

Client Alert

April 27, 2017

House Financial Services Committee Holds Hearing on the Financial CHOICE Act of 2017

On April 26, 2017, the Financial Services Committee of the U.S. House of Representatives (the “Committee”) held a hearing entitled “A Legislative Proposal to Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs.” The purpose of the hearing was to examine the discussion draft of the “Financial CHOICE Act of 2017” (or “CHOICE Act 2.0”) which was unveiled by Committee Chairman Rep. Jeb Hensarling (R-TX) on April 19, 2017.¹ CHOICE Act 2.0 repeals and makes fundamental changes to many components of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). It is anticipated that this draft legislation will set the agenda for consideration of financial regulatory reform initiatives in the current Congress.

The Committee heard testimony from the following witnesses:

- Mr. Peter J. Wallison, Senior Fellow and Arthur F. Burns Fellow, Financial Policy Studies, American Enterprise Institute²
- Dr. Norbert J. Michel, Senior Research Fellow, Financial Regulations and Monetary Policy, The Heritage Foundation³
- The Honorable Michael S. Barr, Professor of Law, University of Michigan Law School⁴
- Mr. Alex J. Pollock, Distinguished Senior Fellow, The R Street Institute⁵
- Dr. Lisa D. Cook, Associate Professor, Economics and International Relations, Michigan State University⁶
- Ms. Hester Peirce, Director, Financial Markets Working Group and Senior Research Fellow, Mercatus Center, George Mason University⁷
- Mr. John Allison, Former Chief Executive Officer, BB&T⁸

¹ A section-by-section summary of the draft bill is available here: https://financialservices.house.gov/uploadedfiles/042617_fc_memo.pdf. The full text of the discussion draft is available here: https://financialservices.house.gov/uploadedfiles/choice_2.0_discussion_draft.pdf.

² For Mr. Wallison’s written testimony, please see: <https://financialservices.house.gov/uploadedfiles/hhrq-115-ba00-wstate-pwallison-20170426.pdf>.

³ For Dr. Michel’s written testimony, please see: <https://financialservices.house.gov/uploadedfiles/hhrq-115-ba00-wstate-nmichel-20170426.pdf>.

⁴ For Prof. Barr’s written testimony, please see: <https://financialservices.house.gov/uploadedfiles/hhrq-115-ba00-wstate-mbarr-20170426.pdf>.

⁵ For Mr. Pollock’s written testimony, please see: <https://financialservices.house.gov/uploadedfiles/hhrq-115-ba00-wstate-apollock-20170426.pdf>.

⁶ For Dr. Cook’s written testimony, please see: <https://financialservices.house.gov/uploadedfiles/hhrq-115-ba00-wstate-lcook-20170426.pdf>.

⁷ For Ms. Peirce’s written testimony, please see: <https://financialservices.house.gov/uploadedfiles/hhrq-115-ba00-wstate-hpeirce-20170426.pdf>.

⁸ For Mr. Allison’s written testimony, please see: <https://financialservices.house.gov/uploadedfiles/hhrq-115-ba00-wstate-jallison-20170426.pdf>.

Client Alert

The hearing served as a political platform for members of both parties to either criticize the draft legislation, or praise it. No members appeared to cross party lines regarding their support for or opposition to the bill. Below is a summary of the topics discussed at the hearing.

AREAS OF BIPARTISAN AGREEMENT

It is widely viewed that no financial reform will be able to pass Congress without the support of some Democrats, due to the supermajority voting requirement for legislation in the Senate. As a result, parsing out the areas of potential agreement between the parties may be helpful for predicting which aspects of CHOICE Act 2.0 may actually become law. Despite the clear ideological lines, there were some areas of apparent agreement.

- Rep. Brad Sherman (D-CA) requested that CHOICE Act 2.0 be split up into multiple pieces of legislation. He noted that the draft legislation is a combination of many different bills, 12 of which have majority support from both Democrats and Republicans. He provided two examples: a bill preserving access to manufactured housing and the Mortgage Choice Act.
- Rep. Gwen Moore (D-WI), agreeing with earlier statements by Rep. Randy Hultgren (R-IL), stated that a more workable distinction between proprietary trading on the one hand, and market making and hedging, on the other hand, would be an appropriate reform to the Volcker Rule.
- Rep. Dan Kildee (D-MI), who serves as Vice Ranking Member of the Committee, stated that he supports improving some aspects of the Dodd-Frank Act, indicating there may be room for compromise on the Democratic side.
- Rep. John Delaney (D-MD) stated that he agrees that regulatory relief for community banks would be appropriate and that the Financial Stability Oversight Council ("FSOC") may be overreaching in some respects.

