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Adam J. Levitin
Professor of Law

Written Testimony of

Adam J. Levitin
Professor of Law
Georgetown University Law Center

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"Fostering Economic Growth: The Role of Financial Institutions in Local Communities"

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Witness Background Statement

Adam J. Levitin is a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in financial regulation, structured finance, contracts, bankruptcy, and commercial law. Among his publications is *Financial Restructuring: Business Bankruptcy in the Modern Commercial World* (Wolters Kluwer 2015).

Professor Levitin has previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board, as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP).

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College. In 2013 he was awarded the American Law Institute's Young Scholar's Medal.

Professor Levitin has not received any federal grants or any compensation in connection with his testimony, and he is not testifying on behalf of any organization. The views expressed in his testimony are solely his own.

Chairman Crapo, Ranking Member Brown, Members of the Committee:

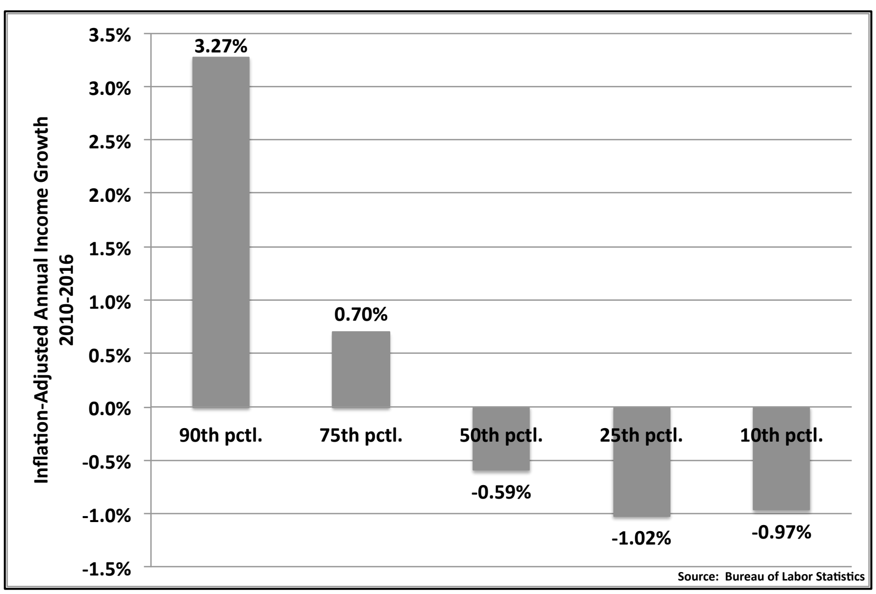
Thank you for inviting me to testify at this hearing. My name is Adam Levitin. I am a Professor of Law at the Georgetown University, where I teach courses in financial regulation and bankruptcy among other topics. I am here today solely in my academic capacity and am not testifying on behalf of any entity.

Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the banking sector as a whole, including community banks, has been doing incredibly well. The percentage of profitable community banks at the end of the first quarter of 2017 was the highest it has been in the last twenty years.[1] From the second quarter of 2010 (just before the passage of the Dodd-Frank Act) until the second quarter of 2016, the pre-tax return on assets in the banking sector was 25% for community banks, and 36% for other banks.[2] **Since Dodd-Frank, the cumulative pre-tax return on equity in the banking sector has been 225% for community banks and 320% for mega-banks.**[3]

To put this in perspective, a $100 equity investment in the average community bank in the second quarter of 2010 would have returned $325 by the second quarter of 2016, while a $100 investment in a mega-bank would have returned $420 over the same time, far better than the $185 return that a $100 invested in an S&P 500 index fund would have produced.

Meanwhile, American families are struggling. Median pre-tax income has *declined*. Although the US economy has grown by 9% in real terms since 2010, annual median pre-tax income has not kept up with inflation. **Since 2010, real income has fallen for the typical American family by 0.6%.**[4] (See Figure 1, below.) Families in some states haven't even fared this well. The typical Nevada family, for example, saw a 3% decline in real income.

Figure 1. Inflation-Adjusted Annual Household Income Growth, 2010-2016



To be sure, not all families are doing badly. The real income of the top 10% of American families has continued to grow, with most of the gains going to the top 1% of the population.[5] But the rest of America is being left behind.

The problem, then, is not one of economic growth, but of economic distribution. It is important that economic growth be a tide that lifts all ships, but that hasn't been happening.

Unfortunately, the proposals made by the financial services industry in response to this Committee's request for growth proposals have little to do with growth and have nothing to do with improving the economic condition of American families. Instead, the bank trade groups have proposed a set of deregulations that deregulations will benefit banks and their shareholders, but put American families and the stability of the financial system at risk. In other words, the proposed deregulations are about privatizing gains and socializing losses. The whole point of the Dodd-Frank Act was to try and prevent that problem after the devastating financial crisis in 2008.

Rather than pretending that deregulation is synonymous with growth, we should be having a conversation about how to ensure that growth benefits all Americans. In terms of this Committee's ambit, it means addressing the continued specter of too-big-to-fail, so that we don't end up with privatized gains and socialized losses and harmful spillovers from risky behavior by banks. It means addressing anticompetitive practices, such as credit card swipe fee pricing, which is a $73 billion dollar annual regressive wealth transfer from American consumers to banks. It means facilitating more robust competition among financial institutions for deposits by enhancing account and financial data portability. That means continuing to support the CFPB's strong enforcement of consumer financial protection laws to ensure that consumers get the deals they bargained for and aren't taken advantage of by their banks or discriminated against by lenders. And that means tamping down on excessive speculative activity, such as by maintaining the Volcker Rule and enacting a 21st century Glass-Steagall Act.

