

Written Testimony of Senator Phil Gramm Before the U.S. House of

Representatives Committee on Financial Services

Washington, D.C.

July 28, 2015

It is a great honor and pleasure to be asked to testify today. I am especially honored to sit at the witness table with Peter Wallison and Congressman Brad Miller. Peter Wallison has been the strongest and clearest voice on the subprime crisis and has contributed more to our understanding of that problem than anyone.

Many of you know I have a long and deep relationship with your Chairman. Long ago and far away I taught him Money and Banking at Texas A&M, and as any old teacher would, I take great pride in the job he has done and the man he has become.

By any measure we are today experiencing the weakest recovery of a post-war era. Had this recovery simply matched the strength of the average of the other ten recoveries since World War II, 14.4 million more Americans would be working today and the average income of every man, woman and child in the country would be \$6,042 higher. The incomes of the poor, middle income workers, women and minorities have fallen even during the recovery, an unprecedented event. All this economic carnage has occurred despite a doubling of the Federal debt and an

expansion of the Federal Reserve Bank balance sheet and the monetary base at rates never before witnessed.

Five years after the enactment of Dodd-Frank, the causes and effects of the failed recovery can be seen throughout the banking system. Monetary easing by the Fed has inflated bank reserves but has barely increased lending. Today banks hold an extraordinary \$29 of reserves for every dollar they are required to hold. In the first quarter of 2015 banks actually deposited more money in the Fed (\$65.1 billion) than they lent (\$52.5 billion).

According to the FDIC, 1,341 commercial banks have disappeared since 2010, one each day in the first quarter of 2015. Remarkably, only two new banks have been chartered in the last five years. By comparison, in the quarter century prior to the financial crisis roughly 2,500 new banks were chartered. Even in the depths of the Great Depression of the 1930s, on average 19 banks a year were chartered.

As regulatory burden has exploded under Dodd Frank, community banks have hired 50% more compliance officers while overall industry employment has expanded by only 5% and is still below the pre-crisis level. Industrial, consumer and mortgage finance has continued to flee the banking system, as increasing regulatory burden has led almost half the banks to cut offerings of financial products and services. New financial services technology has continued to blossom, but it has been almost exclusively developed and implemented outside the banking system. As a result,

massive amounts of resources and talent in banks have been sidetracked rather than being employed to make loans and grow the economy.

Much of our slow growth is not just a product of mounting regulatory burden but of legislative and executive actions that have empowered regulators to set rules rather than implement rules set by Congress. Dodd-Frank has undermined a vital condition required to put money and America back to work -- legal and regulatory certainty.

To be fair to the Dodd-Frank Act, Congress has been more descriptive than proscriptive in banking laws for some time, and a certain amount of regulatory flexibility is necessary. But, in the Securities Exchange Act of 1934 and most subsequent banking law before Dodd-Frank, the powers granted to regulators by Congress were fairly limited and generally exercised through bipartisan commissions, where major decisions were debated and voted on in the clear light of day. Precedents and formal rules were knowable by the regulated. Also, regulators generally had to be responsive to Congress, which controlled their appropriations and possessed super majority confirmation powers. These checks and balances, while imperfect, did promote general consistency and predictability in federal regulatory policy.

The Dodd-Frank Act delegated far more discretionary power to financial regulators than had ever been granted before and undermined the checks and balances that

had historically marked the process. For example, the Consumer Financial Protection Bureau (CFPB) was structured with no bipartisan commission and automatic funding, which virtually eliminated any real ability for elected officials to check its policies. In the process, consistency and predictability were replaced by uncertainty and fear.

U.S. regulators are now imposing restrictions on financial institutions that were never contemplated by Congress and pushing international regulations on insurance companies and money market funds that Congress never authorized.

The Financial Stability Oversight Council (FSOC) was specifically empowered to override precedents and bipartisanship. Since FSOC meets in private and is made up exclusively of the sitting President's appointed allies, bipartisan input and sunshine -- the historic checks on regulatory abuse -- have been lost. In addition, since what constitutes a systemically important institution was never defined by Dodd-Frank, it has become whatever FSOC says it is. The systemically important designation of FSOC is now a sword hanging over the head of every major financial institution. Banks that have been designated have regulators embedded in their executive offices to monitor and advise, eerily reminiscent of the old political officers who were placed in every Soviet factory and military unit.

Despite years of delay and hundreds of pages of new rules, no one knows what the Volcker Rule requires—not even Paul Volcker.

Over the years the Federal Trade Commission and the courts had defined “unfair and deceptive”, but when Dodd-Frank added “abusive” without defining it, financial institutions can now engage in activities that are not unfair or deceptive by long standing precedent and still be judged by the CFPB as being “abusive”.

Then there is the “living will”, a plan not of how banks will be run but how they would be liquidated if they failed. The Fed and the FDIC have almost total discretion in deciding whether the plan is acceptable and therefore whether to institute a variety of penalties, including the divestiture of assets. No other industry in the nation makes or publishes such plans, or expends management energy and board time on how to shut down their business. Their energy is rightly focused on how to build their business and the economy.

What does the stress test test? Not only does no one know, but the regulators see that as a virtue. The Fed’s Vice Chairman has stated that giving banks a clear road map for compliance might make it “easier to game the test”. But isn’t the fact that compliance is easier when you know what the law says the whole point of the rule of law?

To limit abuse by its rulers, ancient Rome started the then-revolutionary practice of writing down the law and permitting citizens to go and read it. Under the Dodd-Frank Act, and numerous other actions taken during this Administration, regulatory

authority is so broad and so vague that the conditions of Roman law are no longer met in America. The rules are now whatever regulators say they are. This is the rule of government, not the rule of law.

Most criticism of Dodd-Frank focuses on the massive increase in regulatory burden it has imposed, but the most costly and dangerous effect of Dodd-Frank, ObamaCare and virtually every other legislative and regulatory action of this Administration is the uncertainty and arbitrary power it has created by the destruction of the rule of law. These policies are shackling economic growth but more importantly, they are imperiling our freedom.