November 27, 2017

Senator Mike Crapo  Senator Sherrod Brown
Chairman  Ranking Member
U.S. Senate Committee on Banking,  U.S. Senate Committee on Banking,
Housing, and Urban Affairs  Housing, and Urban Affairs
534 Dirksen Senate Office Building  534 Dirksen Senate Office Building
Washington, DC 20510  Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

We appreciate the committee’s work to find solutions to the challenges facing consumers and the U.S. economy. Indeed, the financial crisis dealt a severe blow to the economy from which many Americans are still recovering. In the aftermath of the crisis, unemployment skyrocketed to 10 percent, 10 million homes were lost, and $19 trillion in wealth was wiped out. Between 2007 and 2010, the real wealth of the average middle-class family plummeted by nearly $100,000, or 52 percent. Consumers continue to struggle with financial institutions, as evidenced by the Wells Fargo fake account scandal and most recently, the Equifax data breach affecting an estimated 143 million Americans. Just last week, a Senate report demonstrated that there are 122 million confirmed errors on Americans’ credit reports that consumers flagged for the three main credit bureaus between 2014 and 2016 – on average, roughly one per U.S. household.


In general, the Center for American Progress, or CAP, does not believe that financial deregulation is helpful in achieving stronger economic growth.\(^5\) We nevertheless respect the desire of policymakers to fine-tune the regulatory system to improve outcomes. Such fine tuning should be carefully drawn, and not create large, unintended loopholes. Moreover, to the extent fine-tuning includes lightening the rules on some actors, it would be natural to expect commensurate improvements to consumer protections and financial stability.

Unfortunately, as currently drafted, the “Economic Growth, Regulatory Relief and Consumer Protection Act” does not yet achieve those goals. First, the changes proposed in the bill are unlikely to measurably improve economic growth. More troubling, though, many of the provisions have significant negative consequences. Some of the proposed regulatory changes, if not removed or meaningfully tightened, could put many consumers in harm’s way—especially in rural areas. The bill would also make sizable parts of the financial system more vulnerable to shocks. And, in an attempt to exempt community banks from the Volcker Rule, it creates a loophole that the largest Wall Street trading banks and others could take advantage of. These outcomes could have significantly deleterious impacts on economic growth for working Americans who need it the most.

Nor does the bill provide commensurate benefits to consumers and households. The bill’s purported benefits are claimed to be aimed at community and regional banks, which make up about 30 percent of the present banking sector by assets.\(^6\) But the bill also includes provisions that benefit banks of all sizes, including the largest banks. On the other hand, the new consumer protections, such as the right to free credit freezes, are of quite modest scope given the extensive harm that consumers have suffered in recent years.

On balance, the benefits of the bill are overwhelmingly tilted toward the executives and shareholders of financial actors. The ordinary working Americans—who continue to feel the effects of insufficient regulation and enforcement through lost homes and jobs, damaged credit, and reduced wealth—deserve more.

In this letter, we will identify significant weaknesses and loopholes in the bill as drafted. We hope to have the opportunity to work with you and bill sponsors to improve the it. We


separately urge the committee to consider ideas that CAP and others have and will propose to better protect consumers and strengthen financial stability.\(^7\)

**The bill does not provide adequate protections for consumers, especially those living in rural communities**

Today, thanks in large part to Congress and the Consumer Financial Protection Bureau (CFPB), there are standards in place to support sustainable homeownership in the United States. The rules ensure high quality mortgage underwriting, appraisal requirements to help ensure that borrowers do not overpay for a home, and a firewall to prevent manufactured housing retailers from improperly steering customers to in-house financing operations that are more expensive than the competition. The provisions below undermine these important standards. The consequences of this deregulation, as presently drafted, could hit rural consumers especially hard.

