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TO THE HOUSE FINANCIAL SERVICES COMMITTEE ON

THE DODD FRANK ACT FIVE YEARS LATER—ARE WE MORE STABLE?

July 9, 2015

Good morning, Chairman Hensarling, Ranking Member Waters, and members of the Committee. My name is Damon Silvers, I am the Policy Director and Special Counsel to the AFL-CIO, and my testimony today is given both on behalf of the AFL-CIO and Americans for Financial Reform, a coalition of over 200 organizations that seeks to ensure the public interest is represented in the financial regulatory process in Washington in decision making about the financial system in Washington.

This hearing marks the occasion of the 5th anniversary of the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the most comprehensive financial regulatory legislation passed in the United States since World War II. The Dodd-Frank Act was passed in the wake of the financial crisis that began in the United States in 2007, reached its peak in the United States in late 2008 and early 2009, but which appears to be ongoing in much of Europe. The economic crisis that resulted cost the United States $22 trillion dollars according to a 2013 GAO study. The crisis resulted in ten million families losing their homes through foreclosures and forced sales, and condemned tens of millions of America's workers to long-term unemployment.

It is important to begin this five year review by noting that the Dodd-Frank Act was a compromise. For those who looked at the financial system as it was in 2008 and saw a need for profound structural change, Dodd-Frank was definitely half a loaf. The Dodd-Frank Act did not place firm size limits on financial institutions, it did not restore the Glass-Steagall Act, and it did not fundamentally restructure the incentives created by the basic structures of executive compensation in the financial system, just to give some salient examples. The Dodd-Frank Act did not give the SEC and the CFTC independent funding,

nor did it address large banks' dominance of regional Federal Reserve boards. Instead, the Dodd-Frank Act gave regulators significant new powers and the discretion to use those powers either to simply increase transparency and make prudential regulation more uniform, or to make structural change.

What Dodd-Frank did do was renovate a financial regulatory structure that had literally become decrepit, and resurrect fundamental principles of financial regulation that had been lost or forgotten in the race to deregulate in the 1980's and 1990's. This renovation has resulted in a U.S. financial system, which while it continues to suffer from structural problems, is no longer as vulnerable to crisis as it was, has a regulatory architecture that has placed the protection of America's families at the center of the regulatory mission, as it always should have been, and has the flexibility to adopt to changing business models within financial firms and markets.

Most of all, the Dodd-Frank Act created a clear, workable alternative to the bailout of systemically significant institutions—the resolution process contemplated in Title II of the Act—that places the responsibility for first dollar losses in distressed situations clearly where it should be—on the too big to fail firm, its equity holders, its bondholders and its executives.

But it is critical to note that in the area of systemic risk and counteracting too-big-to fail, as in almost every aspect of the Act, its effectiveness depends on the willingness of financial regulators to properly implement it. In the area of systemic risk, the public has been well served by the FDIC's insistence that the living wills prepared by systemically significant financial institutions involve genuine simplification of those organization's structures, so that in a crisis they could be resolved. Without this insistence, the promise of Title II that we would end too-big-to-fail would be simply empty words.

However, the full potential of Dodd-Frank's systemic risk provisions have not been realized. For example, Title II gives the bank regulators and the FSOC broad powers both in terms of setting capital requirements and in terms of potentially requiring structural change at systemically significant financial institutions. Among those powers are the power to insist on structural changes in the largest banks as part

of the living will process. Those powers have not been used to anywhere near the extent they could to protect against another bailout of the banks by the public.

At the same time, it was always recognized by those involved in the enactment of the Dodd-Frank Act that it needed to be accompanied by reforms in other areas of the law that involved the financial system—particularly the tax laws and the pension laws. So the continuation of tax subsidies for financial speculation in the form of the carried interest provisions of the tax code and the lack of a financial transaction tax are part of the unfinished business of financial reform. On the other hand, the Department of Labor's fiduciary rule proposal is an example of important forward motion in a key area of consumer financial protection outside the ambit of the Dodd-Frank Act.

The U.S. financial regulatory system prior to the Dodd-Frank Act was a Swiss cheese system—full of holes that allowed financial actors to evade both capital and transparency requirements for the price of a few hours of a lawyer's time. The Dodd-Frank Act closed numerous loopholes, with varying degrees of effectiveness. It eliminated the Office of Thrift Supervision, removing a long time source of regulatory whipsawing. It created registration requirements for the managers of hedge funds and leveraged buyout funds—shining a light on a longtime source of opaque credit risk in the capital markets. The Dodd-Frank Act required increased transparency and safety in the derivatives markets--requiring more transactions to be cleared and traded on exchanges. The Volcker Rule required banks to no longer trade in derivatives on their own accounts. The Act called for higher capital standards for the very largest institutions. The Dodd-Frank Act gave the SEC the power to regulate derivatives that sought to mimic publically traded securities. The Dodd-Frank Act required that over the counter derivatives had to be cleared through clearinghouses that would require both collateral be posted and that somewhat visible records of the transactions be maintained. And the Act made important corporate governance reforms, including requiring advisory Say on Pay votes at public companies, and requiring that public companies disclose the ratio of their CEO pay to the pay of their median employee.

