Testimony of
Michael S. Barr
The Roy F. and Jean Humphrey Proffitt Professor of Law
University of Michigan Law School
Before the
United States House Committee on Financial Services
Hearing on the Financial Choice Act of 2017
April 26, 2017

Chairman Hensarling, Ranking Member Waters, distinguished members of the Committee, it is my pleasure to appear before you today.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was passed in response to the worst financial crisis since the Great Depression. In 2008, the United States plunged into a severe financial crisis that shuttered American businesses, and cost millions of families their jobs, their homes and their livelihoods. The crisis was rooted in years of unconstrained excesses and prolonged complacency in major financial capitals around the globe. The crisis demanded a strong regulatory response in the U.S. and globally as well as fundamental changes in financial institution management and oversight world wide. The U.S. has led these reforms, both domestically and internationally.

In the U.S., the Dodd-Frank Act was designed to reduce the risk of future crises, and to reduce the harm to the real economy should such a crisis occur again. The Act created the authority to regulate Wall Street firms that pose a threat to financial stability, without regard to their corporate form, and to bring shadow banking into the daylight; to wind down major firms in the event of a crisis, without feeding a panic or putting taxpayers on the hook; to attack regulatory arbitrage, restrict risky activities through the Volcker Rule and other measures, regulate repo and other short-term funding markets, and beef up banking supervision and increase capital; to require central clearing and exchange trading of standardized derivatives, and capital, margin and transparency throughout the derivatives market; to regulate payments, settlement, clearance and other systemic activities; to improve investor protections; and to establish a new Consumer Financial Protection Bureau to look out for the interests of American households.[1]

While those American families have not forgotten the pain of the financial crisis, a kind of collective amnesia appears to be descending on Washington. Many seem to have forgotten the causes of the financial crisis, and the brutal consequences for American families. Instead of offering hope and opportunity to American families, the legislation being considered by this Committee would needlessly expose taxpayers, workers, businesses and the American economy to fresh risks of financial abuse and financial collapse.

That's not a risk we can or should take.

---

[1] See Michael S. Barr, Howell E. Jackson, and Margaret E. Tahyar, Financial Regulation: Law and Policy (Foundation Press 2016), pp. 58-63.

While the draft legislation has many serious flaws, I want to focus here on three key problems: (1) weakening oversight of the financial system, (2) eliminating orderly liquidation, and (3) undermining consumer and investor protections. My testimony is not meant to be comprehensive, but illustrative of the many flawed provisions in the bill.

I. Weakening Oversight of the Financial System

a. Eliminating non-bank designations, undermining the Financial Stability Oversight Council, and abolishing the Office of Financial Research.

The Financial Stability Oversight Council (FSOC) has authority to designate systemically important firms and financial market utilities for heightened prudential oversight by the Federal Reserve; to recommend that member agencies put in place higher prudential standards when warranted; and to look out for and respond to risks across the financial system. In support of FSOC, the Office of Financial Research (OFR) provides financial system-wide data on risks throughout the market.

Proposed legislation puts that all at risk.

One of the major problems in the lead up to the financial crisis was that there was not a single, uniform system of supervision and capital rules for major financial institutions. The federal financial regulatory system that existed prior to the Dodd-Frank Act largely developed in the context of the banking system of the 1930s. Major financial firms were regulated according to their formal labels – as banks, thrifts, investment banks, insurance companies, and the like—rather than according to what they actually did. An entity that called itself a “bank,” for example, faced tougher regulation, more stringent capital requirements, and more robust supervision than one that called itself an “investment bank.” Risk migrated to the less well-regulated parts of the system, and leverage grew to dangerous levels.

The designation of systemically important non-bank financial institutions is a cornerstone of the Dodd-Frank Act. A key goal of reform was to create a system of supervision that ensured that if an institution posed a sizeable risk to the financial system, it would be regulated, supervised, and have capital requirements that reflected its risk, regardless of its corporate form. To do this, the Dodd-Frank Act established a process through which the largest, riskiest, and most interconnected financial firms could be designated as systemically important financial institutions and then supervised regulated by the Federal Reserve. The FSOC has developed detailed interpretive guidance and a hearing process that goes beyond the procedural requirements of the Act, including extensive engagement with the affected firms, to implement the designation process outlined in Dodd-Frank. The approach provides for a sound deliberative process; protection of confidential and proprietary information; and meaningful and timely participation by affected firms. The FSOC has already designated a number of firms under this authority.

