Center for American Progress

May 20, 2015

The Honorable Richard Shelby
Chairman
Committee on Banking, Housing,
and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Shelby and Ranking Member Brown:

This week, the Senate Banking Committee will consider the *Financial Regulatory Improvement Act of 2015*—a comprehensive piece of legislation that rolls back many important protections for American consumers and rules governing the health and stability of our financial system.

The Center for American Progress, a nonprofit, independent and nonpartisan policy institute dedicated to improving the lives of Americans, through bold, progressive ideas and action, asks members of the committee to reject what it believes is an aggressive assault on the sensible laws and regulations Congress passed in order to prevent a repeat of the financial crisis. Unless significantly amended and improved, the *Financial Regulatory Improvement Act* could harm the public and provide little real help to America's small, community banks. In fact, it could even further cement the advantages enjoyed by large banks.

Despite our opposition to the bill as a whole, there are some sections of the bill with which we agree or which we do not oppose. For this reason, we encourage the committee to revisit its strategy on these matters and to consider more targeted solutions to the real problems that continue to exist in the U.S. financial system. It is possible to develop a proactive agenda to assist small and rural banks and the manufactured housing sector through approaches that do not undermine consumer protections, and we would welcome more discussions in that direction.

While there are multiple sections of the bill that undermine the safety and soundness of the financial system, we would like to highlight our most important concerns.

It weakens the ability-to-repay rule

The *Dodd-Frank Wall Street Reform and Consumer Protection Act*'s ability-to-repay rule codifies a basic business axiom that should be common sense but was largely ignored during the run-up to the financial crisis: A lender should not make a home loan unless it has reasonably determined that the borrower can afford to pay the entire loan back. Section 106 of *The Financial Regulatory Improvement Act* would once again enable creditors to make loans without considering whether the loan is affordable to the borrower by allowing a mortgage made by a creditor of any size to qualify for Qualified Mortgage status, meaning consumers have no legal rights against the lender, as long as a creditor holds the mortgage in portfolio. While this Qualified Mortgage definition would not apply to interest-only or negatively amortizing mortgages, few other consumer protections remain in the definition.

Proponents of this bill argue that because loans are held on portfolio, lenders have an incentive to ensure a borrower will succeed. But history has shown otherwise. Some of the most egregious predatory lenders, such as Countrywide and Washington Mutual, kept a considerable number of their risky loans on their portfolios. Furthermore, under this bill, a loan retains Qualified Mortgage status when the originator sells it to another creditor, which reduces the originator's incentive to lend safely.

In sum, enacting this provision would give lenders legal immunity to issue the sort of risky, high-cost loans that triggered the financial crisis.

It disadvantages families living in manufactured housing

Section 108 would strip critical protections for buyers of manufactured homes, many of whom are rural, lower-income, and/or seniors, by raising the cost threshold for a loan to receive the enhanced protections that Congress put in place for high-cost loans, such as prohibiting balloon payments. As a result, manufactured housing residents would pay much higher interest rates before receiving the same protections that residents of site-built homes enjoy.

The bill also would make it easier for a manufactured home salesperson to steer a consumer who could qualify for a more affordable loan into a higher-cost mortgage. A recent investigation by *The Seattle Times* revealed the conflicts of interest, kickbacks, and upselling that run rampant through the manufactured housing finance sector. Eliminating the Dodd-Frank protections would only make these practices more prevalent.

It weakens the requirement to provide consumers with accurate disclosures regarding their mortgages

By creating a safe harbor for lenders who make a good faith effort to comply with the new integrated *Truth in Lending Act* and *Real Estate Settlement Procedures Act*, or TILA-RESPA, disclosure requirements, this bill would let lenders off the hook for misleading or inaccurate disclosures about the terms of their loans. What's more, this erosion of a critical consumer protection is entirely unnecessary since the Consumer Financial Protection Bureau, or CFPB, already has the authority to consider good faith efforts or provide flexibility without suspending a lender's legal responsibility to provide accurate disclosures under the old regime. If the CFPB believes lenders need more time to implement the new disclosures, it has the authority it needs to delay the new regime or allow lenders to choose between the old and new regimes during a grace period.

It hamstrings financial regulators

Robust oversight could have prevented the financial crisis, but regulatory capture and a lack of appropriate tools prevented this oversight from taking place. Dodd-Frank gave regulators important new oversight and regulatory tools, but this bill would make it harder for regulators to do their job of safeguarding the U.S. financial system. For example, the bill includes burdensome requirements to revisit financial protection rules wholesale on a regular basis under the *Economic Growth and Regulatory Paperwork Reduction Act* even though the Dodd-Frank rules are brand new and only 60 percent have even been finalized.

Additionally, the bill provides financial institutions with a path to make routine challenges to their examinations by regulators through a new ombudsman office. This would lead to increased burden on regulators and discourage them from appropriately careful oversight practices.

It impedes efforts to monitor and manage systemic risk

By raising the minimum asset value at which a bank holding company becomes automatically eligible for enhanced supervision from the Federal Reserve from $50 billion to $500 billion, the bill exempts all but the six largest bank holding companies from oversight that specifically takes account of riskiness, complexity, and interconnectedness. This new threshold ignores history, as Bear Stearns had about $400 billion in assets when it failed, and Countrywide and Washington Mutual fell within this band as well. The new enhanced supervision tools such as stress tests, capital requirements, and short-term debt limits were designed to make the U.S. financial system safer. Drastically reducing the number of banks subject to this supervision will take us in the opposite direction.

The bill also includes measures to make the Financial Stability Oversight Council less effective by complicating the process for the designation of systemically important nonbanks and bank holding companies. The process already allows for hearings and for judicial review, but the bill will require redesignation every five years, opening the door to repeated litigation of stale issues. Making it harder to oversee such entities is a particularly bad idea given the additional risks posed by insufficient information. For example, more information about the derivative trading subdivision of the American International Group, or AIG—a systemically important nonbank—could have prevented the need for the federal bailout of that company.

Finally, by exempting bank holding companies with assets less than $50 billion from stress tests, the bill would create a blind spot for the Federal Reserve by depriving it of information on how banks with assets collectively totaling more than $1.4 trillion would fare if financial and real economy conditions turned against them. Furthermore, by exempting banks with assets less than $10 billion from the Volcker Rule—which prohibits banks from engaging in proprietary trading and other high risk behaviors—it invites financial engineers to set up shop in banks of this size. As the London Whale trades demonstrated, traders can take positions in complicated products, such as synthetic credit derivatives, and then disguise the risks until losses mount.

Beyond the objections described above, we also have serious concerns about a number of other sections, such as provisions that would undermine measures to prevent appraisal fraud, prevent homeowners from receiving advance notice of their mortgage costs, and delay publication of crucial information collected under the *Home Mortgage Disclosure Act*, among others.

Thank you for your consideration of our views. We look forward to continued dialogue on these and other issues affecting U.S. housing and financial markets, the health of the economy, and most of all, the well-being of America's families.

Sincerely,

Julia Gordon
Senior Director, Housing and Consumer Finance
Center for American Progress