Five years later, the results of these changes are a financial system with greater resiliency, with more transparency and thus a greater ability for regulators to manage systemic risk, and a reduction in the credit market's perception that investments in the nation's largest banks are risk free. For example, the GAO did a study in 2014 using 42 different financial models of the credit subsidy resulting from implicit federal guarantees to the nation's largest banks. They found that while there was a very large subsidy in 2009 and 2010, it fell following 2010 to a level near zero in 2014. In general, the retreat in perception of a subsidy was associated not with the passage of the Act, but with the sense over time, likely associated with the progress of living wills and stress tests, that the bank regulators were serious about enforcing the provisions of Title II.

There is also evidence of these positive effects in the growth rates of different sized bank holding companies. After years of rapid growth, the total risk exposures of the top 6 bank holding companies have stabilized at just over $14 trillion since 2013. At the same time, regional bank holding companies are growing rapidly—with annual growth in the 5-10% range for the same period.

These studies are best understood as measures of directionality—the Dodd-Frank Act has clearly decreased credit markets' perception that the debts of the largest banks are guaranteed by the federal government. However, given the very large size of the nation's eight largest financial institutions—the equivalent of 85% of the U.S. GDP—it would be naïve to conclude that the problem of too big to fail banks is behind us.

But the Dodd-Frank Act was not simply about protecting the financial system from itself. Its explicit purpose was to make financial markets less of a rigged game from the perspective of consumers and investors. Here the track record is impressive and expanding. Most importantly, the consolidation of consume protection functions in the CFPB has been a clear success—the CFPB has been hailed by not just consumer advocates, but by the firms it regulates as a model of regulatory efficiency. The CFPB has returned $5.38 billion dollars of improperly obtained fees and penalties to 15 million consumers.

More recently, the Securities and Exchange Commission has taken steps to use the information the Dodd-Frank Act provided through is registration requirements for managers of private equity firms and hedge funds to determine that a wide range of institutional investors—pension funds providing benefits for millions of people—had been charged improper expenses. The Commission found violations of law or material weaknesses in over 50% of these examinations. These problems would have gone unnoticed but for the provisions of the Dodd-Frank Act.

While the basic principles of the Dodd-Frank Act of transparency, closing regulatory loopholes, and treating consumer and investor protection seriously are becoming more embedded in our financial system with the passage of time, the achievements of the Dodd-Frank Act face several serious threats.

The first is the simple failure of regulators to implement provisions of the Act, including notably in areas that affect executive compensation in the financial sector. Five years later, the Securities and Exchange Commission has not issued regulations implementing the transparency provisions of Dodd-Frank in executive pay, particularly the provision requiring public companies to disclose the ratio of their CEO's pay to the pay of their median employee. And the Board of Governors of the Federal Reserve has failed to issue a final rule implementing Section 956 of the Act requiring the regulators take steps to ensure that large financial institutions stop paying executives in ways that encourage excessive risk taking.

Among the most serious problems here is the erosion of a culture of robust enforcement in financial regulatory bodies. This problem is manifest in the Dodd-Frank context in the routine waivers granted by the Securities and Exchange Commission to the prohibition under Rule 506 on those found guilty of securities fraud from participating in exempt securities offerings. But, as documented by among others, Judge Jed Rakoff, this problem is pervasive at both the Securities and Exchange Commission and the Justice Department and has eroded public confidence in the even-handedness of the enforcement of our nation's laws..

The second threat is the impulse some in Congress seem to have to want to increase systemic risk and to make banks more likely to become too big to fail. We saw this on display most prominently in the Cromnibus negotiations last spring, where Congress worked with the Obama Administration to repeal the hard-fought derivatives push out provisions—once again directly allowing depositors' funds to be used to back derivatives trading businesses—both increasing the risks associated with core banking functions and making resolution of a failed mega institution more difficult.

Since the passage of Dodd-Frank, every legislative session of the Congress has featured a whole range of proposals to weaken the Dodd-Frank Act—most of which are thinly disguised efforts to help too big to fail banks, public company CEO's and the managers of large hedge funds and private equity funds—the wealthiest, most powerful people and institutions in the country. There have been proposals to weaken the CFPB's financing and governance and to limit its jurisdiction, to exempt private equity fund managers from registration, to weaken the derivatives clearing procedures, and to repeal the CEO pay disclosure provisions. More informally, there has been unrelenting pressure on regulators to either not enforce or create loopholes in implementing Dodd-Frank in areas that are critical for protecting our economy such as derivatives regulation.

Those who have sought to undermine efforts to protect the American public from the systemic risk in the financial system have made a series of spurious arguments against the implementation of the Act. Among these spurious arguments have been "cost-benefit analyses" that looked only at the costs and not at the benefits, arguments about liquidity that fail to assess (a) whether liquidity is always a good thing, and (b) whether other factors affect liquidity, or raising concerns that derivatives' clearinghouses might have embedded credit risk, and then attacking bank regulators for requiring capital to be set aside to buffer those risks.

These sorts of arguments only have weight because of the political and economic power of the people making them. And this brings us back to the issue of too-big-to-fail banks.

The truth is that because the Dodd-Frank Act was a compromise, because it largely left to the regulators the question of structural change, it has proven to be vulnerable to the continuing political power of the handful of too big to fail banks that continue to dominate our financial system and exert a disproportionate influence on our politics.

In this sense, the unfinished agenda of financial reform is inextricably intertwined with the ability of the regulatory system to effectively implement the Dodd-Frank Act as it is, to ensure the financial system does its job of efficiently transforming savings into investment, and to protect the U.S. economy and the American public from a costly repeat of the financial crisis that began in 2007.

Thank you for the opportunity to testify and I look forward to your questions.