workers.

A financial system that serves the purpose of taking excess capital and moving it to productive capital is the point. If it is doing something else, it is diverting funds. Deepening of the financial sector does not necessarily mean moving excess savings to productive capital.

How did we grow so successfully from 1946 to 1979? There are a couple of things that correlate with that. Primary is an agreement between Republicans and Democrats that we had to invest in the American people and we had to invest in America. It was a belief by both parties that if you invest in America and you invest in Americans, it will always—always—pay high dividends. So whether it was the effort of Dwight Eisenhower, a Republican President, to give us the National Student Defense Loan system that propelled many Americans into the high-tech sector, gave us the teachers that taught the people who produced the Internet and produced the micro computer, or whether it was Eisenhower giving us the Interstate Highway System, the infrastructure that is still the backbone of our Nation's transportation system.

These were bipartisan beliefs that Government played a key role in providing the means by which America could pay dividends to its citizens and to the world. It created a growth pattern that was equal so that we saw all income portions grow. Whether you were at the bottom of the income distribution or at the top, everyone grew together. The key element there is that what matters in economics is the customer market. When all incomes grow, then the budget line for all households grows, and everyone is a potential new customer. Businesses grow from new customers. And so if you want innovation, if you want faster growth, you have to have broad-based income growth. That is what we had from 1946 to 1979 from that consensus and that belief, and the role of Government to foster that kind of investment and to believe in broad-based income growth.

Since then, we have departed. We have had massive inequality. Those at the bottom have not benefited as those at the top, and our customer base is not expanding. The result is we have had slower new business formation, and that has been key at slowing our growth.

Sound fiscal systems are necessary for the stability of that growth, systems that do not continue to foster huge banks. Small businesses have succeeded as the economy has rebounded because of small banks. That is where the majority of small businesses are now getting their funding.

So we need a competitive banking system, we need a sound banking system, and we need to remember, as we were just reminded, the very high cost of this economic downturn. The costs of regulation against the trillions of dollars that our economy lost from the financial collapse have to be weighed. Those trillions of dollars we have not yet regained.

Thank you.

Chairman CRAPO. Thank you, Mr. Spriggs. And as we begin the question period, I remind all Senators to please honor the 5-minute rule. As usual, we are under some time pressures here.

Senator Brown has a real time pressure, so I am going to let him go first.

Senator BROWN. Thank you, Mr. Chairman. I will honor the 5 minutes and set the pace, so thank you for that.

I will start with Dr. Spriggs. Thank you for your testimony, all five of you. Most public companies seem to have become beholden to the quarterly earnings report. One survey of financial executives found that 78 percent would sacrifice economic value of their own company just to meet financial reporting targets. That is no way, obviously, to grow our economy. Families do not think in terms of 3-month earning quarters. They think in terms of school years. They think in terms of 30-year mortgages. They think in terms of years left to save for retirement.

Why is it important for Congress to focus on workers and consumers when trying to foster economic growth?

Mr. SPRIGGS. Well, thank you, Senator. It is very important to focus on consumers and workers because that is the real economy, and we do not want to lose sight of that. And the real economy grows when we have customer bases grow. So we need workers, all workers, to have raises, to have their wages match productivity growth, so that we can see a dynamic business environment.

The rate at which new businesses are being created in the United States has slowed down, and instead of new businesses, the way that companies are getting new customers is through consolidation. They buy each other out. And this phenomenon that you mention is part of that. Part of that is the financialization of our system.

So for a CEO, I can actually get higher pay, not by taking capital to invest in my company and increase my capital, but by simply buying back my stock. Billions of dollars have been spent simply buying back stock, simply bidding up the price of stock, which is the barometer by which the CEOs declare that they have been successful to the stockholders.

That is not adding to the productive capacity of the economy. It is not feeding back into training workers. It is not feeding back into higher wages. It is not feeding back into making us more competitive.

So this is why Congress has to be concerned with this type of practice, and the growth of inequality means that Congress has to be concerned about the growth of the consumer base.

Senator BROWN. Thank you.

Ms. Del Rio, you spoke of community development financial institutions, CDFI. I want to ask you a question about that. East Liverpool, Ohio, a small city, used to be the center of the pottery industry in the United States, a county on the Ohio River in eastern Ohio. The Progress Fund, a CDFI, worked with American Mug and Stein, a small manufacturer, many of them—they were hiring. They hired in many cases people who needed a second chance, former offenders. The CDFI restructured its debt after it was turned down by a traditional lender. Starbucks is now a steady customer of their mugs. It has doubled its workforce. The Administration's "skinny budget" eliminates CDFI Fund grants, but CDFIs play an important role in rural and urban communities in Appalachia and New York City and communities in every State. I would add that the area where this company is was a huge—President

Trump, Candidate Trump, won a huge majority in that county, as he did along the Ohio River.

Ms. Del Rio, tell us who CDFIs serve, whether the private market can meet the needs of these communities, and how the Administration proposed cuts to CDFI grants would impact urban and rural communities.

Ms. DEL RIO. Sure. Thank you for that question. So CDFIs can be loan funds, credit unions, many other kinds of institutions. My primary experience is with credit union CDFIs, so that is what I will focus on. But all CDFIs serve economically distressed communities. That is their focus, and that is why they are certified by Treasury as such, and they receive investments through CDFI Fund.

One note is that I think there is a misunderstanding about what the CDFI Fund does. It does not make grants. It is not charity. It provides capital grants, capital investments into institutions that then get leveraged at rates of \$12 to \$23 per every CDFI dollar invested. And so it is actually an investment in financial services to support economic growth.

CDFIs make loans to support affordable housing, small business development, jobs, commercial and community spaces, to expand access to child care, and many, many other services. And they have their ear to the ground. They are truly community-based, and that is their focus, as in the example that you provided.

There are 8 million people served by credit union CDFIs across the country in 46 different States, and my credit union is one of them. And we have used CDFI Fund and other support that we have been able to receive to expand business lending in our community, to provide a whole range of services that we would not otherwise be able to do. And, critically, it has enabled us to grow.

So for small institutions, when you bring in a lot of deposits or you make a lot of loans, in the short term your net worth decreases. Your capital ratio decreases. So for a small credit union or any institution that is serving a low-income population that does not have a lot of resources, these infusions of capital are critical to enable us to meet the loan demand in our communities. We would not be able to make the volume of loans—we are 100 percent loaned out in terms of our member deposits right now. We could not do that if we were not able to get these infusions of investments.

And one of the things that we are really proud of in New York City is that we are one of the sole lenders—banks do not make these loans—to low-income housing cooperatives. They are low-income, limited-equity cooperatives, and they represent one of the last remaining affordable homeownership options for low-income New Yorkers, and we have been able to extend \$18 million in loans to these buildings themselves and to individuals that are purchasing in those buildings. And to give you a sense of that, some people are able to purchase their apartments for as low as \$5,000 in New York City. These are limited equity. People cannot flip them to make a profit, and so they are not sort of on the market. They are not something that lots of investors or lenders want to be involved in. But it is something that we do as a CDFI that we are really proud of.

Senator BROWN. Thank you so much.

Thanks, Mr. Chairman.

Chairman CRAPO. Thank you.

And I will continue to forgo my questioning, and we will go next to Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman. Thanks to all of you for coming today. I have learned a lot listening to you. I particularly want to thank Mr. Powell. Mr. Powell was in charge of recovery in Louisiana after Katrina. You did an extraordinary job, and the people in my State owe a great debt of gratitude to you, and I wanted to recognize that.

I wanted to ask each of you a question about Dodd–Frank and community banks. I am defining a community bank or a community credit union as being \$10 billion or less. My understanding is that those institutions comprise about 98 percent of all of our financial institutions.

The Chairwoman of the Federal Reserve talked to us a few weeks ago. I asked her directly what did the community banks do to contribute to the meltdown in 2008, and she said, “Nothing.”

I would like your thoughts, given the regulatory costs and the impact on lending and the forced consolidation that has gone on in community banking, I would like your thoughts on whether you think it would be appropriate to exempt community banks, \$10 billion or less, from the regulations of Dodd–Frank. We will just start at the end, if that is OK.

Mr. HELLER. I think that is a very good idea that really needs to be explored. I am in favor of exempting them from the regulations as long as they are well managed, as determined by the regulators, and that they have a good, sound level of capital. Those are two things that I would require and then you ease up on the rules so that you do not have that enormous regulatory burden.

In our community bank—I am on the board of a \$2 billion bank—we have doubled our compliance staff over the last 10 years, and that does not do anybody any good.

Mr. POWELL. Senator, I think without question that there is an extraordinary amount of burden upon community banks. They do not have the cost structure to comply with some of the burdens of Dodd–Frank.

Having said that, obviously, Dodd–Frank was implemented for certain purposes, but I am on a community bank board, and I was just reflecting, as you were speaking, about our last board meeting. We reviewed 50-some-odd policies as it relates to compliance with Dodd–Frank. That takes a lot of effort, a lot of cost. I think it is appropriate to review those and to eliminate some of those, specifically on these issues. The qualified mortgage issue as it relates to community banks is a big handicap in serving their customers. I understand the rationale behind qualified mortgage, but we have got to get away from customizing—we are getting away from judgment.

And so these community banks really know their community and they know their customers. And the last thing they want to do is make a bad loan. We forget that. We forget that nobody wants to make a bad loan. So a qualified mortgage, we have commoditized these products, and you cannot do that in a community bank.

I think the second issue is that data collection, we really need to review that in a community bank. Why do you need all the data collection? I recognize and understand that, but it is a real burden upon a community bank. A community bank, you have got to remember, they are a reflection and they are the alter ego of the community. They want to serve their community. But they know their customers probably better than anybody else in the community. They have lived with them; they work with them. They go to school with them; they go to church with them.

So the burden of the Dodd–Frank I think needs to be exempt to these smaller institutions, without compromising capital ratios, not compromising liquidity. Safety and soundness is clearly an issue.

Senator KENNEDY. OK. Mr. Deas.

Mr. DEAS. Senator, I can only say as an end user and a large company corporate treasurer, I have dealt mostly with larger banks, but I will say that with the efforts of Members of this Committee in the last Congress, there was a bipartisan consensus to exempt end users from some of the regulations under Dodd–Frank that would outweigh the benefits of those regulations. And so by analogy, I would think that if community banks whose function is to take funds from where they are generated, redeploy them where they are needed in their community, are being unduly burdened by these regulations, that we should relieve them of that burden.

Senator KENNEDY. OK. I have got 12 second—no. I think I am over. I am sorry, Mr. Chairman.

Chairman CRAPO. Well, we will let the remaining witnesses provide written responses to this question as well.

And thank you very much, Senator Kennedy, for paying attention to the clock.

Senator Reed.

Senator REED. Well, in order to—Mr. Spriggs, why don't you answer that question? It was a very good question posed by Senator Kennedy, and then Ms. Del Rio briefly.

Mr. SPRIGGS. Thank you, and I will be brief to respect your clock, Senator.

I think that flexibility has already been shown to the smaller banks. They do play the vital role, as I mentioned; close to 70 percent of the small business loans were from small banks, and so they provide the backbone for helping businesses grow.

But we have to think about what those regulations do in total. The greatest threat to the community banks is that we continue to have banks too big to fail that dominate the market and continue to present too great a systemic risk to our economy. We need them broken up so that that will create more space for community banks to thrive and to prosper. Their greatest enemy right now are these huge banks.

Senator REED. Ms. Del Rio.

Ms. DEL RIO. As a small institution, the credit union I am on the board of has \$51 million in assets. We already have certain accommodations for us under Dodd–Frank. An example is that we are supervised for compliance with consumer protection laws by our existing Federal regulator, the National Credit Union Administration.

Additionally, since we are CDFI certified in certain CFPB rules, including the qualified residential mortgage rule, there are exemptions made for institutions like ours.

I think that there has been thoughtful consideration of how to accommodate smaller institutions. Our experience is that community banks are a spectrum. They are not all wonderful. They are not—and there are problematic practices at some of these institutions, so a wholesale exemption is not something that I would support.

Senator REED. Well, thank you. And let me thank Senator Kennedy or the wonderful question. It helped me. Thank you.

Mr. Spriggs, one of the issues that we are struggling with here is the cost-benefit analysis. Obviously, you do not want to burden any system with costs in excess of benefits or derive short-term benefits at huge cost. And we saw in 2008–09 extraordinary costs to the system, and I do not think the community banks were immune from the economic chaos. And as a result, part of Dodd-Frank is to sort of avoid another catastrophic event.

Again, does the current system help insulate us from that shock of another catastrophe? It could be improved a bit, but isn't it a vast improvement over what we had before the crash?

Mr. SPRIGGS. Yes, Senator, it is a vast improvement, and all previous bank failures, as I gave the whole history for the U.S., we have had Congress respond, and this time Congress did respond. Now, we still have banks that are too big to fail, and we still have to address that. But we do have to remind ourselves the tremendous cost in trillions of dollars—almost our entire GDP, one might argue, in cost—lost banks; community banks that got swallowed up, not because of something they did; pension funds, the costs to municipalities when pension funds collapse because of this financial crisis. Many of our cities and State governments ran into huge problems because their pension funds collapsed.

You have to look at the loss from the household sector in terms of homeownership wealth, in terms of pension wealth. All of this cost, the cost to the global system, the collapse of international trade that took place, the loss to potential GDP of the United States. When you look at projections that were made in 2001 through 2005 of what our economy would look like, when you add all that up, almost 1 year's worth of GDP after you add it all up, you have to say that a few cautionary measures by banks to prevent that has to be worth it.

Senator REED. Thank you. Just one point that you made, Ms. Del Rio, in your testimony—and you alluded to it—is the Consumer Financial Protection Bureau, and one of the impressions I have is that, again, looking back at the crisis, some of the difficulties were caused by these nonbank banks, entities that were chartered by States, not as financial institutions, not regulated properly, et cetera, but were competing in the mortgage market and competing in other markets. And one thing that the CFPB does to protect particularly smaller institutions is they actually have some authority to regulate these nonbank banks.

Have you found that to be helpful or impactful on your credit union?

Ms. DEL RIO. Extremely so, and in my work as well as New Economy Project. I think that that is what is so crucial about the CFPB, is that it is the first Federal agency with the mission of—its core mission of protecting consumers in this marketplace. This was a piece of lots of different agencies' responsibility, but inevitably, it was not a priority. The priority was on other regulations and prudential regulation, which, ironically, helped to lead to the sort of regulatory failure, because in the short term subprime lending was extremely lucrative until the crash happened. Payday lending is extremely lucrative.

So, you know, there are a lot of practices that can be profitable for an institution and good for their bottom line, but that are harmful and present systemic risk as well as harming consumers and communities, and that is the key to strong financial—why financial regulation in addition to capital requirements and skin in the game is needed.

Senator REED. Thank you very much.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator PERDUE.

Senator PERDUE. Thank you, Mr. Chairman. I will do this standing up, if that is OK.

Chairman CRAPO. Sorry about that.

[Laughter.]

Senator PERDUE. No. It is fine.

This is a topic that is at the forefront, I think, of what we need to be talking about in Congress. Look, there is no question that parts of the financial industry got ahead of itself leading up to 2008–09, but let us remember that the basic instrument that caused that was created by the desire back in the late 1990s to increase homeownership, and things like no-income and low-income verification loans were created that started defaulting almost immediately in the 40-percent range. But rating agencies and all that, that is not the direction I want to go in today.

Dr. Spriggs, I could not agree with you more. Your testimony today I thought was pretty much right on. I agree with most of it. But I want to come back to a question about small businesses. It looks to me like over the last 70 years, since 1946, as you well called out, Dr. Spriggs, our economic miracle—which, by the way, is the largest in the history of humankind for all Americans, basically—was created by innovation, capital formation, and the rule of law. Ms. Del Rio, I agree, though, that there was an imbalance in that growth, and it had to do with a lot of things—geographic issues, racial issues, et cetera, et cetera. But, by and large, those were the three things that created this.

Today, unfortunately, I think that our unilateral chase toward Basel III when these other countries are not doing that as well, we required our small and regional banks to have capital requirements that are well beyond any reasonable level that would require—that they should be required to be protected. They did not have anything to do with the debacle of 2009. They were not levered up 67 times like some of those guys were. And today the impact on small businesses—and this is the question I have for Dr. Heller first. Small business today, we have around 650,000 missing, as I cal-

culate it, small businesses today, and this is from the Bureau of Census, that if you take the jobs created from 1977 through 2007 and extrapolate that forward to the number of small businesses that we should have today, we have about 650,000 fewer businesses today. And that is a steep fall from 2009.

I would argue that that is probably caused mostly by a lack of capital. Innovation has not fallen off. The rule of law has not been changed much. So it is basically access to capital in small communities that I am so familiar with.

Can you address that? You are on the board of a community bank. You just answered the question about Dodd–Frank. But I would like to know about the capital requirements for not just small community banks but also regional banks that had no part in the debacle of 2009. Could you address that first?

Mr. HELLER. It is a very serious problem, as you say. First of all, community banks with about \$300 to \$400 million in asset size, they have a very, very hard time surviving, and they are merging incessantly. They are going out of existence, and they get swallowed up by either like-sized institutions or by larger banks that are acquiring them.

Senator PERDUE. In my State alone, we have lost 90 banks, small banks, since 2009, and it had nothing to do with their financial position. It had to do with the cost of compliance, and it made them an extremely attractive target for a bigger bank. So it looks to me like what we have done is incited the consolidation of an industry where we want to break up larger banks in theory. But the reality, the unintended consequences, we have done just the opposite. Do you agree or—

Mr. HELLER. And to make it worse, Senator, every year typically we have between 150 and 200 new banks being formed, and that stopped totally with the imposition of Dodd–Frank. Since then, there have been virtually no new bank formations. In the last 5 years, there were two new banks, according to the last statistics available from the FDIC. So no new banks are replacing the ones that are disappearing, and so you get exactly the effect that you point out. Small bank lending to small corporations, to small customers, that has come mostly to a standstill. And recently we have seen for the first time in U.S. history that the exit of small corporations was larger than the formation of new corporations. So there is no new lifeblood coming into the country because more companies are exiting than entering, paralleling the scene on the bank side.

Senator PERDUE. Mr. Powell, estimates have been made that this is somewhere around \$2 trillion that is not at work in the economy right now, that is on the balance sheets of small regional banks. I do not know if you have seen that number. Do you agree that there is a significant amount of capital that should be released into these small communities?

Mr. POWELL. That is a complex question. I think capital will follow opportunity. I think in the community banks that capital is not an issue. I think they have plenty of capital to loan, and I think they have money to loan.

I think the issue is more complex than that, Senator. I think part of it is the regulator oversight, the tone, the mood, the environ-

ment, they have to be very, very careful. I think complying with certain standards, complying with certain laws and regulations is, in fact, a burden. And I might add that the small business person has the same thing.

So one of the reasons that people are not creating new businesses is not necessarily for the lack of capital, because they can get the capital from outside banks.

Senator PERDUE. So you think the regulatory environment has something to do with that?

Mr. POWELL. Yes, sir.

Senator PERDUE. So here is the final question. I am out of time, but I would like to see this answered in writing, if you all do not mind. That is, the true cost of compliance is lack of jobs in local communities, and I would love to know what we can do, what are the priorities you guys all see on all sides of what we could do that does not change the intent of what we needed to do after the 2009 debacle to fix the problems we had there, but that would release some of the problems we have with the unintended consequences in these small communities?

Thank you very much. Thanks to all of you.

Chairman CRAPO. Senator Heitkamp—oh, wait a minute. I did not realize. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

Senator HEITKAMP. I should have jumped in.

Senator WARREN. You should have. You should have. You lost it there.

[Laughter.]

Senator WARREN. But I do want to get this in, and thank you for holding this hearing.

It is clear that a robust, well-functioning financial sector can help grow the economy, and a healthy financial sector helps officially allocate capital and manage risk, and that is good for consumers, and that is good for businesses.

But according to a number of recent research papers, a growing financial sector does not necessarily mean a growing economy. In fact, after a certain point, growth in the financial sector can hurt the overall economy, and it can hurt it a lot.

A 2015 paper from the International Monetary Fund found that an economy too dominated by the financial sector is less productive and less efficient at allocating capital. And a 2015 paper from the Bank for International Settlements found that after a certain point, financial sector growth sucks money away from the real economy, particularly hurting industries that depend most on research and development.

And here is the kicker. According to that 2015 IMF research report, which gathered empirical data from countries around the world, America's financial sector is too big a part of our economy. In other words, the economy would be more productive if we scaled back the financial services industry and reoriented it to making investments in the real economy.

Now, Mr. Spriggs, a lot of the discussion today has been about how to make life easier for banks, how to encourage them to grow and engage in more activities, with the assumption that economic

growth will follow. As banks get bigger, do they necessarily help the economy grow?

Mr. SPRIGGS. Thank you for the question, Senator, and by grow, I think more specifically what we found is as they grow as a share of the economy and, very importantly, as a share of the workforce, oddly, productivity increases have kept the share of Americans in manufacturing declining, just as with agriculture, the share of people in agriculture has declined because of productivity increases.

With computers, with advances that we have in technology, one would well imagine that the financial sector, therefore, should shrink as a share of the economy because very smart people working with very smart computers should be able to do it with fewer people. Remarkably, they do it with more people.

Senator WARREN. Right.

Mr. SPRIGGS. It is the one sector that does not reflect this productivity growth. So right there is your hint that maybe this is not the way to go.

Senator WARREN. All right.

Mr. SPRIGGS. I would just give you one anecdotal evidence of stealing from the productive sector. Fortunately, many Howard University students work for the top firms on Wall Street. Those firms do not just recruit from our School of Business. They do not just recruit from the Department of Economics. They love the School of Engineering. Now, we are taking the Nation's key innovators and putting them on Wall Street. This type of competition for people who the economy might be better served doing innovative things I think is one of those other indicators that perhaps it is getting too big.

Senator WARREN. That is a very helpful comment, Mr. Spriggs, and, in fact, given the conclusion of the IMF paper, it looks like to me that our question today should be how to push banks toward investing in the real economy instead of investing in complex, high-risk activities that produce very little economic value. I take it you would agree with that?

Mr. SPRIGGS. Yes.

Senator WARREN. Yeah. So the IMF paper had another interesting finding that I want to talk about for a second here. Expanding access to the financial sector always had a positive impact on growth, so more access helped growth. To me, that means one of the best things we can do to promote economic growth in this country is to make every effort to provide basic banking services to the 40 million unbanked households in this country.

So let me ask you this, Mr. Spriggs: For the past few years, I have argued that the post office should be permitted to provide basic banking services, just checking, savings, bill paying, that sort of thing. This would be a win-win for consumers and for the post office.

Do you think it would also help promote economic growth if postal banking expanded access to the financial system for some of the 40 million households that are locked out today?

Mr. SPRIGGS. Yes, it would, Senator. I mean, one of the key factors is that we have improved on the public sector side in how we can deliver transfer funds, how we can help low-income families. We can do this electronically. But because they are unbanked, we

end up with lots of leakages. In fact, my State, Virginia, had to take some steps because we used to do the State income tax refund that way. Many people found out that it cost more to access the refund because of that than the refund was worth, and the State has tons of dollars wasted because of that.

Reaching the unbanked would provide the stability in those economies, those local economies, those micro economies, that helps small businesses to develop. And one of the difficulties at the smaller level, the neighborhood level, is the managing of cash-flow. The problem with payday lenders is part of people trying to manage their own cash-flow because they do not have access to banking. And that would help small businesses at the neighborhood level.

Senator WARREN. That is very helpful, Mr. Spriggs, and I really do appreciate it. You know, a lot of Americans have known for a long time that the financial sector has gotten too big, too complex, and too powerful. And now there is a big stack of research to back that up.

It seems to me that our job here on this Committee is to advance policies to make the economy grow, not policies just to make big banks even bigger. Reining in the big banks is good for financial stability and avoiding bailouts, and it is good for the economy. There is no tradeoff here between regulation and growth. They work hand in hand if done right. And I hope that will be the focus of this Committee and Congress. Thank you very much.

Thank you, Mr. Chairman.

Senator COTTON [presiding]. Thank you.

Mr. Heller, in your written testimony, you say there are two basic ways to increase bank safety: one is more regulation, one is more capital. Could you explain a little bit more for the Committee about the tradeoff from those two choices and what might be the wiser course of action as a matter of policy?

Mr. HELLER. Well, like I say in the statement, if we have well-capitalized banks—and Senator Warren was citing IMF studies. There are also IMF studies that, for instance, show that banks, once they reach about 15 percent capital, the marginal benefit, the incremental benefit of that additional capital really is very close to zero. So by well capitalized, I would say somewhere between 10, 15 percent, roughly in that range, according to the IMF data, basically, banks do not fail. If banks do not fail, that means that they can serve the communities very well, and they do not need all the regulatory restrictions in order to make them safer. So that is the tradeoff that we have, and I think the CHOICE Act does exactly that. It says if you are a well-managed, well-capitalized bank, then you are relieved from the regulatory straitjacket that we are talking about.

Senator COTTON. Is it fair to say that having a higher capital standard is a simpler, less complicated way to ensure bank safety than having exquisitely refined regulations written by a multiplicity of banking regulators?

Mr. HELLER. Exactly, Senator. And, furthermore, it is a much cheaper way because you do not have to have all the armies of regulators coming in. We have plenty of regulatory agencies that supervise even small banks. They come in; there is a lot of man-

power. And then the bank staff has to respond to them, and as a result, there is an endless dialogue between the regulators and the banks. And the compliance staff is growing, and that does not make the economy more efficient, and it does not make the banks more efficient.

Senator COTTON. Who, in your opinion, in the industry would resist such higher capital standards in lieu of greater regulation?

Mr. HELLER. Well, traditionally—I mean, I am an old man. I remember Walter Wriston arguing at Citibank that they did not need any capital at all; you know, zero was enough. Clearly, that was wrong. So, typically, large financial institutions tend to resist it more than the smaller institutions. But also for the smaller institutions, it clearly means that they are not earning as much on every dollar invested in the institution. So, in a sense, they say less is better.

But I think your role in Congress is to say that—give people a choice, either regulation or the capital requirements. Please do not do both.

Senator COTTON. Mr. Powell, I saw you nodding your head, perhaps in agreement, perhaps in fond memory of some of the same battles fought years ago when you were at one of these agencies. Would you care to share your thoughts?

Mr. POWELL. You have got to remember I was CEO of a bank in the late 1980s that almost failed. We were in a cease-and-desist order. So I have tattooed on my chest, “Capital.”

I am kidding. It is not on my chest, but it is very sacred to me.

Having said that, I think—I do not want to give the wrong impression from my view that regulation is not necessary. It is. Just as self-assessment is not one of my virtues, all of us need some type of oversight. When you have FDIC insured and the United States treasury is at risk, you have got to have some type of regulatory. Capital is extremely important, but I do not think it replaces that you should ignore regulation. So I think the balance is very important, that we try to get it right. We go to extremes every time there is a crisis one way or the other.