I. CONSOLIDATION IN COMMUNITY BANKING AND CREDIT UNIONS IS NOT DRIVEN BY REGULATION

Community banks and credit unions play an important role in the American financial system. Community banks are key sources of credit in small business and commercial real estate lending. They tend to pride themselves on more personalized customer service and products, and they are often deeply engaged with the civic fabric of their communities. Credit unions are also important sources of fair, straight-forward consumer financial products because credit unions are mutuals, owned by their members, and like community banks they often offer superior and more personalized customer service. The health of community banks and credit unions is critical for preserving choices for consumers and small businesses in the financial products market place.

A. Community Banks and Credit Unions Are Thriving

Community banks and credit unions suffered during the financial crisis. They are exposed to macroeconomic trends and are also exposed to larger financial institutions through correspondent and service relationships. But since the Dodd-Frank Act, community banks and credit unions have been doing extremely well as measured by all traditional measures of health of the banking industry. Returns on assets and returns on equity are both up significantly and are now in the range of pre-crisis levels. (See Figures 2 and 3.) These gains have been shared broadly in the community banking industry. The percentage of unprofitable community banks is the lowest it has been since 1997.[6]

The same holds true for credit unions. A higher percentage of credit unions (81%) had a positive return on assets in 2016 than in any year since the Dodd-Frank Act.[7] Almost all of those with negative return on assets are very small credit unions with total assets of under $50 million.[8] Total credit union assets are up 41% and membership is up 18% since 2010, even as the number of credit unions has decreased by 21%.[9] Credit unions are sitting on some $372 billion in surplus funds, indicating more than adequate liquidity.[10]

Figure 2. Community Bank Return on Assets (pre-tax)

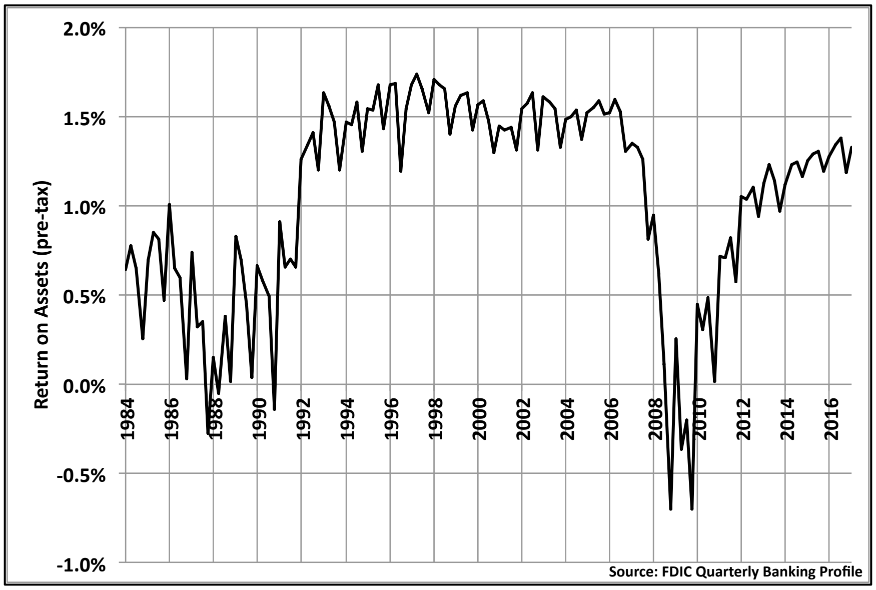
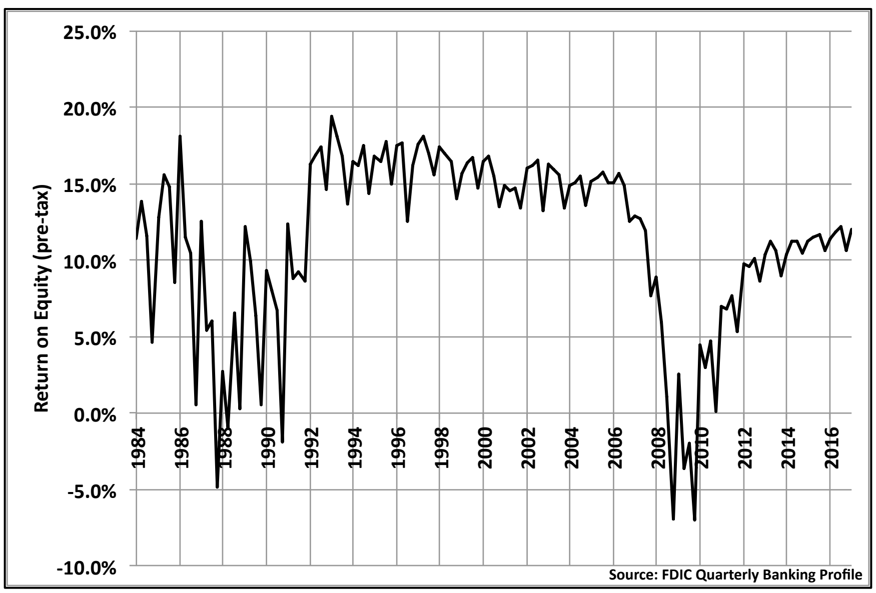


