Statement of the U.S. Chamber of Commerce

ON: Legislative Proposals for a More Efficient Federal Financial Regulatory Regime

TO: House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit

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DATE: September 7, 2017

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Chairman Luetkemeyer, Ranking Member Clay, and members of the Subcommittee on Financial Institutions and Consumer Credit. My name is Tom Quaadman, executive vice president of the Center for Capital Markets Competitiveness (CCMC) at the U.S. Chamber of Commerce (Chamber).

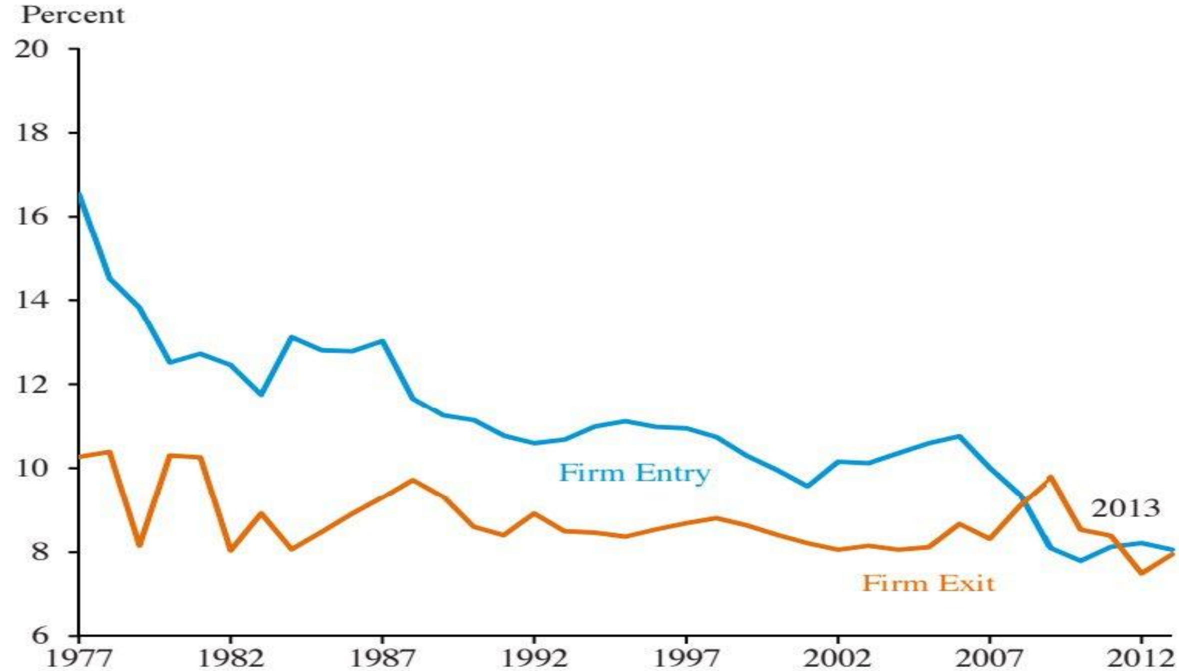
This hearing, "Legislative Proposals for a More Efficient Federal Financial Regulatory Regime," is an important opportunity to address critical matters and fix shortfalls in the federal financial regulatory regime.

America has the most diverse and deepest capital markets in world and businesses use many different types of financing to grow. Entrepreneurs use consumer financial products such as credit cards and home equity loans, Main Street businesses may use bank loans, large businesses will use the debt and equity markets, while businesses that trade overseas will use globally active banks. This diversity in both financing and business organization is unique in the world and has enabled the American economy to be the most prosperous in world history.

Capital markets and financial institutions that fuel economic growth need to be properly regulated to ensure a transparent and reliable structure for businesses, investors and consumers. While policymakers have been laser-focused on stability since 2008, we have lost sight of the fact that you can't have stability without growth. Now that countless rules and regulations have been implemented and the financial crisis is almost a decade behind us, it is critical that we address the second component of a robust economy: growth.