So I think reassessing, rethinking about what the regulatory environment is for small and large institutions—and, incidentally, the large institutions have been getting batted around a little bit. I was on the board of Bank of America, so I have been at a community bank and I have been at large institutions. Clearly, those institutions provide a service and provide an economic engine for entities that the community banks cannot take care of.

So I think capital is extremely important, but you have got to remember, Senator, shareholders want a return. So you have got to attract capital, so if you attract too much and the return is not much, there is no capital there.

So you have got to understand that shareholders want a return and that there is a base of capital there that, as you said, there is no return for it. But I do not want anybody to have the impression that we do not need any regulation from my point of view, because we do.

Senator COTTON. Thank you. My time has expired.

Senator HEITKAMP.

Senator HEITKAMP. Thank you, Mr. Chairman.

Just a couple points on previous conversations. Mr. Spriggs, Dr. Spriggs, we have got a little bit of a chicken-and-egg problem as it relates to big versus small, right? You said, well, look, you know, the big threat to small institutions is the growth of large institutions. But by overregulating the small institutions, what was supposed to be too big to fail has become too small to succeed, driving business up. And so we have got to figure out the small business and the small bank piece of this.

We have been working very hard on compromises, trying to advance some additional regulatory relief, taking a look at a lot—a lot of the discussion that we have had here today is very helpful.

Senator Perdue said, look, we have a problem that we are not moving enough capital into business. I am not sure I agree with that, but I do agree with that as it relates to small rural counties and communities. And I just want to give you some statistics, and this is for Mr. Heller and Mr. Powell mainly. If you look at economic studies, from 2010 to 2014 U.S. counties with 100,000 or fewer residents combined to lose more businesses than they created, despite a growing national economy and a falling unemployment rate.

In a recovery beginning in 1992, by comparison, those counties, those same counties created a third of the Nation's new business on net. Moreover, nearly two out of three rural counties lost business in this recovery, on net, from 2010 to 2014, and that is up from just two in five counties in the early 2000s.

What is happening? And how do we fix this? And I know that that is a bigger question probably than just the banks, but capital formation is obviously a key component to economic growth. So what do we do to turn this around? Because we saw the reaction to this in this last election. And people keep saying, "What is going on in rural America?" This is what is going on in rural America. So how do we fix this?

Mr. HELLER. I fully agree with you, Senator, with what you are saying, if I understood you right. In the current expansion, there was less business formation than in previous expansions.

Senator HEITKAMP. In rural counties.

Mr. HELLER. In rural counties, and especially among small firms, and that is exactly the point I am making in my testimony. Firms are actually leaving currently at a faster clip than there are entering new ones, so we have net losses. We also have the same phenomenon on the small bank side. There are no new banks coming in, rural or urban, basically none. And both of those things hang together. The topic of today is: What does the financial sector contribute to economic growth? And the financial sector in these rural counties especially is weak, and there is no new lifeblood coming in, and nobody can afford—and Mr. Powell, who is more of a rural small town banker than I am—I am a suburban small banker—can speak to that, I am sure.

It is very difficult to get the additional funds and to be able to stand the regulatory burden for these small institutions. So they are just not being formed.

Senator HEITKAMP. Mr. Powell.

Mr. POWELL. Senator, I think that is a valid point. I think one of the things—it is a complex question because quality-of-life

issues, there are a lot of issues that contribute to that. But from a bank standpoint, if I were going to put a bank in a rural community, I have got to see economic activity. I have to get a return on my capital. So I have a choice where I go. My capital will follow where I make money. So one way I can make money is that the regulatory burden—I am not saying free ride, free lunch, and all those things. I hope you understand that.

Senator HEITKAMP. Yes.

Mr. POWELL. But I cannot be worrying about assembling data. I cannot be worrying about a qualified mortgage when I have a farmer who has got a farm that is clear and he wants to borrow a 100 percent loan on the house. I cannot worry about stuff like that.

So you have got to give me a different set of regulations in order that I can breathe and exist, because I have choices, and I am not going to go to that rural market unless I can make a buck. And if you burden me with regulations to open a bank there and to try and engage in banking, I am not going to do it.

Senator HEITKAMP. You know, the dirty little secret is that these community banks are relationship bankers.

Mr. POWELL. Absolutely.

Senator HEITKAMP. And I can tell you, I grew up in a town of 90 people, and you could look at a balance sheet of one guy and say he is—you know, just on the numbers, he is the guy that you should be giving money to. No one in town is going to give him money because he does not pay his bills.

Mr. POWELL. Absolutely.

Senator HEITKAMP. And you can see the guy come in whose balance sheet is net loss, and you know he is going to pay you back because you know him. It is character banking, and we are losing it in this country. And it is part of why rural America is not—retracting, I believe, is that we do not have that anymore.

Mr. POWELL. But, Senator, they cannot make that loan. They cannot make that loan under current regulations.

Senator HEITKAMP. Right. I agree.

Mr. POWELL. They cannot do it.

Senator HEITKAMP. We have got to unleash it. But I think that rural economic development is so complex, and one of you raised the quality-of-life issues. I have a test: Can they stream Netflix? You know, it seems like such a small thing, but I can tell you, housing and quality of life, we have—we used to say in rural America that if you created primary sector jobs, you build it, they will come. Guess what? We have 80 open primary sector jobs in places in my State where they cannot get workforce. And so we have got to build back these communities, but that bank, that community corner bank, has always been a huge part of that economic development, and we are losing it as a result of overregulation of the community banks and the credit unions. There is no doubt in my mind.

And so we are adamant that this is going to get fixed, but I do not want to walk out of here and not point out that the most despair economically in this country is in rural America.

Mr. POWELL. Right.

Senator HEITKAMP. Thank you, Mr. Chairman.

Senator COTTON. Senator Van Hollen.

Ms. VAN HOLLEN. Thank you, Mr. Chairman. Thank you to all our witnesses. Just a couple points on some of the issues that have been raised.

Clearly, we need good capital requirements in banks, but I agree with Mr. Powell, they cannot be a complete substitute for some kind of reasonable regulation.

Mr. Chairman, I would just like to put in the record an article that appeared in the *American Banker* called, "Risk Weights or Leverage Ratio? We Need Both", by Aaron Klein at Brookings on this topic.

Senator COTTON. Without objection.

Ms. VAN HOLLEN. The other issue I would like to just raise and tag and am interested in maybe feedback later is this issue of community banks and commercial banks generally, because a lot of the discussion is that you saw this rapid decline after Dodd–Frank. And I would just point out—and I have this chart, put together by the FDIC, 2014, which indicates a dramatic drop in commercial banks in the United States, starting back in the mid-1980s where we had over 14,500 commercial banks, and before the financial crash, that was cut almost in half—in fact, a little more than half. And the decline since then is just on the same trajectory that it was before Dodd–Frank.

Mr. POWELL, could you comment on that?

Mr. POWELL. Yes, Senator. I think some of the things we have talked about here today is that if I have—if I am going to capitalize an entity, capitalize a bank, I have choices. So I have got to have a return on my capital. I have got to expect that I am going to be able to increase my capital and continue to make money, so I will look at the handicaps and the burdens of that. I will look at the community; I will look at a lot of things. But one of the things and a primary factor, very frankly, Senator, is the burden of regulation. And it is more than the written burden of regulation. It is the tone, the attitude. I could tell you that plays very important in the decision.

I mean, I can read the regulations and understand what the cost of the regulation is. But when a regulator comes in and how he or she addresses those issues is critical. It is really, really important. And that is the reason in my testimony I said agency heads, leadership, these agency heads are critical.

Ms. VAN HOLLEN. And I agree with that, and I agree we need to find ways to strengthen community banks. I just think it is important to recognize that the drop in the number of commercial banks in the United States is something that long preceded Dodd–Frank—in fact, even more dramatically so. So there are other things that are going on.

Mr. POWELL. That is right.

Ms. VAN HOLLEN. Not that we do not need to address them. We do.

In Dr. Heller's testimony, his written testimony, you reference the fact that in the 1970s and 1980s we had a lot of companies providing the defined benefit retirement plans, and we have obviously gotten away from that a lot with the defined contribution plans. And you indicate, Dr. Heller, in your testimony that that puts con-

sumers in charge of their own “financial destiny,” and that is much more true today.

The problem we have got is that there are many companies, more than half of companies and businesses in the United States do not provide their employees right now access to 401(k) plans. In fact, according to Brookings Institute, 52 percent of employers with 50 to 99 workers do not offer retirement plans, and among companies with fewer than 10 employees, that proportion rises to 80 percent.

Now, in the State of Maryland and some other States, we have adopted legislation, bipartisan legislation, signed by the Republican Governor of Maryland, to create these State-based retirement plans that employees can voluntarily enter into if their employer is not providing access to 401(k)s. And you are finding lots of people, especially a lot of young people, signing up for this.

At the same time, right here in Congress, we have a piece of legislation coming through that could undermine those efforts.

Dr. Spriggs, could you comment on this? Because we all know that trying to build a secure retirement requires providing more access to these vehicles? Could you comment on the legislation and the whole concept? And then I would be interested—

Mr. SPRIGGS. Well, that type of legislation that you speak of is actually a compromise because part of it is to figure out a way to handle the fiduciary responsibility of the company that initially collects that savings. And that is a compromise at the State level in how we handle that so that it can, in fact, take place.

That type of compromise, as long as it is in law and protects the workers, we are very much in favor of it, and States are responding to Congress not expanding Social Security. The best thing we could do is to expand Social Security. But without that taking place, having States take the initiative is a good thing, and particularly for low-wage workers: school cafeteria workers who are no longer part of the public system, they have been privatized; the school crossing guard. These people are vital to our community and have been cut-off from this access to retirement savings, and this is a way to let States begin to address that. And as I mentioned, in each case that it has happened so far, it has been a compromise to protect the savings of those workers, and I think it is a thing to encourage, not a thing to discourage, because it is one time where the States as a laboratory are leading.

Ms. VAN HOLLEN. Thank you, Mr. Chairman. I realize my time is up, but if Dr. Heller or others have time and any interest in a written response, I would be interested in your comments. Thank you for raising the issue in your testimony. Thank you.

Senator TILLIS [presiding]. Thank you, Senator Van Hollen.

Thank you all for being here today. I happen to be next in the order and sitting in the chair. We have got people cycling through like me with three different committees many of us are bouncing between, so I apologize for not being here earlier.

Mr. Powell, I want to start with you. You wrote an interesting article just recently back in January that was titled, “Why Dodd-Frank Is Unfair to Banks”. I apologize if people have asked this question before, but I would like to go back and maybe in the context of all my questions, answer it in the context of what I consider

to be the financial services ecosystem, which I think is out of balance now. I will give you my prejudice.

You know, at the high end are the big banks, then the regional banks, and then the community banks and credit unions. But other financial institutions that are at that base of the pyramid provide access to money in an orderly fashion, if it is regulated properly, that people may not otherwise be able to get. So can you tell me in the context of that ecosystem which banks Dodd–Frank is unfair to and what you think we should consider as a matter of regulatory reform?

Mr. POWELL. Yes, Senator, thank you. That piece, the caption was a little bit misleading in that the sense of that was due process. So I think that is something that we have forgotten about. I mean, it is an American—

Senator TILLIS. And I love the way that you—I should have entered that into my question or thought about it in my question. The board that you are talking about to actually provide due process that has a balance of people with banking industry experience, regulatory experience at the State and Federal level, how does that play out, again, within that ecosystem, knowing that as you get further down to the base of the financial ecosystems, people's resources are limited? But I think that that is a great example. We could use better due process in a lot of regulatory contexts, but if you could explain it in that manner, I would appreciate it.

Mr. POWELL. Sure. Well, it is alive at the top and at the bottom on that whole process. I think it would enable the bottom. I think it would enable—I think it would give power—it would be an enabler to the bottom because of resources. I mean, if larger—mid-sized and larger institutions have an array of attorneys and an array of compliance officers at their disposal. So whereas the smaller institutions, they do not have that, and when they have a dispute or a disagreement with the regulator, what are they going to do? They are going to forget about it. Whereas, large institutions have a lot of resources to combat that. So I think that particular thought—my suggestion was—that is just one suggestion. There may be others. It would empower those people.

Senator TILLIS. And, Ms. Del Rio, I was not here, but I know that you having some experience with credit unions and credit unions have what I think is an appropriate exemption that is not extended to maybe other peers at the base of the pyramid, why is it fair for one area to have that exemption and others not?

Ms. DEL RIO. Thanks for the question. I actually do not think that credit unions should have wholesale exemptions, or any institution. My credit union, as I discussed earlier, is a community-based small financial institution that focuses on serving low-income and immigrant communities, and, you know, yes, we have costs of regulation. We are under lots of regulation, not just Dodd–Frank. And we try our best to embrace that and to recognize that there are bigger needs for that that, you know, we do have exemptions as CDFI-certified credit unions from certain rules. But, by and large, I am not aware of wholesale credit union exemptions, nor would we support that per se.

Senator TILLIS. Nor am I. I am getting more to the point of other—I think that we have to look at the different strata of the

financial services ecosystem and figure out whether or not we have a fair or consistent treatment with those who are at, I think, the base of the ecosystem, as I think credit unions are, community banks, and other lending resources. There is always a question about how you regulate it for consumer protection, and I get that. But how do you have a more consistent treatment for the people whose customer base and the nature of their products have similarities and should either enjoy the same exemptions or not have them?

I have a general question so that I can move to Senator Schatz, and it is around—I think that we are at our best when we set expectations right for what we can do around this building for regulatory reform. And I think there are a lot of opportunities for small “R” regulatory reform—reforms that reduce the disproportionate burden that goes on smaller financial institutions for regulatory compliance. We clearly need regs to ensure consumer protections and market viability, but do it in a way that I think is beneficial to the financial services community.

I heard it said in this Committee that we need to focus less on the financial services community and more on the real economy. The real economy does not exist without a thriving and secure financial services community. I do not see how the two work. Who underwrites risk? Who provides the funding for long-term capital investments, et cetera?

So I am probably going to stick around for another round, but, Mr. Deas, I want to tell you that I was even skeptical about small “R” regulatory reform until South Carolina made it to the Final Four. Now I know anything is possible. So if I have time for a second round, I am going to go back and ask this question again.

Senator Schatz? Or, I am sorry, it is Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you, Mr. Chair, and I apologize for bounding back and forth as well in the Banking Committee. And let me just say to the Chair, I am an alum of Gonzaga, so we will see you at the Final Four.

Senator TILLIS. I am counting on them to win in the Final Four and then lose against my Tar Heels.

[Laughter.]

Senator CORTEZ MASTO. We will see. We will see.

So let me just say I am from Nevada. As you well know, subprime mortgages had a devastating impact on us. I was the Attorney General at the time, and I will say this: I am not for a wholesale rollback of Dodd–Frank just because we can. I think it was important regulations that were put in place, an important law to address a horrific thing that happened with subprime mortgages and will continue to support it.

However, I am also about finding the balance, and I think there are times when we do overregulate, and we need to figure that out. So I am willing to work with my colleagues to figure out what we can do to tweak it or improve it. But at the end of the day, when it comes to homeowners who suffered and people who had no control, who are still suffering in Nevada, I am going to be there fighting for them every step of the way. So I am about reasonable, commonsense laws and legislation.

Here is my concern, and I am going to open this up to all of you. A few weeks ago, the Trump administration released their “skinny budget” for the coming fiscal year. And while the document lacked many key details, it did outline a 15-percent cut relative to the housing and urban development funding bill that passed the Senate committee last year.

Last week, my office released a report on the proposed budget’s impact to Nevada which found that, if enacted, the Trump budget would cause my State to lose over \$39 million in grant assistance and more than 1,300 housing vouchers. If we are interested in promoting economic growth, does it make sense to severely cut investments in community infrastructure such as sidewalk repairs, accessibility, enhancements for people with disabilities, social services like youth mentoring, food pantries, and transportation to take elderly people to medical appointments, and affordable housing construction? These are all types of programs that would be defunded in Nevada. I am curious if any of you have a comment on what I have just talked about.

Mr. SPRIGGS. Well, Senator, if I may go first, thank you for the question. One of the key elements in the real economy is the growth of the labor force. This downturn has slowed labor force participation. The labor force participation rate especially for American women flattened back in 2000, and we cannot continue to have—or we cannot return to faster growth until we find ways to increase our labor force participation rates.

The U.S. has lagged all other countries. We have now fallen behind, in terms of female labor force participation, countries which we thought culturally were not predisposed to it. So we now have a lower labor force participation rate for American women than for Japanese women, as an example.

Compared to Canada, we have also done worse, and that is our neighbor and very similar in many ways to the U.S.

One of those key elements is the provision of adequate child care. Those funds that are going to be cut to Nevada and to other American communities go straight to funding child care. Without that, we cannot get American women back to work. Without having assistance to people with disabilities, we cannot get their labor force participation rate up. Without the kind of infrastructure that makes it possible to get to work on time that the housing community development funds provide, we cannot have the infrastructure in many communities that lock people out from access to jobs. We need to find ways to invest in Americans and to make that investment where it counts, and where it counts for growth is you have to have a faster labor force participation rate—a higher labor force participation rate and faster labor force growth.

So these things are going to hurt growth, and the chicken or the egg in all of this, it is not that businesses then get us people. The causation runs the other way. The causation is wages go up. These are now new potential customers, and businesses develop to take advantage of that, to see where the opportunity is, and that creates a virtuous cycle. But the causation is wages go up, then you get the businesses. And so if you do not have widespread income growth, if you do not serve the communities that will be hurt by

these cuts, then you are not going to see the customer base grow widely.

Senator CORTEZ MASTO. Thank you. And, Mr. Chair, I see my time is up. If there is a second round of questions, I would like to ask one more. Thank you very much.

Senator TILLIS. Senator Cortez Masto, also happy birthday tomorrow.

Senator Schatz.

Senator SCHATZ. Thank you, Mr. Chairman. Thanks to all the panelists for an interesting discussion.

I want to talk to you about student loan debt, and the reason for that is that I think in the context of the U.S. Congress, there is a lot of conversation about student loan debt as a sort of family issue, as a personal issue, and none of us escape it, whether we are parents or grandparents or kids or some of us paying off debt while we are saving up for our own children. But that is not the part I want to talk to you about. I want to talk to you about it as a national economic issue. And it seems to me that there is Fed data that indicates that it is quickly becoming a real macroeconomic question. The Fed says that student loan debt now tops \$1.3 trillion and continues to grow. It has surpassed all other kinds of consumer debt except for mortgages. And it is not sustainable. The Fed shows that about 50 percent of all borrowers have not begun repaying, and 30 percent of borrowers who are in repayment are delinquent on their loans.

So the question becomes two things, in my view: First of all, it is clearly crowding out the ability for consumers to afford other things, right? To purchase cars, to purchase consumer items, to get a mortgage, to get on their feet financially. So that is one aspect of how it is impacting the overall national economy.

The other thing is it seems to me that even though we spend more and more in real dollars and in inflation-adjusted dollars on Pell grants and subsidies on the Federal side than ever, we continue to see the cost of college rise more than ever.

And so now we have got this system where we are throwing free money at the system, right? And yet we have got massive disincentives. For the very first time, you can sit down with a 17-year-old, and it is an open question whether or not it makes economic sense for them to pursue a higher education. And that is not just a personal question. That is not just a political or ideological question. That is a question of our national economic strategy. If we have configured a system where we are disincentivizing our young people from going to college or we are saddling them with so much debt that they cannot even get on their feet once they are done, it seems to me that has got macroeconomic impacts. And I would like each one of the panelists to quickly comment, starting from left to right.

Mr. HELLER. A very important topic, Senator. First of all, let us look at the cost side of the equation that you have just talked about. I used to be a professor at UCLA. We used to teach two or three courses a week. You know how much they teach now? One. That means the cost of an education has doubled or even tripled. You know, there is a relationship between how many professors teach how many students.

I think it is almost unconscionable what is happening in many of the universities around the country. So you have got to increase teaching loads, and that will bring down the cost of college educations for the individual.

Senator SCHATZ. In the interest of time, that is compelling and provocative, so I will just move on so we can hear from everybody else.

Mr. HELLER. Thank you.

Senator SCHATZ. Mr. Powell.

Mr. POWELL. Senator, I recently served on the Board of Regents of Texas A&M University system, which is a large system. I will give you some data.

Of the graduates at Texas A&M, the flagship institution, only 30 percent of the graduates have debt, and it is less than \$30,000. So there is a way to do it. Now, part of it—it is a complex question. Some of it is efficiency. Some of it is a lot of other things. But part of it is culture, also. Part of it is culture, and part of it is sacrifice, part of it is—I think this has been fed because of some Government programs. It is easy to get debt. It is very easy. I can get, anybody can get student debt. So we have got to change those standards, too, and then we have got to look at success ratios.

Senator SCHATZ. Mr. Deas.

Mr. DEAS. Thank you, Senator. I am speaking as director of the University of South Carolina Educational Foundation, and I can say from the time I graduated in 1972 to now, the percentage of support from the State of South Carolina to the university has decreased greatly. We just completed a \$1 billion capital campaign, one of the principal purposes for which was to support students who would otherwise be unable to afford our education.

Senator SCHATZ. Thank you.

Mr. Spriggs.

Mr. SPRIGGS. I think that last point is the key. In the 1970s, 60 percent of the budget came from State and local governments. Now it is 30 percent. We have asked students to catch up with that gap, and that has driven universities to be tuition-driven. They need the money. And if you look at the growth in income inequality, remember that the top 20 percent of income distribution consumes 60 percent of the education budget. So if you are running a university, you are chasing those dollars. Specifically, you are chasing the 1 percent.

So if you look at tuition increases, they follow the increase of income for the 1 percent. Because the 1 percent have had faster income growth than the median or even the 20 percent, that is where the gap is coming from. And we have asked students to fill that gap. So the key is to reinvest as a Nation in our students.

Senator SCHATZ. Ms. Del Rio.

Ms. DEL RIO. Thank you. So at the beginning of my testimony, I made the point that although credit is vital, it should not be advanced as a sole solution to deeper issues, and this is an example where student loan debt, especially when placed on very low income students, has been advanced to fill the gaps left by public investment in higher education. Payday lending has been advanced—these usurious 400-percent interest rate loans have been advanced as a solution to the fact that people are not earning living wages.

These are the examples that really have impact not just on people and communities but on the economy ultimately, as you see this \$1.3 billion in student loans being amassed.

Our organization operates a free legal-financial justice hotline in New York City, and I just want to point out that some of the calls that we used to get around student loan debts really exemplified another public policy issue, which is that these student loans, especially when they are made to cover tuition at for-profit and often fraudulent schools, are by and large subsidized by the Federal Government in the form of student loan guarantees. And this business model has been well documented. These are schools that are set up not to provide education but to siphon public dollars by using these low-income individuals and their eligibility for Federal guarantees. And not only is that a poor use of public subsidies and dollars, but those individuals then, once they did not get their degree or they were not able to get a job or they found out the degree they had was actually not—was worthless, they were not able to then get Federal student loans to go and attend a sound school because they had used it up for these shoddy schools.

Senator SCHATZ. Thank you—

Ms. DEL RIO. So there are layers and layers, so thanks for the question.

Senator SCHATZ. Thank you very much, and I thank the Chair for his indulgence.

Senator TILLIS. Thank you, Senator Schatz.

I think that Senator Cortez Masto and I both have plans to ask a second round. And, Senator Cortez Masto, as a birthday gift, I will let you go before me.

Senator CORTEZ MASTO. Thank you, Mr. Chair.

I am interested in the discussion on how we grow the economy, and one of the areas that is important for me is the issue that I believe—and I have seen the statistics to show—that if we just passed comprehensive immigration reform, that would grow our economy. I know—and I have seen and let me just run through it really quickly—the studies that are consistent that show President Trump's Executive order would reduce our Nation's cumulative GDP over 10 years by \$4.7 trillion. An article in Politico today that says the Hispanics, who make up two-thirds of the Nation's undocumented population, are critical players in the building and sale of single-family homes, which account for about one-sixth of the U.S. economy.

I am curious from your perspective, Ms. Del Rio, is that true, that you see a correlation between economic growth and passing comprehensive immigration reform?

Ms. DEL RIO. There are ample stories that show different cities and towns throughout the country that were experiencing economic disinvestment that were revitalized as a result of immigration to these new areas, often for the first time. These were sort of not the traditional immigration corridors.

Our organization for many years ran an immigrant financial justice project that tried to address barriers and worked very hard with a broad section of groups and lenders and advocates and others to address and eliminate barriers that immigrants face with respect to our economy, and these include things as fundamental as

basic bank access. New York City, as you may know, our population is 40 percent foreign-born, and yet the biggest banks routinely impose identification requirements that go far beyond what the law requires, that basically exclude low-income and undocumented immigrants. There are no requirements right now, there are no legal barriers to immigrants, regardless of status, participating in the economy through purchasing homes, starting businesses, and, in fact, many do, and so on. And yet banks, which are supposed to be the gateway into the economy, have consistently put up barriers.

I think that is a really critical issue to examine because I think if immigrants that are here now have pathways to status and also have pathways into the real economy and are not relegated to sort of these high-cost, fraudulent, often unregulated sectors, it would do a lot for the overall economy.

And just one other note. You know, immigration status—yes, immigration reform we believe would go far toward advancing fairness and economic growth overall. But, you know, immigration status even without comprehensive reform can be very fluid, and, you know, the Deferred Action program is one example. You have now hundreds of thousands of people across the country who have this status where they are able to work, they are able to get work permits, Social Security numbers, and participate in the open in the system, and yet financial institutions are not by and large serving that population either. And so I think that this is an unrecognized by really critical issue.

Senator CORTEZ MASTO. Thank you very much.

Thank you, Mr. Chairman.

Senator TILLIS. Thank you, Senator Cortez Masto.

Back on a point that Senator Schatz was making—and I think, Mr. Heller, you went on a good path, because instead of answering how do we continue to address the increasing cost of education, how do you get to the underlying cost drivers, you used one example. Another one, in North Carolina, the public university system there estimates that they spend about \$1.2 billion a year in regulatory compliance, and it disproportionately harms the smaller institutions.

So one of the ways, if we are really going to get serious about addressing student loan debt and affordability of college, we need to understand that we are also the root cause of some of the spiraling costs. And we have got to work on that, and I am glad that Senator Schatz brought it up. It is something we need to work on. It is not in this lane, but it is critically important because it affects those who want student loans, bending the curve.

Mr. Deas, since I took a shot at the University of South Carolina earlier, I am going to start with you, but in a positive way. I actually like the Gamecocks except when they are playing a couple other teams down in the Carolinas. But I want to ask you and Mr. Heller to explain to me how large, medium, and small financial services institutions are helping U.S.-based companies get access to international markets and whether or not you think that is important.

Mr. DEAS. Senator, I think it is very important, and companies have a network of banks providing committed credit, and since

committed credit is the most important thing they need, they frequently rely on those banks to provide other ancillary services, especially those that would take advantage of their international networks for documentary letter of credit collection and other activities through the financial system that would facilitate trade, exports, and other activities. So it is very important.

Senator TILLIS. Mr. Heller.