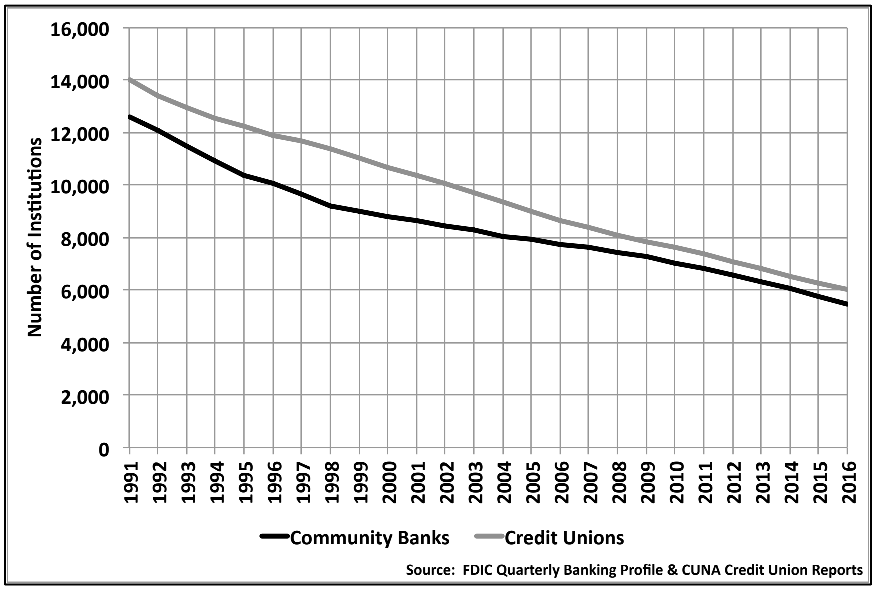
Figure 3. Community Bank Return on Equity (pre-tax)



B. *Consolidation in Community Banking and Credit Unions Is a Long-Term, Steady Trend*

Community banks and credit union trade associations often point to consolidation in their sectors as evidence that their industries are in trouble (for which the solution is invariably regulatory relief of some sort). While there has been substantial consolidation among both community banks and credit unions, it is a long-term trend. As Figure 4, below, shows, the rate of consolidation in terms of number of institutions has been virtually constant for the last quarter century: 248 community banks and 311 credit unions per year. The constant rate of consolidation for the last quarter century is irrefutable evidence that consolidation is not being driven by the Dodd-Frank Act or the CFPB, because the consolidation trend pre-dated both the Dodd-Frank Act and the CFPB and therefore could not be caused by either. There has been no acceleration in the consolidation following the passage of the Dodd-Frank Act or the effective date of the CFPB, or the effective date of any CFPB regulations.

Figure 4. Number of Depositories in United States, 1991-2016[11]



Consolidation is not necessarily a sign that community banks and credit unions are ailing.[12] Even with consolidation, the United States still boasts far more financial institutions per capita than any other developed country. Most of these institutions are very small—community banks and credit unions. The extraordinary number of small financial institutions in the United States is a legacy of historical bank regulation. Interstate branch banking restrictions splintered the United States in 50 retail banking markets (or truly more given that some states have had inter-county branching restrictions), which artificially inflated the number of banks that could be supported, even while limiting the size of those banks.

The causes of consolidation have likely changed over the last quarter century. Many small financial institutions failed during the savings and loan crisis in the early 1990s. Subsequently, the removal of interstate branch banking restrictions in 1994 as well as the Gramm-Leach-Bliley Act of 1999 encouraged bank mergers and the emergence of megabanks that engaged not just in traditional commercial banking activities, but also in investment banking, insurance, and proprietary speculation in commodities, derivatives, and stock markets.

C. Community Banks and Credit Unions Lack the Economies of Scale Necessary to Compete Effectively in Many Product Markets

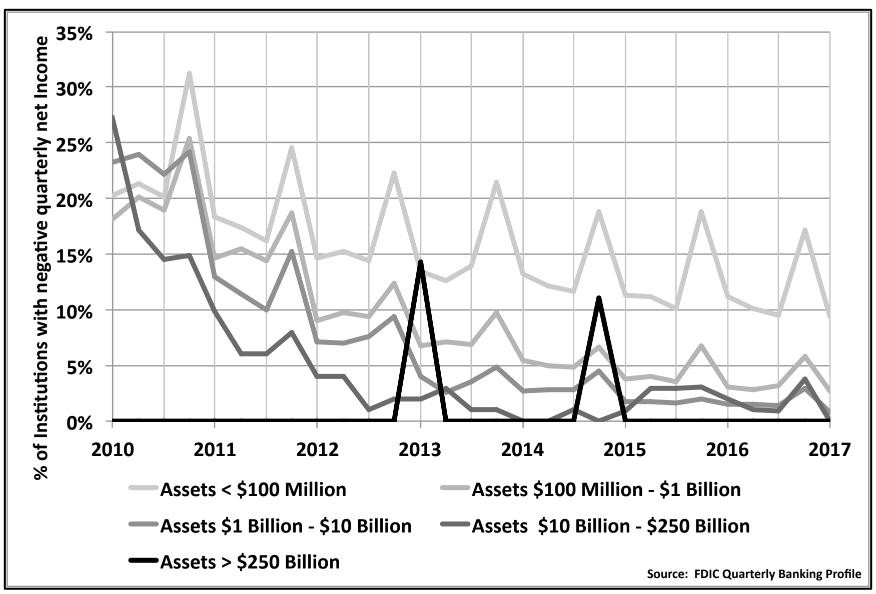
The emergence of megabanks has serious changed the competitive playing field in financial services and left community banks and credit unions at a severe disadvantage because they lack the economies of scale and the implicit too-big-to-fail subsidy of the megabanks. Not surprisingly, consolidation has continued among community banks and credit unions. Community banks continue to fail, be gobbled up by larger banks, or, more rarely, grow out of being community banks.[13] A similar story exists for credit unions, which have failed, merged, or demutualized.

While community banks and credit unions are generally quite healthy financially today, we should expect on-going consolidation in both sectors because of the structural disadvantages that community banks and credit unions face: they lack the economies of scale necessary to be competitive in many product markets. Size matters in consumer finance, which is a business that consists of a large number of relatively small transactions. Many consumer financial markets—mortgages and credit cards in particular—have critical economies of scale, as do customer service (such as call centers), information technology, cybersecurity, and compliance programs. Moreover, Fannie Mae and Freddie Mac will not deal with small mortgage originators because of their perceived counterparty risk.