Critics of designation contend that it fosters “too big to fail,” but the opposite is true. Regulating systemically important firms reduces the risk that failure of such a firm could destabilize the U.S. financial system and harm the real economy. It provides for robust supervision and capital requirements, to reduce the risks of failure, and it provides for a mechanism for the FDIC to wind down such a firm in the event of crisis, without exposing taxpayers or the real economy to the risks of their failure. The FDIC is developing a “single point of entry” model for resolution that would allow it to wind down a complex financial conglomerate through its holding company with “resolution-ready” debt and equity, while permitting solvent subsidiaries to continue to operate. Similar approaches are being developed globally.

Other critics argue that the FSOC should be more beholden to its member regulatory agencies, but again, the opposite is true: Congress wisely provided for its voting members, all of whom are confirmed by the Senate, to participate based on their individual expertise and their own assessments of risks in the financial system, not based on the position of their individual agencies, however comprised. Members must individually attest to their assessments in the FSOC’s annual reports. The FSOC has the duty to call on member agencies to raise their prudential standards when appropriate, and member agencies must respond publicly and report to Congress if they fail to act. This system of checks and balances requires that FSOC members leave their agency’s “turf” at the door, and focus on system-wide risks and responses. If anything, the FSOC’s powers should be strengthened, so that fragmentation in the financial regulatory system does not expose the United States to enormous risk, as it did in the past.

Some critics contend that certain types of firms in certain industries or under certain sizes or with certain levels of leverage should be categorically walled off from heightened prudential supervision, but such steps will expose the United States to the very risks we faced in the lead up to the last devastating crisis. The failure of firms of diverse types and diverse sizes at many points in even very recent memory—from Lehman and AIG to Long Term Capital Management—suggest that blindspots in the system should at the very least not be intentionally created in advance by the Congress. The way to deal with the diversity of sizes and types of institutions that might be subject to supervision by the Federal Reserve is to develop regulation, oversight and capital requirements that are graduated, dynamically responsive, and tailored to the types of risks that such firms might pose to the financial system, as the Federal Reserve and other agencies have been doing. FSOC and member agencies also have other regulatory tools available with respect to risks in the system for firms not designated for Fed supervision, including increased data collection and transparency, collateral and margin rules for transactions, operational and client safeguards, risk management standards, capital requirements, or other measures.

Some critics complain that the FSOC’s work is too tied to global reforms by international bodies such as the Financial Stability Board (FSB). But global coordination is essential to making the financial system safe for the United States, as well as the global economy. The United States has led the way on global reforms, including robust capital rules, regulation of derivatives, and effective resolution authorities. These global efforts, including designations by the FSB, are not binding on the United States. Rather, the FSOC, and U.S. regulators, make independent regulatory judgments about domestic implementation based on U.S. law. U.S. regulators follow the normal notice and comment process when developing financial regulations. The FSB itself has become more transparent over time, adopting notice and comment procedures, for example, but it could do more to put in the place the kind of protections that the FSOC has established domestically.[2]

As with designation, global coordination—and independent regulatory judgment—is essential to capital rules. Strong capital rules are one key to a safer system. Before the crisis, the financial system was woefully undercapitalized, and that the system was saved only with a massive infusion of taxpayer-funded capital, and a wide variety of unprecedented guarantees, liquidity provision and other backstops by the FDIC, the Federal Reserve, and Treasury. There's already double the amount of capital in the major US firms than there was in the lead up to the financial crisis. Globally, regulators are developing more stringent risk-based standards and leverage caps for all financial institutions, and tougher rules for the biggest players. In the U.S., regulators have proposed even stronger leverage and capital requirements for the largest U.S. firms, and other countries are putting in place stricter approaches when warranted by their local circumstances.

In my judgment, the local variation based on a strong minimum standard is healthy for the system, taking into account the different relative size of financial sectors and differing local economic circumstances. There's been progress on the quality of capital—focusing on common equity—and on better and more comparable measures of the riskiness of assets, but more could be done to improve transparency of capital requirements across different countries and to make them stronger buffers against both asset implosions and liquidity runs. We need to continue to insist that European capital standards and derivatives regulations are strong—and enforced even-handedly across the board.

The United States has taken a strong lead in pursuing global reforms, galvanizing the G-20, pushing for the creation of the global Financial Stability Board (FSB), and pursuing strong global reforms on capital, derivatives, resolution, and other matters.

The G-20 has been driving financial reforms at a global level; the Financial Stability Board pursues agreement among regulators; and technical teams at the Basel Committee on Banking Supervision, the International Organization of Securities Commission, and the International Association of Insurance Supervisors hash out industry-relevant reforms. While the process of reaching global agreement has at times been quite messy, divisive, and incomplete, the last thing we need is to hamstring global cooperation or U.S. regulation. These mechanisms should be strengthened and improved, not ignored or weakened.