Mr. HELLER. Yes, I have testified that all financial institutions are important, different sizes, and that we need a mix of them. But if you focus specifically on international trade, obviously, the large institutions are the ones that really play the important role. A community bank just cannot be involved in international trade finance or offer various facilities to make international commerce easier for the corporations. So you need specialized institutions or large institutions that offer these very specialized services. In this country, we are interested in increasing our exports, so we have got to have export finance, private export finance available. You have got to have receivable finance, and by its very nature the time periods are longer. It takes 2 or 3 weeks until the ship gets over to Europe or to Asia. So these larger institutions play a vital role there, and foreign exchange services, all those things together.

Senator TILLIS. And, Mr. Deas, I just have one other question for you. I know in your testimony you talked a little bit about the impact of rules that are promulgated on the end users. Can you talk a little bit more maybe in specific terms about risk mitigation instruments an end user may have had at their disposal at one point in time but through the regulatory process it is not a factor in their process of seeking capital or financing?

Mr. DEAS. Yes, sir. Thank you for that question. From the end-user's standpoint—and I have had the privilege of working for American manufacturing companies for almost 40 years—we view the financial system as very similar to the electric transmission system that takes electricity from where it is generated and transmits it to where it is needed. And the financial system for us does the same thing. It takes funds from wherever they may be generated and in excess and transmits then to where they are needed.

They do the same thing for the transmission of risk, if we have one company that is exporting and selling in a foreign currency, it needs to lay off that foreign currency risk to somebody that may be importing and needs to purchase the foreign currency.

And so when there is a burden that is placed on this transmission system, it inevitably raises the cost to end users. And so through the actions of Chairman Crapo and others on this Committee in the last Congress, we were able to get a clear exemption from the end-user margin requirement that would have required us to post cash to offset derivative positions. But now the bank capital requirements are imposing the exact same economic burden on end users through the imposition of—the capital that we would have paid in margin is now capital banks have to set aside against our derivative positions. And when that transmission of risk becomes too complicated, companies do not take the risk. They do not produce, and ultimately they do not hire more American workers.

Senator TILLIS. Thank you. I could go on forever, particularly since I have got the gavel right now.

[Laughter.]

Senator TILLIS. But, Mr. Spriggs, I did have one final question for you, and it relates to the line of comments and questions that Senator Cortez Masto had on immigration reform.

What is your opinion on what she said and the extent to which immigration reform is important for economic growth and American job growth in the United States?

Mr. SPRIGGS. Well, thank you very much for that question, Senator, because I think it is very important. When workers do not have the security of the certainty of their status, it means they have to be in the shadows. Their companies have to be in the shadows. And it means that we have a poorly regulated labor market. The protections to make sure that workers do not have their wages stolen, be safe at work—all of those things disappear.

When workers have the certainty of their status, several things happen. The labor market becomes more dynamic. They are free to move. They are free to take the job that they would like to take. And a more dynamic labor market, a labor market in which workers are free, is one of the prerequisites for getting wages to go up. They need to be able to bargain. Workers without status would not dare risk forming a union because they know they are going to be in trouble right away. Workers who do not have a clear status are not going to go to the Department of Labor, even though the Department of Labor, while I was there, made sure to let workers know that we enforce the laws of the United States, period.

But all of those things mean that the labor market does not function as well; workers are not in the positions that would be the most productive. And giving them that certainty, giving them that path to know that I am going to be free to move around in the labor market benefits all workers. No one benefits by having 11 million people in the shadow, and we should understand that this is not a “them” and then an “us.” People who are undocumented are married to American citizens. They have American citizen children. So this is not kind of a—

Senator TILLIS. Let me just ask one follow up, and then we will bring the Committee to an end. Let us assume, now that we know anything is possible, that we move into some immigration reform dialogue. The next logical step or one of the components in immigration reform would obviously be the consideration for work visas at the full spectrum, highly skilled STEM resources to lower-skilled resources. How does that weave into your concept of comprehensive immigration reform suggested by Senator Cortez Masto?

Mr. SPRIGGS. We believe that workers always have to have a path to citizenship. Temporary visa programs—the H-2B program, the H-1B visa program—all exploit workers and work to the detriment of American workers and to those workers. And we have seen the abuse of the H-1B for high-end workers where Americans recently in the University of California hospital system had to forfeit their jobs and train a set of workers to replace them—

Senator TILLIS. Do you believe that there is a sufficient number of American citizens and the population that is illegally present to fulfill the H-1B visa needs of this Nation and a 3- to 3.5-percent GDP growth? I do get the exploitation. That is why we want to find the businesses that do that, that actually discredit visa programs.

But do you believe that we have sufficient labor force to meet a growing economy at 3.5-, 4-percent GDP growth?

Mr. SPRIGGS. If we continue to make the proper investment in American—

Senator TILLIS. But I am talking about today.

Mr. SPRIGGS. Today we have enough workers. If we continue— if we can return to making the proper investment in American children and believe in them, we can educate enough people to do the job. During the downturn, we continued to bring in H-1B visa workers even though we were laying off workers in that industry and even though we were continuing to graduate students desperate for jobs. That generation—anyone born between 1985 and 1994 is going to pay a permanent lower wage penalty because of the size and duration of this downturn, including those who got advanced degrees in computer science.

And I would just note, you know, they are smart enough to know this. My son is going to graduate in electrical engineering because we do not do H-1B visas in electrical engineering. Students in engineering know this. They know that if you do certain fields, there are no H-1B visas. And they know if you do other fields, you face that competition.

Senator TILLIS. I have completely swum out of the lane of banking into my position on the Immigration Subcommittee in Judiciary, and what I am hoping—and maybe that is an appropriate committee for you or others to come before. But I think that there is a way to—if we are going to get serious about immigration reform, we have to recognize that these are all levers that need to be available. They need to be scaled up and ramped down based on the needs of the U.S. economy and the supply of the resources to fill some of the roles. When we see the analytics, we may disagree on the outcomes on some of them, but I do think that that is a key part of—otherwise, we are just going to continue the 40-year-old chorus of failing to fix immigration reform in this country.

But I appreciate you all being here today. On behalf of Chairman Crapo, I thank you all for spending the time here.

We will bring the Committee to an end, but we will leave the record open for 1 week so that any additional information or questions from the Members can be submitted to you for your response. Thank you all so much for being here. The meeting is adjourned.

[Whereupon, at 11:37 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

**PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO**

A strong and vibrant economy is important for American consumers, businesses, and the stability of the financial sector.

Financial companies of all sizes and forms provide critical services to businesses and consumers, helping businesses manage operations, entrepreneurs get funding to start companies, and average citizens buy a first home or deal with a financial emergency.

As policymakers, we must diligently and frequently study the state of our economy, our regulatory framework, the use of capital, and provision of financial services.

According to recent studies, since the crisis, large businesses are experiencing a more robust recovery than small firms and entrepreneurs.

One of the main drivers of underperformance by new and small firms compared to their larger counterparts is their limited access to credit.

There are direct links between post-crisis regulation and restricted finance.

Data from the St. Louis Federal Reserve shows that a mere decade ago, small banks made more business loans compared to larger banks. That is no longer the case.

Consumers, many on the periphery of mainstream banking, are seeing certain products and product features disappear.

For example, one product line, short-term, small-dollar credit, is expected to see a 60–70 percent decrease in market size—according to the CFPB—with virtually no other avenue for product users to access credit.

These are a few examples that support the need for a thorough review of our regulatory framework and the role of financial companies in the economy.

I have been encouraged by President Trump's executive orders and memoranda on regulations and core principles for regulating the financial system.

The Treasury Department has begun its review, and I look forward to seeing the recommendations it puts forth on how well existing laws and regulations promote or inhibit economic growth.

Last Monday, Ranking Member Brown and I announced a formal process to receive stakeholder proposals that will help consumers, market participants, and financial companies responsibly participate in the economy in a more effective and efficient manner.

And last Tuesday, the Federal banking regulators released their EGRPRA report, which sought to identify regulations or laws that are outdated, unnecessary, or unduly burdensome.

Taken together, these actions will provide a clearer picture of what is working and what is not working within our financial regulatory framework.

Today, this Committee will study how financial companies participate in the economy, with a goal of better understanding their role in fostering economic growth.

Our witnesses have diverse backgrounds, and I look forward to hearing their unique perspectives on this issue.

For example, why are community financial institutions important in local communities, and what happens when communities begin losing financial institutions?

What services do financial companies provide businesses of all sizes, and are services being deployed in an effective and efficient manner?

How can large financial companies help U.S.-based companies compete in global markets?

Ranking Member Brown and I have started working together on a bipartisan basis to hear the thoughts and concerns of various stakeholders and Members of the Committee.

It is my hope that Members will find this to be a thorough, inclusive process, and one that is structured for success.

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**PREPARED STATEMENT OF ROBERT HELLER**

FORMER GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MARCH 28, 2017

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you very much for inviting me to testify on the contribution made by financial institutions to foster economic growth and the role of regulation in that context.

Having spent most of my career in banking and related financial sectors of our economy, I had the honor of serving as a member of the Board of Governors of the Federal Reserve System, where I served as the chairman of the Committee on Bank Supervision and Regulation. Currently I am on the board of directors of Bank of

Marin, a community bank located in the San Francisco Bay Area. It is my pleasure to offer the following observations.

### **The Role of the Financial System in the Economy**

Every student of economics knows about the vital role played by the financial system in supporting and fostering economic growth. In the interest of time, I will focus my remarks mainly on the role of the banking system, but there are many other financial service companies that perform similar or complementary functions as well.

The variety of financial services offered by our Nation's banks is truly extraordinary and ranges from simple payments and banking services to highly complex financial products.

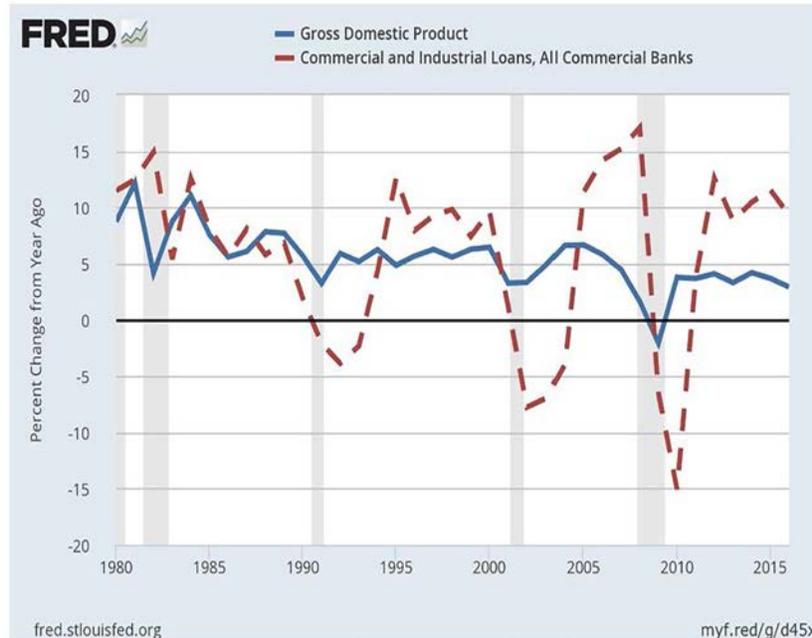
Consumers benefit from having convenient, secure and efficient payments and depository facilities like checking, savings, and money market accounts available to them. Credit cards allow them to buy now and pay later for their purchases. As people go through the various phases of their life, they may have a need to finance their college tuition, buy a car with the help of an automobile loan or lease, or take out a mortgage or home-equity loan to purchase a house and to furnish it. Over a lifetime, people also want to accumulate enough resources to provide for a secure retirement and maybe fund a trust account to provide for the needs of loved ones.

Large and small businesses also have an ever-changing need for a broad range of financial services. Small companies may need simple cash management services as well as a loan to finance inventory or to buy new equipment. Larger corporations may want to issue bonds and stocks to finance their growth and expansion. Companies that are active in international markets will also need foreign exchange and remittance services. Finally, large multinational corporations may want to avail themselves of a myriad of complex financial services, such as swaps and derivatives, which enable corporations to shift risk from their own balance sheet to others through hedging activities carried out with the help of experienced financial intermediaries. In addition, they may need local banking services in the foreign countries around the world where they do business.

In a sense, the financial flows pulsing through our financial system and supporting the economy at large are akin to the lifeblood coursing through our body and nourishing all vital organs. Without the financial flows nourishing the economy, the rest of the economy would wither and die.

#### *Loan Growth Parallels Economic Growth*

Over the economic cycle, loan growth tends to parallel economic growth as is shown in Figure 1, which depicts the growth rates of GDP and that of commercial and industrial loans made by banks since 1980.



Each recession is accompanied by a decline in loan growth and once economic growth recovers, loan growth also tends to accelerate. The relationship works in both directions: higher economic growth calls for new financing of supplies and equipment, and new loans by banks help to spur economic activity. Economic growth and financial activity go hand in hand.

#### *Our Multifaceted Economic and Financial System*

Our economic system is composed of a multitude of enterprises of various sizes. All enterprises start small and, if they are successful, they grow into huge multinational enterprises. It is truly amazing that in our dynamic economy, two companies founded during our lifetime in Bentonville, Arkansas, and Cupertino, California, grew into some of the largest corporations in the world. Small, dynamic companies often experience the highest growth rates and create the most new jobs.

The same holds true for our financial institutions, which range in size from small community banks to trillion-dollar strong, multinational financial corporations that span the globe.

Community banks have always been a mainstay of the American financial system. They are generally small, community-based institutions, which tend to focus on relationship banking. They serve the banking needs of the consumers and the small- to mid-sized businesses within their footprint. They know their customers well and have established relationships that often last for decades. Community bankers know their customers by name and are intimately familiar with the customers they lend to—often because they live next door to them. They do not tend to compete on price, but on the quality of the services they provide on the basis of personal relationships. Community banks that have a solid credit culture and avoid risky exposures can do very well by serving their established customers.

At the other end of the spectrum, we have a handful of large banks that offer a broad range of financial services to their customers. These trillion-dollar strong universal banks provide a broad range of depository services and loans as well as sophisticated financial products and services to their customers from coast-to-coast and indeed around the world. Their services encompass consumer-oriented products as well as products oriented towards middle-market firms. They also offer sophisticated financial services to multinational corporations that include nationwide payments services as well as all the traditional investment banking services available in today's sophisticated capital markets.

It was not always that way.

Until the 1980s, our financial system was mostly composed of community banks and even sizeable institutions consisted basically of a large number of community banks under one common umbrella.

In those days, the Nation's banking system was fragmented along geographic and functional lines. In addition to the community banks, there were specialized financial institutions that served the unique needs of their customers. There were investment houses that catered to the needs of corporations wanting to issue stocks or bonds; savings banks that specialized in the issuance of mortgages; and even credit card banks to issue credit cards. Moreover, traditional commercial banks were largely prohibited from crossing State lines.

Several factors combined to lead to the elimination of these geographic and functional barriers. There were the insights of academic and financial experts that pointed to the risk-reducing advantages of diversified business activities and portfolios. While one set of activities was lagging, other sectors might be booming. Thus, the enterprise as a whole would have a more stable income stream. Asset or loan portfolios would be better balanced and able to weather unexpected risks. Diversification along both geographic and functional lines was seen as making financial institutions safer.

### **Regulations Shaping Our Financial System**

Besides these fundamental academic insights on diversification, there were new laws and regulations that shaped the financial landscape as it exists today. The financial services sector has always been highly regulated, and legal and regulatory actions have fundamentally influenced the structure of the industry. Let us look at just a few seminal events in recent history.

#### *Geographic Barriers*

Until the 1980s, financial institutions were strictly regulated along geographic lines. The depression era McFadden Act of 1927 prohibited federally chartered banks from branching outside their home State. While one might argue that this was in contravention to the interstate commerce clause, it established equality between federally chartered and State-chartered institutions, which were restricted to just that one State in their operations. Furthermore, many States were so-called unit-banking States, where branch banking was prohibited and where banks were restricted to a single locality to conduct their business.

Eventually, bank holding companies overcame some of these restrictions by combining individual banks under a bank-holding company umbrella. But these banking confederations were limited in their ability to lend by being separately capitalized and therefore severely restricted in their lending limits. Each bank also had its own separate board of directors, which was not only an expensive proposition, but also required multiple decisions made by often independently minded directors who wanted to move in different directions.

The double-dip recession of the early 1980s hit various parts of the country with different intensities. It affected many of the unit banks negatively and resulted in a record number of bank failures. It became clear that geographic diversification would add considerable strength to the American banking system and the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 legalized interstate banking and permitted branching across State lines. The passage of this legislation enabled many multistate bank holding companies to consolidate and made de novo interstate branching, as well as acquisitions across State lines, possible.

The resulting banks were safer because they were more diversified geographically and enabled to serve their commercial customers on a nationwide basis. The result was greater efficiency for the banks as well as better service for their customers—especially nationwide corporations.

#### *Functional Barriers*

Ever since the Glass-Steagall Act was passed in 1933 at the height of the Great Depression, American consumers and businesses were served separately by commercial banks and investment banks for their financial needs. This was not the case in the rest of the world, where the “universal” banking model prevailed and financial institutions were allowed to serve both the commercial and investment banking needs of their customers.

As the U.S. economy expanded during the 1970s and 1980s, both consumers and companies began to argue increasingly in favor of allowing one banking institution to serve all their financial needs. For instance, the Employee Retirement Income Security Act (ERISA) of 1974 enabled consumers to save tax-free for their retirement. At the same time, many corporations terminated their defined-benefit retirement plans and switched to defined-contribution plans or IRA accounts. Increasingly, consumers were in charge of their own financial destiny. But commercial banks could

only offer a rather limited product range to their customers. Consumers questioned why they could not conveniently avail themselves also of investment products, such as stocks, bonds and annuities, through their own familiar banking institution.

Some commercial banks therefore tried to “follow their customers” and began to acquire brokerage firms. For instance, Bank of America acquired the Charles Schwab Company in 1983.

At the same time, commercial banks wanted to increase their investment banking services to their corporate customers as well. The regulatory agencies slowly responded to these demands by increasing the magnitude of the securities activities permitted for commercial banks from virtually nothing to 10 percent.<sup>1</sup> But it took legislative action in the form of the Financial Services Modernization Act of 1999, also known as the Gramm–Leach–Bliley Act (GLB Act), to give banks the power to offer both commercial and investment banking services under one roof. President Clinton signed this bill into law on November 12, 1999.

By this legislative act, commercial banks were enabled to also offer their retail customers a complete line of investment products and asset management services under one roof.

Similarly, the new universal banks could offer their corporate customers the complete line of payments, loan and securities products that they needed. For instance, a bank that had helped a small start-up company grow by financing their first receivables and equipment, was now also able to introduce the growing company to the securities market and to issue stocks and bonds.

The Gramm–Leach–Bliley Act also made American banks more competitive with their foreign counterparts in Europe and Asia, which had always benefitted from the integrated universal banking model.

At the height of the 2007–08 banking crisis, many financial institutions were under severe stress. Those exposed to the subprime mortgage sector either through their mortgage origination activities, such as Countrywide Financial, or through their syndication and trading activities, like Lehman Brothers and Bear Stearns, were hit particularly hard.

During the crisis, which culminated in the collapse of the Lehman Brothers investment bank on September 15, 2008, all major American investment banks were either merged into commercial banks or took out bank charters themselves. For example: JPMorgan acquired Bear Stearns and Bank of America absorbed Merrill Lynch. Both Goldman Sachs and Morgan Stanley became bank holding companies. They became universal banks, subject to supervision by the Federal Reserve and gaining access to the discount window as well as other credit facilities.

Some observers have argued that the elimination of the Glass–Steagall barriers made banks more vulnerable during the financial crisis of 2007–08. I believe that nothing could be further from the truth. Without the ability to merge commercial and investment banks, the banking crisis would have been much deeper and widespread than it was and there would have been more Lehman-like failures or the Government would have had to engage in many additional large bailouts.<sup>2</sup>

Of course, that judgment begs the question of what caused the crisis that triggered the Great Recession in the first place. It is evident that both subprime mortgages and mortgage-backed securities were at the center of the crisis.

Prior to the crisis, many American presidents<sup>3</sup> championed the idea of widespread home ownership. Much legislation and regulation promoted the idea that homeownership should be supported by our financial institutions above and beyond the levels

<sup>1</sup>For my own role in this process, see: Robert Heller, *The Unlikely Governor*, Maybridge Press, 2015, p. 287.

<sup>2</sup>President Clinton, who signed the Gramm–Leach–Bliley Act into law, also believes that the legislation helped to stabilize the American banking system during the crisis. He stated so in the following exchange between himself and Maria Bartiromo (*BusinessWeek*, September 23, 2008)

Maria Bartiromo: Mr. President, in 1999 you signed a bill essentially rolling back Glass–Steagall and deregulating banking. In light of what has gone on, do you regret that decision?

Former President Clinton: No, because it wasn’t a complete deregulation at all. We still have heavy regulations and insurance on bank deposits, requirements on banks for capital and for disclosure. I thought at the time that it might lead to more stable investments and a reduced pressure on Wall Street to produce quarterly profits that were always bigger than the previous quarter. But I have really thought about this a lot. I don’t see that signing that bill had anything to do with the current crisis. Indeed, one of the things that has helped stabilize the current situation as much as it has is the purchase of Merrill Lynch by Bank of America, which was much smoother than it would have been if I hadn’t signed that bill.

<sup>3</sup>That includes President Roosevelt (Homeowners Refinancing Act of 1934 and the Home Owners’ Loan Corporation Act. Fannie Mae was created in 1938), President Carter (Community Reinvestment Act of 1977), President Clinton (Housing and Community Development Act of 1992) and President George W. Bush who advocated the “Ownership Society.”

that would result if regular market forces were left alone to determine the level of mortgage loans made. Many of these subprime loans were made to people who could not afford to service them. Subsequently, they were packaged into complex and little-understood financial securities that were then sold to third parties, such as Fannie and Freddie. Thus, a toxic brew of opaque and risky securities was created that eventually imploded when delinquencies reached unexpected levels.

But as President Clinton pointed out, if the Glass–Steagall barriers had still been in place, the crisis might well have been even worse than actually experienced.

### **Regulation Versus Capital**

Extensive legislative and regulatory rules govern the conduct of all commercial banks. Everyone will agree that our financial organizations—and especially our depository institutions—should be as safe as possible and that a repeat of the financial turmoil experienced a decade ago needs to be avoided.

There are two basic methods to increase bank safety: more regulation or more capital. Let us consider each in turn.

#### *Regulation*

Rules and regulations are one way in which financial institutions can be made more safe and secure. They will prohibit especially risky behavior and limit the scope of risk-taking by the institution. But as one rule is established, the drive to serve their customers and to make more profits often leads managers to develop ways to circumvent the rule and to develop new products that are not governed by the existing regulations.

The natural reaction by regulators is to counter with the imposition of even more rules. As a consequence, an ever-tighter and more cumbersome straightjacket of regulations develops that becomes more and more complicated to implement and follow.

One look at the three-page contract that I signed in order to obtain my first mortgage many years ago, compared to the six-inch stack of papers and supporting documents and dozens of signatures that I had to sign to obtain my latest refinancing loan, tells the story of increased regulation over the decades.

Bank supervision is also by its very nature a backward-looking process. It looks at what has actually happened in the past and whether any transgressions or rule violations have occurred.

A friend of mine, who spent his entire career in the automobile-manufacturing sector, always espouses the mantra that “quality should be built into the production process—and not inspected-in afterwards.” By this he means that it is much more efficient to build a high-quality automobile in the first place than to try and find defective cars at the end of the assembly line through an arduous inspection process.

The same applies to financial institutions. Auditors may be able to identify bad loans, but it is much more efficient not to make any questionable loans in the first place. At Bank of Marin, we endeavor to make only solid loans and during the entire 27-year history of the bank, we have foreclosed on only one single loan that we originated. Regulators, consumers and trade magazines recognize this attention to quality. For instance, American Banker has consistently ranked Bank of Marin among the Top 100 community banks.

We have tried to make only solid loans in the first place and have worked diligently with the customer, if he should encounter difficulties in servicing the loan. That’s what relationship banking is all about.

Nevertheless, at Bank of Marin our Compliance Department expenses have more than doubled since 2009. But these direct costs do not tell the whole story. In addition, lenders and branch personnel have to undergo costly compliance training and a great deal of compliance-related information has to be collected and documented throughout the new loan approval and boarding process. Our staff also spends considerable time in compliance working group meetings to assure that all developments and updates are communicated throughout the organization. Then there are the internal and external auditors to look over the shoulders of the line officers to make sure that all is in order and well-documented and is able to stand scrutiny by the regulators.

Since the passage of the Dodd–Frank Act, there is even a federally chartered organization to scrutinize the work of the independent auditors: the Public Company Accounting Oversight Board (PCAOB).

When will there be enough layers of supervision and control?

#### *Capital*

In a modern company, capital consists of the financial resources provided by the shareholders of the corporation. It is invested in the means of production, be that land, equipment or human resources. It is also an essential part of the financial re-

sources that enable a company to operate. Finally, it is an important cushion to absorb any losses. Scarce capital provides a powerful incentive to management and directors to make only prudent investment and loan decisions. This will enable the institution to make profits, which will in turn accrue to the owners of the capital stock.

Capital is not cheap, and because it is the cushion that will have to absorb any losses, shareholders (as the owners of the capital) have a vital interest in making sure that the institution follows prudent policies in their lending department as well as in other risky activities, such as trading.

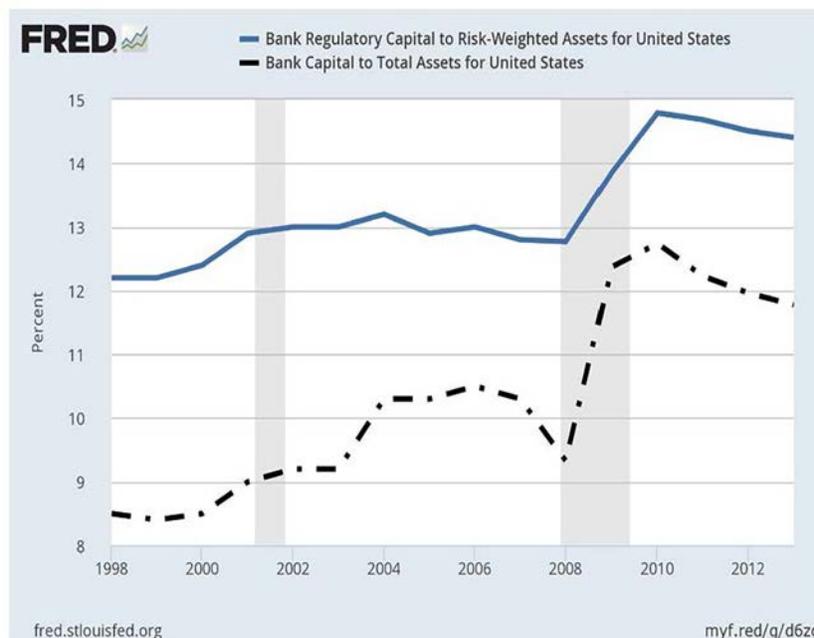
Higher capital levels provide important protection against failure of a financial institution. A recent study by the International Monetary Fund points out that an optimal level of capital takes into account not only the costs and benefits to bank shareholders, but also to the overall economy. The study concludes that additional bank capital is beneficial at first, but has rapidly diminishing values above a risk-weighted capital to asset ratio of 15 to 23 percent.<sup>4</sup> The law of diminishing returns applies to capital as well.