CAUSES OF THE FINANCIAL CRISIS

Underpinning both parties' approach to financial reform is their diagnosis of the causes of the 2008 financial crisis. The Republicans on the Committee appeared to agree with several witnesses that the crisis was caused by U.S. government housing policy. Democrats on the Committee disagreed, attributing the causes to other factors, including inaccurate ratings of mortgage backed securities by private rating agencies. These differing assessments of what went wrong animate each party's approach to financial regulatory reform.

COMMUNITY BANKS V. BIG BANKS

Members from both parties argued over whose policies would be more favorable for community banks and whose policies would support the growth of big banks.

- Republicans on the Committee argued that heightened regulation imposes higher costs on community banks, which in turn encourages consolidation and creates a barrier to competition with bigger banks.
- Ranking Member Maxine Waters (D-CA) noted that the banking regulators have already indicated that they will revise capital standards applicable to community banks. She also suggested that CHOICE Act 2.0 would permit more consolidation in the banking sector.
- In a discussion with Rep. Steve Pearce (R-NM), Mr. Allison suggested that exemptions applicable to community banks are an insufficient means for reducing their regulatory burden since regulators often still require compliance.

Client Alert

- Rep. Ed Royce (R-CA) expressed concern that the Consumer Financial Protection Bureau (“CFPB”) has not used its authority to exempt community banks and smaller institutions from many onerous obligations.

ADMINISTRATIVE REFORM

CHOICE Act 2.0 provides for certain administrative reforms that would impact the financial regulatory framework. For example, the draft legislation would require regulatory agencies to consider the unintended effects of proposed rulemakings and would require a cost benefit analysis. The draft legislation would also bring the CFPB and the FSOC within the congressional appropriations process.

- Republicans argued that FSOC’s ability to designate non-bank systemically important financial institutions (“SIFIs”) is an unconstitutional delegation of authority by Congress. Further, Rep. Tom Emmer (R-MN) suggested that FSOC’s track record with respect to designations of non-bank SIFIs reveals a non-transparent process that does not reflect adequate deliberation.
- Concerning the CFPB’s authority to bring enforcement actions for unfair, deceptive, and abusive acts or practices, Rep. Blaine Luetkemeyer (R-MO) expressed concern that the term “abusive” is undefined, leading to a lapse in the rule of law.
- Rep. Ann Wagner (R-MO) raised concerns with the structure of FSOC as a committee of individual officials and not as representatives of the agencies.
- Rep. Warren Davidson (R-OH) stated that institutions lack due process rights when facing agency enforcement actions.

10% LEVERAGE RATIO “OFF RAMP”

One of the key elements of CHOICE Act 2.0 is a provision that would allow banks to avoid certain regulations, including risk-based capital requirements, if they maintain a 10% leverage ratio. The “off ramp” is broadly opposed by Democrats on a number of grounds, including the concern that it would encourage banks to book the riskiest assets.

- Chairman Hensarling argued that the 10% leverage ratio reduces the ability for banks to game capital requirements, which he suggested is possible with the capital requirements established by the Basel Committee on Banking Supervision currently implemented in the United States.
- Ranking Member Waters suggested that the “off ramp” would encourage the largest banks to grow larger and become more interconnected.

ORDERLY LIQUIDATION AUTHORITY

Republicans on the Committee argued that Title II of the Dodd-Frank Act, which provides for orderly liquidation authority (“OLA”), institutionalizes bank bailouts because the Treasury is given authority to provide liquidity as a key element of the one-point-of-entry process.⁹ Republicans argued that the resolution of financial institutions should proceed under the bankruptcy code, as authorized in CHOICE Act 2.0. Use of the bankruptcy process would not call on government debtor-in-possession funding. Democrats disagreed. For example, Rep. Carolyn Maloney (D-NY) stated that, for her, the elimination of the OLA is the most troubling aspect of CHOICE Act 2.0. She argued that bankruptcy should be one option for a non-bank SIFI, but not the only option.

⁹ As currently enacted, the OLA grants tools to the Federal Deposit Insurance Corporation (“FDIC”) and the Board of Governors of the Federal Reserve System (“Federal Reserve”) to unwind failing financial firms in a declared crisis.

Client Alert

OTHER ISSUES DISCUSSED

- Some Democrats on the Committee expressed concern that the reforms provided in CHOICE Act 2.0 would upend the international regulatory order that the United States helped formulate in the post-crisis era. Republicans disagreed; for example, Rep. Ann Wagner (R-MO) suggested that the United States should not be bound by decisions made by the Financial Stability Board, an international regulatory body.
- Rep. Barry Loundermilk (R-GA) suggested that the stress-testing required by the Dodd-Frank Act is ineffective and that all banks should be exempt from the qualitative assessment of the Federal Reserve's Comprehensive Capital Analysis and Review (CCAR).¹⁰
- Rep. Bill Huizenga (R-MI) was concerned with the slow rate of initial public offerings in 2016 and suggested that the rules regarding shareholder proposals, executive pay rules, and other disclosure requirements are to blame.

