CRS INSIGHT

The Financial CHOICE Act

September 12, 2016 (IN10524)

|

Related Authors

- Sean M. Hoskins
- Marc Labonte

View More...

|

Sean M. Hoskins, Analyst in Financial Economics (shoskins@crs.loc.gov, 7-8958)
Marc Labonte, Specialist in Macroeconomic Policy (mlabonte@crs.loc.gov, 7-0640)
Gary Shorter, Specialist in Financial Economics (gshorter@crs.loc.gov, 7-7772)

This *Insight* highlights some of the major policy proposals included in H.R. 5983, the Financial CHOICE Act (FCA), and links to relevant CRS products. The FCA was the subject of a July 12, 2016 hearing and is scheduled for a markup in the House Financial Services Committee on September 13, 2016. The FCA is also part of the House Republicans' "A Better Way" policy agenda. The FCA encompasses a broad package of reforms to the financial regulatory system, including significant changes to the Dodd-Frank Act (DFA; P.L. 111-203). The FCA incorporates many bills that have previously received committee or floor consideration.

Regulatory Relief

The FCA would provide regulatory relief throughout the financial system, including to banks and capital market participants. Regulatory relief may face tradeoffs between reducing regulatory burden and potentially reducing the benefits of regulation (e.g., safety and soundness, consumer and investor protection, and financial stability).

The FCA contains regulatory relief provisions involving securities that are overseen by the Securities and Exchange Commission (SEC). Some provisions would make it easier for small firms to raise capital, such as by broadening crowdfunding and fostering venture exchanges. Another provision would repeal a DFA prohibition of incentive-based compensation structures that encourage "inappropriate risks" at large financial institutions. Other provisions would repeal DFA regulations requiring private equity adviser registration with the SEC and disclosure of whether a company's supply chain contains conflict minerals. SEC rulemaking on a uniform fiduciary rule for broker-dealers and investment advisers would also be prohibited until after it reported to Congress and a recent Department of Labor rulemaking on a fiduciary duty for investment advisers in retirement plans would be overturned.

The FCA would also provide regulatory relief for banking organizations by incorporating 19 narrower bills. Some of the proposals are aimed at assisting community banks, whereas others would apply to all institutions that perform certain regulated activities, regardless of size and whether they are banks or nonbanks, such as certain DFA mortgage rules. Some would modify or repeal rules stemming from the DFA, such as the "Durbin Amendment" limiting interchange fees, whereas others target supervision or other long-standing regulatory practices, such as bank examinations. Some provisions modify prudential regulation, such as the Volcker Rule, whereas others modify consumer protection.

Under the FCA, a banking organization could choose to be subject to a higher, 10% leverage ratio in exchange for being exempt from risk-weighted capital ratios, liquidity requirements, and other regulations. Current regulation requires banks to meet both risk-weighted capital ratios, which require banks to hold more capital if their assets are riskier, and an unweighted leverage ratio, meaning that the riskiness of a bank's assets does not influence how much capital is required. Proponents argue that a leverage ratio alone would be less burdensome and more transparent, and opponents argue it would encourage excessive risk taking.

The FCA would repeal many of the provisions of the DFA addressing "too big to fail" (TBTF) and financial stability. The DFA created an enhanced prudential regulatory regime administered by the Federal Reserve (Fed) for bank holding companies with more than $50 billion in assets and non-bank financial institutions designated as systemically important (SIFIs) by the Financial Stability Oversight Council (FSOC). FSOC can also designate payment, clearing, and settlement systems as Financial Market Utilities (FMUs) that are then subject to enhanced prudential regulation. The FCA would repeal enhanced regulation of non-bank SIFIs and FMUs. It would also exempt banks that meet the 10% leverage requirement from many recent regulations targeted at large banks. Proponents of the DFA believe the risk posed by TBTF could be contained, in part, through heightened regulation. Proponents of the FCA argue that designation effectively amounts to explicitly identifying these firms as TBTF, exacerbating the problem by reducing market discipline.

Failure of Financial Firms

The FCA would eliminate some existing policy alternatives to the Bankruptcy Code for distressed financial firms. It would repeal the Orderly Liquidation Authority (OLA), which was created by Title II of the DFA to wind down financial firms and was modeled after the bank resolution process administered by the Federal Deposit Insurance Corporation (FDIC). It would replace OLA with a new chapter in the Bankruptcy Code that is tailored for financial firms. It would repeal or restrict emergency authority used by the FDIC, Fed, and Treasury (through the Exchange Stabilization Fund) to stabilize financial markets during the financial crisis. Although these authorities have not been used since they were created or revised after the financial crisis and were restructured to prevent future "bailouts," critics fear that they could nevertheless be used to "bail out" failing firms in the future.

Regulatory Independence and Accountability

The FCA would also make reforms to the financial regulatory structure and rulemaking process. Many of these reforms would reduce regulatory independence in favor of increasing accountability to Congress.

Those regulators that currently set their own budgets would be subject to the congressional appropriations process (except for the Fed's monetary policy functions). The bill would modify the leadership structure of agencies with a single head, such as the Consumer Finance Protection Bureau (CFPB), to be bipartisan, multi-member commissions. The rulemaking processes for agencies would also be modified. For example, regulators would be statutorily required to perform more detailed cost-benefit analyses when issuing new rules and use cost-benefit analysis to review existing rules. The bill would also require congressional approval for a major rule to come into effect (as opposed to the status quo of the rule coming into effect unless Congress acts). Additionally, in lieu of deferring to an agency's reasonable interpretations of silent or ambiguous statutes in accordance with the Supreme Court's seminal 1984 "Chevron" decision, the bill would require courts to apply a heightened-judicial review standard for actions taken by certain federal financial regulators. The FCA would make numerous agency-specific changes, such as requiring input on FSOC decisions from all members of an agency's leadership rather than just the agency's head and eliminating the Office of Financial Research (OFR). It would subject the Fed to an annual GAO audit. It would change the name, authority, and mission of the CFPB.

Enhanced Penalties

The FCA would increase the amount of certain penalties that financial regulators are allowed to assess on financial market participants and would restrain certain agency enforcement powers.