---

[2] *See* Michael S. Barr, *Who's in Charge of Global Finance?,* GEORGETOWN JOURNAL OF INTERNATIONAL LAW 45, no. 4 (2014): 971-1027.

Strong U.S. financial rules are good for the U.S. economy, American households and businesses, and we also need a stronger, harder push to reach global agreement on core reforms. In fact, such an approach is essential in order to reduce the chances of another devastating global financial crisis that crushes the U.S. economy.

Why would anyone want to poke out the eyes of financial regulators by eliminating the Office of Financial Research, an agency with no regulatory turf, but with the sole mission of informing regulators, markets and the public about evolving financial risks? The proposed legislation would mindlessly eliminate an agency dedicated to fostering transparency, improving science and knowledge, and exposing harmful practices.

b. Hollowing Out Supervision of Bank Holding Companies

The Federal Reserve has supervisory authority, as it has long had, over bank holding companies. The Fed is directed under section 165 of the Dodd-Frank Act to provide for a graduated system of regulation, with increasing stringency, depending on the risk that the firm poses to the financial stability of the United States, based on its nature, scope, size, scale, concentration, interconnectedness or other factors. The Fed may tailor these more stringent prudential standards for individual firms or categories of firms, based on a similar set of factors regarding risk.

These enhanced prudential measures include risk-based capital requirements and leverage limits, liquidity requirements, risk management, resolution planning, credit exposure reporting, concentration limits, and annual stress tests.

The Fed is not required under this provision to apply these more stringent standards to bank holding companies with assets under $50 billion. Annual firm-led stress tests, however, are required for financial institutions between $10 and $50 billion in size, and the Fed must itself stress tests firms over $50 billion in size, in addition to such financial firms semi-annual firm-led stress tests. Publicly traded bank holding companies with $10 billion or more in assets must establish risk committees. (I should also note that under the Dodd-Frank Act, the Federal Reserve may, upon recommendation of the Financial Stability Oversight Council, raise the threshold above $50 billion for certain prudential standards, those involving contingent capital, resolution planning, concentration limits, enhanced public disclosures and short-term debt limits.)

None of these enhanced measures apply to about 95% of banks, the category commonly described as community banks, those under $10 billion in assets. Thus exempt are more than 6,000 banks in communities all across the country.

Graduated standards are already at work. Fed stress testing applies to the largest firms in the country, the 31 firms with assets of $50 billion and above. Such firms represent a wide variety of risk profiles, business strategies, sizes, specializations, and include both foreign and domestic firms. The largest, most complex financial institutions face the most stringent standards, as provided for under the Dodd-Frank Act. The Fed, for example, imposes a supplementary leverage ratio, a counter-cyclical capital buffer, and detailed liquidity coverage rules only on 14 firms with over $250 billion in assets. The very largest U.S. banks on a global basis, currently eight bank holding companies, are subject to even tougher standards, including capital surcharges, more stringent leverage ratios, and long-term debt requirements.

Stress testing is a central and innovative risk management tool used since the financial crisis by both regulators and practitioners. Stress testing attempts to capture the effects of macro shocks on the balance sheets and activities of firms. Unlike fixed capital ratios, of either the risk-based or leverage ratio type, stress testing seeks to understand how macro shocks would deplete capital. Moreover, the stress tests are not as easy for financial institutions to game as fixed capital rules. It would be a serious mistake to exclude bank holding companies from stress testing based merely on meeting a fixed capital ratio, or to otherwise hamstring stress testing by the Fed.

In my view, the Fed's graduated approach to supervision and regulation makes sense. Some have argued that the size threshold for heightened prudential standards should be substantially increased, while others have argued that banks should not be subject to any heightened standards unless they are specially designated as systemic. Both approaches, in my judgment, are mistaken.

First, as to size, some have mistakenly said that the Dodd-Frank Act describes firms with only $50 billion in assets as systemic. But that is simply not the case. Congress set the $50 billion threshold, and another threshold for other measures at $10 billion, to provide a floor under which smaller firms would know that they are not subject to the new sets of rules. But the rules were not meant to only apply to the very few largest firms in the country. They are not intended to apply only to systemically important firms.

They are designed to work in a graduated, tailored way to increase the resiliency of the financial system as a whole. Risks aggregate across the financial system, including from institutions of a variety of sizes and types. It is the very anti-thesis of macro-prudential supervision to focus only on the very largest handful of financial firms and to ignore risks elsewhere in the system. The public interest is in the health of the financial system as a whole. Moreover, smaller financial institutions themselves face risk from larger institutions and from activities across the system as a whole. Understanding those risks is essential if we are to have a safer financial system than the one we had before the financial crisis. We must not intentionally blind regulators to these risks in advance.

