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Questions to Which Answers Would be Useful*

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Every now and then it is desirable to pause and review where we are, and what can be done to make where we are better for all. The end of the year is a good time to do that. Here, for example, are a few questions to which clear answers would promote an environment that would make financial goods and services more accessible to all.

1. How much downsizing are the regulators seeking? It appears that the regulators, most of the financial press, and certainly the financial industry activists, have taken the position that the largest banks have not been punished enough. While it isn't clear exactly for what they should have been punished, since there were so many culprits that caused the Great Recession, that they haven't been sufficiently punished is clear in the minds of this persuasive band of brothers. Therefore, additional regulatory burdens have been imposed on the largest banks and cries for the revival of restrictions that no longer fit the way the public now does business are being suggested.

   When the largest banks make major changes in their operations, there is no sign that any of this group of commentators notice, or that the steps are worthwhile. For example, in a speech before the Economics Club of Washington, the CEO of Citigroup pointed out that the company had shed more than $700 billion of assets since the crisis, including 60 businesses around the world. It no longer has insurance, hedge funds, private equity funds and is not an asset manager or retail brokerage. The $700 billion of assets it dropped would have been the 7th largest bank holding company in the U.S., much larger than notable institutions such as GE Capital, U.S. Bancorp, BONYMellon or PNC. The news was like a tree falling in an uninhabited forest — it didn't make a sound.

   Nor did this result in any reduction of regulatory burden. That, of course, is the question that needs answering. What is the incentive that regulators are using to persuade the largest institutions to become smaller? Putting aside the question that must first be answered —

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should these institutions be smaller — wouldn't that happen quicker and with less dislocation in the marketplace if there were incentives for downsizing? When Citi drops in size by $700 billion with the disposal of 60 businesses around the world, and nothing happens, that suggests that the regulators either have an unrealistic view of what downsizing means, or they simply haven't thought about using incentives.

2. Can industry and consumers rely upon CFPB informal guidance? A variety of regulations were demanded by sections of the Dodd-Frank Act, the most visible in many respects being those created by the Consumer Financial Protection Bureau. Hundreds of pages of rules were created and are still being created by the Bureau. Many of them were straight forward and were self-explanatory. Many, however, were not. That is not unusual since financial services is a complex field.

   In the past, agencies who then had responsibility for supervision in these fields attempted to address those ambiguous provisions in the rules through any of a variety of ways — FAQs, General Counsel letters, guidelines, agency letters to CEOs, etc. The agencies did not back away from those rules although they were free and did challenge some interpretations of the informal opinions. That approach usually worked and the industry and its customers benefitted from clarity in the rules. CFPB, however, has taken a different approach to ambiguity in its rules.

   The Bureau has been very good at communicating with the public and almost as good at communicating with the industry. The communication with the industry, however, has resulted in informal guidelines, webinars, comments before industry trade groups, etc., all of which are prefaced by the comment that what follows does not necessarily reflect the position of the agency. That, too, is standard, but in a recent administrative appeal, the Bureau made it clear that unless the guidance from the agency is formal and is published in the Federal Register, it has no precedential value. In other words, the precedential value of the basic methods of communicating interpretations of ambiguous provisions has been eliminated, at least insofar as the industry can rely upon the interpretations.

   The industry is left without a good answer to the question of just what confidence it can put in communications from regulators when those communications are not published in the Federal Register.

3. Is anyone reviewing the risks of regulation? It is probably a maxim that the country is better off if its banks are not at risk of failure. Operations, business policies, management practices and other activities or products that create risk must be monitored so that the risk is not a risk that is unbalanced or that increases the chances of a major failure. Legislators and regulators have been careful to review and examine banks carefully to find and surface risks. There is one risk, however, that is seldom seen as a risk and that is unmonitored by the regulators.

   Regulatory burden may itself be a risk. Imposing too much regulation on the industry can lead to institution instability or changes in business practices that eliminate good safe sources of revenue and place burdens on the bank to meet shareholder and regulator demands with other businesses that may be riskier and less productive. For example, where will the burden of meeting the credit needs of low and moderate income people fall in some product fields, say mortgages, when the risk to institutions that go outside the QM credit box remains alive and well. Inside the QM box many of the LMI consumers cannot qualify. Yet, the public and commentators and regulators expect banks to lend to that group of consumers.

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Or take the pressure on larger institutions to make living wills that will make it easier for the regulators to break them up and resolve any problems they might create should they fail. Meeting the requirements for the regulators' judgment of an apt living will may well require banks to forego good business and accept other business that is not so good, thereby lowering the return on equity to their shareholders and making further investment in the companies less desirable to capital not yet invested. Over time, that can make them more susceptible to gyrations in the economy and therefore more likely to give the regulators an opportunity to make use of the living will of the institution.

The logical question to ask, therefore, is — Will the regulators commence a study to see if the imposition of regulations can lead to less stable and less productive institutions that must implement those regulations?

4. What is the best way to extend credit to more LMI borrowers? A very large number of consumers who on retrospect probably did not have the ability to repay their mortgage loans managed to get such loans and buy better homes during the Great Recession. They have managed to continue to pay those loans and live in these better homes ever since. Another group of such consumers who would not fit within the QM credit box obtained similar loans and have long since lost in foreclosure not only those homes but most of whatever savings they might have had. That is the dilemma the legislators faced and their solution was to forbid products and processes that made such loans available; violations for those who nevertheless made such loans were made severe. The result is that those who are now unqualified but have shown that they could make payments would no longer get loans.

   Statistical tests that have raised questions about their validity are now employed by the Justice Department and other regulators to determine if lenders are discriminating, notwithstanding the lack of intent to discriminate. The blowback from that approach should not be underestimated. At a minimum it puts government and the industry on opposite sides of what should be a common effort to encourage wider distribution of resources among the public.

   Left unanswered through this haze is the answer to what the best way is to extend credit to those on the lower end of the economic totem pole. Lenders are spending their time and resources trying to ensure that they don't run afoul of rules that to them seem to be strangely enforced. Regulators appear to be intent upon catching those whom they categorize as bad guys and not in trying to determine how best to solve the problem. The gap between the two does not lead to a resolution of the underlying problem.

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