NEXT STEPS

During the hearing, Democrats on the Committee expressed their desire for additional hearings on CHOICE Act 2.0 and Republicans insisted that they already held a sufficient number of hearings on the relevant topics. Rebuffing the Democrats on this point, Chairman Hensarling appears ready to move the bill through the Committee quickly, which is consistent with his public statements that financial reform is a priority to complete this year.¹¹

At the beginning of the hearing, Ranking Member Waters stated that a Dodd-Frank Act rollback bill would result in disaster and that Democrats will fight against the bill.¹² As a result, it can be expected that Democrats will use all tools at their disposal to slow down the legislative process. For example, during the hearing, Ranking Member Waters used a procedural maneuver to require an additional hearing which will be hosted by the minority party prior to the Committee's consideration of the legislation.

The release of the draft of CHOICE Act 2.0 was a significant step towards the enactment of financial regulatory reform. In the coming weeks and months, despite Democratic efforts, we expect more movement on financial regulatory reform and anticipate further debate.

Contact:

Henry M. Fields

(213) 892-5275
hfields@mofo.com

Oliver I. Ireland

(202) 778-1614
oireland@mofo.com

Jiang Liu

(212) 468-8008
jiangliu@mofo.com

Barbara R. Mendelson

(212) 468-8118
bmendelson@mofo.com

Marc-Alain Galeazzi

(212) 336-4153
mgaleazzi@mofo.com

Mark R. Sobin

(212) 336-4222
msobin@mofo.com

¹⁰ Note that banks with total consolidated assets between \$50 billion and \$250 billion were recently exempted from the qualitative assessment. See <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20170130a.htm>.

¹¹ <http://www.cnbc.com/2017/03/22/reuters-america-corrected-key-house-lawmaker-dodd-frank-overhaul-remains-a-2017-priority.html>.

¹² Ranking Member Waters' full statement is available at: <http://democrats.financialservices.house.gov/news/documentsingle.aspx?DocumentID=400406>.

Client Alert

Financial Services Team

California

Alexis A. Amezcua	(415) 268-6557
Elizabeth Balassone	(415) 268-7585
Roland E. Brandel	(415) 268-7093
Sarah Nicole Davis	(415) 268-7478
Henry M. Fields	(213) 892-5275
Joseph Gabai	(213) 892-5284
Angela E. Kleine	(415) 268-6214
Jim McCabe	(415) 268-7011
James R. McGuire	(415) 268-7013
Mark David McPherson	(212) 468-8263
Ben Patterson	(415) 268-6818
Sylvia Rivera	(213) 892-5734
Nicholas Alan Roethlisberger	(415) 268-7534
William L. Stern	(415) 268-7637
Nancy R. Thomas	(213) 892-5561
Lauren Lynn Wroblewski	(415) 268-6458

New York

James M. Bergin	(212) 468-8033
Meghan E. Dwyer	(212) 336-4067
David J. Fioccola	(212) 336-4069
Marc-Alain Galeazzi	(212) 336-4153
Adam J. Hunt	(212) 336-4341
Jessica Kaufman	(212) 336-4257
Mark P. Ladner	(212) 468-8035
Jiang Liu	(212) 468-8008
David H. Medlar	(212) 336-4302
Barbara R. Mendelson	(212) 468-8118
Michael B. Miller	(212) 468-8009
Judy Man Ni Mok	(212) 336-4073
Jeffrey K. Rosenberg	(212) 336-4130
Mark R. Sobin	(212) 336-4222
Joan P. Warrington	(212) 506-7307

Washington, D.C.

Rick Fischer	(202) 887-1566
Adam J. Fleisher	(202) 887-8781
Natalie A. Fleming Nolen	(202) 887-1551
Calvin D. Funk	(202) 887-6930
Julian E. Hammar	(202) 887-1679
Oliver I. Ireland	(202) 778-1614
Crystal N. Kaldjob	(202) 887-1687
Steven M. Kaufmann	(202) 887-8794

Washington, D.C. (continued)

Donald C. Lampe	(202) 887-1524
Jeremy R. Mandell	(202) 887-1505
Amanda J. Mollo	(202) 778-1609
Obrea O. Poindexter	(202) 887-8741
Ryan J. Richardson	(202) 887-8761
Sean Ruff	(202) 887-1530
Trevor R. Salter	(202) 887-1527
Nathan D. Taylor	(202) 778-1644

Client Alert

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer's* A-List for 13 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.