Second, as to the idea of designation, others have argued that bank holding companies should have to be designated for heightened supervision by the same process the FSOC uses for non-bank firms. But that runs counter to the purpose of nonbank designation. Bank holding companies should not be required to be designated for heightened supervision. Bank holding companies are already supervised by the Fed, and the Fed already has authority to impose heightened prudential supervision on such firms, on a graduated basis, as they increase in size and complexity.

The reason for the designation process, under section 113 of the Act, for nonbank financial institutions is that such institutions were not subject to meaningful, consolidated supervision by the Fed at all. In the lead up to the Financial Crisis, firms such as Lehman Brothers and AIG could operate with less oversight, more leverage and riskier practices. Recognizing that policing the boundaries of financial regulation is critical to making the financial system safer, fighting regulatory arbitrage, and providing oversight of shadow banking, the Dodd-Frank Act established a process for bringing such non-bank financial institutions into the system of regulatory oversight.

It makes little sense to require designation of firms that are already supervised by the Fed, and it will dramatically slow down and disrupt the Fed's existing oversight system. It will make the financial system weaker, not stronger.

The proposed legislation offers up a simple option, to be exercised at the discretion of Wall Street firms—a 10% leverage ratio gets big firms like Goldman Sachs and Wells Fargo out of the heightened supervision of the Fed. That's a big mistake, not just because it will incentivize firms to take on riskier activities, but also because it will blind the Fed to future risks. It adds another layer of complexity to the existing set of capital rules. It benefits only the biggest banks subject to the Fed's heightened supervision. It lets Wall Street firms choose whatever approach is least constraining for them, even if it means bigger risks for the rest of us. That's choice for Wall Street, pain for American families.

None of these changes will help truly small, home-town banks. There is undoubtedly much that could be done to reduce regulatory burden on the smallest banks. Small banks could benefit from clear safe harbor rules and short, plain-language versions of regulations that do apply to them. The Fed can continue to improve its tailored and graduated approach to supervision. Strong, compliant small banks should have longer examination cycles and streamlined reporting requirements. Regulators and the industry should come together in a task force to come up with better ways to implement the goals of the Bank Secrecy Act and related rules to make it more likely that we catch terrorists and criminals, with lower regulatory burden. And we need a level playing field for small business lending, so community banks can compete with non-bank providers to provide safe, transparency, consumer-friendly loans to small businesses and entrepreneurs.

II. Eliminating Orderly Liquidation

The Financial Crisis produced the worst economic recession in the United States since the Great Depression, leading to the near-total collapse of the global financial system, wiping out retirement savings, and costing millions of American families their jobs, homes and livelihoods. At the height of the crisis, Lehman collapsed into disorderly bankruptcy, causing panic throughout the financial system, American International Group (AIG) was bailed out by the government, prompting widespread revulsion and exposing taxpayers to extreme risks, and President George W. Bush and Congress stepped in to pass the Troubled Asset Relief Program, which, though essential to stem the panic, was one of the most reviled economic enactments in modern memory.

In response to the crisis, Congress passed Dodd-Frank, to help make the financial system safer and fairer. The Act strengthened oversight of the largest banks, provided a mechanism to ensure supervision of firms like Lehman and AIG that had escaped Fed regulation, created tough new rules for derivatives trading, and bolstered consumer and investor protection. One key measure the Act contained is the Orderly Liquidation Authority, which for the first time provided the FDIC with the tools it needs to deal with the failure of failure of a systemically important firm.

Why is Orderly Liquidation important? When a traditional bank or thrift depository institution is either failing or on the verge of failure, the FDIC has long had the authority to step in to guide the failing institution through a process that limits collateral damage, and protects taxpayers and the broader economy as a whole. As the Financial Crisis demonstrated, though, with respect to failing non-bank institutions like Lehman Brothers or AIG, or complex bank holding companies, the only available options were bankruptcy or government bailouts, both of which proved unacceptable.

Under the Orderly Liquidation Authority, the FDIC now has the capacity to deal with the potential failure of a major financial conglomerate in an orderly fashion that limits collateral damage to the system. Shareholders and other providers of regulatory capital and long-term convertible debt to the firm will be forced to absorb any losses.

The FDIC has made significant progress in developing a strategy under the Dodd-Frank authorities, known as the "single point of entry," which would permit the holding company of a financial conglomerate to be resolved without necessarily disrupting the ability of its operating subsidiaries—bank, broker-dealer, or other parts—to function. Firms are required to hold sufficient long-term debt at the holding-company level to facilitate an orderly winding down of the holding company while permitting operating subsidiaries of the firm to continue to operate. Management can be terminated and the compensation of culpable managers can be clawed back. Critical assets and liabilities of the firm can be transferred to a bridge institution so that the firm can be resolved without causing cascading collapses in the financial system. In the event that the firm's internal capital and long-term debt are insufficient to support restructuring and ongoing operations, liquidity can be obtained through Treasury borrowing that is automatically repaid from the sale of assets of the failed firm or, if necessary, from a preauthorized, ex post assessment on the largest financial firms—not by taxpayers. In this manner, the resolution authority allows the government to resolve the financial conglomerate without exposing the system to a sudden disorderly failure that puts the whole financial sector at risk.