Economic growth has consistently been below historic growth rates since 2008. Numerous reports, ranging from the Census Bureau to the recent Economic Innovation Group report, *Dynamism in Retreat*, demonstrate that business creation is sputtering to historic lows and struggling to outpace business destruction. We are losing the dynamism and creativity that has made our economy unique and enabled it to thrive. As we know, a thriving economy creates jobs, expands businesses, allows for greater capital investment, and promotes financial security. To regain this vital progress, we need to reverse this trend quickly.

Figure 5-3
Firm Entry and Exit Rates in the United States, 1977–-2013



Source: U.S. Census Bureau, Business Dynamics Statistics.

There are many reasons for these troubling trends, but the financing of businesses and consumers is a part of the problem. Fortunately, several of the bills under consideration by the Subcommittee are a part of the solution. These bills would help to restore the financing needed for Main Street businesses and their consumers, while ensuring markets are well-regulated.

We thank the Subcommittee for the opportunity to testify and are pleased to offer our views on the legislation below.

<u>H.R. 3312, the Systemic Risk Designation Improvement Act</u>

The U.S. business community depends on banks of all sizes to finance long-term growth, manage cash flow, and help make payroll. While a range of issues impact business financing, we wish to confine our comments to the regulations affecting mid-size and regional banks that are near or above the $50 billion systemically important financial institution ("SIFI") threshold, but not designated as global systemically important banks ("G-SIBs"). Many regulations affecting G-SIBs merit critical examination – for example, those domestic prudential regulations substantively more stringent than the internationally-negotiated standard – but not in the context of today's hearing.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") established an arbitrary threshold that banks with over $50 billion in assets are deemed a SIFI. These banks are subject to enhanced prudential and supervisory standards by the Board of the Governors of the Federal Reserve System ("Federal Reserve"). The enhanced standards include, but are not limited to: stress-test and capital plan requirements, risk-based and leverage capital requirements, liquidity standards, requirements for overall risk management, and the periodic submission of resolution plans.

SIFI Regulations Are Not Appropriate for Mid-size and Regional Banks

Mid-size and regional banks are pillars of the business community and the broader U.S. economy. They are highly integrated into their local communities, and generally operate strong retail branch networks across several states. Perhaps most importantly, mid-size and regional banks follow a traditional, low-risk business model: the taking of customer deposits and making of loans to consumers and small and mid-size businesses. In addition to directly supporting Main Street, mid-size and regional banks are also important liquidity providers to other financial institutions that support small businesses. Analysis by the Office of Financial Research confirms that mid-size and regional banks simply do not generate or implicate significant systemic risk.[1]

In this context, the application of the enhanced prudential and supervisory standards required by under the Dodd-Frank Act is entirely without warrant. These enhanced regulations are intended to address the risks associated with large, complex, globally-interconnected financial institutions. By indiscriminately applying the enhanced standards to mid-size and regional banks that do not create or implicate systemic risk, the arbitrary asset threshold has imposed enormous and entirely avoidable burdens on the U.S. financial system, the business community, and the broader economy. As detailed below, these burdens are particularly pronounced with respect to small and mid-size business lending.

[1] Office of Financial Research, U.S. Department of the Treasury, BCBS Systemic Risk Importance Indicators Reported by Large U.S. Bank Holding Companies (Feb. 12, 2015), *available at* https://www.financialresearch.gov/briefs/2015/02/12/systemic-importance-indicators-for-us-bank-holding-companies/.

The State of Small and Mid-size Business Lending

Notwithstanding suggestions that overall bank lending is strong, granular analysis of government data and private studies reveals significant constraints in lending to small and mid-size businesses. Across all depository institutions insured by the Federal Deposit Insurance Corporation (FDIC), the total balance of commercial and industrial (C&I) loans smaller than $1 million has increased only 0.188% percent since 2008 – an absolutely dismal statistic given the 26.1% increase in U.S. gross domestic product.[2] The total balance of nonfarm nonresidential (*e.g.,* commercial real estate, or CRE) loans has *declined* by 24.86% in the same time period.[3]

Community Reinvestment Act (CRA) data on small loans to businesses is even more alarming. According to the most recent report by the Federal Financial Institutions Examination Council, originations and purchases of small business loans reported under the CRA declined 44% from 2008 to 2015, from 10.75 million to 6.07 million.[4] Troublingly, business loans less than $100,000 were disproportionately responsible for this decline. These smaller loans – often required by the self-employed, businesses with only a handful of employees, and startups – are perhaps most indelibly linked to the American dream of starting a small business.