In the United States, the overall ratio of bank regulatory capital to risk-weighted assets is now close to this 15 percent level, as shown by the solid line in Figure 2. However, the ratio of bank capital to total assets (shown by the dash-dot line) is somewhat lower. In any case, we may conclude that these increased capital levels have made the American banking system much safer and more resilient.

#### *The Choice Between Capital and Regulation*

The question remains whether higher capital levels or more regulation offer a better protection for depositors, shareholders, and taxpayers alike.

Based on my experience, both as the Chairman of the Committee on Bank Supervision and Regulation at the Federal Reserve Board and my banking experience, I would argue that strong capital requirements are generally much more effective than a myriad of regulations in keeping a financial institution healthy.



First of all, capital is a flexible buffer that protects the shareholder, depositor, and taxpayer alike against all the activities carried on in various parts of the bank. One year, commercial loans may be experiencing particularly high losses and in another

<sup>4</sup> Jihad Dagher, Giovanni Dell'Ariccia, Lev Ratnovski, and Hui Tong, "Capital Buffers", International Monetary Fund, Finance and Development, September 2016.

year, it may be mortgages that are stressed. A large bank may experience losses in its trading or underwriting activities, while the regular banking business flourishes.

In contrast, regulations are a straightjacket where each and every activity is constrained in its own right. It is almost impossible to take advantage of unusual opportunities that avail themselves, even if they are not particularly risky under the circumstances.

I believe that the financial sector, and thereby indirectly the entire economy, will thrive best if there are as few rules and regulations as possible. Efficiency is not obtained by having so many rules that essentially all institutions are forced to follow a similar business model. That amounts to central planning more appropriate for a command economy. One size does not fit all and leaves no room for innovation.

A centrally planned economy is certainly not immune to errors, and command economies have suffered many economic setbacks and generally low growth. Similarly, regulators are not exempt from the potential to make errors in their guidance. As recent history shows, when the governmental authorities attempted to encourage more lending than the mortgage sector could safely bear, the results were not pretty.

Furthermore, bank supervision is by its very nature a backward-looking activity that tries to catch errors and transgressions made in the past.

Regulation also results in never-ending meetings between regulators and management. It drives up staffing costs in the compliance department as well as in the operational departments that have to supply the necessary information to the compliance officers. In addition, the staff of the regulators needs to be paid.

Of course, capital is expensive, but given a choice between higher capital and more regulations, I would generally recommend the higher capital levels. This will enable financial institutions to deploy their capital in a flexible manner, so that the growth of the economy at large can be supported in an optimal manner. The economy at large will thrive if banks and other financial institutions can accommodate the needs of their customers in a flexible, but safe manner.

One such way to ease the regulatory burden for financial institutions is proposed in the Financial CHOICE Act, which gives regulatory relief to financial institutions that are not only well-managed, but also maintain very high capital levels. This approach will allow banks to essentially “self-regulate” if they have enough skin in the game in the form of high capital levels.<sup>5</sup>

Allowing banks to obtain relief from onerous micro-regulations by electing to maintain higher capital levels benefits everybody: the banks gain flexibility to manage their own affairs and have lower compliance costs; consumers and corporations will benefit from being able to deal with more flexible and responsive banks; shareholders will receive higher returns; and bank regulators will save in personnel and other oversight costs.

### **Eliminating Overlapping Regulation**

There is one further improvement in the financial services sector that would considerably lower costs and thereby enhance economic growth. This is the elimination of overlapping regulatory agencies in the financial sector.

Among the Federal financial regulators, we have the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the newly formed Consumer Financial Protection Agency, the Commodity Futures Trading Commission for institutions active in the derivatives markets. In addition, there are the State bank supervisors for State-chartered institutions. Moreover, institutions offering insurance products are also subject to the supervision of the relevant State insurance regulators.

A typical financial institution is subject to the supervision and regulation of at least two or three of these regulators and the more complex organizations may be subject to the supervision of six or even seven regulators.

In fact, there are now so many regulatory agencies that there exist even additional agencies to coordinate and streamline the regulators. The Federal Financial Institutions Examination Council (FFIEC) is tasked to coordinate the rulemaking by the various agencies. In addition, the Financial Stability Oversight Council (FSOC) is there to coordinate and, if necessary set aside, regulations of the various agencies in the interest of overall financial stability.

<sup>5</sup>I was honored that the Preamble to the Financial Choice Act cites my recommendation to that effect in: House Committee on Financial Services, The Financial CHOICE Act, *www.FinancialServices.House.Gov/CHOICE*, June 23, 2016, pp. 6–7. The citation is from: Robert Heller, *The Unlikely Governor*, Maybridge Press, 2015, p. 231.

The time has come to simplify this regulatory jungle.<sup>6</sup> If we need special councils to coordinate the regulators, we have a few regulators too many and one layer of bureaucracy should be eliminated.

Ideally, there should be only one Federal regulator for each federally chartered financial institution. This simplification would not only result in less confusing and possibly contradictory regulatory requirements, but also bring about significant manpower and cost savings to the industry and budgetary saving to the Government.

### **The Impact of Regulation on Small Banks**

While the Dodd–Frank legislation was mainly aimed at the large financial institutions that were deemed as being systemically important or as “too big to fail,” its impact was probably more heavily felt by the Nation’s community banks—those with less than \$10 billion in assets.

Research has shown that the burden of complying with the Dodd–Frank Act was particularly burdensome for these small banks.<sup>7</sup> A full 90 percent of the respondents to a survey stated that their compliance costs had increased in response to the passage of the Dodd–Frank legislation, with 83 percent stating that their costs had increased by more than 5 percent. Nearly 64 percent of the institutions anticipated making changes to their residential mortgage offerings. Ten percent anticipated discontinuing their mortgage banking activities entirely, with 5 percent having already done so by 2014. In spite of the fact that the CFPB has no direct supervisory authority over small banks (those with less than \$10 billion in assets), 71 percent of the surveyed banks reported that the Bureau affected their business activities and in particular their mortgage offerings negatively.

By adding approximately 20,000 pages of complex rules and regulations to the American banking system, the Dodd–Frank Act made it more difficult for financial institutions to operate efficiently and maybe even to survive.

Perhaps the most drastic effect of the Dodd–Frank legislation has been its impact on the entry of new banks. Figure 3 shows that in the decade before 2010, each year 100 to 200 new banks were established. In contrast, during the 5 years after the passage of the Dodd–Frank Act, only two new banks were formed.

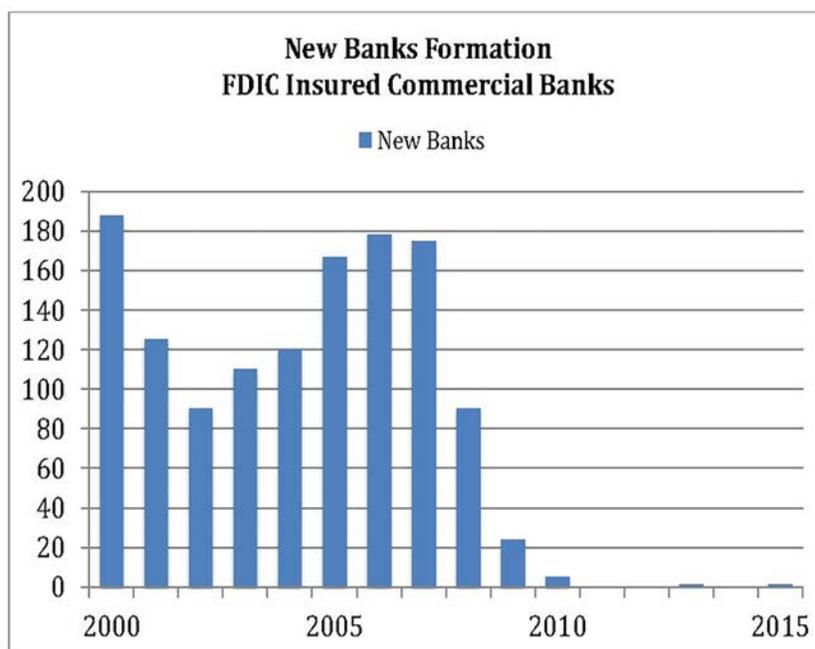
Furthermore, the total number of FDIC-insured banks decreased from 6,533 in 2010 to 5,349 by 2015, representing an overall decline in the number of banks by approximately 19 percent.

Just last week, the House Financial Services Subcommittee held hearings on the chilling impact of the Dodd–Frank Act on the formation of new financial institutions. One of the key takeaways from the Hearing was that the number of new or “de novo” banks and credit unions has declined to historic lows since the passage of the Dodd–Frank Act.<sup>8</sup>

<sup>6</sup> Robert Heller, “The Time Has (Finally) Come for a Single Regulator”, *American Banker*, December 7, 2016.

<sup>7</sup> Hester Peirce, Ian Robinson, and Thomas Stratmann, “How Are Small Banks Faring Under Dodd–Frank?” Mercatus Center at George Mason University, Working Paper, February 27, 2014.

<sup>8</sup> House Financial Services Subcommittee, “Subcommittee Examines Chilling Impact of Dodd–Frank on New Financial Institutions”, Press Release, March 21, 2017.



While other reasons were also contributing to this virtual cessation in new bank formation, such as generally low interest rates accompanied by low net interest margins; the evidence is nevertheless very troublesome. The Dodd-Frank Act, together with the low interest rates engineered by the Federal Reserve, which was supposed to stimulate the economic recovery, created an absolutely toxic environment for formation of new banks.

#### **The Financial Sector and Economic Growth**

Finally, let us turn to the relationship between growth in the financial sector and overall economic growth. In a recent study by the Federal Reserve Bank of St. Louis, the authors conclude that financial conditions do indeed affect real economic activity. As might be expected, the impact is stronger for smaller firms and for industries that depend more heavily on external financing for investment. But the authors caution that the overall effect is rather moderate.<sup>9</sup>

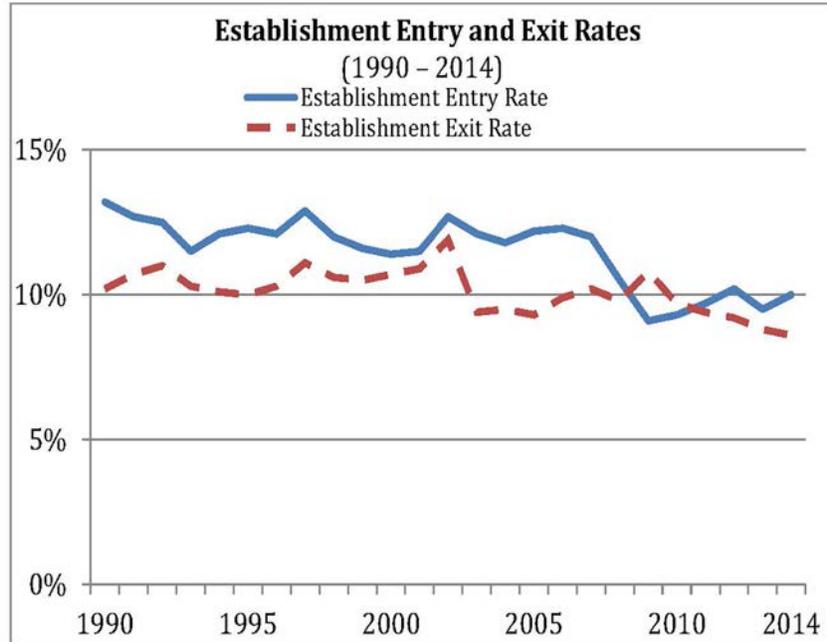
Let us examine the nexus between small community-based banks and the formation of new firms a bit more closely. Many new firms have to rely on financial resources from community-based banks. These local banks may even know the founders or owners of the new company personally. In many cases, these new firms rely on personal loans, credit cards or home-equity lines of credit for the initial financing of their company's equipment and supply purchases because the firm itself is not yet creditworthy.

It is therefore not surprising that during the same time period that saw virtually no new bank formation, we also experienced a very low rate of entry by new establishments. As solid line in Figure 4 shows, during the 4 years prior to the passage of the Dodd-Frank legislation (2006–09), on average 740,000 new establishments were formed. That number dropped to an average of 652,000 in the 4 years after the passage of the Act (2011–15).

As a matter of fact, in the years 2009 and 2010 the exit rate of new firms (dashed line in Figure 4) exceeded the entry rate (solid line) for the first time in 2009 as firms were leaving in greater numbers than new firms being formed. These were the years of the Great Recession that also saw virtually no new bank formation. While other factors were also at work, low bank formation rates and low entry rates

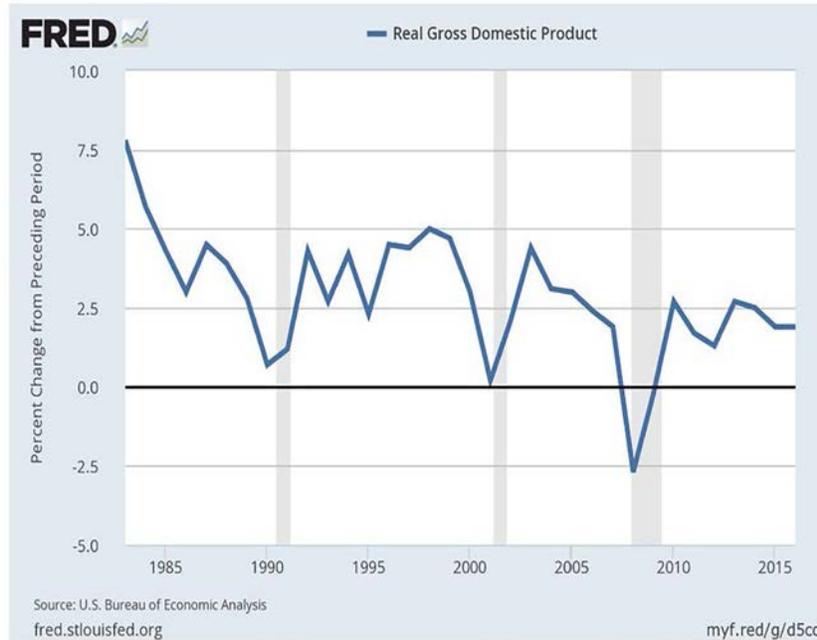
<sup>9</sup>Hee Sung Kim and Juan M. Sanchez, "Financial Conditions—Do the Ups and Downs Affect the Rest of the Economy?" Federal Reserve Bank of St. Louis, *The Regional Economist*, First Quarter 2017.

for firms certainly go hand-in-hand, showing the nexus between the banking system and the business sector.



The Dodd–Frank Act of 2010 was passed one year after the Great Recession ended. It was supposed to make the financial system safer, but also resulted in many new restraints and additional costs to the financial system. As Figure 5 shows, GDP growth ranged between only 1.7 and 2.7 percent during the subsequent recovery, making it the slowest recovery on record since World War II.

During the recovery, the Federal Reserve maintained a highly expansionary monetary policy and the Federal Government ran a very stimulative fiscal policy. The Federal Reserve not only kept the Federal Funds rate at zero until 2015, but also added \$2.8 trillion in Treasury and mortgage-backed securities to its portfolio, thereby vastly expanding the lending power of banks. Federal deficits during the period of 2010–2016 ranged between \$438 billion and \$1.3 trillion per year, adding a total of over \$4.5 trillion to the Federal debt since the end of the Great Recession. Not since World War II has the Nation experienced a similar period of highly expansionary monetary and fiscal policies.



As both monetary and fiscal policies were exceptionally stimulatory, the reason for the slow economic growth rate during the current expansion must be found somewhere else. It is difficult not to come to the conclusion that it was the regulatory policy focused on the financial sector that was holding the economy back.

### Conclusion

We have examined in some detail the nexus between the financial system and the economy and have established the important role that financial institutions, both large and small, play in fostering economic growth.

The financial system is a highly regulated sector of the economy and legislative and regulatory changes play an important role in shaping the lending behavior of commercial banks as well as other institutions.

During the 1980s and 1990s, important changes allowed banks to expand across both geographic and functional barriers that had previously existed. First of all, the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 legalized interstate banking and permitted branching across State lines, thereby enabling geographic diversification. Second, the Gramm–Leach–Bliley Act of 1999 gave banks the power to offer both commercial and investment banking services under one roof, thereby allowing greater product diversification and creating “universal” banks.

As a result of increased geographic and product diversification, the American banking system was made both safer and more efficient.

But at the same time, other regulations pushed financial institutions to make a large number of sub-prime mortgages that could not be served properly by the homeowners. Many of these mortgages were packaged and sold to investors in the form of mortgage-backed securities. When a large number of these often highly complex mortgages and securitized loans went into default starting in 2007, it triggered a major financial crisis.

In turn, the financial collapse sparked the Great Recession, which affected many consumers and businesses adversely and led to a sharp decline in GDP.

After the crisis had begun, the Federal Reserve did act swiftly by providing liquidity and emergency capital to the affected financial institutions. Moreover, the regulators facilitated the merger of many endangered institutions across previously existing industry barriers and an even worse financial and economic calamity was avoided with the help of the Government. In the absence of these actions, the crisis could have been even worse. But many consumers, businesses and their employees suffered greatly as a result of the Great Recession.

But it should also be pointed out that the regulatory and supervisory agencies did not see the crisis coming and did little to prevent the calamity from occurring in the first place. They only acted after the horse had bolted from the barn.

The main legislative reaction was the imposition of many more highly complex regulations through the Dodd–Frank Act. While this legislation was largely designed to prevent large banks from failing in the future, it also affected adversely virtually all community banks that had little or nothing to do with triggering the financial crisis. The new regulations, as well as the low interest rate policy implemented by the Federal Reserve and the accompanying low lending margins, brought new bank formation to a total standstill.

These circumstances made it more difficult for many consumers and small businesses to obtain financing and the rate of new business formation dropped precipitously. The entrepreneurial spirits that drive new economic growth were severely constrained, making the recovery the slowest one on record in the post-war period.

My suggested financial sector reform solutions to restore financial vitality and thereby help to reignite economic growth are twofold: first of all, allow small banks and maybe even banks of all sizes to “opt out” from the regulatory straightjacket by holding a sufficiently large capital cushion. Second, eliminate the multiple layers of regulatory authorities that financial institutions of all sizes have to cope with at the present time. Instead, have only one Federal regulatory agency be responsible for each institution under its supervision. The resulting increases in efficiency and cost savings will be beneficial to bankers, consumers, businesses and taxpayers alike.

Thank you very much for giving me this opportunity to express my views on this important topic.

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**PREPARED STATEMENT OF DONALD POWELL**

FORMER CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

MARCH 28, 2017

Chairman Crapo and Ranking Member Brown, Members of the Committee, thank you for the opportunity to testify.

I have spent 40 plus years working in the financial service industry. My experience includes serving as an employee, CEO, owner and board member of various small- and mid-size banks. Additionally, I’ve served as a banking regulator as Chairman of the FDIC. Furthermore, I’ve served on the board of one of the world’s largest financial institutions.

All of these experiences have caused me to understand and respect the critical role a bank has in the success of a community, State, and in our Nation. The quality of life in a community has a direct link to the bank’s activities and services, including the creation of jobs, the caliber of education, the excellence of health care, and the general prosperity of a community. The bank is the alter ego of a community. Banks, both large and small, contribute to the well-being of a community. Most banks have a culture that demands that all of its employees participate and provide leadership in all that is good within the community.

The data is overwhelming as to the role banks play in economic activity, and when banks are not engaged in lending or in providing other services, the local, State, and national economy suffers and economic growth becomes anemic. Thus, it is important that the Nation have viable, safe and sound banks serving this great country. Part of the confidence placed in banks is a result of depository protection offered by the FDIC and of the supervision of each insured institution. Confidence in the soundness of an institution is critical to the success of the banking system, and thus, the free enterprise system.

During my career, I have experienced good and bad economic times and have observed the various reactions to these cycles by the marketplace, policy makers, regulators and other stakeholders. I have studied the cause and effect of each downturn. After each decline, Congress, as well as banking regulators, have attempted to address the issues attributed to the slump in our banking system. All of the banking supervisors have reacted by creating more stringent rules and a tougher oversight process.

Today’s examination and supervisory process includes, as expected, more focus on threats to our way of life and to treating every potential customer in a fair, transparent, and forthright manner. Laws and supervision oversight may be fluid depending upon the latest threats, risk, and conditions within the banking industry.

There has been discussion, supported by data, that banks today, especially smaller banking institutions, are not the vehicle that breathes economic life into a com-

munity because of the unnecessary burden of the examination process and of certain regulations. Often, after a downturn, the tone, attitude and trust between banks and regulators become strained, which results in negative energy and a nonproductive environment. It is important to understand the cost of regulation and to distinguish between sound policy and unnecessary rules, laws and policies that stifle economic activity. The overriding issue is how does this policy, law, or regulation support economic activity without burdening the consumer, small business owner, or other business ventures?

I remain active in the financial services industry and have direct knowledge of the supervisory process and would offer some guiding principles rather than specific regulations, policies, and laws that are valid in all seasons. Without the principles—laws, policies and regulations might be neutered or weakened.

1. Every banking regulator must be fiercely independent and cannot be politically influenced. The independence includes no political agenda and activity must follow the mission established by law. Accountability is balanced with term limits and oversight from an independent Inspector General. Regulators should not be intimidated by any force of direct or indirect influences, and should not be a political tool for any agenda.

2. Leadership at the various regulator agencies is critical. As with any enterprise, leadership sets the tone and mood for the entity. The ability to work with all stakeholders without compromising the mission should be a tenet for all leaders. Obviously the confirmation process should measure leadership that is validated by life's experiences.

3. Disputes must have a due process path. Without a trustworthy, reliable and transparent due process, an American core principle is lost. There is not a valid due process existing today to resolve disputes between regulator and banker. I have offered a solution and the paper is attached for the record.

4. Rule making should be transparent and common sense and judgment should prevail. Experience is vital to an understanding of the banking industry and the process should be deliberate and seek input from all interested parties. Rule making does not include making laws or incorporating a political agenda into the regulation.

5. Accountability follows authority and a vigorous review process is important; proper oversight by a responsible IG is important.

While there are certain core principles to a safe and sound banking system, banking cannot be commoditized as every community market is different and judgement must be part of the process. Banking laws and regulations must be followed, but policy makers must understand the cost, burden and intentions of these laws and amend them when necessary. Today's data indicates that there is more emphasis on compliance than on safety and soundness. It is important to understand that without the soundness of a bank the community cannot thrive. We must get compliance with laws, safety and soundness all collaborated to benefit the community.

Finally, after experiencing several banking crises first hand and participating in mistakes, and questioning myself and industry leaders, my conclusion is that there will continue to be cycles and new risks will emerge but these common themes are present in those entities that survive:

1. Sufficient Capital
2. Liquidity to support the apparent risk and the unexpected events.
3. Management that understands risk and provides oversight with the proper balance between serving community, return on capital, and commitment to the basics without complexity.



Specialist Jason Hardzewicz, left, works at his post on the floor of the New York Stock Exchange, Wednesday, Oct. 5, 2016. Richard Drew — AP

## Why Dodd-Frank Is Unfair to Banks

[Donald E. Powell](#)

Jan 26, 2017

President Trump has been in office less than a week, but so far it seems he and Congress share similar views as Wall Street: Less regulation is better, particularly when it comes to Dodd-Frank Act that aims to prevent a repeat of the 2008 financial crisis.

While amending certain parts of the landmark law would certainly reduce the burden on the financial services industry and thus assist in providing a spark to the economy to increase lending and job creation. But one should pause to reflect on the risky banking practices that led to the collapse of the financial system in 2008. We should also acknowledge that Dodd Frank and certain changes in the regulatory regime have made for a more safe, and sound banking system, which has served as the backbone of free enterprise.

It is also important to remember that regulations are imperfect, especially the process by which regulators regulate U.S. banks: one man's red tape is another man's accountability. However, the cost of regulation has been well-documented and without credit, the economy

will not create jobs or contribute to individual prosperity. We need to strike a balance between the need to protect customers from abuse, perceived or real, and the need to attract capital that will produce a return to shareholders. The problem is the process to execute the principles of the law: when a dispute arises between regulator and the regulate—the financial institution—the process fails to provide the most basic of all constitutional rights.

This problem dates back before Dodd-Frank. More than 20 years ago in 1994, Congress created an internal regulatory appeals process to add additional protection in resolving disputes between financial regulators and bankers. However, many industry observers believe reform efforts have failed, while most bankers do not believe that a clear, fair, and objective process is available when a dispute arises. Here's the crux of the problem: the regulator is the prosecutor that initiates the action. If the bank chooses to challenge the matter, the regulator is the judge and jury. Any appeal is stacked against the accused. The dispute may go to an internal review committee or to an ombudsman, who reports to the agency head, or may go to an administrative law judge who has been appointed by the agency. Even if the fix on the appeal circuit magically went in the accused's favor, the final decision ultimately returns to the very regulator who initiated the action. This is just wrong and offensive to our basic notions of due process.

Thus, the banker does not challenge or appeal because of the defective process and the threat of retribution. One can only observe the history of conclusion by the various banking regulators to see why most bankers believe that when there is a dispute there is not equitable and reasonable recourse when they have a legitimate objection to a purported regulatory violation or decision.

I am not saying that the banking industry does not need a strong, independent banking regulator that is committed to fulfilling its mission. And it is critically important that dishonest, incompetent bankers who have harmed customers be removed from the system and the regulator should have every tool to enforce its mission. But again, not without due process. Not all bankers are crooks and not all regulators are unbiased and objective.

One alternative that could improve the existing process would be an opportunity for the accused bank to go before a five-member panel that would make a binding decision. The panel would be appointed for five years. Members would be paid only expenses plus a per diem fee and include two members from the banking industry who aren't currently working at a bank but have the financial expertise that others don't (one from a large institution and the other from a small one). The other two members would come from the regulatory agency (one a federal regulator and the other a state regulator), plus a single member representing the general public.

All individuals must have depth of experience in their background, and have no direct or indirect interest in any insured financial institution. The panel would be selected by the board of the FDIC from a list of 20 names submitted by the bipartisan leadership of the House Financial Services Committee and Senate Banking Committee. The panel would have the ability to draw upon experts from time to time and its authority and limitation would be part of its charter established by Congress.

I have worked within the banking industry for over 40 years in both a small/mid-sized and large financial institution as well as having banking regulatory experience at the federal level. There are honorable, well-meaning, and smart people representing both the banking industry and the regulatory agencies, but on occasion, well-meaning people have disputes and for that reason, it is important that a valid "due process" system be in place.

It's possible in America to have a robust, safe and sound banking system along with a fair regulatory system. It doesn't have to be a choice of one over the other.