When Lehman Brothers entered into bankruptcy in September 2008, it caused a seismic shock in our financial system. The complicated web of Lehman's financial obligations left balance sheets worldwide exposed to a cascade of default risk, and contagion spread the risk throughout the financial system. It would be foolish to rely *solely* on the hope that bankruptcy judges, even if the House-passed bill were to become law, could manage the failure of a financial institution of the size, complexity, and interconnectedness, and cross-border exposures and activities of Lehman, AIG, or the largest U.S. bank holding companies, insurance conglomerates, or investment banks.

Orderly Liquidation has three essential features: First, supervision, planning, and management. Resolution of a failing firm is part of an integrated system of ongoing supervision by the Fed and FDIC, including stress tests, living wills, pre-placed capital and convertible debt. It relies on management of resolution by an expert agency with a large, dedicated and experienced staff. Supervisors, seeing deep financial stress at a firm, can put the firm into resolution, restructure its capital and debt, and create a bridge institution for its ongoing operation—before it is too late.

Second, the availability of FDIC-provided liquidity in a crisis, backed by the firm's assets, when private sector lenders are likely to balk. Without that, resolution is a fool's errand, likely to spark widespread panic. Taxpayers are fully protected by the firm's collateral and by automatic assessments on the largest financial institutions should such assets prove insufficient.

Third, global coordination with foreign regulators, based not only on pre-negotiated legal memorandums of understanding, but also war gaming, communications, and, most importantly, the development of a trusted relationship earned over time.

Bankruptcy, even if reformed, cannot replicate these three essential features.

The proposed legislation under consideration by the Committee would eliminate OLA, blind the FDIC by removing it from the living will process, and take other measures to weaken Federal Reserve oversight of Wall Street firms, both banks and non-banks. To eliminate OLA is to consciously forget key lessons of the Financial Crisis. It is to carelessly throw away a useful and necessary tool and blind oneself to the amount of risk the failure of large, complex financial institutions pose to our financial system. Without OLA, a central and known problem that contributed to our last financial crisis will become a core problem of our next one. We have enough work still to do on the path of reform without undermining our progress thus far.

III. Undermining Consumer and Investor Protection

a. Weakening the Consumer Financial Protection Bureau

Congress created the Consumer Financial Protection Bureau (CFPB) to protect people from harmful and abusive financial practices. And that is exactly what the consumer bureau has done; in just six years, the agency has secured nearly $12 billion in relief for more than 29 million consumers.

Yet the consumer bureau has been under perpetual attack by many in the financial sector and by a significant number in Congress, with calls to fire the Bureau's Director and to weaken the agency. Proposed legislation before the Committee would cripple the agency, through a wide-ranging set of procedural changes, blocking its ability to regulate payday lending, auto finance, payment cards, unfair, deceptive, or abusive acts or practices, and barring the consumer agency from taking on abusive practices in arbitration agreements, agreements that often block a consumer from getting her day in court.[3] That would be a profound mistake.

The Financial Crisis of 2008 stripped millions of Americans of their livelihoods. Many consumers lost everything—their jobs, their money, their homes—in a matter of months, days, even hours. And those most affected were those that needed the most protection. The young, the elderly, our nation's service members and veterans, minority households and, in fact, all working families across our nation were brutally assaulted by the crisis.[4]

In an effort to curb the abusive practices that abounded pre-crisis, the Dodd-Frank Act created the Consumer Financial Protection Bureau. President Barack Obama appointed Richard Cordray as the Director of the Bureau and after a lengthy review, the Senate overwhelmingly confirmed him on a bi-partisan basis, 66-34.

Under the direction of Cordray, Ohio's former Attorney General, longtime champion of consumers, and a man of deep integrity, the CFPB has made huge strides in bringing to light and fighting abusive and deceptive behavior of financial institutions.

Through its supervision, enforcement, and rule-making, the CFPB is helping consumers get a fair shot in a financial system that too often seems to ignore basic values of trust and honesty.

To date, the CFPB has recovered $11.7 billion from credit card banks, payday lenders and other financial firms, providing relief for approximately 27 million consumers. The CFPB has also imposed $440 million in civil penalties to punish wrongful conduct and deter future harms.