Banks from around the nation have told us that the regulatory compliance burdens for loans are the same for a $100,000 loan as for a $1 million dollar loan. These regressive regulatory encumbrances create disincentives for banks to help small businesses.

Arguments that these declines reflect weak demand for small business loans, or that demand is being satiated by alternative, nonbank lenders, are unpersuasive. In April 2017, the twelve Federal Reserve Banks reported the results of their annual survey of small business credit among employer firms.[5] While finding "widespread demand" for small loans – 45 percent of firms applied for funding – there were substantial financing shortfalls. 60 percent of firms obtained less than the amount for

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[2] Federal Deposit Insurance Corporation, Loans to Small Businesses and Farms, FDIC-Insured Institutions, 1995-2016, *available at* https://www.fdic.gov/bank/analytical/qbp/timeseries/small-business-farm-loans.xls.

[3] *Id.*

[4] Federal Financial Institutions Examination Council, Community Reinvestment Act National Aggregate Reports, 1 Originations and Purchases for Small Business and Farm Loans, *available at* https://www.ffiec.gov/craadweb/national.aspx.

[5] Federal Reserve Banks, 2016 Small Business Credit Survey: Report on Employer Firms (Apr. 2017), *available at* https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf.

which they had applied, and almost a quarter of small businesses were unable to obtain any financing at all. Last month, the Federal Reserve Banks specifically reported on the financing and credit experiences for startup firms – businesses five years old or younger.[6] The report identified even more significant financing challenges for startup firms. This is particularly troubling, given the outsized role startups play in driving economic growth.

In nation-wide discussions with small businesses and their banks it is clear that there is demand for more capital. However, the demand isn't readily apparent as businesses are disinclined to apply for a loan because of the obstacles in obtaining a loan.

The anemic state of small and mid-size business lending merits the utmost concern from policymakers. Small businesses have long been recognized as key drivers of U.S. innovation, productivity, and job creation – they create over 60% of net new private-sector jobs, employ nearly half of America's workforce, and produce 16 times more patents per employee than larger firms.[7]

Impact of Enhanced Prudential and Supervisory Standards on Lending

Recent scholarly research traces the stagnation and decline in small and mid-size business lending at U.S. banks – and the resulting constraints on job creation and economic growth – directly to the capital and liquidity regime implemented in the wake of the financial crisis. In May 2017, a team of economists concluded that "small business lending in all size categories is statistically significantly less at stress-tested banks" – consistent with the hypothesis that stress-tested banks reduce the supply of credit in order to reduce bank risk – after analyzing Community Reinvestment Act loan origination data.[8] Researchers at The Clearing House came to the same conclusion after analyzing loan data in Federal Reserve and FDIC call reports.[9]

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[6] Federal Reserve Banks, 2016 Small Business Credit Survey: Report on Startup Firms (Aug. 2017), *available at* https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-StartupFirms-2016.pdf.

[7] Office of Advocacy, U.S. Small Business Administration, Frequently Asked Questions About Small Business (Aug. 2017), *available at* https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf. Statistics on patents per employee can be found in the March 2014 edition of this document, *available at* https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf.

[8] Viral V. Archarya, Allen N. Berger, & Raluca A. Roman, Lending Implications of U.S. Bank Stress Tests: Costs or Benefits?, J. of Fin. Intermediation (forthcoming; last rev. Aug. 18, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2972919.

[9] The Clearing House, Are the Supervisory Bank Stress Tests Constraining the Supply of Credit to Small Businesses? (May 2017), *available at* https://www.theclearinghouse.org/-

In March 2017, researchers at Harvard Business School linked the decline in small business lending at U.S. banks to stress tests' relatively severe assumptions about the losses on small business loans, as well as the sheer amount time and effort required of senior managers to comply with the full array of regulations implemented after the financial crisis.[10]

Researchers' conclusions are supported by reports from the business community. In 2016, the Chamber surveyed over 300 corporate financial professionals on their core financial services needs and the indirect regulatory impact of newly adopted financial regulations.[11] Almost 4 in 5 respondents reported they have been affected by changes in the financial services markets, and 50 percent specifically identified increased bank capital charges as having increased their costs and created challenges with respect to financing. Troublingly, one-third of companies expect the regulatory effect to worsen over the next three years.