**Section 107 Protecting Access to Manufactured Homes**

This provision undermines the efforts to introduce much-needed competition within the extremely consolidated manufactured housing industry, where consumers frequently pay unfair rates and fees for their mortgages.\(^8\) Companies owned by one large corporation were responsible for 39 percent of all new manufactured housing mortgages in 2013.\(^9\) These companies accounted for 72 percent of manufactured housing loans made to African-American borrowers in 2014.\(^10\) Often, customers obtain financing from the same company that built and sold them the house.

There are promising innovations underway at Fannie Mae, Freddie Mac, and at various state housing finance agencies to encourage more private lenders to offer competitive financing for manufactured homes. Section 107 could disrupt this progress by allowing employees at retailers to steer customers to their sister companies for financing.

While the bill requires certain disclosures, including regarding the recommendation of at least one non-affiliate lender, and prohibits compensation for the retailer based on loan

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characteristics, these features are unlikely to provide sufficient guardrails. Today, even though it is not legal for most employees of a retailer to make referrals, stores may be encouraged to send business to in-house lenders, according to a Seattle Times investigation.\textsuperscript{11} It is important to remember that the families that buy these homes are some of the least economically secure families in America. Given the sales and cost pressures already placed on them, they need stronger, not weaker, consumer protection.

If Section 107 is passed as drafted, it will become hard to impossible to prevent retailers in practice from steering consumers to in-house lenders who are more likely to originate loans with higher rates, fees and add on products.

\textit{Section 109 Escrow Requirements Relating to Certain Consumer Credit Transactions}

This provision would exempt depositories and credit unions with fewer than $10 billion in assets that have originated fewer than 1,000 mortgage loans in the previous year, from maintaining escrow accounts for the mortgages they service. Currently, these lenders are only required to maintain escrow accounts for homeowners with higher-cost loans.

During the housing crisis, many foreclosures could have been avoided if more homeowners had escrow accounts – especially those with higher-cost subprime loans. Setting aside a homeowner’s tax and insurance payments in an escrow account supports sustainable homeownership and prevents foreclosures because these accounts help homebuyers better understand the costs of homeownership at the outset, empowering them to make more informed purchase decisions. These accounts also safeguard the consumer, and the lender, from the costs of losing a home to tax foreclosure and from the high costs associated with lender-placed insurance if a homeowner were to miss insurance payments. Eliminating escrow requirements without sufficient guardrails opens the door to more mortgages that are unaffordable from the outset when taking the full costs of ownership into account. This does not serve the interests of homebuyers, lenders, or taxpayers, and will only set borrowers up to fail.\textsuperscript{12}

\textit{Section 103 Exemption from appraisals and real property located in rural areas.}

This provision would allow lenders to waive the appraisal requirement for purchases under $400,000 if they have been unable to secure an appraisal by closing.

While the provision proposes guardrails to try and ensure that lenders make a reasonable effort to find an appraisal, including a requirement that they contact three appraisers, these guardrails are likely insufficient to ensure that a good faith effort has been made. Moreover,

\textsuperscript{11} Ibid.

the provision, as written, is overly broad and applies to the overwhelming majority of homes in rural America. The cap for this proposed waiver is set at $400,000 when the median home value in rural America is $114,000.\(^{13}\)

Waiving the requirement for an independent appraisal could lead homebuyers to pay more for a home than it’s worth, increasing the likelihood that they’ll lose equity or become underwater on their mortgage. Homeowners in rural communities are already more likely than their suburban or urban counterparts to owe more on their mortgage than their home is worth on the market.\(^{14}\) This provision could make matters worse. While there can be legitimate difficulties obtaining appraisals in rural communities, the committee should explore alternative approaches for solving this problem rather than minimizing the need for an independent assessment of home value.

**Section 104 Home Mortgage Disclosure Act Adjustment and Study**

This provision would exempt from updated Home Mortgage Disclosure Act (HMDA) reporting requirements any institution that has originated fewer than 500 mortgage loans and 500 open-ended lines of credit in each of the last two years.