Increasingly, community banks and credit unions will have trouble competing for deposits as they lose locational advantages to mobile banking platforms and find themselves unable to keep up in the cybersecurity arms race. National fintech charters from the Office of Comptroller of the Currency will exacerbate this problem because federal fintechs will present national competition for lending and deposits in markets in which larger brick-and-mortar banks do not compete.

That leaves small business, commercial real estate, and agriculture lending as spaces in which community banks remain competitive. It is unclear whether that alone will be enough to support many community banks; credit unions are limited in their ability to offer products in all of those spaces. What is clear is this: smaller banks are much more likely to be unprofitable than larger ones. (See Figure 5.)

Figure 5. Percentage of Depositories with Negative Quarterly Net Income



D. Community Banks Often Face Intergenerational Transition Problems that Encourage Mergers

Additionally, many small community banks are family-owned firms and they face a generational transition problem. The bank might be located in a rural district, and the next generation in the controlling family may have moved away to the big city and not be interested in returning to a small town to run the family bank. In such cases, the controlling family has little choice but to sell, typically to another, larger bank. As baby boomers have begun retiring, the generational transition problem has become more salient.

E. Community Banks and Credit Unions Already Receive Significant Regulatory Relief

The point here is that overregulation is *not* the problem facing community banks.[14] To the contrary, community banks and credit unions already receive significant relief from consumer finance regulation, their bread-and-butter area of business. The Dodd-Frank Act codifies special solicitude for community banks and credit unions through several provisions:

- Community banks and all but six giant credit unions are exempt from the Durbin Interchange Amendment's debit card fee regulation.[15] This gives community banks and almost all credit unions a significant competitive advantage over megabanks, by allowing them to receive higher interchange fees than the megabanks.
- All financial institutions with less than $10 billion in assets are exempt from examination and enforcement actions by the CFPB.[16] There are only 139 banks and credit unions and affiliates that are subject to CFPB examination and enforcement.[17] Instead, smaller banks and credit unions are examined and subject to enforcement by their regular prudential regulators. This means that community banks and credit unions have to deal with fewer examinations and are not subject to the scrutiny of a dedicated consumer protection agency.
- In addition to the regular notice and comment requirements of the Administrative Procedures Act, the CFPB is required to go through a special rulemaking process under the Small Business Regulatory Enforcement Fairness Act when it promulgates rules that will affect small businesses, including community banks and credit unions.[18] The SBREFA process lets small businesses comment on proposed rules when they are in an early stage, before the "train has left the station."

The CFPB has also codified special provisions for community banks and most credit unions in its regulatory implementations of the Dodd-Frank Act, even though it is not required to do so. The CFPB has built in numerous exceptions for smaller financial institutions to its rules:

- Small creditors (with less than $2 billion in assets) can make mortgage loans at APRs 200 basis points (2%) higher than larger creditors and still qualify for the absolute safe harbor to the Ability to Repay Rule.[19]
- Small creditors (with less than $2 billion in assets) that originate less than 500 mortgage loans per year can qualify for the absolute safe harbor to the Ability to Repay Rule for the loans they retain on portfolio even if those loans have debt-to-income ratios above 43%.[20] If these loans are held in portfolio for three years, they retain their safe harbor even if subsequently sold to another small creditor. [21]
- Small creditors (with less than $2 billion in assets) that operate predominantly in rural and underserved areas are exempt from the requirement of maintaining escrow accounts for high-cost mortgages.[22]
- Small creditors (with less than $2 billion in assets) in rural and underserved areas are exempt from the prohibition on high-cost balloon loans.[23]
- Small creditors in rural and underserved areas were given a two-year transition period to continue making balloon mortgages that qualify for the safe harbor from the ability-to-repay rule.[24]
- Implementation of balloon payment limitations was delayed for two-years for all small creditors (with less than $2 billion in assets) irrespective of whether they operate predominantly in rural or underserved areas.[25]
- Loans made against rural properties are not subject to the same rules regarding appraisals for high-cost mortgage loans.[26]

- Small mortgage servicers are exempted from the Truth in Lending Act requirement of periodic statements.[27]
- Small servicers are exempted from most of the Real Estate Settlement Procedures Act loss mitigation requirements (other than prohibition on commencing foreclosure until 120 days delinquency).[28]
- Entities that handle 100 or fewer remittances per year are exempt from the Remittance Rulemaking under Regulation E under the Electronic Fund Transfers Act.[29]

CFPB has expanded the definition of "rural" creditor and as well as increase the small creditor debt-to-income exemption from 500 loan originations to 2,000 loans sold annually (and unlimited originations).[30]

Beyond this, the CFPB has voluntarily taken actions to ensure that the voices of small institutions are heard in the regulatory process:

- The CFPB has voluntarily created a Community Bank Advisory Board and a Credit Union Advisory Board, in addition to its statutorily required Consumer Advisory Board.
- The CFPB has included representatives of small financial institutions on its Consumer Advisory Board, which has previously been chaired by the chairman of rural community development credit union.

All of this is to say that the CFPB has shown particular solicitude for small financial institutions, attempting to balance their particular concerns and cost structures with the need for uniform consumer protection laws.

F. The Continued Too-Big-to-Fail Problem Hurts Community Banks and Credit Unions

The Dodd-Frank Act and the CFPB have put a friendly thumb on the regulatory scale to ease regulatory burdens for community banks and credit unions, but no amount of regulatory relief will offset the structural problems faced by community banks and credit unions. There is really no way to avoid the fact that size matters in consumer finance. If Congress wants to help community banks and credit unions, the best course of action would be to take steps to end the too-big-to-fail problem that poses not just a systemic risk, but also gives too-big-to-fail institutions a competitive advantage over community banks and credit unions because of the perceived implicit guaranty of their liabilities.