The Chamber earlier this year released a survey, in conjunction with Morning Consult, on small business lending.[12] The survey of over 500 small businesses found that 77 percent of small businesses think that the resources provided by banks are important to success. A majority felt that affordable credit had not improved in the last year, and 51 percent of small businesses strongly believe that regulations are inhibiting lending to small businesses. 68 percent of small businesses with less than 10 employees do not expect to be able to take another loan or line of credit over the next four years.

H.R. 3312, the Systemic Risk Designation Improvement Act, replaces the arbitrary and groundless $50 billion asset threshold with the Federal Reserve's existing methodology to identify global systemically important bank holding companies

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/media/tch/files/research%20content/2017%2005%2011%20are%20supervisory%20bank%20stress%20tests%20constraining%20the%20supply%20of%20credit%20to%20small%20business%20lending.pdf?la=en.

[10] Brian S. Chen, Samuel G. Hanson, & Jeremey C. Stein, The Decline of Big-Bank Lending to Small Business: Dynamic Impacts on Local Credit and Labor Markets (March 2017), *available at* http://www.people.hbs.edu/shanson/BigBankSmallBiz_paper_20170317_FINAL.pdf.

[11] Center for Capital Markets Competitiveness, Financing Growth: The Impact of Financial Regulation (June 16, 2016), *available at* https://www.uschamber.com/sites/default/files/documents/files/financing_growth_report_16_june_16.pdf.

[12] Morning Consult, Survey of Small Business Executives, Mar. 30, 2017, *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Financial-Services-Survey-For-Small-Businesses-Growth-and-Credit-Go-Hand-in-Hand.pdf?x48633.

subject to a capital surcharge, codified at 12 C.F.R. part 217.[13] This methodology assesses an individual institution on twelve specific systemic indicators across five broad categories: size, interconnectedness, substitutability, complexity, and cross jurisdictional activity.[14] Given the explicit objective of the enhanced standards is to prevent or mitigate risks to financial stability, the wisdom of H.R. 3312's determinative process is self-evident: regulations intended to address systemic risk should be applied with reference to an institution's actual risk profile. This concept – *tailoring* – enjoys broad bipartisan support and is a core principle of good governance.[15]

Such an approach, based upon risk profile and activities, is a much cleaner means to identify and deal with systemic risk. This also provides a balance to allow for financing activities that support growth, thereby promoting a stronger and more stable economy and financial system. The SIFI thresholds in the Dodd-Frank Act, though well intentioned, were painted with a broad brush and have failed at regulating systemic risk, while depriving Main Street businesses of the resources needed to grow.

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[13] As implemented by the Federal Reserve, the G-SIB surcharge is a deeply flawed rule that exemplifies an overly complex, illogical, and unjustifiably burdensome approach to prudential regulation. The Department of the Treasury has further observed that the U.S. G-SIB surcharge was calibrated to be roughly *double* the negotiated international standard, and is facially inconsistent with efforts to bolster the global competitiveness of the U.S. institutions. The incorporation by reference of the G-SIB identification methodology must not be interpreted as an implicit endorsement of the rule, nor dissuade policymakers from appropriately recalibrating the surcharge.

[14] 12 C.F.R. § 217.404. The twelve specific systemic indicators and their respective weightings are: total exposures (20%), intra-financial system assets (6.67%), intra-financial system liabilities (6.67%), securities outstanding (6.67%), payments activity (6.67%), assets under custody (6.67%), underwritten transactions in debt and equity markets (6.67%), notional amount of OTC derivatives (6.67%), trading and available-for-sale securities (6.67%), Level 3 assets (6.67%), cross-jurisdictional claims (10%) and cross-jurisdictional liabilities (10%).