*Donald E. Powell, a banker for over 40 years, was chairman of the FDIC from 2001-2005.*

**PREPARED STATEMENT OF THOMAS C. DEAS, JR.**

CHAIRMAN, NATIONAL ASSOCIATION OF CORPORATE TREASURERS

MARCH 28, 2017

Chairman Crapo, Ranking Member Brown, and the other Members of this Committee: Thank you for the opportunity to testify at this important hearing focusing on our country's future economic growth. I am Thomas C. Deas, Jr., recently retired vice president and treasurer of FMC Corporation and current 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. I also represent the NACT on the Steering Committee of the Coalition for Derivatives End Users (the Coalition), comprised of several hundred companies that employ derivatives to manage risks in their day-to-day business activities, principally through the dedicated efforts of their corporate treasurers.

At the outset, I would like to thank you, Chairman Crapo, for your efforts to make sure that end users are able to engage in prudent risk-management activities without facing costs that could make such activities prohibitively expensive. We appreciate your efforts to move a bill, enacted in the last Congress, to exempt end users from unnecessary margin requirements.

**Background on End-Users' Interactions With the Financial System**

I am thankful you have asked me to assist your efforts to foster future economic growth by ensuring that American Main Street companies can interact in ways that make sense economically with the financial system you help to oversee. The financial system is critical to the day-to-day business activities of end-user companies, including through activities such as:

- Collecting payments from customers
- Concentrating cash collections in secure depository institutions
- Sending cash safely from where it was collected and concentrated to wherever it is needed to meet the company's day-to-day business obligations to suppliers, employees, Government entities, investors, and others due payments
- Borrowing or investing to meet temporary or longer term cash shortfalls or surpluses
- Managing the company's capital structure with adequate committed credit and appropriate amounts of debt and equity capital with repayment obligations to investors structured to limit risks, especially anticipating future periods when liquidity may be constrained
- Identifying and hedging the company's financial risks from exposures to such factors as:
  - Interest rates
  - Foreign exchange rates
  - Commodity prices

End users are fundamentally different from financial companies in that they use the financial system to facilitate their business operations and they do not engage in speculative, inherently risky position-taking as do some financial firms. For example, end users employ derivatives to reduce risks arising from operating their businesses and do not engage the kind of transactions that roiled the markets during the financial crisis. End users comprise less than 10 percent of the notional amount of the over-the-counter (OTC) derivatives market and do not meaningfully contribute to systemic risk. However, in markets as complex and interrelated as we have now in the global financial system, there is a clear need for a regulatory framework that recognizes these complex interactions. We have been gratified at the bipartisan consensus that has developed since the financial crisis that:

- end users employ the financial markets to reduce risk and, therefore their activities should not be unduly burdened, and
- recognizing that the financial markets in today's world are truly global, American companies and their workers should have a consistent, predictable, and level regulatory playing field in which they do not suffer any relative disadvantages compared to their foreign competition.

We believe a clear understanding of end-users' interactions with the financial system is critical to maintaining a regulatory framework that does not burden the end-user producers and job creators with the costs of well-intentioned measures more

appropriately applied to financial firms. With these complexities in our increasingly interrelated markets, it can easily be the result that a regulatory change at one end produces an unintended consequence and higher costs on end users several steps down the chain. Further, foreign regulators have in certain cases granted exemptions to end users that are not available under U.S. law, placing American end users at a competitive disadvantage compared to their foreign competitors.

Since its start in the early 1980s, the OTC derivatives market has grown to be the largest financial market in the world with outstanding transactions totaling nearly \$700 trillion in notional amounts.<sup>1</sup> Transactions between swap dealers and other financial intermediaries represent most of the trades, with nonfinancial end users comprising less than 10 percent of derivatives activity, as mentioned above. However, much of the trading by financial intermediaries can be assumed to be transactions to balance risk positions that originated with end-user trades. The exponential growth in the derivatives market came in significant part from end users in the real economy needing to hedge their exposures to changes in interest rates, commodity prices, and foreign exchange rates, along with credit exposures to customers or suppliers, exposures to equity prices, and other commercial risks they face in their day-to-day business operations. OTC derivatives can be matched exactly as to timing, currency, rates or amounts of the underlying exposures in ways that the futures markets, with round lots and fixed settlement dates could not. The customization available in the OTC derivatives market has been essential in allowing end users to match exactly derivatives with underlying business exposures so that they move in equal, but opposite ways. Additionally, OTC derivatives together with relevant regulatory exemptions allow end users to negotiate credit support measures individually with their derivatives counterparties.

Today I propose to focus on a few areas in which certain regulatory changes could benefit Main Street companies so that we can grow our businesses and increase employment opportunities for our American workers.

#### **Day-to-Day Business Examples of End-Users' Interaction With the Financial System**

End-user corporate treasuries today routinely use the financial system to facilitate their day-to-day business tasks. However, they are matching exactly in amount, currency, and duration the financial transactions with the business flows they are managing. Instead of speculating, for example in foreign currencies, through a foreign exchange transaction unmatched to a committed business transaction, an end user is offsetting a known transaction to lock in the price and manage the risk of future movements in the currency markets.

Corporations engaged in manufacturing activities with their costs in one currency and selling into foreign markets in another currency have access to derivatives transactions that will allow them to hedge this cross-currency risk. Depending on the predictability of future sales, they can enter into forward sales of the selling currency while taking back payments in the currency in which they are incurring their manufacturing costs. Since the future sale is not yet recorded on the corporation's financial statements, it is important to achieve the objective of reduced earnings volatility, that changes in the derivative's valuation be deferred from being recognized in income until the anticipated sale is actually made and recorded on the end-users' financial statements, creating an offset. Accounting rules in the U.S. and Europe generally permit this treatment.

Multinational manufacturing groups have often sought to locate production facilities where they can match the currency exposures of their production costs with anticipated revenues in the same currency. This is referred to as creating a "natural hedge" of like-currency offsets and reduces the need to hedge in the OTC derivatives market. Multinationals are monitoring the increasing costs and operational complexities of cross-border derivatives regulatory compliance. By keeping end-users' regulatory burdens appropriate to the actual financial risks their transactions represent, we sustain U.S. manufacturers' ability to produce at home, export abroad, and manage the cross-border currency risks with derivatives whose costs are not too expensive.

Commodity derivatives are used by end-users' corporate treasuries to manage movements in prices of raw materials used in their production or goods they sell. Consider a manufacturer using natural gas in its production. It can fix the price of this important cost component by entering into a fixed-price contract with one of several deregulated natural gas suppliers. This effectively embeds a derivative in its supply agreement. Alternatively, it can enter into a floating-price purchase contract

<sup>1</sup> Bank for International Settlements OTC derivatives statistics at <http://www.bis.org/statistics/derstarts.htm>.

and have its corporate treasury arrange a matching commodity derivative in which it pays a fixed price and receives the floating price it passes on to its supplier. With either arrangement, there is a risk to the corporation that its price-locked structure fails when the mark-to-market is in the money to the corporation. It is generally far easier to monitor the creditworthiness of a swap counterparty, often a regulated financial or trading institution, than to try to monitor an energy supplier. This in part is why end-user businesses are increasingly relying on the derivatives market to hedge commodity price risks.

Another important use of commodity derivatives is to allow structuring cross-border bartering transactions. Consider a multinational agricultural chemicals manufacturer selling into Brazil. Like its fellow BRIC countries, Brazil has plentiful land and labor as classic economic inputs to production, but less access to capital and associated financial markets. The multinational chemicals company can, however, access the global derivatives markets. Its customer in Brazil needs crop-protection chemicals at planting time, but can only pay 6 months in the future, at harvest time. During this period, the Brazilian farmer has commodity price risk and currency risk. The multinational manufacturer arranges a barter trade where the Brazilian farmer agrees to pay in soybeans at harvest time 6 months forward for the chemicals it needs to apply at planting time. The farmer has transferred the commodity price risk to the chemicals manufacturer, which can enter into a customized OTC commodity derivatives locking in the U.S. dollar price 6 months in the future, thereby hedging its risk in the derivatives market.

In some cases, large sales requiring several years to fulfill may motivate a supplier to enter into a credit default derivative to hedge the risk that its customer goes bankrupt before it is paid. A credit default derivative can be structured for a notional principal amount sufficient to mitigate the payment risk. As discussed below, the amount of capital regulated swap counterparties have to hold against this type of trade as an aftermath of the financial crisis make it a costly hedge for most corporate treasuries to enter into.

By reducing the overall volatility of its business results, the end-user corporate treasurer contributes to the stability and predictability of his or her business. If done consistently and communicated properly to stakeholders, the result is a lower overall riskiness for the end-user business, justifying a lower risk-adjusted discount rate for its estimated future cash flows and hence a higher valuation.

### **Capital Requirements**

A bipartisan effort in the last Congress, supported by the leadership of Chairman Crapo, resulted in the enactment of a clear end-user exemption from having to post cash margin for end-users' derivatives positions.<sup>2</sup> However, we are increasingly concerned that the uncleared OTC derivatives we seek to continue using to reduce our business risks will become too costly because of much higher regulatory capital requirements imposed on the financial companies that we rely on as our derivatives counterparties.

The Prudential Banking Regulators have now finalized rules implementing Basel III capital requirements which increase the capital bank counterparties are required to hold against derivatives. Additionally, other bank capital measures, including the net stable funding ratio (NSFR) and the supplemental leverage ratio (SLR), risk further increasing derivatives transaction pricing and loans for end users.

#### *Credit Valuation Adjustment*

European policymakers have implemented capital charges on derivatives positions significantly more favorable to end users than the U.S. Prudential Banking Regulators. The European approach recognizes that end-users' hedging activities are in fact reducing risks, and accordingly, exempts end-user derivatives transactions from the credit valuation adjustment (CVA) risk capital charge, which would otherwise require the calculation and subsequent holding of capital to mitigate counterparty credit risk in a derivatives transaction. The absence of a U.S. exemption puts American companies at a meaningful competitive disadvantage compared to our European competitors.

The lack of a CVA exemption for U.S. end users that are hedging their commercial risks would deny or significantly reduce the end-user community the benefits of the statutory exemptions from clearing and margin requirements as end users that engage with banking organizations that are the subject of the CVA charge imposed by the U.S. Prudential Banking Regulators see those charges passed through in the form of higher pricing. Such a result thwarts the will of Congress to provide clear exemptions for American end-user companies.

<sup>2</sup> See 7 U.S.C. §2(h)(7); 7 U.S.C. §6s(e)(4).

Further, the CVA charge may force end users to post collateral to offset banks' CVA capital requirements. If banks require collateral, end users may be put in the position of borrowing from financial institutions to obtain the cash required to support those transactions, resulting merely in a shift of risk between financial institutions. The result of requiring the posting of collateral contradicts the objective of facilitating end-users' access to capital, drives costs directly to end users, and does nothing to mitigate risk within the financial system, as the risk is simply being transferred from one bank to another.

#### *Net Stable Funding Ratio*

We believe the Prudential Regulators' June 2016 proposal on the NSFR could lead to billions in additional funding requirements for end-users' derivatives and borrowing activities. This is especially concerning given that many of the provisions of the NSFR would further restrict end-users' ability to hedge by increasing the cost of risk management and could lead to decreased liquidity in the derivatives markets. We are concerned that long-term funding costs required under the NSFR might limit and discourage dealer involvement in derivatives and derivatives-related transactions, effectively reducing liquidity in the market that end users rely on to hedge risk. Additionally, costs associated with capital-raising in a less liquid market would inevitably be borne by derivatives end users and consumers. The immediate impact of the NSFR can already be seen as fewer bank counterparties are willing to extend longer-term credit, including in the form of swaps used to hedge end-users' long-term business exposures. Additionally, the costs to hedge are likely to be passed on to end-user companies in the form of increased fees or transaction costs, less favorable terms, and collateral requirements.

These concerns are particularly reflected in the add-on costs associated with counterparty payables; the treatment of uncollateralized receivables; the lack of collateral offsetting provisions; and the liquidity squeeze related to the treatment of corporate debt. For example, requiring dealer counterparties to provide required stable funding for 20 percent of the negative replacement cost of derivative liabilities (before deducting variation margin posted) is a clear example of the direct burdens that would affect end-users' ability to mitigate risk efficiently.

Another concern under the NSFR is the treatment of dealers with respect to uncollateralized net receivables, which could require 100 percent long-term funding. As we are now seeing, end users are being required to collateralize transactions with cash margin to meet the stringent Basel III leverage ratio requirements. Or, if a dealer counterparty did not demand collateral, the costs of long-term funding could simply be passed on to end users through embedded derivatives fees.

Moreover, we believe that disproportionate discounting of the collateral posted by end users forces dealers to mitigate costs elsewhere. As a result, in implementing the NSFR, the Prudential Banking Regulators should align collateral posted by commercial end users with long-term funding obligations under NSFR. This is particularly true because, while most end users are exempted from posting margin for their derivatives with bank counterparties, the "back-to-back" hedges entered into by banks to offset end-user transactions are still subject to mandatory clearing and margin requirements. Consequently, the costs borne by banks to offset end-user transactions are passed on to the very end users that were meant to be exempt from the costs of mandatory clearing and margin requirements—and ultimately to consumers.

Further, the NSFR's treatment of corporate debt could hinder end-user capital-raising efforts. The NSFR does not take into account the maturity of end-user-issued debt when determining a dealer's required stable funding and would restrict liquidity in the corporate debt markets by requiring dealers to raise 50–85 percent long-term funding to support their inventory of end-user notes, which would discourage market making. End users rely on market-based funding and the importance of liquid markets for corporate bonds and commercial paper (CP). To cite a real-world example of the costs and diminished liquidity from these rules, many corporate treasuries issue CP daily to balance their funding requirements. If they are faced with a same-day payment that they identify too late in the day to complete a placement in the market of the required CP, their bank CP dealer frequently will take the paper overnight for its own account and fund out the requirement the next day in the market. The NSFR rules require the bank to hold 85 percent of that overnight funding as long-term funding—at a cost multiple times the overnight amount. Ultimately this liquidity will no longer be available to end-user treasury departments. Accordingly, the Prudential Banking Regulators should carefully consider the impact of the NSFR's 50–85 percent long-term funding requirements on end users.

### *Supplemental Leverage Ratio*

The SLR is another capital requirement imposed on financial institutions that flows through to end users through the lack of an end-user exemption. The SLR penalizes high-quality assets and acts as a disincentive to market participants to provide clearing services. The SLR does not permit the clearing member to take “credit” for the segregated initial margin posted by its customers, including end users, even though the initial margin is expressly for the purpose of limiting the clearing member’s exposure to the derivative it is clearing. Further, segregated initial margin in the form of cash may be required to be added to a clearing member’s balance sheet exposure, requiring additional capital. On the whole, the SLR seems to ignore the fact that for derivatives cleared on behalf of a customer, the customer’s segregated initial margin must be held to margin the customer’s positions and cannot be used as leverage by the clearing firm.

Ultimately, the failure of the SLR to recognize the risk-reducing effect of segregated client collateral will likely lead to fewer banks willing to provide clearing services for customers, thus constraining the ability of end users that clear derivatives to access central clearing. Further, even end users that do not clear derivatives will likely see the impact of the SLR in the form of increased costs for hedging, as their bank counterparties will see their clearing costs increase on their back to back hedges and will pass those costs along to end users. We are hopeful that regulators can work together to get this right in the United States and abroad.

In summary, although a bipartisan consensus in the last Congress confirmed the original legislative intent of the Dodd–Frank Act to exempt end users from having to use their own capital for mandatory margining of derivatives transactions, capital requirements imposed on banks would seem to undermine this intent by forcing our bank counterparties to hold much more of their own capital in reserve against end-users’ derivatives positions, passing on the increased costs to these end users and ultimately consumers.

### **Cross-Border Harmonization of Regulations in the Global Financial System**

NACT and the Coalition appreciate the important efforts being undertaken by U.S. and foreign regulators to resolve differences in how their regulations apply to cross-border transactions. Applying derivatives reform rules in a global marketplace is an inherently complex undertaking. Unlike most stock market transactions, a derivative creates an ongoing relationship between parties that continues from its initial inception until its final termination in the future. Thus, many transactions exist between parties in different jurisdictions for many years. While the United States has completed many of its derivatives rules, other regulators around the world are just now finalizing and implementing 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, American end users are subject to incentives to avoid complication by limiting their transactions to counterparties located in their same jurisdiction. The lack of regulatory harmonization can cause fragmented and less efficient markets for end users, and can raise the cost of delivering stable prices to consumers. We believe it is critical that you urge U.S. regulators to continue working closely with their foreign counterparts and move quickly to recognize equivalency and substituted compliance with foreign regulatory regimes when the objectives of foreign regulations are comparable to those under the Dodd–Frank Act and where foreign regulations do not unduly burden U.S. end users.

### **Commodity Derivatives To Hedge End-Users’ Commodity Price Risks**

End users are subject to the risks of changing prices for such items as commodity inputs to their manufacturing processes and energy consumed in manufacturing their final products. To hedge these exposures, they prefer to arrange properly constructed commodity derivatives contracts with one of their banks. The Federal Reserve Board proposes to issue a final rule imposing limitations and restrictions on the physical commodity activities of the financial holding companies it regulates. Among other things, it would make physical commodities trading by financial holding companies more expensive by imposing up to a 1,250 percent risk weighting, even on some physical commodities that are widely traded such as oil and certain other petroleum-based products. NACT is concerned that:

- Financial holding companies already are being forced to exit the physical commodity markets and end users that rely on bank counterparties for physical commodities transactions are having to find substitutes that can be less credit-worthy and less strictly regulated than their banks

- The exit of banks from these markets brings about reduced liquidity resulting in higher costs from less competition
- New documentation is being required that is less credit efficient in the sharing of risks among counterparties, also bringing higher costs

#### **End Users and Money Market Mutual Funds**

There is no question that liquidity is the lifeblood of any business. Without having ample liquidity, production comes to halt, inventories run low, and bills are not paid on time. The cyclical nature of many businesses places significant importance on the availability of committed financing so that they can operate efficiently and without disruption. To illustrate the interconnectivities between end users and the financial markets, it is useful to consider their use of money market mutual funds (MMMFs). This has been a market of more than US\$2.5 trillion not only selling short-term investments to handle treasurers' temporary excess cash, but on the other side, buying the commercial paper corporate treasurers issue to finance the day-to-day funding needs of their companies. However, in September 2008 the Primary Fund of the Reserve Fund group of mutual funds "broke the buck" when it reported a net asset value per share that rounded to less than a dollar.<sup>3</sup> In the period since the financial crisis, regulators have sought new rules for MMMFs to strengthen the market during times of financial stress. MMMFs had always operated with fixed net asset values (NAV) with a price per share greater than US\$0.995 and less than US\$1.005, so that the NAV rounded to the nearest cent was one dollar per share.

Congress felt it unnecessary to include additional reforms for MMMFs in the Dodd-Frank Act as the SEC had already enhanced regulations under its Rule 2a-7 changes in 2010. However, additional changes went into effect on October 14, 2016 that impose liquidity fees and redemption gates to spring up during periods of market stress. A requirement for a prime fund's NAV to float and be reported to the nearest hundredth of a cent significantly complicates investments in prime funds for corporate treasurers. The floating NAV requirement does not apply to MMMFs investing in Government securities, however.

The practical implications of the new rules are daunting for corporate treasurers. Corporate treasury and financial reporting systems up until now have treated fixed NAV MMMFs as cash equivalents. Now MMMF shares in nongovernment funds will have a floating NAV per share that must be tracked essentially in real time. For Federal and State income tax purposes, a floating NAV requires treasurers to keep track of gains and losses when they inevitably buy MMMF shares at one price and sell them at another in the routine redemption of their investment. Since treasury systems must compete with other departments for internal IT resources, the question of what alternatives are available must be answered. Corporate treasurers can abandon the prime MMMF market and instead invest in Government MMMFs that can retain the dollar per share fixed NAV. However, prime funds are important to treasurers not only as a flexible alternative for investments of temporary excess cash balances, but also as providers of short-term funding by buying corporate CP notes. As the graph below shows, in the year running up to the October 14, 2016, implementation of the new regulations, fund purchases of corporate CP declined significantly.

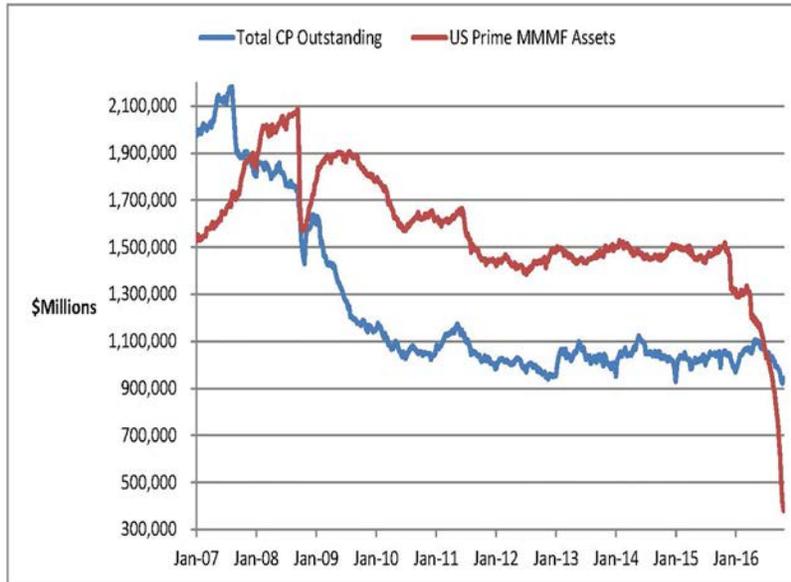
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<sup>3</sup>The *New York Times*, Dealbook, September 7, 2008, "Money-Market Fund 'Breaks the Buck'".



Source: Fitch Ratings and Crane Data

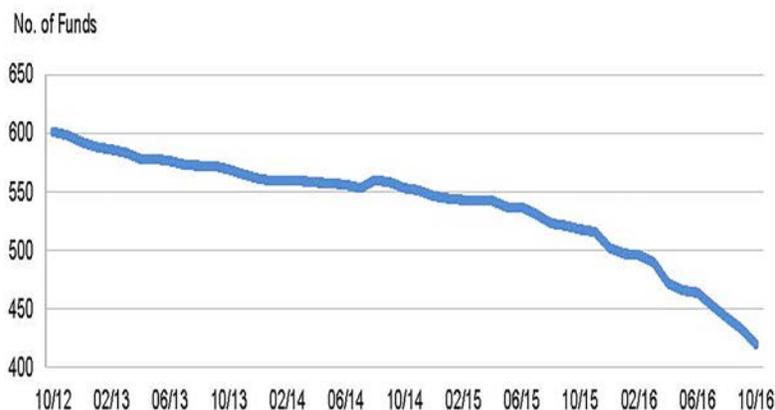
Concerns about investors fleeing prime MMMFs have indeed proven true, declining by US\$1 trillion to US\$376 billion since the rule became final (see Chart below).



Source: Federal Reserve, iMoneyNet, Fitch Ratings

The cure proved worse than the disease for many fund managers as they closed almost 200 institutional prime funds (see Chart below).

### Number of Money Market Mutual Funds



Source: SEC

The cumulative effect of the regulatory changes on MMMFs caused US\$1 trillion to leave prime funds with much of that moving to Government funds unaffected by all the same rules. Corporate treasury investors in these funds were unable to justify or implement quickly enough changes to their treasury and financial reporting systems required by the new rules. End-user companies were adversely affected not only through fewer choices for the investment of their cash, but for many, an uptick in CP borrowing costs as an important investor base went away.

#### Summary

A bipartisan consensus in the last Congress confirmed that the legislative intent of the Dodd-Frank Act was to exempt end users from having to use their own capital for mandatory margining of derivatives transactions, which would have diverted these funds from investments to build inventories for higher sales, conduct research and development activities, expand plant and equipment, and ultimately grow jobs. However, the imposition of additional capital requirements by the Prudential Banking Regulators on financial institutions acting both as derivatives counterparties and lenders to end users would undermine this intent by forcing banks to hold much more of their own capital in reserve against end-users' derivatives and borrowing positions, passing on these increased costs to end users and ultimately their customers.

The cumulative effect of new derivatives regulation threatens to impose undue burdens on end users. The indirect effects of this regulation of end users through bank capital and liquidity requirements serves to discourage end-user risk management through hedging and would effectively negate the benefits of Congress' clear intent to exempt end users from margin requirements. There are also several adverse effects on end-users' funding costs from the way certain bank capital requirements are applied. We urge you to direct financial regulators to conduct a study of major regulatory initiatives for cumulative impacts on end users directly and indirectly through financial institutions. Many NACT members participated in a recent survey by the U.S. Chamber of Commerce, which underscores the need to examine our financial services regulatory structure. The Chamber's report, *Financing Growth: The Impact of Financial Regulation*, asked more than 300 corporate finance professionals, including CFOs and treasurers, to report on the impact of financial

services regulatory reform on the availability and cost of the products and services most crucial to the growth of Main Street businesses.

One key finding from the report includes the fact that access to credit remains their top concern. However, more than three-quarters of American companies of all sizes believe that the cumulative effect of financial regulations adopted over the past 6 years is making it harder for them to access the financial services they need. In addition, 79 percent of respondents indicate that they are affected by changes in financial services regulation, resulting in 39 percent of respondents absorbing higher costs and 19 percent delaying or cancelling planned investments.

We need a regulatory system that allows Main Street companies to use the financial system to hedge day-to-day commercial risks, securely manage their cash flows, fund their businesses in the most cost-effective way, and play on a level field with their foreign competitors. By having a regulatory system that allows businesses to improve their planning and forecasting, manage unforeseen and uncontrollable events, offer more stable prices to consumers, end users can more readily contribute to economic growth.

End users are using the financial system to mitigate the business risks they face in their day-to-day business activities. In this respect, they are fundamentally different from financial companies who maintain an open book of exposures and who seek profit through properly structured speculative positions. However, when rules intended to apply to financial institutions directly or indirectly burden end users, it is the end-user segment of our economy that bears the higher costs. The imposition of unnecessary burdens on end-user businesses restricts job growth, decreases investment and undermines our ability to meet and beat international competition, leading to material adverse cumulative impacts on corporate end users, American workers, and our economy.

The consequences of getting the right balance in the regulation of our financial system will benefit American business, our customers and our workers.

Thank you. I will do my best to address any questions you may have.

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**PREPARED STATEMENT OF DEYANIRA DEL RIO**  
COEXECUTIVE DIRECTOR, NEW ECONOMY PROJECT

MARCH 28, 2017

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify at today's hearing. My name is Deyanira Del Rio and I am the codirector of New Economy Project, an economic justice center based in New York City. For more than 20 years, our organization has worked with an array of community, labor, civil rights and other organizations to press for fair lending and financial inclusion, as a matter of racial justice and equitable neighborhood development. I am pleased to share our experiences and perspective about the vital role that responsible financial institutions play in fostering economic growth and opportunity—as well as the devastating and destabilizing impact of abusive and unregulated lending on communities and the economy.