Megabanks present a competitive problem for community banks and credit unions because of their economies of scale and implicit government guaranty. But they also present a direct threat to community banks and credit unions. When big banks go down, they take small banks with them. Small banks are often tied into big banks through correspondent banking relationships that can leave small banks exposed to losses when big banks fail, as well as to disruption in business services. Moreover, when there is trouble with too-big-to-fail institutions, markets freeze and the spillover effects can be brutal for smaller financial institutions, even if they have played by the rules.

The credit union industry knows only too well the costs of too-big-to-fail. In 2009 four corporate credit unions, which collectively played a role similar to regional Federal Reserve Banks for the credit union industry, failed. So did the U.S. Central Credit Union, which served as a corporate credit union for the other corporate credit unions, roughly an equivalent role to that played by the Federal Reserve Bank of New York. The failure of these corporate credit unions left the credit union industry desperately short of liquidity because many natural person credit unions had deposited their own funds at the failed corporate credit unions. The corporate credit unions failed because in search of yield they had loaded up their books with private-label mortgage-backed securities that turned out to be of little value. From 2009 up until 2016, the entire credit union industry found itself paying assessments into an industry "stabilization fund" to recapitalize the National Credit Union Share Insurance Program. Natural person credit unions were not too-big-to-fail, but they paid the price for megabanks' misbehavior.

III. Specific Bank Deregulatory Proposals Have No Connection with Economic Growth

A number of banking industry trade associations have responded to this Committee's call for proposals to encourage economic growth with various deregulatory proposals. Many of the proposed deregulations have either no obvious connection to sustainable growth or would result, at best, in growth of a very small magnitude, and the proposed deregulations do nothing to ensure that there will be an equitable division of the gains from growth. This section reviews some of the proposals to show just how risible the connection is between industry's deregulatory ask and economic growth, much less growth that will help American families' bottom lines, rather than simply enrich bank shareholders.

A. Small Business Lending Data

The American Bankers Association (ABA) and the Independent Community Bankers Association (ICBA) have both proposed repealing of section 1071 of the Dodd-Frank Act,[31] which requires the collection of small business lending data in order to facilitate screening for discriminatory lending practices. Without section 1071 data, it is extremely difficult to investigate whether there are disparate impacts in small business lending. Ensuring fair lending to small businesses is critical if economic growth is to be equitably shared among all Americans. Repealing section 1071 is hardly a step toward facilitating equitable growth, and given that section 1071 has yet to be implemented by the CFPB, it is hard to see how a repeal of section 1071 would possibly produce economic growth of any sort.

B. Raising the Exemption Threshold for CFPB Examination and Enforcement Authority

Currently the CFPB has examination and enforcement authority over depositories and credit unions with total assets of $10 billion or more plus their affiliates.[32] At present there are 116 depositories and credit unions that (with their affiliates) are subject to CFBP examination and enforcement. While these are a small fraction of the number of depositories and credit unions in the United States, the collectively have around 80% of total depository and credit union assets.

It is important to understand that the threshold for CFPB examination and enforcement is based on the total assets of the depository alone, not of the consolidated affiliated group of the depository. This is different from the calculation of the threshold for the Durbin Interchange Amendment or stress testing under section 165 of the Dodd-Frank Act, both of which are keyed off of total consolidated assets of affiliated groups.[33] Because the CFPB examination and enforcement threshold is keyed only to the assets of the depository, it is effective a higher threshold than under the Durbin Amendment or for stress testing under section 165 of the Dodd-Frank Act because depositories will always have fewer assets than their consolidated affiliated group.

The National Association of Federal Credit Unions (NAFCU) has suggested a $150 billion threshold for CFPB examination and enforcement authority, a proposal that would affect all of 3 federal credit unions and 3 state credit unions. Other prior proposals have been for a $50 billion threshold for CFPB examination and enforcement authority. Both are terrible ideas and neither threshold has any connection to economic growth.

The NAFCU's $150 billion threshold proposal would leave only 15 depositories subject to CFPB supervision and enforcement. Excluded from CFPB supervision and enforcement under this proposal would be, among others: Santander, the largest subprime auto lender in the country, as well as American Express, BancorpSouth Bank, Citizens Bank, Discover Financial Services, Fifth Third Bank, First National Bank of Omaha, Flagstar Bank, M&T Bank, Navy Federal Credit Union, M&T Bank, Regions Bank, and Synchrony Financial (GE Capital Retail Bank). Every one of these banks has been subject to CFPB enforcement actions resulting in consent orders, with American Express, Discover, Synchrony Financial, and Fifth Third Bank each being the subjects of two separate consent orders. These consent orders have totaled over $792 million in consumer relief and another $102.8 million in fines.

Even under a $50 billion proposed threshold, there would still be only 42 depositories subject to CFPB supervision and enforcement. Still excluded from CPFB supervision and enforcement jurisdiction would be banks like American Express, Citizen's Bank, Barclay's, BancorpSouth Bank, First National Bank of Omaha, Flagstar Bank, and TCF National Bank (against which the CFPB has a pending enforcement action).

If the conceit behind the $50 billion threshold is that banks that are smaller than $50 billion in total assets are somehow "community banks" that are unlikely to engage in misbehavior because of their reputation in and connection to their communities, this is simply not plausible.

<u>Community banks don't have $10 billion in assets, much less $50 billion</u>. American Express Bank, FSB ($49 billion in assets), for example is not a community bank. Neither is e*Trade Bank, with $36 billion in assets. Nor is Sallie Mae Bank, with $18 billion in assets. The $10 billion cutoff is already much higher than any true community bank's assets, but it has the virtue of being used elsewhere in federal regulation (even if through a slightly different calculation), namely in the Durbin Interchange Amendment and the stress testing under section 165 of the Dodd-Frank Act.