[15] *See, e.g.,* Exec. Order 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011) (requiring the executive departments to "(1) propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify); (2) tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations; (3) select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity)"). *See also Examining the Regulatory Regime for Regional Banks: Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs* 114th Cong. 32 (prepared statement of Daniel K. Tarullo, Governor, Board of the Governors of the Federal Reserve System) (stating "the Federal Reserve aims not only to achieve the Dodd-Frank Act goal of mitigating risks to U.S. financial stability, but to do so in a manner that limits regulatory costs and the expenditure of supervisory resources where not needed to promote safety, soundness, and financial stability.").

Regulations that unduly discourage small and mid-size business lending are equally harmful, no matter whether they apply to a large bank or a small one. However, the plight of mid-size and regional banks, which simply do not present systemic risk, is particularly unacceptable. The Chamber urges this Subcommittee to support the Systemic Risk Designation Improvement.

The Facilitating Access to Credit Act

We are pleased to see Representative Royce's introduction of the Facilitating Access to Credit Act because this legislation is critical to correct the unintended application of the Credit Repair Organizations Act of 1996 (CROA).

The Chamber believes that an efficient and fair consumer financial marketplace is one in which regulators, through supervision and enforcement, root out and deter fraud and predation. At the same time, regulators should always endeavor to fulfill their important consumer protection mission in a manner that maximizes consumers' access to diverse products and services offered on competitive terms, and that promotes innovation. Importantly, financial regulators should recognize that as of 2013, almost one-in-three Americans was unbanked or underbanked, and accordingly should make good on their promise to "increas[e] the participation of unbanked and underbanked households in the financial mainstream."[16]

One way to improve consumer participation in mainstream financial services is to empower Americans to take greater charge of their financial well-being by, for example, regularly reviewing their credit reports for irregularities. Since we live in a credit-based economy, healthy credit scores are crucial for consumers to buy a home, car, or other necessities, and to create overall financial security for themselves and their family. For these reasons, credit bureaus go to great lengths to work with consumers with less than ideal credit or thin credit files, and have robust financial literacy programs to education consumers about how to achieve good credit.

Unfortunately, the overbroad nature of CROA has had the effect of chilling the credit bureaus from further innovating and providing valuable credit improvement education and programs. In 2014, the Ninth Circuit Court of Appeals extended CROA's reach to cover even credit monitoring services in *Stout vs. Freescore.*

CROA was intended by Congress to deter "[c]ertain advertising and business practices of some companies engaged in the business of credit repair services have

[16] FED. DEPOSIT INS. CORP., 2013 FDIC NAT'L SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 4 (2014).

worked a financial hardship upon consumers, particularly those of limited economic means and who are inexperienced in credit matters."[17] However, the overly broad statutory language has unintentionally swept in valuable credit education and identity theft protection services, in many instances, forcing consumers to jump through specific hurdles that were designed specifically to prevent credit repair scams. CROA is a strict-liability statute that includes, among other protections, a three-day waiting period before services can be delivered. This waiting period is meant to give consumers time to 'cool off' before they agree to proceed with credit repair. However, that same three day waiting period must also be observed by the bureaus and others when a consumer asks them the simple question: "How can I improve my credit score?"

Even the Federal Trade Commission (FTC), the agency tasked with enforcing CROA, stated in congressional testimony the FTC "sees little basis on which to subject the sale of legitimate credit monitoring and similar educational products and services to CROA's specific prohibitions and requirements, which were intended to address deceptive and abusive credit repair business practices."[18] We agree, which is why we support Representative Royce's Facilitating Access to Credit Act and thank the Subcommittee for considering this important piece of legislation.

H.R. 2539, The FCRA Liability Harmonization Act

H.R. 2359, FCRA Liability Harmonization Act, would align the Fair Credit Reporting Act (FCRA) with other financial consumer protection laws by capping the amount of statutory damages allowed in class action lawsuits at one percent of a defendant's net worth or $500,000, whichever is less, and eliminating the possibility of punitive damages. The bill would alleviate the uncertainty of the amount of liability that businesses face in class action lawsuits. The legislation would provide economic stability for a wide range of impacted businesses by reducing the potential for crippling and catastrophic class action damage awards.