New Economy Project has led efforts in New York to challenge predatory lending and other discriminatory economic practices, including by pressing for policy change and regulatory accountability at the local, State and Federal levels. Our accomplishments include winning strong antipredatory mortgage lending and foreclosure prevention legislation; keeping payday lending debt traps out of New York, through vigorous defense of New York State's 25 percent usury cap and other consumer protections; ending in NYC an insidious form of employment discrimination based on a job applicant's personal credit history; and settling a groundbreaking class action lawsuit brought against a debt buyer network, resulting in a \$59 million monetary award and the imminent vacating of almost \$800 million in debt collection default judgments.<sup>1</sup>

My testimony today is additionally informed by my 15 years as a board member (and current board chair) of the Lower East Side People's Federal Credit Union (LES People's), a regulated, not-for-profit community development financial institution (CDFI) that serves a majority low-income and immigrant membership in New York City. I previously served on the board of directors of the National Federation of Community Development Credit Unions, which helped to establish the Federal

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<sup>1</sup>[Cite—<http://www.nytimes.com/2015/11/14/nyregion/victims-of-debt-collection-scheme-in-new-york-win-59-million-in-settlement.html>; [www.neweconomynyc.org/resource/sykes-v-mel-s-harris-associates](http://www.neweconomynyc.org/resource/sykes-v-mel-s-harris-associates)]

CDFI Fund in 1994 and continues to serve CDFI and low-income designated credit unions across the country.

I have two overarching points that frame my testimony today: First, eliminating barriers to fair banking and credit access is important to ensuring economic inclusion and opportunity for all. Indeed, in communities across New York and around the country, unequal access to credit has long fueled housing segregation, racial disparities in homeownership and small business-ownership, and vast and deepening wealth inequality.

Second, although affordable and appropriate financial services and credit are vital components of a healthy economy, we reject the notion that consumer credit is in itself a solution to structural inequities in our economy. Exploitative credit and debt can worsen these inequities, as we saw with subprime mortgages that led to the foreclosure crisis and wiped out hard-won homeownership gains among families of color; and payday loan debt traps that exploit working poor Americans struggling to make ends meet, and who would benefit from living wage laws and other measures to address root causes of economic insecurity.

It must also be said up-front that efforts by the Trump administration and Congress to dismantle financial reform laws, if successful, will inevitably lead to new crises and further erode Americans' trust in the financial services industry. On the one hand, we must do everything possible to preserve existing financial reforms and consumer protections, as inadequate as they are—thanks in no small measure to banks' relentless lobbying to defeat even basic reforms. On the other hand, we need to change our financial services system more fundamentally, if we are to have an equitable system that serves the real economy, rather than a financialized economy that is intrinsically extractive and exploitative of people and communities.

I would like to address three additional points in my testimony:

1. The financial crisis inflicted enormous costs on communities, on our economy, and on responsible financial institutions—with repercussions that continue today. Communities of color, in particular, are still reeling from the crisis.

The financial crisis exacerbated historical inequities in our financial services system and broader economy. Between 2007 and 2010, the median net worth of American families decreased by nearly 40 percent, driven primarily by a collapse in housing prices.<sup>2</sup> Losses were especially devastating for people of color, whose wealth was overwhelmingly concentrated in the form of homeownership, and whose neighborhoods were targeted by predatory mortgage lenders. Fully half of the collective wealth of black families and 67 percent of Latino families' wealth—already far below that of whites—were destroyed during the Great Recession.<sup>3</sup>

The big banks fueled this wave of predatory lending, by facilitating the securitization of high-cost loans and by directly acquiring or financing the worst subprime lenders. The banks further exacerbated the foreclosure crisis through abusive and often illegal mortgage servicing practices—including systematically failing to offer loan modifications equitably in communities of color.<sup>4</sup>

Banks have also fueled the growth of the bottom-feeding debt buyer industry, which purchases charged-off consumer debts from banks and others, for pennies on the dollar, and pursues people through civil lawsuits and other aggressive methods—often violating Federal debt collection and consumer protection laws and people's fundamental due process rights. These companies specialize in amassing court default judgments against consumers, which they use to garnish people's wages and freeze their bank accounts—another form of wealth extraction that disproportionately harms communities of color.<sup>5</sup> Predatory lending, foreclosures, and abusive debt collection, meanwhile, appear in people's credit reports and can block their access to housing, jobs, affordable insurance and other vital opportunities.

Responsible lenders and the communities they serve were not spared the effects of the financial collapse and ensuing Great Recession, including loan losses resulting from long-term unemployment; and the ongoing challenges of operating in a depressed interest rate environment. According to the U.S. Treasury Department, the

<sup>2</sup>“Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances”, at [www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf](http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf).

<sup>3</sup>“The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide” (Institute on Assets and Social Policy), at <https://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf>.

<sup>4</sup>“Troubled Asset Relief Program: More Efforts Needed on Fair Lending Controls and Access for Non-English Speakers in Housing Programs”, at [www.gao.gov/products/GAO-14-117](http://www.gao.gov/products/GAO-14-117).

<sup>5</sup>“The Debt Collection Racket in New York: How the Industry Violates Due Process and Perpetuates Economic Inequality”, at [www.neweconomynyc.org/wp-content/uploads/2014/08/DebtCollectionRacketUpdated.pdf](http://www.neweconomynyc.org/wp-content/uploads/2014/08/DebtCollectionRacketUpdated.pdf).

U.S. economy lost 8.8 million jobs and \$19.2 trillion in household wealth between 2007 and 2009.<sup>6</sup>

2. Strong prudential regulation and consumer protections—including a robust and independent Consumer Financial Protection Bureau—are crucial to avert future crises and to ensure a fair financial services system that meets the needs of people and communities.

Congress enacted the Dodd–Frank Wall Street Reform and Consumer Protection Act in 2010, in the wake of undeniable regulatory failure and destructive lending that destabilized neighborhoods, exposed the financial system to broad, systemic risk, and nearly brought down the global economy. Among the Act’s provisions is a requirement that lenders assess borrowers’ ability to repay loans—a basic, common sense tenet of responsible lending that nevertheless has been cited by opponents of the Act as an example of unwarranted regulatory intrusion.

New Economy Project and allies across New York and the country advocated for the creation of the Consumer Financial Protection Bureau (CFPB)—the first Federal agency with a core mission of protecting consumers in the financial services marketplace. Our organization has since testified at numerous CFPB field hearings; organized meetings between the CFPB and local groups, to elevate issues and inform the bureau’s rulemaking and enforcement; and pressed the CFPB to promulgate strong Federal rules to end predatory payday lending, debt collection, and abusive bank overdrafts.

The CFPB plays an absolutely vital role in identifying and eliminating financial exploitation—a function that was sorely missing in the years leading up to the crash. To date, the Bureau has returned \$12 billion to 29 million Americans, while bringing payday lenders, credit reporting agencies, and other powerful industries under meaningful supervision for the first time. The fact that banks are pushing relentlessly to weaken the CFPB is a testament to its effectiveness and its independence.

LES People’s, the credit union whose board I chair, similarly welcomed the establishment of the CFPB and its efforts to level the playing field for responsible community development lenders. We have urged the CFPB to crack down on rampant abusive lending practices, including payday lending and hidden overdraft fees. These two financial products alone siphon billions of dollars from low income people and communities each year. In many markets, these high-cost loans additionally force a “race to the bottom” in which otherwise responsible lenders compete, for example, with payday lenders by mimicking the structure of these harmful loans; or rely on high and hidden overdraft loan fees that drain the accounts of low income bank and credit union customers, to compensate for low interest income and to compete with other financial institutions.

3. Community development financial institutions (CDFIs) have a proven track record of meeting affordable housing, small business and consumer credit needs. The proposed gutting of the Federal CDFI Fund puts them at grave risk.

After receiving trillions of dollars in TARP bailout money and no-interest loans from the Fed, banks have failed to meaningfully extend credit to small businesses and other vital sectors of the economy. New York City is 40 percent foreign-born, yet banks routinely bar immigrant NYC residents from opening accounts, through restrictive identification requirements and other discriminatory barriers. Not a single one of the big banks accepts NYC’s municipal identification card, IDNYC, as a primary form of ID, despite guidance from Federal regulators confirming they may do so, and despite pressing need.

As banks continue to consolidate and become further removed from communities and local economies, community development financial institutions (CDFIs) play an increasingly important role in stimulating small business, affordable housing and other development in economically distressed neighborhoods, through fair and transparent loans and investments. CDFI-certified credit unions, including LES People’s, serve more than eight million people across 46 States and, despite serving low income communities, exceed the financial growth and performance of their mainstream peers.<sup>7</sup>

Since 1994, the U.S. Treasury has provided CDFI certification and investments to qualifying institutions, shoring up their net worth and allowing them to grow deposits and loans, as well as attract other investors. (CDFIs must match Federal investments dollar for dollar with private sources.) CDFI investments have helped my

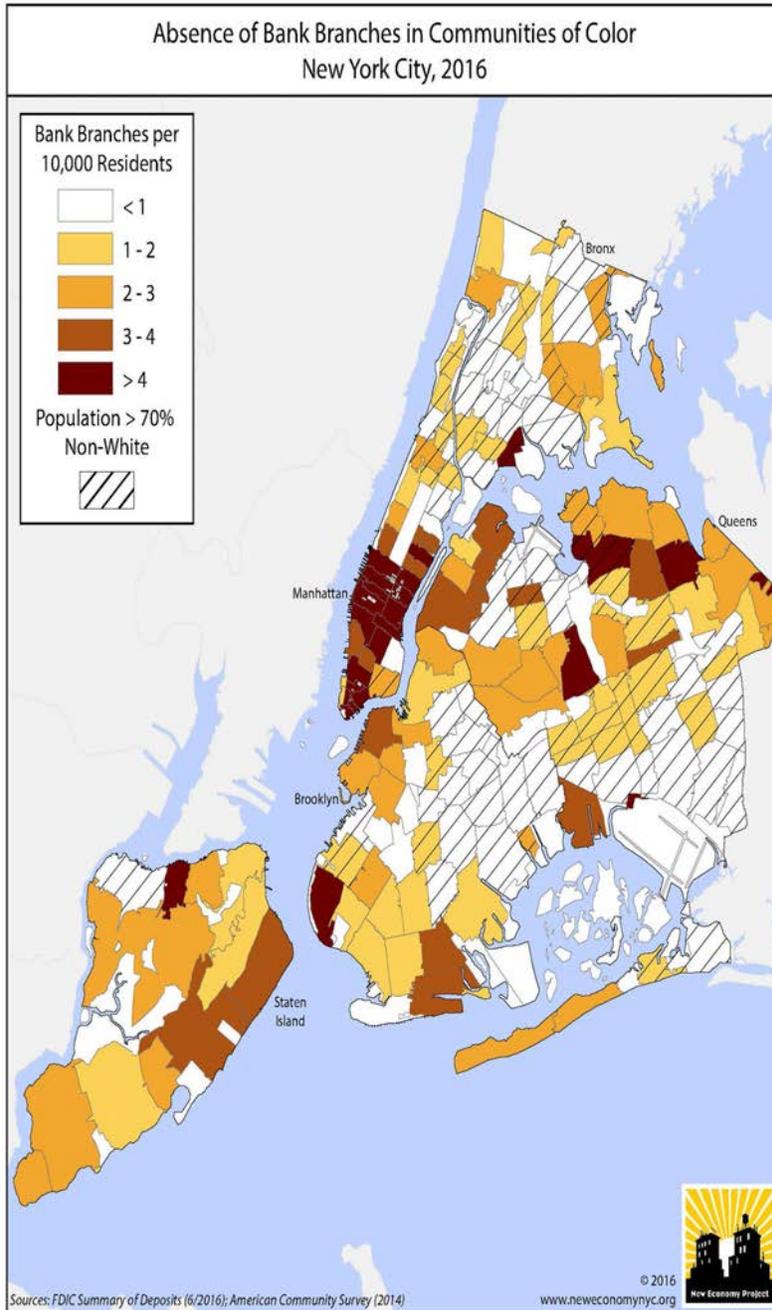
<sup>6</sup>“The Financial Crisis Response in Charts”, at [www.treasury.gov/resource-center/data-chart-center/Documents/20120413-FinancialCrisisResponse.pdf](http://www.treasury.gov/resource-center/data-chart-center/Documents/20120413-FinancialCrisisResponse.pdf).

<sup>7</sup>“CDFI Certification: A Building Block for Credit Union Growth: Performance, Profiles, and Prospects for CDFI Credit Unions”, at [www.cdco.org/wp-content/uploads/2014/05/CDFI\\_whitepaper\\_final.pdf](http://www.cdco.org/wp-content/uploads/2014/05/CDFI_whitepaper_final.pdf).

credit union, LES People's, for example, to make more than \$92 million in business, mortgage and consumer loans since our inception, and to grow in assets from \$33 million to \$51 million in a few short years. Our members' deposits are fully loaned out, and among the needs our credit union fulfills is lending to low income, limited-equity housing cooperatives in NYC—one of the few remaining avenues to homeownership that are accessible to low income New Yorkers.

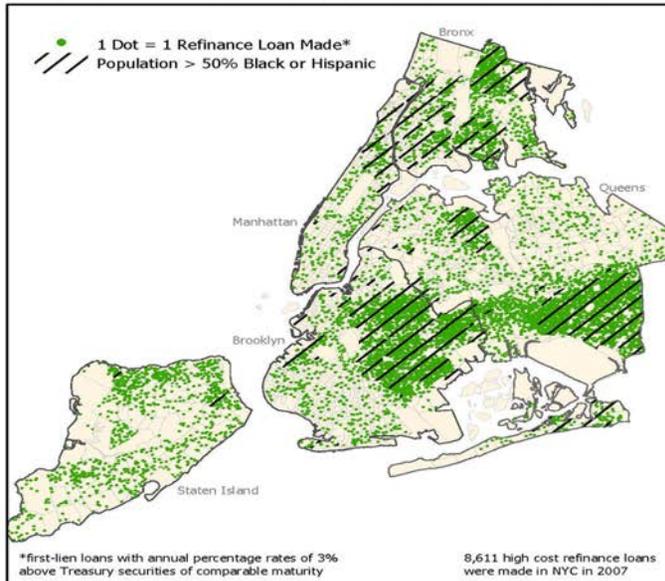
Given the CDFI Fund's ability to achieve massive impact with relatively small investments, it has consistently garnered broad, bipartisan support. The Trump administration's recently proposed FY2018 budget, however, virtually zeroes out the CDFI Fund, along with other vital community development programs. Federal disinvestment from a sector that is financing true economic growth and jobs would have a devastating impact on communities across the country, and we hope this funding is swiftly and fully restored.

Thank you again for the opportunity to testify today. Unfortunately, we find ourselves in a position in which we must do everything possible to resist attacks on financial reform and consumer protection. I would be happy to respond to any questions you might have about the role of the financial sector in fostering economic growth, including our vision for a just and equitable economy.

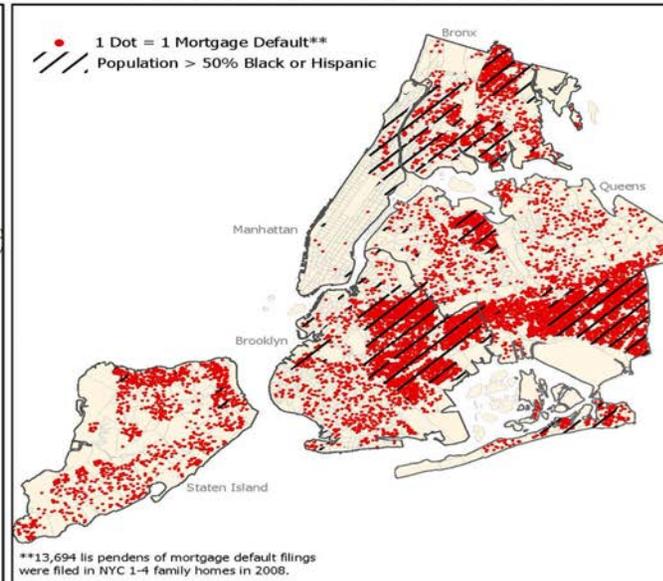


# NEW YORK CITY

## HIGH-COST REFINANCE LOANS MADE - 2007

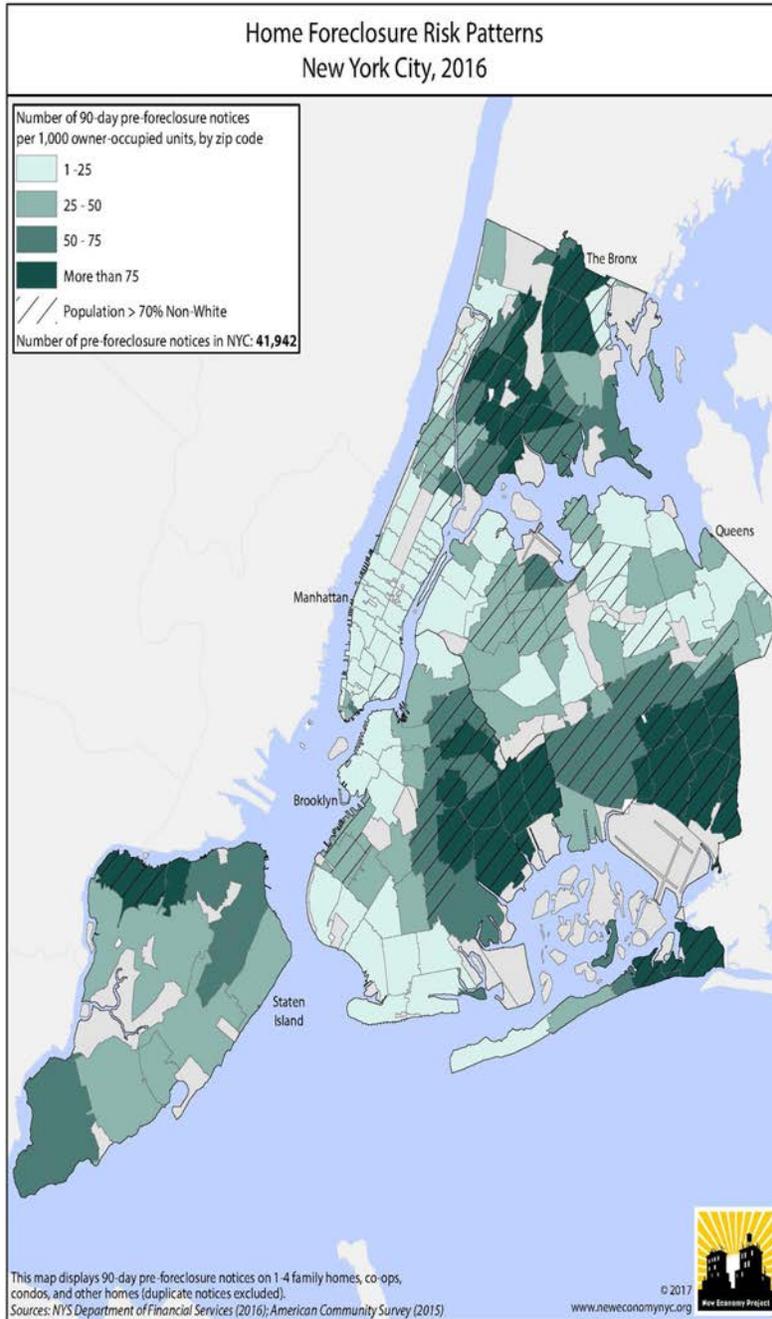


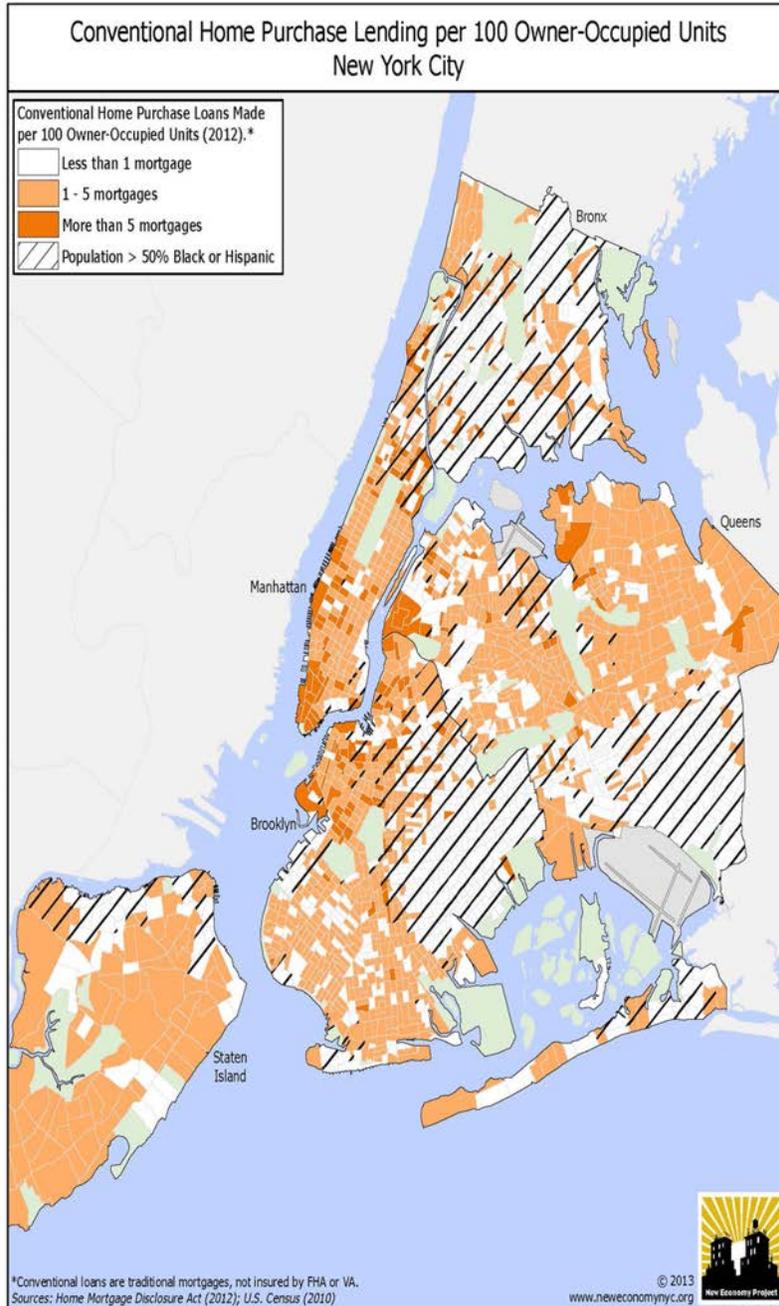
## FORECLOSURE PATTERNS - 2008

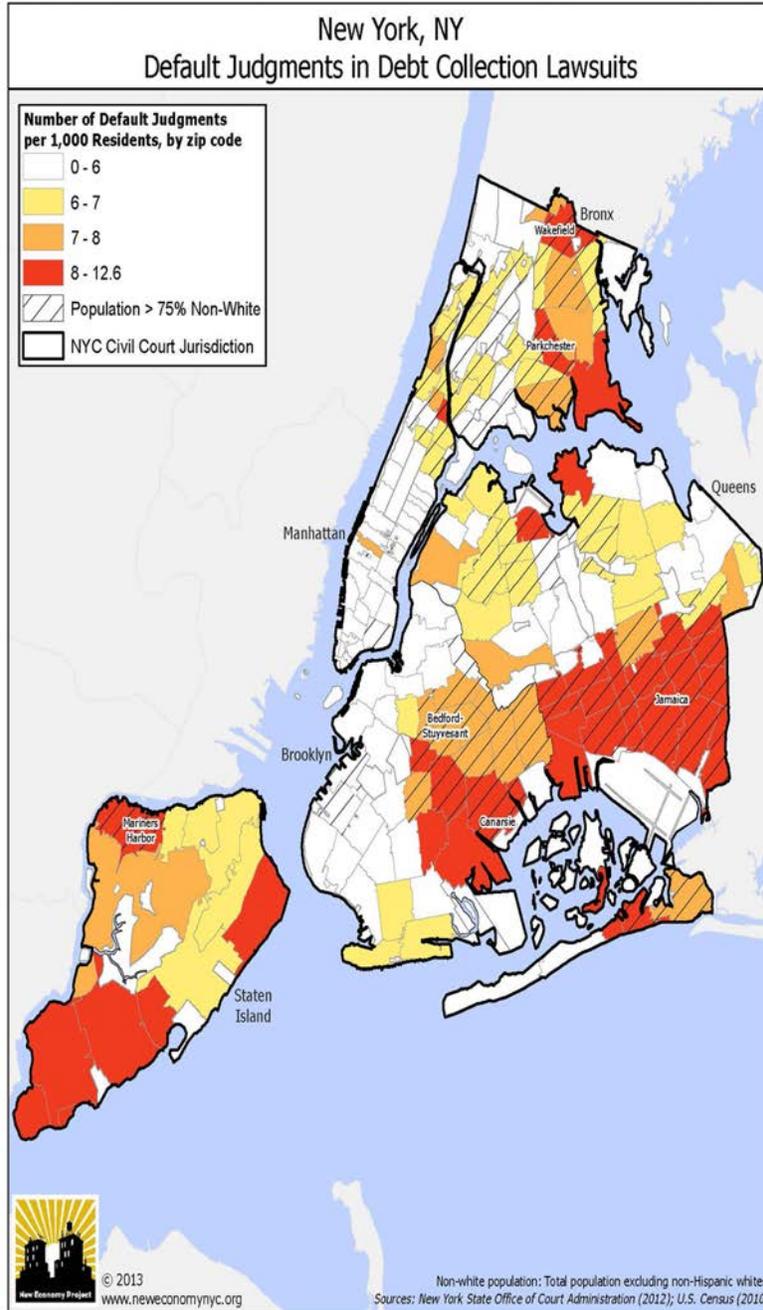


Sources: HMDA (2007); Profiles Publications; U.S. Census (2000)

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Mr. Thomas J. Curry  
 Comptroller of the Currency  
 Office of the Comptroller of the Currency  
 Washington, DC  
[regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)

January 13, 2017

Re: Exploring Special Purpose National Bank Charters for Fintech Companies

Dear Comptroller Curry:

The undersigned consumer, civil rights, and community groups write to express our strong opposition to the proposed new federal nonbank lending charters that would enable lenders to avoid state interest rate caps, other state protections, and state oversight. State laws often operate as the primary line of defense for consumers and small businesses; thus, the proposal puts them at great risk.

**The OCC must not undermine state rate caps.** Interest rate caps are the simplest, most effective way to protect borrowers from unaffordable, high-rate loans and to align the interests of lenders and borrowers. However, given the general absence of federal usury caps, lenders under the OCC's proposal would have no functional limit on the interest rates and related fees they could charge. This would effectively nullify critical existing state rate caps. Today, over 90 million people live in 15 states plus D.C. that enforce rate caps to prevent abusive high-cost short-term loans and collectively save over \$8 billion in high-cost loan fees. Many more states have rate caps on longer term loans: a \$2000, two-year loan that has an APR above 36%, including all fees, would violate the law in 30 states and D.C. Many of these states have never allowed high-cost loans, aggressively enforcing their strict usury limits. Other states used to authorize exemptions to their rate caps, but reversed course because of the damage caused to consumers and their communities. In both cases, states have worked tirelessly over many years to enact and enforce laws to protect against the abuses of high-cost loans and have withstood numerous attempts by unscrupulous lenders to circumvent these protections. The OCC, with the stroke of its pen, will put millions of people and years of state level enforcement at risk of exploitation by high-cost lenders.