For some perspective on how ridiculously high a $50 billion threshold is, it substantially exceeds the total endowment of Harvard University ($35.7 billion), the wealthiest university in the world and is more than the total endowments of the next two wealthiest universities, the University of Texas system and Yale University. $50 billion is also the 2016 valuation of the twenty most valuable teams in the National Football League (which, as its name implies, is not a community football league): Cowboys, Patriots, Giants, 49ers, Redskins, Rams, Jets, Bears, Texans, Eagles, Broncos, Dolphins, Packers, Ravens, Steelers, Seahawks, Vikings, Colts, Falcons, and Raiders.[34]

In terms of flows, $50 billion is roughly the gross domestic product of Croatia ($50.4 billion) or the total 2016 revenue of the entire National Football League, *plus* Major League Baseball, the National Basketball Association, the National Hockey League, Major League Soccer, *and* the top soccer leagues in England, France, Germany, Italy, and Spain (Premier League, Ligue 1, Die Bundesliga, Serie A, and La Liga, respectively). Any institution with assets approaching $50 billion is *not* a small bank or a community bank by any definition.

To be sure, eliminating CFPB supervision from institutions with less than $50 billion or $150 billion in total assets would not leave them without supervision; consumer protection supervision would instead be conducted by institutions' primary prudential regulators. But that point shows that there is no economic growth rationale possible for the proposal. Instead, the whole rationale for the proposal is that prudential regulators are often seen by industry as being less serious about consumer protection supervision and enforcement, a conclusion that finds some support in the scathing report on the OCC's supervision of Wells Fargo issued by the OCC's Office of Enterprise Governance and the Ombudsman.[35] Putting aside questions of regulatory motivation, however, CFPB examiners are specialists in consumer financial protection with greater expertise in these issues than generalist examiners for other banking agencies. There is no good reason to change the threshold for CFPB supervision and enforcement, and such a change has no connection to economic growth.

C. Structural Reforms to the CFPB

NAFCU has suggested that transforming the CFPB from a single director to a commission structure will facilitate economic growth. Putting aside the questionable merits of this proposal, which would diffuse accountability and undermine the CFPB's effectiveness, it is hard to see how a commission structure would facilitate growth in any way. This isn't a proposal about economic growth. It's a proposal to hamstring an effective consumer financial protection regulator and nothing more.

D. Credit Union Exemption from CFPB Rulemakings

The NAFCU has urged that credit unions be exempted from CFPB rulemakings under section 1022 of the Dodd Frank Act.[36] It's worth noting as an initial matter that only six (!) credit unions, those with total assets of over $10 billion are subject to CFPB supervision and enforcement.[37] For the other 6,000 or so credit unions, it is the rest it is the NCUA or their state regulator that undertakes supervision and enforcement.[38] Thus, for most credit unions, the only interaction with the CFPB is its rulemakings, which generally apply to all entities dealing with particular consumer financial products or services.

There is no reason to exempt credit unions as a class from all CFPB rulemakings. Such a blanked approach is overbroad. While most credit unions are "good actors," not all are all the time, unfortunately. In October 2016, the CFPB entered into a $28 million consent order with Navy Federal Credit Union (the largest credit union in the country) for improper debt collection actions, including falsely threatening legal action and wage garnishment, falsely threatening to contact members' commanding officers about debts, and illegally freezing accounts. While credit unions may be tax-exempt, there is no reason that they should get a free pass from compliance with the laws applicable to other entities that do business in the consumer finance marketplace.

E. Portfolio Lending

The ABA and ICBA have both proposed exempting mortgage loans retained in portfolio by depositories from the Dodd-Frank Act's Ability-to-Repay (ATR) requirement[39] such as through the proposed Portfolio Lending and Mortgage Access Act or by deeming such mortgages to qualify for the CFPB's Qualified Mortgage (QM) safe harbor rule[40] to the ATR requirement. The ATR requirement is a centerpiece of the Dodd-Frank Act and requires nothing other than common sense in mortgage lending: lenders should not make loans without first taking reasonable steps to verify borrowers' ability to repay. The consequences of lenders failing to do that were felt all too keenly in the 2008 crisis. While many of the bad mortgage loans that fueled that crisis were securitized, it is important to remember that both Countrywide and Washington Mutual also kept many mortgage loans in portfolio. The same was true with savings and loans in the 1980s and early 1990s. Portfolio lending alone is not a guaranty of prudence.

As an initial matter, lenders' concern about ATR is also massively overblown. The remedy for a violation of the ATR provision is weak: it is only a right to set-off Truth in Lending Act damages—actual damages, statutory damages of between $400 and $4,000, and reasonable attorneys' fees—against the balance owed on the loan in the event of a foreclosure.[41] The QM rule provides a safe harbor for the ATR requirement for certain mortgages, but a non-QM mortgage can still satisfy the ATR requirement. Given that any prudent portfolio lender would already take care to underwrite a loan with sufficient documentation to ensure the borrower's ability to repay, portfolio lenders should already be in compliance with the ATR requirement. Thus, it is not clear what cost savings there would be from a portfolio lending exemption from the ATR requirement.

From a regulatory perspective, however, the proposed portfolio lending exemption from ATR is problematic because it has a huge loophole: it does not prevent lenders from shifting the risk of loans held in portfolio through derivative instruments, just as Fannie Mae and Freddie Mac have been doing with through credit risk transfers using credit-linked notes. Put another way, it's possible through derivatives to create the equivalent of a securitization while still doing portfolio lending. The ATR rule is a critical protection for both consumers and the stability of financial markets and should be loosened only with great caution. The CFPB has authority to exempt portfolio lenders from the ATR requirement, but has not done so; Congress should defer to the agency's expertise on the matter.