The CFPB has created a consumer complaint database to ensure that consumers are heard. This complaint process provides consumers with a forum for comparing financial companies and helps the Bureau pinpoint the most dangerous practices. Consumers have filed nearly a million complaints through the system. The CFPB handled over 26,000 consumer calls every month, and over 3,500 companies have responded to consumer complaints submitted through the database.

---

[3] For background on arbitration clauses, see Michael S. Barr, *Mandatory Arbitration in Consumer Finance and Investor Contracts,* NEW YORK UNIVERSITY J. OF LAW AND BUSINESS vol. 11-4: 794-817 (2015).

[4] See, e.g., Michael S. Barr, NO SLACK: THE FINANCIAL LIVES OF LOW INCOME AMERICANS, Brookings Institution Press, 2012; Michael S. Barr and Daniel Schaffa, *Nothing Left to Lose?,* Washington Center on Equitable Growth Working Paper 2016-09 (Sept. 2016), http://equitablegrowth.org/working-papers/nothing-left-to-lose/.

The CFPB has made significant progress in protecting and empowering consumers that are among the most vulnerable to financial manipulation, including students, veterans and military families, and the elderly.

The CFPB has put together a toolbox to help students make informed choices about loans and payments. One resource in this toolbox is the Financial Aid Shopping Sheet, which the CFPB created together with the Department of Education to help students understand the types of loans they would qualify for. The CFPB has also fought against bad practices, including by recovering $480 million for students at for-profit chains who were deceived into taking predatory loans.

The CFPB has helped veterans and military families, who are too often taken advantage of, especially during overseas deployments of loved ones. The CFPB protects servicemembers from by practices by payday lenders and has recovered over $100 million in refunds. It has provided military families with materials to help educate them about financial services, including payday loans and mortgages. Through both enforcement and education, the CFPB has made significant strides to ensure the financial safety of our military servicemembers.

Older consumers are much more susceptible to financial abuse, and the CFPB has helped to shield the elderly from deceptive practices. According to a survey conducted last year, 6.8 million American citizens aged 65 or older—approximately 17% of America's senior citizens—have been "taken advantage of financially." Many older Americans may not even realize that they have been deceived. The CFPB has collaborated with the Federal Deposit Insurance Corporation to create the Money Smart for Older Adults, which help equip senior citizens with tools to detect and prevent financial exploitation. The CFPB has released other tips to protect the elderly from financial fraud and manipulation, and its enforcement actions are protecting older Americans from abuse.

American consumers cannot afford to see the CFPB weakened or its director fired.

Now some are arguing that the consumer agency's structure is unconstitutional, and the legislation being considered by this committee would strip the Director of removal protections designed to preserve the agency's independence. I recently joined others in filing an amicus brief in support of the consumer agency. The crux of the constitutionality question is this: Can an independent agency be run by a single director, or must it be run by a multi-member commission? The constitutional question is part of a broader fight that began during the debate over Dodd-Frank itself over whether to create the new consumer agency at all.

Opponents charge that the consumer bureau is too powerful because it is independent from the White House—its director can only be removed "for cause," unlike some agency heads, who work at the pleasure of the President, such as the Secretary of Housing and Urban Development. This question of the President's ability to remove the head of an independent agency may seem obscure, but it has some notoriety as a legal question, owing to a landmark 1935 case stemming from when Franklin D. Roosevelt tried to fire a Federal Trade Commission official. The Supreme Court held then that Congress could protect independent agencies from presidential impulses by including a "for-cause" removal provision in an agency's enabling statute.

There is no one-size-fits-all approach to creating a new agency, and Congress has properly experimented with a wide variety of agency designs since America's founding. Currently, a range of structures and organizational features exist across government agencies. Some, like the CFPB, the Office of the Comptroller of the Currency, and the Social Security Administration, are run by a single director, while others have commission structures of different shapes and sizes. Some agencies have fixed terms for directors and statutory removal protections, while others do not. Agencies are funded through a wide variety of mechanisms, including fees, fines and penalties, deposit insurance premiums, earnings on reserves, revolving funds, and permanent spending authorizations; in fact, most federal spending today does not occur through annual appropriations.

To promote the accountability and effectiveness of the consumer bureau, Congress established it as an independent agency with a single director. Congress also provided that the director could not be removed except for good cause. And as Congress has with other bank regulators such as the Federal Deposit Insurance Corporation, it provided the consumer agency with a funding stream without requiring annual congressional appropriations.

In other words, Congress sought to make the consumer bureau truly *independent*—to minimize the risk that the agency would be "captured" by the financial firms it regulates through pressure on Congress or on the President.