This provision would exempt the majority of mortgage lenders from the new HMDA reporting requirements: a 500 mortgage loan threshold could exempt about 85 percent of banks from the new reporting requirements, according to the CFPB.\(^{15}\) HMDA reporting is the primary source of information on the availability and quality of mortgage lending and serves a vital function in fair lending assessments. This bill would result in the remaining data painting an incomplete or inaccurate picture of lending activity in communities across the country, making it vastly more difficult for regulators and researchers, as well as the committee itself, to assess the state of the mortgage market. It would also decrease incentives for lenders to maintain fair and equitable access to credit.

It is unclear why this permanent exemption is necessary. The new reporting requirements should not cause administrative strain for banks. Banks already collect most of the data regulators are asking them to share and the new reporting should cost small banks less than $9,000 per year to implement, according to Georgetown Law Professor, Adam Levitin.\(^{16}\)

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\(^{13}\) CAP analysis of 2015 American Community Survey 5-year data.

\(^{14}\) CAP analysis of 2017 Q1 Zillow data showing that the mean negative equity rates in rural counties is 14 percent compared to 11 percent in all other counties for which we have data (note that data are not reported for Texas and Vermont).

\(^{15}\) Home Mortgage Disclosure Act Final Rule, Federal Register Vol. 80, No. 208 (October 28, 2015) at 66279. The CFPB data includes purchase mortgages.

Section 101 Minimum Standards for Residential Mortgage Loans

This provision would allow loans held in portfolio by depository institutions and credit unions with fewer than $10 billion in assets to receive safe harbor status if the loan meets certain consumer protection standards. Safe harbor status means that a court is instructed to find that a lender complied with ability to repay requirements if a consumer raises a claim that a lender originated an unaffordable loan.

The ability to repay rule was designed to ensure that lenders fully assesses a borrower’s income and expenses and whether the borrower can afford the loan before making the loan. Currently, only the very safest loans are provided a safe harbor, or legal immunity, from claims that the lender originated an unaffordable loan. This provision would weaken the eligibility requirements for this safe harbor, undermining the strength of the ability to repay rule. For instance, under this provision, adjustable rate mortgages with weaker underwriting standards and mortgages with terms that exceed 30 years, which have caused problems for consumer in the past, could qualify for safe harbor status.

The bill reduces post-crisis enhanced oversight not only for regional banks but also for the largest banks and foreign banking organizations, making the financial system and regional economies more vulnerable to a financial shock

The regional banks deregulated by this bill make up a sizable segment of the U.S. banking sector, are important to the U.S. economy, and often serve vital economic functions to the regions they serve. The potential failure of several of them during a period of significant financial sector stress would put regional economic growth at significant risk and could ultimately disrupt U.S. financial stability overall. It was for those very reasons that banks such as Continental Bank of Illinois were rescued during the Latin American debt crisis of the 1980s. Moreover, given the strength of lending growth overall, there is also no public interest argument to be made for significantly adjusting banking regulation for most of these firms.

In addition, the bill reduces the stringency of enhanced prudential oversight for the largest financial firms, which is a serious step in the wrong direction.

Sec 401. Enhanced Prudential Standards for Certain Bank Holding Companies

This provision would increase the Dodd-Frank Act’s asset threshold for applying enhanced prudential standards, including stress testing, resolution planning (often called “living wills”), enhanced liquidity requirements, oversight of the acquisition of non-bank affiliates, and more, from $50 billion to $250 billion. Separately, this section also weakens prudential regulation of banks with assets greater than $250 billion by requiring more tailoring of regulations for the

largest banks, encouraging regulators to raise the threshold further, and weakening resolution planning and stress testing by making previously required provisions discretionary and reducing the number of adverse scenarios tested.