Finally, it's hard not to be skeptical of ATR exemption proposals given that the banking industry was complaining about the effects of the ATR requirement years before it was implemented. In 2012, GOP Presidential nominee Mitt Romney accused the QM rule of constraining mortgage lending, despite the fact that the rule did not become effective until some two years later.[42] In other words, the complaints about QM are nothing new and have no relationship to QM's actual effect on mortgage lending. In any event, even if this proposal were to encourage more mortgage lending to some borrowers, increased lending should not be confused with economic growth. It is simply an expansion of consumer debt of questionable sustainability.

F. Durbin Interchange Amendment

Both the ABA and the NAFCU have argued for the repeal of the Durbin Interchange Amendment.[43] The Durbin Amendment's price cap on debit card swipe fees applies only to financial institutions with consolidated assets over $10 billion. Smaller financial institutions are not subject to the price cap and in fact charge higher debit card swipe fees. Thus, 99% of banks and credit unions are not subject to the Durbin Amendment's price cap. The Durbin Amendment is thus an important competitive leg-up for smaller financial institutions. Given that only 6 ginormous credit unions and around 115 banks are subject to the Durbin Amendment, it is frankly perplexing that trade associations like the ABA and the NAFCU are advocating for a position that is detrimental to most of the thousands of institutions they claim to represent.

Indeed, a serious economic growth proposal would be to extend the Durbin Amendment to the credit card swipe fees or other reforms to bring competitive market pressures to bear on credit card swipe fee pricing. Credit card swipe fees represent a $73 billion annual regressive transfer from consumers to banks.[44] Only a small fraction of this is rebated back those consumers with rewards cards.

In competitive retail markets, such cost-savings should be passed on to consumers in the form of lower prices or better service, meaning more employees. Indeed, one study of the Durbin Amendment's impact is that it resulted in $5.8 billion in direct consumer savings in its first year and merchant savings of $2.6 billion.[45] Together these savings are estimated to have led to an increase in economic activity and hiring, producing 37,000 new jobs.[46] Given that credit card swipe fees are significantly higher than debit card swipe fees, one would expect substantially greater job creation from extending the Durbin Amendment to credit cards or otherwise reforming the credit card swipe fee market to make it more competitive. This would be true bottom-up growth, not a doubling-down on disproven trickle-down theories.

G. Reciprocal Brokered Deposits

Several trade associations support a loosening of the statutory restrictions on reciprocal brokered deposits, such as in S.3373 (sponsored by Senators Warner and Moran). Among the deregulatory proposals, this is one of the more reasonable ones, but a loosening on reciprocal brokered deposit regulations should be accompanied by supervision of deposit brokers as if they were bank service companies or financial market utilities.

Financial institutions attract deposits not just from their direct customers, but also from other banks through deposit brokers. Banks will place funds at other banks through deposit brokers as a way to enable their customers to functionally avoid the FDIC's insurance limit of $250,000 per depositor per institution per ownership category.[47] Large deposits that exceed the FDIC insurance limit are split up and farmed out to other banks through deposit brokers using a trust relationship as to circumvent the FDIC insurance limits.

Brokered deposits have long been a source of regulatory concern because they can function as "hot money" that chases yield and encourages unsustainable lending, while also being flighty when signs of trouble emerge. There is substantial evidence to support this concern.[48] In particular, there is a correlation between use of brokered deposits and bank failures.

Federal Deposit Insurance Act limits the acceptance of brokered deposits by depositories that are not well capitalized.[49] Some brokered deposits, however, are "reciprocal brokered deposits," meaning that if a bank were to accept a brokered deposit of $250,000 it would also place a brokered deposit of $250,000, either with the bank that gave it the deposit or with another bank in a multilateral brokered deposit network. The point is that the total deposits at the bank do not change, but they are broken down differently for FDIC insurance limit purposes enabling more deposits to qualify for insurance. There is far less data on reciprocal brokered deposits, but that data does not indicate the "hot money" concerns that exist with brokered deposits generally.

That said, reciprocal brokered deposits are not without risks. The firms that broker such reciprocal deposits are potentially a source of risk. If such firms should fail or even simply have operational problems (such as from a hacking), they could expose depository institutions to risk. Thus, any exception to the Federal Deposit Insurance Act's provisions on brokered deposits for reciprocal brokered deposits should be accompanied by a supervision regime for deposit brokers as bank service companies or financial market utilities.

CONCLUSION

Deregulation is not equivalent to growth, and unsustainable growth may be more harmful than no growth at all, particularly to the most vulnerable in society who are the least shielded from a volatile economy.[50] Even as American families are struggling, the banking industry is doing the best it has in years. In such circumstances it takes a certain brazenness to push deregulatory proposals that have nothing to do with fostering economic growth or equitable distribution of growth, only about improving banks' bottom line.

Community banks and credit unions are a critical part of the economy, but it is important not to put the cart before the horse. The profitability of community banks and credit unions should not be a goal in and of itself. Instead, the goal should be to ensure the provision of fair and transparent financial services to American families and businesses.

This Committee should reject deregulatory proposals that would benefit bank shareholders at the expense of American families in terms of consumer protection or the stability of the financial system and should instead purpose policies that ensure fair, competitive consumer finance markets and prevent too-big-to-fail firms from privatizing gains and socializing losses.

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[1] FDIC Quarterly Banking Profile (1 minus Percent of Institutions Reporting Negative Quarterly Net Income: Community Banks).

[2] FDIC Quarterly Banking Profile (sum of pre-tax quarterly return on assets from Q2:2010 to Q2:2016).

[3] FDIC Quarterly Banking Profile (sum of pre-tax quarterly return on equity from Q2:2010 to Q2:2016).