However, Congress wanted to make sure the consumer bureau would be, nonetheless, accountable to the public through their elected officials and other means.[5] As such, it has been subject to regular scrutiny by Congress, including regular reporting and more than 60 hearings thus far at which representatives of the agency have testified. And there are many other ways the agency is held accountable: unlike other bank regulators, it is subject to a statutorily imposed budget cap; it must undergo Government Accountability Office audits and Federal Reserve Board Inspector General oversight; it is subject to the strictures of the Administrative Procedures Act; by statute it must use cost-benefit analysis; and, as with other agencies, the bureau's actions are reviewable by the courts. Uniquely, the consumer agency's rules are subject to a potential veto by other regulators on the Financial Stability Oversight Council. The consumer bureau shares enforcement with state attorneys general, and must coordinate with the Federal Trade Commission and bank regulators, providing another check on its actions.

---

[5] See Michael S. Barr, *Accountability and Independence in Financial Regulation: Checks and Balances, Public Engagement, and Other Innovations,* LAW & CONTEMPORARY PROBLEMS 78(3): 119-128 (2015, symposium issue).

The consumer bureau is also directly accountable to the public in a number of ways. The bureau's consumer complaint database allows the public the opportunity to provide input directly into the agency's decision-making process. The bureau is required to consult with the public and small businesses; to establish and consult with advisory boards, including those representing military families, veterans, and older Americans; to have a public ombudsman for student loans; and to conduct regular public reviews of markets and its regulations. The agency has also held 38 public field hearings around the country since its inception.

These measures provide constitutionally sufficient and effective accountability to the public. Congress should not re-write the Dodd-Frank Act to make the CFPB's director removable at will, continually call for the Director's removal, subject it to annual appropriations, curtail its supervisory, enforcement or rule-writing authorities, or otherwise hamstring its ability to protect American consumers. The Consumer Financial Protection Bureau should be allowed to do its job.

b. Investor Protections

In the lead-up to the financial crisis, investors were mis-led by broker-dealers who sold them mortgage-backed securities and other investments that made little sense for them, but were advantageous to Wall Street firms. Retirement savers were offered products based on sales incentives to brokers, rather than their own needs. Managers of financial companies saw huge bonuses even as they drove their companies were driven off a cliff. Voices of reason and shareholder advocates were shunted to the side, while irresponsible behavior helped to crush the U.S. economy.

Proposed legislation under consideration today would stifle American investors, limit their voice, and expose American workers once again to abuse.

Remarkably, the proposed legislation would abolish the Department of Labor's fiduciary duty rule, which was designed to protect American workers from conflicted investment advice. Repeal of the rule would eat into the retirement savings of hard-working Americans and expose them to risks from products peddled to them more to pad the wallets of brokers than to meet the true investment needs of retirement savers. Investment advisors and brokers providing investment advice should meet the same high standard of care, one focused solely on the interests of their clients and customers.

The proposed legislation would limit shareholder's ability to vote annually on "say on pay" resolutions regarding management compensation, and burden proxy advisory firms working to give investors a "say on pay." The bill would also make it harder for shareholders to submit proposals for management reform, and burden the ability of shareholders to vote on boards of directors, such as the hotly contested fight expected over the Wells Fargo board, in the wake of the Wells Fargo fraud scandals.

The bill, through a variety of provisions, would reduce transparency and accountability in credit ratings, making it easier for credit rating agencies to dupe investors with flimsy ratings methodologies.

The bill would repeal authority for the SEC to restrict mandatory pre-dispute arbitration clauses, exposing investors to abuse without any right to their day in court.

Doubling down on a flawed strategy recently taken under the Congressional Review Act, the bill would eliminate the duty of oil and gas companies to report on their payments to foreign governments and the duty to be transparent about the use of minerals fostering conflict in Africa.

The proposed legislation would eliminate the designation of Financial Market Utilities (FMUs) and the authority to impose heightened prudential requirements on such entities. These FMUs are the essential plumbing of the financial system. They connect our financial markets and institutions and are responsible for managing the flow of trillions of dollars a day in transactions in payments, settlement and clearance systems. They are essential for the smooth functioning of every U.S. financial market—derivatives, securities, payments, and foreign exchange. Weakening oversight of FMUs will expose every financial institution in the United States to risks throughout the financial network.

The bill would eliminate prohibitions on conflicts of interest in securitizations, and by repealing the Volcker Rule, unleash bank holding companies to engage in proprietary trading and hedge fund investments without prudential safeguards. Structural reforms, including the Volcker Rule, are important for several reasons.

First, having a clear sense of who is in charge of what is vital when it comes to management and supervision, especially in times of stress. Structural reform can be used to help clarify lines of authority, and simplify structures of complex financial institutions.