If enacted, 25 of the 38 largest banks in the U.S. that currently face heightened prudential standards would escape important regulatory improvements established since the financial crisis. These banks collectively account for roughly $3.5 trillion in assets, or about one-sixth of total U.S. banking assets, and received $47 billion in TARP bailout funds. As presently drafted, this universe of banks that also would be deregulated by this proposal appears to include the U.S. branches and affiliates of foreign global systemically important banks (G-SIBs), many of which received large amounts of Federal Reserve emergency lending.

The enhanced prudential standards loosened by this provision set out important requirements that banks and regulators need to protect firms and the regional economies they serve, as well as the financial system as a whole. Given the substantial resolution challenges encountered in 2008, even for simple regional banks, requiring firms to regularly file living wills setting forth how they would resolve themselves seems eminently reasonable. Similarly, post-crisis liquidity requirements and counterparty credit limits and exposure reports also seem hard to argue should not apply to banks of any meaningful size and importance, given the runs on banks that were witnessed in 2008. Stress testing, too, was one of the most useful tools for banks to prove to the markets that they had the capital they needed to survive the crisis, and therefore obtain additional capital investments and the liquidity they needed. Rolling back stress testing invites market uncertainty and fragility for the very firms it seeks to benefit, as well as the regional economies they serve.

Although the bill would allow the Federal Reserve Based to reapply these standards to many banks with between $100 billion and $250 billion in assets, the deregulatory sentiments of

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19 Section 401(a)(1)(B)(i).
20 Section 401(a)(2).
21 Sections 401(a)(3), 401(a)(5)(A), and 401(a)(5)(B)(i).
23 Although ambiguity exists in the bill’s drafting, it would appear that a parent company’s identification as a G-SIB by a foreign regulator would not trigger the provisions of section 401(f), which operate under identification under relevant U.S. law, to exclude the U.S. holding company, branch, or affiliate from the deregulatory coverage of the bill.
Trump-appointed regulators at the Federal Reserve Board suggest that is unlikely. In addition, the provisions that weaken statutory requirements in resolution planning and stress testing applies to all banking groups, and not just those under $250 billion in assets. As such, it could have significant deregulatory implications beyond that of the regional banks.

Ultimately, this entire section appears to be a solution in search of a problem. Out of more than 6,000 banks, only 38 at present have to comply with the provisions set forth under the standard. And there is already a sensibly tiered system of regulation in place for banks of this size. For example, compared to banks with greater than $250 billion in assets and G-SIBS, banks between $50 billion and $250 billion in assets are subject to less stringent liquidity requirements, do not face the qualitative portion of the Fed’s annual CCAR stress testing, have more calibrated risk based capital requirements, are not subject to the Supplementary Leverage Ratio, are subject to less stringent single counterparty credit limits, and do not face contingent capital requirements. But tying the regulators’ hands and saying that none of these should apply, or could apply, in the future is unnecessary, unwise, and potentially dangerous.

*Sec. 402. Supplementary Leverage Ratio for Custodial Banks*

This provision requires the banking agencies to amend the Supplementary Leverage Ratio (SLR) rule to exclude deposits held at central banks from the denominator when calculating the SLR for custody banks.

Custody banks play a systemically important role in the U.S. financial system. In addition to holding securities in custody, these banks provide execution, clearing, settlement, and other traditional back office services for their clients—important plumbing functions of the financial sector. The two largest custodial banks, which are subject to the SLR, have a combined $60 trillion of assets under custody, and their clients include nearly all of the most important institutions that enable the U.S. capital markets to function, such as pension funds, endowments, insurance companies, and other institutional investors.

The proposed change to the SLR for custody banks aims principally to address a potential problem that may arise during a financial crisis. In this scenario, when institutional clients liquidate securities en masse during a crisis, which are held in custody by the custody banks off balance sheet, to flee to cash, it’s possible that cash will be deposited quickly at the custody bank on its balance sheet. The custody bank would likely put this influx of cash into central bank deposits. The bank’s risk weighted capital level would be unchanged, as central bank deposits receive a zero percent risk weight, but the leverage ratio would decline.

