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Financial Reform Newsletter: June 8, 2017

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Insane: House Republicans Passing Biggest Financial Deregulation Bill in Decades, Stripping Away Consumer, Investor, Retiree and Bank Stability Protections.

Sometimes a single word says everything you need to know about something the House Republicans do: in the case of de-regulating and unleashing Wall Street on Main Street AGAIN, that word is "insane."

Deregulating Wall Street was one of the leading causes of the 2008 financial crash, which caused the $20 trillion price tag in bailouts, lost jobs, homes, retirement savings and so much more. Yet, just nine years after that catastrophe, House Republicans just passed the biggest deregulation bill in decades. They apparently want Wall Street to party like its 2005 and pretend that 2008 never happened, even though millions of American families are still suffering economically from the last crash.

The so-called CHOICE Act would strip away essential financial protection rules for consumers, investors and stability will once again allow Wall Street's biggest financial firms to operate virtually unchecked, unleash financial predators on unsuspecting consumers and almost certainly lead to another crash, crisis and more bailouts. For example, it would allow the biggest Wall Street banks to opt-out of significant financial protection rules and weakens key protections like living wills and stress tests, which the President's own National Economic Advisor Gary Cohn praised last year when he was President of Goldman Sachs. Perhaps most disturbing, the CHOICE Act would cripple two of the most important post-crash reforms: the Financial Stability and Oversight Council (FSOC) and the Consumer Financial Protection Bureau (CFPB).

The FSOC is the country's only early warning system to detect emerging systemic risks and prevent future financial crashes. It alone has the authority to regulate systemically significant nonbanks, where so many of the financial blowups happened last time. This virtually guarantees the revival of the shadow banking system, the migration of risk from regulated banks and the ignition of future financial explosions.

The CFPB has been one of the most effective consumer protection agencies ever created. It has returned almost $12 billion to more than 29 million Americans who have been ripped off by financial firms. Eliminating or crippling it by making it a commission or subjecting it to the annual congressional appropriations process would take the consumer cops off the Wall Street beat.

Stress tests, living wills, capital, FSOC, CFPB and the other financial protection rules should be seen as an arsenal of weapons meant to spot the warning signs of the next crisis, hopefully prevent it, and certainly reduce its severity. As the country continues to recover from the 2008 crash and as our banking and finance system once again support the real economy, that progress should not be reversed by repeating history, deregulating finance, laying the groundwork for future crashes and, worst of all, yet more bailouts for Wall Street. That's insane and the American people deserve better.

Talking with the Treasury Department about the President's Executive Order Regarding

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Financial Reform Rules and Building a Stable Financial Sector that Supports the Real Economy. We were privileged to be invited a few months back by the administration to participate in a Treasury Department roundtable meeting to discuss President Trump's Executive Order on "Core Principles for Regulating the United States Financial System." While we participated in the entire roundtable, we were asked specifically to address systemic risk regulation with a focus on FSOC and the designation process for systemically significant nonbanks.

We have continued that dialog, met with Treasury's senior staff and submitted a letter with supplemental materials addressing a number of key financial reform issues that the administration is considering generally and in connection with the Executive Order in particular. We began with addressing the false choice at the core of many arguments for deregulation: that you can have financial protection rules or robust bank lending and profitability and economic growth. Of course, this supposed choice is false because you can have both and, indeed, you need both, as Gary Cohn has eloquently stated and we have written about in the past.

We provided the evidence in the letter which shows bank lending in all channels and bank profitability are all rising if not setting records. Lending growth is also twice the rate of economic growth, clearly evidencing support for the real economy. More importantly, stronger, well capitalized banks are not only less susceptible to failure, but also lend more throughout the business cycle. Don't believe the false choice when you hear it. (We also provided them with a copy of Morris Goldstein's excellent new book that makes this case compellingly, as we discussed here.)

Better Markets also discussed the continuing costs of the 2008 financial crisis, how cost-benefit analysis has been abused to stall essential financial rules, the vital role played by the Financial Stability Oversight Council, the need for better regulation of derivatives dealers, and how the repeal of Glass-Steagall led to the super-sizing of banks and ultimately contributed to the financial crisis. Finally, we also reviewed the importance of the DOL's "best interest" fiduciary rule, living wills and the $50 billion SIFI bank threshold, all as detailed in the letter and supplemental materials.

As the Treasury Department finalizes its first in a series of reports on financial regulation in the coming days, we hope that they continue to meet with and listen to diverse voices and consider the range of views on these critically important issues. With so many Americans still suffering from the economic wreckage caused by the 2008 crash, public officials need to be very careful when changing the financial protection rules enacted to prevent another crash.

The Supreme Court Sides with Crooks and Handcuffs the Cops on the Wall Street Beat. The Supreme Court this week limited the SEC's ability to require financial wrongdoers to give up money they illegally obtained. The Court said that disgorgement is a penalty, but it is not. It merely requires crooks to give up - to disgorge -- their ill-gotten gains, which is money they ripped off from other people and never had any right to. That is the opposite of a penalty, which is supposed to extract a price above and beyond giving up money that was never rightfully yours.

Put simply, if a person robs a bank of $1 million and is caught, everyone thinks the bank robber should give up the $1 million. That is disgorgement. Of course, people also think the bank robber should be punished by prison and additional fines. Those are penalties.

The SEC routinely seeks to have civil criminals disgorge money that they take from other people illegally. The Supreme Court has now denied the SEC the power to do that, effectively allowing the bank robber to keep the $1 million he took from the bank, if the rip off occurred more than five years ago. In the case the Supreme Court ruled on the wrongdoer will get to keep almost $30 million that he ripped off. That makes no sense. No matter when a criminal is caught, he or she should have to at least give up the money ripped off from other people.

Disgorgement stands for the basic principle that people should not profit from their crimes. However, the Supreme Court decision will allow some criminals, likely the most sophisticated and those with the best lawyers, to keep the fruits of their crimes. That's just wrong.

In Case You Missed It...
Antonio Weiss and Simon Johnson had an important Op Ed in Bloomberg View on the importance of FSOC, which everyone who cares about systemic risk should read: Financial Regulation Calls for 20/20 Vision. Weakening the Financial Stability Oversight Council will raise the odds of another crisis. They also issued a more detailed Policy Brief, offering an informed perspective on the vital role FSOC plays in protecting the financial system and avoiding crashes and bailouts.

As mentioned above, Morris Goldstein has a very important new book out on the core issues of systemic stability: "Banking's Final Exam: Stress Testing and Bank-Capital Reform." This book should be read by every financial policy maker and regulator. It is a data driven analysis of the current empirical literature and thinking on the crucial subjects of capital and stress testing, concluding with sensible concrete proposals. (If you don't have time to read the entire book, at least read the short executive summary at the beginning!)