Second, structural reform can help to bolster "horizontal buffers", which can help stop crises spreading when they start. Limits on the activities of retail deposit banks, restrictions on transactions between retail banks and their affiliates, independent capital, and caps on counterparty credit exposures can help minimize contagion. The core banking services upon which everyday economic life depends would be better protected.

Third, paying attention to structure will help to resolve companies when they get into distress. As discussed above, the FDIC is developing a "single point of entry" model for resolution that would allow it to wind down a complex financial conglomerate by separating it into a holding company with "resolution-ready" capital and equity, while permitting solvent subsidiaries to continue to operate. Structural reform will make it much more likely that such resolution plans would work in a crisis.

The US has long used the bank holding company structure to try to separate banking from other financial activities within a complex group. Recent reforms under the Dodd-Frank Act strengthened the wall between banks and other parts of a financial group, and pushed proprietary trading and significant hedge fund investing outside the group entirely.

None of these approaches is perfect, and all are evolving. Structural reform involves difficult trade-offs: introducing rigidity may decrease efficiency and increase the risks faced by individual banks, while reducing the potential harm done to the system as a whole. In response to these trade-offs, the US has permitted a wide range of financial activities within bank holding companies, but has also insisted structural safeguards.

Ring fencing by itself, of course, will not bring financial stability. We had forms of ring fencing before the crisis, as in the US, where it blinded regulators to the dangers of shadow banking. As a result, non-bank financial institutions engaged in increasingly risky activities with too little oversight and far too much leverage. So structural reforms need to be part of a broader change in supervision and capital requirements, including resolution procedures for large financial companies regardless of their corporate form, and reforms to derivatives, repo and other markets. Ring fencing is no excuse to avoid regulating non-bank firms and markets that can pose a risk the financial system.

The proposed legislation hamstrings SEC enforcement against bad actors and frees fraudsters to prey on investors once again. It also weakens clawback provisions designed to keep executive officers focused on sound accounting company-wide.

In sum, the proposed legislation crushes investor hope, mocks investor opportunity, and undermines the transparency, honesty, and trust essential for capital formation.

IV. The Path of Reform

The Dodd-Frank Act laid a firm foundation for a more resilient financial sector, one that works for American families, instead of exposing us all to needless risk and harm. Since enactment, a new and highly effective Consumer Financial Protection Bureau has been built from scratch. New rules governing derivatives have been implemented to bring trading out of the shadows and reduce risk through central clearing, capital and margin requirements. A resolution authority has been put in place to deal with failing firms so we are no longer faced with the devastating consequences of the failure of a firm like Lehman Brothers or the untenable bailouts of firms like AIG. Regulators have the ability to designate large firms for supervision by the Fed, so the financial sector can no longer avoid stringent regulation just by altering their corporate form. The largest firms have to hold a lot more equity capital as a buffer against losses, and the Volcker Rule, heightened prudential supervision, stress tests and other measures are reining in risk.

The U.S. financial system is more resilient than it was in 2008. But there's still much work to do.[6]

---

[6] See, e.g., Michael S Barr, *The Financial Crisis and the Path of Reform,* 29 YALE J. ON REG. 91-119 (2012); Michael S. Barr, ed., FINANCIAL REFORM: PREVENTING THE NEXT CRISIS, The Russell Sage Foundation Journal of the Social Sciences, Vol. 3:1 (Jan. 2017).

We need to keep pushing for stronger reforms of the largest, most complex banks and other financial institutions. Stress testing and new capital rules have dramatically increased the levels of capital at the largest firms, but we do not yet know whether these levels are sufficiently robust to withstand a severe financial crisis. A bank liability tax could help further reduce incentives to take on risky short-term debt. Shadow banking activities, repo and securities financing transactions, and short-term funding need to be made safer with strong margin and collateral rules. We need to better align manager's incentives with financial stability, by putting banker bonuses at risk when a firm's capital level drops below specified levels or when the firm is hit with fines or sanctions.

More broadly, Fannie Mae and Freddie Mac remain in conservatorship without a decision about long-term housing finance; money market mutual funds remain susceptible to runs; certain high-frequency trading strategies and market structure problems threaten financial stability and undermine the fairness of our markets; and critical investor protection authorities have gone unused.

To be clear: the financial system is safer, consumers and investors better protected, and taxpayers more insulated, than they were in 2008—by a lot.

But that is not enough. We need to stay on the path of reform to make the financial system safer, fairer, and better harnessed to the needs of the real economy. We must not roll back the essential reforms put in place in the wake of the financial crisis. We must not weaken the independence of agencies and make them more prone to industry capture. Rather, we need to keep pushing for a financial system that works for all of us.