Other financial consumer protection statutes, such as the Electronic Fund Transfer Act (EFTA), the Fair Debt Collection Practices Act (FDCPA), the Equal Credit Opportunity Act (ECOA), and the Truth in Lending Act (TILA), place similar caps on damage amounts in class action litigation. When the FCRA was enacted, it only permitted consumers to seek actual damages and did not permit statutory or

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[17] 15 U.S.C. § 1679.

[18] *Oversight of Telemarketing Practices and the Credit Repair Organizations Act (CROA): Hearing Before the Senate Committee on Commerce, Science, and Transportation,* 110th Cong. 8 (2007) (written statement of Lydia B. Parnes, Dir., Bureau of Consumer Prot., Fed. Trade Comm'n).

punitive damages in a private right of action and, therefore, caps on damage awards were unnecessary. As FCRA class action litigation has become more prevalent, however, Congress should appropriately revisit the liability structure of the FCRA.

Bringing the FCRA in line with other financial consumer protection statutes is especially important in light of the current trend of FCRA class action litigation against employers. In recent years, FCRA class action lawsuits have been filed against businesses from a variety of sectors including fast food restaurants, grocers, retailers, universities, and transportation companies. These employers are particularly victimized by lawsuits where consumer harm is not at issue but rather the allegations are highly technical violations related to their use of consumer reports for employment screening. With the possibility of unlimited damages and grave reputational harm, employers and others often settle instead of defending their practices in court.

Now is the time to revisit the FCRA and establish reasonable limits on class action liability. Even with the proposed limits on total economic damages in FCRA class actions, the FCRA would permit consumer redress, but close the loophole for trial attorneys suing over merely technical violations. Under the FCRA Liability Harmonization Act, consumers could continue to bring individual cases seeking damages for actual harm and the costs of litigation. The tool of class action litigation would also still be available for violations impacting a broader population. We support the FCRA Harmonization Act because it fulfills the spirit of FCRA – preventing actual consumer harm – while protecting businesses from frivolous lawsuits.

The TRID Improvement Act

Finally, the Chamber also supports a bill expected to be introduced by Representative French Hill entitled the TRID Improvement Act.

Small businesses, particularly new start-ups, are often funded through consumer financial products. Home mortgages and home equity loans are an important part of the financial mosaic that helps to provide capital to new businesses fueling economic growth.

The Truth In Lending Act and Real Estate Settlement Procedures Act Integrated Disclosure Rule ("TRID rule"), promulgated by the Consumer Financial Protection Bureau ("CFPB"), is designed to combine, integrate and streamline disclosures in the origination and closing of a mortgage. The TRID Rule, however, had vague requirements that created a chilling effect on home sales and mortgages. For years leading up to the finalization of the TRID rule, we explained the difficulty of system implementation and delays due to the limited amount of vendors in the marketplace. The CFPB finally delayed the implementation date slightly, but institutions still need clarification. Although the TRID rule was finalized almost two years ago, financial institutions are still trying to get answers and correct interpretations of the rule from the CFPB.

While we generally encourage streamlined and concise disclosures, the unintended consequences of the TRID Rule have had adverse impacts upon the housing industry, creating both regulatory uncertainty and potential civil liability for mortgage providers. As a consequence, the TRID rule has harmed the ability of entrepreneurs to tap home equity to fuel start-ups. The CFPB has also acknowledged problems with the implementation of TRID.

The TRID Improvement Act would create a cooling off period and provide a means of addressing minor errors. We believe that this is a common-sense step to try and achieve the goals of TRID and ensuring a balance in the marketplace that can help both American homeowners and job creators. While we support this common-sense bill, we urge Congress to provide additional cure language under TRID to assist with TRIC cures that do not fit neatly under the TRID or TILA cure provisions. We would welcome the opportunity to work with Congress on a broader "cure" package to provide much-needed clarity for the marketplace.

We appreciate the work of the Financial Institutions and Consumer Credit Subcommittee on these important bills and issues. The Chamber is prepared to work with the Subcommittee on a bipartisan basis to achieve the reforms necessary to help American businesses and consumers. We must be successful in these efforts to spur economic growth to stimulate investment and create good paying jobs.