Senator Warren and FDIC Director Hoenig Present Financial Regulatory Reform Proposals*

Jim Sivon

April, 2015

In separate speeches that happened to be given on the same day, Senator Elizabeth Warren and FDIC Director Thomas Hoenig proposed significant changes in financial regulation. The proposals are noteworthy because of their detail, and because they could receive some consideration as Congress debates financial regulation legislation.

The proposals also illustrate how the financial crisis continues to influence policy recommendations. Director Hoenig bases his recommendations on the "distortions to the financial system" that arise when banks engage in trading and other types of business. He states that the "public subsidy" associated with deposit insurance "allows the commercial bank that engages in this extended set of activities to obtain funding on favorable terms, operate with less capital demanded by creditors, and profit from the upside of investments while pushing the downside onto the taxpayer." He calls this an "unstable" situation that contributed to the financial crisis and the passage of the Dodd-Frank Act.

Senator Warren bases her recommendations on a broader theory of "deregulation" during the 1980's that contributed to the financial crisis. This "new political wind" permitted "big financial institutions" to find new ways to "trick their customers" as federal regulators "looked the other way." These tricks included credit card practices, mortgage practices, and a "raft of new financial products." The result was the "worst crash since the 1930s."

Senator Warren's speech is entitled "The Unfinished Business of Financial Reform". As this title suggests, Senator Warren believes that, while the Dodd-Frank Act made some real progress in addressing financial reform, "there is more to be done." Her list of additional financial regulatory reforms include the following: (1) give the CFPB authority to regulate auto lending by dealers; (2) prohibit the Justice Department from entering into a deferred prosecution agreement with any firm that already is operating under such an agreement; (3) require the Board of Governors of the Federal Reserve System to vote on all major enforcement and supervisory decisions; (4) break up the big banks by imposing a size limit or prohibiting affiliations between banks and investment banks (i.e., re-imposing Glass-Steagall); (5) adopt "smarter and simpler" regulations that give smaller institutions a "fighting chance" to meet compliance obligations; (6) make changes in the tax code to align executive compensation with the long-term health of companies and the economy; (7) remove

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

the bias in the tax code that favors debt financing over equity financing; and (8) "tackle" the shadow-banking sector.

The political viability of these recommendations is mixed. Some of the recommendations may be difficult to achieve, such as CFPB regulation of lending by auto dealers, which was rejected by Congress during the debate over the Dodd-Frank Act. Others are ill-defined, such as "tackling" the shadow banking sector. Still others, such as smarter and simpler regulations, may find some traction, especially given the framework for such a system outlined in Director Hoenig's speech.

Director Hoenig's speech is entitled "A Conversation about Regulatory Relief and the Community Bank." The speech calls for "regulatory relief" for the nation's smaller banks that do not engage in trading and other business activities, and, as such, pose less risk to taxpayers. A bank would be eligible for this regulatory relief if the bank: (1) does not hold trading assets or liabilities; (2) holds no derivative positions, other than interest rate swaps and foreign exchange derivatives; (3) has derivatives exposures, including cleared and non-cleared derivatives of less than $3 billion; and (4) has a GAAP equity-to-assets ratio of at least 10 percent.

Banks that meet the foregoing criteria would: (1) be exempt from all Basel capital standards; (2) be exempt from several entire schedules on the Call Report, including schedules related to trading activities; (3) not face referrals to the Justice Department for de-minimis or inadvertent violations of fair lending laws; (4) be exempt from appraisal requirements; (5) be exempt from stress testing requirements; and (6) be subject to an 18-month examination cycle.

The Senate Banking Committee has announced plans to consider a financial regulatory reform package in mid-May. It would not be surprising if Director Hoenig's framework for regulatory reform is reflected in that package.

Jim Sivon is a partner with the law firm of ***Barnett Sivon & Natter, P.C.***

©2015 Barnett Sivon & Natter, P.C.