House can boost lending, improve stability through financial reform bill

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Today, the House of Representatives may take an important step toward revitalizing small-bank lending and improving U.S. financial stability by passing the Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs (CHOICE) Act.

This legislation, sponsored by Chairman Jeb Hensarling (R-Texas) of the House Financial Services Committee, seeks to addresses a variety of problems plaguing the financial system, largely by reforming many aspects of the Dodd-Frank Act of 2010, which vastly expanded government regulation of the banking and financial systems.

Data from the Mercatus Center at George Mason University show that the number of regulatory restrictions on U.S. banks has doubled since the passage of Dodd-Frank. Not only has this flood of regulations stifled bank lending and economic activity, but Republicans, as well as many economists, argue that the convoluted structure of these rules has actually destabilized the financial system.

To address these dangers, a main tenet of the Financial CHOICE Act is that small banks with limited risk could avoid the crushing burden of excessive regulation. In recent decades, U.S. banking regulators have moved away from using bank leverage as a measure of risk, instead relying on increasingly complex risk metrics.

Although such measures are irrelevant for all but the largest banks, small and community banks must, at the risk of severe penalties for inaccuracy, devote countless hours to compliance paperwork rather than productive activities, such as mortgage origination or small-business lending.

In addition, many economists argue that the complex risk metrics used by U.S. regulators are less effective than a clear and simple leverage ratio, because they allow banks to exploit loopholes and game the system. Many studies, including by economists from the Bank of England, the World Bank, the International Monetary Fund and Nobel Prize winners find that leverage ratios are more effective and that using simple measures would help reduce risk in the banking system.

The Dodd-Frank Act contains many provisions that inhibit bank lending, including an entire title of restrictions on mortgages alone. The Financial CHOICE Act aims to reverse this trend with its own titles dedicated to regulatory relief for Main Street and community financial institutions, as well as small businesses, innovators and job creators.

The act would also repeal a number of well-intentioned but ineffective regulations, such as the Volcker Rule and the Durbin Amendment. These measures have reduced bank revenues, forcing them to raise fees and cut services to consumers.

Perhaps the most controversial provisions are changes to the Consumer Financial Protection Bureau (CFPB). The Financial CHOICE Act restructures the CFPB, changes its name and mission and budgets the agency through the regular appropriations process. The act also repeals the Dodd-Frank title on orderly liquidation authority which is a core provision of Dodd-Frank considered essential by many Democrats.

Because it targets such high-profile items, many consider the Financial CHOICE Act to be a non-starter in the Senate. As Chairman Mike Crapo (R-Idaho) of the Senate Committee on Banking, Housing, and Urban Affairs takes up the issue of regulatory reform, finding compromise among the senators of the committee will be no easy task.

Even one who values balance as much as Sen. Crapo's may have difficulty striking such a balance, resulting in legislation that may be quite different than the bill passed by the House.

On the other hand, there is clearly a shared desire in the Senate for tailored and appropriate reforms. At today's Senate Banking Committee hearing, Republicans and Democrats both expressed concerns over the lack of lending in local communities and the role that regulations have played in that decline.

Despite rhetoric from both parties describing a "repeal" of the Dodd-Frank Act, the Financial CHOICE Act leaves many Dodd-Frank provisions intact and may provide a useful strategy for effective reform: maintaining an emphasis on financial stability while trimming excessive regulations that have harmed consumers and business activities.

Let us hope that earnest, bipartisan calls for regulatory reform may yet provide a path toward a stable and revitalized financial system.

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