**The OCC must not weaken states' ability to oversee lenders and take action to prevent harmful lending practices.** Beyond interest rate caps, the proposal weakens states' ability to protect consumers and small businesses through supervision and enforcement. The OCC's charter proposal enables companies to avoid state licensing regimes and oversight by state regulators and attorneys general. Even where AGs would retain enforcement authority, their ability to investigate abuses would be curtailed. The OCC alone cannot prevent every problem. States are closer to the ground and are more likely to take quick action when problems are still small and local, before abuses become nationwide problems attracting the attention of the OCC. The OCC should not take state law enforcers off the beat of preventing predatory lending.

**The OCC must not undermine efforts to provide fair and inclusive lending practices,** particularly for people of color and low- and moderate-income consumers, in the areas where they operate. While the fintech industry has the potential to encourage innovation, we have also seen costly payday lenders hide behind the costume of "fintech." The OCC's proposal promotes the expansion of questionable lending practices that are not only not subject to state interest rate limits or state-level enforcement, but also

would not be subject to the Community Reinvestment Act's requirement to provide responsible, not predatory, credit.

The OCC's legal authority to charter non-depository lenders unilaterally, without congressional approval, is also doubtful. For all of the above reasons, the OCC should not charter such entities even if it has power to do so.

We very much appreciate your attention to our concerns.

Sincerely,

A New Leaf  
Action Advocacy Law Office  
ACTION Housing Inc.  
Action NC  
Advantage Housing, Inc  
AFSCME Montana Council 9  
Alaska PIRG  
Alexander County Habitat for Humanity  
Allied Progress  
Americans for Financial Reform  
AMOS Project  
Arcade Credit Union  
Arizona Community Action Association  
Arkansans Against Abusive Payday Lending  
Asheville Area Habitat for Humanity  
Baltimore CASH Campaign  
Baltimore Community Real Estate Center, Inc  
Bonnie Wright & Associates  
BPFNA ~ Bautistas por la Paz  
Bread for the World - South Dakota  
Brooklyn Legal Services Corporation  
Bucks County Women's Advocacy Coalition  
CAFE Montgomery MD  
California Reinvestment Coalition  
Cambridge Economic Opportunity Committee  
Carolina Small Business Development Fund  
Catalyst Miami  
Catholic Community Services of Southern AZ

Connecticut Citizen Action Group  
CCCS of WNC, Inc. DBA OnTrack Financial Education & Counseling  
Cedar Grove Institute for Sustainable Communities  
Ceiba  
Center for Economic Integrity  
Center for Housing and Community Studies  
Center for NYC Neighborhoods  
Center for Responsible Lending  
Central Florida Jobs with Justice  
Century Employees Savings Fund CU  
CEO Pipe Organs/Golden Ponds Farm  
Chhaya CDC  
Children First/Communities In Schools of Buncombe County  
Citizen Action/Illinois  
Civil Justice, Inc.  
Clarifi  
Cambridge Neighborhood Apartment Housing Services (CNAHS), Inc  
Coalition on Homelessness & Housing in Ohio  
Coatesville Center for Community Health  
Colorado Center on Law & Policy  
Colorado Coalition for the Homeless  
Community Action Association of Pennsylvania  
Community Action Committee of the Lehigh Valley  
Community Development Network of Maryland, Inc.  
Community Economic Development Association of Michigan (CEDAM)  
Community Empowerment Fund  
Community Investment Fund of Indiana  
Community Law Center, Inc.  
Community Legal Services, Inc., of Philadelphia  
Connecticut Association for Human Services  
Connecticut Fair Housing Center  
Connecticut Legal Services, Inc.  
Consumer Action  
Consumer Federation of America  
Consumer Federation of California  
Consumers for Auto Reliability and Safety

Consumers Union  
CoPIRG  
Covenant House  
CWA  
Demos  
District Council 37 Legal Services  
Durham Regional Financial Center  
Eastside CDC/LEAP  
Eastside Community Development Corporation  
Economic Progress Institute  
Empire Justice Center  
Episcopal Diocese of North Carolina  
Every Child Matters in New Hampshire  
Fair Share  
Fayetteville Area Habitat for Humanity  
Financial Pathways of the Piedmont  
Financial Protection Law Center  
First Unitarian Church of Philadelphia  
Florida Alliance for Consumer Protection  
Florida Alliance for Consumer Protection (FLACP)  
Florida Alliance for Retired Americans  
Florida Consumer Action Network  
Florida Legal Services, Inc.  
Georgia Watch  
Gila County Community Services  
Gowen Consulting  
Granite State Organizing Project  
Greater Yellowstone Central Labor Council  
Greensboro Housing Coalition  
Habitat for Humanity Cabarrus County  
Habitat for Humanity Georgetown County  
Habitat for Humanity New York City  
Habitat for Humanity of Florida  
Habitat for Humanity of Forsyth County  
Habitat for Humanity of Gaston County  
Habitat for Humanity of Greater Greensboro

Habitat for Humanity of Indiana  
Habitat for Humanity of Lancaster County (SC)  
Habitat for Humanity of North Carolina  
Habitat for Humanity of Thomasville NC Area  
Hawaii Appleseed Center for Law and Economic Justice  
Haywood Habitat for Humanity  
Health, Education, and Legal Assistance Project  
Heartland Alliance for Human Needs & Human Rights  
Helping Families In Need  
Henderson County Habitat for Humanity  
Hispanic Baptist Convention of Texas  
Holistic Transformations  
HomeFree-USA  
Homeword  
HOPE of Evansville  
Housing Alliance of Pennsylvania  
Housing and Family Services of Greater New York, Inc.  
Housing Opportunities of Beaver County  
Howard County Office of Consumer Protection  
Illinois Asset Building Group  
Indiana County Community Action Program, Inc.  
Indiana Institute for Working Families  
Innovative Systems Group Inc.  
Irvington Development Organization  
Jacksonville Area Legal Aid, Inc.  
JASA/Legal Services for the Elderly in Queens  
Jesuit Social Research Institute  
Jewish Federation of Greater Seattle  
Just Harvest  
Keystone Progress  
Keystone Research Center  
King Park Development Corporation/Build Fund  
La Fuerza Unida Community Development Corp  
Laborers' Local #1686  
Latino Community Credit Union  
Law Foundation of Silicon Valley

Lazarus Financial Planning, LLC  
Legal Aid Society of Palm Beach County, Inc.  
Legal Aid Society of the District of Columbia  
Legal Services NYC  
Legal Services of New Jersey  
Legal Services of Southern Piedmont  
Lexington Area Habitat for Humanity  
LifeStyles of Maryland Foundation, Inc.  
Lower East Side People's Federal Credit Union  
Lutheran Advocacy Ministry in PA  
Main Street Alliance  
Maine Center for Economic Policy  
Making Work Pay PA Coalition  
MakingChange, Inc.  
Maryland CASH Campaign  
Maryland Consumer Rights Coalition  
MASSPIRG  
MFY Legal Services, Inc.  
Michigan Coalition Against Homelessness  
Military Assistance Project  
Mission Asset Fund  
Mississippi Center for Justice  
Missoula Area Central Labor Council, AFL-CIO  
Missouri Faith Voices  
Montana Organizing Project  
Montgomery County Community Action Development Commission  
Montgomery County, Maryland Community Action Board  
Mothers and Families of Murdered Children  
Mountain State Justice  
Northern Arizona Council of Governments  
National Development Council  
National Association for Latino Community Asset Builders  
National Association of Consumer Advocates  
National Association of Social Workers, West Virginia Chapter  
National Center for Law and Economic Justice  
National Coalition of 100 Black Women, Phoenix

National Consumer Law Center (on behalf of its low-income clients)  
National Council of La Raza  
National Fair Housing Alliance  
National Rural Social Work Caucus  
NC AFL-CIO  
NC Council of Churches  
NC Justice Center  
NC Rural Center  
Near West Collaborative  
Neighborhood Economic Development Corp  
Neighborhood Trust Financial Partners  
NeighborWorks Great Falls  
New Economy Project  
New Hampshire Legal Assistance  
New Jersey Citizen Action  
NHS of Baltimore  
North Carolina Assets Alliance  
North Carolina Conference of the United Methodist Church  
North Carolina Consumers Council  
North Carolina PIRG  
North Carolina Veterans Council  
North Dakota Economic Security and Prosperity Alliance  
Northwest Indiana Reinvestment Alliance  
NY StateWide Senior Action Council  
NYPIRG  
Ohio Valley Environmental Coalition  
Oklahoma Policy Institute  
One Colorado  
OneAmerica  
Open Hearth, Inc  
Opportunity Alliance Nevada  
OptInference LLC  
Oregon Food Bank  
Our Savior Lutheran Church & Campus Ministry  
PathWays PA  
Pennsylvania Council of Chapters, Military Officers Association of America

Pennsylvania Council of Churches  
Pennsylvania Public Interest Research Group  
Pennsylvania War Veterans Council  
People's Action  
PICO National Network  
Pisgah Legal Services  
Progressive Congress Action Fund  
Progressive Leadership Alliance of Nevada  
Prosperity Indiana  
Public Good Law Center  
Public Interest Law Center  
Reinvestment Fund  
Reinvestment Partners  
Rural Dynamics, Inc  
Sargent Shriver National Center on Poverty Law  
SC Appleseed  
South Baltimore Partnership  
South Carolina Association of Habitat Affiliates  
South Dakotans for Responsible Lending  
Southern Poverty Law Center  
Southwest CDC  
St Barnabas Episcopal Church  
Statewide Poverty Action Network  
Systemic Change Team, Unitarian Universalist Church of the North Hills  
Tennessee Citizen Action  
Texas Appleseed  
Texas Legal Services Center  
The Capital Good Fund  
The Collaborative  
The Interfaith Alliance of Colorado  
The Leadership Conference on Civil and Human Rights  
The Midas Collaborative  
The One Less Foundation  
The Working World  
Thermal Belt Habitat for Humanity  
Thrive Alliance

Union-Snyder Community Action Agency  
Unitarian Universalist Legislative Advocacy Network (UUPLAN)  
Unitarian Universalist Pennsylvania Legislative Advocacy Network (UUPLAN)  
United Methodist Advocacy in Pennsylvania  
United Valley Interfaith Project  
United Way of Erie County  
United Way of Frederick County  
United Way of Greater Greensboro  
United Way of the National Capital Area  
Upper Yadkin Valley Habitat for Humanity  
Urban Affairs Coalition  
Urban Asset Builders  
Urban Community AgriNomics  
Urban Homesteading Assistance Board  
Virginia Citizens Consumer Council  
Virginia Organizing  
VOCAL-NY  
Washington Asset Building Coalition  
Washington Heights and Inwood Development Corporation  
Washington Low Income Housing Alliance  
Washington Student Association  
West Virginia Center on Budget and Policy  
West Virginia Citizen Action Group  
West Virginians for Affordable Health Care  
Westchester Residential Opportunities Inc.  
Westminster Economic Development Initiative, Inc.  
Westmoreland Community Action  
Wilson Area Habitat for Humanity  
Woodstock Institute  
Yakima County Asset Building Coalition

**PREPARED STATEMENT OF WILLIAM E. SPRIGGS**

PROFESSOR OF ECONOMICS, HOWARD UNIVERSITY, AND CHIEF ECONOMIST, AFL-CIO

MARCH 28, 2017

Thank you to Chair Mike Crapo and Ranking Member Sherrod Brown for this invitation to give testimony before your Committee today on issues of policies to promote economic growth. I am happy to offer this testimony on behalf of the AFL-CIO, America's house of labor, representing the working people of the United States; and based on my expertise as a professor in Howard University's Department of Economics, whose alumni include your colleague Senator Kamala Harris.

Financial firms and monetary policies can and do play a role in shaping economic growth. But, it is important to first note that economic growth characterizes events in the real economy; the production and sale of goods and services. The key elements of growth are the growth rate of the labor force, the skills of the labor force and the productivity of the labor force. Financial markets play a role in insuring that investments add to productive capital that can boost the productivity of workers, and there are fair terms for workers to make investment in their education and skill attainment. And, fair and equitable access to financial institutions can insure that households can have enough liquidity to smooth their consumption to be resilient during economic downturns and in retirement, and to make investments in capital, like housing, that can boost employment.

To have sustained growth, the financial system must remain stable. When banks grow too large and present systemic risks to the system, or when banks can create shadow investments trading in their own debt, the system itself becomes a risk. Glass-Steagall, the Banking Act of 1933,<sup>1</sup> provided a period of such stability. The financial collapse of 2007-2008 clearly demonstrated that the financial system cannot self-regulate. The fallout in the real economy was deep and far reaching, causing a collapse in private and public investment, and the stripping of wealth of the household sector by depleting savings to keep households going. Nine years away, we have yet to restore public investment to the level needed to sustain strong growth. So, similarly to the lessons learned from the financial collapse of the Great Depression, Dodd-Frank, the Wall Street Reform and Consumer Protection Act of 2010,<sup>2</sup> addresses the excesses that the financial collapse of the Great Recession demonstrated create a system of great economic risk. For that reason, the AFL-CIO supported the Dodd-Frank reforms and continues to believe it prudent to defend them as necessary for sustained growth.

It is key for monetary policy to provide enough liquidity to the market to allow for investment in productive capital, and enough liquidity for households to make long term purchases like automobiles and houses; and with regulation to reduce systemic risks from market concentration and discrimination in access. A necessary condition for growth is monetary policy that adheres to the Humphrey-Hawkins Act, the Full Employment and Balanced Growth Act of 1978, to keep Americans at work, letting the economy run at a rate that keeps unemployment low.<sup>3</sup>

In the real economy, many policies fostered a period of shared prosperity and rapid economic growth in the United States. From 1946 to 1979, the wages of American workers grew with their productivity. And, income gains were roughly equally shared throughout the income distribution. There were many Federal policies that invested in the American people and put the Government on the side of raising wages. In sum, these policies promoted shared prosperity, so incomes grew at each income quantile. Economists are converging on a consensus that equality promotes faster economic growth. And, equality provides the basis for enhancing social mobility and a more meritocratic society.

Several key Federal programs stand out for enhancing shared prosperity. The GI Bill, gave many World War II veterans access to college by paying their tuition and giving them living stipends; home ownership through reduced down payments and low interest loans—two tickets to the middle class.

The introduction in 1946 of Federal legislation to establish a national school lunch program decreased the food insecurity of children. Participation of children in inter-

<sup>1</sup> Public Law 73-66 <http://www.legisworks.org/congress/73/publaw-66.pdf>.

<sup>2</sup> Public Law 111-203 <https://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm>.

<sup>3</sup> Public Law 95-523, 92 Stat. 1887, <https://www.gpo.gov/fdsys/pkg/STATUTE-92/pdf/STATUTE-92-Pg1887.pdf>.

ventions to address basic food needs has been shown to improve the health of children and have lasting impacts on educational attainment.<sup>4</sup>

During this period, broad political consensus maintained a neutral National Labor Relations Board that maintained balance in labor management relations. The period allowed for the continued ability of workers to exercise their right to organize. So, during this period, the share of workers who were organized rose, as did their diversity. At higher levels of union density all workers benefit, both union and nonunion in striking deals to divide the benefits of rising productivity.<sup>5</sup>

Each President during the period signed legislation to raise the minimum wage and keep all wages in step with general growth in productivity and wage gains. This spread the benefits of increases in productivity to the wages of the lowest quantile; insuring that work paid. Increases in the minimum wage are linked to reducing food insecurity and lowering low-birth weight and premature babies for less educated women.<sup>6</sup>

Republican President Dwight Eisenhower, when the former Soviet Union launched Sputnik in October 4, 1957, got the Democratic Senate to pass legislation in less than 1-year to launch the National Defense Student Loan program that assured American students could borrow enough money to cover an Ivy League education at interest rates below the prime rate. Students who were supported by the loans but accepted jobs in K–12 education had their loans forgiven.

American became the world's most educated country with the highest share of its workforce holding college degrees. The NDSL provided the money for the teacher corps that then produced the inventors of the personal computer and internet.<sup>7</sup>

President Eisenhower also launched one of the largest peace time Government programs in creating our current modern interstate highway system. Not only did this create many middle-class construction jobs, it vastly improved America's infrastructure and lowered transportation and production costs for American business. It spurred the expansion of new industries like motels and reduced the isolation of rural communities.

In the 1960s, President Lyndon Johnson expanded the role of the Federal Government in investing in the early education of America's children. The Head Start program, launched in 1965 has proven to be a valuable program in changing the long-run prospects for children from low-income families: increasing their success in school, earnings in adulthood and lowering criminal activity.<sup>8</sup>

Also in 1965, President Johnson put in place Medicaid and Medicare. Medicaid has been shown to increase the educational attainment and earnings of women who had greater access to Medicaid as children, and boosts the taxes paid by young adults who were helped by Medicaid.<sup>9</sup> Medicare ended racial segregation in the pro-

<sup>4</sup> Craig Gundersen, Brent Kreider, and John Pepper, "The Impact of the National School Lunch Program on Child Health: A Nonparametric Bounds Analysis", *Journal of Econometrics*, Vol. 156 (January 2012): 79–91; Peter Hinrichs, "The Effects of the National School Lunch Program on Education and Health", *Journal of Policy Analysis and Management*, Vol. 29 (Summer 2010): 479–505.

<sup>5</sup> Daniel Tope and David Jacobs, "The Politics of Union Decline: The Contingent Determinants of Union Recognition Elections and Victories", *American Sociological Review*, Vol. 74 (October 2009): 842–864; Jake Rosenfeld, Patrick Denice, and Jennifer Laird, "Union Decline Lowers Wages of Nonunion Workers: The Overlooked Reason Why Wages Are Stuck and Inequality Is Growing", *Economic Policy Institute*, (August 30, 2016) at <http://www.epi.org/files/pdf/112811.pdf>.

<sup>6</sup> George Wehby, Dhaval Dave, and Robert Kaestner, "Effects of the Minimum Wage on Infant Health", National Bureau of Economic Research, NBER Working Paper No. 22373 (June 2016); William M. Rodgers III, "The Impact of the 1996/97 and 2007/08/09 Increases in the Federal Minimum Wage on Food Security", manuscript, Rutgers University (September 2015) at <https://www.researchgate.net/publication/266023361-The-Impact-of-the-199697-and-20070809-Increases-in-the-Federal-Minimum-Wage-on-Food-Security>.

<sup>7</sup> Public Law 85–864 (September 2, 1958) <https://research.archives.gov/id/299869>; Saul B. Klamman, "The Postwar Pattern of Mortgage Interest Rates", in Saul B. Klamman (ed.) *The Postwar Residential Mortgage Market* (Princeton University Press, 1961) sited from: <http://www.nber.org/chapters/c2341.pdf>, University of Pennsylvania, "University History, Tuition and Mandated Fees, Room and Board and Other Educational Costs at Penn Since 1900: 1950–1959" web page: <http://www.archives.upenn.edu/histy/features/tuition/1950.html>.

<sup>8</sup> Patrick Kline and Christopher Walters, "Evaluating Public Programs With Close Substitutes: The Case of Head Start", National Bureau of Economic Research, NBER Working Paper No. 21658 (October 2015); Hilary Shager, Holly S. Schindler, Katherine A. Magnuson, Greg J. Duncan, Hirokazu Yoshikawa, and Cassandra M.D. Hart, "Can Research Design Explain Variation in Head Start Research Results? A Meta-analysis of Cognitive and Achievement Outcomes", *Educational Evaluation and Policy Analysis*, Vol. 35 (March 2013): 76–95.

<sup>9</sup> David W. Brown, Amanda E. Kowalski, and Ithai Z. Lurie, "Medicaid as an Investment in Children: What Is the Long-Term Impact on Tax Receipts?" National Bureau of Economic Research, NBER Working Paper No. 20835 (January 2015).

vision of health in the United States, improved the lives of older Americans and began narrowing the life expectancy gap between whites and African Americans.

These investments in American children and the American people, and the investment in public infrastructure put the Federal Government clearly on the side of empowering Americans to achieve a high level of productivity. It provided American corporations the largest pool of highly educated and healthy workers to propel American growth. And, the Government was clearly on the side of American workers in getting their fair share of the increased productivity. Wages rising with productivity insured all the correct market signals in the labor market would encourage Americans to make the investment in their skills. And, by keeping unemployment rates low, fiscal, and monetary policy gave incentive to firms to train workers, invest in their productivity and aim at retaining those workers.

Since that era, most of those policies have been undermined. In the 1980s and again in the 2000s the NLRB too often took positions favorable to management to limit workers organizing; raising the minimum wage went from a bipartisan effort to a partisan battle; the wages for the middle stagnated and the wages at bottom fell. Profits as a share of national income rose, but taxes from corporate America shrank, putting more of the Nation's tax burden on workers as the wage share of national income fell. Once the United States stood out for its highly educated work force, as recently as 1995 ranking first for the share of workers with college degrees, but by 2012 the United States ranked 19th among 28 advanced economies.<sup>10</sup> In 1975 State and local governments provided 63 percent of all expenditures on higher education, by 2010 that figure fell to 34.1 percent resulting in a trend of ever rising tuition for individual students.<sup>11</sup>

The financial collapse of 2007–2008 further crippled American manufacturing, forcing American automobile manufacturing into bankruptcy and reorganization, and crushed public sector investment beyond de-investment in higher education. Falling values of pension investments and drops in revenue, led to the greatest drop in State and local public investment since the Great Depression.

Americans see politicians that argue for tax breaks for the top 1 percent, and a retreat on policies to invest in them while their wages stagnate and corporations are given support to suppress those wages, hours and working conditions. This is a great source of cynicism as workers no longer believe in “trickle down” economics.

Now most economists agree. The International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) find that income inequality hurts growth.

The IMF finds that near term growth over the business cycle, roughly 5 years, is slower and of shorter duration in those advanced economies where net income inequality is higher; where net income inequality considers market-based income (or gross inequality) net of income transfer programs (safety-net and other redistributive programs).<sup>12</sup> There are various reasons for this. At high levels of inequality, those at the bottom of the income distribution are more vulnerable and lack resiliency to absorb downward shocks in income. Workers also become highly leveraged to keep up when the economy expands, increasing systemic risks for the economy. Importantly, the IMF find that redistribution of income has no effect on growth, but inequality does. This means that concerns that safety-net programs slow growth by reducing labor supply and effort is not shown in the data. But, the effects of inequality do show. So, the net benefit of redistribution that lowers inequality is clear.

Focusing on income distribution more specifically, the IMF finds that when growth goes up disproportionately to the top 20 percent of the income distribution that national income growth—GDP per capita—falls. Clearly, policies that aim to increase the post-tax income of the top do not trickle down; they instead slow overall growth. They further find that programs that increase access to education and health in particular, that help the middle class and the poor specifically, reduce inequality, and spur growth.<sup>13</sup> And, that labor market policies that do not exclude the

<sup>10</sup> Liz Westin, “OECD: The U.S. Has Fallen Behind Other Countries in College Completion”, *Business Insider* (September 9, 2014) at <http://www.businessinsider.com/r-us-falls-behind-in-college-competition-oecd-2014-9>.

<sup>11</sup> Thomas Mortenson, “State Funding: A Race to the Bottom”, American Council on Education (Winter 2012) at <http://www.acenet.edu/the-presidency/columns-and-features/Pages/state-funding-a-race-to-the-bottom.aspx>.

<sup>12</sup> Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides, “Redistribution, Inequality, and Growth”, IMF Staff Discussion Note, SDN/14/02 (February 2014) at <https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>.

<sup>13</sup> Era Dabla-Norris, Kalpana Kochhar, Nujin Suphaphiphat, Frantisek Ricka, and Evridiki Tsounta, “Causes and Consequences of Income Inequality: A Global Perspective”, IMF Staff Dis-

Continued

poor from accessing middle income jobs spur growth. In short, the very policies pursued by the United States across Democrat and Republican Presidencies during the 1946 to 1979 era.

The IMF further investigates and finds that the growth in inequality is mainly driven by gains at the top 10 percent and is tied together with a reduction in the share of workers in labor unions to bargain for a higher share of gains to the middle and the lowering value of minimum wages that protect earnings at the bottom. The report also found evidence that declining top marginal income tax rates increases inequality, as does financial deregulation. Technological change was not a driving force.<sup>14</sup>

The OECD research finds a sizable impact on growing inequality and slowing growth. Specifically, the decline in the share of income for the bottom 40 percent of income distribution hurts growth the most. The OECD finds a clear link between the shrinking income share of the bottom 40 percent and a drop in educational investment. Clearly, an effect of rising inequality that can be mitigated is to increase public investment in education targeted toward the bottom 40 percent. They also find that policies that can increase women's labor force participation, like supporting child care, paid sick days and family leave, also reduce inequality, and promote growth. And, raising labor standards to reduce nonstandard and irregular work, reduce poverty and inequality, and promote growth.<sup>15</sup>

OECD research also finds that increased centralized bargaining structures, like those that can come from higher labor union density, help to reduce the risk of extreme failures from economic shocks. And, it is also the case that higher minimum wages reduce the risks of very negative extremes from economic shocks. Perhaps explaining stability in the United States economy during the 1946 to 1979 period.<sup>16</sup>

The evidence from the IMF and OECD that has been built on a growing economic literature on the effects of inequality are reassuring in understanding what helped form greater political and social cohesion in the United States from 1946 to 1979 when U.S. productivity, income growth and educational attainment led the world. The loss of faith of American workers in the system has risen with policies that have promoted inequality, that reversed patterns of investing in America and Americans and led to rising inequality that has slowed economic growth. There can be little social cohesion when policies consistently favor those at the top, as they do not help growth.

Since 1979, incomes have grown very unequal in the U.S.<sup>17</sup> This growth in inequality has been accompanied by several other discouraging factors. Among those factors has been a decline in new establishment creation including small businesses. The creation of new firms is related to product innovation and labor market reallocation. These two help increase aggregate productivity, a key to faster economic growth rates.<sup>18</sup>

Firm growth is dependent on the growth of their customer base.<sup>19</sup> When there is broadly shared prosperity more households have their budget constraint expanded; resulting in a larger increase in potential customers. When the economy produced shared prosperity, new establishments were created without hurting the market share of large firms. But, when income growth is limited, there is a smaller increase in potential customers. Customer growth becomes a zero-sum game. Firms with adequate liquidity compete by lowering prices or buying competitors. But, lowering costs by lowering wages means a competition for customers that lowers the incomes of some households, further shrinking the aggregate customer base. In 1980

cussion Note, SDN/15/13 (June 2015) at <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1513.pdf>.

<sup>14</sup>Florence Jaumotte and Carolina Osorio Buitron, "Inequality and Labor Market Institutions", IMF Staff Discussion Note, SDN/15/14 (July 2015) at <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1514.pdf>.