[4] Bureau of Labor Statistics, Occupational Employment Statistics (annual median wage, May 2016 divided by annual median wage, May 2010); Bureau of Labor Statistics, Consumer Price Index (indicating that $100 in May 2016 was worth $90.82 in May 2010). Thus, nominal income has increased by 9%, but inflation-adjusted income has fallen by 0.5%.

[5] Bureau of Labor Statistics do not offer a breakdown beyond the top 10%, but the Bureau of Labor Statistics numbers can be complemented with IRS data that allows for a finer grain breakdown. The IRS data only goes through 2014, but shows a 17% increase in real income for the top 1% from 2010-2014. *See* IRS, Statistics on Income, Individual Income Tax Returns Excluding Dependents.

[6] FDIC Quarterly Banking Profile (1 minus Percent of Institutions Reporting Negative Quarterly Net Income: Community Banks).

[7] CUNA, U.S. Credit Union Profile, Year End 2016, Table 1.

[8] *Id.* Table 2.

[9] *Id.*

[10] *Id.*

[11] The slope for the community bank line is -248 per year with an r^2 of 96%, while the slope for credit unions is -311 per year with an r^2 of 99%, indicating that there is nearly a perfectly steady rate of consolidation through the period for both community banks and credit unions.

[12] Likewise, the lack of de novo chartering in the last few years is not necessarily a sign of problems in the banking industry, so much as a reflection that it is cheaper to buy an existing charter than to obtain a new one.

[13] While community banks' share of total banking system assets is shrinking, their total size is actually growing. This is consistent with a more optimistic view that community banks are reasonably healthy, but that large banks continue to enjoy economies of scale and too-big-to-fail benefits.

[14] If you are wondering why, if this is true, you are hearing so much about regulation from banking lobbyists, consider what a governmental affairs expert might have to propose in terms of regulatory changes to address economies of scale and generational transition problems. Every problem looks like a nail to a man who earns his living with a hammer.

[15] 15 U.S.C. § 1693o-2(a)(6).

[16] 12 U.S.C. §§ 5515, 5516(d).

[17] CFPB, Consumer Financial Protection Bureau by the Numbers, July 15, 2015, *at* http://files.consumerfinance.gov/f/201507_cfpb_factsheet-by-the-numbers.pdf.

[18] 5 U.S.C. §§ 603(d), 609(d)(2).

[19] 12 C.F.R. § 1026.43(b)(4), (e)(5).

[20] 12 C.F.R. § 1026.43(e)(5)(i); 1026.35(b)(2)(iii)(B)-(C).

[21] 12 C.F.R. § 1026.43(e)(5)(ii)(A).

[22] 12 C.F.R. § 1026.35(b)(2)(iii).

[23] 12 C.F.R. § 1026.43(e)(6).

[24] 12 C.F.R. § 1026.43(f)(1)(vi).

[25] 12 C.F.R. § 1026.43(e)(6).

[26] 12 C.F.R. § 1026.35(b)(4)(vii)(H).

[27] 12 C.F.R. § 1026.41(e)(4).

[28] 12 C.F.R. § 1024.41(j); 12 C.F.R. § 1026.41(e)(4).

[29] 12 C.F.R. § 1005.30(f)(2).

[30] 80 FED. REG. 59944 (Oct. 2, 2015).

[31] 12 U.S.C. § 1691c-2.

[32] 12 U.S.C. §§ 5515-16.

[33] 12 U.S.C. § 5365(a)(1), (i)(2)(A); 15 U.S.C. § 1693o-2.

[34] Forbes, 2016 NFL Valuations, *at* https://www.forbes.com/nfl-valuations/#43a58a8712ce.

[35] https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-wells-fargo-supervision-lessons-learned-41917.pdf.

[36] 12 U.S.C. § 5512(b)(3).

[37] 12 U.S.C. § 5515(b)-(c).

[38] 12 U.S.C. § 5516(c)-(d).

[39] 12 U.S.C. § 1639c.

[40] 12 C.F.R. § 1026.43.

[41] 15 U.S.C. § 1640(k). *See also* Adam J. Levitin, *How Risky Is It to Make a Non-QM Mortgage and Is QM Going to Hold Back Access to Credit,* Creditslips.org, Dec. 17, 2013, *at* http://www.creditslips.org/creditslips/2013/12/how-risky-is-it-to-make-a-non-qm-mortgage-and-is-qm-going-to-hold-back-access-to-credit-.html; Ben Lane, Urban Institute: Qualified Mortgage impact overblown, HOUSING WIRE, Aug. 21, 2014, *at* http://www.housingwire.com/articles/31125-urban-institute-qm-impact-is-overblown. In theory there is also the ability to bring stand-alone action for a violation of the ATR requirement for the first three years of the loan, but it is unlikely that such suits will ever be brought outside of the foreclosure context.

[42] Adam J. Levitin, *Is QM What's Holding Back the Housing Market,* CREDITSLIPS.ORG, Oct. 4, 2012, *at* http://www.creditslips.org/creditslips/2012/10/is-qm-whats-holding-back-the-housing-market.html.

[43] 15 U.S.C. § 1693o-2.

[44] *See* NILSON REPORT, # 1109 (May 2017) at 1, 7.

[45] Robert J. Shapiro, *The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees*, October 1, 2013, *at* http://bit.ly/1McU0NS, at 2.

[46] *Id.*

[47] Broker-dealer sweep accounts are also placed with banks using deposit brokers.

[48] FIDC, Study on Core Deposits and Brokered Deposits, July 8, 2011, *at* https://www.fdic.gov/regulations/reform/coredeposit-study.pdf at 38-39.

[49] 12 U.S.C. § 1831f; 12 C.F.R. § 337.6.

[50] *See* JACOB HACKER, *THE GREAT RISK SHIFT* (2006).