Clarifying regulators’ emergency authority to exclude a rapid influx of deposits parked at central banks during a crisis from the calculation may be appropriate. However, any accommodation of the ordinary operations of this custodial business model needs to take account of the extraordinarily significant risk to financial stability that would be created by the failure of even one of these custody banks – risks that the SLR targets by effecting a somewhat tighter leverage ratio for custody banks. The bill’s current approach does not address those risks.
In addition, undermining the principle of the leverage ratio through a change in the calculation is unwise and would open the door to further erosion of the SLR.\textsuperscript{27} Ultimately, current capital requirements at the largest banks in the U.S. remain outside of the socially optimal range set out by recent research.\textsuperscript{28} Capital changes that have the net effect of lowering capital requirements at the largest banks, including custody banks, should not be enacted.

\textit{The bill’s “community bank exception” is not narrowly tailored but instead creates a loophole to the Volcker Rule that could potentially be used by the largest financial institutions; it also fails to account for private fund activities or other evasion risks}

\textit{Sec. 203 Community Bank Relief}

This provision purports to exempt community banks from the Volcker Rule (Section 13 of the Bank Holding Company Act and regulations issued thereunder). The provision allows a depository institution with less than $10 billion in assets and total trading assets and trading liabilities that are not more than 5 percent of total assets to be exempt from the Volcker Rule. Unfortunately, however, the bill may do far more than that. By tying the exemption to the definition of “banking entity,” rather than creating a safe harbor under permitted activities section, the provision creates a largely unconstrained exemption from the Volcker Rule. Moreover, by crafting the exemption on the basis of each individual institution that meets the requirements noted above, the provision does not appear to be limited solely to community banks.\textsuperscript{29} Instead, it appears that the provision could be used by a depository institution even if it was owned or controlled by another financial firm of any size, including a bank holding company or a non-bank financial company and without limit as to the number of exempted depository institutions under the holding company umbrella.\textsuperscript{30}

Moreover, the provision has no guardrails with respect to private fund investments, which can be equal sources of risk and conflicts of interest as on-balance sheet proprietary trading. It also


\textsuperscript{29} “Total consolidated assets” appears to refer to that of the depository institution only, and not to include affiliates and subsidiaries in the rest of the banking organization, although some ambiguity could be asserted. See section 203.

\textsuperscript{30} Although obstacles exist to creating this structure, it is worth noting that the Wall Street trading banks’ structure in the run-up to 2008 featured small depository institutions with holding companies exempt from the Bank Holding Company Act. See G. Edward Leary, Testimony before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, U.S. House of Representatives, July 12, 2006, available at https://dfi.utah.gov/wp-content/uploads/sites/29/2015/06/IB-Congressional-Testimony-07-12-061.pdf.
does not sufficiently account for abuses, such as through available-for-sale accounts, or give the appropriate Federal regulator anti-evasion authority.

Putting aside the larger loopholes that need to be closed, a broader principle is at stake: the Volcker Rule was passed as a means to reorient the entire banking sector toward the traditional client-serving functions of banking. Banks, no matter their size, should not be engaged in proprietary trading or sponsoring or investing in hedge funds or private equity funds.\(^{31}\) The Volcker Rule regulation in place today already has a highly tailored, tiered system of implementation, offering effectively “check-the-box” compliance for community banks. To the extent that further certainty, such as through a safe harbor, can be provided to community banks, those options should be explored. But an outright exemption is dangerous and contrary to the best interests of a banking system that serves real economic growth.

Thank you for considering the concerns we raise in this letter. We look forward to discussing ways to improve the bill.

Sincerely,

Andy Green
Managing Director, Economic Policy

Sarah Edelman
Director, Housing Policy

Joe Valenti
Director, Consumer Finance

Gregg Gelzinis
Special Assistant, Economic Policy