<sup>15</sup>"OECD, In it Together: Why Less Inequality Benefits All", (OECD Publishing: Paris, 2015) at <http://www.keepeek.com/Digital-Asset-Management/oecd/employment/in-it-together-why-less-inequality-benefits-all-9789264235120-en#.V-FiwCgrKhc>.

<sup>16</sup>Aida Caldera Sanchez and Oliver Roehn, "How do Policies Influence GDP Tail Risks?" OECD Economics Department Working Paper (forthcoming).

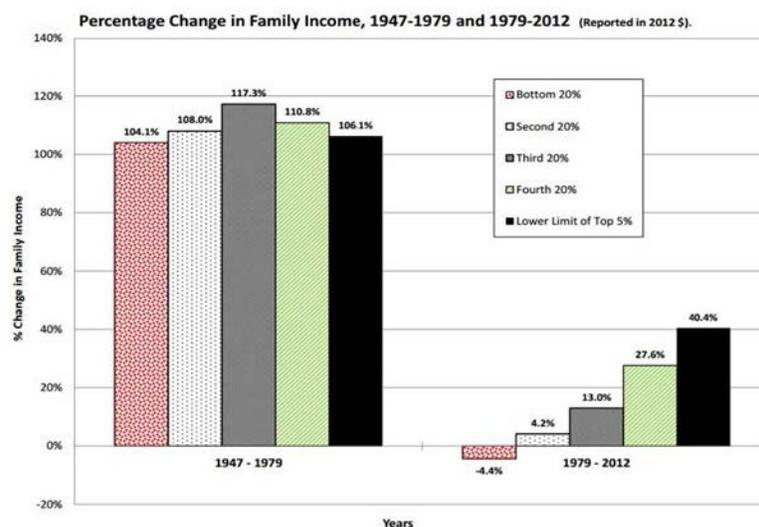
<sup>17</sup>Congress of the U.S., Congressional Budget Office, Trends in the Distribution of Income Between 1979 and 2007, October 2011 at <http://www.cbo.gov/sites/default/files/cbofiles/attachments/10-25-HouseholdIncome.pdf>.

<sup>18</sup>Ryan Decker, John Haltiwanger, Ron S. Jarmin, and Javier Miranda, "Where Has All the Skewness Gone? The Decline in High Growth (Young) Firms in the U.S.", NBER Working Paper No. 21776 (December 2015) at <http://www.nber.org/papers/w21776>.

<sup>19</sup>Simon Gilchrist and Egon Zakrajsek, "Customer Markets and Financial Frictions: Implications for Inflation Dynamics", Federal Reserve Bank of Kansas City, 2015 Economic Symposium: Inflation Dynamics and Monetary Policy, (August 2015) at [https://www.kansascityfed.org/media/files/publicat/sympos/2015/2015gilchrist\\_zakrajsek.pdf?la=en](https://www.kansascityfed.org/media/files/publicat/sympos/2015/2015gilchrist_zakrajsek.pdf?la=en).

when the Federal Reserve deliberately created a slowdown in the economy, incomes dropped as did wages. The depth of the drop was the most severe since the Great Depression to that point. The slowdown was achieved greatly limiting access to liquidity. Real wages for Americans fell, accommodated by a fall in the real value of the minimum wage. The result was rise in income inequality, and a slowing of the growth of the customer base. And, a trend of declining new establishments ensued, as expected initially in the retail sector; the one tied directly most directly to need for the growth of a broad customer base.<sup>20</sup>

RSF Russell Sage Foundation - Chartbook of Social Inequality



Data Source: U.S. Census Bureau, Table F-1, Income Limits for Each Fifth and Top 5 Percent of Families, from Historical Income Tables (<http://www.census.gov/hhes/income/data/historical/index.html>).

Figure 1 shows the difference between the broadly shared growth of incomes from 1947 and 1979 with the period from 1979 to 2012. Fast and equal growth before 1979 has given way to negative growth at the bottom for workers like those who keep our schools in order as crossing guards, cafeteria workers or janitors (for those workers most affected by policies that keep unemployment rates too high and away from full employment) and meager growth for the rest of America's workers in the bottom 80 percent.<sup>21</sup>

Indeed, between 1992 and 2015, there is a high correlation between income growth in each portion of the income distribution and the growth rate in the formation of new establishments in the following year. But, that correlation is more pronounced for income growth from the bottom up through the upper middle income fifth than between the top 20 percent and new establishment formation. When incomes grow widely, more potential customers make it easier to create a firm to take advantage. Increases among the highest income groups are more likely to increase the intensity of demand (spending more money on the same things) than demand of more goods. With this correlation, clearly the rate of new establishments will be lower in the post 1979 era of rising inequality and modest income growth for the bottom 80 percent.

<sup>20</sup>Decker, Haltiwanger, et al. (2015).

<sup>21</sup>Russell Sage Foundation Chartbook of Social Inequality at <http://www.russellsage.org/sites/all/files/chartbook/Income%20and%20Earnings.pdf>.

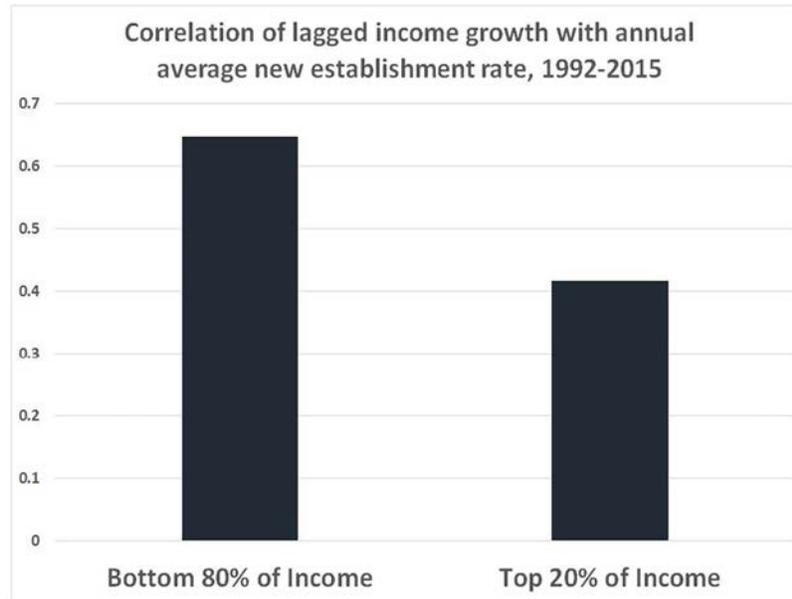


Figure 2 shows the correlation between income growth of the bottom 80 percent of the income distribution, roughly households with incomes less than \$110,000 a year, and the rate of new establishment formation in the following year, and for the top 20 percent of the income distribution. The correlation for the bottom 80 percent is presented to summarize the relationship between each of the lower fifths of the income distribution (the lowest fifth of the household income distribution making less than roughly \$22,500 like meat packers and textile workers, lower-middle income households making less than \$42,600 like computer control machine tool operators and bus drivers, middle income households making less than \$68,200 like airplane mechanics and fire fighters and those in upper middle income households like air traffic controllers and registered nurses) who are the backbone of America's working families with new establishment formation.<sup>22</sup> New establishment creation needs accommodating financial conditions, but more importantly first needs customer growth through widely shared income growth.

From 2014 to 2015 when all parts of the income distribution showed income growth, the share of small firms with employees reporting profitability and rising revenues increased from 15 to 27 percent, and from 21 to 26 percent. In 2015 among growing and start-up firms, credit availability ranked fourth among their challenges, mentioned half as often as the more highly ranked problems of hiring and cash flow. While only 47 percent of small firms with employees applied for funding, 61 percent did so to expand their business. Firms were more successful borrowing from small banks than large banks; overall, 79 percent of firms who applied for funding received at least some funding.<sup>23</sup> So, the data on small business financial demand point to responding to growing opportunities from rising revenue and to

<sup>22</sup> Calculations based on authors calculations from U.S. Bureau of Labor Force Statistics, Consumer Expenditure Survey data, and Business Employment Dynamics data. The correlation is between pre-tax income growth by quintile reported in the Consumer Expenditure data and average quarterly New Establishment Rate data for each year from the Business Employment Dynamics data. The reverse correlation, using the rate of new establishments correlated to income growth the following year is much lower, suggesting the causation is more likely that income growth leads to new establishment formation.

<sup>23</sup> Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond, St. Louis, 2015 Small Business Survey Report on Employer Firms (March 2016) at <https://www.newyorkfed.org/medialibrary/media/smallbusiness/2015/Report-SBCS-2015.pdf>.

fuel growth. They also point to the need of financial regulation to insure there is fair access to capital.

The data suggest that promoting new establishments (including small business) requires an economy that creates broad based income growth for all workers, and supportive small banks close to the action of small business and willing to invest in their growth; that is an economy that needs regulations to protect workers and protect the viability of a competitive banking landscape. Legislation like Dodd-Frank is necessary to limit systemic risk and excesses of exploiting consumers. Sustained growth needs conscious Government investment in Americans, in their health and their education, and in the Nation, in its environment and its infrastructure.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN  
FROM ROBERT HELLER**

**Q.1.** GDP grew 1.9 percent in the fourth quarter of last year. During the same period, community banks' loan balances grew by over 8 percent. According to the most recent NFIB survey, only 3 percent of small business respondents said that they were unable to get loans, and a record 67 percent said they had no interest in borrowing. Yet we hear from banks that if only there were fewer regulations, they could loan more. It seems to me that banks are having no problems growing their loan portfolios, while growth of goods and services produced is at a much slower pace. Figure 1 in your testimony appears to confirm the premise of this question. Isn't it true that the only other time where the spread between GDP and growth in loans was this high during the credit bubble before the crisis?

**A.1.** You are correct in noting that towards the end of 2016 the growth rate of overall bank lending exceeded that of economic activity. This is not atypical for the late phase of the economic cycle. In fact, during most expansions the growth rate of bank lending tends to exceed the economic growth rate late in the cycle. That is the time when exuberance can take over and sow the seeds for future loan losses.

But, rather than focusing on very short periods for growth or lending comparisons, I believe it is also very important to look at longer periods, such as the decade before or after the passage of the Dodd-Frank Act, as I did in my testimony.

The difficulty facing analysts at the present time is to distinguish between the cycle and the trend. In that context, the increased regulatory burden imposed by the Dodd-Frank legislation may well have contributed to the rather slow rate of expansion that we have experienced in the current cycle. The question is whether an easing of the regulatory burdens would lead to greater economic growth and a continuation of the expansion. I believe that this is the case and that an easing of some of the onerous and costly restrictions would be beneficial for economic growth.

At the same time, it needs to be recognized that it is the responsibility of the banking industry to originate only quality loans. Banks should only make loans that will be able to perform during an economic slowdown and not to make loans for loan growth sake. This is where solid, experienced bank management comes into play. Disciplined management is the key to a healthy bank and a solid financial system.

I currently serve on the board at Bank of Marin. It has a very disciplined, conservative management which has kept the bank safe, sound and highly profitable over the past decades. No amount of regulation alone is going to have the same effect. If you increase regulation, you just add complexity and expense, thereby punishing the well-run, strong-performing community banks.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN  
FROM DONALD POWELL**

**Q.1.** GDP grew 1.9 percent in the fourth quarter of last year. During the same period, community banks' loan balances grew by over

8 percent. According to the most recent NFIB survey, only 3 percent of small business respondents said that they were unable to get loans, and a record 67 percent said they had no interest in borrowing. Yet we hear from banks that if only there were fewer regulations, they could loan more. It seems to me that banks are having no problems growing their loan portfolios, while growth of goods and services produced is at a much slower pace. Might demand be a constraint on the growth of lending?

**A.1.** Growth of loans outstanding at U.S. banks exceeded 5 percent per year in each of the years 2014, 2015, and 2016. During these years, bank loan growth significantly exceeded the growth of U.S. gross domestic product (GDP). This loan growth reflects that U.S. banks have recovered strongly from the crisis, both in terms of earnings and in terms of significantly stronger capital positions to support lending activity.

That said, what banks are not able to do is generate as much new business through outreach and marketing efforts. For community banks the time and staff that would be available for marketing is increasingly devoted to filling out forms and other compliance activities.

Moreover, the Fed's latest Small Business Credit Survey for 2016 (drawn from input from all 12 FR banks), reported the following:

Forty-five percent of small business firms applied for financing, a slight tick down from 2015. Three-quarters said they received at least some financing, and 40 percent said they received the full amount—down from 50 percent the year before. Traditional bank lending remains the primary source of financing for the Nation's small businesses, the small banks approving at least some of the amount requested for 67 percent of credit applicants, while large banks approved credit for 54 percent of applicants. Credit approval rates fell in all lender categories. Firms with revenue of more than \$1 million were more likely to have credit approved.

Loan demand appears to have been greater among larger business borrowers in recent years. Commercial and industrial loans outstanding at banks grew 21 percent during the 3 years period 2014–2016. Construction loans outstanding at banks grew 40 percent during the same period, and commercial real estate loans secured by nonfarm, nonresidential property grew 19 percent.

FDIC data show that loan growth slowed during the fourth quarter of 2016 across a number of loan categories. It is too soon to say whether this marks the beginning of a cyclical slowdown in lending activity. Anecdotal information suggests bankers continue to compete vigorously for lending business, notwithstanding the extra compliance burden not experienced by nonbanks.

#### **RESPONSES TO WRITTEN QUESTIONS OF SENATOR HELLER FROM DONALD POWELL**

**Q.1.** In Nevada, Industrial Loan Companies (ILCs) play an important role in our economy. Mr. Powell, you have stated in the past that “The FDIC believes the ILC charter, per se, poses no greater safety and soundness risk than other charter types.” Do you still believe that ILCs are safe and sound? Do you believe that the FDIC has all the tools and resources to manage and oversee cur-

rent and new ILCs properly? Do you believe that new ILCs should be chartered if they meet FDIC standards?

**A.1.** I have previously said and would still say that the safety and soundness of a given institution depends on the characteristics of the institution rather than its charter type. The risks posed depend on the appropriateness of the institution's business plan and model, management's competency to administer the bank's affairs, the quality of the institution's risk-management processes, and the institution's level of capital.

I do believe the FDIC has the tools necessary to properly oversee existing and newly insured ILCs. Generally, the FDIC focuses its supervisory efforts on the activities and risks of the institution and its holding company, regardless of charter type. ILCs are held to the same standards as other FDIC-insured institution. The FDIC's supervisory efforts include ensuring that ILCs comply with all applicable laws and regulations and operate with sufficient capital. Parent companies of ILCs are subject to regulation or oversight by the State banking agency under which the ILC is chartered. While parent companies of ILCs are not generally required to meet regulatory requirements imposed by the Bank Holding Company Act of 1956 (BHCA), the FDIC does have authority under the FDI Act to examine the affairs of any affiliate, including the parent company, as may be necessary to disclose fully the relationship between the institution and the affiliate, and to determine the effect of such relationship on the depository institution.

The FDIC's approach to ILC supervision was ultimately tested during the recent financial crisis, when several ILCs' parent companies or affiliates experienced severe stress, but their ILCs did not fail. I would say, however, while the regulation and supervision of ILCs is adequate, consolidated supervision authorities provide important safety and soundness safeguards.

Finally, I do believe that new ILCs should be insured if they meet the underlying statutory factors for deposit insurance.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN  
FROM THOMAS C. DEAS, JR.**

**Q.1.** GDP grew 1.9 percent in the fourth quarter of last year. During the same period, community banks' loan balances grew by over 8 percent. According to the most recent NFIB survey, only 3 percent of small business respondents said that they were unable to get loans, and a record 67 percent said they had no interest in borrowing. Yet we hear from banks that if only there were fewer regulations, they could loan more. It seems to me that banks are having no problems growing their loan portfolios, while growth of goods and services produced is at a much slower pace. Might demand be a constraint on the growth of lending?

**A.1.** End users view the financial system in very much the same way we see the electric transmission system. The electric grid takes electricity from where it is generated and transmits it to where it is needed. We hope it is regulated in a way that makes it function reliably and in the most cost-effective ways possible. For those of us who have had the privilege of serving in U.S. manufacturing companies, we seek to keep all our costs as low as possible. If the

costs of electric transmission rise too much, they will hamper manufacturing competitiveness and constrict growth in output and ultimately employment. End users have the same expectations for the functioning of the financial system. If a project has started up and is generating cash, the system should be able to take that cash and through a series of transactions and intermediaries move it in the most cost effective way to where it is needed for new investments. If excessive costs are imposed by regulators, less investment can be justified and fewer new projects will be started. Some of these regulations impose costs directly on end users, while others impose costs directly on banks. In either case, end users face higher costs, which can reduce capital expenditures and cost jobs.

The National Association of Corporate Treasurers recently worked with the U.S. Chamber of Commerce through their Center for Capital Markets Competitiveness on a survey that is worthwhile to review. Responses were received from more than 300 financial professionals, including treasurers and CFOs. The study was published last year as *Financing Growth: The Impact of Financial Regulation*. In it more than three-quarters of American companies of all sizes responding saw the cumulative effect of the Dodd-Frank Wall Street Reform and Consumer Protection Act and other financial regulatory rules adopted over the past 6 years as making it harder for them to access the financial services they need. This was true among small, midsized, and large companies and was felt most acutely in a lack of access to services helping them manage day-to-day liquidity. Further, 79 percent of respondents indicated that they have been affected by changes in financial services regulation, resulting in 39 percent of respondents absorbing higher costs and 19 percent delaying or canceling planned investments.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY  
FROM THOMAS C. DEAS, JR.**

**Q.1.** As you noted in your testimony, Congress recognized the important benefits to the economy when end users use OTC derivatives to manage their business risks. Title VII of Dodd-Frank included an end-user exemption from certain derivatives rules like central clearing and margin to reduce burdens that might otherwise prevent them from managing their risks. Are the current exemptions sufficient or should Congress reexamine them to ensure they do not unnecessarily burden productive firms in our economy?

**A.1.** End users of derivatives are grateful for the bipartisan support they have received from Congress and for the passage of amendments to the Dodd-Frank Act exempting them from central clearing and requirements to post initial and variation margin for their derivatives positions. If end users had not been exempted, margin requirements would be a direct subtraction from limited funds that would otherwise be invested to grow inventory to support higher sales, to conduct research and development activities, to buy new plant and equipment, and to sustain and ultimately grow U.S. employment. While these exemptions are critical for end users, Congress should reexamine how certain financial regulations impact end users.

One relates to the Credit Valuation Adjustment (CVA) which is a capital charge imposed on bank counterparties to OTC derivatives transactions. The CVA causes increased costs to U.S. commercial businesses that are seeking to manage risks associated with their businesses and effectively undermines the exemptions from mandatory clearing and margin requirements that Congress expressly granted to end users. European regulators have provided an exemption from the CVA charge for a European bank's trades with end users; however, the U.S. Prudential Banking Regulators have not provided a similar exemption for U.S. banks trading with end users and instead impose the CVA charge on end-user trades. This uneven playing field results in higher capital requirements for U.S. banks and ultimately higher costs for U.S. commercial businesses compared to their European competitors.

Another area of concern involves the definition of "financial entity" in the Commodity Exchange Act. The definition as currently drafted inappropriately captures certain smaller financial affiliates of commercial end users (e.g., cash pooling entities, in-house insurance companies) and financial end users that are using swaps to hedge or mitigate commercial risks in the same way as non-financial end users. Other jurisdictions around the world have recognized this and provide exemptions from mandatory clearing and margin requirements for financial entities that do not exceed a de minimis threshold of nonhedging activities. Most recently, the European Commission has proposed to expand their clearing exemption (which is already broader than that in the U.S. rules) to include small financial companies. U.S. commercial end users and financial end users are again placed at a competitive disadvantage as compared to competitors around the world.

Finally, we believe it is critical for financial regulators to conduct a study of the major financial regulatory initiatives to determine their cumulative effects on end users. Such a study should consider both direct and indirect effects on end users, looking both at regulations of end users and of their counterparty financial institutions. It also should consider the effects on the cross-border comparability of the regulations and their ultimate effects on U.S. competitiveness.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN  
FROM DEYANIRA DEL RIO**

**Q.1.** Hard work isn't paying off the way it used to. At the same time, predatory lenders often target workers that don't make a living wage because they know these people are under constant financial pressure. What is the economic impact of predatory lending in low-income communities and how does the Consumer Financial Protection Bureau help here?

**A.1.** Response not received in time for publication.

**Q.2.** GDP grew 1.9 percent in the fourth quarter of last year. During the same period, community banks' loan balances grew by over 8 percent. According to the most recent NFIB survey, only 3 percent of small business respondents said that they were unable to get loans, and a record 67 percent said they had no interest in borrowing. Yet we hear from banks that if only there were fewer regu-

lations, they could loan more. It seems to me that banks are having no problems growing their loan portfolios, while growth of goods and services produced is at a much slower pace. Might demand be a constraint on the growth of lending?

**A.2.** Response not received in time for publication.

**Q.3.** At the hearing, Senator Perdue asked what we can do, and what our priorities should be, to best help small communities, including the small financial institutions in those communities, form small businesses, create jobs and grow the economy. Do you have other recommendations about how to strengthen community development lenders, particularly smaller institutions that are meeting small business, housing and consumer needs in neighborhoods across the country?

**A.3.** Response not received in time for publication.

**Q.4.** What other recommendations do you have to meet the needs of individuals that aren't currently being met by private actors?

**A.4.** Response not received in time for publication.

**Q.5.** At the hearing, Senator Cortez Masto asked a question about the impact of the Trump administration's "skinny budget" on communities. She detailed the cuts in grant assistance, housing vouchers and construction programs, investments in community infrastructure like sidewalk repairs and enhancements for people with disabilities, and social services like youth mentoring, food pantries, and transportation for elder Americans, among other cuts. What will be the impact of cuts to these types of programs in the communities you work in?

**A.5.** Response not received in time for publication.

#### **RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM WILLIAM E. SPRIGGS**

**Q.1.** How does predatory lending impact wealth inequality? How does the Consumer Financial Protection Bureau help?

**A.1.** Response not received in time for publication.

**Q.2.** GDP grew 1.9 percent in the fourth quarter of last year. During the same period, community banks' loan balances grew by over 8 percent. According to the most recent NFIB survey, only 3 percent of small business respondents said that they were unable to get loans, and a record 67 percent said they had no interest in borrowing. Yet we hear from banks that if only there were fewer regulations, they could loan more. It seems to me that banks are having no problems growing their loan portfolios, while growth of goods and services produced is at a much slower pace. Might demand be a constraint on the growth of lending?

**A.2.** Response not received in time for publication.

**Q.3.** At the hearing, Senator Perdue asked what we can do, and what our priorities should be, to best help small communities, including the small financial institutions in those communities, form small businesses, create jobs and grow the economy. What do you think?

**A.3.** Response not received in time for publication.

**Q.4.** At the hearing, Senator Schatz asked a series of questions about the increase in student loan debt and the increase in the cost of college. Is there anything you'd like to add to your answer to his question?

**A.4.** Response not received in time for publication.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

**“RISK WEIGHTS OR LEVERAGE RATIO? WE NEED BOTH”, AMERICAN  
BANKER****AMERICAN BANKER****BankThink Risk Weights or Leverage Ratio?  
We Need Both**By [Aaron Klein](#)

Published December 20 2016, 8:30am EST

As a Jew I will be spending Dec. 25 at my local Chinese restaurant. This fact has made me think about, of all things, bank capital.

One can eat Chinese food elegantly with two chopsticks. With only one you are just stabbing at your food with a stick. It is the same with bank capital regulation.

The two chopsticks in this analogy, which I initially made at a recent [conference](#), are the simple leverage ratio — core capital divided by assets — and the more complex risk-weighted capital calculations. Much of the discussion around capital requirements is which of the two measures is preferred, as well as which measure should be the standard for an adequate capital base.

But this shouldn't be an "either or" debate. The banking system ultimately needs a balanced approach to capital, which allows banks to efficiently function while also maintaining financial stability. Apply only one capital measure — it doesn't matter which one — and the capital system will eventually flop.

Advocates for either the leverage ratio or risk-weighted measures often fail to appreciate this need for balance. Hence the regulatory debate too often consists of people on both sides embracing a one-chopstick approach.

The simple leverage ratio and risk-weighted tests each have their benefits and drawbacks, their supporters and opponents, and their proper place in the regulatory system. Start with the leverage ratio. The beauty of the leverage ratio is its simplicity: It is hard to game and easy to compare across institutions. It provides clear data for markets to react to and to help regulators do their job. However, the leverage ratio also provides a perverse incentive to banks to seek risk. Because capital charges are identical regardless of the riskiness of assets, banks seeking to maximize returns on capital should load up on risky assets.

Risk-weighted capital tests are designed to avoid that problem. Tailoring capital levels to adjust for risk should make banks safer. It should also improve the distribution of capital for society by eliminating a governmental incentive for the financial sector to steer investment toward risky assets.

The problem with risk-weighting is in the name: getting the risk weights right. Humans and models are not perfect judges of risk and when they err, they can do so in a correlated and spectacular fashion. Historical experience and multiple regression analysis completely botched the risk of subprime mortgages and the corresponding securities built off of those supposedly "low-risk" assets. A secondary problem is who runs the models and sets the weights: the banks, the regulator, or both? Since banks underwrite their assets, the industry has long argued that individual institutions should be given some control or deference to set risk weights. However, letting the banks run the models has a fox-guarding-the-henhouse problem.

Given the debate, it should come as no surprise that certain regulators are predisposed to either approach. The Federal Deposit Insurance Corp. — in its role as insurer and resolver of failed institutions — has historically [backed a strong leverage ratio](#) as part of the capital regime. The Federal Reserve Board — in its role as economic modeler, monetary policy setter and quantitative regulator — has usually focused on risk-weighted tests.

In the years following the financial crisis and passage of the Dodd-Frank Act, both the leverage ratio and risk-weighted capital ratios were increased substantially. Both were also tailored to specifically increase capital on the largest banks — whether through leverage surcharges on globally significant banks or through additional conservative assumptions in big-bank stress tests through the Fed's Comprehensive Capital Analysis and Review.

Much of the focus of the current debate around capital requirements is on which measure — leverage or risk-weighted — should be the "[binding constraint](#)" for banks, that is, which standard should determine the adequate amount of capital a bank should hold. Some in the banking industry argue that increases in the simple leverage ratio have made that the binding constraint for banks. Meanwhile, the debate continues as to whether [additional capital](#) is needed or whether regulators have [gone too far](#).

Policymakers, industry and the general public should become comfortable with a world in which the binding constraint alternates between the simple leverage ratio and the complex risk-weighted test. Each has its own advantages and disadvantages and the relative value of those tradeoffs changes throughout the business cycle. It is tempting for one to skew toward each of the two sides at various moments, as some did in favoring the Basel II advanced risk-weight approach right before the financial crisis (which in hindsight was a clear mistake.) But the reality is that if both are set properly, each will take turns as the ultimate decider of total capital.

In that world, the chopsticks work together, and you can actually eat a meal. Otherwise we will continue to face warring factions, poking each other with sticks.

*Aaron Klein is a fellow at the Brookings Institution and policy director at the Center on Regulation and Markets.*